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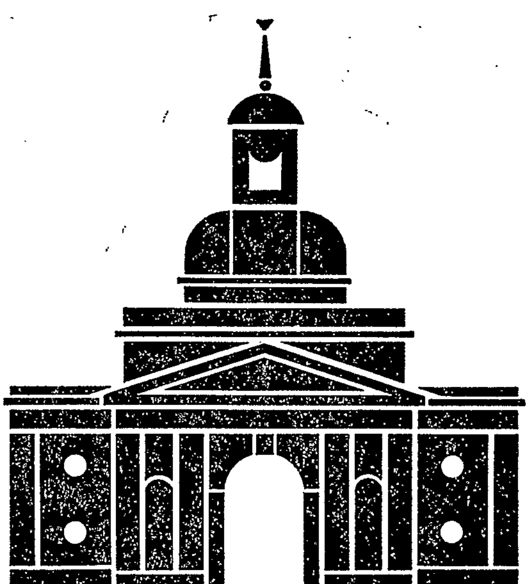

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For an index of Articles, Documents, Developments in International Tax Law, Bibliography and Supplements to the Bulletin, published in 1976 and a list of authors, see page 539 et seq.

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* * * ARTICLES * * *

NIZAR RAFEI *:

THE TAX SYSTEM IN SAUDI ARABIA

1. The tax system in Saudi Arabia is both unique and simple. There is no tax at all on wages or salaries whether the employee concerned is a Saudi national or a foreigner. Only commercial and industrial gains are taxed. The nature, base and nomenclature of the tax differ according to the nationality of the taxpayer and whether he is an individual or a legal entity. If he is a Saudi, his gains are subject to Zakat (an Islamic tax which is levied on gains and invested capital) whereas the foreigner pays income tax on his realised profits only.
Of prime importance for a foreign individual or company planning to carry on business activities in Saudi Arabia is a knowledge of the tax structure of that country; that is, therefore, the subject of this analysis.

2. Saudi Arabia is one of the few developing countries in the world which do not need foreign capital; being an oil exporting nation it earns a tremendous amount of foreign exchange which maintains a cash reserve fund considered as one of the three largest in the world (the other two are Western Germany and the United States of America, respectively).
As a result of this, Saudi Arabia has reserved many business activities for Saudis, particularly those types of business of a purely commercial nature; non-Saudis are, however, welcome to invest in the fields of industry or agriculture. This policy was adopted not because of the need for foreign capital but rather for the purpose of getting foreign skill, experience and technology. In order to encourage foreign investment and enterprise, and subject to the codes of Islamic Sharia,[1] the Saudi Government has offered the following benefits to every resident in the country:

(i) Complete freedom to transfer money to and from the country.

(ii) Political stability in the absence of economic or financial set-backs.

(iii) Complete security, considered as unique in the world.[2]

In addition to these features which represent the basic structure of any real development the Government has given the following incentives to the foreign investor:

(i) Agricultural investment is totally and permanently exempted from taxes both direct and indirect.

(ii) In order to give the opportunity to Saudis to acquaint themselves with Western know-how, the foreign investment regulations grant the foreign investor an exemption of income tax due on industrial profits

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* Member of the Middle East Society of Associated Accountants (FAA).

1. The Islamic Sharia commands the legal incapacitation of the offender, i.e. execute the killer and cut off the hand of the thief.

2. Here, unbelievably, one can drive alone in the desert without any fear of being robbed or killed even if one is carrying one million U.S. Dollars.

realised during the first five years if at least 25 percent of the total amount of industrial investment is contributed by a Saudi.

(iii) The Government makes available to the industrial investor sufficient areas of land required for industrial projects in return for payment of a nominal rent; this privilege will continue as long as the investor considers the land fit for his requirements.

(iv) The permanent exemption of individual income from tax on salaries and wages.

(v) Extensive banking facilities including medium and long term interest free loans are available from the Industrial Development Fund.

(vi) Machinery, equipment and raw materials imported from abroad for the use of industrial projects are exempted from customs duty.

(vii) Provision of cheap electrical power to industrial projects (1.4 U.S. Cents per unit).

In addition to these facilities which are considered to be sufficient incentives to attract foreign investment, particularly in industry, the Government is ready to discuss any additional facility which may be helpful in that respect.

3. The profits derived by a foreign investor from industrial activities or from contracts signed with the Saudi Government for certain projects are subject to income tax at the following rates:

25% on profits not exceeding SR. 100,000 per annum (U.S. $ is equivalent to SR. 3.50).

35% on profits between SR. 100,000 and SR. 500,000 per annum.

40% on profits between SR. 500,000 and SR. 1,000,000 per annum.

45% on profits exceeding SR. 1,000,000 per annum.

4. Note that the actual Saudi system does not allow any foreigner, whether an individual person or a legal entity, to run a business in Saudi Arabia. Two exceptions to this rule exist:

(a) When a foreign investor wins a tender and enters into a contract with a Saudi Ministry or a public sector body.
In this case, the foreign contractor can establish a branch or subsidiary in Saudi Arabia acting in his own name and having a temporary registration at the Commercial Register for the strict purpose of his contract. He has no right to do business in the private sector.

(b) When the foreign investor is granted a license from the Ministry of Industry (or Agriculture) to do business under the provisions of Foreign Investment Regulation to establish any developing project that the country needs for its progress.
In this case, the investor is not limited to any sector, public or private, and can act through a branch, or create a new Saudi Arabian subsidiary or corporation, or join a Saudi party if he wishes. He can obtain a permanent commercial registration as well.

5. Some of the more important characteristics of the Saudi income tax system are shown below:

(i) *Freedom to choose the financial year:*
Tax legislation in most countries of the world usually stipulates that the financial year should cover a specified period of time and in many cases suggests the adoption of the solar year.
In Saudi Arabia it is left for the person concerned to determine the beginning and the end of the financial year. The traditional procedure, with respect to capital investment, is to start the financial year concurrently with the beginning of operations. The first financial year may cover less than one calendar year provided it is adjusted to an annual basis later on.
The taxpayer must however, always notify the tax authorities in advance of the financial year he has chosen.

(ii) *No carry forward of losses:*
Many tax systems in the world allow losses to be carried forward and subtracted from the realised profits of the next year so as to spread the losses between the taxpayer and the treasury. Other systems specify a number of years during which the taxpayer may carry his losses forward. This principle is not applied in Saudi Arabia. The taxpayer is not permitted to carry his losses forward and they are considered as the liability of the taxpayer in the year in which they were incurred.

(iii) *Accounts accepted if audited by an international legal auditor:*
The Saudi Arabian tax system considers as valid all accounts audited by an international legal auditor.
Saudi Arabia, by approving auditing activities, has gone far in supporting international auditing firms and has in fact surpassed many advanced western countries which are still reluctant to accept this procedure. The Saudi tax system has, as a result, been able to overcome three problems:

(a) The shortage in qualified and experienced auditors within its financial institutions. Legal auditors were therefore encouraged to assume part of the responsibility.
(b) The system held the legal auditors responsible for the accounts they approve. This attitude had a great impact on the progress of the auditing profession in as much as it increased the responsibility of the auditing firms.
(c) It promoted and spread interest in taxation and accountancy principles among taxpayers who started to ask auditors to organize their accounts and to verify their financial position.

(iv) *Principle of territoriality:*
Only income realised in the Kingdom of Saudi Arabia is subject to tax. It makes no difference to the Saudi Authorities whether or not such income would be subject to tax in the investor's own country.

(v) *Net profits which constitute the tax base, are determined through normal accounting procedures:*
Although Saudi tax regulations are consistent with general rules of accountancy, it is agreed that appropriation reserves are considered as distributed profits and not debited to the profits account: they are hence subject to taxation. On the other hand, provision reserves to cover liabilities no matter what the net profits or losses are, are still a subject of dispute between the taxpayer and the tax authorities of the Government. Some of these reserves such as end of service indemnity reserves are ac-

cepted and agreed to while others such as bad debt reserves are still disputed because their approval depends on the tax authorities' belief in their legitimacy.

As for depreciation of fixed assets, the Saudi Authorities have published a list of the fixed assets [3] together with the rate of depreciation approved for each.

6. Saudi Arabia has now become a very attractive place for those international entrepreneurs who are eager to do business. The whole country is like a big busy workshop and development work is going on so fast that few countries of the free world can compete with it. The industrial progress of Saudi Arabia is being facilitated by huge income from oil revenues, and the aim of the Government is to ensure an accelerated pace of development and modernisation in all domains — industrial, agricultural and technological.

3. See Appendix on page 7.

APPENDIX

RATES OF DEPRECIATION ACCEPTABLE BY THE SAUDI TAX AUTHORITIES

FIXED ASSETS	*Rate %*
1. *Showrooms and offices:*	
Furniture and fixture	10
Office equipment	15
Electrical equipment: refrigerator, tv, fans	10
Cold storage for food	7.50
Airconditioning	25
Desert cooler	20
Computer machines	12.50
Steel safe	2.50
2. *Means of transport:*	
Airplanes	15
Ships	5
Steam boats	20
Passenger car	25
Pick-up car	25
Pick-up car carrier	15
Scooter and bicycle	25
3. *Building, roads and harbours:*	
Buildings	3
Equipment and machinery for road and buildings	12.50
Heavy duty digging equipment	7.50
Surveying equipment	10
Compressor for digging	20
Tents	20
Block and brick making equipment	7.50
Machinery and tools for harbour construction	10
Machinery for ship repair	10
4. *Electricity and natural gas:*	
Diesel generating	5
Gas turbine generating	5
Overhead network	5
Underground network	5

FIXED ASSETS	*Rate %*
Machinery for manufacturing and filling natural gas	7.50
Gas warehouse	5
5. *Miscellaneous factories:*	
Fixed machinery	7.50
Mobile machinery	10
Pumps	20
Gas station pumps	10
Boilers	10
Tools for car wash and lubrication	10
Electric oven	12.50
Small electric generators	20
Welding machinery	7.50
Small tools	20
6. *Specialized factories:*	
Spinning and weaving machinery	12.50
Cement making machinery	7.50
Grain grinding machinery	7.50
Oil mill machinery	7.50
Tanning and hides treatment equipment	10
Glass making equipment and accessories	7.50
Empty can production machinery	10
Timber cutting and furniture manufacturing	12.50
Carpentry equipment (for doors, windows etc.)	12.50
Metal furniture manufacturing machinery and equipment	10
Soap making machinery	10
Ice making machinery and equipment	7.50
Machinery for filling soda water, dairy products, and all types of fruit juices and refreshments	10

FIXED ASSETS	Rate %
Chemical industries equipment	10
Metal pressing machinery	10
Plastic making equipment	10
Rubber making machinery	7.50

7. *Printing houses:*

Printing machinery	10
Paper cutting and shaping machinery	10
Book binding machinery	10
Printing letters	20
Engineering office equipment	10

8. *General services:*

Clothes wash, cleaning and ironing machinery	10

FIXED ASSETS	Rate %
Barber shop equipment	10
Bakeries machinery	7.50
Fishing equipment and tools	7.50
Neon-light fittings	12.50

9. *Medical services:*

Private clinics equipment	10
Medical testing laboratory equipment	10
Operation rooms at hospitals	15

10. *Lething and Whetting:*

Lething machinery	6
Whetting machinery	6
Measuring equipment	6
Water scales	12.50
Measuring tapes	20

Note: (these depreciation rates will be calculated annually on the basis of fixed flat rate.)

PHILIPPE DEROUIN *:

LOCAL TAXATION IN FRANCE - II -

The replacement of the business licence tax (contribution des patentes) by a new business tax (taxe professionnelle) [1]

1. It took about one and a half years of discussion and drafting, a revised Bill [2] and a decision of the Constitutional Council [3] but the law replacing the business licence tax by a new business tax has finally been enacted [4] and will come into force as from 1st January 1976.[5]
As compared with the first Bill, the law is both shorter (17 clauses instead of 24) and more comprehensive since it covers a number of miscellaneous additional taxes which were levied together with the "patente" and which will follow the same rules as the new business tax.[6]

2. More specifically, the amended Bill and the Law have made two major changes to the business tax scheme previously contemplated:

(a) the first one is a further simplification of the rules defining the basis of assessment of the tax. One of the elements of that basis was the net profit of the taxable person. All the mechanisms considered for allocating that profit among the various "communes" where the taxpayer might carry on its business proved too unsatisfactory and also too complex to allow this component of the basis of assessment to be retained.[7]

(b) The second major change consists of a further shifting of the bases of assessment — and accordingly of the tax load, since the tax rate will be a flat rate — from smaller businesses to larger ones.
This transfer of tax load between categories of taxpayers was estimated to amount to approximately frs 2 billion,[8] the expected proceeds from the business tax being frs 19 billion for 1976.

3. The detailed features of the new business tax will be examined below according to the same plan as followed in our review of the first Bill.[9]

SECTION I: SCOPE OF THE BUSINESS TAX

A. *Taxable and exempt persons and activities*

a) *Persons liable*

4. (substantially unchanged) [10]

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* Member of the Paris Bar.
1. This article supplements and updates the information contained in a previous article by the author and Christian Bouckaert which was published in the September 1974 issue of this Bulletin pp. 364-372.
2. Bill n° 1634 discontinuing the business licence tax and creating the business tax — hereinafter referred to as "the amended Bill", the Bill n° 931 examined in our previous article being quoted as "the first Bill".
3. Decision of 23rd. July 1975 - JO 24th. July 1975 p. 7534.
4. Law n° 75-678 of 29th July 1975 - JO 31st. July 1975, pp. 7763 and foll. — hereinafter referred to as "the Law".
5. Art. 1 of the Law.
6. Art. 1 II and 13 of the Law.
7. § II 1° of the Preamble to the amended Bill.
8. § II 2° of the Preamble to the amended Bill.
9. See note (1) above.
10. Art. 2 I of the Law.

b) *Exemption*

5. (Substantially unchanged).[11] However, the special exemption provided for very small taxpayers has been abolished since the new scheme contains other — and more substantial — provisions which will have the effect of reducing the burden on small taxpayers.

B. *Territorial scope of the tax*

a) *General domestic rules*

6. (Unchanged) [12]

b) *Special domestic rules*

7. (special scheme for international transport companies unchanged) [13]
Harbour authorities, except for pleasure harbours, will be deemed to carry on no activities in France.[14]

c) *Tax treaties*

8. (unchanged).

SECTION II: BASIS OF ASSESSMENT OF THE BUSINESS TAX

A. *Definition*

9. As mentioned above (n° 2 (a)), the formula for calculating the basis of assessment of the "taxe professionnelle" will be reduced to the total of two amounts:
— a portion of the — actual or assumed — amount of wages and salaries (as defined in C. hereunder).
— the rental value of fixed assets (as defined in D. hereunder).[15]

10. (Substantially unchanged).[16] The one half reduction of the basis of assessment is also granted to farming cooperatives.[17]

B. *Determination of net profit*

11. (not applicable since the net profit is no longer an element of the basis of assessment).

C. *Determination of wages and salaries*

12. (substantially unchanged). However wages and salaries will include the compensation paid to managers and managing directors which was included in the net profit item in the first Bill.[18]
A major change in the new scheme is the reduction of the portion of wages and salaries included in the basis of assessment from one half — in the first Bill — to one fifth — in the Law.[19]

12 bis. An entirely new provision of the law relates to self-employed professional persons liable to personal income tax on their non-commercial income (i.e. members of the liberal professions such as physicians, dentists, lawyers, accountants, etc.) and to self-employed business intermediaries (such as brokers, agents, estate agents, etc.): provided they employ less than five employees, an amount equal to one eighth of their gross receipts — instead of one fifth of the wages and salaries they pay to their employees — will be included in their basis of assessment to the business tax.[20]

11. Art. 2 II of the Law.
12. Preamble to Art. 5 of the amended Bill.
13. Art. 5 I of the Law.
14. Art. 5 II of the Law.
15. Art. 3 I of the Law.
16. Art. 3 II of the Law.
17. Ibid.
18. Art. 3 I third subparagraph of the Law.
19. **Art. 3 I in fine of the Law.**
20. Art. 3 I second subparagraph of the Law.

B. *Determination of the rental value of fixed assets*

a) *Determination of assessable fixed assets*

13. to 15. (Substantially unchanged).[21]

b) *Determination of rental value of fixed assets*

16. (Unchanged)

(i) Rental value of assets liable to property tax ("taxe foncière").

17. (Substantially unchanged).[22] However the valuation rules are changed on some minor points relating to buildings.[23] This change, of course, applies to both business and property tax.

17 bis. Although not qualifying as assessable property for property tax purposes, items of equipment and of movable property which are depreciable over thirty years or more are to be included in the basis of assessment of the business tax according to the same rules as buildings forming part of an industrial establishment.[24] This means that their rental value will be deemed to amount to 12% of their cost possibly revalued or partly written down in accordance with the rules applicable to property tax.

(ii) Rental value of other fixed assets.

18. (★) Generally, the rental value of fixed assets owned by the enterprise — or rented by it under a lease-back agreement — is fixed at an amount equal to 16% of their cost, whatever the nature of those assets.[25]
(The revaluation provision and the Fr. 150,000 allowance included in the first Bill have been removed from the amended Bill and the Law).
(★★) Rented assets (except for assets rented under a lease back agreement) will be assessed according to the amount of rent actually paid. This amount may not be more than 20% higher — or lower — than the rental value computed as under (★) above.[26]

(iii) Special reductions and overall allowance.

18 bis. In order to alleviate the tax imposed on small businesses, taxpayers whose turnover does not exceed a certain amount — Fr. 400,000 if their activity consists of supplying services or if they carry on a liberal profession, Fr. 1 million otherwise — will be liable to business tax on the rental value of assets liable to property tax only.[27]
And in order not to make too sharp a distinction between these privileged taxpayers and those subject to normal treatment, all other taxpayers will be allowed to deduct Fr. 25,000 from the assessed rental value of their fixed assets.[28]
It should also be noted, that a special reduction applies to nuclear plants, airports and anti-pollution installations; only two thirds of their rental value will be included in the basis of assessment.[29]

19. (Substantially unchanged).[30]

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21. Although the content of these paragraphs is substantially unchanged, reference should be made to Art. 4 of the Law in which Arts. 8 and 9 of the first Bill have been incorporated.
22. Art. 4 I of the Law.
23. Art. 16 of the Law.
24. Art. 4 II of the Law.
25. Art. 4 III first subparagraph of the Law.
26. Art. 4 III Second subparagraph of the Law.
27. Art. 4 IV of the Law.
28. Ibid.
29. Art. 4 V of the Law.
30. Art. 8 of the Law.

E. *Territorial allocation of the elements of the basis of assessment*

20. As a basic principle, each taxpayer will be liable to the tax in the "commune(s)" where he carries on business.[31]

More specifically, businesses which carry on their activities in several "communes" will be taxed in each "commune" where they have premises and land at their disposal.[32]

The basis of assessment will be allocated between those "communes" according to the following rules:

(a) *As far as rental values are concerned*
— The rental value of assets liable to property tax will obviously be allocated to the "communes" which levy that tax — or which would be entitled to levy it were it not for some special exemption.
— The rental value of other fixed assets will be allocated to the "communes" where those assets are located (if the taxpayer also has premises or land at its disposal there) or to which they can be attributed.[33] This implicitly refers to the case law previously applicable to the "patente" relating to e.g. automotive equipment, etc.[34]
— The standard Fr. 25,000 allowance mentioned above (n° 18) will be allocated to the "commune" where the taxpayer has its major establishment.[35]

(b) *As far as wages and salaries are concerned*

This element of the basis of assessment will be allocated in proportion to the wages and salaries paid to the personnel who usually work in each "commune" concerned.[36]. The practical allocation rules used for "patente" purposes should be maintained as far as travelling employees and employees working at home are concerned.[37]

21. (Substantially unchanged).[38]

D. *Conclusion*

22. (a) As compared with the scheme resulting from the first Bill, the above rules provide a further simplification of the process of determining the basis of assessment and allocating it among the various "communes" concerned.[39]

(b) As compared with the present "patente", the reform should bring a substantial transfer of the bases of assessment from smaller taxpayers to larger ones.

— Craftsmen and retail businesses employing less than three persons and members of liberal professions with a turnover not exceeding Fr. 350,000 [39a]	— 60%
— small industrial concerns employing between three and ten persons;	— 30%
— industrial and transportation businesses employing more than ten persons;	+ 25%
— members of liberal professions with a turnover exceeding Fr. 350,000 [39b]	+ 35%
— aggregate variation	nil

31. Preamble to Art. 6 of the amended Bill.
32. Art. 6 I of the Law.
33. Art. 6 I First Subparagraph of the Law.
34. C.E. 22nd January 1951 "Roth" and C.E. 30th, October 1944 "Sournia".
35. Art. 6 I second subparagraph of the Law.
36. Art. 6 I first subparagraph of the Law.
37. Instr. 30th. May 1955 § 104.
38. Art. 6 II of the Law.
39. § II 2° of the preamble to the amended Bill.
39a. Figures used in the amended Bill and raised to Fr. 400,000 in the Law (see n° 18 bis) — no adjusted statistics have been published.
39b. See note 39a, above.

SECTION III: RATE OF THE BUSINESS TAX

A. General

23. (General principle of local authorities' freedom maintained).[40]
However a law to be decided upon prior to 1st July 1977 will determine a method of fixing the tax rates according to the following objectives:

(i) the business tax rates applied by the various "communes" in de same "département" shall be harmonized and

(ii) the variation of the business tax rate applied by each local authority shall be harmonized with the rates applicable to the other direct local taxes (i.e. property taxes and tax on household occupation).[41]

B. *Transitional provisions*

(a) *Determination of the tax rate for 1976 and 1977*

24. For the next two fiscal years the local tax authorities will still decide the full amount of tax they wish to raise on the basis of "fictitious principals" subject to some amendments and the tax rates will be drawn from that amount.[42]

However, the business tax load will be allocated between taxpayers in the same "commune" or "département" in proportion to the new bases of assessment.

(b) *Harmonization of local tax rates*

25. (To be deleted)

C. *Tax incentives*

26. (Substantially unchanged but no reference is made to the EEC rules).[43]

SECTION IV: MISCELLANEOUS PROVISIONS

A. *Tax returns*

27. (Substantially unchanged).[44]
The treasury claim-back period is fixed at three years following the year when the tax is due.[45]

B. *Payment of taxes - Payment on account*

28. (Substantially unchanged).[46]
As compared with the first Bill, the payment on account is reduced to 50% of the tax due for the previous year and is not payable if that tax amounts to less than Fr. 10,000.[47]
The balance cannot be claimed prior to 1st December of each year.[48]

In 1976, however, a first payment on account will be payable prior to 15th. June, a second one being payable prior to 30th. November. Each of these payments on account will amount to 40% of the "patente" paid in 1975.[49]

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40. Art. 12 first subparagraph of the Law.
41. Art. 12 second subparagraph of the Law.
42. Art. 11 of the Law. It should be recalled that fictitious principals ("principaux fictifs") are the assumed proceeds of the "old four" taxes which were the major source of income of the state until 1917 and are still the basis of determination of the local tax rates in the present French local tax system — see our previous article (n° 1a).
43. Art. 3 II in fine of the Law.
44. Art. 7 of the Law.
45. Art. 7 fourth subparagraph of the Law.
46. Art. 9 I first subparagraph of the Law.
47. Art. 9 I second subparagraph of the Law.
48. Art. 9 I fifth subparagraph of the Law.
49. Art. 9 II of the Law.

CONCLUSION

29. As pointed out in our previous article, this reform provides a valuable modernization of the French local tax system. The amended Bill and the Law have further provided a considerable simplification of the business tax scheme.

This reform should enable most businesses and particularly foreign businesses investing or wishing to invest in France to determine their potential business tax liability much more easily — to say the least — than under the present system.

Last, but not least, the adoption of fairer bases of assessment of the tax and the transfer of a substantial portion of the overall basis from numerous — and politically sensitive — minor taxpayers to a smaller number of major businesses should enable local authorities to collect a larger amount of tax through the channel of the business tax. Despite the principle of parallel variation of the various direct local tax rates set forth in the present law (see n° 23 (ii) above) — a principle which might be abandoned in the anticipated law — a sizeable increase in the business tax load should, accordingly, be expected in the future.

ELIZABETH A. DE BRAUW-HAY *:

THE NIGERIAN BUDGET 1975-76**

The Budget proposals for the year 1975-76, outlined by the former Head of the Federal Military Government, General Yakubu Gowon, in a speech on March 31, 1975, are mainly concerned with measures to reduce the pace of inflation affecting the level of prices of both imports and locally produced goods. It is proposed to achieve this aim mainly by making a number of changes in customs and excise duties, changes which will, it is hoped, facilitate importation of consumer goods in short supply, stabilise the cost of local products and create an incentive for new local production. Local industry will also be assisted by certain changes in the taxation of companies. The details of these and other changes contained in the budget are outlined below.

1. RELIEF FROM INDIRECT TAXES

a. *Import duty*

Import duties on building materials in short supply have been reduced from 50 to 20 per cent and on most basic good items to 10 per cent; import duty on milk has been abolished altogether.

On other general consumer goods the rates of duty have been reduced to levels between 5 and 40 per cent. These include electronic and photographic equipment and beer. Import duty relief is also given for the soap and detergent, confectionery and candle manufacturing industries.

b. *Excise duty*

Excise duty has been abolished on a wide variety of everyday products. These include textiles, motor tyres, butter, matches, furniture and perfumery and toilet preparations.

2. RELIEFS FROM DIRECT TAXATION

a. *Company profits tax*

Prior to the Budget companies were liable to tax at the rate of 40 per cent on the first 10,000 Naira of taxable profits and at the rate of 45 per cent on the excess. Small companies whose profits did not exceed 6,000 Naira were not liable at all to company profits tax in the first six years. The Budget proposes that the first 6,000 Naira of profits made by any company should be free of tax and that any profit in excess of that amount should be taxed at a flat rate of 40 per cent.

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** The material in this note is taken from the 1975-76 Budget Speech and the Press Statement on the 1975-76 Budget published in Recurrent and Capital Estimates of the Government of the Federal Republic of Nigeria, 1975-76 by the Federal Ministry of Information, Printing Division, Lagos.

b. *Taxation of dividends*

The present system of taxation of dividends was introduced by the 1972-73 Budget. Prior to that companies paid dividends net to their shareholders who, when the dividends became taxable as personal income, were then able to claim relief in respect of the tax already paid by the company. After that Budget however, profits from investment in shares were taxed in the hands of shareholders who received dividends gross. In order to avoid the double incidence of taxation and encourage investment in shares, it has been decided to revert to the pre1972-73 system whereby dividends were paid net.

c. *Capital allowances*

An initial qualifying building expenditure allowance for other than industrial buildings of 5 per cent will now be given and the existing annual building expenditure allowance will be raised from 5 to 10 per cent.

3. OTHER FISCAL MEASURES

a. *Capital gains tax*

The new Budget extends the capital gains tax to individuals in all states of the Federation and also to non-residents.
The present law on capital gains tax only applies to individuals in Lagos State and Mid-Western State and only to the extent that taxpayers are resident in Nigeria. Capital gains tax payable by non-residents will be collected by the Federal Board of Inland Revenue and by the various State Governments in the case of residents.

b. *Cattle tax (Jangali)*

The Budget proposes to abolish this tax throughout the country.

4. OTHER MISCELLANEOUS ASPECTS OF THE BUDGET

a. *Proceeds of indigenisation*

Proceeds from sales of businesses subject to indigenisation under the Nigerian Enterprises Promotion Decree, 1972 may now be freely repatriated. This represents a certain liberalisation of the repatriation procedure laid down in the 1974-75 Budget.

b. *Management and technical fees and royalty payments*

The 1975-76 Budget reiterates the policy laid down in the previous budget as regards management and technical fees and royalty payments, namely that a fixed fee only will be payable in the first five years of the establishment of a company and thereafter a percentage of gross profit not exceeding five per cent may be considered in deserving cases. Turnover or net sales will only be used as a criterion in exceptional cases. Applications for technical fees and royalty payments are related to the state of technology of the industry concerned as well as to the existence or otherwise of a centrally directed research and development effort in the particular industry involved.

* * * DOCUMENTS * * *

Unofficial Translation of the Resolution Adopted by the VII Latin American Meeting on Tax Law on Subject I: Tax Treaties between Developed Countries and Countries in the Process of Development: Regime of Interest, Dividends, Royalties, Technical Assistance Fees and Other Income

Considering:

1. That the subject has been submitted to this Meeting as a consequence of whereas no. 10 and paragraph no. 4 of Resolution no. 2 on Subject II, discussed in the VI Latin-American Meeting on Tax Law, held at Punta del Este in 1970, for the purpose of rendering more precise the application of said resolution to the specific problems of interest, dividends, royalties, technical assistance fees and other similar income paid by an enterprise, generally located in a developed country.

2. That, consequently, it is advantageous to ratify formally the general principles approved by the IV Meeting (Buenos Aires, 1964), Subject I, Resolution no. 1 and by the VI Meeting (Punta del Este, 1970) Subject II, Resolution no. 2, in the sense that the principle of the source must be the fundamental and prioritary principle in force for applying tax internationally notwithstanding the subsidiary application of other principles in order to take into account the economic reality in matters of international transfers of capital and technology, the need to implement a fiscal policy that attracts foreign investments and technology, and does not create incentives for the export of national capital to other countries.

3. That this meeting should precise the manner in which these principle should be applied specifically in the case of dividends, interest, royalties and technical assistance fees.

4. That for this purpose the deliberations have shown the need to establish clearly the distinction between royalties and technical assistance, having reached the conclusion that royalties comprise the cession of the use, not only of trade marks and patent proper, but also of all technical knowledge previously obtained by the owner, even if they have not or could not be patented, and all accessory services, such as the information necessary for the application of the patents and other similar technical knowledge, whereas the technical assistance covers the services of industrial, technological or similar advice, but not the professional services proper, which were excluded from the agenda of this meeting.

5. That the amount subject to tax, should be the net income, i.e. the amount obtained after deduction of the expense necessary to obtain, maintain or preserve the income.

6. That in practice it may be difficult to present evidence that the expense is real, necessary and reasonable, especially in the case of payments made between related enterprises, and for this reason alternative methods of deduction of expenses may be recommendable.

7. That the indicated results can only be reached through international treaties entered into with the country capable of furnishing the desired capital and technology.

8. That when referring to "related enterprises" the meeting understands by such expression those enterprises comprised in the definition given by article 9 of the OECD model.

9. That notwithstanding the possibility of considering the payment for interest, royalties and technical assistance as part of the total income of local source for all non-fiscal purposes and also for the purpose of establishing the rate of tax, it is necessary that the taxation be by way of withholding from the foreign enterprise, in order to allow the latter to obtain the tax credit in its country, thus encouraging the investment, and

10. That it is advantageous to bring these conclusions to the knowledge of the pertinent international entities.

The VII Latin American Meeting on Tax Law recommends:

1° to ratify previous recommendations on the adoption of the principle of territorial taxation in the country where the taxable profits are originated (principle of the sources or of the territory) disregarding the nationality, domicile and residence of the beneficiary, as the prioritary basis for taxation, not only because of its intrinsical virtues but also because it is the most appropriate to obtain the international encouragement of the transfers of capital and technology for the purpose of economical and social development.

2° to declare that the source of the income studied in this Meeting must be placed on the basis of the following specific criteria based on the common characteristic of the relations between the tax payer and the place where the income is obtained:

a. *Dividends:* in the place where the company paying such dividends operates;

b. *Interest:* in the country where the lender places its capital. In view of the well-known difficulties that establishing this place presents, it is acceptable to adopt simple presumptions based on the domicile of the debtor (Mexico agreement) or on the place from which the payment is made (Andean Pact);

c. *Royalties:* for the cession of use of trade marks, patents and similar, and their accessories, in the country where these are used or exploited as a consequence of the agreement;

d. *Technical assistance fees:* in the place where the person giving the assistance carries out its activity; nevertheless considering the practical difficulties to determine the nature and effective placement of the assistance activities, it is admissible to adopt simple presumptions on the basis of the place where the assistance is used or from which the payment is made;

3° to declare that the preceding types of income must be taxed after deduction of the expenses necessary to obtain and present the productive source, in accordance with the ordinary rules in force for income of similar nature obtained in the country. In case where this is not possible, there should be established, by way of presumption, percentage deductions in accordance with the characteristics of the activity that produces the income or reductions in the rate of tax that produce an equivalent effect.
This general principle is subject in practice to the need of proving that the expenses were actually incurred and that their amount was reasonable.

4° to recommend that international tax treaties be negotiated with developed countries, inspired in the principle of the source and having as their main purpose to coordinate the tax administration in both countries for the purposes of:

a. helping the above mentioned transfers to the developing countries, through the granting of incentives, equitably shared between the contracting parties, limited to the needs of development and subject to real reduction in prices;
b. fighting against tax evasion, through the interchange of information and the answering of consultations, procedure which it would be desirable the collaboration of the specialized international bodies, governmental and scientific;
c. organizing a legal procedure for solving conflicts, arising out of insufficiency or lack of clarity in the treaties.

5° to declare that the policy of incentives must be established by the developing countries in accordance with their discretionary valuation of their needs and advantages.

6° to declare that the tax treatment of related enterprises must follow the general rules applicable for independent enterprises but nevertheless recommending:

a. that special regimes be established for the control, both unilaterally by each interested country and jointly by both, to avoid the distortions which the practice has allowed to establish.
b. that legal limitations and requirements be established to prevent the abuses which may not be evidenced by the controls of the administration;

7° to establish, for the case of payment of interest, royalties and technical assistance, authorized by the country of source because they are considered necessary for its technological development, that the tax should always be established in the form of a tax withheld from the enterprise receiving such payments.

8° to transmit the conclusions approved to the XIX Conference of the Inter American Bar Association to be held in Cartagena the 26th of this month; to the XXIX Congress of the International Fiscal Association to be held in London the 21st of September; to the Latin American Free Trade Association (LAFTA) and to the Commission for the Cartagena Agreement (Andean Pact).

INDIA

Decision of the Madras High Court of January 10, 1975 [1]

Commissioner of Income-tax, Madras versus J. Jenkin Thomas and Others

SUBSISTENCE ALLOWANCE PAID TO FOREIGN TECHNICIAN LINKED WITH PROVISION OF FURNISHED ACCOMMODATION ETC.

The assessees, who were foreign technicians, were employed by PDTS in Neyveli Lignite Corporation and their salaries were payable by the Corporation. They were also paid a subsistence allowance of Rs. 30 per day from the date on which furnished quarters were provided by the Corporation and Rs. 45 per day till that date if they lived in the accommodation furnished by PDTS but they had to surrender Rs. 15 per day to PDTS towards the cost of providing such accommodation. The claim of the assessees that this subsistence allowance was exempt and not liable to tax by virtue of section 4(3)(vi) of the Indian Income-tax Act, 1922, was negatived by the Income-tax Officer and the Appellate Assistant Commissioner. The Appellate Tribunal, however, held that the employer of the assessees was PDTS and not the Corporation, that when the employees came over to India for carrying out the specific work at the mine of the Corporation there would be extra expenses over and above what would normally be spent by them at their respective native places and such expenditure was incurred by the assessees in the performance of their duties and hence the subsistence allowance would be exempt under section 4(3)(vi) and clause (ii) of Explanation 2 *to section 7(1) did not apply. On a reference to the High Court at the instance of the department:*

Held, *(1) there were no facts to show that the amount was actually a kind of reimbursement for any expenditure incurred in the performance of the duties of their office, but on the facts the amount reached the assessees by virtue of their employment and in accordance with the appointment letter and hence the amount of subsistence allowance was part of their salary or wages;*

(2) in order that a person may claim the exemption under section 4(3)(vi), he has to show that the amount was received not for his own benefit but for the purpose of meeting the expenses wholly and necessarily incurred or to be incurred in the course of or during the performance of his duties of the office; and

(3) the subsistence allowance paid in the instant case was not related to the duties as such but was linked with the provision of furnished quarters and the same was not exempt under section 4(3)(vi).

JUDGMENT

The judgment of the court was delivered by

Sethuraman J.—This is a common reference relating to the assessment of three persons, viz., Messrs. J. J. Thomas, E. B. Lewis and R. Dow. On 9th May, 1957, the Neyveli Lignite Corporation entered into

1. Reported in Income Tax Reports, Madras (1975) 101 I.T.R. at 511.

an agreement with Messrs. Powell Duffryn Technical Services Ltd. incorporated in U.K. doing the work of consultants. This company will hereafter be referred to for convenience as "P.D.T.S." It had prepared a scheme for development of a lignite mine and a ground water control system at Neyveli. As from 10th May, 1957, it was employed by the Neyveli Lignite Corporation, hereinafter referred to as "N.L.C.", for a period of 3 years and 6 months. The term of employment of the consultants was liable to be extended for such further period and on such terms as might be agreed upon between the parties. P.D.T.S. had to appoint in consultation with and approval of N.L.C. from overseas and maintain at the mine, starting not later than three months from 10th May, 1957, the following among other staff, one directing engineer, one mechanical engineer and one mining engineer. The P.D.T.S. had to make available to N.L.C. as and when necessary the services of their whole organisation in U.K. and had to arrange for additional engineer to visit India when necessary. In clause 8, it was provided that P.D.T.S. had to ensure that their staff at the mine was available when required to attend meetings with or convened by N.L.C. Under clause 9, N.L.C. had to take all necessary steps to ensure that its employees at the mine co-operated with the consultants and their staff to the extent necessary and to enable the consultants to carry out their duties. N.L.C. undertook under clause 11 to provide free of charge to the consultants, i.e., P.D.T.S. office accommodation at Neyveli and under clause 12, free residential accommodation, suitable for Europeans for each member of the site staff of the consultants, with basic furniture and free power for lights and fans and free supply of water. The site staff were to be given the necessary transport facilities as contemplated by clause 13. The remuneration of the consultants was fixed under clause 14 on a consolidated fee of £200,000 payable in quarterly instalments of £14,250 each in Sterling in London as shown by clause 15. In clause 23(a) it was provided that the following officers, who are the assessees herein, were to be posted as site staff against the posts shown below, viz.:

(1) Director Engineer: E. B. Lewis.
(2) Mechanical Engineer: J. J. Thomas.
(3) Mining Engineer and Surveyor: R. Dow.

Clause 23(b) stated that the individual salaries of the site staff were payable by N.L.C. as notified in writing by P.D.T.S. before the arrival of the relative individual at the site and that the sum total of the rates per annum of the salaries of the nine members of the site staff as shown in clauses 6 and 23(a) was not to exceed £27,500. The salary was payable for the period actually spent on duty on the work of N.L.C. in India in Indian currency. The staff was eligible for leave and the salary for the leave period was to be paid in Indian currency. Then followed the following paragraph in clause 23(c):

"Each member of the site staff shall be eligible for a subsistence allowance of Rs. 30 per day from the date on which furnished quarters are provided by the Corporation under clause 12 above and Rs. 45 per day until then, if he lives in accommodation found by the consultants themselves. The subsistence allowance shall be payable for the period actually spent on Corporation duty including travel on Corporation duty but shall not be admissible for any one who is on leave, for the period of such leave."

It is necessary to refer to the other clauses of the said agreement between P.D.T.S. and N.L.C.

On 17th June, 1957, an appointment order was issued to Mr. R. Dow by P.D.T.S. His U.K. salary was £1,200 per annum, but during the period of his appointment, he would receive remuneration in India in rupees equivalent to £2,000 per annum. Such remuneration would be paid in monthly instalments, at the rate of exchange in force on the last day of the working month being adopted. Paragraph 4 of the letter of appointment stated that he would be paid a subsistence allowance of Rs. 30 per day, which would be increased to Rs. 45 if accommodation was provided by P.D.T.S. but out of the said sum of Rs. 45 he (the employee) would be expected to surrender Rs. 15 per day to the company towards the cost of providing such accommodation. The appointment letters in the case of the two other employees are not annexed to the statement of the case. The case proceeded, however, on the basis that the appointment letters in the other two cases were identical except for any variation in the salary as such.

Under section 4(3)(xiv) of the Indian Income-tax Act of 1922, exemption was available to the income chargeable under the head "Salaries" for a period of 36 months in the case of "foreign technicians", the contracts with whom were approved by the Government of India. In the present case the period of exemption with reference to these technicians came to be closed on 23rd June, 1960. The salary became thereafter taxable.

We are concerned in the present case with the assessment year 1961-62. During the preceding financial year, Mr. J. J. Thomas rendered services up to 9th November, 1960, and the other two technicians throughout the relevant previous year. The question that arose in the respective assessments was whether the subsistence allowance payable under clause 23(c) of the agreement between P.D.T.S. and N.L.C. and paragraph 4 of the appointment letter was liable to be taxed. Before the Income-tax Officer, the respective assessees claimed that the relative amounts received in each case would not be brought to tax as it was exempt under section 4(3)(vi) of the Indian Income-tax Act, 1922. The Income-tax Officer did not accept this contention and on appeal the Appellate Assistant Commissioner also rejected it. When the matter was taken on appeal to the Tribunal, the contentions appeared to have been on a slightly wider basis. Before the Tribunal a reference was made to section 7 and also to section 4(3)(vi) of the Act.

The Tribunal held that the employer of the respective assessees was P.D.T.S. and not N.L.C., that when the employees came over to India for carrying out the specific work at the mine of the N.L.C. there would, necessarily, be extra expenses over and above what would normally be spent by them at their respective native places and that such expenditure was incurred by the respective employees in the performance of their duties. The Tribunal considered that clause (ii) of *Explanation 2* to section 7(1) did not apply herein and that the subsistence allowance would fall under section 4(3)(vi) of the Act of 1922.

At the instance of the Commissioner of Income-tax, this reference has been made raising the following two questions:

"1. Whether, on the facts and in the circumstances of the case, the subsistence allowance constitutes 'profits in lieu of salary' as referred to in clause (ii) of *Explanation 2* to sub-section (1) of section 7 of the Indian Income-tax Act, 1922, and, therefore, falls under the head 'Salaries' within the meaning of that term under section 7(1) of the Indian Income-tax Act, 1922?

2. Whether, on the facts and in the circumstances of the case, this was an allowance specifically granted to meet the expenses wholly and necessarily incurred in the performance of the duty of an office or employment of profit and, therefore, not includible in the total income of the assessee in terms of section 4(3)(vi) of the Indian Income-tax Act, 1922?"

At the time of the hearing of the reference Mr. Ramgopal, the junior counsel for the assessee, took a preliminary objection saying that the answer to the first question was self-evident as clause (ii) of *Explanation 2* to section 7(1) could not have any application to the facts herein. In his submission this reference was confined only to question No. 2. Mr. Jayaraman, the learned counsel for the Commissioner of Income-tax, submitted that even on the first question as framed, the argument that the subsistence allowance was assessable under section 7(1) was open to him and that, in any event, the question could be reframed so as to bring out the real issues between the parties, as the Tribunal could not have intended to place before the court a mere academic question or a question the answer to which was self-evident.

After carefully considering the respective submissions, we think it proper to reframe the question No. 1 as follows:

"Whether, on the facts and the circumstances of the case, the subsistence allowance falls under the head 'Salaries' within the meaning of section 7(1) of the Indian Income-tax Act, 1922?"

We have reframed the question substantially on the language used by the Tribunal itself. We have only omitted the reference to *Explanation 2*. Both for purposes of appreciating the reasons for reframing the question as above and for considering the issues involved in this case, it is necessary to make a brief reference to the provisions of sections 7 and 4(3)(vi) of the Act. Under section 7(1), the tax is payable by the assessee under the head 'Salaries' in respect of any salary or wages, perquisites or profits in lieu of, or in addition to, any salary or wages. *Explanation 1* to section 7(1) expands the content of the term "perquisite" by giving an inclusive definition. Similarly, *Explanation 2* expands the ambit of "profits in lieu of salary" by providing another inclusive definition. The fact that these two expressions have not been actually defined, their meaning being extended by an inclusive definition goes to show that in each case we have to find out whether any particular receipt would be "perquisite" or "profits in lieu of salary" in their primary sense. If the particular receipt could be brought within the primary sense of the respective terms, then there is no need to go to the *Explanation*. If, however, the receipt does not come within the scope of the primary meaning of the terms, then we have to see whether they come within the scope of the *Explanations* which expand the meaning of these terms.

Section 7(2) provides for certain deductions. Clause (iii) thereof allows the deduction of any amount actually expended by the assessee, which he, by the conditions of his service, is required to spend *out of his remuneration,* wholly, necessarily and exclusively in the performance of his duties. Section 4(3) is a provision designed for the purpose of not including in the total income of the person receiving the amount, particular categories specified therein. We may set out section 4(3)(vi) of the Act to the extent necessary herein as follows:

"4. (3) Any income, profits or gains falling within the following classes shall not be included in the total income of the person receiving them :......

(vi) Any special allowance or benefit, not being in the nature of an entertainment allowance or other perquisite within the meaning of subsection (1) of section 7, specifically granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit, to the extent to which such expenses are actually incurred for that purpose."

The distinction between section 7(2)(iii) and section 4(3)(vi) has to be borne in mind. The Gujarat High Court in *J. C. Mankad* v. *Commissioner of Income-tax* [2] has brought out the distinction between the two provisions as follows at page 454:

"Where a special allowance is specifically granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit, such allowance, to the extent to which it is actually spent, is covered by section 4(3)(vi). If on the other hand no special allowance is granted, but the assessee is required by the conditions of his service to meet such expenses out of his remuneration, the sum so expended is deductible from his assessable income under section 7(2)(iii). But in both cases the expenses must be expenses which are wholly and necessarily incurred in the performance of the duties of the office."

Bearing in mind the distinction pointed out above we should approach the problem before us.

As indicated earlier, the primary investigation has to be whether any particular receipt has to be brought within the scope of section 7(1) of the Act. If the receipt is found as not satisfying the primary meaning of the expressions "perquisites" or „profits in lieu of salary", then alone we have to go to the *Explanations.* Both sides are, however, agreed before us that in the present case *Explanation 2* to which reference has been made by the Tribunal has no application. We have, therefore, reframed the question as to find out whether these receipts could come within the scope of the main provisions of section 7(1) itself.

We may now examine the decisions relevant to this point. In *C. Lakshmi Rajyam* v. *Commissioner of Income-tax* [3] the point for consideration was whether certain payment received by an actress from one of the partners of a firm by which she was employed under a document executed in her favour was liable to be taxed. The actress had acted in a film called *Samsaram.* One Ranganatha Das and his brother-in-law constituted a firm which produced the said picture. The actress played the leading role in the said picture and it was successful beyond expectation. Ranganatha Das executed a document in her favour about 18 months after the release of the picture agreeing to pay her a fourth share of the realisations from the picture in consideration of her wholehearted help, co-operation and valuable services rendered by her and by way of special remuneration in addition to the fixed remuneration paid to her. She, accordingly, received two amounts, which were brought to tax for the assessment years 1952-53 and 1953-54.

2. [1965] 55 ITR 448 (Guj).
3. [1960] 40 ITR 340 (Mad).

The question before the court related to the taxability of these amounts. At page 351, after considering the several decisions cited before it, this court observed as follows:

"It has, therefore, to be seen whether, from the point of view of the assessee, the amount received accrued to him by virtue of his employment."

Earlier at page 349 the contention that the amount not having been received from the employer was not liable to be taxed in the hands of the assessee was noticed and it was observed as follows:

"......the mere fact that a gift or payment was made by a person other than an employer will not be decisive of the question whether it was intended as a remuneration or present."

For this proposition, the learned judges have referred to the decision in *Bridges* v. *Bearsley*.[4] In the said case it was decided by the Court of Appeal in U.K. that the assessee had served long and had expected some shares in the company to be transferred to him; but the major shareholder had died without transferring the shares either inter vivos or by a will which he left. The owner of the major shareholder transferred the shares to the assessee. It was held that a benefit provided for the holder of an office or employment under a company may be a profit of that office or employment, although provided by the shareholders and not by the company itself, which was the natural paymaster.

A slighty different note appears to have been struck by a decision of the Calcutta High Court in *David Mitchell* v. *Commissioner of Income-tax*.[5] In that case the assessee was a chartered accountant by profession and he was a partner in a leading firm of chartered accountants. The promoters of the company engaged the services of the chartered accountant firm to assist them in the floatation of the company. The assessee attended to this work as partner of the firm. As a token of appreciation for the assistance rendered by him, he was given 2,500 shares in the company which was an unsolicited gift in his favour. The point for consideration was whether the value of these shares was liable to be taxed. At page 714, the learned judges observed as follows: [6]

"The contract of employment in connection with which he had rendered services to the promoters was a contract between them and Messrs. Lovelock and Lewes. The assessee was not an employee of the promoters under that contract as an individual, nor could he claim any salary or wages as such. The contract of employment could neither be enforced against him personally and individually nor could he, acting as an individual, enforce it against the promoters...... Personally, he was not entitled to claim any salary or wages...... It seems to me to be beyond argument that whether or not the value of the shares was taxable in the hands of the assessee as his income, it was not taxable under section 7(1)."

In that case there was no contract of employment so as to attract section 7. The learned judges sustained the assessment under the head "Other sources" in that case.

Assuming that N.L.C. is not the employer (on this point, we have our own doubts about the correctness of the Tribunal's findings) even then as pointed out in the

4. [1958] 33 ITR 653 (Ch D).
5. [1956] 30 ITR 701, 714 (Cal).
6. [1956] 30 ITR 701 (Cal).

decision of this court in *C. Lakshmi Rajyam* v. *Commissioner of Income-tax,*[7] which is binding on us, the source from which the amount was received is not material.

The real point to be examined is whether the amount reached the employee by virtue of his employment. If it did not, then the amount would not come within the scope of section 7(1) of the Act. If it did, then, subject to any other contention, it would be primarily assessable under section 7(1) of the Act.

This is not a case where the amount was given as salary as such. It was called subsistence allowance, which would be a perquisite or profit in lieu of salary. We may at this stage consider some of the decisions relevant to this aspect of additional receipts of an employee. In *Fergusson* v. *Noble* [8] the assessee was a detective sergeant in the employment of the Corporation of Glasgow. A sum of £ 11-14-3 was paid to him in cash as allowance for clothing. Detective officers for the purpose of their work had to wear plain clothes. In order to avoid uniformity each officer received an allowance in cash and out of it he supplied his own requirements. The allowance was fixed by reference to the corresponding free issue of clothing made to uniformed members of the force. The clothing which the employee purchased was specified and was subject to the approval of a superior officer. The question was whether this allowance was liable to be taxed. At page 180, Lord Salvesen of the Court of Session (Scotland) observed as follows: [9]

"It seems to me to be a payment accruing to the respondent by reason of his office... it seems to me that once we have reached the conclusion that this money allowance is part of the salary or wages, perquisites, profits or other emoluments which are derived from his office, we must hold that it is assessable to income-tax......"

The question as to whether the assessee could get deduction for the purchases actually made was left for consideration of the taxing authorities.

In *Corry* v. *Robinson* [10] the facts were as follows: The assessee, a civil servant, was the deputy cashier of the naval base at Singapore working for the British company. He received the salary appropriate to his rank and in addition a "colonial allowance" to meet the increased cost of living abroad. The question was whether the "colonial allowance" was liable to be taxed. Finlay J. held that the amount paid for extra cost of living was assessable to tax. The case went up to the Court of Appeal. But the question of assessability was disputed on other grounds, which are not material for our present purpose.

Recently the House of Lords had to go into this point in *Owen* v. *Pook (Inspector of Taxes)*.[11] The assessee in this case was a medical practitioner. He had two part-time appointments as obstetrician and anaesthetist at a hospital 15 miles away from his residence. Under the appointments he was on stand-by duty at certain specified times, to deal with emergency cases at the hospital. At such times he was required to be accessible by telephone. On receipt of the telephone call from the hospital he gave instructions to the hospital staff, and then either advised and awaited a further report or set out immediately for the hospital. His responsibility for a patient began as soon as he received a tele-

7. [1960] 40 ITR 340 (Mad).
8. [1919] 7 TC 176.
9. [1919] 7 TC 176.
10. [1933] 18 TC 411 (CA).
11. [1969] 74 ITR 147 (HL).

phone call. The hospital authorities paid him travelling expenses at a rate per mile for journeys between the residence and the hospital up to a single journey of 10 miles.

He bore the cost of the additional five miles. Two questions arose in his assessment, viz., (1) whether the travelling expenses received by him from his employers were emoluments from his office or employment, and (2) whether such travelling expenses qualified as admissible deductions under rule 7. We shall go into the question of deductibility of the expenses a little later and, therefore, at this stage it is necessary to refer only to the discussion in the House of Lords regarding the assessability of the amount as the emoluments from the office. The discussion discloses a divergence of opinion on this point. At page 153 Lord Guest pointed out as follows: [12]

"If the allowance was, as in *Fergusson* v. *Noble* [13] a clothing allowance payable whether it was expended or not, I can see the argument that it was an emolument in the sense of a profit or gain and I do not wish to question the authority of that case; but if the payment was merely a reimbursement for actual expenditure, different considerations arise......"

At page 154 he observed as follows:
"The allowances were used to fill a hole in his emoluments by his expenditure on travel. The allowances were made for the convenience of the employee to allow him to do his work at the hospital from a suitably adjacent area. In my view, the travelling allowances were not emoluments."

Lord Pearce stated at page 158 as follows:
"The reimbursements of actual expenses are clearly not intended by 'salaries', 'fees', 'wages' or 'profits'. It is contended that they are 'perquisites'. The normal meaning of the word denotes something that benefits a man by going 'into his own pocket'."

He held that it was not an income.

Lord Donovan observed at page 160 as follows:

"On the footing that the travelling expenses paid to Dr. Owen simply reimbursed what he had spent (or part of what he had spent) on travelling in performance of his duties, I do not think they should be regarded as emoluments of his employment within the meaning of Schedule E. I think the case is distinguishable from *Fergusson* v. *Noble,* [13] where a cash allowance was paid to the employee which, although he may have been required to spend it on buying a civilian suit, yielded a benefit or advantage to him."

Lord Wilberforce did not specifically decide this issue except saying at page 164 as follows:

"......I should have difficulty in seeing how the appellant could succeed, on his alternative point, in establishing that reimbursement of a non-deductible expense is something other than an emolument."

Lord Pearson took the view that the amount received as travelling allowance was an emolument.

Applying the majority view of the House of Lords, we would have to examine the character of the amount received by the assessee as and by way of reimbursement of any actual expenditure, while on duty. We do not find any facts to show that the amount was actually a kind of reimbursement for any expenditure incurred in the performance of the duties of his office. One has to subsist whether in office or otherwise. The amount is not received to

12. [1969] 74 ITR 147 (HL).
13. [1919] 7 TC 176.

meet any part of the duties of the office or in the actual performance of the duties. It is different from what the U.K. doctor received as travelling expenses, while on duty, so as to enable him to reach the hospital to treat the patient urgently.

On the facts herein, as the amount reached the assessee by virtue of his employment and in accordance with the appointment letter, it follows that the amount of subsistence allowance is part of the salary or wages. The name given to a particular payment is not conclusive. So long as it was intended to be paid to the employee under the contract of service, it would have the character of income from the employment just as the clothing allowance and colonial allowance were in *Fergusson* v. *Noble* [14] and *Corry* v. *Robinson* [15] respectively.

Mr. Swaminathan, the learned counsel for the assessee, drew our attention to several decisions wherein the question of deduction of expenditure has been examined. In the present case the assessee never put forward the contention that there was any expenditure which he made out of the salary and which was deductible. If one had to go into this contention, one would have to find out the facts as to whether the assessee did incur any expenditure and if so the quantum thereof. This would involve investigation of facts. On the record, as it is before us, we do not find any fact which can in this connection be taken into account to find out whether the respective assessees have incurred any expenditure which could be allowed as deduction under section 7(2)(iii) of the Act. We do not, therefore, think it possible to go into this aspect on the materials before us. As the question of deduction is not material for this reference, we are not also considering the decisions that were cited before us on this point.

We now go into the second question. We have already extracted section 4(3)(vi) of the Act. That provision would come in for application if it satisfies the following requisites:

(1) there must be a special allowance or benefit;

(2) it must not be in the nature of entertainment allowance or other perquisite within the meaning of sub-section (1) of section 7; and

(3) it must have been specifically granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit.

If all these three conditions are satisfied, then the exemption is available to the extent to which such expenses were actually incurred for that purpose. The exemption was restricted to the actual expenditure incurred by an amendment made by the Finance Act of 1955. Before this amendment the Bombay High Court had taken the view in *Tejaji Farasram Kharawalla* v. *Commissioner of Income-tax* [16] that once it was established that the grant was for a particular purpose it was no longer necessary for the assessee to prove that in fact he expended the grant for the purpose for which it was given. It was also held that the assessee might have spent more or less, but qua that grant, he was entitled to the exemption. The validity of this view of the Bombay High Court was canvassed before the Supreme Court in *Commissioner of Income-tax* v. *Tejaji Farasram Kharawalla Ltd.*[17] In that case the assessee was a distributor of dyes and dye stuffs manu-

14. [1919] 7 TC 176.
15. [1933] 18 TC 411 (CA).
16. [1948] 16 ITR 260 (Bom).
17. [1968] 67 ITR 95 (SC).

factured by Ciba. Ciba agreed to pay a commission at the rate of 12½ of which 7½% was treated as selling commission and 5% as compensation in lieu of the contingency expenses, which the selling agent had to meet, such as commission to dyeing-masters, agents, etc. The question before the Supreme-Court was whether this 5% was liable to be taxed at all or not. At page 99 it was observed as follows:

"An allowance, though made to a person holding an office or employment of profit, intended for appropriation towards expenditure incurred or to be incurred in the discharge of the duties, does not constitute any real income of the grantee. It is in truth expenditure incurred by the employer through the agency of the grantee. The intention of the framers of the Act was to grant exemption in respect of amounts received by the assessee, *not for his own benefit* but for the specific purpose of meeting the expenses wholly and necessarily incurred or to be incurred in the performance of his duties as an agent. It would, therefore, be reasonable to hold that the allowance granted to meet the expenses wholly and necessarily incurred or to be incurred in the performance of the duties of the office or employment of the grantee alone qualifies for exemption under the Act, and any surplus remaining in the hands of the grantee after meeting the expenses does not bear the character of the allowance for meeting expenses but for performing the duties of the office or employment...... the surplus remaining in the hands of the grantee acquires for the purpose of the Income-tax Act the character of additional remuneration".

From the above passage it would be clear that in order that a person may claim the exemption under section 4(3)(vi) of the Act the has to show that the amount was received not for his own benefit, but for the purpose of meeting the expenses wholly and necessarily incurred or to be incurred in the performance of his duties. In the present case the submission was that but for this engagement to do the work in Neyveli the respective assessees would not have left Britain and would not have put themselves to the additional expenditure that arose because of their having to be away from their home. It was, therefore, submitted that the amount was received only for meeting the expenses wholly and necessarily incurred or to be incurred in the performance of the duties.

The words "in the performance" have come in for consideration in *Nolder* v. *Walters*.[18] That was a case of an aeroplane pilot who was employed by a limited company and who claimed deduction of expenses on telephone, etc., in the assessment of his remuneration to income-tax under Schedule E of the U.K. Act. At page 387 Rowlatt J. said as follows:

" 'In the performance of the duties' means in doing the work of the office, in doing the things which it is his duty to do while doing the work of the office. A man who holds an office or employment has, equally necessarily, to do other things incidentally, and spend money incidentally because he has the office. He has to get to the place of employment, for one thing...... but it is not in doing the work of the office, which begins when he arrives, and sets to work to perform his duties."

Similarly, in *J. G. Mankad* v. *Commissioner of Income-tax* [19] the Gujarat High Court had to deal with a case where a charter-

18. [1930] 15 TC 380 (KB).
19. [1965] 55 ITR 448 (Guj).

ed accountant practising in Ahmedabad was employed as a part-time professor of accountancy in Bhavnagar on a salary of Rs. 400 per month including travelling allowances and all other allowances. He claimed exemption under section 4(3)(vi) of the Indian Income-tax Act, 1922, or deduction of the travelling expenses under section 7(2)(iii) of the Act. It was held that he did not receive any special allowance so as to come within the scope of section 4(3)(vi) of the Act. We have already extracted a passage earlier in this judgment where the distinction between section 4(3)(vi) and section 7(2)(iii) was set out. After pointing out this distinction and while dealing with the scope of the expression "in the performance of his duties" occurring in both these provisions, it was pointed out at page 454 as follows:

"But in both cases the expenses must be expenses which are wholly and necessarily incurred in the performance of the duties of the office...... The expenses must also be expenses which the assessee is required by the conditions of his service to incur out of his remuneration...... the expenses of travelling between Ahmedabad and Bhavnagar could not be said to be expenses incurred by the assessee wholly and necessarily in the performance of the duties of the office of part-time professor of accountancy held by the assessee, for they were incurred partly before the assessee commenced to perform such duties and partly after he concluded them."

Under section 4(3)(vi) the special allowance must relate to expenses incurred or to be incurred in the course of the performance of the duties of the office or during the performance of the duties of the office.

For instance, a person after he reaches his office has to go on duty to various parts of a city for which purpose he receives certain allowances. That would come within the scope of section 4(3)(vi) of the Act. The subsistence allowance in the present case is not related to the duties as such. We have already extracted the relevant paragraph from the agreement. It is linked with the provision of furnished quarters. If N.L.C. provided the furnished quarters then he would receive Rs. 30 per day. If P.D.T.S. provided the furnished quarters, he would receive from N.L.C. Rs. 45 out of which he would part with Rs. 15 to P.D.T.S. In either event he would have in his hands only Rs. 30. This is called the subsistence allowance. The meaning of the word "subsistence" is so clear that it cannot have anything to do with the duties of an office as such. The circumstance that the assessee would have to incur extra expenditure because of his posting in India has really no effect on the problem under consideration.

As pointed out in *Corry* v. *Robinson* [20] in the case of a person engaging in for work at Singapore and receiving a "colonial allowance" the amount received is liable to be taxed as income. The claim for exemption could be sustained only if it is proved that the subsistence allowance was received specifically for meeting the expenses wholly and necessarily incurred in the *performance* of the duties. There is no evidence on this point. Merely because a person is employed and, therefore, he receives the amount the exemption does not follow.

The fact of his employment coupled with the receipt would render the amount taxable as observed earlier. The exemption can be claimed only if the conditions of section 4(3)(vi) of the Act are satisfied.

20. [1933] 18 TC 411 (CA).

Though the amount is described as the subsistence allowance and can in that sense be considered to be a special allowance, it would not be eligible for exemption, because it is not shown to have been granted to meet the expenses wholly and necessarily incurred in the performance of the duties. The learned counsel for the Commissioner of Income-tax submitted that if a particular amount was liable to be treated as a perquisite under section 7(1) of the Act, then it would not come within the meaning of section 4(3)(vi) of the Act at all. We do not think it necessary to decide this point. The claim for exemption has to be made out by the assessee by showing that the amount was granted to meet the expenses wholly and necessarily incurred in the performance of the duties. The fact that it is called a subsistence allowance and the circumstance that it is related to the provision of residence clearly go to show that it is an amount received by the assessee for his own benefit and not for meeting the expenses incurred in the performance of the duties at all. The duties had ended in the office. The assessee would have to stay and subsist somewhere, whether employed in India or in his own country. Any receipt for meeting such expenses would not come within the ambit of section 4(3)(vi) of the Act as such expenses are not shown to be incurred in the performance of duties. The assessee has failed to make out a claim under section 4(3)(vi) of the Act.

In the result, the first question as reframed by us is answered in the affirmative and against the assessee. The second question is answered in the negative and against the assessee. The Commissioner of Income-tax will have his costs. Counsel's fee Rs. 250.

THE 29TH CONGRESS, LONDON 1975

RESOLUTIONS

SUBJECT I:

The treatment of the importation and exportation of technology — know-how, patents, other intangibles and technical assistance.

(original version)

Considering:

1. the desirability of free transfer of technology in our modern world to promote economic and social development;

2. that the tax treatment of payments for technology in the importing and exporting country should not impede but should encourage such transfer and in particular double taxation should be avoided;

3. that high taxation of payments for technology may be to the detriment of economic development;

4. that income taxes are imposed on net income after deduction of expenses;

5. that there is no general agreement as to whether the importing or the exporting country has the prior right to tax payments for technology;

the XXIXth Congress of the International Fiscal Association *recommends* that

a. all payments for technology should be deductible in calculating the taxable profits of the payer;

b. wherever possible the importing country should consider exempting payments for technology from taxation in its country;

c. in the absence of such exemption taxation in the importing country should be charged on net income. For practical reasons the tax charge may be determined by allowing a standard deduction for expenses or alternatively by charging tax on the gross income at a reduced rate;

d. the taxation of payments for technology between related corporations should follow the general rules applicable to payments between independent parties in so far as the payment is at the arm's length rate;

e. the exporting country should take measures to avoid double taxation of payments for technology either by exemption or by giving credit for taxes paid in the importing country;

f. where the above recommendations are not already contained in national law importing and exporting countries should endeavour to include these recommendations in their tax treaties;

g. where developing countries grant special tax incentives or exemption in accordance with paragraph b. in order to attract technology such measures should be matched if possible by tax sparing measures either through treaty or unilateral provisions in the exporting country;

h. importing and exporting countries may depart from the above recommendations, wholly or partly, to avoid abuse.

SUBJECT II:

Allocation of expenses in international arm's length transactions of related companies

(original version)

Considering:

that in international tax matters States should on the basis of the principle of international comity take account of the tax claims of other States where those claims conflict with their own tax claims, and should avoid anything that could give international tax affairs the appearance of unresolved confrontations of national interests that hinder international trade and economic progress to the detriment of all States;
that in the absence of any tax evasion the division of the conduct of operations among related enterprises should be accepted by the tax authorities;
that it is important to establish objective criteria to allocate expenses in relations between international related enterprises;
that any allocation or charge which is in itself justifiable should not be rejected only because the companies concerned are related;
the XXIXth Congress of the International Fiscal Association *recommends* that

1. In determining the deductible charges resulting from transactions that occur between international related enterprises States should make every effort to avoid any double taxation as far as possible by the application of their national tax law.

2. In the allocation for tax purposes of certain classes of expenditure the following principles should be followed:

a. The charges and expenses arising from the control by the parent company as shareholder of its foreign interest should be deductible by the parent company.

b. When a parent company or another related company provides a foreign subsidiary with special services such as commercial services, publicity, or the right to use rights or patents etc. the charge for these services should be deductible by the subsidiary insofar as the services are undertaken in order to benefit the operations of the subsidiary company. The amount deductible by the subsidiary should generally correspond to the cost to the parent or other related company. This principle should not preclude the possibility that in appropriate cases the proper amount to be deducted can be established by reference to the market price for similar services.

c. In the case of expenses of centralised functions — e.g. research; group planning in the fields of finance, investment, production or marketing; general public relations — it is recognised that parent companies may follow either the approach of allocating the expenses among the group or of making charges only when subsidiaries utilise specific services, provided that the basis adopted is followed consistently. In view of this established commercial practice the tax authorities of the countries concerned should refrain from imposing conditions which would result in double taxation.

3. While recognising that the enterprises concerned may be required to submit evidence in support of their claim to deduct the expenditure, the evidence required should not exceed what is sufficient to

establish the position objectively nor what is reasonable in the circumstances.

4. Where nevertheless States disallow expenses incurred in the cases described above they should ascertain whether the disallowance of the expenses causes double taxation and in such a case should enter into bilateral discussions. In such discussions the States concerned should attempt to eliminate double taxation either by flexible application of their own national law or through bilateral agreement.

5. The imposition of withholding tax by the country of the subsidiary company on payments to a related company should take account of the fact that the related company has incurred expenses in providing the services to the subsidiary.

6. In addition to implementing at the level of national law the principles set out above, it is recommended that they be confirmed in double taxation agreements.

The International Fiscal Association asks the Organisation for Economic Cooperation and Development and the United Nations Organisation to take these principles into account in the formulation of guidelines for conventions for the avoidance of double taxation.

AUSTRALIAN BRANCH

(i) At the Annual General Meeting of the Australian Branch held on 25 August 1975, the following officers were re-elected:
Chairman: Mr. Graeme L. Herring
Secretary: Mr. Charles J. Berg, O.B.E.
Treasurer: Mr. William J. Mulligan

(ii) Papers given to Meetings of the Australian Branch during the past 12 months have included:

"Australian Exchange Control" by Mr. Graham Leighton of the Reserve Bank of Australia.

and

"IRS Operations in Foreign Countries" by Mr. James Barnett, IRS Representative.

(iii) The Australian Branch has issued an invitation to host the 1978 IFA Congress at the Opera House in Sydney. Preliminary planning is well in hand.

(iv) The Australian Branch has doubled its membership over the past 12 months to a present total of 190. Recruitment of suitable new members is continuing.

(v) In April 1975 the Australian Branch of IFA co-operated with the Taxation Institute of Australia at their National Convention held at Hobart's Wrest Point Casino. IFA sponsored speakers Messrs. Walter O'Connor and Sidney Roberts, both of the U.S. Branch presented a joint paper entitled "United States Tax Law and Practice".

(vi) The Australian Branch is seeking to increase IFA membership in the Asian and Pacific Islands areas, and there has already been an encouraging response in this regard.

(vii) The Australian Branch has established a very cordial relationship with the domestic taxation body, The Taxation Institute of Australia.

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WEALTH TAX ACT, 1975.

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Collection of articles originally presented at an Andean Pact Seminar held as part of the International Fiscal Association Congress of 1974. The essays express current attitudes of both developing and developed countries in respect to double taxation agreements. Included are Andean Group Decisions Nos. 24, 40 and 46 in their unofficial English versions. (B 9340)

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HOOFDLIJNEN VAN DE LEER DER OPENBARE FINANCIËN.

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Printed text of speech on 50 years practising tax science in the Netherlands held in commemoration of 50 years existence of the Vereniging voor Belastingwetenschap on October 24, 1975 at The Hague. (B 9337)

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(32nd edition). Incorporating: income tax tables for individuals, income tax tables for companies, depreciation allowances, estate and gift duties, land tax tables. Wellington, Sweet & Maxwell (N.Z.) Ltd., 1975. 311 pp. (B 9333)

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ASPECTOS MAS IMPORTANTES DEL SISTEMA TRIBUTARIO DE PUERTO RICO.

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the legal and tax aspects arising from the acquisition of real estate and the renting of summer cottages in Spain. (B 9308)

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BUTTERWORTHS TAX HANDBOOK.

14th Edition. Income Tax - Corporation Tax - Capital Gains Tax. Setting out the amended text of the Taxes Acts as operative for 1975-76. Edited by David Roberts. London, Butterworths, 1975. 1076 pp., £ 7.60.
This tax handbook omits the provisions which do not relate to the year 1975-76. (B 9334)

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ARTICLES

NIZAR JETHA [*]:

THE STRUCTURE OF MAJOR TAXES IN GUYANA

This paper describes the salient features of major taxes in Guyana. The taxes to be discussed accounted for about 90 percent of the tax revenues in 1973. Thus, the paper has a fairly comprehensive scope. However, the legislation concerning capital gains taxation [1] and fiscal incentives [2] will not be discussed here.

Guyana's participation in the economic integration movement in the Caribbean has affected her tax structure in a number of ways. In this connection, two developments are particularly important for placing many recent changes in the tax structure in their proper perspective. First, import duties on most goods originating from other member countries were eliminated on May 1, 1968, when the country became a member of the Caribbean Free Trade Association (CARIFTA), with the remaining duties phased out over the following five years.[3] Second, on August 1, 1973, Guyana, together with Jamaica, Trinidad and Tobago and Barbados, became a member of the Caribbean Community — which provides for the establishment of the Caribbean Common Market (CARICOM), common services and co-operation in a wide range of fields — and adopted CARICOM's common external tariff (CET).[4]

PERSONAL INCOME TAX

Chargeable Income. Chargeable income is defined as aggregate income minus applicable personal allowances and deductions. All persons whose chargeable incomes are less than G$500 are exempt.[5]

Personal Allowances and Deductions for Residents

(a) Personal allowance — G$1,000.

(b) Wife allowance — G$1,000.

(c) Earned income allowance — Deduction of 5 percent of income from employment and pensions, with a maximum of G$500.

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* International Bank for Reconstruction and Development, Washington, D.C. The author is greatly indebted to a number of Guyanese officials, and in particular to Messrs. French and Odiri of the Inland Revenue, and Messrs. White and Abrahams of the Customs and Excise for their assistance. Special thanks are due to Victor Gangadin for discussions and critical comments.

1. Capital gains tax brings negligible revenues.
2. See Victor J. Gangadin, "Fiscal Incentives in Guyana", *Bulletin for International Fiscal Documentation,* June 1975, pp. 223—230; and *Agreement on the Harmonization of Fiscal Incentives to Industry* (CARICOM Secretariat, Georgetown, Guyana).
3. The other members of CARIFTA were Jamaica, Trinidad and Tobago, Barbados, Grenada, St. Vincent, Dominica, St. Lucia, St. Kitts, Antigua, Montserrat and Belize.
4. All remaining members of CARIFTA have joined the Caribbean Community since May 1, 1974.
5. The exchange rate is pegged to the £ sterling at G$5.21 = £1.

(d) Wife's earned income allowance — Deduction of the wife's income from employment up to a maximum of G$400.

(e) Child allowance — Deduction of G$400 in respect of each unmarried child under the age of 16 years, or a child receiving full-time education at any school, college, university or other educational establishment. The taxpayer is also entitled to an allowance for a child who is not his child but who is in his custody and is wholly maintained by him.

(f) Dependent allowance — Deduction of G$300 for each dependent relative maintained by the taxpayer. "Dependent relative" is defined as: (i) a taxpayer's or his wife's relative who is incapacitated by old age or infirmity; or (ii) the taxpayer's or his wife's widowed mother whose income does not exceed G$300 per year. The taxpayer's claims in respect of dependent relatives, including children who are not his children but are in his custody, are limited to four persons.

(g) Allowance for interest on housing loans — Deduction of the interest payable on a loan for the purpose of financing the construction or purchase of a new building to be used by the taxpayer as his residence.[6]

(h) Deductions for life insurance premiums, contributions to superannuation schemes and investment in prescribed Government securities — Premiums for life insurance on the life of the taxpayer or his wife paid to an approved company and contributions to approved superannuation funds are deductible, subject to a maximum of one-fifth of income. Premiums in excess of 10 percent of the capital sum of each policy are not allowable. Amounts invested in prescribed Government securities in the year preceding the year of assessment are allowed as a deduction, subject to aggregation with the premiums and contributions and the one-fifth limit.

(i) Deduction for contributions to the National Insurance Scheme — Contributions to the scheme are deductible.

(j) Deduction for medical expenses — Allowance of up to G$150 for salary and wage earners in receipt of incomes below G$4,800 per annum, and of up to G$100 to those with incomes of between G$4,800 to G$7,200 per annum for hospitalization expenses, medical consultant fees and dental fees for themselves and their families.

(k) Deduction for school expenses — Salary and wage earners in receipt of incomes below G$4,800 per annum who have more than three children attending school, are granted a school allowance of G$100 for each child in excess of three between the ages of 6 and 18 years attending school in Guyana.

(l) Allowance for rented dwellings — A tax credit of ½ percent of the annual rent, with a minimum of G$2 and a maximum of G$10, is available to a taxpayer who lives in a rented house.

6. The imputed income of owner-occupied housing is, however, not taxable.

Marginal Rates of Tax

Chargeable Income (G$)		Tax rate (Cents in the G$)
First	1,000	5
Next	1,000	10
,,	1,000	15
,,	1,500	25
,,	1,500	35
,,	2,500	40
,,	3,000	50
,,	3,000	60
Above	14,500	70

National Development Surtax. The budget for 1974, introduced on December 10, 1973, proposed a surtax of 5 percent on the chargeable income of all individuals, including unincorporated enterprises. The surtax is levied on the chargeable income in excess of G$500.

COMPANY TAXATION

Chargeable Income. All expenses wholly and exclusively incurred in the production of income are allowed in the computation of taxable income, subject to certain limitations. The major restrictions are as follows:

(a) "Expenses in excess of the amount which the Commissioner considers reasonable and necessary having regard to the requirement of the trade and business" are not deductible.

(b) No deduction is allowed for head office expenses [7] in excess of 1½ percent of sales or gross income in the case of a commercial company [8] and 1 percent in the case of a company other than a commercial company.

(c) Property tax payable cannot be deducted.

Annual Depreciation Allowances. The annual wear and tear deductions vary according to the type of asset. Unless otherwise indicated, the depreciation allowances are calculated with reference to the written-down value (i.e. cost of asset *minus* the annual deductions already made). Some representative rates of depreciation are given below.

	Percentage allowed
Bauxite Industry	
Buildings	
Industrial - Steel	3
Wooden	5
Workers' Houses	5
Drilling Equipment	20
Drag Lines	15
Plant and Machinery	10
Sugar Industry	
Ploughs, tractors, etc.	20
Barges, boilers, distilling plant	30
Drainage and irrigation plant, factory plant and machinery	32½
Storage tanks	32½

7. The definition includes charges made by non-resident parent companies, associate companies and head offices in respect of administrative, technical, professional or other similar services of an essentially managerial nature.

8. Defined as a company at least 75 percent of the gross income of which is derived from trading in goods not manufactured by it, and includes any body carrying on banking or insurance business, other than long-term insurance business. "Long-term insurance" includes life insurance, non-cancellable sickness and accident insurance and bond investment business.

	Percentage allowed
Timber Industry	
Ballahoos	33⅓*
Bulldozers	10
Logging equipment	20
Log hauling plant	33⅓*
Agricultural machinery (tractors, ploughs, harvestors, etc.)	20
Boats	10
Boilers	7
Buildings (for housing machinery)	
Brick, stone, concrete	2*
Wooden	3*
Concrete Mixers	10
Generators	10
Lorries, motor cars	25
Office equipment	10
Agricultural plant (dips, pans, spray pumps, irrigation plant)	10
Brickmaking plant	10
Brewery plant	10
Distillery plant	30
Biscuit-making plant	10

* On cost.

Valuation of Stocks. The legislation does not specify the method to be used for the valuation of stock in hand. The normal practice is to value stocks at cost or net realisable value, whichever is the lower. However, stock at the beginning and end of an accounting period must be valued on the same basis.

Treatment of Losses. Losses can be carried forward for as many years as required to absorb them against future profits, subject to two restrictions:

(a) Losses from a particular source of income can only be set-off against profits from the same or a similar source.[9]

(b) In any year, the set-off is only allowed to the extent that the tax payable for any year is not reduced by more than one-half of the tax that would have been payable had there been no claim for the previous years' losses.

Tax Rates. Companies are taxed partly through an income tax and partly through a corporation tax.[10] The crucial difference between a company income tax and a corporation tax is that the shareholders receiving dividends can claim credit against their income tax liability for the former, but not the latter.[11] The tax rates are as follows: [12]

9. The tax return specifies eleven different sources of income. A major implication is that losses suffered in agricultural activities cannot be set-off against profits in non-agricultural activities, and *vice versa.*
10. A major difference in the tax bases for corporation tax and income tax as far as companies are concerned is that dividends received in respect of preference shares are treated as taxable income for the former but not the latter.
11. Resident individuals must include dividends gross of income tax deducted at source in their return; income tax deducted by the company is then allowed as a set-off against the total tax liability.
12. Special provisions apply to investment companies. For the definition and tax treatment of such companies, see Victor J. Gangadin, "Guyana: A Brief Outline of the Imposition in Guyana of Income Tax, Corporation Tax, Capital Gains Tax, Withholding Tax and Property Tax with Special Reference to Foreign Corporations Operating in Guyana, Through a Branch Establishment or an Agency", *Bulletin for International Fiscal Documentation,* November 1973, pp. 455—463.

	Income Tax	Corporation Tax
Commercial Companies	20%	35%
Non-Commercial Companies	20%	25%
Long-term Insurance Business	45%	nil

Special Provisions Concerning Close Companies. A close company is defined as a company controlled by not more than five persons. In the case of such companies, where it appears to the Commissioner that further distributions of dividends could be made "without detriment to the company's existing business", the Commissioner has powers to treat any such undistributed profits as distributed. Additionally, there are restrictions on the deductibility of the fees paid to directors. Fees paid to a director other than a whole-time service director are only deductible to the extent of 10 percent of chargeable profits or G$3,000, whichever is the lesser. For fees paid to a director who is required to devote substantially the whole of his time to the service of the company in a managerial or technical capacity, the maximum deduction permissible is G$12,000 in the case of the highest paid director and G$9,600 in other cases. However, where any such director receives remuneration by way of a salary as a full-time employee of the company, the deduction in respect of the fees paid is limited to G$6,000.

WITHHOLDING TAX

Tax Base. A withholding tax is imposed on all "distributions" made to non-resident individuals and all companies, resident as well as non-resident.[13] It is also imposed on "payments", which constitute income arising in Guyana, made to non-resident individuals and companies. The recipient of such income is liable for the tax, but the person (including a company) making "payments" and "distributions" is required to collect the amount of tax due. In addition, certain insurance transactions are also subject to the withholding tax.[14]

Definition of "Distribution". The definition includes any dividend paid by a company (including a capital dividend). Any remittance made or deemed to have been made [15] by an office, branch or agency of a non-resident company carrying on business in Guyana is also treated as a distribution.

Definition of "Payment". Payment is defined as a payment without any deductions whatsoever, other than a distribution, including interest, rentals, royalties, and management charges or charges for the provision of personal services and technical and managerial skills.

"Grossing-up" of Dividends and Set-Offs against Withholding Tax Liability. In the case of dividends, a hypothetical tax base is used for computing the tax. The liability to withholding tax is computed with reference to dividends actually distributed grossed-up by certain percentages; set-offs amounting to certain percentages of the dividends actually distributed are then al-

13. Dividends received by a resident company from another resident company are not subject to further income and corporation taxes in the hands of the recipient company.
14. See Gangadin, *Bulletin for International Fiscal Documentation*, November, 1973, *op. cit.*, pp. 460—461.
15. Profits are deemed to have been remitted, except to the extent they have been reinvested in Guyana to the satisfaction of the Commissioner, other than in the replacement of fixed assets.

lowed against this liability. The withholding tax to be paid is arrived at by deducting set-offs from the withholding tax liability (before taking account of set-offs). The percentages for grossing-up and set-offs, which depend on the nature of the company and the source of its income, are given below:

Dividends distributed to non-resident individuals and resident and non-resident companies by a	Withholding tax Rates Applied to Dividends Actually Distributed Grossed-up by	Amount of Set-off arrived at by applying to Dividends Actually Distributed the following Percentages
Commercial company, from income received as a distribution for a resident company	166.7%	66.7%
Commercial company, from income other than a distribution received from a resident company	144.5%	44.5%
Company (other than a commercial company), from income received as a distribution from a resident company	153.9%	53.9%
Company (other than a commercial company), from income other than a distribution from a resident company	136.4%	36.4%

Withholding Tax Rates. Withholding tax rates for distributions, which in the case of dividends are applied to the grossed-up amounts, vary according to the nature of the paying company and according to whether the recipient is an individual or a company. The tax rates applicable to distributions and payments are as follows: [16]

16. A numerical example might clarify the operation of the tax.

(a) Case of resident commercial company (Company A) distributing all its net profits to a resident or a non-resident company (Company B).

- 100 Gross-of-tax profits of Company A
— 20 Income tax payable by Company A
— 35 Corporation tax payable by Company A

45 Net-of-tax profits of Company A available for distribution to Company B.
65.025 45 grossed at 144.5%
26.010 Withholding tax liability (before set-off) at 40% on 65.025
20.025 Set-off (44.5% of 45)
5.985 Withholding tax payable after the set-off (26.010 minus 20.025)
39.015 Amount distributed to Company B after the deduction of withholding tax payable (45 minus 5.985)

(i) Total income, corporation and withholding taxes payable - 60.985 (20 + 35 + 5.985)

(ii) Withholding tax payable (5.985) as % of the distribution (45) - 13.3%

(b) Case of a resident non-commercial company distributing all its net profits to a resident or a non-resident company. A similar exercise will show that:

(i) Total income, corporation and withholding taxes payable - 51.237 (20 + 25 + 6.237)

(ii) Withholding tax payable (6.237) as % of the distribution (55) - 11.34%

Distributions to:		Where Paying Company is Commercial	Non-commercial	Long-term Insurance
Non-resident individuals:				
Dividend under G$10,000	Per shareholder per year	31%		
Dividend over G$10,000	Per shareholder per year	40%		
Dividend under G$ 8,000	Per shareholder per year		27%	45%
Dividend over G$ 8,000	Per shareholder per year		35%	
Resident and non-resident companies		40%	35%	
Payments to non-residents		25%	25%	25%

PROPERTY TAX

Tax Base. The definition of property includes immovable and movable property situated in Guyana or elsewhere. The property tax is imposed on net property, which is defined as the aggregate value of the property minus the aggregate value of the allowable debts. In the case of an individual, debts in excess of 50 percent of the value of the property are not taken into account, whereas companies can only deduct debts up to 20 percent of the value of the property.[17] These limitations do not apply to the deposit liabilities of banks and the liabilities of insurance companies in respect of life assurance policies.

Exemptions. Specified individuals, corporations and institutions (including ecclesiastical and educational) are exempt from the scope of the tax. Any company granted a tax holiday under the Income Tax (In Aid of Industry) Ordinance is also exempt during the tax holiday period in respect of property employed in business, income from which is exempt from income tax.

Property excluded from Net Property. The following are excluded from the definition of net property of an individual:

(a) right or interest in a life insurance policy before it becomes payable;
(b) right to receive a pension or annuity;
(c) tools and instruments (but not plant and machinery) necessary to carry on a profession or vocation, subject to a maximum of G$5,000;
(d) works of art and books, subject to a maximum of G$5,000;
(e) household furniture and equipment, subject to a maximum of G$2,000;
(f) jewelry, subject to a maximum of G$2,000;
(g) the amount to an employee's credit in any provident fund;
(h) property donated to the taxpayer subject to a life interest in the donor, as long as the life interest subsists; and
(i) investment in prescribed Government securities.[18]

Valuation of Property. Where any property was acquired before January 1, 1956, its value is taken to be its estimated price in open market as at January 1, 1956, together with the cost of improvements and additions made to it after that date. For

17. The 1974 budget proposed the removal of the restrictions on the extent to which debts could be deducted from the aggregate value of the property, but the proposals have not been implemented so far.
18. Prescribed securities are also excluded from net property of companies.

property acquired on or after January 1, 1956, the value is defined as the cost of purchase and the cost of improvements and additions made to it since the purchase. For those assets for which wear and tear allowances are available under the Income Tax Ordinance, the value for the property tax purposes is subject to deductions for wear and tear allowances (but not initial allowances) received since the acquisition of the property or January 1, 1956, whichever is the later.

Set-off Provision. The legislation provides for set-off of property tax paid by a company against the tax payable by a shareholder where the stocks and shares of the company which has paid or is liable to pay the tax are included in the net property of the shareholder. Set-off is allowed at the company rate of one-half percent but is limited to the amount of property tax payable by the shareholder, if any.

Liability to Tax. Residents possessing net property in excess of G$50,000, non-residents possessing net property in Guyana in excess of G$50,000, and all companies that are registered in or carry on business in Guyana are subject to the tax.

Tax Rates

	Rate %
(a) For a person other than a company:	
on the first G$50,000 of net property	Nil
on the next G$150,000 of net property	½
on the next G$300,000 of net property	¾
on the next G$500,000 of net property	1
on the remainder	1½
(b) For a company: [19]	½

IMPORT DUTIES

The import tariff applies to all imports other than those originating from CARICOM. A product is considered to be of regional "origin" if materials imported from outside the region do not exceed 50 percent of the export price of the product. However, a wide range of raw materials and semi-manufactured goods, designated as "basic materials", are regarded as being of local origin even when imported from outside the region.

Apart from a few exceptions, Guyana adopted CET on joining the Caribbean Community. The exceptions relate primarily to commodities such as wood and wood products including furniture, paper and paper products and clothing where protective considerations necessitated a transitional period. All differences between the current tariff and CET are to be eliminated at the rate of ⅓ per annum over the period August 1, 1974 to August 1, 1976.[20]

Under CET, raw materials and capital goods bear rather low rates of tax. Somewhat higher rates are imposed on semi-manufactured goods. The highest rates apply to finished goods. Foodstuffs, however, enter duty-free except where protective considerations are involved. The tariff is divided into preferential and general rates. The former are confined to goods

19. The 1974 budget proposed a higher rate of ¾ percent for net property valued at over G$500,000, but this change has not yet been implemented.

20. The differences between the tariff adopted in August, 1973 and CET were substantially narrowed on March 14, 1974 in line with this requirement. The tariff changes were accompanied by adjustments in the rates of consumption taxes.

originating in and consigned from the British Commonwealth; the general rates apply to imports from all other countries. Guyana's current rates of import duties on selected commodities will be found after the description of the consumption tax.

CONSUMPTION TAX

Consumption duties were introduced in 1969 to counteract the revenue loss resulting from the removal of import duties on goods originating from the other members of CARIFTA. Their scope, as well as the range of tax rates, was widened substantially in August 1973, when CET, which is generally much lower than Guyana's then prevailing tariff, was adopted.

Scope. Specified goods, whether imported or locally-manufactured, except goods utilized as materials by a registered manufacturer, are taxable. Exports are exempt from the tax.

Registration. The following enterprises are required to be registered:

(a) every manufacturer whose business includes the disposal of taxable goods manufactured by him; and

(b) every manufacturer who uses taxable goods manufactured by him in his business.

However, a manufacturer who is not required to be registered may be permitted to register if he uses taxable goods in substantial quantities as materials. Business with a turnover of less than G$10,000 have been exempted from registration; for the furniture and gold and silver jewellery businesses the exemption limit is G$50,000.

Tax Base. For imports, the consumption tax is levied on the c.i.f. import value plus the import duty payable, whereas the price realized by the manufacturer in the "open market" constitutes the tax base for domestically-produced goods.

Rates of Tax of Import and Consumption Duties. Import duties on selected goods, together with the corresponding consumption duties, are as follows:

	Rate of Import Duty General	Preferential	*Rate of Consumption Tax*
Foodstuffs			
Cheese	10%	5%	12%
Potatoes			30%
Garlic	G$0.81 per 100 lbs.	G$0.54 per 100 lbs.	5%
Onions			20%
Split peas	G$0.43 per 100 lbs.	G$0.33 per 100 lbs.	5%
Wheat flour	10%	5%	G$0.85 per 100 lbs.
Tea	G$0.27 per lb.	G$0.16 per lb.	20%
Confectionery	45%	35%	30%
Grapefruit and orange juices	45%	35%	10%
Aerated waters	30%	20%	G$0.02 per bottle

GUYANA: STRUCTURE OF MAJOR TAXES

	Rate of Import Duty		Rate of Consumption Tax
	General	Preferential	
Alcoholic Beverages and Tobacco			
Brandy	G$56.47 per gal.	G$54.30 per gal.	G$12.00 per gal.
Rum	G$64.07 per gal.	G$56.47 per gal.	G$ 6.12 per gal.
Whisky	G$59.73 per gal.	G$57.56 per gal.	G$12.00 per gal.
Gin	G$60.82 per gal.	G$58.64 per gal.	G$ 6.12 per gal.
Vodka	G$70.59 per gal.	G$67.33 per gal.	G$ 6.18 per gal.
Beer	G$ 5.97 per gal.	G$ 5.54 per gal.	—
Wine	G$13.03 per gal.	G$ 9.77 per gal.	—
Cigarettes	G$20.05 per lb.	G$19.83 per lb.	G$ 6.23 per lb.
Petroleum and Products			
Gasoline	G$0.54 per gal.	G$0.43 per gal.	76%
Diesel oil	G$0.33 per gal.	G$0.22 per gal.	5%
Fabrics and Clothing			
Woven fabrics of:			
Man-made fibres	35%	25%	—
Wool	30%	20%	—
Cotton-printed or dyed	34%	24%	—
Cotton-other (white)	27%	21%	—
Under garments	45%	35%	10%
Outer garments	63%	47%	20%
Consumer Durable Goods			
Motor cars:			
under 1,800 c.c.	45%	35%	15%
over 1,800 c.c.	45%	35%	25%
Refrigerators	35%	25%	25%
Airconditioners	30%	20%	15%
Stoves (electric)	30%	20%	35%
Water heaters	30%	20%	25%
Washing machines	30%	20%	18%
Radios	45%	35%	18%
Radiograms	45%	35%	45%
Gramophone records	35%	25%	30%
Jewelry	60%	50%	25%
Cameras	30%	20%	30%
Watches	50%	40%	15%
Furniture	63%	49%	20%
Carpets	45%	35%	7%

	Rate of Import Duty General	Preferential	Rate of Consumption Tax
Other			
Travel goods	57%	40%	13%
Photographic films	30%	20%	15%
Razor blades	30%	20%	10%
Nitrogenous fertilizers	G$16.29 per ton	G$10.86 per ton	2½%
Cement	G$10.26 per ton	G$ 7.60 per ton	G$0.12 per 100 lbs.
Paints and enamels	25%	15%	2%
Wide range of machinery	7½%	5%	3%
Shampoo, toothpaste	35%	25%	7%
Perfumes and cosmetics	55%	45%	15%
Toilet soap	30%	20%	15%
Polishes and creams	25%	15%	18%
Glassware	25%	18%	15%
Office equipment	25%	15%	15%
Footwear	25%	15%	—

EXCISE DUTIES

Excise duties are levied on specified domestically-produced goods. However, similar goods imported from CARICOM bear import duties at rates equivalent to the rates of excise duties. Thus, in effect, locally-produced goods and goods originating from CARICOM can be regarded as constituting the tax base for excise duties. No excise duties are payable in respect of exports. The current excisable goods and tax rates are as follows:

Commodity	*Tax Rate*
Rum or other spirits	G$14.40 per proof gallon
Spirituous liquors, including:	
Gin	G$14.40 per proof gallon
Vodka	G$14.40 per proof gallon
Whiskey	G$23.00 per proof gallon
Brandy	G$26.00 per proof gallon
Liqueurs	
Creme de Menthe	G$14.60 per proof gallon
Cherry Brandy	G$35.50 per proof gallon
Creme de Cacao	G$33.70 per proof gallon
Methylated spirits	G$ 0.05 per liquid gallon
Sweets (wine made from fruit)	G$ 0.50 per liquid gallon

GUYANA: STRUCTURE OF MAJOR TAXES

Commodity	*Tax Rate*
Bay rum, lime rum or other toilet preparations (incl. limacol, vitrex)	G$ 3.00 per liquid gallon
Perfumed spirits	G$ 6.00 per liquid gallon
Spirituous medicinal compounds (for use as medicines or in compounding medicines, including tinctures)	G$ 1.20 per liquid gallon
Spirituous medicinal compounds (medicines, including Ferrol and Livogen)	G$ 3.90 per proof gallon
All other compounds	G$14.40 per proof gallon
Matches	G$ 0.50 per gross boxes each not more than 60 matches
Malt liquor (e.g. beer, stout)	G$ 3.16 per liquid gallon

EXPORT DUTIES

Export duties are, in general, confined to specified commodities exported to non-CARICOM countries. The Community Treaty prohibits the imposition of export duties on goods exported by one member state to another. However, for a transitional period of five years, export duties may be levied on certain commodities (including bauxite and sugar) exported to other member states at rates not exceeding those that prevailed before the coming into force of the Treaty.[21] The current export duty rates are as follows:

Commodity	*Tax Rate*
Precious stones other than cut and polished precious stones	G$3.00 per carat
Bauxite	G$0.45 per ton
Unrefined cane sugar	G$1.00 per ton
Greenheart, round piling and hewn	G$0.08 per cubic ft.
Greenheart, sawn	G$1.20 per 100 b. ft.
Aquarium fish	5%
Shrimp	G$0.19½ per lb.
Molasses	G$4.45 per 100 gal.

21. Article 18 of the Common Market Annex of the *Treaty Establishing the Caribbean Community.*

Export Levy on Sugar Exports

An export levy on sugar exports was introduced in 1974. The rates vary with the f.o.b. export price, as follows:

F.o.b. export price per ton	*Tax payable per ton*
Under £70	G$26.50
£70—£100	G$26.50 *plus* 55% of the excess above £70
£100—£120	G$43.00 *plus* 70% of the excess above £100
Above £120	G$57.00 *plus* 85% of the excess above £120

H. W. T. PEPPER *:

INDEXATION: SOME FISCAL ASPECTS

1. *Introduction*

There is nothing like double-digit inflation to concentrate the thoughts of Finance Ministries on the problems of equating revenue with expenditure.

2. Indexation, nowadays almost a cult word as far as salaries and pensions are concerned, has important fiscal implications, some obvious, some less so, and no Finance Minister can afford to neglect any of them.

3. In the fiscal field "indexation" includes the process of reviewing all charges, taxes, duties, and dues of all kinds, which are *expressed in terms of money,* so as to vary them at regular intervals in accordance with variations in the value of money, in order to maintain the value in real terms of such revenue.

4. Without systematic reviews a Government may overlook certain more obscure items of revenue. It is usually in no danger of missing items of expenditure which ought to be indexed since it can expect to be reminded by those concerned.

5. A government's main indexation interest is in the revenue from Customs and Excise duties, specific stamp duties, a wide spectrum of licenses, fees and dues and in charges for services of all kinds provided by Government. The relevance of indexation to non-specific taxes such as income tax and death duties will be examined below.

5a. "Indexation" strictly relates to the variation of charges by some formula connected to an index such as a cost-of-living index, or retail price index.

6. *Equity*

Although increases in taxes and charges of any kind are never popular, curiously enough it is in the general interest of taxpayers that *all* such items should be carefully reviewed, since equity cannot be fully served if variations are allowed to occur so that, for example, some charges are fully indexed and other services supplied below cost. In such a case some taxpayers are likely to receive an unwarranted benefit. Even where it is policy for certain services to be subsidised, some indexation adjustment should be made (see "Subsidies" below) so that at least a reasonably precise quantification of the subsidy is possible.

7. *Government Expenditure*
: Salaries and Wages

Although automatic indexation is sometimes applied to salaries and wages (particularly those payable by Government) it may become a somewhat dangerous device if workers come to look upon indexed cost-of-living (C.O.L.) adjustments as routine and still expect other wage increases from time to time. Accordingly employers, including Governments, do better to allow arguments in wage negotiations to be based partly on cost of living without building in a specific C.O.L. factor in wage structures.

: Pensions and Social Benefits

Social security pensions and benefits are items which in principle obviously ought to be indexed. In practice Governments understandably often exclude them from *automatic* indexation so that they may derive political credit when they grant, and can be seen to grant, increases to those (voters!) who receive such pensions and benefits.

8. *Government Revenue*

A Government's power to control the quantum of *outgoings* is more or less restricted to its bargaining potential in respect of its own employees' wages and pensions, since it has to pay the going price for materials, contract work and so on (subject to anything it can do in the realms of general Price Control). On the revenue side, however, there are many more items where it has some scope for action.

9. *General Policy*

A good practical political policy for a Government to adopt is in fact to "index" all taxes, charges etc., (i.e. *revenue* items) which are expressed in specific terms so that people become used to small increases being made yearly or regularly from time to time, but to avoid too specific a commitment regarding outgoings which might reasonably qualify for indexation. In practice a Government should preferably *not* index even its revenue items in a formal, *automatic* way (e.g. to be triggered by reference to a rise of so many points in the cost of living index) but do so by ad hoc adjustments, e.g., at the time of the annual Budgets.

10. The reason for this is partly administrative. Some specific charges are small and it would be troublesome to make a series of small increases which would produce odd-looking amounts. Forms used in the administration of charges and taxes are often printed in bulk and it would be relatively expensive to have numerous reprints or overprints.

11. *Administrative Procedure*

Moreover if Government proceeds by way of ad hoc adjustments, it has greater flexibility to modify charges etc. by reference to special circumstances or quirks of the economy, and to "round off" variations in existing rates. The only caveat necessary, if Government adopts the more empiric approach, is that a schedule or Indexation File should be compiled and maintained of *all* revenue items which are expressed in specific monetary terms and which, therefore ought to be *reviewed* annually, without failure or omission, even if no adjustment is made in a particular year, to particular items.

12. Even trade unions often prefer pay negotiations at annual or other intervals to automatic indexation increases since a union has to justify, and be seen to justify, its existence. More publicity and more credit is likely to accrue from the process of negotiation with employers and/or Government where leaders are interviewed on television and radio about the progress made and so on, than from the quiet unpublicised clicking of any mechanism by which wages etc., are automatically geared to a price or other index.

13. *Customs and Excise Duties*

Most customs duties are expressed as percentage ad valorem levies, the main exceptions being the "Big Three" of Alcohol, Hydrocarbon Oils, and Tobacco, which are customarily subjected to specific monetary levies per unit of value or weight.

14. It is usual in any event to adjust at least annually the duties on this major dutiable group of commodities because it forms such an important source of revenue. Over an inflationary period a Government can hardly go wrong if it increases the duties in this sector roughly in accordance with movements in the C.O.L. index. (In times of increasing affluence the duties may be increased at a somewhat higher rate than the indexation factor because at such times there is a greater demand for luxuries).

15. Other items subjected to specific duties are those where valuation may present problems, or where there is a "countervailing " factor. For example, if there is a duty on imported matches and a cigarette lighter, however cheap the model, will last as long as 10,000 matches, it may be desirable to ensure that there is a specific duty on lighters at least equal to the duty on 10,000 matches. The duty on matches is also often specific because of the difficulty of comparing one type with another and arriving at an equitable method of evaluation. Sometimes an ad valorem duty is coupled with a minimum specific duty, the latter being varied according to circumstances. All such items should of course be subject to indexation reviews but no such review is necessary for the great body of ad valorem duties the yield from which accurately reflects variations in price and value.

16. *Consumption and Sales Taxes including V.A.T.*

Although consumption taxes of all kinds are normally expressed as a percentage levy ad valorem (exceptions are specific taxes on room occupancy in hotels or table occupancy in night clubs and cabarets) there are usually "exemption" or "exclusion" limits expressed in money terms. For example a small trader might be "excluded" from a tax without being exempted from it if his annual sales were below a certain limit. In such a case he would not be troubled with the administrative work of complying with the sales tax law but would have to buy his goods on a tax-paid basis.

17. In the case of a multi-stage turnover or cascade taxes, or of value-added tax, a small trader is often exempted from tax on his own sales although one or more "layers" of tax may already be embedded in the price he pays for his supplies.

18. In all these cases the annual sales limits below which exemption or exclusion applies have to be reviewed from year to year, and the review may conveniently be made on an indexation basis, in order to raise the limits appropriately to avoid overburdening the administrative machinery with many small trader-taxpayers. Where taxation is a specific levy per unit, such as a hotel bed, or a table in a cabaret, it is of course desirable to "index" these levies so that they move upwards consonant with the increases in yield from percentage goods and service taxes.

19. *Income Tax*

Income tax is invariably a percentage levy upon income but some countries employ an element of "poll tax" (see paragraphs 26-31 on Payroll and Poll Taxes) by instituting a minimum payment from all taxpayers except the very poor. The minimum payment, usually a fairly nominal sum should of course be subject to indexation though the writer hesitates to stress this point because such tax features are a "colonial" relic and a regressive form of taxation which has little place in modern tax systems, where, in fact, there is instead a trend towards "negative taxation" for lower income groups.

20. *: Reliefs*

Monetary values do, however, have two points of incidence upon income tax codes. The income level (or "exemption limit") above which income tax is payable, and the reliefs or abatements customarily allowed according to the extent of a taxpayer's dependants and other personal commitments are all expressed in terms of money.

21. *: Fiscal Drag*

If reliefs are left unchanged in monetary terms so that they become less valuable in real terms while monetary incomes increase, the incidence of income tax becomes automatically heavier in real terms, a process known as "fiscal drag". A few countries now index income tax reliefs so that there is a virtually automatic annual increase. Reliefs can, indeed, only be amended annually since income tax has to be geared to the income of a whole year.

22. It is probably better "politics" for a Government not to have automatic indexation since it is usually able to obtain some public credit for a "give away programme", often under some such newspaper headline as "Finance Minister gives $ ...... millions relief to taxpayers", where such relief is introduced as a budgetary measure.

23. *: Graduated Tax Rates*

The other point of incidence of monetary values is the taxable income levels in the graduated scale of rates. If, for example, taxable income in excess of $ 10,000 is chargeable at 40% and there is a subsequent fall in the value of money to the tune of 20%, fiscal "justice" is only restored if the income level above which the 40% rate applies is increased to $ 12,500 (since the value of $ 12,500 is only $ 10,000 in the old currency if one deducts 20% for currency depreciation). Adjustments to the scale of tax rates to amend the income levels at which rates are successively increased should also thus be subject to indexation and should also be included in annual budgetary reviews.

24. *Gift and Bequest Taxes*

Taxes on Gifts and transfers inter vivos and on bequests (known, inter alia, as death duties, estate, inheritance, or succession taxes) are broadly similar to income tax in that there are normally exemption limits, reliefs, and graduated rates of tax, although of course such taxes relate to *capital* rather than *income.*

25. Exactly similar needs for indexation adjustments arise as those described above for income tax in respect of the level of capital transfer or inheritance to be exempted from payment of tax and as regards the incidence of the scale of tax rates.

26. *Payroll and Poll Taxes : Social Security Contributions*

Payroll taxation is most usually in the form of percentage levies on pay, which may be charged upon the employer or upon both the employer and the employee, and occasionally upon the employee only. In the last case the tax is usually in the nature of a crude income tax upon the employee which may be a "schedular tax" (i.e., one of a series of separate taxes, each levied on a separate type of income, such as remuneration, profits, interest, rents, royalties) or a kind of "graduated poll tax". This type of taxation is commonly used to finance Social Services and State Pensions.

27. A payroll tax which was purely a percentage levy would not, of course, require indexation adjustments.

28. *: Relevance of Indexation*

It is fairly common, however, for a payroll tax to have a cut-off point so that it does not apply to that part of an employee's pay which exceeds a certain monetary value. In a (diminishing) number of countries also, the "Beveridge" system of fixed specific levies in respect of each employee still operates, the levies varying only between males and females, adults and juveniles, and so on, but otherwise being a fixed charge, producing fixed benefits in certain eventualities such as sickness, unemployment, maternity, and death.

29. Indexation adjustments will be appropriate both to the "cut-off" point in a percentage levy, and to the specific levies in a "Beveridge" type scheme. In both cases in fact such changes may be enforced by actuarial reviews of revised funding requirements when the benefits themselves have been subjected to indexation or other increases. Actuarial reviews are sometimes done only at intervals of a few years and there is a strong case in the interim for making at least annual indexation adjustments as a minimum contribution towards keeping the scheme solvent in all cases where the payroll taxation is levied to fund social security benefits.

30. *: Poll Taxes*

The term poll tax is here used to mean a fixed personal or "head" tax, sometimes levied as a charge on adults only, or on male adults only, and sometimes as a "hut" or "hearth" tax upon heads of households only. Specific social service contributions which are in the same amount, say, for all male adult employees, are a type of poll tax and so are minimum income tax payments (such that everyone has to pay a small minimum sum of perhaps 2 or 3 dollars, however low his income).

31. Such fixed levies are against the modern trend in taxation because they are regressive, but, where they exist, should be subject to indexation if it is desired to maintain the revenue from them in real terms. Where it is desired to phase out such levies the amount in money terms may be allowed to remain fixed, until, with the erosion in the value of money, the revenue yield is attenuated and they may be finally taken off the statute book.

32. *Property Taxation : "Rates" to pay for "local" services*

Certain governmental services are traditionally paid for by taxing real property, either by a series of separate charges to cover such items as street lighting and cleaning, police and fire-fighting services, refuse and sewage disposal, supplies of fresh water and so on. The traditional manner of charging such rates or taxes is to value all the real property in the area for which the services are supplied and divide the total cost of providing the services by the total value of the property. The quotient, usually expressed as a percentage, or as so many cents in the dollar (or other unit of currency). Some countries, however, adopt fixed tax percentages and do not, therefore, precisely equate revenue and expenditure.

33. *Re-valuation*

Re-valuations of property are usually made at 5-yearly or other regular intervals. If a re-valuation had been made in 1971, all new properties completed in 1972, 1973, 1974, or 1975 would be valued not at current cost but at what an equivalent property would have been worth in 1971. Thus for the 5-year period until the next revaluation the total tax base diminishes in value to the extent of monetary devaluation. If the tax rate is fixed by the quotient method described above, this constitutes an "automatic" indexation adjustment which copes with the ever-increasing cost of providing the services.

34. If no such system operates it is necessary to increase by reference to some relevant index the fixed or statutory rate of tax from year to year if proper provision is to be made for the cost of services. In the type of case quoted above, a revaluation would be made in 1976, bringing the values of all existing property up to current levels and the rate of tax would then be *reduced* to the level which produced adequate revenue. The process of valuing new property (at 1976 values for the time being) and of successively increasing the tax rate again year by year until the next revaluation in 1981 would then begin again.

35. The above is not affected by whether the tax is charged by reference to capital values, annual or rental values, site values, or a mixture of all three methods since all such values tend to move together.

36. *Export Duties and other Agricultural and Mineral Levies*

Although commodity prices often move erratically in the short run, they do in the longer run generally reflect any inflationary trend in the prices of manufactured goods and of services.

37. Therefore levies on these basic commodities, exported or produced, which are expressed in money terms, or which use monetary limits for the operation of a sliding scale of percentage levies, require fiscal review at regular intervals.

38. *Sliding-scale rate structure*

Nowadays, it is usual to prefer a sliding scale type of levy upon commodities so that if prices suddenly rise sharply a higher proportionate levy will immediately cream off some of the windfall gains, while a lower rate (perhaps tapering down to a NIL rate) will apply when prices suddenly collapse. Sometimes a non-revenue levy or cess will be imposed in the higher price ranges as a price-stabilisation measure the proceeds going into a fund which will be used to subsidise producers when commodity prices are abnormally low, i.e., below a fixed minimum-price-level.

39. Where tax rate scales of this kind are employed it is of course vital to keep the price levels and limits, at which the rates vary, constantly under review so that they can be revised as monetary values change.

40. For example, if commodity X (whether agricultural or mineral produce) can be exported at a reasonable profit to the producer at say \$100 per unit but the

price varies from $50 (at which price profit disappears for less efficient producers) to $250 (at which level a handsome profit is made by all producers), the levy might be scaled as follows—

Price Range	Over	$250	per unit	30%	of gross selling price
		$200	to $250	25%	
		$150	to $200	15%	
		$100	to $150	8%	(With suitable marginal
		$ 75	to $100	4%	adjustments at the
		$ 50	to $ 75	1%	change-over points)
	Under	$ 50		NIL	

If after such a table has been in operation for say 2 years and the value of money has decreased by 20% (and the value of commodities in general has thus increased by 25%) it would be necessary to increase the limits to the following —

Over	$312.50	per unit	30%	of gross selling price
	$250	to $312.50	25%	
	$187.50	to $250	15%	
	$125	to $187.50	8%	(With marginal
	$ 93.75	to $125	4%	adjustments)
	$ 62.50	to $ 93.75	1%	
Under	$ 62.50		NIL	

41. *Stamp Duties*
: specific

Many stamp duties are small, specific, (and often archaic!) charges, traditionally paid by buying postage stamps (or other special stamps) and sticking them to documents relating to dutiable transactions.

42. Annual reviews of stamp duties for indexation purposes may provide opportunities for abolishing some minor fees that have lost revenue significance and are an irritant, slowing down commerical transactions. Any revenue thus given up may usually be easily replaced by increases in more meaningful duties.

43. *: percentage duties*

No routine review is necessary of percentage stamp duties, which are sometimes levied on such transactions as transfers of real and other property. There may, however, be an application of indexation where exemptions or abatements are fixed by reference to monetary levels.

44. For example, some countries exempt small dwelling houses up to a certain value from stamp duty on transfer, and abate the duty where the price falls between that value and some higher figure. For example, it might be decided to exempt from duty houses upto a value of

$U.S. 10,000, so as to encourage home ownership by the lower income groups, and abate the duty where the value is between $U.S. 10,000 and $U.S. 15,000. Clearly it would be necessary to amend those values from time to time, either by reference to a general cost of living index or by reference to a "building costs index" where such data is obtainable.

45. *Public Utilities*

Some countries provide the services of public utilities, either because they have always done so from the time development began, or because utilities, previously in the private sector, have been "nationalised" or put into public ownership. Even in the U.S.A., where private enterprise is generally responsible for utilities, the Government has its T.V.A. (Tennessee Valley Authority) to provide water, irrigation, and hydro-electricity, a scheme which goes back to "New Deal" days, and more recently AMTRAK representing a take-over by the Government of a part of the railway system.

46. Public Utilities include water, electricity, motorways, railways, telephones, cable and telex services, refuse and sewage disposal, and postal services. Where provided by Government, the charges for these services have to be kept constantly under review, because of the constant fluctuation in the cost of providing the services.

47. Ideally all such services, when provided by Government, should pay their way, i.e., be self-balancing as to revenue and expenditure after making full provisions for depreciation and amortisation, and for the notional rental value of any Government property occupied by the undertaking, and cost of any services provided free by Government.

48. *: Variation of charges: "Commercial" Accounting*

The other important practical point is that reviews of charges should be made not less than annually and charges made whenever necessary so that consumers become used to such charges being variable. Where "commercial" accounting is practised so that the total cost of a service is charged out fully to consumers there is no case for a separate indexation review since this element is fully covered in the ordinary accounting procedures adopted in preparing balance sheets and profit and loss accounts.

49. *: Payment by Property Taxes/"Rates"*

Sometimes services provided by governments are not specifically charged out to the consumer but paid for partly by "local" taxation, including "rates" or taxes on real property (see paras. 32-35) and partly by general taxation raised by the Central Government (see also "Subventions" and "Subsidies" below) (paras. 60-63). In such cases, where, for example, it is usual to provide 50% of the cost from local taxation, the usual "indexation" points will arise in connection with ensuring that the locally-raised tax keeps pace with rising costs since exactly the same problems arise with a 50%, as with a 100% contribution.

50. *: Postal, Cable, Radio, T.V. and other international services*

To a material extent the charges imposed by a government for postal, cable, telex, and international telephone services, as well as radio and T.V. where these services are provided, are imposed from outside. All such services depend upon the co-operation and services of other Governments, the charges sometimes being internationally quantified, e.g., by the U.P.U. (Universal Postal Union), in Bern, Switzerland in the case of postage rates on letters and parcels.

51. International correspondence and parcels have to be carried part of the way by the ships, aircraft, trains or road vehicles of other countries and delivered by the postal workers of the country of destination. International telephone calls, cables, and telex messages have to be carried partly over foreign wires. Some radio and T.V. programmes may be hired or rented from foreign radio and T.V. systems, either on tapes or records or "directly" by satellite transmissions.

52. *: Cost increases : Subsidies*

Increases in overseas costs have naturally to be passed on. Local costs may or may not rise as fast as overseas costs but have to be taken into account particularly with regard to internal postage, telephone etc., charges. While indexation factors will give a rough guide it is clear that other factors, including both-way payments for mutual handling by countries of each others' mail, radio and wire-borne communications, have to be taken into account in computing economic charges. Some charges may be abated for "social" reasons, e.g., mail etc. services to remote and not too affluent areas a long way from population centres. In such cases abatements should come as subsidies from general taxation, rather than by increased charges upon other users of the same services.

53. *Company Registration Fees: Licence Fees*

Company registration fees and licence fees should normally yield appreciably more than the cost of administration and the need for indexation springs from the requirement to maintain the value in real terms of revenue in general. Registration fees are often expressed as a fraction or percentage of capital in which case no indexation adjustments are needed. Trade, liquor, gambling, entertainment, restaurant, hotel and other licences are usually in specific terms and subject to change from time to time, often in the light of the prosperity or otherwise of the particular economic activity. Where changes are not being made for other reasons, however, indexation adjustments should be more or less routine for specific licences.

54. *Leases of Government Land and Property*

Although it is in a Government's interests to obtain rents at the full economic level for its lands, buildings and other property it sometimes is prepared to rent property for sub-economic rents for an initial period as a form of incentive to new enterprises.

55. A usual form of lease nowadays would contain provisions for reviews at not less than 5 to 7 years intervals. The total length of a lease, at one time traditionally 99 years, may now be no more than from 35 to 60 years depending on the situation of the property. In longer leases, and particularly where a full 99-year lease is granted it is now usual to make provision for the site to be re-developed at intervals when it is expected that the whole area may need "renewal" or re-development in accordance with current needs.

56. For example, a city centre may at present be planned to allow the flow of vehicular traffic and the presence of shops, offices, and residential apartments. In 25 years' time, however, it may be that the usual city centre will be a pedestrian precinct and there may be different "mixes" of offices, shops, and apartments, and public amenities such as small gardens or other havens in city centres, from what are customary today.

57. If leases are granted for too long periods without suitable conditions a particular lessee may be in a position to hold up development in an area where land in general is leased by Government and can only be properly planned as a complete entity.

58. For the purpose of these notes, however, attention will be focussed on the level of lease rents. The points must be made that where the initial rent is a sub-economic one, there is no purpose in providing an automatic review clause in the lease by which the *original* rent is adjusted by reference to a price index since this merely preserves the difference between the economic and actual rent for the term of the lease. Although the point seems an obvious one, the writer has encountered cases in practice where the point has been missed. Where the sub-economic rent is to be enjoyed for, say, the first 5 or 7 years, e.g., of a pioneer industry, the first rent review — at the end of the 5 or 7 years — must be such as to put the rent on a full economic footing, by comparison with current arm's length rents for comparable property.

59. Once rents, initially, or after an "incentive" period, are put on to an economic footing it may be simplest for review purposes (say, at 5-year, or 7-year intervals) to link the rent to some appropriate index. There are several possibilities. Apart from the index indicating variations (nowadays normally downward!) in the value or buying power of the currency in terms of which the rent is expressed, the cost-of-living index, or the retail price index, some countries maintain statistics recording the movement of average rents, particularly of business premises but this degree of sophistication is not generally available in smaller countries. Where there is no suitable index to which to link rent revisions, however, it will be necessary instead to have a revaluation exercise at the review dates.

60. *Subventions and Subsidies: Central and Local Governments*

Subventions, usually from Central to Local or Regional Government bodies are often fixed in cash terms. There are exceptions, for example, in Britain the Central Government traditionally pays 50% of the cost of certain important services provided by local authorities: in such cases no indexation point arises.

61. *: Temporary subsidies*

Sometimes a subvention or subsidy is granted as a temporary measure with the ultimate idea that eventually the service will be self-supporting. For example, mail contracts at subsidised prices were at one time granted in some countries to infant airlines to help them become established — the subsidies could later be stopped when air services became economically viable.

62. In the event that a subvention or subsidy fixed in cash terms is intended to

be phased out over a period of years, the erosion of its monetary value operates as an automatic downward phasing factor although the erosion will never completely extinguish the value of the payments. At any rate, since subsidies often have to be maintained in practice longer than was expected in theory, the erosion of value by monetary devaluation exercises a certain tacit pressure on the management of the subsidised service to become more efficient without overt action by the payer of the subsidy, a generally desirable development.

63. *Permanent Subsidies*

Sometimes it is recognised that a subsidy will be required more or less permanently as a social measure which is unlikely ever to generate proportionate economic benefits. For example, it may be decided to subsidise a railway or air service to poor and remote parts of the country to maintain communications with all the citizens of that country. In such a case, as an alternative to complex computations of the estimated cost of providing a particular service, which is often part of wider services supplied by the same operator (the remainder of whose operations may be viable) it may be decided to index the subsidy and either dispense with full costing reviews or (preferably) hold these at longer intervals, such as every 5 or 6 years.

64. *Charges for Government Services*

Apart from major "utility" and other services referred to in paras. 45-62, governments often provide a miscellany of minor services. Such services may range from repairs done in government workshops, contract ploughing, spraying, and other agricultural operations, and road-building done for private developers, to the supply of planting materials for "economic" crops or ornamental bushes etc. from government plant nurseries. In small developing countries, particularly those which have recently achieved independence, there may well be a very wide spectrum of services traditionally provided by Government (which may be taken over by private enterprise as the country develops).

65. The usual practice is for the Ministry of Finance to write to all Heads of Departments and of Governmental or quasi-Governmental bodies and organisations that provide services or sell goods of any kind to the public at large or to concerns in the private sector, to supply information on all these with schedules of the prices charged. The annual "processing" of such charges should, as a minimum, involve indexation adjustments, preferably in multiples of 5% or 10% when the relevant index has moved at least that number of points since the previous review.

A. NOOTEBOOM *:

INTERNATIONAL TAX TREATMENT OF ROYALTIES**

The tax treatment of payment for supplies of technical assistance and know-how in international trade has been a subject of discussion for many years.

Without looking back too far, discussions as early as 1928 led to the Model Convention of the League of Nations.

In Latin America there has been extensive discussion on this subject. The 1970 Congress of the Latin American Tax Institute was of particular importance in this respect; it influenced also the present Andean Pact.

During 1972, the OECD published the revised text of certain articles of the 1963 Draft Convention and also issued additional commentary on the taxation of royalties (Article 12); in the same year an Ad-Hoc group of Experts on Tax Treaties between developed and developing countries, set up by the United Nations, issued its third report which contains copious comments on the taxation of royalties.

In September 1975, detailed reports on this subject were submitted to the IFA Congress held in London, while in 1969 a related topic was the subject of the Rotterdam IFA Congress.

These are just a few reminders of recent events which suggest that we should be aware that many before us have examined this difficult subject.

In looking at the abovementioned discussions the conclusion is evident that a person's thinking on the legal norms of taxation is materially influenced by the cultural and social environment of the country or continent in which he has grown up and to which he still belongs. Therefore certain clear lines should be drawn from the outset.

In order to enable them to stay in business, business enterprises must recover *in* the selling price of their product the expenses incurred by that business and a profit margin. The profit is then subject to profits tax. To arrive at taxable profit, expenses of e.g. raw materials, wages, depreciation of fixed assets and financial interest are then deducted.

In determining the amount of taxable profit *no distinction whatsoever* should be made between whether the price for raw materials has been paid to domestic or foreign suppliers; similarly, in the determination of profit, expenses incurred in respect of *foreign-made* machinery should be treated as deductible in the same way as those incurred in respect of *domestic* machinery.

* Partner of Loyens & Volkmaars, tax lawyers, Rotterdam.

** Speech held at the IFA Conference, London, on September 22, 1975. See also A. Nooteboom & Dr. J. H. Th. Schipper, *The Tax Treatment of Royalties and Lump Sums paid by Enterprises in Developing Countries for Technical Assistance and Licences under Patents,* International Bureau of Fiscal Documentation, Amsterdam.

Consequently, in the determination of profit no distinction should be made between royalties paid to domestic and foreign suppliers; royalties would therefore always be deductible in the computation of taxable profit. This approach is not followed by some Latin American countries and, in the view of the author, incorrectly.
Perhaps the Latin American viewpoint has been influenced by the example of internationally operating companies who charged their Latin American subsidiaries very high amounts of royalties which may have created the impression that amounts deducted as royalties thus are merely distributions of profit and not deductible from profits. The point under discussion then is not whether royalties are deductible or not, but whether payments made to affiliated companies under the name of royalties are really royalties and not wholly or partly distributions of profit. *This is* the problem of arm's length pricing which is decisive in determining the level of royalties.
Once this level has been established, such expenses are incurred in respect of technical know-how and should be deductible from profit, regardless of whether they were incurred in relation to domestic or foreign suppliers of such know-how.

The first question is obviously whether any research and development (R & D) should be allocated to royalty income at all. It is often argued that R & D is so basic to the business of manufacturing and selling the main product that royalties received are actually a bonus marginal income to which no costs are attributable.
This statement is too generalized and therefore incorrect. In present-day business, manufacturing and selling operations are usually distributed over a number of subsidiaries in any countries. It follows that each of them will benefit from, and even need, the R & D support. Therefore, the royalty flow to the company engaged in R & D is a structural part of its earning capacity which should bear its fair share of R & D expense.

A second important tax question is: what country has the right to tax royalty receipts?: The country where the user of the technical know-how is located, or the country where the supplier of the know-how is located?

In phrasing this question, care should be taken to avoid implying an answer.
For example, a distinction is often made — in the author's view, incorrectly — between the "source country" and the "recipient's country of domicile". In fact, the *source* of the know-how is the country where the person producing the know-how is operating, and the knowledge flows from that source *to* the country of the user.
That is why it is better perhaps to avoid the term source country and rather use the terms country of the user and country of the supplier.

In the country of the supplier, costs will have been incurred in developing the know-how. It is widely recognized that R & D expenses are a relatively rapidly escalating category of expenses. In the business world internationally operating companies are often the ones which incur very substantial R & D expenses and they wish, quite correctly, to recover these expenses with a profit margin in their sales of products and/or in earning royalties.
Having determined that R & D should be allocated to royalty revenue on the one hand and sales revenue on the other, the next question is what is the basis for such allocation?

It should be emphasized that a pragmatic approach can provide a sound basis for a general approach to the allocation of R & D expenses among sales proceeds and royalty revenue.

It would be a serious mistake to base such allocation on the proportion of gross revenue from sales versus gross revenue from royalties. The variable costs of a product must obviously be allocated to the sales proceeds therefrom, and it is, therefore, fair to eliminate at least these expenses from the allocation basis; variable expenses (other than withholding taxes) are rarely attributable to royalty income. Perhaps a fair method of allocating R & D expenses between sales revenue and royalty revenue is on the basis of value added, thus eliminating not only the variable expenses but also the directly attributable fixed expenses.

The view that R & D expenses should be deducted only from the profits of the supplier while the country of the user has the right to levy tax on the gross royalties paid appears incorrect.
It is stated in the general report paragraph IV, at (ii) that: "a royalty article in the OECD model convention would result in giving up by the user's country of substantial taxes with very little return; moreover, the benefit would not accrue to the licensor but accrues to his government".[1]

This statement cannot be a criticism of the government of the supplier because the expenses in developing know-how have been deducted from taxable profits in *that* country and have thus reduced tax revenue. It appears fair that the expenses recovered should be added to taxable profits in that country.

For clarity's sake it should be emphasized that the author does not take the view that the right to tax the net profit element of royalties should in all circumstances belong exclusively to the country where the producer of the know-how is located.
However, several substantial arguments support that position and particularly in view of the desirable free exchange of know-how the author would plead in favour of that system which is also that of the great majority of the OECD Member States.

In trying still to find a solution to the differences of opinion existing in different countries — notably that of the developing versus the developed countries — one might have some difficulty in finding a legal basis for granting the user countries the right to tax part of the royalty income. Several arguments have been put forward none of which, in the author's view can be decisive since:
— the developing countries habitually are debtors when it comes to exchange of know-how;
— they need enormous public revenues to improve their social structure.

If these arguments are accepted, the developed countries should see their giving up of taxing rights as development aid within the framework of the recommended 0.7% contribution objective set by the United Nations.

A legal ground for granting the right to tax royalties to user countries — which are often developing countries — may be found in an adaptation of the concept of

1. See Tax Treatment of the importation and exportation of technology — know-how patents, other intangibles and technical assistance, Studies on international fiscal law, Vol. LX a (IFA Congress London 1975).

permanent establishment or — for Anglo-Saxon countries — carrying on a trade within a country. A compromise might be found in meeting the desires of the developing world by accepting that the continuous use of know-how leads to such a strong and durable participation in the user countries' economies that part of the profit element contained in royalty payments should be taxed by them.

The conclusion may be that:

1. Royalties must always be expenses deductible by the user of the know-how, regardless of whether they are paid to domestic or foreign suppliers of the know-how.

2. In order to determine whether something which is called a royalty is indeed a reasonable reimbursement for know-how and not a disguished dividend, the arm's length principle should be applied.

3. For the great majority of OECD member countries the basic rule that royalties should only be taxed in the supplier country is well-founded and should be maintained. However, it should be recognized that the position of the developing countries is fairly valid in that *part* of the profit element inherent in royalty payments may be taxed in those countries. In that case the position of an enterprise in the supplier country as regards expenses charged against its taxable profits should be considered carefully. Consequently, as a principle, a withholding tax should embody only a tax on that *part* of the profit element contained in royalty payments. As a result the amount of tax expressed as a percentage of gross royalties would appear deceptively low.

S. AMBALAVANER AND MANO SARAVANAMUTTU *:

SRI LANKA BUDGET FOR 1976

1. The Budget for 1976 was presented on 5th November 1975 by the Minister of Finance and Minister of Justice Mr. Felix R. Dias Bandaranaike, M.P. The Budget for 1975 was presented on the 6th November 1974 by the then Minister of Finance Dr. N. M. Perera. Many of the proposals in the 1975 Budget have not been implemented and will now not be implemented.

2. *Foreign Banks*

There has been since 1933 restriction on the establishment of new Banks (Foreign as well as Local Private Sponsored) in Sri Lanka. The activities of the foreign commercial banks were also restricted. However, under the policy outlined by the Minister of Finance the Foreign Banks will now be permitted to establish branches and to operate in Sri Lanka subject to certain conditions. The policy is set out as follows:—

"What is required is not merely the modernisation of Domestic Reserves and the channelling out to traditional forms of investment, but the inclusion of new external capital for new enterprises in Sri Lanka, to provide new employment, to teach new skills, to develop new projects, to provide Management Consultancy Services, to provide a catalyst service to bring talents and skills, technical competence and knowhow — for this purpose apart from existing commercial banks, new foreign banks interested in coming to this country would be welcome and invitations will be extended to them to participate in the development efforts on the basis of mutually satisfactory terms to be negotiated."

3. *Foreign Investment Law*

The Government has set out in general terms the area in which and the conditions subject to which foreign colloboration will be permitted. There is however at present no legal guarantee on repatriation of foreign capital invested in the country. Announcing the proposal to provide such legal guarantee the Minister of Finance said "A foreign investment law will be enacted which will provide for guarantees and built-in controls". This will give legal form to the policy set out in the White Paper on Foreign Investment. The institution of a Foreign Investment Authority will also be established under the Law. An export oriented approach to foreign investment would be promoted under which the foreign investor "fades-out" once he has performed his catalytic function. The period of "fade-out" and other terms and conditions will be clearly specified in advance.

4. *Excise Duties*

(a) Tobacco Tax increased.

(b) Locally manufactured liquor duty increased.

5. *Customs Duty*

Imported liquor Whisky, Brandy, Gin, Rum, duties increased by Rs.60/- a gallon.

6. *Import Duties*

Duties on pharmaceutical products and two-wheeled tractors completely removed. Import duty rate on synthetic yarn reduced by 10%.

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7. *Turnover Taxes*

Rates of taxes are reduced —

(a) Handloom sarees from 5% to 1%
(b) Cotton sarees and cotton cloth by 5%
(c) Sports goods to 5%
(d) Sewing machines from 25% to 10%

Rate of Tax on Tourist Hotels turnover increased from 1% to 10%.

8. *Export Development and Promotion*

(a) Complete abolition of export duties on copra, coconut oil and desiccated coconut.
(b) The Convertible Rupee Account Scheme. Under this Scheme exporters are entitled to foreign exchange (for specified purposes) the rates varying up to 15% of the value of the exports. The rate for Gem Exports will remain at 20%.

9. *Dividends from Companies enjoying Tax Holidays*

Dividends from such companies were exempt from tax. Now only dividends up to 10% of the equity capital subscribed before 6.11.74 will be exempted in respect of companies incorporated before 5.11.75.

10. *The Ceiling on Income & Compulsory Savings*

This Scheme is abolished. Contributions made for previous years will be refunded over a period.

11. *Wealth Tax*

Approved investments will also be taxed. Previously they were exempt. The rates of tax progressing to 8% proposed in the 1975 Budget of 6.11.74 will not be implemented.

12. *Gifts Tax and Estate Duty*

Revised rates of tax proposed in the 1975 Budget will not be implemented.

13. *Capital Gains*

Capital Gains arising on gifts or death will remain taxable. The 1975 Budget proposals exempting from tax such Gains on gifts or death will not be implemented.

14. *Lump Sum (Accelerated) Depreciation & Development Rebate*

These deductions will continue to be allowed.

The 1975 Budget proposals withdrawing these allowances will not be implemented.

15. *Withholding Tax on Interest*

The 1975 proposals for withholding tax of 33⅓% on Interest paid to residents will not be implemented. The withholding tax (advance collection) on interest payments to non-residents will remain.

16. *Calendar Year Assessment*

The 1975 Budget proposals to tax income from January 1976 on a current calendar year basis will not be implemented. The Assessment Year will remain as 1st April to 31st March and the basis year will continue to be the preceding accounting year. This applies to residents and non-residents. However, income from employment will continue to be assessed on the current year basis.

17. *Taxation — Personal Income*

(a) Exemption limit for salaried employees raised from Rs.6000 to Rs.9000. Only those earning over Rs.750 per month will be taxed.
(b) Aggregation of husband and wife's employment income for taxation

abolished upto certain limits.

(c) Aggregation of employment income with other sources of income also abolished upto certain limits.

(d) Maximum rate of taxation on personal income reduced from 65 to 50 percent. It was proposed in the last Budget to increase the maximum rate to 75%.

(e) If a resident of Sri Lanka goes abroad on short assignments of employment on professional work his earnings not to be subject to Sri Lanka Income Tax, if, foreign exchange earnings are brought back.

(f) Compulsory Savings abolished; funds already deposited to be credited to controlled Bank Accounts with facilities for withdrawal.

18. *Rates of Income Tax — 1975/76*

The rates of income tax announced in the 1975 Budget (maximum rate of tax — 75%) will apply for the year of assessment 1975/76.

Resident Individuals

On the

first	Rs.1800	of taxable income	7½%
next	1800	,,	10%
,,	2400	,,	12½%
,,	2400	,,	15%
,,	2400	,,	17½%
,,	2400	,,	20%
,,	3600	,,	25%
,,	4800	,,	30%
,,	7200	,,	40%
,,	7200	,,	50%
,,	7200	,,	60%
,,	7200	,,	70%
,,	Balance	,,	75%

Note: Each of the first two slabs of Rs. 1800 is increased by

(a) Rs.600 in respect of the wife

(b) Rs.600 in respect of one child or dependant/two children or dependants

(c) Rs.1200 in respect of three children or dependants/four children or dependants.

For instance where a family consists of a husband, wife and four children, the first two slabs will be — Rs.1800 plus Rs.600 plus Rs.1200 = Rs.3600 at 7½% and Rs.3600 at 10%.

Non-Resident Individuals

	Taxable Income	*Rate per cent*	*Tax*
First	15000	15%	2250
Next	6000	20%	1200
,,	6000	25%	1500
,,	6000	30%	1800
,,	6000	40%	2400
,,	6000	50%	3000
,,	10000	60%	6000
Balance		65%	

Rates of Income Tax 1976/77

The 1975/76 Rate schedule will apply subject to the maximum rate being 50%.

19. *Aggregation of Family. Income, Wealth*

Income and wealth of children under 21 only will be aggregated. Employment income of the spouse and children will not be aggregated subject to certain limits.

20. *Non-Residents — Shipping and Aircraft*

The taxable profits of non-residents will be 6% of the freight and the passenger fare earnings from Sri Lanka. This will not apply to profits of Air lines, Aircraft profits will continue to be assessed on a

"Ratio Certificate" basis or on a "Fair Percentage" basis as in the past.

21. *Incentives to Workers*

(a) Pensions to State employees restored.

(b) Gratuity Scheme to provide terminal benefits will be formulated.

(c) Legislation for profit sharing will be enacted.

22. *Production Incentives*

Specific relief will be made available in the form of discounts on tax on the following categories of enterprises:—

(a) those which increase the units of productive labour employed during the course of 1976 on prescribed proposals;

(b) those which negotiate and receive foreign exchange for their ventures without drawing on our national resources;

(c) those which increase the volume and value of their exports compared to 1975 on a prescribed formula;

(d) those which will increase their productive capacity during the course of 1976, e.g. by working extra shifts or in the case of agriculture register increases in production through crop diversification;

(e) enterprises and persons who undertake investment in housing stock and urban development projects.

25. *Expenditure Tax*

This will be re-introduced. Proposals intended to curb excessive consumption expenditure.

24. *Interest Rates*

This will be kept under review to maximize domestic savings.

25. *Company Taxes*

The present rate of tax of 60% will continue but a 10% rebate will be given for approved specific investments. Broadbased (shareholding) companies will however have a tax rate of 40%. The tax rate of non-resident companies will be $77^1/_9$%, including tax on remittance.

When the legislation giving effect to the proposals is passed by the National State Assembly, it will be possible to state more precisely the changes in taxation that will be implemented. It is advisable to await the legislation before the above are considered final.

* * * DOCUMENTS * * *

INDIA

Decision of the Gujarat High Court of September 23, 1974 [1]

Commissioner of Income-tax, Gujarat versus Saurashtra Cement and Chemical Industries Ltd.

INTEREST PAYABLE BY RESIDENT COMPANY TO NON-RESIDENT COMPANY ON AMOUNTS OF BILLS OF EXCHANGE ETC.

The assessee-company was doing the business of manufacture of cement. In order to import certain plant and machinery, the assessee-company entered into an agreement with a foreign company A of Genoa, Italy. Under the terms of the agreement, the plant and machinery were to be delivered by A at one of the European ports. One of the terms about the payment of price was that 30 per cent. of the price was to be paid by the assessee against three bills of exchange to be drawn by the non-resident company A on the assessee and to be accepted by the assessee. The assessee was to pay six per cent. interest on the three bills of exchange on the expiry of six months from the date of issue of the bills till their maturity and the interest was to be paid by means of other bills accepted at the same time and falling due at same maturities as the corresponding main bills of exchange. It was provided that the price was to be paid in terms of pounds sterling and the rate of pound sterling with reference to Italian lira was fixed in the agreement. The assessee showed the amount outstanding in its books of account and the interest which was stipulated as payable on the amount. The non-resident company was shown as a creditor to the extent of the amount receivable by it in the books of the assessee-company. The Income-tax Officer held that in respect of interest payable on the bills of exchange, the assessee-company would be liable under section 9(1)(i) of the Income-tax Act, 1961, as agent of the non-resident company and he passed assessment order accordingly. On appeal, the Appellate Assistant Commissioner held that section 9(1)(i) did not apply to the case and that the assessee was not liable to pay any tax on the items of interest in its capacity as an agent of the non-resident company. The Appellate Tribunal agreed with that view. On a reference:

Held, *that the correct test to be applied, according to the decision of the Supreme Court in* Delhi Cloth and General Mills Co. Ltd. *v.* Harnam Singh (AIR 1955 SC 590), *is the law of the country in which the elements of the contract were most densely grouped and with which factually the contract was most closely connected. In view of the terms of the contract in this case, it was obvious that so far as the non-resident company A was concerned, all that the company did was to send a representative when the contract was signed in India.*

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1. Reported in Income Tax Reports, Gujarat (1974) 101 I.T.R. at 502.

Barring that action, so far as the performance of the contract was concerned, the non-resident company nowhere came near the shores of India or territories of India. It put the goods on board the ship concerned at a port in Europe. It received all the price in Europe and that too in terms of foreign currency. The plant was not to be erected or put up by the non-resident company but the assessee-company was to set up the plant in India. Even the instalments were to be paid in foreign currency. So far as the unpaid price was concerned, the amount was to be paid by bills of exchange drawn in a foreign country and accepted by the assessee in India. Thus, most of the elements of this contract are found to be most densely grouped with the country, namely, Italy, where the non-resident company A was carrying on its business of supplying plant and machinery and hence the debt which the assessee-company owed to the non-resident company was not an asset held by the non-resident company in India. Therefore, the interest which was payable in respect of this debt was not income arising from or through any asset held by the non-resident company in India. Since the non-resident company had no income accruing or arising in India, it could not be said that there was any liability of the non-resident company to pay income-tax on the amount of interest of the three instalments and, consequently, there could not be said to be any liability of the assessee-company as the agent of the non-resident company so far as this aspect of income accruing or arising through or from any asset held by the non-resident company in India was concerned.

As regards the alternative argument on behalf of the revenue regarding income accruing or arising through or from any money lent on interest and brought into India in cash or in kind, in view of the decision of the Supreme Court in Bombay Steam Navigation Co. (1953) (P.) Ltd. *v.* Commissioner of Income-tax ([1965] 56 ITR 52), *obviously the amount of unpaid price could never be said to be a loan advanced by the non-resident company to the assessee-company. Since the non-resident company could not be said to have lent the amount of the unpaid purchase price to the assessee-company either in cash or in kind, there was no question of the interest payable by the assessee-company to the non-resident company being deemed to be "income" accruing or arising from any money lent at interest and brought into India in kind.*

Therefore, the amount payable by the assessee to company A by way of interest on the unpaid purchase price so far as the amount represented by the bills of exchange was concerned was not taxable in the hands of the assessee as agent of the non-resident company under section 9(1)(i) of the Act.

JUDGMENT

The judgment of the court was delivered by

Divan C. J. — In this case at the instance of the revenue the following question has been referred to us for our opinion:

"Whether, on the facts and in the circumstances of the case, interest on the amount payable by the assessee to M/s. Ansaldo under the contract in the assessment years 1962-63, 1963-64 and 1964-65 was taxable in the hands of the assessee as the agent of the non-resident company under section 9(1)(i) of the Income-tax Act, 1961?"

The assessment years with which we are concerned in the present case are assessment years 1962-63 to 1964-65. The assessee is a limited company incorporated in 1956. The business of the assessee is to manufacture cement. In order to import certain plant and machinery, the assessee-company entered into an agreement on December 12, 1956, with a foreign company known as Messrs. Ansaldo, S.P.A. (Ansaldo Joint Stock Company) of Genoa, Italy.

The agreement provided for various matters including the payment of price for the entire plant and equipment aggregating to Rs. 7,53,345. Under the terms of the agreement plant and machinery were to be delivered by Messrs. Ansaldo at one of the European ports. 35 per cent. of the price was to be paid on the date of the agreement; 15 per cent. on supply of certain machinery and the remaining 50 per cent. of the price was to be paid in five annual instalments of 10 per cent. each. 30 per cent. of the price was to be paid by the assessee against three bills of exchange to be drawn by the non-resident company on the assessee and to be accepted by the assessee. The assessee was to pay six per cent. interest on the three bills of exchange on the expiry of six months from the date of issue of the above bills till their maturity and the interest was to be paid by means of other bills accepted at the same time and falling due at same maturities as the corresponding main bills of exchange. The assessee was to be entitled to pay the bills of exchange even before their maturity but if that was done, the payment of the interest was to be waived by the non-resident company. There were clauses in the agreement as to what should be done if the deliveries were delayed and there were clauses with regard to tests and performance guarantee. The other clauses are in usual terms to be found in such contracts. One of the clauses in the agreement provided that the price was to be paid in terms of pound Sterling and the rate of pound Sterling with reference to Italian Lira was fixed in clause 10A.

The main dispute in the present reference is with regard to the payment of interest on the three bills of exchange. The assessee showed the amount outstanding in its books of account and the interest which was stipulated was payable on the amount. The non-resident company was shown as a creditor to the extent of the amount receivable by it in the books of the assessee-company. The Income-tax Officer held that in respect of interest payable on these bills of exchange, the assessee-company would be liable under section 9(1)(i) of the Income-tax Act, 1961, as agent of the non-resident company and he passed the assessment order accordingly. When the matter was carried in appeal before the Appellate Assistant Commissioner by the assessee, that officer held that the conditions laid down in section 9(1)(i) did not apply to the present case and, therefore, the non-resident company was not liable, in respect of interest payable by the assessee and, consequently, the assessee-company was not liable to pay any tax on these items of interest in its capacity as an agent of the non-resident company. He, accordingly, allowed the appeal. The matter was carried in appeal by the revenue to the Appellate Tribunal and it was contended that the interest payable to the non-resident company was income arising through or from any asset in India and hence it fell within section 9(1)(i) of the Income-tax Act, 1961. The Tribunal held that there was no business connection in India inasmuch as the non-resident company belonged to a foreign nation and had no branch or place of business in India. It was merely a supplier of goods and the assessee had purchased goods from the non-resident company. The Tribunal, after examining the question in the light of the general principles and relying on the decision of the Supreme Court in *Delhi Cloth & General Mills Co. Ltd.* v. *Harnam Singh,*[1] held that the true test was as to which was the country in which the elements of the contract were most densely grouped and with which factually the contract was most closely connected. Applying this test the Tribunal found that according to the terms of the contract payments were made in foreign country; the non-resident company was not a usual supplier of plant and equipment; it had no sales office or any representative in India; and that being a non-resident company it agreed to sell the goods on payment in foreign currency. It was not a case of the non-resident company coming into India to erect the plant and the delivery was also effected f.o.b. European port. The non-resident company was nowhere near the territories of India in relation to the supply of plant and equipment except for the purpose of signing the agreement and no representative of the non-resident company was posted in India; the bills were drawn by the non-resident company in a foreign territory and were sent to the assessee for being accepted; and that the assessee having accepted the bills paid the moneys in foreign currency again. On facts, the Tribunal held that most of the elements in the contract were closely connected with the country in which the non-resident company was functioning and it, therefore, held that the amount payable under the contract was not an asset held by the non-resident company in India. The appeals for the three years filed by the revenue before the Tribunal were, therefore, dismissed by the Tribunal. Thereafter, at the instance of the revenue, the question hereinabove set out has been referred to us for our opinion.

Under section 9(1) provision is made for certain types of income which are deemed to accrue or arise in India and under section 9(1)(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through or from any money lent at interest and brought into India in cash or in kind or through the transfer of a capital asset situate in India, is deemed to accrue or arise in India. Under the charging section income-tax has to be charged in respect of the income which arises or accrues in India or under the deeming provisions of the Act is deemed to accrue or arise in India. On behalf of the revenue, Mr. Kaji urged before us that the interest on the amount payable by the assessee to Messrs. Ansaldo was income accruing or arising through or from an asset held by a non-resident company in India and, in the alternative, he contended, that this interest was income accruing or arising through or from money lent at interest and brought into India in cash or in kind. Though the second alternative is not covered by the question referred to us, we have heard counsel on the point because the question directly arose under section 9(1)(i). If we had been inclined to accept the alternative contention of Mr. Kaji, we would have amended the question accordingly in order to bring out the real controversy between the parties.

Mr. Kaji referred us to the principles of private international law and the relevant passages from *Cheshire's Private International Law* and *Dicey's Conflict of Laws.* However, we find that the question is com-

1. AIR 1955 SC 590.

pletely covered by the decision of the Supreme Court in *Delhi Cloth & General Mills Company's* case,[2] and hence it is not necessary for us to refer to these principles of private international law or of conflict of laws. The Supreme Court there was concerned with a question of a debt owed to a foreigner and it held that a debt is property. It is a chose-in-action and is heritable and assignable and it is treated as property under the Transfer of Property Act which calls it an "actionable claim". Choses-in-action arising out of contract have two aspects: (1) as property, and (2) as involving a contractual obligation for performance. The property aspect is relevant for purposes of assignment, administration, taxation and the like; the contractual aspect for performance. It further held that debt, being intangible, cannot have location except notionally and in order to give it notional position rules have to be framed along arbitrary lines. Determination of the legal liabilities which arise out of the facts relating to a debt raises complex questions of private international law. Two distinct lines of thought emerge. One is that applied by the English courts, namely, the lex situs: the other is the one favoured by Cheshire in his book on *Private International Law,* namely, the "proper law of the contract". Bose J., delivering the judgment of the Supreme Court, has pointed out that the English approach is to treat the debt as property and determine its "situs" and then, in general, to apply the law that obtains there at the date when payment is due. But the difficulty of the English view is that they have different sets of rules for ascertaining the "situs", with the result that the "situs" shifts from place to place for different purposes, also that it is determined by intention. Thus, the situs can be in one place for purposes of jurisdiction and in others for those of banking, insurance, death duties and probate. The "situs" also varies in the case of simple contract debts and those of speciality. After examining the several authorities on the point, the Supreme Court observed in paragraph 48:

"But when all is said and done, we find that in every one of these cases the proper law of the contract was applied, that is to say, the law of the country in which its elements were most densely grouped and with which factually the contract was most closely connected. It is true the judges purported to apply the 'lex situs' but in determining the 'situs' they apply rules (and modify them where necessary to suit changing modern conditions) which in fact are the very rules which in practice would be used to determine the proper law of the contract.

The English judges say that when the intention is not express, one must be inferred and the rules they have made come to this, that as reasonable men they must be taken to have intended that the proper law of the contract should obtain. The other view is that the intention does not govern even when express and that the proper law must be applied objectively. But either way, the result is the same when there is no express term.

The 'proper law' is in fact applied and for present purposes it does not matter whether that is done for the reasons given by Cheshire or because the fluid English rules that centre round the 'lex situs' lead to the same conclusion in this class of case."

Therefore, the correct test, according to the Supreme Court, to be applied is the law of the country in which the elements were most densely grouped and with which factually the contract was most closely con-

2. AIR 1955 SC 590.

nected. That is the test to apply, whether one applies the test of "lex situs" as done by the English judges or whether one applies the proper law of the contract. In view of the terms of the contract which we have set out in this case, it is obvious that so far as the non-resident company, Messrs. Ansaldo of Genoa was concerned, all that the company did was to send a representative when the contract was signed in India. Barring that action, so far as the performance of the contract was concerned, the non-resident company nowhere came near the shores of India or territories of India. It puts the goods on board the ship concerned at a port in Europe. It received all the price in Europe and that too in terms of foreign currency. The plant was not to be erected or put up by the non-resident company but the assessee-company was to set up the plant in India. Even the instalments were to be paid in foreign currency. So far as the unpaid price was concerned, the amount was to be paid by bills of exchange drawn in a foreign country and accepted by the assessee-company in India. Thus, most of the elements of this contract are found to be most densely grouped with the country, namely, Italy, where the non-resident company, Messrs. Ansaldo, is carrying on its business of supplying plant and machinery and hence the debt which the assessee-company owed to the non-resident company was not an asset held by the non-resident company in India. Therefore, the interest which was payable in respect of this debt was not income arising from or through any asset held by the non-resident company in India. Since the non-resident company had no income accruing or arising in India, it cannot be said that there was any liability of the non-resident company to pay income-tax on the amount of interest of the three instalments and, consequently, there cannot be said to be any liability of the assessee-company as the agent of the non-resident company so far as this aspect of income accruing or arising through or from any asset held by the non-resident company in India was concerned.

As regards the alternative argument urged by Mr. Kaji regarding income accruing or arising through or from any money lent on interest and brought into India in cash or in kind, in view of the decision of the Supreme Court in *Bombay Steam Navigation Co. (1953) (Pte.) Ltd.* v. *Commissioner of Income-tax*,[3] it is obvious that this amount of unpaid price can never be said to be a loan advanced by the non-resident company to the assessee-company. In the *Bombay Steam Navigation Company's* case [3] the facts before the Supreme Court were that pursuant to a scheme of amalgamation between two shipping companies, the assessee-company before the Supreme Court was incorporated to take over certain passenger and ferry services carried on by one of the amalgamating companies. The assessee-company took over assets, which were finally valued at Rs. 81,55,000, and agreed that the price was to be satisfied partly by allotment of 29,900 fully paid up shares of Rs. 100 each and the balance was to be treated as a loan and secured by a promissory note and hypothecation of all movable properties of the assessee-company. The balance remaining unpaid from time to time was to carry simple interest at six per cent. The question was whether the amount of interest could be considered to be interest on capital within the meaning of section 10(2)(iii) of the Indian Income-tax Act, 1922. The Supreme Court held that the expression "capital" used in sec-

3. [1965] 56 ITR 52 (SC).

tion 10(2)(iii), in the context in which it occurred, meant money and not any other asset and it was held on the facts that there was in truth no capital borrowed by the assessee in this case. Shah J., as he then was, delivering the majority judgment, observed at page 57:

"The parties had agreed that assets of the value of Rs. 81,55,000 be taken over by the assessee-company from the Scindias. Out of that consideration Rs. 29,99,000 were paid by the assessee-company and the balance remained unpaid. For agreeing to deferred payment of a part of the consideration, the Scindias were to be paid interest. An agreement to pay the balance of consideration due by the purchaser does not in truth give rise to a loan. A loan of money undoubtedly results in a debt, but every debt does not involve a loan. Liability to pay a debt may arise from diverse sources, and a loan is only one of such sources. Every creditor who is entitled to receive a debt cannot be regarded as a lender."

In view of this clear-cut pronouncement of the Supreme Court, it is obvious that the amount of the unpaid price cannot be said to be a loan advanced by the non-resident company to the assessee-company nor can the non-resident company be said to be a lender to the assessee-company so far as that amount was concerned. Since the non-resident company cannot be said to have lent the amount of the unpaid purchase price to the assessee-company either in cash or in kind, there is no question of the interest payable by the assessee-company to the non-resident company being deemed to be "income" accruing or arising from any money lent at interest and brought into India in kind. Hence, the alternative argument urged on behalf of the revenue must be rejected since there was no money lent by the non-resident company to the assessee-company though the amount of the unpaid price was undoubtedly a liability which the assessee-company owed to the non-resident company. Since the alternative contention on behalf of the revenue is being rejected, we have not thought it proper to frame an additional question to cover that aspect.

Under these circumstances it must be held that the amount payable by the assessee to Messrs. Ansaldo by way of interest on the unpaid purchase price so far as the amounts represented by the bills of exchange were concerned, was not taxable in the hands of the assessee as agent of the non-resident company under section 9(1)(i) of the Income-tax Act, 1961. We, therefore, answer the question referred to us in the negative and in favour of the assessee. The Commissioner will pay the costs of this reference to the assessee.

Question answered in the negative.

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SYLVAIN R. F. PLASSCHAERT *:

FIRST PRINCIPLES ABOUT SCHEDULAR AND GLOBAL FRAMES OF INCOME TAXATION**

BASIC CONCEPTS

1.1. From a morphological viewpoint, income taxes can be distinguished into schedular, global and mixed or composite ones. As a first approximation, and in their bare essentials, the three alternative systems can be described in these terms:

(a) In a schedular income tax system, each of the various *incomes* — such as salaries, dividends or business profits —, that flow to the same taxpayer, is subjected to a separate tax. In other words, the schedular system of income taxation consists of a coordinated set of separate taxes on various types of *income*.

(b) In a global income tax, all (partial) *incomes*, from whatever source derived, that accrue to the same taxpayer, are taxed jointly, as a single mass of *income*.

(c) A mixed or composite system consists merely of the juxtaposition of a set of schedular taxes and of a global-type tax, that both apply to the same income. Thus, a mixed frame of income taxation, is not original, structurally speaking. As the schedular taxes are generally more important, both in terms of coverage and yield, it may be more accurate to state that in a mixed system, a global tax is superimposed on a schedular system. The global tax component frequently carries the label "complementary tax", indeed.

As the present paper deals mainly with the basic morphological differences — and similarities — of resp. the schedular and global-type income tax systems, the composite system, can for the time being, be disregarded.

THE SCHEDULAR UNDERPINNINGS OF A GLOBAL INCOME TAX SYSTEM

2.1. The definitions, given above, already suggest that there is at least one basic difference between schedular and global systems. Yet, when looking at actual global-type income taxes, one discovers at once that, paradoxically, the tax returns distinguish various heads or categories. In the United Kingdom and in the United States, these subdivisions are even called "schedules". In each of them, the taxpayer is requested to state the amount of gross receipts, derived from a given source of income, such as salaries, dividends or rent; each schedule, generally, also provides space where allowable deductions have to be listed. The aggregate taxable basis, to which a progressive rate scale is applied,

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** This paper contains the first part of a larger research project on "Schedular, Global and Mixed Systems of Income Taxation, with Particular Reference to Developing Countries", which is presently being carried out by the author, assisted by Drs. Jan Borremans, at the "Center for Development Studies" of the St. Ignatius Faculties, University of Antwerp. The tax design and tax policy aspects of the subject matter will be covered in subsequent papers.

consists of the sum of the various net incomes in each schedule, after some further deductions from this sum total have been effected. Thus, a schedular rubrication clearly emerges as a necessary ingredient and as the foundation of a global type of income taxation.

2.2. The statutory definition of taxable (gross) income in several global-type countries proceeds by way of itemization of the various types of income. A systematic example is provided by the Dutch statute, where the definition of taxable income reads as follows:

"Aggregate Income consists of the total sum of:

1. Net income from enterprise and labor, viz.
   a) profit from agricultural enterprise,
   b) profit from non-agricultural business,
   c) profit from independent professions,
   d) net yield from employment,
   e) other net income from labor,
2. Net income from property, viz.
   a) net income from real estate,
   b) net income from movable capital,
3. Net incomes, in the form of periodic payments, inasfar as they are not mentioned under 1 and 2".[1]

2.3. In glancing through the tax statutes, one will also notice that, the global aim notwithstanding, for each schedule, or type of income, specific rules are prescribed. This again confirms, that a global pattern of income taxation rests on schedular underpinnings — an important finding which requires explanation, and deserves closer attention.

2.4. A first explanation could be inferred from the need to clearly and precisely spell out the obligations of the taxpayers.

Certainty has been a time — honored canon of taxation since the days of Adam Smith. While an orderly lay-out of tax rules is obviously required, this argument fails to explain why a great many legal regulations tend to be organized per type of income. If legal craftmanship were the overriding consideration, why not list and discuss, for example, the deductions in a single chapter, instead of having most of them linked to specific categories of income?

2.5. Alternatively, an explanation may be adstrued in terms of "administrative convenience". Each category of income has its own characteristics, as regards the opportunities and/or difficulties in accurately assessing the gross and net amounts of income. Taxation at the source, for example, can be applied to wages and salaries, and to dividends and interest payments, as well. Other categories of income are "hard to tax"; a recent paper on Colombia lists agricultural incomes and those accruing to self-employed professionals as particularly stubborn cases [2] — a state of affairs which is no monopoly of Colombia, but can be noticed, to a greater or lesser degree, in all countries. Given these congenital discrepancies in the degree, to which different categories of income are amenable to "wa-

1. Author's translation. Some terms cannot be quite accurately translated into English. Thus, what we have called aggregate income, as an equivalent for "onzuiver inkomen", stands for the sum of net incomes in the various categories, before some deductions are allowed against that sum total. We have also translated "opbrengst" by "income", although, as discussed in the post-script on Semantics, the term "opbrengst" carries a slightly different connotation.

2. *Federico J. Herschel* "Taxation of Agriculture and Hard-to-Tax Groups" in "Fiscal Reform for Colombia", Final Report and Staff Papers of the Colombian Commission on Tax Reform, Richard A. Musgrave, President; edited by Malcolm Gillis Harvard Law School, 1971, p. 301-330.

tertight" assessment, the need to spell out specific assessment rules, per category, appears unavoidable. Such rules are intended either to strengthen the powers of the tax authorities, or to define more indulgent methods of reaching some types of incomes. In many countries for example, small businesses are assessed not according to their actual, and accurately declared incomes, but by way of presumptive methods, such as the *forfaits,* which infers a notional or average amount of income from some incomplete information given by the taxpayer or from rudimentary economic and financial indicators. The "administrative convenience" thesis, however, while rightly emphasizing the need for adapting the assessment methods to the characteristics of each category of income, is not entirely convincing. As a matter of fact, in some highly developed economies with rather comparatively stringent standards of tax discipline, as in the United States and the Netherlands, the assessment methods with respect to agriculture and self-employed professionals have become largely similar. Furthermore, more lenient assessment methods, such as the forfait procedures, tend to be restricted to taxpayers of modest means, while taxpayers exceeding a given amount of income, within the same schedule, are usually subjected to tighter disclosure and assessment standards.

2.6. The fundamental reasons why the global-tax system constitutes, so to say, a "superstructure" of an initially given schedular "infrastructure" transcend the administrative aspects of taxation. They relate to the basic economic fact that the inputs, that are combined in the production process, belong to different persons and that income taxation only makes sense when predicated on a net income concept.

2.7. The combination of inputs that belong to different people, has become an all-pervasive feature of modern production. Only in primitive societies can production processes be visualized, that are entirely sustained by inputs of labor and real capital, supplied by the producers' family itself. But such units, say, in subsistence agriculture, are doomed to remain at very low levels of productivity. Income taxes hit income, but are due by taxpayers. Hence, tax assessment requires not only the segregation of the various inputs that concur in a given production process — i.e. the functional distribution viewpoint — but also the identification of those to whom the factor services belong — i.e. the personal distribution angle. The gross receipts that originate within an enterprise must be apportioned amongst the persons, that have supplied the inputs. Contractual determination of the prices of the inputs greatly facilitates this imputation.

2.8. Each taxpayer is also entitled to deduct from his gross receipts, the outlays incurred in order to earn such income. If the income tax were not based on a net concept, the same income would be taxed twice, both with the payer and the payee of the income, although the production costs paid by one taxpayer constitute receipts for another person. For example, the gross receipts that accrue to a big Company, are predominantly used up for payments to the suppliers of inputs, such as labor services, raw materials, financial capital. Corporate net income, i.e. the profits (before taxes) typically appear as a comparatively small portion of the gross receipts. Basing income taxation on a gross concept, would violate the essence of the income tax. A netted-out taxable base as also a prerequisite to achieve an equitable distribution of the income tax burden. Only net income represents purchasing power to the taxpayer, indeed. Besides, as the ratio of production costs to gross income differs among taxpayers, such costs should be deductible, in order to avoid inter-personal inequities.

2.9. It follows that the schedular specification of net taxable income cannot be avoided within a global income tax system. The remunerations for the inputs supplied in the production process to the economic agents, are the original building stones, that are required to systematize an income tax system. Each of those incomes derives from a distinct source of income. Besides, it presents specific possibilities and/or constraints with respect to its assessment.

2.10. Hence, there exists a *first-stage concordance* between schedular and global income tax systems, in the sense that both require the "analysis" or identification of (partial) incomes, that may accrue to a given taxpayer. Once those partial incomes have been identified, however, the two income tax systems part ways and display a *second-stage dissimilarity*. According to what we might call the "schedular principle" — or, at the cost of a neologism, the "compartimentalization principle" — each of the various types of income is assessed separately and subjected to the rate set in the corresponding schedule. When the "global" — or "aggregation principle" — prevails, the assessment proceeds with a "synthesis" of the primary schedular incomes and subjects their sum total to a single progressive rate scheme. As noticed by Neumark, "In contrast to the (partial) incomes (German: "Erträge") of which it is composed, (total) income has no objective but only an accounting existence" (our translation).[3]

RATIONAL ARCHETYPES AND EMPIRICAL PHENOTYPES

3.1. The question arises immediately whether the compartimentalization or the aggregative principle implies that different fiscal techniques be used when organizing the main segments of the income tax law, such as the defining the taxpaying unit, fixing the applicable rates, or allowing deductions.

A casual look at actual tax statutes, of schedular or global make, reveal that such differences do exist, indeed. For that matter, they are also discernible when the technical features of two "floors" of a mixed system are compared.

Without, at this stage of the research, delving into a detailed analysis of the tax design implications of the schedular or global principles, two well-known logical consequences are worth mentioning, by way of example.

- The progressivity principle has been extolled in public finance theory as the suitable means to distribute income tax burdens according to the "ability to pay" (taxes) of the various taxpaying units.[4] Now, all incomes, from whatever source derived, constitute purchasing power. It follows that a set of progressive rates can only be applied in a rational way i.e. without entailing built-in inconsistencies, within a global-type income tax. Conversely, in a schedular system, progressive rates are inappropriate.
- Global-type systems also typically allow the deduction of expenses that are not in-

3. Author's translation. *Fritz Neumark* "Theorie und Praxis der modernen Einkommensbesteuerung", Bern, 1947, p. 35.
4. In the view of most scholars, the "ability-to-pay" only makes sense for individuals, not for corporations.

curred with a view to obtaining income. The rationale underlying the deductibility of those non-business expenses is that some subgroups of taxpayers may be saddled with compelling outlays that reduce their well-being and their ability-to-pay. Tax reductions for dependents are a case in point. Tying such non-business deductions to a category of partial income contain a schedular system, however, is not appropriate.

3.2. For purposes of analysis, it may be enlightening to distinguish between rational archetypes or prototypes of income taxation and empirical phenotypes. A *rational* income tax system could be defined as one on which the various technical features are consistent with each other and do not transgress the canons, that derive from either the basic schedular or global principle.

This does not necessarily mean that two actual tax systems, even if they basically belong to the same, schedular or global family, are identical. As a matter of fact, many technical features found in two countries with, say, a global system, may be quite different. Besides, historical or empirical phenotypes also diverge, sometimes often substantially, from their theoretical prototypes, in the sense that techniques may be used that conflict with strict tax-design rationality. Both propositions deserve some comment.

3.3. Variety of tax parameters between countries that have adopted the same frame of income taxation, is, of course, unavoidable as each tax jurisdiction has its own preference scale with respect to such matters as the degree of steepness of a set of progressive rates, or the cut-off point below which incomes are left untaxed. Besides, the variety of empirical tax systems is also due to the fact that frequently the implementation of a given tax canon, such as the "ability to pay principle" through, for example, the granting of non-business deductions, can be achieved by way of alternative techniques, none of which conflicts with the ability to pay criterion. For a given taxpayer, it is not indifferent whether the alleviation of tax liabilities on account of dependents is given in the form of (a) "splitting" the global tax base by factor 2, or in other words taxing somebody with a net income of $ 1000 twice on $ 500 — a practice used in France and in some African countries; (b) the removal (deduction) of an given sum ("allowance") from the income tax base (c) the so-called credit-against-tax mechanism, whereby the benefit is granted by way of deducting a given percentage from the tax liability. The precise impact on the taxpayer's liability between the three methods depends, of course, on the actual average and marginal tax rate curves. None of these three methods, however transgresses the basic canon of global-type income taxation. They can be practiced without causing structural inconsistencies.

3.4. There are, however, numerous cases where techniques used in empirical phenotypes do conflict with precepts that follow organically from the basic principles embodied in schedular or global systems.

Thus, in most schedular systems, labor incomes, both from wage-earners and self-employed persons, tend to benefit from non-business deductions whereas, according to strictly schedular logic, such deductions should only be applied once all incomes are subsumed within a single, global tax base.

Also, in several Latin American countries, as in Panama, corporate profits are subject to a set of progressive rates, although it can easily be demonstrated that, both in a rational schedular and global system, a proportional rate should prevail.

Furthermore, in almost all empirical global systems one notices a great many instances whereby particular types of income, such as interest on government bonds, are exempted or are taxed separately from the global tax base, and at lower rates. In actual fact, those lapses from the intended comprehensiveness of the taxable base, insert schedular elements in the global — type tax.

The comprehensive reach of the global tax is further usually weakened by numerous exemptions or tax rebates that are granted for particular uses of income, such as incentives accorded to specified channels of savings or investments.

As a curiosity, one may also mention that in India, owing to the constitutional apportionment of taxing powers within a federal state, taxes on agricultural incomes belong to the domain of the states. This feature introduces a distinctly schedular element in the income tax system. As a matter of fact, incomes from agricultural activities are separately assessed in each state, whereas other incomes are subjected to an all-India global tax, enacted by the Central Government.[5]

3.5. Thus, empirical systems display a large degree of variety and many instances of structural "impurities". A comparison with architectural styles comes to mind, almost spontaneously.

Anybody, somewhat acquainted with architecture, is able to recognize a gothic cathedral from a romanesque one. The pointed arch, which is the main characteristic of the Gothic frame, largely determines other general features of Gothic cathedrals, such as the shape of the windows, the use of "flying buttresses" to reduce the pressure on the nave vaults etc. Only conformity with the standards of the gothic architecture allows esthetic "purity" and excellence. Yet, none of the famous cathedrals in Northern France is identical. Each of them has its specific details and displays its own individuality. Spanish Gothic will also show its particularities as compared with French Gothic, were it only because environmental factors, such as the intensity of outside light, differ in Spain and in the North of France. There are also cases where the original stylistic purity of a cathedral has been impaired by later additions or transformations, that were cast in another architectural style; the Abbey Church of the Mont Saint Michel, in Normandy, may serve as an example. This composite style, while not pure, may be acceptable from an esthetic viewpoint, provided in each of the constituent parts the canons of their respective styles are respected.

3.6. Like cathedrals, tax systems are evolving over decades. New tax canons are emerging. Once they have gained acceptance, they give rise to modifications of the existing tax system; thus, the recognition of the "ability to pay", principle in the second half of the 19th century, has given strong impetus to the adoption of the global-type system. In several countries, the existing schedular system has been wholly substituted by a global one; in other cases, however, remnants of the old systems

5. The 1973-1974 Budget, following recommendations of a Committee headed by K. N. Raj, has enacted a partial integration. The agricultural incomes at the State level are henceforth added to the federal income tax base, for purposes of computing tax liabilities on the latter.

have remained in place, even at the cost of some structural "impurities" in the newly adopted systems. Tax reforms seldom involve a complete break with the previous systems, indeed; they tend to be evolutionary, rather than revolutionary.

RATE DISCRIMINATIONS AND OTHER DIFFERENTIATIONS OF INCOME TAX BURDENS LIABILITIES

4.1. The schedular and global prototypes of income taxation diverge fundamentally inasfar the originally given (partial) incomes are subjected to separate tax rates in the former, but are aggregated and subjected to a single tax rate in the global tax system. In the public finance literature, the rate differentiation within the schedular systems is predicated on the doctrine of the "qualitative discrimination", towards which Italian writers have probably contributed most. This doctrine holds, in essence, that net income from capital should be taxed more severely than income from labor, of equal amount. An intermediate position is assigned to mixed incomes, i.e. those that derive from the joint input of labor and capital. In other words, according to the "qualitative discrimination" theory, the nature or "source" of income, not its size, is the main determinant of tax rate differentiation.

4.2. However, in actual fact, apart from overt rate discrimination, there are other factors that may vary the tax burden on different categories of income of same amount. As the various types of income coincide to a large extent with distinct socioeconomic sectors, in any realistic analysis of income tax burdens, such concealed, non-rate differentiations should also be heeded, although they may not be easily amenable to quantification.

4.3. Income tax burdens would be equitably and rationally distributed among taxpaying units and socio-economic groups, if the tax base, intended by law, were also effectively subjected to income taxation, at the statutory rates. This however, is, not the case as empirical tax systems are frequently affected by a large degree of underassessment, i.e. by a large shortfall of the effectively taxed base as compared to the statutory tax base. Besides, one should specify what is meant by "intended by law".

4.4. As a matter of fact, various factors narrow down the tax base. They can be properly systematized as follows:

(a) The most comprehensive definition of income may be called the *economic income.* In macro-economic terms, it is tantamount to national income. As applied to the individual taxpayer, the income which, theoretically can be considered as taxable, consists of (i) amounts of income received from other persons, (ii) the imputed value of consumption, enjoyed by the taxpayer and (iii) the appreciation in the value of capital assets — reduced to a net basis, i.e. the expenses incurred to obtain these components of gross income having been duly deducted.

(b) The above description of taxable individual income conforms to the well-known "accretion theory", already propounded by G. van Schanz in 1891 and later revisited by H. Simons.[6] However, *taxable or statutory income,* as we may call the reach of income which the tax law re-

6. Amongst the theoretical literature on the definition of taxable income, which is of enormous size, *Henry Simons*, "Personal Income Taxation. The Definition of Income as a Problem of Fiscal Policy", Chicago, 1939, still holds a high grade.

cognizes as subject to taxation, falls considerably short of the economic income, defined above. Four sources of "leakage" can be identified:

— First, even the staunchest supporters of the accretion theory, have been forced to recognize that comprehensive, effective taxation of the various ingredients of income, according to that theory, cannot possibly be achieved. Amongst the obstacles in the realm of capital gains, imposition of purely nominal appreciation is not recommendable, on practical grounds. Besides, attempts at specifying imputed income, run into conceptual difficulties, as the borderline between gainful activities and leisure is often quite tenuous.

— Some items of income or classes of income earners may be altogether exempted from taxation. In a great many countries interest from government bonds is statutorily exempt. Exemptions of persons whose net income does not exceed a specified, low level, are also a familar feature of income taxation. This exemption however, rests on solid equity and administrative considerations.

— One series of deductions account for outlays which are unavoidable for given taxpayers and which reduce their disposable income and accordingly, their ability to pay.

— Another category of deductions or exemptions aims at directing the spending of income towards privileged channels. The lavish "incentive laws" which many countries have enacted in order to attract foreign and domestic investment, are the most conspicuous examples. They mainly cater to big companies. But, tax statutes also frequently provide tax reductions for specified investments in financial assets or for charitable distributions. One should notice that this category of deductions or exemptions does not predicate upon equity considerations, but intends to bring about some preferred allocation of resources.

(c) The *effectively taxed income,* which is in fact the only yardstick that is appropriate in analyzing the actual impact of income taxes, in most countries, is considerably narrower than the statutory or taxable income norm. This gap is attributable to two main factors:

— In view of the administrative difficulties which a watertight assessment would encounter and the degree of irritating and costly controls that would be involved, the tax authorities may be content with applying a more simple method of assessment, such as the forfait procedures, even if the latter imply some degree of deliberate underassessment of taxable income.

— A second source of the shortfall against statutory income consists in unchecked underreporting and tax evasion by the taxpayers. In principle, and abstracting from the case of tax avoidance, which is pursued througd legal means, tax evasion can only be succesfully practiced to the extent the Fisc is unable to thwart evasion and is to be blamed for its inefficient tax administration. Needless to say, however, the extent of evasion and underreporting, as some analyses have indicated, is interwoven with more subtle factors such as public attitudes towards taxation or the quality of tax administration, that differ greatly among countries.

4.5. Some of the deductions or exemptions, that scale down the effective reach of income taxation, are benefitting well-defined types of income and/or socio-economic groups and can be ascertained in a clear-cut way. From the widespread statutory under-assessment of the agricultural sector (by way of forfait systems, or outright exemptions on large subsectors) one can infer that the allocation of taxpayer's resources will be somewhat biased, other things being equal, towards agriculture. Other tax benefits, such as charitable contributions, are not unequivocally linked to a single socio-economic group.

4.6. In our view, the analysis of differentiations in tax burdens among individuals and among social groups, that derive from the factors, just mentioned, is of paramount importance in any endeavour to assess the comparative merits and drawbacks of schedular, global and composite systems of income taxation. In schedular-type systems, to the extent the tax schedules correspond to well-defined groups, such differentiation is openly aimed at and is clearly visible. In global taxes, on the other hand, with their emphasis on the "vertical" distribution of tax burdens along the income pyramid, the "horizontal distribution" among socio-economic groups may, at first glance, appear to be of no relevance. This opinion, however, is not warranted. To the extent the underreporting and the various deductions have a differential impact on socio-economic groups, the widely acclaimed equitable distribution of tax burdens, which is attributed to the global systems, on account of the use of progressive rates on net statutory income, may become illusory or grossly distorted, at least.

A SYMBOLIC PRESENTATION OF THE SCHEDULAR AND GLOBAL INCOME TAX FUNCTION

5.1. A symbolic presentation of the topics, analyzed so far, may facilitate understanding. It may also afford some building stones towards a formal model, although no such exercise is attempted in this paper. Two sets of equations are given here, viz. the tax functions of schedular and global income taxes and equations that allow to specify (and, theoretically, in empirical exercises, to measure) the impact of various leakages that effectively narrow down the reach of the income tax. We thereby assume that there are three types of income and that a distinct socio-economic group can, by and large, be identified with each of those sources of income.

5.2. The following *symbols* are used:

- L, P, R : partial net incomes, arising from three sources of income, that accrue to the same taxpaying unit, say labor income, profits and rent.
- S : the sum total of those incomes, or $S = L+P+R$.
- t_L, t_P, t_R : the nominal flat-rate parameters, applied in each of the categories in a schedular system.
- t^a_S : accordingly, this symbol represents the average tax rate on total income. This rate derives either from the impact of progressivity in a global system; out of the differentiated rates in a schedular system, a weighted average rate can also be derived.
- $t^m \dots t^a$: the m and a superscripts to the tax rate parameters, indicate resp. the marginal and average tax on taxable income, used according to the circumstances, in a schedular or a global frame. Subscripts indicate the schedule or global base, on which the average

or marginal tax is applied.

— T_L, T_P, T_R: the tax liability in each of the schedules of a schedular system.

— T_S : the tax liability on total income, either in a schedular or a global frame.

5.3. In a *schedular* system, the tax function can be written as:

$$T_S = T_L + T_P + T_R = t^a_S S$$

$$\text{and } t^a_S = \frac{t_L L + t_P P + t_R R}{L + P + R}$$

whereby, for each of the schedules, $t^m = t^a$, indicating the use of flat rates.

5.4. In a *global* system, the tax function becomes:

$$T_S = t^a_S . S \quad \text{or } T_S = t^a_S (A+B+C)$$

whereby $t^m_S > t^a_S$; indicating the use of progressive rates.

5.5. The above functions or definitions, however, do not specify which definitions of income are used. Does S, and hence its components L, P and R stand for economic, statutory or effectively taxed income? This depends on the viewpoint adopted. For purposes of assessing the actual impact of income taxation on individuals and social groups, only the effectively taxed base yields realistic results. In order to devise tax policy, however, a normative reference frame is generally necessary. The tax base, and hence, the tax revenue lost on account of inefficient tax administration and underreporting is a major concern of tax authorities. They may also deem that statutory exemptions and deductions are being granted too generously. The above functions allow, by way of specifying more clearly the meaning of the S (L, P, R) symbols and through the insertion of coefficients, to picture the leakages, i.e. the gaps between the actually taxed base (or actual revenue) and the base (or yield) that should have been reached. It is important, however, when looking normatively at income tax performances, to explicitly state which criteria are being adopted. In our view, it is clearly inappropriate to evaluate performance with reference to the "economic income" standard, as, for various reasons, the theoretically maximum reach of income taxation cannot be achieved in practice. Statutory income, therefore, appears, generally speaking, as a more appropriate yardstick, although some of the statutory exemptions, deductions etc. granted may not stand up well on their own merits.

5.6. By way of example, let us incorporate two coefficients α and β which express the impact of deliberate underassessment (by the Fisc) and of underreporting (by the taxpayers). As suggested above, S (L, P, R) represent statutorily taxable income. We can then rewrite the effective schedular income tax function as follows:

$$T_S = (1 - \alpha_L)(1 - \beta_L) T_L + (1 - \alpha_P) \times (1 - \beta_P) T_P + (1 - \alpha_R)(1 - \beta_R) T_R$$

Other variations can, of course, be adstrued. One should also notice that the above functions can be used, either as regards a single taxpayer, or for the whole income tax paying population.

GEOGRAPHICAL SPREAD: AN OVERVIEW

6.1. How are the three types of income taxation distributed across the globe? The following overview summarizes the actual situation and recent trends as well. No attempt is made, however, to exhaustively list the countries; those mentioned merely serve as examples. Centrally-planned economies are thereby disregarded, as the income tax in such countries is of limited importance and is essentially restricted to a wage tax.

6.2. As a first generalization, it should be mentioned that schedular income taxes, as such, exist almost nowhere. Only a few examples could be mentioned, such as Zaire, Ruanda and Burundi. Usually, the set of schedular taxes is capped by a complementary, global-type tax, although, as already mentioned, the schedular layer is generally by far the predominant element of the composite income tax. The complementary tax, in many instances, has been added, at a later stage.

— In most high-income, developed countries, the income tax is at present molded in a global cast. In those countries there has definitely been an tendency to substitute, wherever relevant, a global income tax frame for a mixed system. Thus, in France (1962) and in Belgium (1963), although in both countries, the architecture of the new system cannot be labeled as an unqualified global system. In Italy, an official commission recommended the shift from a mixed towards a global tax, already in the early 1960's, but that change was implemented only in 1974. The so-called Neumark Report (1962) commissioned by the EEC, did recommend the use of global systems in all EEC-countries, and apparently strengthened the case for a global system, although the Commission did not enact formal directives on this score. Another Southern European country, at an intermediate level of development, viz. Spain also substituted a global tax system for a rather primitive mixed system (1964).

— The long-standing dichotomy between European countries with a mixed and those with a global income tax, that was only resolved in recent years, suggests a link with distinct cultural patterns. Whereas Germanic countries (Prussia in 1891, and the Netherlands in 1914) and Great Britain (already in 1802) introduced income taxation directly in global form, the mixed systems (usually preceded by a more or less complete set of schedular systems) have been typical of Latin countries (France, Italy, Spain) and Belgium — where, despite ethnic duality, French influence has been rampant.

In low-income, developing countries, however, mixed-type systems are widespread. They are typically found in Latin America and in French-speaking Africa. In Africa, the mixed system, introduced by the metropolitan powers in their colonies were generally maintained after independence. In Latin America, the link has been less directly of a political nature, but reflects strong cultural influences, emanating from either the French or the Spanish legislations. In some countries of the Middle East or of South East Asia that were open to strong French political or cultural influences, mixed-type income taxes are also still in use. The prevalence of "cultural style" [7] in tax matters is the more striking if one considers that global-type income taxes prevail in countries that were once British colonies. Hence, countries, as dissimilar as Ghana and India have global

7. *Harley H. Hinrichs* in his "A General Theory of Tax Structure Change during Economic Development", Harvard Law School, 1966 recognizes cultural style as a determinant of tax structure change.

types of income taxation, whereas countries like Brazil and Senegal are both adhering to the mixed frame.

— In recent years, the shift from mixed to global-type systems appears to have gained some momentum in the developing world, as exemplified by legislative changes in the Congo-Brazaville, and in Peru, whereas to our knowledge no reverse sequence, from a global to a schedular or mixed frame, can be mentioned. It is difficult to foresee whether the change-over to a global system will develop into a more general trend. The moves that have occurred may be due to rather random factors, such as the prevalence of tax advisers of Anglosaxon background; amongst the latter, the superiority of global over mixed or schedular systems, in terms of their suitability as an instrument of tax policy, has generally been taken for granted.

A POSTSCRIPT ON SEMANTICS

7.1. *Semantics:* the expressions "schedular" and "global" (income taxes) are not familiar in Anglosaxon public finance literature, although several well-known scholars occasionally use these terms.[8]

In Western Europe, and more particularly in countries where schedular taxes have been in use, the pair of terms "schedular and global", naturally, have been trademark jargon in the tax literature. Several authors, especially in Italy and the Netherlands, however, have adopted the expressions "analytical" and "synthetic" as equivalents to "schedular" and "global" (income taxes).[9]

7.2. One further semantic issue is worth mentioning. There has been in Germany a fairly consistent tradition to contrast the "income tax" ("Einkommensteuer") with "Ertragsteuern". The latter expression can, at best, be translated into "taxes on produce". Ertragsteuern are then stylized as a set of taxes on (partial) incomes, that originate from the social production process, and whereby, in designing those taxes, no features are inserted that "personalize" the tax liabilities according to the "ability to pay" canon. In other words, "Ertragsteuern" are strictly "objective" taxes, that are contrasted with the "personalized" income tax, in which not only the taxable object but also the economic circumstances of the taxable subject are of great importance. In that scholarly tradition, schedular taxes refer to the empirical phenotypes of Ertragsteuern, which have become tainted by personalizing features and hence, are morphologically impure. It is worthwhile to note that in the landmark 1946 study of Prof. F. Neumark on income taxation, already mentioned, and in the 1962 Report of EEC-Experts, headed by the same scholar, only global taxes appear to deserve the qualification of "income taxes".[10]

7.3. Such conception, however, in our view, appears unjustified. A schedular tax, even if it would display the strictly objective features, postulated by the prototype

8. Examples are found with *Albert G. Hart* "Fiscal Policy in Latin America", Journal of Political Economy, 1970, who writes the word as "cedular" and with *Carl S. Shoup* in "Public Finance", Chicago 1969, p. 291-292. However, we do not share the rather confusing interpretation given by Shoup to "schedular and quasi-schedular" which is based more on coverage than on structural characteristics.

9. Such as *P. J. A. Adriani,* in the Netherlands and *Cesare Cosciani,* in Italy *Luigi Einaudi* spoke about "imposizione reale" and "imposizione personale".

10. "Rapport du Comité Fiscal et Financier", 1962.

of "Ertragsteuern" is a tax on a given type of income, deriving from a specified source.[11] Besides, the co-ordinated juxtaposition of various schedular taxes, each on a particular type of income, results in a system, whereby all major types of income are effectively subjected to taxation, albeit as separate objects. Finally, as stressed above, the taxable basis of a global *income* tax is, of necessity, composed of the various original *incomes*.

11. The systematization of two contrasting prototypes, the (global) personalized income tax and the impersonal "Ertragsteuern" in the German tax literature, may be linked to the availability in Germanic languages, of words that allow to express both the impersonal and the partial character of income, arising from a specified source. The word "Einkunft", in German (and "inkomst" in Dutch) carries those connotations. No such full-fledged equivalents exist in English and in Latin languages and only paraphrases as "partial" income or "income*s*" convey the same meaning.

LUC DE WULF *:

THE TAXE CONJONCTURELLE: CAN IT WORK?

The March 1975 issue of this Bulletin gave a detailed description of the taxe conjoncturelle and its legal provisions.[1] Other publications have also discussed this new levy, yet, no discussion on its impact on inflation has thus far been presented.[2] It is the purpose of this paper to discuss several of the channels through which this levy may influence the rate of inflation. The novelty of this levy, that is neither a value added tax nor a profit tax, warrants such an inquiry. The fact that the implementation of this levy was postponed for the first six months of 1975 and may be removed altogether from the fiscal apparatus available to the French authorities, does not lessen its appeal as an instrument in the fight against inflation.[3]

1. THE TAXE CONJONCTURELLE IN BRIEF

The taxe conjoncturelle was initially presented as a measure that would gradually replace other, more global anti-inflation policies, but was later discussed as a fiscal instrument that would support these other anti-inflation policies. A brief reminder of the essential aspects of the taxe conjoncturelle is given below. For details we refer to the Berg and Tron article in this Bulletin, March 1975. The base of the taxe conjoncturelle (or margin) for a business is determined by the level by which the value added of an enterprise exceeds last year's value added by more than a permitted percentage or "norm". As value added includes labor and capital costs, an adjustment is made for the difference in labor and capital assets utilized in both years. Exports are excluded from the base. The "norm" exempts from taxation an increase in the value added that is attributable to an average level of productivity gain and an unavoidable increase in the price level.

Beyond an average productivity gain that is assumed to prevail in all sectors of the economy, the firm is permitted to adjust for above-the-"norm" productivity gains, and for wage and salary increases that are beyond the employer's control. This "norm" is established annually, and for 1975 is set as 14.3 per cent (9.7 per cent "built-in" inflation combined with a 4.2 per cent productivity gain).

To compute the base for the calculation of the levy for any given year, the firm must calculate the difference between the value added of that year, and the value added in the previous year to which 5 per cent of the wages paid to workers who earn less than 120 per cent of the minimum wage, is added. The rate retained for the levy is 33⅓ per cent. The revenue of the prélèvement remains the property of the firms, and must be reimbursed when the application of the law is discontinued. These

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1. *Roger E. Berg and Jean-Michel Tron,* "France: The Taxe Conjoncturelle", *Bulletin for International Fiscal Documentation* Vol. 29 (March 1975): 105-116. Although a reimbursable levy, this "prélèvement conjoncturel" is, for expositional purposes, often referred to as a tax.
2. To be fair I should mention a very brief discussion in *R. Torrel,* "La Taxe Conjoncturelle," *Revue du Science Financière,* 67 (January-March 1975): 226-32.
3. The 1976 Budget proposes its reintroduction.

funds must, however, be invested in the firm within a two-year period after reimbursement. The repeal of the prélèvement conjoncturel is automatic when the quarterly increase of the price index for industrial products falls below 1.5 per cent. The new tax liability must be paid in quarterly instalments and is not deductible in computing the corporation profit tax.

The prélèvement conjoncturel applies to (a) commercial enterprises with a turnover in excess of FF 30 million, or in excess of FF 10 million if employing more than 150 people; (b) other firms with a turnover in excess of FF 8 million, or in excess of FF 3 million if employing more than 150 people; and (c) firms that engage in both commercial and non-commercial activities for which special limits are set. This tax also applies to the banking sector and other financial institutions. However, due to their special nature, a separate set of tax provisions applies to them. These provisions will not be discussed in this paper. It is estimated that only about 14,600 firms out of a total of 1.7 million will be affected by the new tax.

2. ITS EFFECT ON INFLATION

An investigation into the price effects of the prélèvement should consider whether this levy is likely to bring down prices below the level they would have reached in its absence. Therefore, one would ideally like to isolate the effects of the anti-inflation tax from other effects on the price level. Such an analysis supposes a general equilibrium model covering all the factors influencing the price level. In the absence of such a model, we will present some tentative conclusions by using a partial analysis and drawing on the existing incidence theory and its relevance to the prélèvement conjoncturel.

For the purpose of this analysis, the prélèvement will, despite its reimbursable nature, be considered to have the features of a regular tax. As the revenues of the prélèvement are only reimbursable in some uncertain future when their purchasing value may be considerably eroded by inflation, and must be reinvested within a two-year period, such a simplification seems warranted and does not alter its basic features.[4] The analysis also ignores exports.[5] Although useful, these adjustments do not appear essential in understanding how the levy functions. A further simplification introduced here is that the base is assumed to be composed solely of profits and wages, while depreciation charges, also part of the tax bases, are ignored. These charges have been omitted from the analysis as they do not seem to be affected by the presently instituted prélèvement conjoncturel. This observation follows from the fact that firms would not reduce these charges below their legally permitted maximum as any such reduction would increase the corporate tax liability (at a rate of 50 per cent) without reducing the firm's tax liability under the prélèvement conjoncturel.

A priori knowledge of the forces that determine prices indicates that the price effects of the new tax will depend on the kind of market structure within which the firm operates. Therefore, attention must be paid to these different market structures. As textbooks tell us, the two extreme

4. The present value of the amounts levied away could, in theory, be ascertained by discounting the expected reimbursement. The data for such an exercise are hypothetical and the present analysis would not gain much by it.

5. This measure does not purport to stimulate exports, but recognizes the fact that export prices are determined on the international market, and that a firm should not be penalized for selling at these prices.

market structures are pure monopoly and perfect competition. The monopolist sets his output so as to equate his marginal cost and revenue, and in the process obtains the profit maximizing price. The perfect competitor, one among many producers that sell identical products and face a perfectly elastic demand curve, is a price taker, and in the long-run realizes only a normal profit on his own inputs. A detailed analysis of the price behavior of these two producers could be made, but would tend to be a purely academic exercise with little bearing on the probable price effects of the new tax within the French context. Only about 14,600 out of 1.7 million firms will fall within the scope of the tax; these firms account for about 45 per cent of the wage employment and most of them are neither the pure competitors nor the textbook monopolists, but rather suppliers of differentiated products that are sold under imperfect competitive conditions. The implications of the oligopolistic price formation models are, therefore, likely to be more informative than the others.

The introduction of the levy is likely to affect the output price of the firm that is liable to it, in two ways. First, in wage discussions with labor unions management will take into account the eventual payment of the levy. This may keep the wage increase below what it would have been in the absence of the levy.

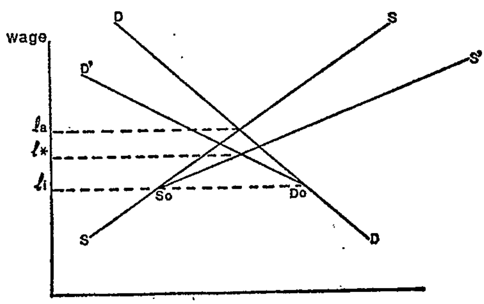
Second, the liability due under the levy will tend to be included in costs and will exercise an upward pressure on prices (forward shifting of the tax).

The net effect of these two factors, one of which would increase the price level, while the other would decrease it, will depend on several factors, the more important among which are the norm of the levy, and levy liability, the elasticity of demand for the product, the labor intensity of the production process, and the particular business outlook at the moment the labor negotiations are undertaken.

a. *Influence of the levy on wage settlements*

To organize our ideas on the effects of the taxe conjoncturelle on wage settlements it may be useful to have before us a simplified model of wage determination. In that model we will determine the general wage level as the point of intersection between (a) the wage settlement supply curve, and (b) the wage settlement demand curve. In graph I, we plotted the employer's wage settlement supply curve as SS. The positive slope of this curve follows from the fact that the employer will agree to grant relatively higher wage increases only when the costs that he expects to result from work stoppage (threatened or used as a bargaining tool by unions) increase. The work stoppage is measured on the horizontal axis.[6]

Graph I - Wage Determination Model



Expected or threatened time of work stoppage in the absence of a settlement

6. This model is similar to the one used by *H. Wallich and S. Weintraub*, "A Tax Based Incomes Policy", *The Journal of Economic Issues*, Vol. 5 (June 1971), pp. 1-19.

The DD curve represents the demand curve for wage settlements by the labor unions. Its slope depends on the trade-off between the cost of strikes and the acceptance of lower wage increases for the union members. The rate of substitution between these two variables is basically a function of the goals of the union and the constraints it must take into account. The demand elasticity facing the firm and the prevailing level of unemployment are two constraints that are often considered important. Without a more in depth analysis of the behavior of the union that faces the employer, there is not much that can be said about the slope of the DD curve, other than the fact that it is negative. The wage rate l_a is obtained at the intersection of the DD and the SS curves, and constitutes the wage rate that would prevail in the absence of the prélèvement conjoncturel.

The introduction of the anti-inflation levy affects both the DD and SS curve.[7] When wage rates reach a certain level, and the entrepreneur realizes that the firm will incur a liability under the new levy,[8] his resistance to further wage increases will stiffen. Using the wage determination model given in Graph I this can be represented by a shift of the SS curve for all wage rates above the level l_i; the magnitude of the shift increases with the tax rate that comes with the prélèvement conjoncturel. One may want to pursue the question as to whether something more specific can be said about the l_i wage level which depends very much on the employer-entrepreneur behavioral reactions. Two broad categories of such possible reactions can be outlined and are likely to embrace real world situations. As shown their implications are not necessarily very different.

First, there is the entrepreneur who, faced with a certain wage demand, attempts to hold constant the share of profits in value added. When wages increase by x per cent, he attempts to increase his profits by an identical rate. This would result in the new levy liability accruing as soon as wage settlements yield a wage in excess of last year's wage times the "norm" or l_n. When the entrepreneur succeeds in keeping his profits a constant share of total value added, we obtain $l_i = l_n$.[9] The incentive for profits to increase beyond the "norm" even when wages do so, will be effectively eliminated only when the rate of the prélèvement conjoncturel is 100 per cent (as was originally proposed). In this case, any increase of profits byond the "norm" would be confiscated and the net of tax profits cannot be increased beyond the "norm". With rates of less than 100 per cent, any increase in profits that the firm can realize will improve its net-of-tax-profits position even when the rate of increase of the before-tax-profits exceeds the "norm". The confiscatory rates, however, are unable to check the wage increases in a similar manner.

The *second* possible reaction of the employer who is faced with demands for

7. If the new levy is expected to be effective in checking wage increases, one would have expected some announcement effect in the sense that both unions and employees would have settled on more generous wage settlements before the enactment of the new legislation.

8. The level of the wages that will be viewed in this way depends also on the labor productivity gains realized in the firm.

9. The stability of the relative shares of value added that goes to employment remuneration and to profits has been well documented for several industrial countries; and hints to the fact that over longer periods wage increases are often followed by increases in profits (or vice versa, of course).

higher wages could stem from his attempts to keep constant the rate of return on invested capital. Wage rates beyond the "norm" would not, in this case, necessarily lead to the accrual of liability and to a stiffening of the employer's resistance to such wage increases, because a higher rate of wage increase could be combined with a lower rate of increase of profits. The wage increases permitted beyond the "norm" would depend on the relative share of wages and profits in value added. The lower the wage share in value added, the larger the permissible wage increase would be. This can be expressed as

$$l_i = (n \times \frac{VA}{W}) + 1$$ where VA is value added and W the wage bill. If, for instance, $\frac{VA}{W} = 2$ and $n = 15\%$, l_i would be 1.30; thus permitting wages to increase by 30 per cent over the previous year's level before any shift in the SS curve would occur. However, the employer may attempt to keep his real profits constant and thus attempt to increase his profits at the anticipated rate of inflation. The smaller the difference between the rate of inflation anticipated by the employer and the norm set by the government, the closer the l_i level will get to l_n. Where this difference is zero, ($l_i = l_n$) it can be seen that the employer's behavior would be identical to the one discussed in the previous paragraph.

The DD curve also can be expected to shift somewhat as a result of the introduction of the prélèvement conjoncturel. This shift is more difficult to interpret as it depends on the degree to which the wage stance of the union is affected by the probability that the liability of the levy will increase when wage settlements reach a certain level. If they do, their DDoD curve will shift downward at all wage levels exceeding that level. Whether this level is l_i or higher will depend on whether and with what intensity, the unions view the level of profits as just right or excessive. The level of wages at which the union will shift its demand for a wage settlement curve will be flatter in the former case than in the latter, since in the first case the union could insist that wage increases can easily be afforded by the firm if it only reduces its profits. A more specific model of union behavior is needed before more specific comments can be made with respect to this shift of the DD curve, but if it moves at all one can assume that it will be downwards. For expositional purposes the shift of the DD curve in Graph I was drawn so as to shift at the level l_i.

The intersection of de DDoD' and SSoS' curves determines a new wage level l^*. At this level of wage $l_a > l^* > l_i$. The degree of these differences can only be speculated upon, and depends on all the factors that determine the relative shifts of both the SS and the DD curves. The important conclusion drawn from the analysis above is that the introduction of the new levy will tend to lead to a wage increase that is somewhat below the level it would have reached in its absence.[10] As seen in Graph I, the time of work stoppage (threatened or actual) required to reach the new wage agreement can increase, decrease, or remain unchanged, depending on the relative shifts of the two curves.

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10. If $l_a < l_i$ then $l_a = l^*$ would result because the new tax would not have affected that portion of the DD and SS curves that are relevant for the wage determination.

b. *Forward shifting of the levy*

Some firms will incur a tax liability resulting from the taxe conjoncturelle. To gauge the impact of this extra cost on the prices charged by the business, we will take a closer look at the several price formulation mechanisms that may be typical for the type of firms that fall under the scope of the new levy. These firms tend to operate in an oligopolistic market, i.e., a market with few participant sellers who supply very similar goods and whose pricing decisions are interdependent. No generally valid theory of the oligopoly exists because the reactions of the competitors are so important in each firm's pricing strategy. The several models most frequently used in the study of oligopoly are based on different assumptions with respect to the competitors' reactions to the price and output decisions of the firm studied. Reference will be made here to the oligopoly models that come to be associated with the kinked demand curve, and with price leadership; finally there will be a comment on markup pricing.

The first oligopoly model is referred to as the "kinked demand curve". It analyzes the reaction of the demand curve to price changes of the product concerned. Starting from an equilibrium point where the producer supplies a share of the total market for that type of products we can visualize the reaction of the demand curve to a price change. An individual price increase would not automatically be followed by the competitors and would lead to a loss of customers who, at the new price would buy from the competitor. A price decrease would not attract many new customers, because the competitors would tend to protect their market share and would also lower their prices. Prices will be rather sticky at their present level as a result of this asymmetrical response of the competitors to a rise or fall in the price of the products of the firm. The demand curve facing the producer will be kinked at that level, with greater demand elasticity at prices above the original price level than for prices below it.

Small changes in the marginal cost curve of one firm will, in this model, not lead to price changes, but only result in higher or lower profits for the firm. But if the marginal cost curves of all the firms are shifted upwards, the situation becomes different, and rather than accepting lower profits they may all charge higher prices. Such a reaction to a cost increase would be reflected in an upward shift of the kink of the demand curve, with each producer supplying a slightly smaller output (because the demand curve facing the industry has a negative slope), while keeping its relative share of the market unchanged. The essential fact in ensuring such a price adjustment is that all rivals understand their interdependence, and realize that all are faced with this increase in costs.

Some price leadership may be needed to initiate this price adjustment, but basically all rivals are anxious to retain their eroded profit position by rising prices, a fact that reduces the risk involved by rising prices in the model considered here. Such behaviour is encouraged by an inflationary environment in which consumers put forth less resistance to price increases.

Wages are cost elements in the firms' operation accounts, and cost increases exercise pressures to increase prices. If the wage pressures are uniform for all competitors, which is the case where wages are settled industrywide, price increases are likely to follow. Now consider the impact of the prélèvement conjoncturel. The base of this levy consists of increases beyond the norm of wages and profits.[11] The oligopolists, given a wage increase beyond the "norm" can thus either lower their profits, and avoid the new liability, or can accept it and attempt to protect their profit position by increasing the price of their output to reflect both the increased wage costs and the impact of the prélèvement. Given their profit maximizing goal, they will attempt to pursue the latter alternative. As all oligopolistic competitors are basically in a similar position, and know it, prices will increase. The degree of this increase will be less than the per unit liability of the levy because the demand curve facing the industry is not a perfectly inelastic one; the forward shifted part of the levy will be larger the smaller this demand elasticity. This price increase will also depend on the rate of the prélèvement conjoncturel. That portion of its liability not reflected in higher prices will reduce the firm's profits.

A different oligopoly model can be based on price leadership which assumes that a price "leader", the one with the lowest marginal cost, sets the price so as to maximize his profits, forcing, so to speak, the other rivals to adjust their pricing to his behavior. As these rivals still make economic profits at that price level, they continue producing. The introduction of the prélèvement, and the ensuing tax liability will be seen by the leader as an increase in the cost of production. He will increase his price to reflect this new cost situation. The followers will adjust to this new price, even in a situation where they themselves are not liable to the levy as this brings them closer to their profit maximizing price. But, the elasticity of demand facing the industry is negative so that only smaller quantities can be sold at higher prices. The greater the demand elasticity, the less forward shifting of the liability of the levy will occur; but, because the demand curve facing the oligopolist is not infinitely elastic, some forward shifting will occur. The oligopolist will thus earn somewhat lower profits than in the absence of the new levy. The profits of the followers will be similarly affected to the extent that they also incur additional liability.

A third pricing approach that has relevancy within the framework of oligopolistic pricing is the "markup" pricing model. The typical firm in this model is assumed not to know its marginal cost curves, and prices its output at average cost plus a "markup". This "markup" is obtained from an informed guess of the market response to price changes; a guess that presupposes some knowledge of the elasticity of the demand curve facing the firm, and yields pricing and output policies that are very similar to those obtained by the use of marginal cost principles.

The application of "markup" to a new and higher average cost, that now includes the new levy, will lead to output prices that exceed the prices that would have been chosen in the absence of the prélèvement by more than the levy. However, the producer realizes that at higher prices he will sell less of this product, and may have to reduce his "markup" somewhat so as to limit the fall in his profits. In this model the levy may thus reduce profits, but certainly it leads to higher prices.

The several oligopolistic models seem to indicate that the sectors that incur some liability under the prélèvement conjoncturel will increase their prices, but that their

11. Plus depreciation charges, the variation of which does not offset the amounts due under the "prélèvement" but can only increase the corporation tax liability if these depreciation charges fall below the legal maximum.

profits may be reduced in the process. The magnitude of these results depends largely on the elasticity of the demand curve. The more elastic the demand curve, the lesser the amount of forward shifted tax, and the more the profits will be reduced below the level they would have reached in the absence of the levy.

c. *The net effect on the price level*

According to the analysis presented above two definite influences on the price level of the products sold by firms affected by the prélèvement conjoncturel were identified. The moderation in the increase in labor costs will tend to be reflected in lower price increases, while the new tax liability will create pressures for further price increases of the products sold by those firms that incur the levy. Given the complexity of the factors that influence both these tendencies, it is hard to offer more than generalizations with respect to their net effect on the price level.

Tightening up the provisions of the new levy, such as lowering the "norm" or increasing the levy, can be expected to affect the above-mentioned tendencies in opposite directions. A stiffer prélèvement will decrease wage settlements but will also increase the liability as soon as the firm becomes liable to this levy. But the impact of changes in the provisions of the levy on wage settlements is not necessarily continuous, as the shift in the demand for settlement curve may only occur once a certain threshold of liability is reached. In this case, prices may rise with a moderate levy, but their increase may be slowed down with a more rigorous one.

The effect of the new levy on the price level is not expected to be identical for all firms that fall within its scope because the elasticity of demand facing the different industries varies. Industries that face an inelastic demand curve will put up less resistance to wage increases, and thus have a steeper SS curve for wage settlements. This would reduce the levy's dampening effect on wage increases and ease its forward shifting.

With inelastic demand curves for a product it can be hypothesized that the demand for wage settlements will shift downward to a lesser degree, contributing to the small impact of the prélèvement conjoncturel on the new wage settlement. Industries that face an elastic demand curve, on the other hand, will be less inclined to accede to above-the-"norm" wage increases and have less of a possibility to shift the liability of the levy forward. Therefore, it can tentatively be said that the prélèvement conjoncturel may be successful in moderating prices in those industries that face an elastic demand curve, but that in the other industries price increases will be harder to check.

The analysis of the effect of the prélèvement conjoncturel on the price level indicates that the outcome depends largely on lowering wage increases and on shifting the ensuing liability of the levy. As industries differ in the degree to which they are labor intensive, it follows that they will be affected to varying degrees by the new fiscal measure, whether it leads to accelerating or decelerating price increases.

As indicated above, the introduction of the prélèvement conjoncturel tends to reduce the wage increases in the affected sectors. In France, only large firms fall within the scope of the levy; yet, they are the more advanced and most dynamic ones of the economy, so that one may expect that the wage settlements agreed upon in that sector will influence wage settlements in the other sectors of the economy. A lower growth rate of wages in the affected sector may thus lead to a nationwide slowdown of the wage increases, a spillover effect that should certainly be taken into account when the contribution of the new tax to the slowing down of inflation is evaluated.

3. FURTHER COMMENTS AND CONCLUSIONS

It thus appears that the success of the prélèvement conjoncturel depends on slowing down the growth rate of wages. While the new fiscal measure avoids singling out wages as being responsible for the inflationary trends presently experienced in France, its success nevertheless depends on an adjustment to be made with respect to wage increases. This conclusion did not escape the attention of opponents to the new levy, who, during the debate on the levy in the National Assembly, argued that the prélèvement conjoncturel is one more argument that may be used by the employers to oppose wage demands.[12] Although such pronouncements do not imply that the new measures will be succesful, they at least state the necessary conditions for its success.

The prélèvement may, under certain assumptions, slow down somewhat the increase in profits. Yet, such a reduction would only moderate the extra price increase, and would do nothing to bring the price increase below the level it would have reached in the absence of the new levy. Any fiscal measure that stops short of confiscating the increase in profits will not eliminate that increase, because such a levy still permits a firm to improve its net profit position by increasing profits beyond the "norm".

The provisions for the new levy differentiate between firms with higher than average productivity gains and those for which these gains are, for tax purposes, assumed to have reached the national average. Such a provision is consistent with the approach that productivity gains should benefit the factors of production directly engaged in the sector where these gains are realized. Yet, under present circumstances, it could have been expected that more attention would be paid to the position that productivity gains should lead to lower prices, thus benefitting the consumers.[13]

Any final evaluation of the anti-inflationary impact of the prélèvement conjoncturel will have to face the common economic problem of isolating the effects of an instrument that operates within a constantly changing environment. At the time of writing this paper, the rate of inflation in France is already slowing down somewhat. The arresting of price increases for crude oil, the absorption of previous oil price increases, and a general slack in the economies of the western world, are only some of the factors contributing to this trend. The operation of the prélèvement conjoncturel will be influenced by this economic environment. Its impact on wage settlements and on the firm's possibilities for forward shifting will probably affect the impact of the new levy on the price level.

Some administrative problems that will need to be solved in the process of administering the new levy also deserve some attention. As these problems are obvious, they will only be dealt with briefly. The statutes of the levy permit firms to request an exemption for increases in their value-added that exceeds the combination of the

12. AGEFI, "Le Débat à l'Assemblée Nationale sur le Prélèvement Conjoncturel, December 5, 1974, p. 2.

13. The original proposal would have granted a uniform productivity adjustment factor to all sectors, reflecting the option that the public at large should share some of the benefits of these productivity gains.

average productivity gains and the accepted price increase if they can prove that such increases are not the result of inflationary behaviour. While this seems a reasonable provision, it will give cause for serious disputes. It may well be that some index of productivity gains has been accepted for statistical purposes. However, it is one thing to prepare statistics for research and planning purposes, but quite another for firms to report on their productivity gains knowing that any response they give will affect their liability under the levy.[14] Furthermore, some guidelines will have to be issued on how to deal equitably with increases in value-added that result from an upward adjustment in wages that had remained unchanged for a longer period. Such guidelines are needed as, for instance, an increase of value-added that follows a 20 per cent increase in wages after a two-year interval, is clearly less objectionable than one that follows a similar wage increase after a one-year interval.

The new law provides that the base of the levy may be adjusted for increases in employment and for shifts in the skill composition of the labor force. While this last adjustment prevents the firm from reducing it liability by hiring lower skilled workers, (who in France are often non-nationals), it still allows the firm to reclassify job requirements and job descriptions in such a way as to achieve the same aim. Administrative attempts to eliminate this practice may turn out to be very cumbersome. An adjustment to exclude increases in value added that are due to an increase in the number of shifts may also be desirable because this may involve changes in amounts of premium pay for night work. While increases in labor costs due to these factors may be inflationary, they differ in kind from increases due to successful union demands for higher wage rates.

Perhaps it may be tempting to overlook these sources of potential inequity if the cost-push problem is recognized as a dangerous one. However, the popular support needed for the introduction and application of such a levy will quickly fade away if these inequities are too numerous. Income and price policies can rely on broad guidelines and anyway rely largely on public opinion and voluntary compliance. They are flexible enough to be adjusted for unusual circumstances and can thus avoid hardship. Much higher standards of objectivity and precision have traditionally been demanded of tax legislation. The resulting administrative burden should, therefore, come as no surprise.

14. The existence of such indices was referred to by Mr. *Lionel Stoleru* in his article in *Le Monde* (July 6, 1974), p. 25.

* * * DOCUMENTS * * *

C. E. E.

L'harmonisation de l'imposition des dividendes

Résolution de la Conférence Permanente des Chambres de Commerce et d'Industrie de la Communauté Européenne du 21 novembre 1975

LA CONFERENCE PERMANENTE DES CHAMBRES DE COMMERCE ET D'INDUSTRIE DE LA COMMUNAUTE ECONOMIQUE EUROPEENNE

a examiné de façon approfondie la proposition de directive concernant l'harmonisation des systèmes d'impôt des sociétés et des régimes de retenue à la source sur les dividendes.

Se référant à ses résolutions antérieures et en particulier celles:
— sur l'harmonisation de l'imposition des mouvements de capitaux, adoptée à Paris le 3 mai 1968,
— sur les objectifs et conditions du rapprochement des impôts directs dans les pays de la C.E.E., notamment en matière de mouvements de capitaux, de fusions et de prises de participations adoptée à Istanbul le 29 mai 1969,
— sur un programme d'harmonisation des impôts directs, propre à assurer le développement et l'intégration des marchés des capitaux dans la C.E.E., adoptée à Bruxelles le 27 novembre 1970,

et également à la lettre du 13 décembre 1972 sur le régime fiscal des dividendes et des revenus d'obligations adressée à M. Haferkamp, Vice-Président de la Commission des Communautés européennes, et à la lettre du 21 avril 1975 sur le rapprochement des législations fiscales à M. Ortoli, Président de la Commission des Communautés européennes,

SE FELICITE DE CETTE ETAPE DECISIVE D'HARMONISATION DES LEGISLATIONS FISCALES NATIONALES,

RAPPELLE EN EFFET

que les différences actuelles de taxation des dividendes
a) affectent les décisions d'implantation des investissements et de placement,
b) entraînent des phénomènes de doubles ou multiples „taxations internationales",
c) créent des discriminations selon la nationalité des actionnaires,
d) favorisent en infraction avec l'esprit communautaire le „bilatéralisme" dans les conventions fiscales internationales,
e) constituent une entrave à l'adoption d'une position commune à l'égard des pays tiers,
f) au total, aboutissent à cloisonner les marchés financiers,

SOUSCRIT PLEINEMENT AU PRINCIPE D'UNIFICATION DU TRAITEMENT FISCAL DES DIVIDENDES,

sans lequel il ne peut y avoir de développement et d'intégration des marchés des capitaux,

REAFFIRME EN OUTRE

que le système commun d'imposition doit aboutir à la suppression de la double imposition économique de façon à:

a) rétablir une certaine égalité dans le coût fiscal des différentes sources de financement de l'entreprise, la rémunération du capital étant actuellement pénalisée par le mécanisme de l'imposition successive dans le chef de la société (au titre de l'impôt sur les sociétés) et dans le chef de l'actionnaire (au titre de l'impôt sur le revenu),

b) „neutraliser" les préoccupations fiscales dans le choix de la forme juridique des entreprises, les sociétés de personnes bénéficiant d'une transparence fiscale qui les met à l'abri de la „double imposition économique",

c) encourager l'épargne à s'investir à long terme dans les entreprises, dont les besoins de financement ne cessent de croître,

d) élargir l'actionnariat grâce à une rémunération plus équitable des capitaux „risqués",

APPROUVE LE CHOIX EN FAVEUR DU MECANISME DE L'IMPUTATION

de préférence au système classique qui, certes, présente l'avantage de la simplicité et se heurte à moins de difficultés pratiques pour les non résidents mais ne peut pas être retenu dans la mesure où il maintient intégralement la double imposition économique,

ESTIME TOUTEFOIS QUE LE TEXTE DE LA COMMISSION APPELLE D'IMPORTANTES RESERVES,

les unes ayant trait à certaines caractéristiques essentielles du système proposé, les autres étant relatives à certaines modalités techniques.

I. OBSERVATIONS GENERALES

1. *Taux de l'impôt sur les sociétés*

a) Le rapprochement des taux d'impôt sur les sociétés pratiqués par les pays membres est éminemment souhaitable dans une perspective d'harmonisation communautaire. Toutefois, la fourchette proposée se situe à un niveau trop élevé. *Le taux maximum ne doit pas être supérieur à 50%,* seuil au-delà duquel le prélèvement, par son poids excessif, prive les associés d'une rémunération équitable, limite les possibilités d'autofinancement par mise en réserve des bénéfices, compromet ainsi le renforcement des capitaux propres et en définitive démobilise psychologiquement les chefs d'entreprises soucieux d'améliorer la rentabilité et la productivité de leur firme et de promouvoir son développement — effets qui ne peuvent être que préjudiciables au bon fonctionnement d'une économie de marché et à la poursuite de la croissance économique de la Communauté européenne.

b) En second lieu, l'harmonisation de la charge fiscale grevant les bénéfices des sociétés ne saurait être assurée par le seul rapprochement des taux. Un effort parallèle doit être déployé pour adopter des règles uniformes de détermination de l'assiette de l'impôt sur les sociétés. A cet égard, il serait illusoire de fixer un taux maximum de taxation si dans le même temps, des modifications de législation tendaient à élargir la base d'imposition et aboutissaient ainsi à aggraver le poids de l'impôt.

2. *L'imputation*

En fixant que le „crédit d'impôt attaché au dividende ne peut être ni inférieur à 45% ni supérieur à 55% du montant de l'impôt sur les sociétés au taux normal calculé sur le dividende mis en distribution augmenté de cet impôt", la Commission des Communautés se prononce pour une imputation partielle qui laisse ainsi subsister pour moitié environ le phénomène de double imposition économique. Ainsi, ce seuil maximum dénature fondamentalement un des objectifs essentiels d'unification du système d'imputation des dividendes.

C'est pourquoi, *le principe de l'imputation intégrale doit être posé,* étant entendu que son application effective pourrait être réalisée progressivement pour tenir compte des contraintes budgétaires des Etats. *Le taux de crédit d'impôt ne devrait pas — dans une première étape — être inférieur à 50%* et devrait tendre à l'unification au cours des étapes suivantes.

3. *La retenue à la source sur les dividendes*

La proposition de directive établit le principe d'une retenue à la source de 25% sur les dividendes distribués mais autorise les Etats membres qui peuvent identifier les bénéficiaires à déroger à cette règle.
La retenue à la source, en réduisant d'autant le dividende au moment de sa distribution fait supporter, en raison du délai de sa restitution, un coût de trésorerie non négligeable aux associés. En outre, facteur supplémentaire de complexité, elle rend peu intelligible pour l'actionnaire le montant réel du bénéfice qu'il perçoit ce qui n'est pas de nature à favoriser le développement de cette forme d'épargne auprès d'un public qui risque ainsi d'être rebuté par les „subtilités" de la fiscalité des valeurs mobilières.
C'est pourquoi, dans la mesure où la retenue à la source n'a pour objet que de prévenir tout phénomène de fraude fiscale, *son institution ne devrait pas être érigée en principe* mais n'être prévue que dans les seuls pays où l'administration fiscale n'a pas les moyens d'avoir communication des bénéficiaires des dividendes distribués.

4. *Les relations avec les pays tiers*

Sous peine de maintenir des discriminations entre associés d'une même société résidente d'un Etat membre et de compromettre ainsi la fluidité des mouvements internationaux de l'épargne et le décloisonnement des marchés de capitaux, il importe que le bénéfice du crédit d'impôt attaché aux dividendes puisse être étendu aux résidents des pays tiers. Dans un souci d'harmonisation, *les conventions bilatérales passées à cet effet devraient être établies sur la base d'un accord type défini au niveau communautaire.*

5. *Sociétés mobilières d'investissements ou de fonds de placement*

Compte tenu du rôle déterminant de ces organismes sur le marché des valeurs mobilières, il est essentiel que la directive technique les régissant soit adoptée conjointement avec la présente directive.

II. OBSERVATIONS TECHNIQUES

1. Après avoir posé le principe de l'institution d'un systèm commun d'imputation et d'un régime commun de retenue à la source, la proposition de directive stipule: „Les Etats membres ne peuvent maintenir ou introduire d'autres dispositions visant à réduire d'une manière générale l'imposition des seuls dividendes". Cette précaution ne devrait pas être à sens unique mais viser également les majorations d'imposition (article premier — paragraphe 2).

2. a) Pour la définition des notions: „société d'un Etat membre", „société mère", „société filiale", „établissement stable" (article 2 — paragraphe 1), il est fait référence à des directives qui n'ont pas encore été adoptées. Cette dépendance risque de retarder la mise en oeuvre de la présente directive. C'est pourquoi, il serait souhaitable que les définitions soient expressément

données en prévoyant, pour les sociétés mères et filiales, de les adapter dans le sens d'une unification ou, du moins, d'un rapprochement des taux.

b) La définition des bénéfices distribués (article 2 — paragraphe 1), en excluant notamment les bonis de liquidation et les actions gratuites, est trop restrictive. En raison de la diversité des traitements juridiques et fiscaux de ces catégories particulières de distribution n'entrant pas dans la définition retenue des dividendes, il conviendrait, pour le moins, de laisser aux Etats membres la liberté de leur accorder le bénéfice du crédit d'impôt. Au reste, cette faculté qui n'entraînerait pas de distorsions sensibles est expressément prévue dans le document de commentaires de la proposition de directive, établi par la Commission des Communautés et devrait donc figurer dans le texte même de la proposition de directive.

3. En prévoyant la possibilité de déroger dans des cas particuliers à l'application du taux normal d'impôt des sociétés pour des raisons de politique économique, régionale ou sociale bien déterminées (article 3 — paragraphe 2), la proposition de directive risque, par les brèches ainsi ouvertes, de contrarier l'effort d'harmonisation. Ainsi, serait-il souhaitable de limiter les dérogations aux seules circonstances économiques ou sociales justifiant un taux inférieur au taux normal ou une exonération complète. Ces dérogations ne sont tolérables qui si elles n'introduisent pas des distorsions de concurrence.

4. Les dividendes provenant de bénéfices soumis à l'impôt des sociétés mais mis en réserve depuis plus de cinq ans pourraient donner lieu (article 9 — paragraphe 2) au paiement par la société distributrice de „l'impôt compensatoire". Une règle comparable (article 10 — paragraphe 1) et encore plus rigoureuse dans la mesure où elle est d'application obligatoire, régit la distribution par la société mère des dividendes reçus d'une filiale. „L'impôt compensatoire", dans la mesure où il a pour objet de neutraliser le crédit d'impôt accordé à des bénéfices qui, n'ayant pas supporté l'impôt des sociétés n'ont pas subi la double imposition économique, n'a pas à s'appliquer à des bénéfices qui ont été soumis à l'impôt des sociétés. Une telle règle, en surtaxant les dividendes provenant de bénéfices mis en réserve depuis plus de cinq ans, introduit une rigidité dans la politique de distribution des bénéfices qui peut être préjudiciable à la bonne gestion.

E. E. C.

Harmonisation of the Taxation of Dividends

Resolution of the Permanent Conference of the Chambers of Commerce and Industry of the European Economic Community of November 21, 1975 (unofficial translation)

The Permanent Conference of the Chambers of Commerce and Industry of the European Economic Community

has made a thorough study of the draft Directive on the harmonisation of systems of corporation tax and of withholding taxes on dividends.

Recalling its earlier resolutions and in particular those:—

— on the harmonisation of the taxation of the movement of capital, adopted at Paris on 3 May 1968,
— on the objectives and conditions for the approximation of direct taxes in the Member States, especially in the matter of movements of capital, mergers and participations, adopted at Istanbul on 29 May 1969,
— on a programme for the harmonisation of direct taxes designed to ensure the development and integration of capital markets in the Community, adopted at Brussels on 27 November 1970,

and also the letter to M. Haferkamp, dated 13 December 1972, on the taxation of dividends and the interest on bonds, and the letter to M. Ortoli, President of the Commission, dated 21 April 1972, on the approximation of tax laws,
the Permanent Conference welcomes this decisive stage in the harmonisation of national tax laws,

points out that the existing differences in the taxation of dividends:—

a) affect investment decisions both in the location of projects and holdings,

b) involve the phenomena of double or multiple "international taxation",

c) cause discrimination according to the nationality of shareholders,

d) favour "bilateralism" in international tax conventions in breach of the Community ethos,

e) are an obstacle to the adoption of a common approach to third countries,

f) all in all, effectually erect barriers between financial markets,

fully supports the principle of the unification of the fiscal treatment of dividends, without which there can be no development and integration of capital markets,

re-asserts additionally that the common system of taxation should be such as to result in the elimination of double taxation in order to:—

a) re-establish some equality in the cost in tax terms of different sources of finance for the company, return on investment being at present penalised by the mechanism of the successive levy on the company's funds (as corporation tax) and on the shareholder's funds (income tax),

b) "neutralise" tax considerations in the choice of the legal form of companies, so that they can benefit from a tax transparency which will protect them from double taxation,

c) encourage the public to invest long term in companies, where financial needs are always growing,

d) increase the number of shareholders because of a fairer reward for risk capital,

welcomes the decision in favour of a system of imputation in preference to the classic system, which while it certainly offers the advantage of simplicity and raises fewer difficulties for non-residents, cannot be retained since it inherently preserves double taxation,

considers nevertheless that the Commission's draft gives rise to significant reservations, some in respect of some of the basic characteristics of the proposed systems, some in respect of technical aspects.

I. GENERAL DOCUMENTS

1. *Rate of Compensatory Tax*

a) the progressive reduction of the difference between the rates of corporation tax levied by

Member States is eminently desirable with a view to Community harmonisation. However, the level of the bracket proposed is too high. *The maximum rate should never exceed 50%,* beyond which point the excessive burden deprives the shareholders of a fair return, restricts the possibilities of self-financing by carrying profits to reserves, thus preventing the building-up of own capital, and finally is a psychological deterrent to a chief executive anxious to improve the profitability and productivity of his company and to develop it — effects which can only prejudice the working of the market economy and the economic growth of the European Community.

b) Secondly, the harmonisation of the tax burden on company profits will not be achieved solely by the approximation of rates. A parallel effort must be made to adopt common rules for the determination of the basis of corporation tax. For it would be illusory to fix a maximum rate of tax if, at the same time, changes in legislation tended to expand the tax base, thus increasing the burden of the tax.

2. *Imputation*

By ruling that "the tax credit shall be neither lower than 45% nor higher than 55% of the amount of corporation tax at the normal rate on a sum representing the distributed dividend increased by such tax", the Commission pronounces itself in favour of partial imputation, thus allowing the phenomenon of double taxation to remain for approximately half. By this ceiling the nature of one of the essential aims of a unification of the imputation system is fundamentally destroyed.

For this reason *the principle of full imputation should be established,* it being understood that its actual application could be progressively achieved to allow for the States' budgetary constraints. *The rate of tax credit in the first stage should not be less than 50%,* and should incline towards unification in the course of subsequent stages.

3. *Withholding taxes on dividends*

The draft Directive establishes the principle of a 25% withholding tax on distributed dividends but authorises Member States who can identify the beneficiaries not to apply this rule.

By reducing the dividend at the moment of its distribution, and by the delay in its recovery, the withholding tax puts a not inconsiderable burden on the financial resources of the shareholders. A further complication is that it makes it very difficult for the shareholder to understand the actual amount of the profit he receives which fact is not likely to promote the extension of this kind of investment by a public in danger of being discouraged by the "subtleties" of the taxation of stocks and shares.

For this reason, in so far as the withholding tax has for its sole object the prevention of tax evasion, *it should not be adopted as a principle,* but should be introduced only in those countries where the revenue has not the means of identifying the beneficiaries of the dividends distributed.

4. *Relations with Third Countries*

To avoid the continuation of discrimination between shareholders of the same company domiciled in one Member State, and thus to obstruct the free flow of international investment and the freeing of capital markets, it is important to extend the benefit of tax credits to residents in third countries. In the interests of harmonisation, *bilateral agreements concluded to this effect should be drawn up on the basis of a Community model.*

5. *Financial and Investment Trusts*

In view of the very important influence of these institutions on the stock market, it is essential that the technical directive which controls them should be adopted simultaneously with this directive.

II. TECHNICAL OBSERVATIONS

1. After having established the principle of the introduction of common imputation and withholding tax systems, the draft directive stipulates: "Member States may not maintain or introduce other regulations aimed at reducing the taxation of dividends only in a general sense". This restriction should not be only a one-way business, but should cover also the increase of taxation (Art. 1, paragraph 2).

2(a) Reference is made (Art. 2, paragraph 1) to directives not yet adopted for the definition of: a "Member State" company, parent company, subsidiary company, permanent establishment. This dependence carries the risk that the implementation of this directive will be delayed. It would therefore be desirable that these definitions should be specifically given, adopting them in the case of parent and subsidiary to suit a unification, or at least a move towards a unification, of rates.

(b) The definition of distributed profits (Art. 2, paragraph 1), excluding as it does in particular surpluses on liquidation and free share issues, is too restrictive. It would be proper, at least, to allow Member States freedom to grant the advantage of tax credit to these particular categories, which are not covered by the definition of dividends, because of the diversity of their legal and fiscal treatment. In fact, this facility which would not lead to serious discrepancies is specifically covered in the Commission's commentary on the draft directive, and it should therefore figure in the text.

3. By allowing for the possibility of not applying the normal rate of corporation tax for economic, regional and social policy reasons (Art. 3, paragraph 2), the draft threatens to obstruct the effort towards harmonisation, by opening such breaches. It would therefore be desirable to limit the departures from the rule only to economic or social circumstances which would justify a rate lower than the normal, or total exemption. These departures are only tolerable if they do not distort competition.

4. Dividends derived from profits subject to corporation tax but placed to reserve for more than 5 years (Art. 9, paragraph 2) could give rise to the payment by the company of "compensatory tax". A similar rule (Art. 10, paragraph 1), even more stringent in so far as its application is obligatory, governs the distribution by a parent company of dividends received from a subsidiary. To the extent that its purpose is to offset the tax credit granted to profits which, not having been assessed to corporation tax, have not been subject to double taxation, the "Compensatory Tax" should not be applied to profits which have paid corporation tax. Such a rule, which overtaxes dividends paid out of profits placed to reserve for more than 5 years, introduces a rigidity in the policy of profit distribution which could be prejudicial to good management.

* * * CASE NOTE * * *

CANADA

Decision of the Federal Court of Canada, Trial Division, April 30, 1975

DOMINION BRIDGE COMPANY Ltd.

versus

HER MAJESTY THE QUEEN *

TAX HAVEN SUBSIDIARY

I. THE ISSUE

The issue is to determine if the operations of a wholly-owned subsidiary of the Appellant, Span International Limited, hereinafter called Span, formed with the purported object of acting as a supplier of off-shore steel, were, in fact, those of Span or those of the Appellant during the years 1967, 1968 and 1969.

II. THE FACTS

Span was incorporated in the Bahama Islands on the 22nd of April 1966;
the capitalization of the company was three hundred and fifty (350) pounds sterling into one thousand shares of the par value of seven shillings each; the issued capital stock was five shares and the paid up capital stock was thirty five (35) shillings;
there being no employee of Span with any background in steel purchasing, the work was managed by officers of a trust company in Nassau after instruction from employees of the Appellant under the close scrutiny of the vice-president; the said vice-president of the Appellant was either a director, an alternate director or present at the meetings of directors; that vice-president was the ever present link between the Appellant and Span; that vice-president saw to the minutest details of the operations of Span; the contacts with the mills throughout the world were made by employees of the Appellant under the supervision of the said vice-president;
In the taxation years 1968 and 1969, starting on November 1st, 1967, the facts were as follows: the president of Span was replaced by a retired officer of the Appellant; a junior executive of the Appellant, who used to be an officer of its purchasing department, was sent to Nassau to look after, to a certain extent, part of the business of Span and that with the title of manager; money-wise the transfer was beneficial to the junior executive but his functions were not of a policy-making nature;
According to the plan set up by the vice-president, once Span knew of the requirements of the Appellant for off-shore steel Span would start negotiating but could not commit itself without the approval of the vice-president who would quote the price the Appellant would pay Span for the off-shore steel;
Span paid the off-shore price for the off-shore steel but the Appellant paid Span up to 95% of the domestic steel price for that same off-shore steel; the off-shore steel purchases by Span were delivered directly to the Appellant and only certain documents were sent to Span, at Nassau; the

* Extract from 1975 DOMINION TAX CASES 5150 (75 DTC 5150).

paper work of Span was quite easy and simple as drafts of all documents were written at the Appellant's head office under the direct control of and ultimate decision of the vice-president; the said vice-president of the Appellant was also by that time a director of Span; the role of Span through its manager was to get and keep contacts with off-shore suppliers in order to assure proper supply to its only customer, the Appellant; the manager of Span considered his functions and duties quite similar to those he had had in the purchasing department of the Appellant; the off-shore steel purchasing department of the Appellant was in fact transferred off-shore and incorporated off-shore but its supervision and control remained the same as if there had been no other legal entity; the difference between the fair market value of off-shore steel i.e. the cost to Span, and 95% of the domestic steel price paid Span permitted Span to make during the years under review a profit of about 18% or of about $1,100,000 in 1968, $1,400,000 in 1969 and $225,000 for the last two months of 1969 and permitted the Appellant to make greater the expenses by the same amounts except those relating to interest and dividends.

III. THE PLAINTIFF'S ARGUMENTS

The Appellant lodged a Notice of Objection against these assessments giving, *inter alia,* as reasons:

Span is a validly constituted legal entity separate in law and in fact from the Taxpayer.

Span is and was at all times during the relevant years a non-resident of Canada and a resident of the Bahamas.

Span is not and has never been an agent of the Taxpayer.

The allegation made in Form T7W-C accompanying the Notices of Assessment that the Taxpayer has overstated its cost of sales is wrong. The prices paid by the Taxpayer for raw steel which it purchased from Span or from anyone else are not in excess of the prices paid to North American mills for similar items in similar quantities meeting similar specifications and sold under similar terms and conditions.

IV. THE MINISTER'S CONTENTION

The assessments as levied indicate that the Minister took the stand that the Appellant was in point of fact carrying on its own business under the guise of Span and that the latter legal entity did not have any *bona fide* operations pertaining to the off-shore steel. Span was an entity that was a puppet.

V. THE JUDGMENT

To incorporate a subsidiary company wherever it might be, in a tax or a tax-free country is immaterial. The intent prompting such an incorporation, the way the object is implemented and the uses to which the subsidiary is put are pivotal for deciding if the subsidiary acted on its own or if the Appellant used that stratagem to camouflage and hide its own operations.

In causing Span to be incorporated the Appellant was in fact going to put aside part of its profits in the hands of Span for safekeeping in a tax-free country.

The fact that the Appellant always controlled every step of the operations of Span from the purchase price to the selling price of off-shore steel, that the Appellant paid Span the price of domestic steel for off-shore steel, the latter steel having a lower fair market value, and the power the Appellant had to control the Board show that the purpose of the incorporation of Span was a sham and that its operations were also a sham because, in point of fact, these operations were those of the Appellant and consequently the expenses and disbursements of the Appellant pertaining to the creation and the operations of Span and the income of Span from interest and dividends are as feigned as the creation and operations of Span.

The relationship between the Appellant and Span is so close as to be in fact that of a single entity. Span was used solely as a vehicle to obtain steel at a profitable price; it was a mere agent, a puppet in the hands of the Appellant.

The conditions in the present instance permit to say that Span was a puppet of the Appellant; that the Appellant was "the directing mind and will" of Span. The business of Span was in fact the business of the Appellant.

In the present case it is impossible to conclude that the Appellant restricted its activities with Span to the holding of shares: hardly anything could be done by Span without the approval of the Appellant as is disclosed by the evidence.

Six tests formulated in case law are applied concerning the determination of the question: "Who is really carrying on the business?"

The first test is whether or not the profits were treated as profits of the Appellant or as profits of Span. The Appellant treated the profits as being those of Span but the Appellant, by incurring expenses paid to Span, was diverting to Span income which was its own and Span being its wholly-owned subsidiary, the Appellant still indirectly owned that income. In a legalistic and formalistic view the profits were those of Span, in a legal and substantive view the profits were those of the Appellant.

The second criterion concerns the appointment of the persons conducting the business of Span. The persons conducting the business of the Appellant were all appointed directly by the Appellant or at least with the final authority of the Appellant.

The third standard pertains to the identity of "the head and the brain" of Span. "The head and the brain" of Span was the vice-president of the Appellant who engineered the plan and saw to it that it was implemented in its minutest details.

As to the fourth question, determining whether or not the Appellant "govern the adventure, decide what should be done and what capital should be embarked in the venture", the answer is definitely yes. Every single step of the inception and of the operations was governed and decided by the vice-president of the Appellant. The thin capitalization of the Appellant is, in this instance, an indication of how Span was intended to be used.

The fifth point raises the question of skill and direction through which the profits were made. Were it not for the skill and direction of the Appellant it is not to be conceived how profits could have been made. Introducing Span to suppliers, getting off-shore steel from Span, being the sole client of Span, fixing the price Span would charge the Appellant, these are all steps made by the Appellant and the profits originated through the skill and direction of the Appellant.

Finally, considering the effectual and constant control of Span one cannot but conclude from the evidence that the Appellant was in full effectual and constant control of Span. The Articles of Association allowed a director to have the full powers of the Board and the vice-president of the Appellant could, if he has not done so, avail himself of these provisions. In any event, the possibility of exercising such a power has to be taken into account just as if it had been exercised. What counts is the possession of power, not its exercise.

In the case at hand it is impossible not to entertain the conviction that there was an arrangement or scheme. The overall and everpresent control of the Appellant in the operations of Span and the excessive price it paid Span are indicative of an arrangement or scheme. Furthermore, the fiscal motive pervades the whole structure of Span and its ways and means of operations. If the Appellant had been content with paying the fair market value of off-shore steel plus a customary commission to Span for services rendered, if they had been rendered, the result might have been different.

Therefore, the Appellant and Span in the present instance may have had between themselves dealings that for them were genuine but these dealings for third parties were not genuine. The Defendant as a third party is not precluded from looking beyond the appearance of the relationship between the Appellant and Span to get to the nature and substance of that relationship. It is not because the Appellant pretends that Span was a steel supplier that *ipso facto* Span was a steel supplier when in substance and in fact Span was nothing but a disguised steel supplier tied by blind obedience to the wishes of the Appellant. The contracts between the Appellant and Span may be valid between themselves but they are not valid towards the Defendant because their nature and substance is not as it appears to be.

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JACOBUS T. SEVERIENS *:

THE IMPUTATION TAX SYSTEM: A RE-APPRAISAL

The European Economic Committee has recently urged all member nations to adopt the imputation tax system.[1] Among the reasons advanced is the need for greater capital formation. By granting shareholder credit for taxes paid on dividends, an imputation tax system boosts investments by offering savers a higher yield on equity shares.

The equity, administrative, and international consequences of the imputation tax have been dealt with at length in a previous special issue of this *Journal* and elsewhere.[2] Up till now, however, little consideration has been given to whether such a system accomplishes its aims in practice.

It is the purpose of this article to examine the experience of two member nations which have already adopted dividend tax credit measures. The lessons learned suggest that a re-appraisal of the imputation tax as a fiscal stimulus for capital formations is in order.

This article first discusses briefly the world-wide capital shortage. From there follows a detailed description of the imputation tax and, the economic and financial effects that should ensue upon its implementation. The empirical section looks at the impact such measures have actually had upon capital formation and corporate financial decisions in France and United Kingdom.

A capital crisis is sweeping the world — from the industrialized West to the State-run economies of Eastern Europe and the Soviet Union. Even the oil-rich nations are not immune. They are running through capital at a prodigious rate and are beginning to borrow to meet their investment goals.

Equity markets are drying up everywhere. Debt markets in London, Paris, Tokyo, and New York are closed to all but the companies with the best credit ratings. Debt-equity ratios for most companies are at an all-time high.

Profits are taking a beating everywhere. Once a major source of risk capital, retained earnings have withered under the combined forces of inflation and a growing tax load to fund increasingly voracious social programs. The profitability of the huge stock of capital throughout the industrialized world has been virtually wiped out by the quadrupling in the price of oil and rapid increases in other raw material prices. Thus industry faces a capital gap. Outright government subsidies are no sure solution to the crisis. All too frequently funds are directed toward favored industries or used to buoy up inefficient and faltering companies. Moreover, much of this capital is money that governments themselves borrow, thereby contributing to tightness in securities markets.[3]

It is in this atmosphere that the European community is turning to the imputation tax system. A dividend tax credit makes good sense if it encourages more external equity financing. Yet, will it actually raise the level of total capital formation? By making

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1. *Wall Street Journal,* August 5, 1975, p. 16.
2. For an excellent summary of the many arguments for and against this system see a special issue of *European Taxation,* Vol. 12, Nos. 5 and 6, May-June, 1972.
3. "The Crisis Crosses National Boundaries", *Business Week,* September 22, 1975, pp. 92-95.

shares more attractive than bond issues, may it not as well lead only to a shift in corporate means of finance? In fact, neither case may occur. As will be shown, the record so far finds the dividend tax credit of marginal value in boosting private investment in shares.

The Imputation Tax: How Should *it Work?*

The imputation tax system is basically designed to reduce or eliminate double taxation of dividends. If implemented to the full extent it integrates corporate and personal income taxes on distributed earnings. In its pure form all adjustments are made on individual returns rather than at the corporate end. Typically, each shareholder grosses up his dividend receipts to include any separate tax already paid on them by the corporation. In other words, an amount equal to the tax is "imputed" to his income. The shareholder adds the grossed-up amount to his other taxable income. He then computes his income tax thereon and deducts the corporate levy as a credit.

A recent American publication explains the *modus operandi* with an example. A $52 dividend is grossed-up to $100 to include the $48 corporate tax. If the shareholder's marginal tax rate is 35 percent, he will have $13 ($48 minus $35) to deduct from any taxes due on his other income. A shareholder in the 48 percent bracket comes out even. An investor in the 70 percent range will owe only $22 on the dividend payment.[4] In effect, the dividend tax credit reduces the personal income tax by some significant percentage or to a zero liability. It thus raises the after-tax yield on individually-held investments. Corporate stock issues should then carry greater investor appeal and share prices should rise.

Stapleton and Burke have recently pointed to another dimension of the dividend tax credit — its impact upon corporate financial policy. The double taxation system on corporate and personal income discourages dividend payments. It rewards retained earnings. Owners stand to benefit more from capital gains distributions associated with sales, since such returns are often taxed at more favorable rates. It also fosters debt over external equity in financing additional capital expenditures. Hence, such tax rules give preference to established companies with large existing profits and discriminate against smaller ones with meagre earnings and large funds requirements.

The imputation tax system can eliminate fiscal considerations in dividend payout decisions. It can be neutral as far as distributions policy is concerned, provided the right level of credit is chosen. It also reduces the comparative advantage of debt financing if corporate and personal tax rates are at similar levels. Any corporate tax benefits from interest charge deductions are offset by personal taxes still applicable on returns from fixed-income securities, if not from dividends.[5]

Taking the above factors into consideration, it becomes apparent that the adoption of an imputation tax should have significant economic and financial consequences. *Ceteris paribus*, the following specific developments should be in evidence upon implementation:

— an increase in investments as a percent-

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4. *Break, George F. and Joseph A. Pechman,* Federal Tax Reform: The Impossible Dream? Brookings Institution, Washington D.C. 1975.
5. For a detailed explanation of these points see *Stapleton, R. C. and C. Burke,* "Financing Policy under the Classical and Imputation Systems", *Bedrijfskunde,* November, 1974.

age of GNP;
- a rise in share prices as investors are attracted to the stock market;
- an increase in dividend payments since traditional policies favoring earnings retention are no longer fiscally justified;
- a shift in corporate financial structures toward a higher proportion of stock.

The Imputation Tax System: How Has *it Worked?*

Have the afore-mentioned developments occurred in those nations which have adopted the tax credit system? Let's look at the record.

The French imputation tax has been in effect for more than a decade — since July 12, 1965, to be precise. Prior to the reform the tax code provided for a corporate levy of 50 percent plus a 24 percent withholding tax on dividends distributed to shareholders. The new system retained the 50 percent rate of corporate income tax, abolished the withholding tax for resident shareholders, increased its rate to 25 percent for non-resident shareholders and provided for a 50 percent credit on the amounts distributed to resident shareholders.

In enacting the new tax law, legislators voiced their hopes of avoiding the drawback they saw in the old code. They expressed concern that the double taxation of dividends had greatly reduced returns to stockholders, and so discouraged investment in shares. Enterprises had had little incentive to distribute profits, and therefore incurred difficulty in finding investors willing to subscribe to increases in share capital. The new rules would enable investors willing to accept business hazards and invest savings to obtain an increased yield on them.[6].

In examining the record, it is difficult to make concrete observations or conclusions about the efficacy of the new French tax system. Its effects have been closely mingled with those of other forces at work in the French capital market and in the French economy in general. Nevertheless, available data provide some interesting implications.

Table 1 presents the stock price index at the Paris Stock Exchange for the periods immediately preceding and following the adoption of the imputation tax. On the face of it, the trend indicates that the stock market was largely uninfluenced by higher yield expectations. The small rise after July 1965 may well have reflected only a seasonal pattern. In fact, prices throughout most of the sixties had generally declined from a peak of 535 in 1962. Not until the approach of the franc devaluation in 1969 was a bull market again in evidence. At best, the imputation tax may have had a cushioning effect. The market did not reflect to any excessive degree the recession experienced in 1967 or the political crisis of 1968.

The number of average-or-middle income shareholders has not risen significantly since the introduction of the tax benefit. Holders of investment company shares did increase slightly. The latter phenomenon, however, reportedly stemmed from the novelty associated with the introduction of mutual funds to the French public in the sixties.[7]

With respect to economic variables, Table 2 shows that private investment in France has increased at a rapid pace over the years. Capital formation has risen steadily as a percent of GNP. Yet, this trend was well

6. OECD, *Company Tax Systems in OECD Member Countries,* Paris, 1973, pp. 48-50.
7. OECD, 74.

underway prior to the adoption of the dividend tax credit. More significantly, perhaps, the tax benefit had no apparent effect on the *mode* of investment. New stock issues as a percent of private investment continually declined during the period 1962-68. Even in the economic recovery that followed, new issues percentages never returned to the high levels of the early sixties.

Results are mixed with respect to changes in the new stock/new bond issues ratio. Share capital as a percent of new issues actually fell during the period 1964-67. Dividends as a percent of gross profits were also lower following implementation of the tax benefit.

The British case follows suit. In his Budget Statement of March 12, 1972, the Chancellor of the Exchequer expressed his intention to:

> remove this (double taxation of dividends) discrimination against distributed profits which distorts the capital market, tends to misallocate scarce investment resources, impedes companies that need to raise equity capital, and lessens the pressure for efficiency.[8]

He subsequently urged the adoption of an imputation tax system. The new rules went into effect April 6, 1973. The main features can be summarized as follows:

1. A company pays corporation tax at a single rate (50 percent) on all its profits, whether distributed or not.
2. A company distributing profits in the form of dividends is required to make an advance payment of the corporation tax at a rate of $^3/_7$ [9] of the dividend paid to the stockholder. This amount is set against the corporation tax assessed on its profits so as to reduce the amount of the tax payable.
3. The recipient of a distribution in respect of which advance corporate tax is payable is entitled to a tax credit.

Thus, instead of receiving a net payment representing a gross dividend from which income tax has been deducted, the shareholder receives a stated amount which carries a tax credit. The credit must be included in his income for tax purposes. But since it corresponds in amount to $^3/_7$ [10] of the dividend it serves to satisfy the basic tax rate charge at 30 [11] percent of the total dividend plus credit. The basic rate taxpayer is therefore not asked to remit any tax on the dividend.

Given the comparatively recent date of introduction of the British dividend tax credit, lasting effects cannot as yet be ascertained. Nevertheless, some preliminary analysis can be made and tentative conclusions drawn.

But first a word of caution. Any attempt to discern the impact of any tax reform in the United Kingdom must be viewed against the background of the serious economic problems befalling that nation. Labor strife and management problems have left British industry behind its foreign competition. Government economic policy has fluctuated widely over recent years — from expansion to contraction to outright bewilderment — making it about impossible for businessmen to plan from one year to the next. The high cost of government social welfare programs has dumped a staggering tax burden on business and consumer alike. The effective tax rate on British industries climbed from 47 percent in 1968 to 64 percent in 1974. That nation is enduring one of the highest rates of inflation in the developed world. These price rises have brought about high

8. Ibid., pp. 89-92.
9. Currently $^{35}/_{65}$th.
10. Id.
11. Currently 35 percent.

interest yields and forced stockholders to reconsider what returns to expect from shares.

The combined impact of all these forces has all but destroyed British industry's ability to generate capital. Return on investment plunged from 14.5 percent in 1955 to 6.3 percent in 1971, and became negative in 1974.[12]

The U.K. dividend credit allowance was thus launched at a very critical and unfortunate moment. The odds against its success proved formidable.

As shown in Table 3, stock prices did go up slightly following the introduction of the dividend credit, but the increase was never sustained. Market response at that time may also have been the result of all-too-rare good trade news.

Most of the growth in GNP in the seventies has been nominal as inflation has slashed economic gains. But capital formation has kept pace over this period. Financing via new securities issues, however, has actually slackened. It fell from a high of 24 percent of investment in the early sixties to six percent in 1973.

New stock issues as a percent of total securities flotations have been erratic over the years, with no discernible developing trend. A detailed monthly analysis of securities issued prior to and just after the tax benefit enactment provides no support for any shift toward equity financing. A bull market in London opened up the equity markets early in 1975, and British companies were able to raise about $1.75 billion. But the rally soon faltered and the money that was obtained was used primarily to retire debt, not to fund new investments.

Dividends as a percent of after-tax profits have declined in recent years, contrary to expectations under the dividend credit allowance. The same fate has befallen shares as a percent of corporate financial structure.

Summarizing both countries' experiences, it is apparent that the statistical evidence so far is by no means encouraging. The tax benefits have not measured up to expectations. At best, any positive impact has been overshadowed by other events.

But figures can tell only part of the story. More important is ascertaining why neither shareholders nor corporations responded to the tax reduction stimulus. To obtain an answer to this question, surveys were made of two dozen multinational firms and investment groups having financial interests in the United Kingdom and France.

The responses from both portfolio managers and corporate planners have been unanimous — neither group has taken the dividend tax credit into consideration in its investment decisions. Shareholders, for their part maintain a wary eye on the economic barometer. The readings of late have not been a source of encouragement. Tax reductions are of little comfort when prospective declines or losses in prices, earnings, and dividends are at stake.

Second, it became immediately evident that the dividend tax credit was of marginal benefit to the average British and French investor. The benefits were set to free only the standard rate taxpayer of liability. Most foreign individual shareholders were in higher income brackets. More important, capital gains tax rates had been left intact, at 30 percent in the United Kingdom and in certain cases 15 percent in France. It remained financially worthwhile to continue to play the game of stock price appreciation.

12. "The Search for Capital in Some Key Nations", *Business Week*, September 22, 1975, pp. 96-98.

To corporations, the tax break made no inroad into the capital budgeting process and gloomy profit expectations. The economic reverses of recent years have undermined business confidence in the ability of industrial nations to maintain stable prices. Many major companies have feared a continued boom-and-bust cycle, and thus have held back on long-term investments.

With respect to financing methods, it should be recalled that any corporate benefits from the dividend tax credit were indirect. Firms responded only to pressures for change from stockholders. Costs of stock financing could be lowered only by an increase in the market price for shares or via a reduction in dividends. The former depended upon stockholder expectations, while the latter was contrary to the intentions of the credit allowance. In addition, extra flotation costs connected with new stock issues could not be assumed away. The same case held for leverage and its continued significance for raising earnings per share figures.

The experience so far indicates that strong constraints exist upon the dividend tax credit as an instrument of fiscal management and a fillup for capital formation. The benefits are a drop in the economic bucket; they are impotent against the major forces shaping business confidence. Continued availability of alternative tax preferences saps shareholder incentive to alter investment programs.

The European Community may better direct its time and efforts to meeting the capital formation problem head-on rather than to apply a small bandage to a continually festering sore. Drastic tax law surgery may be needed — such as the abolition of the capital gains taxes in member nations. Another approach, direct benefits to corporations, may be a better alternative than reliance upon stockholder initiative. In Britain, however, not *even* the ability to write off new investments in a single year's time has been enough to get firms to replace their antiquated and worn equipment.

The message to European officials should be clear. An imputation tax system may be desirable for purposes of tax harmonization and equity considerations. But it should not be relied upon as a panacea for an ailing capital market. In the long-run national or concerted European-wide efforts directed at creating better conditions for business confidence may prove to be the most viable choice. Real economic growth remains the prime stimulus for increasing savings flows into production investment.

Table 1: — French Stock Price Index, 1964-1970 (1949 = 100)

Time Period	Index
July 1964	330
December 1964	355
July 1965	320
December 1965	345
July 1966	320
December 1966	290
July 1967	270
December 1967	300
May 1968	340
July 1968	305
December 1968	320
April 1969	400
July 1969	370
December 1969	400
August 1970	370
December 1970	360

Source: OECD, *Company Tax Systems in OECD Member Countries,* Paris 1973, p. 50.

Table 2: — France; Selected Economic and Financial Data 1960-1974

Year	Stock Price Index / 1961 = 100	Private Investment / GNP	New Stock / Private Investment	New Stock / New Stock & Bonds	Dividends / Gross Profit	Shares / Capital Structure
1960	80	.13	.05	.53		
1961	100	.14	.06	.59		
1962	104	.14	.06	.68		
1963	95	.14	.06	.67		
1964	82	.15	.05	.74		
1965	75	.16	.05	.72	.08	
1966	72	.16	.03	.66	.07	
1967	66	.16	.02	.60	.07	
1968	71	.16	.03	.66	.06	
1969	88	.17	.05	.72		
1970	91	.18	.05	.63		.13
1971	89	.18	.04	.46		.12
1972	99	.18	.04	.58		.11
1973	102	.13	.07	.34		.10
1974	104	.17	n.a.	n.a.		

Sources: Statistique Annuaire, 1973, OECD, *Financial Statistics*, Vol. 8, 1975.

Table 3: — United Kingdom; Selected Economic and Financial Data 1970-1974

	Investment / GNP	New Issues / Investment	New Stocks / New Bonds & Stocks	Div / Profits After Tax	Shares / Capital Structure
1970	.10	.09	.24	.22	
1971	.09	.18	.33	.21	.11
1972	.09	.24	.64	.17	.10
1973	.10	.06	.38	.11	.09
1974			.35		

Stock Price Index (1970 = 100)

	Quarters 1	2	3	4
1972	214	206	199	216
1973	190	193	176	181
1974	161	120	89	69
1975	127			

Sources: OECD, *Financial Statistics*, Volume 8, 1975 *Bank of England Quarterly*, 1972-1975.

MELVYN B. KRAUSS AND GOODMAN GARRY*:

HOW TO SAVE THE "TOKYO ROUND": BORDER TAX ADJUSTMENTS FOR THE CORPORATION INCOME TAX

The multilateral trade negotiations have been going slowly on many fronts. One area of particular concern is the future status of border tax adjustments. The *International Herald-Tribune* of October 4-5th featured, "Trade Conflict Feared by EEC, U.S. Officials", while the *Economist* of September 27th warned, "Europe Steels Itself for Transatlantic Battle".

The specific issue at hand was the complaint filed by U.S. Steel with the U.S. Treasury on September 18th against seven Common Market steel-producing countries — West Germany, France, Belgium, Italy, Luxembourg, the Netherlands and Britain. It contended that the system which exempts Common Market steel exporters from paying value added tax on steel sold in the United States, but requires U.S. producers to pay the tax when selling steel in Europe, is an "unfair trading practice". To counter this alleged "unfair trading practice", U.S. Steel asked Treasury to impose countervailing duties on imports of EEC steel products. On October 20th, the Treasury rejected U.S. Steel's petition, thus temporarily defusing the issue. U.S. Steel may now take the question to the courts. The issue is broader than the treatment of steel products alone. The value added tax is remitted on exports of all EEC products; if the U.S. Steel petition eventually proves successful, other American industries can be expected to follow suit. No wonder the EEC Commission is upset!

Coming on the heels of protest by the American dairy industry against alleged European subsidization of cheese exports, of protest by American canners against alleged European subsidization of exports of canned hams, and the complaint by the United Automobile Workers Union that a number of European cars were being "dumped" on the U.S. market, the U.S. Steel complaint cast a considerable shadow over the prospects for a successful completion to the Tokyo Round of trade and tariff negotiations in Geneva. One EEC official was quoted in the *Herald-Tribune* as saying, "What's the point of the multilateral trade negotiations to rewrite trade rules when the United States won't honor the existing ones?" The anonymous official has a point: the rebate of value added tax on exports and the imposition of a compensatory duty on imports equal to the rate of value added tax paid by domestically-produced and -consumed products is fully consistent with GATT rules. But what the official misses is that one of the precise reasons for having the multilateral trade negotiations is to change those rules that one or more of the trading partners feels unable to live with. The GATT rule on border tax adjustments is obviously one such rule.

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NO SURPRISE

That the United States has not been happy with the GATT rule on border tax adjustments for some time should come as no surprise. Section 121(a)(5) of the Trade Act of 1974 entitled "Steps To Be Taken Toward GATT Revision", calls upon the President to

> "take such action as may be necessary to bring trade agreements heretofore entered into, and the application thereof, into conformity with principles promoting the development of an open, nondiscriminatory, and fair world economic system. The action and principles referred to in the preceding sentence include, but are not limited to, the following —
> (5) The revision of GATT articles with respect to the treatment of border adjustments for internal taxes to redress the disadvantage to countries relying primarily on direct rather than indirect taxes for revenue needs."

Since the United States is one of those countries that relies more heavily on corporate income taxes by comparison with indirect taxes to finance its public sector (see Table 1), the GATT border tax adjustment rules are considered by the U.S. Congress to be prejudicial to U.S. interests. This section of the Trade Act of 1974 raises three questions:

(1) What are border adjustments or, more precisely, border tax adjustments?

(2) What are the GATT provisions pertaining to border tax adjustments?; and

(3) In what sense, if any, do the GATT provisions place countries such as the United States at a disadvantage'

WHAT ARE BORDER TAX ADJUSTMENTS?

Consider the case of a country that wishes to impose an indirect tax at a given *ad valorem* rate. If this country trades with other countries, the question arises as to the proper tax treatment of internationally traded goods. In other words, how should exports be treated taxwise and how should imports be treated taxwise? The answer to this question depends on which principle — location of consumption or location of production — the country desires to implement. According to the location of consumption principle, all goods consumed within the taxing jurisdiction are taxed at the same rate regardless of where they are produced. The location of production principle dictates that all goods produced within the taxing jurisdiction bear the same rate of tax regardless of where they are consumed.

Table 1.

Tax Revenue from Goods and Services[1] and Corporate Income as a Percent of Total Tax Revenues,[2] Principal Industrial Countries, 1972.

Country	*Goods and Services*	*Corporate Income Tax*
Australia	26	16
Austria	36	4
Belgium	31	7
Canada	29	11
Denmark	35	2
France	35	6
Germany	27	5
Italy	33	7
Japan	20	18
Netherlands	25	7
Sweden	29	4
Switzerland	24	8
United Kingdom	26	7
United States	17	11

Notes:

1. Includes general sales, value added, and specific excise taxes.

2. Totals do not add to 100 percent because other taxes, for example, personal income taxes, are not listed.

Source: *OECD, Revenue Statistics of OECD Member Countries, 1965-1972.*

To implement the location of consumption principle, imports must be taxed at the same rate as domestically-produced goods while exports must leave the taxing jurisdiction tax free. This requires that a compensatory tax be placed on imports and a tax rebate be given on exports. The combined imposition of compensatory import taxes and export tax rebates to implement the country of consumption principle is known as destination principle border tax adjustments (BTAs).

To implement the location of production principle, exports must be taxed at the same rate as domestically-consumed goods, while imports must enter the taxing jurisdiction tax-free since they are not produced domestically. The origin principle, as it is known, does not require explicit border tax adjustments. No attempt is made to relieve exports of the tax they carry, nor is there an attempt to impose compensating import taxes. The producing country taxes exports in the same manner as goods produced for the local market, but imposes no additional tax on imports, since it is only in this way that all goods produced within the taxing jurisdiction can be equally burdened regardless of the destination of consumption.

There are thus two systems of border tax adjustment: one to implement the location of consumption principle (destination principle BTAs); the other to implement the location of production principle (origin principle BTAs). Destination principle BTAs consist in the combined imposition of export subsidies and import taxes at an equal *ad valorem* rate. Destination principle BTAs are explicit in that something happens at the border. Conceptually, though not necessarily in practice, the export rebate and import compensatory tax can be thought of as paid at the border. Origin principle BTAs are implicit in that nothing happens as goods cross the political boundary.

ECONOMIC EFFECTS OF ALTERNATIVE BORDER TAX ADJUSTMENT SYSTEMS

A sovereign country clearly has the right to choose which system of taxes it wishes to employ in financing government expenditure. Among these choises are domestic production and domestic consumption taxes. Does it make any real difference to the country if the form of the indirect tax is a domestic consumption tax or a domestic production tax? This question has been the subject of considerable academic debate and the results of that debate can be summarized and interpreted as follows.

If the tax in question is a truly general tax, that is, one that applies proportionately either to all goods and services produced in the economy, or to all factor incomes earned in the economy, the choice makes no difference. If the consumption tax is the preferred form, the incomes of the factors of production stay the same but the prices of goods and services rise in proportion to the tax (assuming that the money supply is increased in proportion to the tax in order to sustain the higher prices of goods and services). In this case, each factor of production bears the burden of the tax in proportion to its contribution to national income, since all goods and services purchased with factor earnings are uniformly X percent higher in price. On the other hand, if the production tax is the preferred form, the prices of goods and services remain the same, but net factor incomes fall in proportion to the tax. Again, each factor-owner bears the burden of the tax in proportion to its contribution to national income. With either form of taxation, the result is the same. Switching from a truly general consumption tax to a truly general production tax has no effect on the distribution of income. Furthermore, because a general tax affects only absolute price levels, and relative prices — the prices at which goods exchange for one another — are the critical determinant of the allocation of resources in the economy, the choice between a truly general production and consumption tax also is irrelevant from the standpoint of efficient allocation of resources.

The analysis of a general tax proves a convenient point of departure for the analysis of taxes in the real world. The real world counterpart of a truly general tax does not exist. All taxes are to some degree specific. When a tax is specific, it does make a considerable economic difference whether the tax appears as a domestic consumption tax or a domestic production tax. It is a decision of some consequence whether a country uses domestic production or domestic consumption taxes.

The economic consequences do not concern the balance of trade or the overall level of production, but rather the *composition* of trade and production.

The present "energy crisis" provides a dramatic example. If the object of national policy is to reduce the domestic consumption of oil products, clearly a domestic consumption tax is superior to a domestic production tax. To achieve a domestic consumption tax in an open economy, destination principle BTAs are necessary. Imports must be taxed at the same rate as domestically-produced goods and exports must be exempted from the tax; otherwise, domestic consumers could avoid the tax by buying on foreign markets while foreign consumers of U.S. oil would have to pay the U.S. tax. In that case, a tax intended to restrict domestic consumption would have the unintended effect of restricting domestic production. On the other hand, if the tax is intended to restrict domestic production, while leaving consumption unaffected, origin principle BTAs are required.

In summation, different countries have different national or domestic policy objectives that they wish to achieve with different taxes. Each country should enjoy maximum flexibility in its use of fiscal instruments. Specifically, a country should have the choice of employing either domestic consumption taxes or domestic production taxes, according to its domestic policy requirements. No one denies that a sovereign nation can choose, for example, between taxing the income earned on the production of oil and the purchase of oil by consumers. But today, with the vast international exchange of goods and the tendency towards price equalization for internationally traded products, the nominal choice between production and consumption taxes cannot be implemented without appropriate border tax adjustments. Moreover, a country might want to alter the economic burden of a particular tax without altering its legal or administrative form. Again, a change in the system of border tax adjustments can achieve the desired result without disturbing the underlying tax structure. A domestic consumption tax requires destination principle BTAs, while a domestic production tax requires origin principle BTAs.

THE GATT RULES AND WHAT'S WRONG WITH THEM

The GATT rules pertaining to border tax adjustments are fairly precise. All members have the right to apply either destination principle or origin principle BTAs to their indirect taxes, but destination principle BTAs cannot be applied to a member's direct taxes. Hence, direct taxes must be levied under the origin principle. Put in somewhat different words, the GATT rules provide that member states can apply their indirect taxes either as production or consumption taxes, but they must apply their direct taxes as production taxes.

The Trade Act of 1974 did not precisely specify the alleged prejudicial nature of the GATT border tax adjustment provisions. The principal complaint, however, is sufficiently well-known to allow it to be paraphrased as such: destination principle BTAs are allegedly equivalent to export subsidies, and the GATT rule permits those countries with high indirect taxes to subsidize their exports more generously than countries with high direct taxes. Furthermore, countries that use indirect taxes can tax imports while other countries cannot. The result of both these effects is to give European countries which rely more heavily on indirect taxes an unfair trade advantage over the United States. Stated in this way, the complaint has a mercantilistic ring about it: the Europeans are able to promote a balance of trade surplus through destination border tax adjustments. Mercantilistic principles have taken a deep hold on the Congressional mind, and economists have spilled much ink trying to overturn the concepts of Johann Joachim Becher. Suffice it to point out that neither the destination principle, nor the origin principle, nor any other principle of border tax adjustments can permanently alter a nation's balance of trade for the simple reason that both exchange rate movements and internal price changes will ultimately offset any initial impact.

In a sense, of course, all taxes affect trade, since they alter the *composition* of domestic production and consumption, and therefore the industrial *composition* of trade flows. But the key question is whether the tax discriminates between domestic and foreign sectors of the economy. This should be the criterion for establishing whether or not a given measure is offensive to the rules of the international economic order. Since a domestic consumption tax applies to all domestic consumption regardless of whether the domestically-consumed goods are produced at home or abroad, the tax does not discriminate between the domestic and foreign sectors of the economy. In this sense, a domestic consumption tax, and the corresponding destination principle BTA, is neutral with respect to international trade. The argument which equates destination principle BTAs with export subsidies overlooks the effect of combining an export rebate and an import tax with the internal tax.

A similar argument can be made for domestic production taxes and origin principle BTAs. As already noted, origin principle BTAs are required for the application of a domestic production tax in an open economy. Since a domestic production tax applies to all domestic production regardless of whether the domestically-produced goods are consumed at home or abroad, the tax does not discriminate between production for home or export use. In this sense, a domestic production tax is also neutral with respect to international trade.

The argument that destination principle BTAs do not discriminate depends upon the assumption that both the import compensatory duty and export tax rebate at the border are equal to the tax carried by domestically-consumed goods. But the destination principle BTA mechanism can be misused for protectionist purposes if there is overpayment of export rebates and import taxes at the border. Overpayment occurs when the export rebate or the import tax is greater than the amount of tax carried by domestically-produced goods. Such overpayment can be a conscious act of economic policy or can be due to error. The latter is more likely to happen when the tax carried by a domestically-consumed good is not readily identifiable. This was a serious problem with the cascade-type sales tax previously employed by most of the European Common Market countries. The EEC changeover to the value added tax (VAT) solved this particular problem since the amount of tax with VAT is easily identified. Hence, rather than intensify any trade distortion due to European use of destination principle BTAs (through overcompensation), the switchover to VAT actually served to reduce the potential for trade distortions by making internal taxes in Europe more readily identifiable.

With the exception of possible overcompensation, destination principle BTAs do not discriminate, or, in the language of practical people, do not constitute an "unfair trade advantage" for those countries that employ such adjustments. To the extent that the GATT rules allow destination principle BTAs for indirect taxes, they are not prejudicial to U.S. interests. But this should not be taken to mean that, *in toto,* the GATT border tax adjustment rules are not prejudicial to the United States.

GATT border tax adjustment rules are deficient to both United States and world interests from the point of view of fiscal sovereignty. While GATT members have the maximum amount of freedom to apply their indirect taxes as domestic production or domestic consumption taxes, this is not the case with respect to direct taxes such as the corporation income tax. Under present GATT rules, destination principle BTAs are allowed only for indirect taxes. Direct taxes must be applied under the origin principle. This constitutes a serious constraint on the fiscal sovereignty of those countries, such as the United States, that rely heavily on direct taxes to finance the public sector. By constraining such countries to apply their direct taxes under the origin principle, the direct taxes must have the economic effect of domestic production taxes. The restriction of destination principle BTAs to indirect taxes constitutes a serious anomaly in the present GATT rules.

The asymmetrical treatment afforded direct and indirect taxes by GATT can be traced both to underlying assumptions concerning the relationship between taxes and the prices, and to considerations of administrative convenience. The Agreement assumes that indirect taxes are reflected in the price of goods while direct taxes are not. Given this assumption, the issue of consumption tax versus production tax only seems relevant with respect to indirect taxes. But it is common knowledge that a direct tax, particularly the corporation income tax, is somehow reflected either in the price of corporate goods, or in the returns to corporate capital, or both. The issue of consumption tax versus production tax is, therefore, just as relevant for direct taxes as for indirect taxes.

It is obviously easier to calculate the appropriate border tax adjustment when the underlying tax is an indirect tax, closely connected with the particular good. But without excessive administrative complexity, it would be possible to make destination BTAs for the corporate income tax on the basis of average sectoral relations between taxes paid and sales.

IT'S UP TO CONGRESS

It is well known that recession breeds protectionist pressures, and the United States, like other western countries, has not shown itself immune during the recent world recession. It is quite clear, for example, that the American labor movement has become significantly more protectionist, as have many industries. But the EEC Commission displayed a certain ignorance of the process of American policymaking when it recently lectured the Ford Administration "to respect its international obligations and to exercise its general responsibility with other members of the international community, to control the forces of protectionism". For what is known of the Ford Administration, it would very much like to honor its "international obligations" as concerns the U.S. Steel protest. Indeed, the petition was turned down. But the problem is not so simple. Besides international agreements, the U.S. Government is bound by its own domestic legislation, which takes precedence over an executive agreement, like GATT. The problem is that the past judicial determination of a major piece of trade legislation — the Tariff Act of 1930 — is in direct conflict with GATT as to the border tax adjustment problem. The implication of this embarrassing fact is that unless Congress changes this law, U.S. Steel may win its case in the courts, regardless of what the Ford Administration wants. Should this happen, the general thrust of the Western trading nations towards a more liberal and open international economy, a thrust that started with the Kennedy Round and hopefully will continue through the Tokyo Round, could be prematurely short-circuited.

LEGAL COMPLICATIONS

The relevant section of the Tariff Act of 1930, essentially repeated in the Trade Act of 1974, is Section 303(a)(1). It states:

> "whenever any country . . . shall pay or bestow, directly or indirectly, any bounty or grant upon the manufacture or production or export of any article or merchandise manufactured or produced in such country . . . then upon the importation of such article or merchandise into the United States . . . there shall be levied and paid, in all such cases, in addition to any duties otherwise imposed, a duty equal to the net amount of such bounty or grant, however the same be paid or bestowed."

A major problem with this language lies in the proper definition of what constitutes a bounty or grant. Specifically, with respect to destination principle BTAs, the issue is whether the rebate of an excise or sales tax upon the export of merchandise from foreign countries constitutes a bounty or grant under the Act, and is thus countervailable by the Treasury.

The Courts have ruled on this issue, and the consistent judicial determination has been that the rebate of an excise or sales tax upon the export of merchandise does indeed constitute a bounty or grant. The principle was first laid down in *Downs v. United States* (1903) when the courts sustained the imposition of a countervailing duty by the Secretary of the Treasury under Section 5 of the Tariff Act of 1897 on sugar exported from Russia on which excise taxes (imposed on all sugar produced in Russia) had been remitted. The courts that these practices encouraged the exportation of sugar from Russia and resulted in the payment of bounties.

In affirming the decision of the Circuit Court of Appeals, the Supreme Court of the United States said, among other things:

> "When a tax is imposed upon all sugar produced, but is remitted upon all sugar exported, then, by whatever name it is disguised, it is a bounty upon exportation."

It is clear from the language in the Downs' case that the Supreme Court regarded tax remission associated with the exportation of merchandise as a bounty. In two subsequent cases, *F. W. Meyers and Co. v.*

United States (1903), and *Nicholas and Co. v. United States* (1919), the Supreme Court also held that tax remission constitutes a form of bounty. These are old cases, and while lower courts have been bound by them, the Supreme Court might reconsider its position if the issue arose today. Nevertheless, the precedents are clear.

Compare the legal situation in the United States with our obligations under GATT. Article IV (4) of the GATT reads:

> "No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to anti-dumping or countervailing duty by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes."

The conflict between judicial determination of the Tariff Act of 1930 and its predecessors on the one hand, and the U.S. obligation under the GATT trade agreement on the other, could not be sharper.

For several decades, the U.S. Treasury has averted this latent conflict by interpreting the countervailing duty statute more narrowly than judicial doctrine might permit. The Treasury has taken the position that countervailing duties should not be applied against the remission of indirect taxes borne by the product. Prior to the Trade Act of 1974, U.S. firms that objected to Treasury's position were effectively precluded from seeking redress in the courts. But the Trade Act radically changed the rules by opening the way for judicial review of Treasury decisions.

SAVING THE TOKYO ROUND

If U.S. Steel carries its petition to the courts, there is at least the possibility that countervailing duties will be judicially imposed. Such action would be considered by Europe as an unacceptable attack on long established practices. A court victory for U.S. Steel could spell defeat for the Tokyo Round. The obvious solution is Congressional modification of the countervailing duty statute so as to exclude destination principle BTAs from the definition of bounty or grant. Congress is likely to do this only if it is encouraged by a change in GATT's border tax adjustment rules that removes the perceived discrimination against U.S. interests. Hence, reform of GATT is both a consequence of a successful conclusion to the Tokyo Round and a precondition for it. Perhaps the best way to encourage Congress to modify present domestic legislation would be for the GATT border tax adjustment provision to be changed to allow destination principle BTAs for selected direct taxes as well as for indirect taxes.

Two other approaches to the border tax adjustment problem should be mentioned. The first, which has been considered by the House Ways and Means Committee, would be to disallow destination principle BTAs for all taxes, indirect and direct. This would guarantee that all domestic taxes would be imposed as production taxes. From the point of view of fiscal sovereignty, this hardly can be considered a reform of the GATT border tax adjustment rules, at least if reform is meant to imply progress. It is safe to predict that the Europeans would consider such a move an intolerable encroachment on their fiscal sovereignty. Just because the United States has accepted a foolish restriction on its fiscal options is no reason for the Europeans to endure a similar restraint.

A second approach is for the United States to follow the European example and adopt a national value added tax. This proposal, which has been supported by such eminent economists as A. C. Harberger, can hardly be called a reform of GATT, since it asks GATT members to adjust to the existing (and anomalous) GATT rules rather than for an adjustment of the GATT rules to the legitimate needs of member states. Adoption of the value added tax for border tax adjustment reasons can hardly be justified. Such a fundamental change in the tax system must be principally defended for its domestic, not its international consequences. If greater fiscal sovereignty is possessed by those nations that employ indirect taxes, the sensible decision is to change the artificial and asymmetrical rule.

POLICY IMPLICATIONS

Increasing fiscal sovereignty and avoiding a potential transatlantic trade dispute are two real advantages of allowing destination principle BTAs for the corporation income tax. After full consideration of the welfare, price, and sectoral implications, Congress might not choose to adopt border tax adjustments for the corporate income tax. But the choice would be up to Congress. No longer would there be legitimate grounds for complaint over unequal GATT rules. If Congress did choose to provide destination BTAs for the corporation income tax, that decision would pave the way for repeal of the Domestic International Sales Corporation. The DISC enables deferral of a part of the corporate tax which would otherwise be collected on export profits. In a sense, the DISC is a partial one-sided border-tax adjustment plan. Because it is one-sided, it is also expensive; the projected revenue cost is some $1,500 million in 1976. By contrast, a complete border tax adjustment plan would probably cost less than $100 million. The revenue savings could be used to reduce the corporation income tax rate or some other useful purpose.

CONCLUSIONS

The U.S. Steel complaint against European use of destination principle BTAs has brought the Tokyo Round to a critical point. The imposition of countervailing duties against European steel could damage hopes for a more liberal world economic order. Congress should not wait for a possible court victory by U.S. Steel and the consequent creation of vested interests. While the outcome is still in doubt, Congress should redefine domestic legislation to conform with present economic realities and sound economic analysis. The Europeans, on their part, must agree to changes of the present GATT rule on border tax adjustments. The change that should be sought by the United States and agreed to by the Western trading nations is that destination principle border tax adjustments can be applied to a wider range of taxes, regardless whether ancient usage defines them as direct or indirect. This, of course, is not a sufficient condition for a successful conclusion to the Tokyo Round, but it may turn out to be a necessary one.

TAX INCENTIVES IN CYPRUS*

To encourage economic re-activation and growth and, more particularly, capital investment, exports, and the inflow of foreign capital, the tax incentives in force have been strengthened and new incentives have been introduced by a recent amendment of the Income Tax Law (No. 37 of 1975). The tax incentives now in force are the following:

Capital Allowances: Allowances are given for capital expenditure incurred on the acquisition of plant and machinery used in trade or business or in scientific research. Allowances are also given on existing buildings or on the construction, reconstruction, extension or adaptation of buildings, used in trade or business or in scientific research or let out for any purpose. The capital allowances granted are:

(a) Investment Allowance: Granted at the following rates in respect of new Plant and Machinery, used plant and machinery imported from abroad, or new Buildings in the "basis year" in which the asset is first used and employed in the trade or business or in scientific research. The investment allowance is granted in addition to the annual wear and tear allowance.

(i) *Plant and Machinery:* 30% on the capital expenditure incurred in acquiring the asset.

(ii) *Hotel Buildings:* 25% on the capital expenditure incurred on their construction.

(iii) *Industrial Buildings:* 20% on the capital expenditure incurred on their construction.

(iv) *Non-industrial Buildings:* 10% on the capital expenditure incurred on their construction.

(b) Annual Allowances (wear and tear): Granted annually beginning with the "basis year" in which the property is first used and calculated on the "straight line" method of depreciation of the capital expenditure incurred on the acquisition or construction of the property. The rates vary depending on the life and type of asset.

Accelerated depreciation: For a period of three years beginning January 1, 1975, in all cases in which firms undertake expenditure on the acquisition of fixed capital assets composed of new plant and machinery or on the construction, reconstruction, extension or adaptation of buildings, instead of the usual depreciation allowances stated above, the whole expenditure will be allowed as a deduction from income in the first year of acquisition; the investment allowance stated above will continue to be granted. In cases where the Commissioner of Income Tax is satisfied that such acquisition or construction or reconstruction started within three years from the 1st January 1975, but it was not found possible to be completed within this period, such expenditure will be allowed if it is incurred within 5 years from 1st January 1975.

Mergers: When firms operating in Cyprus merge, on the used plant and machinery belonging to these firms an additional investment allowance of 15% of the capital expenditure is granted, provided that the Minister of Finance is satisfied that the interests of the Republic are best served by such merger.

* This paper has been prepared by the Ministry of Finance, Nicosia — Cyprus, and is reproduced with the permission of the Director-General of the Ministry of Finance.

Mines: Capital allowances are granted in respect of all capital expenditure, including expenditure on searching for or on discovering and testing mineral deposits or winning access thereto or on development, and on general administration and management prior to the commencement of production, as well as expenditure on the acquisition of the site of the source or of rights in or over the deposits. In the first year the initial allowance is at the rate of 25% on the capital expenditure incurred on the provision of plant and machinery and 10% on any other capital expenditure. The balance of expenditure is depreciated annually, the allowance depending on the output from the source during a year.
The initial and annual allowances stated above are now granted to any person who incurs expenditure on searching for or on discovering and testing mineral deposits, or winning access thereto (and not only to a person carrying on the trade of mining as the Law provided prior to its amendment). As a more attractive incentive for prospecting for and discovering and testing mineral deposits it is further provided that in cases of abortive expenditure on exploration for minerals an amount equal to 130% of the expenditure so incurred is allowed.

Expenditure on Scientific Research: Any expenditure incurred on scientific research, for which no capital allowance is normally granted, is allowed as a deduction from chargeable income and spread equally over the year of acquisition and the five subsequent years.

Expenditure on Patent and Patent Rights: Any expenditure incurred on the acquisition of patent and patent rights is allowed as a deduction from chargeable income and spread equally over the life of the patent or patent rights.

Royalties, Fees, etc.: The gross amount of royalties, premiums or compensation derived from the Republic by non-resident persons is taxed at the rate of 10% instead of the standard company rate of 42.5%. Moreover, if such income is receivable by a resident of a country with which there is in force an agreement for the Avoidance of Double Taxation, this is totally exempted from income tax.

Balancing Additions or Deductions: When buildings or plant and machinery on which capital expenditure has been incurred are sold or otherwise disposed of, or permanently cease to be used for the purpose of the trade, etc., or the trade, etc. is permanently discontinued but the property has not ceased to belong to the person carrying on the trade, etc., if the balance of the unexhausted cost of the asset exceeds the amount (if any) realised from its sale or obtained by way of insurance, salvage or compensation, the excess is allowed as a deduction from the profits of the "basis year" in which the event occurred. If, on the other hand, the proceeds from sale or the amount obtained by way of insurance, salvage or compensation exceeds the balance of the unexhausted cost of the asset, the excess is added to the income of the "basis year" in which the event occurred. The limit of the addition is the aggregate of the allowances made in respect of the asset.
In total, a trader is given tax allowances equal to the cost of an asset plus the investment allowance.
In the case of mines, balancing additions or deductions are not made except where the whole or part of the source is sold as a going concern.

Foreign income: The foreign income of persons who are not citizens of the Republic of Cyprus and of Cypriots who in the past were permanently living abroad, which is remitted to Cyprus is taxed at a maximum rate of 5%.

Foreign capital: The tax exempt period during which the income of an individual derived from interest on foreign money capital imported into the Republic and deposited with any bank operating in Cyprus or earned by lending it for the purpose of financing approved investments has been increased from 3 to 5 years.

Foreign Companies: The profits and dividends of foreign companies and partnerships established in Cyprus are tax exempt, provided they are derived from activities carried out solely outside the Republic of Cyprus.

Tax Amnesty: A tax amnesty is granted in respect of all assets which on the 20th July, 1974, were abroad and which are transferred to Cyprus in the form of money capital not later than the 31st December, 1976. Besides the amnesty granted, the interest earned from the deposit of such money capital with any bank operating in the Republic is exempt from tax for the first five years, as in the case of any foreign money capital which is imported into the Republic and deposited with any bank operating in the Republic, or earned by lending it for the purpose of financing approved investments.

Tax Exempt Income:

(a) The amount of the tax exempt income of an individual derived from Cyprus Government securities and from shares or stocks of public companies incorporated in the Republic has been increased from £100 to £300 per annum. Also the tax exempt income of an individual derived from interest has been increased from £100 to £300 per annum.

(b) For an initial period of five years starting from the 11th July, 1975, and for an additional period as may be determined by the Council of Ministers, 3% of the foreign exchange imported into the Republic, derived from the export of locally produced or manufactured goods is tax exempt, i.e. it is deducted from the chargeable income. An amount equal to 30% of the foreign exchange imported into the Republic derived from the rendering of professional services abroad, and 90% of the foreign exchange imported into the Republic derived from the rendering of labour services to private firms abroad is also tax exempt.

(c) In the case of any business carried out outside the Republic by any person having an interest *not less* than 15% in that business, which in the opinion of the Council of Ministers, promotes the economic, financial, industrial, or other interests of the Republic, 90% of the gains or dividends imported into the Republic is exempt from income tax.

(d) Donations or contributions made for educational, cultural or other charitable purposes to the Republic or to any charitable institution approved as such by the Council of Ministers up to the amount of twenty thousand pounds and 50% of any amount exceeding twenty thousand pounds, are tax exempt. Voluntary contributions to the Special Fund for the Relief of the Displaced Persons, which is under the control of the Accountant-General, are tax exempt without any limit.

(e) Any insurance premiums paid on the taxpayer's or his wife's life, securing the payment of a fixed or determinable capital sum on death, and the annual contributions paid by an employee or an employer to a

Pensions or Provident Fund, approved by the Commissioner of Income Tax are tax exempt.

(f) The Minister of Finance may, with the approval of the Council of Ministers, declare that the interest payable on any loans contracted by the Government shall be tax exempt.

(g) The income of any body of persons formed exclusively for the purpose of promoting art, science, or sport is tax exempt, subject to any conditions which the Council of Ministers may impose.

CORPORATE INCOME TAX

The chargeable income is arrived at by taking the gross receipts and deducting therefrom all expenditure of a revenue nature wholly and exclusively incurred in the production of the income, including expenses for repairs, bad debts, contributions to approved Provident and Pension Funds, donations, or contributions for educational, cultural or other charitable purposes.

The rate of tax payable by companies or other bodies corporate or unincorporate is £0.425 mils per pound or 42.5%. However, if the income of a company incorporated or registered in Cyprus does not exceed £7,000 in a year and that company sets aside to its reserve a sum of up to £5,000, that amount put into the reserve is taxable at the rate of £0.250 mils per pound.

PUBLIC COMPANIES:

Public companies established and registered in the Republic after the 1st of January, 1975, including private companies which are by merging or otherwise turned public, are taxed during the first seven years from the date when they start their operations or from the date when they are turned public, at the reduced rate of £0.250 mils per pound, instead of the standard Company rate of £0.425 mils per pound.

For the purposes of the above tax incentive, a "public company" means a company whose number of shareholders is not less than 200 and of which no shareholder either alone or with his wife and minor children holds more than 40% of the issued and paid up capital, and the paid up capital of which is not less than £100,000.

Company Dividends: Companies are required to deduct from the amount of any dividend payable to any shareholder, tax at the rate paid or payable by them and to issue certificates to the shareholders, stating the amount of the dividend paid as well as the amount of tax which was deducted in respect of that dividend. The individual shareholder has to declare in his return of income the gross amount of a dividend and when his personal income tax liability is calculated he is entitled to set off the tax which the company has already deducted from such dividend and be refunded any excess over his personal tax liability. Thus, double taxation of corporate income is avoided.

Head Office Expenses: Among allowable deductions from tax are a reasonable amount of head office expenses of an overseas company, provided such expenditure can be justified as having been incurred in the production of the profits chargeable to tax.

Losses can be carried forward: Losses incurred in the "basis year" by any person carrying on any trade or business or controlled from Cyprus are in the first instance set off against the income from other sources in the "basis year", and any balance left is carried forward and set off against the income of subsequent years.

Double Taxation Relief and Unilateral Relief: Arrangements for relief from double taxation exist between Cyprus and the United Kingdom, Denmark, Sweden, Eire, Norway and Greece. Agreements with the U.S.A., Italy and the Federal Republic of Germany await ratification.

Under these arrangements a credit is allowed in respect of tax levied by the country in which the taxpayer resides. Thus, if a company controlled in the United Kingdom trades in Cyprus through "a permanent establishment" situated in Cyprus, it will pay tax on its trading profits both in the United Kingdom and in Cyprus, but a tax credit in respect of the Cyprus tax will be allowed against the United Kingdom tax, so that the company will not pay more than the higher of the two taxes.

Income tax paid in a country with which no double taxation agreement has been entered into on income arising there, which is also liable to Cyprus tax, is allowed as a deduction from the Cyprus tax.

TARIFFS:

The Cyprus Customs Tariff is based on the Brussels Tariff Nomenclature. The rates of Customs duties are of four categories, as follows:

(a) The United Kingdom and Republic of Ireland rate of duty, applicable to dutiable goods which by means of an approved certificate of origin are shown to have been consigned to Cyprus from, and grown, produced or manufactured in the United Kingdom, or the Republic of Ireland.

(b) The European Economic Community rate of duty, applicable to dutiable goods which by means of an approved certificate of origin are shown to have been consigned to Cyprus from, and grown, produced or manufactured in the European Economic Community.

(c) The Commonwealth rate of duty, applicable to dutiable goods which by means of an approved certificate of origin are shown to have been consigned to Cyprus from, and grown, produced or manufactured in any country of the Commonwealth.

(d) General Rate of duty, applicable to dutiable goods consigned to Cyprus from and grown, produced or manufactured in any country other than those mentioned in (*a*—*c*) above.

Import Duty Relief:

Under the Customs Tariff, practically all plant and machinery are duty free. Similarly, raw materials, components and other goods used in manufacture are usually admitted duty-free or at reduced rates of duty. This concession does not apply to materials which are available locally. In addition, *drawback* of import duty on certain raw materials and components used in manufacture, on which outright exemption cannot be granted, is allowed on the exportation of the goods incorporating the imported materials.

Protective tariffs:

It is the policy of the Government to afford protection to local industries which have prospects of developing into viable concerns, but which require a period of protection before they can undertake to meet foreign competition. The Cyprus Customs Tariff is revised from time to time with a view to affording such protection to local industries.

* * * DOCUMENTS * * *

U.S A.

Decision of the U.S. District Court of California *

[*Code Secs. 901 and 904*] Foreign tax credit: Exempt income: Carryovers and carrybacks.

[*Code Secs. 6532 and 7405*] Suits by U.S.: Recovery of erroneous refund: Date determined.

MEMORANDUM OF OPINION
AND ORDER

RENFREW, District Judge: This is a civil action brought by the United States of America pursuant to Section 7405, Int. Rev. Code of 1954, to recover erroneous refunds of income taxes paid to W. Keith and Teresa Woodmansee ("taxpayers"). Federal jurisdiction over the subject matter arises under 28 U. S. C. §§ 1340, 1345. Taxpayers filed a motion to dismiss the complaint for failure to state a claim entitling the Government to relief. Subsequently plaintiff filed a motion for summary judgment. Pursuant to Rule 12(b) of the Federal Rules of Civil Procedure, the Court has treated taxpayers' motion as one for summary judgment.

[*German Residence*]
Defendant W.Keith Woodmansee ("Woodmansee") was a flight engineer for Pan American Airlines whose duties resulted in service on Pan American's foreign air routes.[1] With the exception of a period from late 1960 until early 1964, Woodmansee resided in and was based in the United States. During the 1961-1963 period he resided abroad and claims he flew as a flight engineer entirely within German air space. During 1961, 1962 and 1963 he paid German income taxes on his wages and apparently was exempted from United States income taxes.[2]
In 1960 and 1964 taxpayers elected to take the benefits of Section 901 of the Internal Revenue Code of 1954 and took a foreign tax credit against their United States income tax for those years on the basis of the German income tax which they paid. On their 1965 income tax return taxpayers took an additional foreign tax credit of $56 representing German income tax withheld by Pan American for income earned by Woodmansee during the 1960-1964 period.[3]

[*Amended Return Filed*]
In 1971 taxpayers elected to utilize the foreign tax credit carryover provisions of

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* *U.S. v. Woodmansee,* U.S. District Court, Dist. Calif., No. C-74-1346-CBR, 1/15/75 (388 F. Supp. 36).

1. Woodmansee flew solely on routes between a point in the United States and a point in a foreign country or between two points, both of which were in foreign countries. Pan American Airlines has no domestic flights (*i.e.,* flights between two points both of which are in the United States). The mere fact that Woodmansee flew solely on foreign air routes does not by itself render all of his income from services rendered on those flights foreign source income. See note 24, *infra.*

2. The Court does not have before it nor does it rule on the propriety of this exemption from the United States income tax. It does note that taxpayers allege the exemption arose pursuant to Section 911, Int. Rev. Code of 1954.

3. Taxpayers have not specifically attributed this $56 of German income tax to any one year in the 1960-1964 period because of the failure of Pan American to provide them with this information.

Section 904(d), Int. Rev. Code of 1954. Accordingly, they filed amended United States income tax returns for 1964, 1965, 1966, and 1967.[4] In effect, taxpayers took against United States income taxes for 1964-1967 a direct credit for all of the German income taxes which were paid during the 1961-1963 period. Because taxpayers paid no United States income tax for the 1961-1963 period, this dollar-for-dollar reduction resulted in a windfall tax shelter in excess of $8,100. Subsequently, the Internal Revenue Service paid the claims for refund after auditing the amended return and making minor adjustments.

[Refunds Made]

The Internal Revenue Service issued four separate refund checks. In its complaint the Government alleges that the refund check for the 1966 amended return was issued on or about June 26, 1972. Woodmansee, however, alleges that he received the refund check on June 24, 1972. It appears from an affidavit that the check in question was dated June 23, 1972, and was inscribed by taxpayers' bank with the date June 26, 1972.[5] The complaint in this action was filed on June 26, 1974.

The Government contends that as a matter of law the refunds in question were erroneous because the amended returns were filed after the statutory deadline prescribed by § 6511(a), Int. Rev. Code of 1954.[6] Taxpayers, however, contend that the applicable statutory limitation is prescribed by § 6511(d)(3)(A) and therefore that their claim is not barred by the statute of limitations. Additionally, they contend that § 6532(b) bars the Internal Revenue Service suit as to the 1966 refund payment. The Court agrees with this last contention and grants summary judgment for taxpayers as to the 1966 refund. However, the Court finds that as a matter of law taxpayers are not entitled to utilize the benefits of the foreign tax credit provisions under the circumstances of this case and hence grants the Government's motion for summary judgment as to the 1964, 1965, and 1967 refunds.

4.

Tax Year	Tax Paid	Amended Return Filed	Additional Foreign Tax Credit Claimed	Refund Paid
1964	1703	10/21/71	1614	1583.95
1965	2176	10/21/71	1980	2734.92
1966	2534.26	10/21/71	2407	3153.01
1967	1598	2/25/72	37	689.31

5. A photostatic copy of the deposit slip used by taxpayers to deposit the check in question is both rubber stamped and inscribed with the date June 26, 1972. However, taxpayers allege in an affidavit that they deposited the check on June 24, 1972, and the deposit slip was so dated. See Affidavit in Support of Response to Plaintiff's Motion for Summary Judgment, dated September 6, 1974. The Court finds highly credible the handwritten date on the deposit slip. It is highly unlikely that taxpayers considered the statute of limitations ramifications at the time of the deposit of the check.

6. During oral argument the Government did not address itself to the question of the applicability of the foreign tax credit provisions to the present factual situation. In fact, Government counsel conceded that absent prohibition by § 6511(a), taxpayers were entitled to utilize the foreign tax credit provisions. Upon questioning by the Court, Woodmansee addressed his argument to this issue. Because a careful review of the case law and legislative history led the Court to the tentative view that the provisions were inapplicable to the instant case, the Court advised the parties to file supplementary briefs on this issue. Subsequent to the filing of these briefs, the Court heard further oral argument on this issue on December 5, 1974. At this hearing Woodmansee requested leave to file an additional brief ten days subsequent to the hearing. This request was granted by the Court. The Government filed a responsive brief on December 12, 1974.

[*Issues*]

The issues before the Court are the following:

1. Are taxpayers entitled to the benefits of § 901 even if the 10-year limitation period is applicable?

2. Does § 6532(b) bar the Government from bringing suit to collect the 1966 refund?

Section 901 provides that a taxpayer may elect, subject to the limitations of § 904, to take a tax credit against his United States income tax for the amount of any income taxes paid or accrued during the taxable year to any foreign Country.[7] Section 904 (a) establishes two alternate limitations on the size of the foreign tax credit.[8] The overall limitation elected by taxpayers in the instant case provides that the foreign tax credit shall not exceed that same proportion of taxpayers' United States tax which taxpayers' foreign source taxable income bears to their entire taxable income for the same taxable year. Section 904(d) establishes a carryback and carryover provision for that part of the foreign tax credit which taxpayers are unable to utilize due to the limitations prescribed in § 904(a).[9]

7. Section 901 provides in pertinent part:
"(a) Allowance of credit. — If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against the tax imposed by section 56 (relating to minimum tax for tax preferences), against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries) or under section 1351 (relating to recoveries of foreign expropriation losses), or against the personal holding company tax imposed by section 541.
"(b) Amount allowed. — Subject to the applicable limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):
"(1) Citizens and domestic corporations. — In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States * * *."

8. Section 904(a) provides in pertinent part:
"(1) Per-country limitation. — In the case of any taxpayer who does not elect the limitation provided by paragraph (2), the amount of the credit in respect of the tax paid or accrued to any foreign country or possession of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country or possession (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.
"(2) Overall limitation. — In the case of any taxpayer who elects the limitation provided by this paragraph, the total amount of the credit in respect of taxes paid or accrued to all foreign countries and possessions of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the entire taxable year."

9. Section 904(d) provides:
"(d) Carryback and carryover of excess tax paid. — Any amount by which any such tax paid or accrued to any foreign country or possession of the United States for any taxable year beginning after December 31, 1957, for which the taxpayer chooses to have the benefits of this subpart exceeds the applicable limitation under subsection (a) shall be deemed tax paid or accrued to such foreign country or possession of the United States in the second preceding taxable year, in the first preceding taxable year, and in the first, second, third, fourth, or fifth succeeding taxable years, in that order and to the extent not

Section 275(a) provides that a taxpayer cannot take a deduction for any foreign taxes as to which he has taken a foreign tax credit.[10]

I. *Applicability of the Foreign Tax Credit*

A literal reading of the foreign tax credit provisions of the Code and the regulations promulgated thereunder would in the absence of any other considerations result in the applicability of the credit in the instant case. However, it is the duty of the Court to interpret Code provisions consonant with Congress' legislative purpose. *See generally Gregory v. Helvering* [35-1 USTC ¶9043], 293 U. S. 465, 469-470 (1935). It is manifestly clear from both the legislative history and the subsequent case history that the primary purpose of the foreign tax credit provisions was to prevent double taxation of the income of taxpayers whose business activities were subject to taxation by both foreign countries and the United States. The predecessor to Section 901 first appeared in the Revenue Act of 1918. At that time Congress recognized that if a taxpayer's income was subject to both the United States income tax and a foreign income tax, he would be subject to such a severe tax burden that the effective rate would approach a confiscatory level.[11] Congress also realized that the resulting double

deemed tax paid or accrued in a prior taxable year, in the amount by which the applicable limitation under subsection (a) for such preceding or succeeding taxable year exceeds the sum of the tax paid or accrued to such foreign country or possession for such preceding or succeeding taxable year and the amount of the tax for any taxable year earlier than the current taxable year which shall be deemed to have been paid or accrued in such preceding or subsequent taxable year (whether or not the taxpayer chooses to have the benefits of this subpart with respect to such earlier taxable year). Such amount deemed paid or accrued in any year may be availed of only as a tax credit and not as deduction and only if taxpayer for such year chooses to have the benefits of this subpart as to taxes paid or accrued for that year to foreign countries or possessions. For purposes of this subsection, the terms 'second preceding taxable year' and 'first preceding taxable year' do not include any taxable year beginning before January 1, 1958."

10. Section 275(a) provides:

"(a) General rule. — No deduction shall be allowed for the following taxes:

* * *

"(4) Income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 901 (relating to the foreign tax credit)."

11. The House of Representatives in its report on the Revenue Act of 1918 said:

"Under existing law a citizen of the United States can only deduct income, war or excess profits taxes paid to a foreign country from gross income in computing net income. With the corresponding high rates imposed by certain foreign countries the taxes levied in such countries in addition to the taxes levied in the United States upon citizens of the United States place a very severe burden upon such citizens. The bill provides that a credit against the income tax imposed in the United States be allowed a citizen of the United States subject to income and war or excess profits taxes in a foreign country of an amount equal to the tax paid in such country upon income that is received from sources within such country." H. R. Rep. No. 767, 65th Cong., 2d Sess., p. 11.

12. The following statement was made in a report of the House of Representatives in relation to the Revenue Act of 1921:

"Under existing law an American citizen or domestic corporation is taxed upon his or its entire income even though all of it is derived from business transacted without the United States. This results in double taxation, places American business concerns at a serious disadvantage in the competitive struggle for foreign trade, and encourages American corporations doing business in foreign countries to surrender their American charters and incorporate under the laws of foreign countries." H. R. Rep. No. 350, 67th Cong., 1st Sess., p. 8.

The provisions which this statement accompanied taxation would place United States taxpayers at a competitive disadvantage and would tend to constrain American trade abroad.[12] When the Internal Revenue Code of 1954 was enacted, Congress reiterated that the foreign tax credit provisions were designed to prevent double taxation of foreign source taxable income by treating taxes imposed by a foreign country as if they were imposed by the United States.[13]

[*Elimination of Abuse*]

Congress found it immediately necessary to correct an abuse which arose out of the predecessor foreign tax credit provision. Utilization of the foreign tax credit by a taxpayer where the foreign tax rate was higher than the United States rate resulted in the credit sheltering United States source income from the United States tax properly attributable to it. In order to eliminate this abuse, Congress enacted the predecessor provision to the overall and per-country limitations found in Section 904(a).[14] These provisions limited the credit to the United States tax attributable to the taxpayers' foreign source income. Congress did not intend to mitigate high foreign tax rates but rather intended only to shield taxpayers from foreign taxes to the extent that they duplicated the United States income tax burden.[15]

It was not until 1958 that Congress enacted the foreign tax credit carryback and carryover provisions.[16] The purpose of most carryback and carryover provisions in the Internal Revenue Code is to mitigate the effect of taxing on an annual basis as opposed to some other time frame.[17] Yet that rationale is inapposite in the case of

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did not deal with foreign tax credits, but rather excluded from taxable income certain foreign source income of certain taxpayers engaged in foreign business. However, both that provision and the foreign tax credit are means by which the above-stated policy could be implemented and hence it is immaterial that the statement did not accompany a foreign tax credit provision.

13. The House Report accompanying the bill stated:
"Credit is allowed under existing law against United States tax liability for income taxes paid abroad. This provision gives foreign countries a prior tax claim on the income of United States enterprises operating abroad, and in effect treats the taxes imposed by the foreign country as if they were imposed by the United States. The provision was originally designed to produce uniformity of tax burden among United States taxpayers, irrespective of whether they were engaged in business in the United States or engaged in business abroad." H. R. Rep. No. 1337, 83d Cong., 2d Sess., p. 76.

14. The House of Representatives explained the rationale behind the limitation provisions stating:
"The income tax law allows a credit, dollar for dollar, against our tax for any income or profits taxes paid to any foreign country or to any possession of the United States, with certain modifications in the case of alien residents of the United States. Where foreign income or profits taxes are imposed at rates higher than those carried by the similar taxes in this country, this credit may wipe out part of our tax properly attributable to income derived from sources within the United States. To prevent this abuse, section 228 provides that in no case shall the amount of this credit exceed the same proportion of our tax which the taxpayer's net income from sources within the United States bears to his entire net income." H. R. Rep. No. 350, 67th Cong., 1st Sess., p. 13.

15. H. R. Rep. No. 855 which accompanied the Internal Revenue Code of 1939 stated:
"The limitations on the allowance of a credit for taxes paid to foreign countries were placed in the law to make it certain that the Federal Government would receive its full tax on the income from United States sources. It was not intended for the American tax to apply against the income from foreign sources unless the foreign tax rate was less than the tax rate imposed by the United States." H. R. Rep. No. 855, 76th Cong., 1st Sess., p. 5.

16. Int. Rev. Code of 1954, § 904(d).

17. See, *e.g.*, Int. Rev. Code of 1954, § 172, §§ 381 *et seq.*, § 1212, §§ 1301 *et seq.*

a foreign tax credit, because the time period over which taxable income is computed has no impact on double taxation. Double taxation is concerned solely with whether a particular dollar of taxable income is being taxed by both the United States and foreign entities, and this question is completely independent of any subsequent or prior events.[18] Congress did not intend to shield taxpayers from higher foreign tax rates and thus vitiate the effect of the limitations provisions found in § 904(a). See footnotes 14 and 15, *supra*. If Congress had wanted to foster that purpose, it could have repealed those limitation provisions.[19] The legislative reports accompanying the 1958 Amendment to the Internal Revenue Code show that § 904(d) was intended to apply to one particular set of circumstances. Congress realized that double taxation was possible notwithstanding the foreign tax credit provisions because of differences in reporting income in the United States and certain foreign countries. If in a given period foreign source income was reportable in the foreign country but not in the United States, double taxation could result. In period one although a foreign tax credit would arise from the payment of foreign income taxes, the § 904(a) limitation provisions would preclude the utilization of the credit in that period because for United States tax purposes there would be no taxable foreign source income. In period two when the limitation would allow a large credit, because there would be no payment of a foreign tax, no credit would arise. Section 904(d) represents an attempt by Congress to eliminate double taxation in such a case.[20] Allowance of a windfall tax sav-

18. The operating loss carryback and carryover provisions are necessary because of the way in which our tax system defines income (viz. income equals economic gain minus economic loss for the taxable period). Under this definition, income cannot be determined by the consideration of a single economic transaction but rather is dependent upon all prior and subsequent transactions in the taxable period. Administrative and governmental revenue needs require collection of taxes on an annual basis. These carryback and carryover provisions merely recognize the fact that an equitable tax system necessitates a longer taxable period than one year.

19. It could conceivably be argued that rather than repealing the limitation provisions found in § 904(a), Congress wanted to require the taxpayer to spread over several years that part of the tax credit arising from higher foreign tax rates. Yet this argument must fall under careful analysis. It would border on the nonsensical to shield taxpayers from higher foreign tax rates *only* when they had foreign source income in the carry years which was not subject to foreign tax. It would be patently absurd to attribute such an intent to Congress.

20. That Congress enacted § 904(d) with this intent is clearly demonstrated by the House Report for the Technical Amendments Act of 1957 which stated:

"Double taxation can occur at present because of the manner in which this country-by-country limitation works where the methods of reporting income are different in the United States and the foreign country. These differences may result in the same income being reported in one year in the United States and in another year in the foreign country. When this occurs the foreign tax credit available will tend to be less than the taxes paid or accrued to the foreign country in the year the income is reported in that country but not in the United States. In another year when this income is reported in the United States but not the foreign country, the credit which would be available under the limitation will tend to exceed the foreign taxes paid or accrued. Illustrations of the factors which may result in a difference in the timing or reporting of income and allowance of deductions are:

"(1) Reporting of taxable income from sales on the installment basis in the United States without being permitted to report in a similar manner in a foreign country (or possession of the United States);

"(2) Differences under the laws of the United States and those of the foreign country in the pricing of inventories (this may result in the ing by a taxpayer because of Congressional imprecision in drafting would emasculate the legislative purpose underlying the foreign tax credit provisions.

[Primary Design]

The cases construing the foreign tax credit provisions do not support a contrary interpretation. Many courts have found that "the primary design of the [foreign tax credit] provision was to mitigate the evil of double taxation." *Burnet v. Chicago Portrait Co.* [3 USTC ¶882], 285 U. S. 1, 7-8 (1931); *Rinehart v. United States* [70-1 USTC ¶9031], 429 F. 2d 1286, 1288 (10th Cir. 1970); *Associated Telephone & Telegraph Co. v. United States* [62-2 USTC ¶9659], 306 F. 2d 824, 832 (2d Cir. 1962); *Federated Mutual Implement & Hard. Ins. Co. v. Commissioner* [59-1 USTC ¶9435], 266 F. 2d 66, 69 (8th Cir. 1959); *Gordon Duke* [CCH Dec. 24,299], 34 T. C. 772, 775 (1960); *Mary A. Marsman* [CCH Dec. 18,880], 18 T. C. 1, 12 (1952), *modified* [53-1 USTC ¶9431], 205 F. 2d 335 (4th Cir. 1953). Furthermore, it was not the purpose of the foreign tax credit provisions to relieve taxpayers from bearing the full United States tax burden attributable to income arising from sources within this country. *Associated Telephone & Telegraph Co. v. United States, supra,* 306 F. 2d at 832. In deciding whether a final liquidating distribution by a foreign subsidiary to a domestic corporation constituted a "dividend" for the purposes of § 902(a), the court has stated that "[t]o allow the credit here would facilitate a convenient scheme for avoiding the United States income tax * * *. No Congress from 1913 to the present ever 'intended' such a result." *Associated Telephone & Telegraph Co. v. United States, supra,* 306 F. 2d at 833.

Although a literal reading of the statutory provisions would support taxpayers' contention as to the applicability of the foreign tax credit in the instant case, the courts have held that they will follow the clearly stated purpose underlying the legislation where a literal construction would produce absurd or futile results or where it would produce unreasonable results plainly at variance with the policy of the legislation as a whole. *United States v. American*

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reporting of income from the ultimate sale of such articles in a different year in the United States than in the foreign country);

"(3) Differences in reporting foreign exchange profit or loss (such profit or loss may be reported on the accrual basis in the United States but only on the cash basis in some foreign countries);

"(4) Differences in depreciation methods in the United States and in the foreign country;

"(5) The requirement of some countries that income taxes be determined only on a fiscal-year basis; and

"(6) The use of an averaging device in the computation of taxable income in certain foreign countries covering more than 1 taxable year.

"To eliminate the double taxation existing under present law, this section adds a new subsection to section 904 of the code to permit foreign taxes which cannot be claimed currently as a tax credit as a result of the country-by-country limitation to be carried back successively to the 2 prior years and then forward to the 5 succeeding years and used in these years to the extent the foreign taxes for such years are less than the amount allowable under the country-by-country limitation."

H. R. Rep. No. 775, 85th Cong., 1st Sess., pp. 27-38. The provision was originally enacted by the House and then deleted in the Senate version of the bill. S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 117-118 (1958). Subsequently, the Conference Committee restored the provision without any comment as to statutory purpose. See Conference Report No. 2632, 85th Cong., 2d Sess., p. 31 (1958). The Congressional intent could not have been more clearly and explicitly stated.

Trucking Associations, 310 U. S. 534, 543-544 (1940); *Mary A. Marsman, supra,* 18 T. C. at 12.[21]

[*Conclusions*]

The Court holds that the foreign tax credit prescribed in § 901 cannot arise out of foreign taxes paid or accrued on income which is exempt from the United States income tax.[22] It is further held that the foreign tax credit carryback and carryover provisions found in § 904(d) are applicable only as to income which is reportable in different time periods in the United States and the foreign country in question.[23] Accordingly, the Government's motion for summary judgment is granted with respect to the 1964, 1965, and 1967 refund checks.[24]

[*Rulings Disapproved*]

The Court notes that the Internal Revenue Service has issued three apparently contradictory revenue rulings. See Rev. Rul. 72-126, 1972-1 Cum. Bull. 217; Rev. Rul. 68-622, 1968-2 Cum. Bull. 298; Rev. Rul. 54-15, 1954-1 Cum. Bull. 129. In Rev. Rul. 72-126 the Internal Revenue Service held that a tax credit arose out of a foreign tax attributable to income exempt from the United States income tax pursuant to § 911 and that the credit so arising could be carried back and forward in accordance with Treas. Reg. § 1.904-2(b)(2)(i). This holding was based on the authority of Rev. Rul. 54-15 which held that a foreign tax credit allowed under the predecessor section to § 901 was limited in application only as provided by the predecessor to § 904(a). Finally, Rev. Rul. 68-622 held that in determining the foreign tax credit, the foreign income tax paid by the domestic company to the foreign country is not reduced by the tax attributable to income taxed in the foreign country but not taxed in the

21. In *Associated Telephone & Telegraph Co. v. United States, supra,* 306 F. 2d at 833, the court said that on those occasions when circumstances arise in which the statutory scheme falls to operate in accordance with the policies which created it, there is no excuse for failing to effectuate those policies.

22. In *Rinehart v. United States, supra,* 429 F. 2d at 1288, the taxpayer paid Puerto Rican income taxes attributable to prior years when no United States tax liability existed. The court held that since the taxpayer had no taxable foreign source income, the § 904(a)(1) limitation barred utilization of the foreign tax credit. The court also stated: "Again the design of such provision is to mitigate the evil of double taxation. [citations omitted] Here appellants fail to show that the Puerto Rican earnings were subject to federal income taxation. Thus the credit sought under § 901 is not available." *Rinehart v. United States, supra,* 429 F. 2d at 1288.

23. It should be noted that either holding will independently dispose of the present factual situation on the merits.

24. It is important to note that even without the above holdings the Government would partially prevail on its motion for summary judgment. The reasons for this are twofold. First § 904(d) could be read to require that the unused foreign tax credits from 1961-1964 be carried back to 1959 and 1960 regardless of whether the taxpayers can presently assert the right to a refund for those early years. Thus, in the instant case, taxpayers may, because of the statute of limitations, have lost that part of the credit to which they were earlier entitled. Second, a proper judicial construction of "taxable income from sources outside the United States" may impose a § 904(a) limitation which will reduce the amount of the credit which taxpayers were initially allowed for 1964-1967. Woodmansee's assertion that 87% of his income during the 1964-1967 period was foreign source income is not clearly supported in the record. See his affidavit filed December 23, 1974. The test to determine what constitutes foreign source income is based on where the taxpayer rendered his services. See *Tipton & Kalmbach, Inc. v. United States* [73-2 USTC ¶ 9541], 480 F. 2d 1118, 1120-1121 (10th Cir. 1973); 26. U. S. C. §§ 861 *et seq.;* Treas. Reg. § 1.901-2(d), § 1.861-4, § 1.862-1. However, these issues are not now before the Court and we leave their resolution for a later day.

United States. This ruling was also based solely on Rev. Rul. 54-15. However, at the time Rev. Rul. 54-15 was issued, the carryback and carryover provisions had not yet been enacted.[25] Furthermore, the reasoning and holdings in the instant case are dispositive of the issues present in the rulings and hence the rulings are disapproved and overruled to the extent they are contradictory.[26]

Finally, in *Helvering v. Campbell* [44-1 USTC ¶9152], 139 F. 2d 865, 870 (4th Cir. 1944), the court held that the taxpayer was entitled to deduct the entire amount of the Philippine income tax he paid notwithstanding the fact that certain items excluded in computing the taxable income of the taxpayer under federal law were not so excluded under Philippine law. However, the instant case is at least partially distinguishable on its facts from *Campbell.* There the court merely found that where there was only one income generating activity, it would be irrelevant that the foreign country's definition of the tax base was larger. The court could have felt that defining a larger tax base was an indirect method of imposing a higher rate structure. Thus, as long as the same revenues and income generating activities were being taxed, the § 904(a) limitation would prevent any abuses. It should be noted that the carryback and carryover provisions were not in effect during the years in question and hence the question of the construction of § 904(d) was not before the court in *Campbell.* Nevertheless, to the extent that *Campbell* contradicts this opinion, it is disapproved and not followed.[27]

II. *The § 6532(b) Limitation*

Section 6532(b) of the Internal Revenue Code of 1954 provides that a suit for the recovery of an erroneous refund pursuant to § 7405 must be brought within two years after the making of such a refund.[28] It is clear that the two-year period in § 6532(b) runs from the making of the payment and

25. Clearly Rev. Rul. 54-15 is not determinative of the instant case. Since Rev. Rul. 68-622 and Rev. Rul. 72-126 are based solely on Rev. Rul. 54-15, they are also not dispositive of this case.
26. This Court is not bound by administrative regulations or rulings construing the foreign tax credit provisions where they are not supported by valid reasons and are contrary to the legislative purpose. *Burnet v. Chicago Portrait Co., supra,* 285 U. S. at 16, 21.
27. The Government contends that the refunds in question were erroneously made as a matter of law because they were made after the expiration of the applicable period of limitation. See Int. Rev. Code of 1954, § 6514. Whether this contention is correct depends on whether the limitation in § 6511(a) or that in § 6511(d)(3)(A) is applicable. Were this question before the Court, it would conclude that taxpayers are correct when they contend that § 6511(d)(3)(A) is the applicable limitation.
Where a taxpayer seeks a refund of an overpayment of taxes attributable to a recalculation of a foreign tax credit, the applicable limitation period is the ten-year period found in § 6511(d)(3)(A). *Morrison-Knudsen Co., Inc. v. United States,* 22 A. F. T. R. 2d 5757, 5758 (N. D. Cal., September 20, 1968); Rev. Rul. 68-150, 1968-1 Cum. Bull. 564, 565. Here the taxpayers' application for a refund might be construed as "the discovery of creditable taxes which were not reported on the income tax return when filed." Rev. Rul. 68-150, 1968-1 Cum. Bull. 564, 565. Thus, had the merits of this case been decided differently, the Government would have lost on its limitations argument.
28. Section 6532(b) provides:
"Recovery of an erroneous refund by suit under section 7405 shall be allowed only if such suit is begun within 2 years after the making of such refund, except that such suit may be brought at any time within 5 years from the making of the refund if it appears that any part of the refund was induced by fraud or misrepresentation of a material fact."

not from the allowance of the refund. *United States v. Wurts* [38-1 USTC ¶9183], 303 U. S. 414, 418 (1938); *United States v. Fairbanks* [38-1 USTC ¶9250], 95 F. 2d 794, 795 (9th Cir. 1938); *aff'd* [39-1 USTC ¶9410], 306 U. S. 436 (1939). The real issue before this court is what constitutes "the making of the payment." The Government contends that payment is made when all events have been fixed which will permit the taxpayer to obtain the cash equivalent of the refund check, while taxpayers contend that payment is made when they receive the refund check. The Court agrees with taxpayers and hence grants their motion for summary judgment as to the 1966 refund.

At a minimum, payment is deemed made upon the ripening of a legal obligation on the part of the Internal Revenue Service to the taxpayer. *See United States v. Wurts, supra,* 303 U. S. at 417-418. Such a legal obligation would arise at that moment when an account stated arises. *United States v. Wurts, supra,* at 417-418. Since the receipt of the refund check gave rise to an account stated, the date of receipt (June 24, 1972) is the date of the making of payment. *See Daube v. United States* [3 USTC ¶1099], 289 U. S. 367, 370-372 (1933). Acceptance of the account balance did not require the taxpayer to obtain the cash equivalent of the check.[29] Acceptance was manifested by taxpayers' request for a refund. The receipt of the refund check constituted acceptance at least as to the amount of the check. *Cf. United States v. A. S. Krieder Co.* [41-1 USTC ¶9486], 313 U. S. 443, 449 (1941).

The courts have held that "the making of such refund" should be construed in accordance with the common understanding of those words. *United States v. Wurts, supra,* 303 U. S. at 417; *Paulson v. United States* [35-2 USTC ¶9451], 78 F. 2d 97, 99 (10th Cir. 1935). Since refund means to pay back, return, restore, and/or make restitution, then such a return or restoration is made when the check in payment of the obligation is delivered. *Paulson v. United States, supra,* 78 F. 2d at 99.

[*Result Mandated*]

Furthermore, basic policy considerations mandate this result. A construction based upon final payment as defined in the Uniform Commercial Code § 4-213 would result in a nonuniform date of payment. There would be a different date depending upon whether the taxpayer cashed the refund check in a currency exchange, deposited it in his checking or savings account, or merely stored it in a shoebox. Also, a difference in banking laws would result in different payment dates. Accordingly, the Court holds that the § 6532(b) limitations period runs from the date of delivery of the refund check.

The foregoing constitutes the Court's Findings of Fact and Conclusions of Law as required by Rule 52(a), Federal Rules of Civil Procedure.

IT IS HEREBY ORDERED,
ADJUDGED AND DECREED
that the Government's motion for summary judgment is granted as to the 1964, 1965 and 1967 refunds.

IT IS HEREBY FURTHER ORDERED,
ADJUDGED AND DECREED
that taxpayer's motion for summary judgment is granted as to the 1966 refund.

29. Certainly the Internal Revenue Service would owe no obligation to a taxpayer who upon receipt of a refund check placed it in a shoebox and never deposited it in a bank for collection.

IT IS HEREBY FURTHER ORDERED
that plaintiff prepare a form of judgment in accordance with this Memorandum of Opinion.

JUDGMENT

This action came on for due hearing before the Court, Honorable Charles B. Renfrew presiding, and the issues having been duly heard and a decision having been duly rendered on January 15, 1975, by the Court's Memorandum of Opinion and Order it is hereby
ORDERED, ADJUDGED AND DECREED
that the plaintiff, United States of America, recover of the defendants, W. Keith Woodmansee, and his wife, Teresa Woodmansee, as follows:

1. The sum of $1,583.95, plus interest as provided by law at the rate of 6 percent per annum from January 10, 1972, to date of payment with respect to defendants' 1964 taxable year;
2. The sum of $2,734.92, plus interest as provided by law at the rate of 6 percent per annum from September 25, 1972, to date of payment with respect to defendants' 1965 taxable year; and
3. The sum of $689.31, plus interest as provided by law at the rate of 6 percent per annum from July 17, 1972, to date of payment with respect to defendants' 1967 taxable year. It is further hereby

ORDERED, ADJUDGED AND DECREED
that the plaintiff take nothing with respect to defendants' 1966 taxable year. It is further hereby
ORDERED, ADJUDGED AND DECREED
that each party is to bear its own costs.

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* * * ARTICLES * * *

KAILASH C. KHANNA *:

INDIA: THE FINANCE BILL, 1976

The Finance Bill for the financial year 1976 (1st April, 1976, to 31st March, 1977) was presented to Parliament by the Finance Minister on 15th March, 1976. This Finance Bill has been generally well received because, to quote a report in 'The Economic Times', "for the first time in the last two decades, the budget proposals have given relief all along the line to the corporate sector and to the upper income group." Moreover, the Finance Minister's Budget Speech is commendable for its frank and candid observations. For instance, speaking in Parliament about the high tax rates, the Finance Minister stated: "these high rates have not led to any significant reduction of inequality of income and wealth. On the contrary, they have resulted in large tax evasion, generation of black money and conversion of visible assets into invisible ones. It is essential to remove these distortions in the economy."

SUMMARY OF PROPOSED CHANGES IN CORPORATE TAXATION

1. It is proposed to continue the existing rates of corporate income-tax and the surcharge thereon. However, a company may, in lieu of payment of surcharge, make a deposit with the Industrial Development Bank of India and if it does so, the amount of surcharge payable shall be reduced by the amount of the deposit. Thus, if a company makes a deposit during the financial year 1976/77, the surcharge on income-tax payable by it for the assessment year 1977/78 will be reduced by the amount of the deposit so made. A scheme will be framed by the Central Government for the purpose of making a deposit with the IDBI.

2. It is proposed to replace the existing scheme of initial depreciation allowance by a scheme of investment allowance.

The new scheme will be broadly on the lines of the development rebate. Its main features are

(a) The investment allowance will be allowed at the rate of 25 percent of the cost of

(i) new ships or new aircraft acquired after 31st March, 1976, by taxpayers engaged in the business of operation of ships or aircraft;

(ii) new machinery or plant installed after 31st March, 1976, for the purposes of generation or distribution of electricity or any other form of power;

(iii) new machinery or plant installed after 31st March, 1976, in specified industries as listed in a Schedule; and

(iv) new machinery or plant installed after 31st March, 1976, in small-scale industrial undertakings for the manufacture or production of any articles or things.

The investment allowance will also be available on second-hand ships, aircraft and machinery or plant imported from abroad, subject to specified conditions.

(b) An amount equal to 75 per cent of the investment allowance (in the case of ships 50 per cent) to be actually allowed

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shall be credited to an investment allowance reserve.

(c) The investment allowance will be withdrawn and will become liable to tax if the investment allowance reserve is not utilised for the purpose of acquiring new machinery or plant within a period of 10 years. Until the acquisition of new plant, machinery, etc., the reserve may be utilised for other purposes of the business but no part of the reserve shall be available for distribution as profits or for remittance abroad. The allowance shall also stand forfeited if the asset in respect of which it was granted is sold or otherwise transferred before the expiry of 8 years from the end of the year in which the asset was acquired or installed.
The Central Government shall give a notice of three years before withdrawing the investment allowance in respect of any ship, aircraft or machinery or plant.
These changes will apply from the assessment year 1976/77.

3. At present an initial depreciation allowance at 20 per cent of the actual cost is given in respect of buildings newly erected for employees whose income under the head salaries does not exceed Rs. 7,500 per annum. It is proposed to raise the aforesaid monetary limit to Rs. 10,000.

4. It is proposed to reduce the rates of tax on long-term capital gains. Long-term capital gains relating to buildings or lands or any rights therein will be charged to tax at the rate of 40 per cent (as against 47 per cent at present) in the case of widely-held companies having total income not exceeding Rs. 1 lakh and at the rate of 50 per cent (as against 55 per cent, at present) in the case of other companies. Long-term capital gains relating to other assets will be charged to tax at the rate of 40 per cent (as against 45 per cent, at present) in the case of all classes of companies.
These amendments will take effect from 1st April, 1977, and will accordingly apply in relation to the assessment year 1977/78 and subsequent years.

5. It is proposed to exempt interest payable on any monies borrowed by a company in foreign currency from sources outside India. The exemption will be available only if the loan agreement is approved by the Central Government and will be limited to so much of the interest as does not exceed the interest paid at the rate approved by the Government.
The proposed amendment will take effect from 1st June, 1976, and will apply for the assessment year 1977/78.

6. The existing basis of taxation of dividend income in the case of foreign companies is proposed to be modified. Under the proposed basis of taxation, no deduction will be allowed from the dividend income and the gross amount of dividends payable to foreign companies shall be charged to tax at the flat rate of 25 per cent.

7. It is proposed to provide that no deduction will be admissible in computing income by way of royalties and fees for technical services received by foreign companies under agreements entered into with Indian concerns after 31st March, 1976. If the agreements are approved by the Central Government, lump sum payments received by foreign companies for supply of industrial know-how outside India are proposed to be taxed at the rate of 20 per cent of the gross amount of such payments; other payments by way of royalties and fees for technical services will be charged to tax at the flat rate of 40 per cent of the gross amount.

As regards royalties and technical service fees received by foreign companies under approved agreements made with Indian concerns before 1st April, 1976, the existing rate of taxation, 52.5 per cent will continue but a deduction in respect of expenses, limited to a maximum of 20 per cent of the gross income, shall be allowed. The amendments proposed in paragraphs 6 and 7 will apply from assessment year 1977/78.

8. Head office expenses allowable as deduction in respect of Indian branches of foreign companies will be subject to specified ceiling limits, the broad upper limit being 5 per cent of the Indian income.

9. It is proposed to amend the relevant provision of the Income Tax Act to permit deduction for entertainment expenses within specified limits. The maximum deduction will be limited to Rs. 30,000 per annum.

10. A suggested amendment debars donations in kind from income-tax relief even if such donations are made to approved charities. The proposed amendment will take effect from assessment year 1976/77.

Companies (Profits) Surtax Act, 1964

1. It is proposed to raise the statutory deduction under the Companies (Profits) Surtax Act from 10 per cent to 15 per cent of the capital of the company. No change is, however, proposed in the monetary limit of Rs. 2 lakhs. The proposed statutory deduction will be calculated with reference to the capital and reserves of the company and long-term borrowing and debentures will be excluded from the capital base. However, interest paid on long-term borrowings and debentures will not be added-back in computing the chargeable profits as is done under the existing provisions. The amendment will take effect from 1st April, 1977, that is assessment year 1977/78.

2. A proposed change authorises the Income-tax Officer, if he is of the opinion that the amounts credited to accounts such as provision for proposed dividend, provision for taxation, etc. fall short of the required sums, to reduce the capital base of the company by the amount of the shortfall. The proposed amendment will have retrospective effect from the assessment year 1975/76.

SUMMARY OF PROPOSED CHANGES IN PERSONAL TAXATION

Income-tax

1. It is proposed to reduce the rates of income-tax at all levels of personal incomes. The maximum marginal rate, including 10 per cent surcharge, will be reduced from 77 per cent to 66 per cent and will be applicable on the slab of income over Rs. 1,00,000 as against the existing slab of Rs. 70,000.

2. At present, contributions by an employee to a recognised provident fund are limited to one-fifth of his salary or Rs. 8,000 whichever is less. It is proposed to raise the monetary limit from Rs. 8,000 to Rs. 10,000.

3. It is proposed to exempt from tax capital gains arising on the transfer of works of art, such as art collections, books, manuscripts, paintings, photographs, etc. in case the asset is transferred to the Government, a recognised University, a National Museum or any other public institution as may be notified by the Central Government in this behalf.

4. The existing exemption from tax on capital gains arising from the transfer of personal jewellery under specified condi-

tions is proposed to be withdrawn with effect from the assessment year 1976/77.

5. It is proposed to withdraw certain concessions at present enjoyed by Hindu Undivided Families having at least one member with independent income exceeding Rs. 8,000. The intended withdrawal covers the limited tax exemption at present available in regard to income from dividends, bank deposits, Unit Trust, etc.

The Compulsory Deposit Scheme

The Compulsory Deposit Scheme ending in July 1976 is proposed to be continued for another year with increased rates of deposit on the slabs of income above Rs. 25,000. The maximum suggested rate is 12 per cent instead of the existing 8 per cent applicable on the slab over Rs. 70,000. The amendment will take effect from 1st April, 1976.

Wealth-tax

1. It is proposed to reduce the rates of wealth-tax applicable to individuals and Hindu Undivided Families (other than Hindu Undivided Families having one or more members with independent net wealth exceeding Rs. 1,00,000) with effect from the assessment year 1977/78. The suggested rates of wealth-tax are

(a) where the net wealth does not exceed Rs. 5,00,000
½ per cent of the net wealth;

(b) where the net wealth exceeds Rs. 5,00,000 but does not exceed Rs. 10,00,000
Rs. 2,500 plus 1½ per cent of the amount by which the net wealth exceeds Rs. 5,00,000;

(c) where the net wealth exceeds Rs. 10,00,000 but does not exceed Rs. 15,00,000
Rs. 10,000 plus 2 per cent of the amount by which the net wealth exceeds Rs. 10,00,000;

(d) where the net wealth exceeds Rs. 15,00,000
Rs. 20,000 plus 2½ per cent of the amount by which the net wealth exceeds Rs. 15,00,000.

The higher exemption limit of Rs. 2,00,000 in the case of Hindu Undivided Families is proposed to be reduced to Rs. 1,00,000.

2. The levy of additional wealth-tax on land and buildings situated in urban areas is proposed to be discontinued.

3. Small dwelling units, the construction of which has begun on or after 1st April, 1976, with plinth area not exceeding 80 sq. metres are proposed to be exempt from wealth-tax for a period of five successive assessment years from date of completion of construction.

4. It is proposed to freeze the value of one self-occupied house property for purposes of wealth-tax at the value adopted for the year in which the property is constructed or acquired by the taxpayer or for the assessment year 1971/72, whichever is later.

5. It is proposed to exempt for a period of seven assessment years the monies and value of assets brought into India by persons of Indian origin who return to India with the intention of permanently residing in the country.

6. Investment by non-resident Indian citizens in equity shares of companies engaged in specified industries will be exempt from wealth-tax provided such shares form part of the initial issue of equity capital made after 31st March, 1976, or of an issue which is certified by the prescribed authority to have been made for the purpose of expansion or diversification of the company's industrial undertaking.

H. W. T. PEPPER:

THE FISCAL TREATMENT OF OIL REFINERIES AND OIL BONDS

(with special reference to developing countries)

General

1. For the purposes of these notes an oil refinery will be regarded as an installation which refines crude oil or semi-processed oils into finished products such as gasoline (petrol), diesel fuel, and kerosene or into other semi-finished products such as feedstocks for chemical or fertiliser factories. Sometimes a refinery may be associated with oil-fields from which it will draw directly its supplies of crude oil; more rarely the refinery may be integrated with a factory, such as a fertiliser works, as well as producing fuels for general use.

2. Wherever there is an association with an oil-well or a factory the refinery must be regarded as an entirely separate entity and the input and output of the refinery carefully measured. The reason for the separation is of course that the method of taxation for an oil-well and a refinery are widely different. Moreover the output of an oil refinery is usually subject to excise duty and/or consumption taxes (which may include V.A.T.). The input of refined hydrocarbon oils and other feedstocks to, say, a fertiliser works or a factory making synthetic raw materials, e.g., for the production of plastics of various kinds, would normally be taxed lightly, if at all, and under a V.A.T. system any tax on inputs would be offset against any consumption taxation on outputs.

3. In most cases, however, we are dealing with the simpler case of an oil refinery to which crude oil is brought by ocean tanker, or by pipeline, sometimes a long distance, over land, or from the sea-bed, the refinery producing fuels for customers who include electricity generating works and distributors of motor fuels and fuels for cooking, heating, and propelling machinery.

Taxation of an Oil Refinery

4. There are two fields of taxation relevant to an oil refinery, consumption taxation on its *products* and taxation of the *profits* of the refining processes. It is the former with which we shall be mainly concerned.

5. All taxation on the *products* of a refinery represent consumption taxes on the *consumer* which means, normally, the "home" consumer, i.e., the user of hydrocarbon products within the country within which the refinery is situated. If the refinery is reasonably efficient and able to obtain its feedstocks at favourable prices it may be possible for a Government to put a small levy on exported products including bunker fuels without harming the general exportability of its products. A good deal will depend on the proximity of the refinery to neighbouring territories without refineries, and on whether the refinery country is a member of a free trade area, with only a limited power to "tax" its neighbours.

Excise Duties and other Consumption Taxes

6. Excise Duties are a historical relic of other, less sophisticated times when taxes on consumption fell mainly into the two groups, customs duties on imports and excise duties on goods produced within the

country.

7. Nowdays consumption taxation on home-produced goods goes under a variety of names including excise duty and excise tax, commodity tax, manufacturers' tax, purchase tax, sales tax, and value added tax. Whatever the label given to the tax or duty it is customary to make it wholly or partly a specific levy expressed as so much money per unit of volume (e.g., cents per gallon or litre) in the case of fuel oils.

8. Where a country has a general sales tax or a value added tax regime, however, the general tax is often applied in addition to a specific levy (which may be modified to take account of the "double" taxation) — such a general sales tax or V.A.T. will of course be a percentage levy based on *value*.

9. The advantage of a V.A.T. is that it can be applied to the whole output for local consumption without actually burdening any activity or industry which it is desired should be exempt from fuel tax (such as the generation of electricity) because of the precision of the tax offset arrangements which are a feature of the tax.

10. On the other hand the fundamental tax principle of collecting indirect taxation at the earliest possible stage of distribution is best achieved by an "excise" or producer's tax levied at the actual refinery.

: Crude Oil

11. In the fairly common case of a refinery using imported crude oil there is, of course, an even earlier stage at which tax could be applied, i.e., customs duty could be levied on the imported crude oil. This course is not usually followed. As a matter of practice there is not much danger of uncustomed (non-duty paid) crude oil falling into the wrong hands, mainly because (a) crude oil has strictly limited uses outside an oil refinery so that there is no demand for it on local thieves' markets and (b) crude oil is usually stored in large tanks and sent by pipe-line or tank-wagons to refineries so that petty pilfering is ruled out.

: Storage Tanks

12. It is usual to have storage tanks both for the raw material and the finished or semi-finished products of an oil refinery. Where crude oil is delivered intermittently by ocean-going tankers it is obviously necessary to have substantial storage capacity so that a steady inflow of crude oil feedstock to the refinery may be maintained despite irregular deliveries.

13. That the amounts of feedstock in store may vary widely is another reason why it would be onerous to levy tax on crude oil imports thus imposing a substantial and fluctuating demand upon the refinery operator for "locked-up" working capital. (see, however, "Deposits and Bonds").

14. Obviously there may be an appreciable time-lag between receipt of crude oil and sale of refined oils during which the product will be kept in storage tanks, so that payment of tax/duty on consumption should be related more closely to the time of delivery for consumption.

: "Open-Refinery" System

15. Where storage tanks are within the physical boundaries of the refinery it is usual to regard the whole area as within a "ring fence" for tax purposes. Indeed the area will probably be enclosed within substantial walls or fencing as a practical matter for security reasons. Individual tanks may also be separately ringed by fencing/walling and/or dry moats as a combined fire and security precaution.

16. Under what is sometimes called the

"open refinery" system, all movements of feedstocks and products within the outer "ring fence" may be made without duty or tax arising.

17. A minor point is that some of the (taxable) product may be used within the "tax-free" area, e.g., to fuel engines connected with pumps or vehicles used entirely within the area, but it is quite usual to provide such modest duty-free use with the minimum of administrative formality.

18. An alternative arrangement is to have the storage (delivery) tanks, which are filled with products from the refinery, separate from the refinery itself. The "refinery" would then comprise the storage (reception) tanks which house the crude oil and/or other inputs, the refinery plant itself and the outlet pipes (controlled by flow meters) which take the products to a bonded area consisting of fenced-in tanks containing the refinery products. This area would also contain facilities for delivering products to customers either in vessels of vaiious sizes, by tank-wagon, or by (metered) pipe-line.

: Bonding

19. The confines of the refinery or its separate storage area may, in effect, be extended by the use of oil bonds, the mechanics of which will be further considered below. It may be convenient, for example, to have supplies of the finished products, e.g., gasoline, diesel, or kerosene, available in some bulk in other parts of the country, some distance from the refinery. Where such additional storage belongs to the refinery itself deliveries thereto whether by pipe-line or tank-wagon would normally be made on a duty-free and tax-free basis under proper controls.

20. The "external" storage will thus become an extension of the refinery and the application of duty/tax will be made upon delivery from the refinery itself, or the established storage areas, to customers.

: Major Distributors

21. Where external storage capacity belongs to separate concerns, not associated with the refinery, but carrying on the business of distributing oil products, the main storage depots may be bonded so that these tanks also may be filled on a duty- and tax-free basis, tax revenue being collected when distribution to consumers takes place.

: Deliveries to Traders

22. On the other hand road-tanker deliveries of gasoline (petrol), and DERV to filling stations, or of kerosene to hardware stores would be taxable upon delivery to the trader's own tanks.

: Deliveries to Traders' Own Tank-Wagons

23. Where a trader takes deliveries in his own road (or rail) tankers direct from the refinery or from the refinery's own "external" storage depots, duty/tax will normally become payable upon delivery into the tanker at the moment that the vehicle crosses the boundaries of the refinery or depot, i.e., goes outside the ring fence within which duty/tax is not payable. The duty/tax will thus be included in the price charged for the supplies to the trader who is taking delivery. Accounting for the duty/tax by the refinery, is considered below under the heading "Collection of Revenue".

"Oil-in-Process", "Base Stock", "Pipeline Stock" or "Dead Stock"

24. It is necessary to mention a minor practical point, before summarising the position regarding the application of taxation to the products of a refinery.

25. Not even one gallon or litre of output can be produced by a refinery until all the pipes leading into and out of the plant are filled with fluid, i.e., either feedstock, oil in process or the finished product. Even in the case of storage tanks it is not usually desirable to allow the level to fall so low that some pipes may be emptied so that air locks may be created which will interfere with the accurate working of flow meters. Of course tanks have sometimes to be emptied and cleaned, probably involving the use of solvents or cleaning fluids to "wash out" residual amounts of the product. (In such cases there may be a subsequent recovery of some of the product in saleable or usable amounts — if the recovery is done outside the "ring-fence" it will be necessary to establish a special taxing procedure, a matter which will *not* be detailed in these notes.)

26. The oil etc. forming part of this fundamental "pump-priming" volume of "oil-in-process" [1] or "base stock" [1] can normally be quantified by the manufacturers and erectors of the refinery, storage tanks, etc.

27. No great problem is created where all the machinery, piping, and stock is contained within the ring-fence of the refinery, since duty/tax is in any event only applicable to the products that leave the refinery or its external tank depots on delivery to traders and consumers.

28. The quantities involved have, however, to be borne in mind, for example, when making chemical conversion ratio comparisons (see separate heading below "Physical and Chemical Controls"), particularly in the early days of operation of a refinery.

Summary of Position of Incidence of Duty/Tax

29. It may be desirable at this point to summarise.

(1) Duty/tax is not normally imposed on feedstocks such as crude oil supplied to a refinery.

(2) Duty/tax is *not* normally imposed on —

(a) operations or movements of raw, or semi-processed, or finished products within the ring-fence of a refinery; or

(b) on movements of refined products from the refinery to storage depots maintained by the refinery in other parts of the country and supplied under controlled (or bonded) conditions.

(c) on movements of refined products to major distributors, being separate concerns which maintain substantial bonded storage facilities in other locations, where movements between refinery and bonded stores are also controlled (and/or bonded).

(3) Duty/tax *is* normally imposed on —

(a) deliveries to traders in their own tank-wagons (at refinery gate), i.e., when the product leaves the ring-fence area;

(b) deliveries by the refinery of products in drums or other containers, or by the refinery's own tank-wagons on delivery to the trader or consumer (except as in 2 (c).).

(4) Details of arrangements for taking deposits, bonds, or other security in respect of stored, dutiable, products on which duty/tax has not been paid are discussed below.

Deposits, Bonds, etc.
: Security

30. There are two aspects, "security" and "cash flow", involved in considering what

1. These basic quantities are also sometimes known as "pipeline stock" or especially in the case of the layer in the base of a storage tank, as "dead stock".

is the best procedure for bonding dutiable hydrocarbons. One should commence with the tanks of refined products produced in the refinery but not yet sold to customers.

31. If security arrangements are adequate and the Customs and Excise Department has physical control of the outlets, e.g., by locks or seals, it might seem at first sight that it is unnecessary to insist also on any kind of deposit or bond in respect of the stocks of dutiable fuel. In practice it is usual, as an additional safeguard, to require the refinery operator to put up a bond to cover anything from 100% to 200% of the duty and tax embodied in the maximum volume of oil products which could be accommodated in the smaller storage areas to a much lower percentage in the case of the largest bonded installations. Clearly also there must be a minimum size for a bonded store, since, to permit storage on a duty/tax-free basis is to accord a privilege which entails extra administrative cost. In Britain the minimum bond would be £10,000 representing 100% duty, but the percentage tapers as the installation becomes larger, and the maximum sum currently bonded is around £200,000.

32. The fact that a stock of dutiable products is covered by a bond (or bank guarantee) has of course no relevance to a country's current revenue position, since nothing is payable to Government. It is mainly in the event of malfeasance by the operating company itself that the bonding would become important. The circumstances in which the operating company would be willing to put its whole enterprise in jeopardy, and also be able to overcome the physical problems of deceiving the Customs and Excise Dept., and the practical problem of supplying material amounts of duty-free oils to selected members of the commercial community without this being noticed, are however, not likely to occur frequently. A country is not likely to entrust the establishment of an oil refinery other than to operators of some substance.

Defalcations by Employees

33. The greater risk and one which calls for sustained vigilance is that of pilferage by the company's own employees, which, where what is pilfered has not already been taxed, the operator and the Customs and Excise Dept. have an equal interest in stamping out. Such pilferage tends to be opportunist. For example, an employee might notice that a flow-meter had ceased to function and manage to extract and dispose of some unrecorded oil before the defect had been noticed. A thief might take advantage of the fracture of a pipe or leak from a tank caused either accidentally or deliberately, to collect the leaking liquid and dispose of it for his personal gain.

34. A common thieving device in countries where motor fuels are heavily-taxed is that known as "short-dropping". A felonious tanker driver will deliver, or "drop", less than the invoiced quantity of fuel at, say, a filling station where he has observed that employees do not properly check the quantity delivered by reference (before and after) to the tanker's own flow-meter and/or by dipping the receiving tanks. The amount of the short-fall the driver will then deliver and sell for his own gain to an "unofficial" customer, who, if he knows the product to be stolen or misappropriated, compounds the offence by accepting fuel, no doubt at a cut-price. In any of the circumstances referred to in this or the previous paragraph, the employee is, basically, stealing from his own employer or a customer, and the collection of duty/tax by the tax authority would not normally be affected, though the Department would

nevertheless want to see the practices stamped out.

35. The most serious case would be that of defalcation by the local manager, a rare case no doubt, but one which is not inconceivable. For example, if a manager got himself into financial difficulties and decided to steal all he could before absconding — he might be able, by abusing his managerial position, to falsify records or tamper with apparatus so as to defraud both the operating company and the Excise revenue before making a "getaway".

: Variation of Bonds

36. A point to remember is that whenever the duty or tax or both are varied to any extent it is necessary to make an immediate consequential amendment to the sum bonded. The variation is a simple one being merely a matter of arithmetic, e.g., a 10% increase in duty/tax would entail a 10% increase in the bond.

: Deposits by Operating Company

37. As far as the Revenue *security* is concerned, a satisfactory bond or bank guarantee is as good as a deposit of cash.

38. If a cash deposit is insisted on this will have to be financed by the operating company and add slightly to the cost of supplying hydrocarbon fuels. (of course even a bond is not cost-free since a bank or bond broker will probably charge not less than ½% of the sum covered by the bond for the service of providing it). On the other hand an interest-free loan in the shape of a security deposit may be useful to a Government in helping to finance capital projects.

39. Such a deposit is unlikely ever to have to be refunded (at least until the world's fossil fuels are exhausted) since even if the particular operator of a refinery or oil bond gives up, a similar deposit requirement would clearly be sought from his successor. Moreover the monetary quantum of the deposit is not likely to decrease since the only reasonable foreseeable trend of fuel prices is upwards!

40. A further justification for seeking a deposit rather than a bond is that a refinery in a developing country may often be in a more or less monopolistic position — i.e., its profitability is guaranteed, although the Government will normally be able to control the pricing policies fairly closely.

: Quantum

41. Apart from the justification for imposing a deposit scheme on security grounds, there may be good reason also on cash flow grounds, e.g., where duty/tax is settled monthly, but deliveries to consumers are made daily, (see paras. 82-88 on Collection). The amount to be required as deposit should be related to the amount of duty/tax represented by the actual stocks held or the capacity of the bonded storage and to the frequency of deliveries. Whatever sum is taken as deposit, a similar deduction should be made from the bonding requirement.[1]

Physical and Chemical Controls:
Metering, Dipping etc.

: Refineries

42. Where a dutiable commodity is produced by chemical or organic processes it is traditional in Customs & Excise procedures to run a check on what is actually

1. If no interest is paid on the deposit, the impost may be regarded as a "licence" charge if the operator has been granted something of a monopoly position for the supply of oil products — though licence charges are not a wholly satisfactory form of taxation.

produced compared with what should scientifically be expected. Long before oil refineries were "invented" it was usual to pay particular attention to the inputs of brewing and distilling operations, and in the case of products such as beer, ale, and lager, it is still not uncommon to find that duty/tax is levied on the input material (based on the amount of alcohol it is expected to produce) rather than the product.

43. The modern tendency, however, is to levy duty/tax on measured *output*, retaining calculations of putative yields of beer, spirits, and hydrocarbons as an additional check against possible irregularities.

44. In the case of oil refineries, emphasis is placed upon controlling and taxing outputs, but it still makes sense to make checks of outputs against input by requiring the operator to provide the chemical formulae and calculations of expected output when one substance (usually crude oil) is converted into others. A reasonably high degree of accuracy should be obtainable in estimating the products of chemical reactions. It should in any event be of interest to the operator to ascertain whether his plant is producing efficiently what is expected of it so that, once again, operator and tax department have a common interest in accuracy.

44A. The modern tendency, however, is towards the "open-warehouse" system whereby the trader is made responsible for the physical security of stores of dutiable commodities and the duty thereon, subject to general Customs & Excise supervision. This supervision will take the form of examining the trader's security arrangements and requiring them to be tightened up where necessary, e.g., by additional seals, locks, checking routines and so on, and then making random and selective examinations from time to time.

: Physical Controls

45. One may summarise the "chain" of physical controls as follows —

(a) Calibration of storage, reception, and delivery tanks and other vessels so that a reading of the sight-glass (where a tank is so equipped) or of the relevant dip-rod or dip-tape establishes the volume of hydrocarbon oil currently contained therein.

(b) Input of crude oil delivered by tanker: (i) Dipping of reception tanks before and after delivery and (ii) dipping of delivery tanks on the tanker before and after delivery as a check on (i); alternatively, reading flow meters (if provided) and checking by dipping;

(c) Measurement of output of refinery by flow-meters and check on inflow into product storage tanks by dipping;

(d) Calculation of estimated product of chemical changes in the inputs during the refinement process;

(e) Measurement of outflow of dutiable/taxable product from storage tanks by flow meters with check by periodical dipping of the storage tanks, and further check of input by dipping where the product is pumped into a road or rail tank-wagon;

(f) a road tank-wagon will normally be equipped with a flow-meter and its deliveries will be recorded on the meter and checked by dipping its tanks. Such a wagon will often have its capacity divided into two or three separate tanks so that a variety of different products may be carried at the same time and delivered through separate meters;

(g) a further check is possible by weighing with a weighbridge or other weighing machinery. A tank-wagon may be weighed before and after it is filled with oil products. This may be particularly useful where the wagons belong to other traders or customers and so are not under the direct control of the refinery operator. An outgoing cargo of drums or other containers may also be checked by weighing — the weight of the empty containers being normally a matter of record.

(h) all seals and locks on oil stores, installations, tanks, and delivery pipes should be inspected daily. Most of this work will ordinarily be done by the operator, although procedures will be laid down, and periodical and spot checks made by the Customs and Excise Dept. As noted above, the operator normally has a common interest with the Department in avoiding fraud and theft within his bonded field of operation.

: Dipping

Dipping of tanks may be done by calibrated rods of wood or metal or by steel tapes which are weighted by metal plumb weights, the whole length of the tape including the weight at the end (which serves to keep the tape both straight and vertical) being carefully calibrated.

: Sight Gauges

Apart from the dipping device itself being calibrated — usually in units of length (e.g., metric or British linear measure) which can be converted to volumes by reference to calibration tables compiled for the particular vessel concerned, there may be a sight-glass or sight gauge from which the approximate content of the vessel may be read at a glance. These devices are most useful for quick reference by both operator and Customs & Excise Dept. but are not generally used as exact measures of the quantities present, which are determined where necessary by dipping. In the case of tanker-wagons it is usual to have a built-in, sealed, level marker inside the entry at the top of each tank. When the oil pumped into the tanker reaches that level the exact volume of oil in the tank will be known since the capacity of the tank will already have been measured and the flow-meter registering deliveries from each tank will provide a regular cross-check.

: Electronic Gauging

In very modern and sophisticated refineries and oil storage complexes all measuring is done by enclosed systems which produces readings of stocks, deliveries etc. electronically. It is not proposed to discuss those in detail in these notes.

: Check of Meters etc.

It is normal practice to check flow-meters at regular intervals, (e.g., every 3 or 6 months) as well as at any time it is suspected that a fault may have developed. The simplest way of checking is to use a proving tank, the capacity of which has been precisely measured, and fill this, checking the flow-meter reading against the known volume of the vessel being filled.

: System of measurement

46. The *specific* duties or taxes on hydrocarbon oils are normally imposed by reference to *volume* which may be imperial or other ("N.American") gallons, or by metric measurement in litres, or whatever volume measure is used in the consumer country. Volume by any system is readily convertible by tables into any other type of unit.

47. It is essential to specify volume at a certain temperature because the same usable quantity of oil fuel will occupy different volumes at different temperatures. In tropical and equatorial countries 80°F (26.7°C) is sometimes used, while in colder countries a standard of from 50°F

(10°C) to 60°F (15.5°C) is often adopted. Unless year-round temperatures are fairly constant it may be necessary to read temperature as well as volume and adjust the latter by reference to the former when calculating the duty/tax on quantities of hydrocarbon oils.

: Oil Bonds

48. The forgoing notes relating to controls on refineries apply equally to oil bonds although inputs and outputs ordinarily consist solely of finished products, received duty- and tax-free and delivered subject to duty and tax to customers.

Extent of Checking in Practice

49. As indicated above in paragraph 45, (a) to (h), the opportunities for physical checking and cross-checking are comprehensive. In addition all movements of hydrocarbon oil should entail corresponding entries in an operator's accounting books. Part of a Customs & Excise Department's function is indeed to ensure that book-keeping, completion of forms, etc. is done promptly and meticulously. Where necessary the Department itself will design books and forms to suit its needs.

50. There has of course to be systematic checking of the written records with the physical assets they reflect and this is an added safeguard of the revenue position.

51. Although general control of *all* details is part of the Department's task, it may be noted that the duty/tax for each month will be related simply to the sum: —

total stocks of dutiable/tax oil at start of month
plus *additions to stocks during month*
= total available for delivery
less *total stocks at end of month*
= total deliveries on which duty/tax to be paid.

52. The deliveries will also have been ascertained directly but if there is any difference between the two totals, the operator, unless he could explain the difference, might be required to pay on the higher total. (see, however, paras. 57-61 on "Evaporation and other Losses").

53. Broadly speaking, quantities measured by flow-meters should be regarded as more accurate than those measured by dipping, though over a period *total* readings by both methods should be very close indeed.

54. In a simple case where all deliveries are from a single bonded area, the operator may prefer to have all his tank-wagons empty and all his delivery trucks unladen when striking his monthly balance so that the calculation above can be made simply by comparing readings of the quantities in the storage (delivery) tanks at the beginning and end of the period and adding in the taxable quantities received into the bond in the same period. This calculation would be subject to allowances for losses (see later paras.) and should of course agree with recorded deliveries.

55. The calculation will be complicated where deliveries are also made to customers in drums and other vessels, and a stock of these is kept, pre-filled, in storage. To the extent that these vessels merely contain the products of the refinery, however, it is merely necessary to take stock of the vessels each month at the same time as readings are taken of the tanks' contents.

56. Where the refinery is associated with oil bonds in outlying areas of the country, deliveries from one bonded area to the other are normally permitted on a duty- and tax-free basis. Accordingly the monthly accounting for duty and tax would have to include stocks at the subsidiary bonded areas and deliveries to and from these bonds.

Evaporation and other Losses

57. It is usual to make allowances for various losses which are to be expected in the refining and distribution of hydrocarbons. In the refining process itself the output may fall short of what may chemically be calculable as the end-product. All oils evaporate to some extent, and gasoline (petrol) does so more than most — so that some loss from evaporation is inevitable and must be allowed for.

58. There are no universally-applicable guide-lines and it is necessary to calculate reasonable allowances in the light of actual experience, usually on the basis of data compiled by operators and checked by the Customs & Excise Dept.

59. Once suitable allowances have been determined, administration is relatively simple, the main concern of the Dept. will be to watch for unusual variations in the rate of losses that may be evidence of something more serious, which, however, will normally be of equal concern to the operator.

60. Storage tanks are normally fitted with special pressure and vacuum release valves which can cope with different conditions such as very high day temperatures and cold nights in such a way as to avoid dangerous pressures building up in the tanks. Evaporation losses are, however, inevitable and may amount to something of the order of 0.2% to 0.3% per month, or even more under exceptional conditions for motor spirit (gasoline) and the lighter volatile oils, but appreciably less for the heavier oils.

61. It is not usual to embody specific loss allowances in a statute, or even in regulations, but to deal administratively with (1) "manufacturing" or refining losses, and (2) losses by evaporation during storage, and (3) in the course of distribution.

Exemptions and Rebates

: Exemptions

62. There are several uses of hydrocarbon oils which are normally allowed to be on a duty- and tax-free basis. These include —

(a) bunker fuels for ships, including coastwise vessels fishing boats;

(b) aviation fuels for aircraft;

(c) all exports (which would include bunker supplies referred to in (a) and (b);

(d) fuel supplies to electricity undertakings;

(e) kerosene where this is used as a "poor man's fuel" for cooking his food or heating his home. (see, however, para 67 below).

63. In the case of (a) and (b) it is usual for ships and aircraft, particularly those operating to or from a small country, to be engaged in international operations so that the fuel they use is, in effect, an "export". Even where operations are partly within the country there are often opportunities for ships and aircraft to take on fuel outside the country (and then on a tax-free basis) so that the exemption is sometimes merely a recognition that it would be difficult to impose taxation on these fuel users even if it was deemed desirable to do so.

64. Another point is that ships and aircraft are usually in competition with those of other countries and, exemptions being widely given, any country which tried to impose taxation on its ships and aircraft would put them at a competitive disadvantage.

65. Further, small shipping and aircraft operations are sometimes barely viable and tend to need subsidies, rather than being able to bear taxes.

66. In the case of kerosene, the affluent tend to use electricity in their homes and sometimes gas for cooking, while the poor man uses firewood or kerosene. Since elec-

tricity is generally tax-free (see also (d) above) it would be logical to exempt kerosene when used for similar purposes.

67. Unfortunately kerosene has a variety of uses and it is difficult to grant exemption for some domestic *uses* and not others so that in practice kerosene is sometimes subject to a fairly light tax for all uses (except bunkering) even though this does not preserve full equity to the poorest users.

68. Kerosene may, however, be added to propellant fuels for motor vehicles which use diesel engines, in a proportion of up to 30% to diesel fuel for certain uses. Since motor fuels are normally the most highly taxed hydrocarbons the use of lightly-taxed (or exempted) kerosene as a "mixer" has to be strictly prohibited and the prohibition backed by "marking" the cheaper product (see paras 75-81 below on "Dyes and Markers").

69. Where oils are used domestically in central-heating plants it is usual to exempt this use, or apply only a nominal rate of duty — again marking may be necessary if the same oil has alternative, more highly-taxed uses.

Rebates

70. Sometimes it is desired to give some tax relief to a particular use of taxable hydrocarbons but it is not practical to do so by allowing the products to be charged a rebated rate of duty or tax at source. For example, it might be desired to give a tax preference on motor fuel used by vehicles, (trucks or buses) serving rural or remote areas of the country on routes that are barely profitable.

Administration

71. In such a case it is better administration to allow the transport enterprise to buy its fuels at the normal fully-taxed price, and then calculate a rebate or refund based on the actual mileage covered from month to month. (Better still is probably to relate the subsidy to numbers of passengers and quantities of goods carried rather than fuel used).

72. The fewer the quantities of fuels which are allowed out of bond on a no-tax or rebated-tax basis, the less the danger of fraud and evasion.

73. As far as possible it is safest to have exempted or rebated fuels delivered from bond direct to storage or other tanks. For example, bunker fuels may be delivered by road-tanker to storage at airport or sea-port and eventually be pumped directly into the fuel tanks of the aircraft or vessel, although at the airport it will often be necessary to use a specialised tank-wagon within the confines of the airport itself.

74. Central heating fuels are also commonly delivered by road-tankers directly into the storage tanks associated with the heating plant and deliveries to electricity generating plants are also normally by pipeline or road-tanker so that risks of the exempt or rebated oil getting into general "circulation" are minimised.

Dyes and Markers

75. As a safeguard against the illicit use of exempted or rebated oils instead of oils to which higher rates of duty and tax apply, markers and dyes are added to the former, and an efficient Customs & Excise will make routine and surprise checks of fuels in actual use.

76. When a check of fuels used for highly taxed purposes reveals the presence of markers and dyes the Customs & Excise Dept. has an immediate prima facie case against the possessor of the marked fuel and the law will normally place the onus

on that person to prove that his possession was not in default of the law. (*Note.* It is, however, for the Dept. to provide the Court with the initial evidence of finding the marked fuel in the possession of the defendant, if the case comes to trial).

77. Substances commonly used as markers are quinizarin and furfural which are normally mixed in stipulated amounts per each 100,000 gallons of fuel and converted to solution form before being added to facilitate even permeation of oils to be marked.

78. These substances have the characteristic of being difficult to remove but easy to identify. The marking process has to be strictly controlled, the marker fluid being introduced into the oils being marked in liquid form through apparatus connected either to storage tanks or to pipe-lines.

79. In all cases the onus is on the operator to satisfy the Dept. that this methods of marking are efficient and secure so that oil which he is purporting to mark is actually marked to an acceptable consistency and under controlled conditions.

80. Dyes are also commonly added to exempt or rebated oils to provide visible evidence upon Customs exemption, which can be confirmed by the additional evidence of the presence of markers.

Traders' Dyes

81. A further example of the collaboration between trader and Revenue Dept. is afforded by the facility normally accorded to a trader to employ his own "brand" of dyes to identify, indeed advertise, his wares to the public. Provided that the colouring substance does not impede identification of any official markers in the oils and is otherwise satisfactory, permission is normally granted, under suitable controls, for a trader to introduce his own dyes. He may then be able to give the impression that his own pink kerosene is superior to someone else's purple product!

Collection of Duty/Tax

82. In contrast to the usual system of collecting customs duties before goods are allowed to leave the customs-controlled area, it is the practice in some countries to allow hydrocarbon oils to be removed (in controlled and recorded quantities) from the bonded areas and for monthly settlements to be made. At the end of each calendar month the operator will report deliveries made and be required to pay the relevant duty/tax within the first 10 to 15 days of the following month.

82A. In some countries, however, the older system prevails. For example in Britain and Eire there is no deferment of payment of the excise duties on dutiable fuels. Instead the operator has to maintain a Gross Payments Account with the Customs & Excise Dept. in which account he keeps sufficient money to cover the duty on the maximum daily deliveries and arranges to replenish the account daily or at whatever intervals are necessary. Such payments are by cheques (covered by bank guarantee) which are normally delivered to the Customs & Excise office each day, and deliveries of dutiable fuels from the bonded stores is covered by Gross Payment Warrants from the Dept.

82B. On the other hand *customs* duty on motor fuels imported into Britain is dealt with by monthly settlements and such settlements are also accepted for V.A.T. payments. Some small countries collect duty at the commencement of a month which, in effect, covers the liability on deliveries to be made during the month with an accounting to reconcile actual duty chargeable with prior payment at the end of each month.

82C. The trend seems nevertheless to be towards the method adopted, e.g., in the older E.E.C. countries, of accepting monthly settlements immediately after the end of each month (referred to in para. 82), though any country switching to that system from that of current payments would have to bear in mind the cash flow problem likely to be created by having a gap in revenue inflow covering a period of 4 to 6 weeks (see also para. 84).

83. Collection should present few problems because operators are usually large and reputable companies with whom Customs & Excise officials have no difficulty in establishing satisfactory routine procedures for accounting and payment. Sometimes it is possible to arrange for the monthly accounting to take place routinely a few days before the end of the month and for payment to be made by the month-end. Alternatively, this procedure may be adopted exceptionally only at the end of a fiscal year where there may be Budget-balancing problems.

84. In the normal case where tax and duty are accounted for by the end of 2 weeks after the end of the tax-month, the maximum grace period for payment is from 2-6 weeks, an average of 4 weeks. The existence of this time-lag gives some justification for calling for deposits from the operators of oil bonds and bonded refineries. (see paragraphs 37-41). Of course deliveries from bond to customer do not usually represent immediate consumption, since fuels may be delivered to the tanks of a filling-station and from there sold to vehicle-owners over a period of anything from a week upwards.

85. On cash flow grounds the filling station proprietor usually wants deliveries as often as possible from the bonded store, even three or four times per week, since he then has the minimum amount of money tied up in stock. On the other hand the store operator wants to minimise distribution expenditure and therefore prefers to deliver not less than a road-tanker-full at a time. Where deliveries from bond are made twice-weekly, and this is not uncommon for the major filling stations on highways, it is clear that the two to six weeks grace period constitutes generous treatment of the trader by the tax authority.

: Practical Administration

86. As a practical matter, an oil bond may arrange for its monthly accounting to be made on a day, and at a time when its tank-wagons are all empty (i.e., early in the morning before they are filled for the day's sale round) so that only the storage tanks have to be taken into account for meter-reading, or dipping, and counter-checking by Customs & Excise officials.

87. Where there is also an acceptably-secure store of drums and other containers full of dutiable/taxable product, it will usually be best for books to be kept such that the total stock or inventory is on record at any time. A physical check of goods in stock will then merely be to confirm that the recorded quantities are duly present. Such stores are usually kept under separate lock by the trader and to maintain a running record of quantities in hand it is merely necessary to keep stock-cards and note outgoing supplies as deductions and add new stocks as they are received, to achieve constantly updated figures.

88. Where filled drums and other containers are not kept in sufficiently secure conditions to satisfy the Customs & Excise Dept. duty and tax would be paid when they are filled. For example, drums may be kept stacked in the open within the fence around an oil bond which contains large

storage tanks. It would be relatively much simpler for a gang of thieves to steal oil products which are pre-packaged in containers such as drums than to break open storage tanks and pipe-lines. In addition book-keeping for duty and tax is simplified and the levies may be applied solely to quantities delivered from the storage tanks.

Income Tax

89. There is no particular reason why an oil refinery, which is a type of chemical works should be dealt with differently for income tax purposes than any other kind of chemical works.

90. It is likely that where a refinery is set up *on the initiative of an oil company* (and with the consent of the Government) that the refinery is expected to be a viable and profitable industry. Because of the large initial capital expenditure on plant and machinery it is quite possible that because of depreciation or capital allowances ordinarily granted to industries on such expenditure, there may be no income tax payable for the first few years, the depreciation allowances exceeding the taxable profit, but that does not constitute special treatment.

91. Where a refinery might be only marginally viable and is set up on the *initiative of the Government,* the oil company will usually want various guarantees regarding the pricing policy it will be permitted to pursue so that it can be assured that it will be able to operate at a profit in what will often be a captive market.

92. Once the lines on which trading may be done are agreed, however, there should be no need for further incentives such as tax exemption of the profits which have already been assured to the operating company.

S. AMBALAVANER *:

MALAYSIA 1976 BUDGET

From the text of the speech by the Honourable Deputy Prime Minister and Minister of Finance, Datuk Hussein Bin Onn House of Representatives November 6, 1975.

1. The main thrust of Malaysia's 1976 Budget comes from the Government's commitment to a system where the private sector's positive and expansionary role is a pre-requisite for continued and rapid industrial development. Particular recognition is given to the role of foreign private investment. While providing the basis for the first year of the Third Malaysian Plan, 1976—1980, the 1976 Budget seeks to promote economic growth and income distribution within the framework of financial stability.

2. The economy suffered a severe strain due to the protracted world recession, and revenue receipts fell short by 80% ($ 220 million) against estimates due to the decline in imports. The actual expenditure outturn for 1975, estimated at $ 4,595 million exceeded by 9% to $ 5,000 million dollars mainly due to:

(a) implementation of the Harun Salaries Commission recommendations which costs $ 100 million;

(b) the payment of the 13th month bonus to Civil Servants, estimated at $ 150 million which was given to offset adverse effects of inflation;

(c) expenditures on defence amounting to $ 127 million together with $ 26 million for text books subsidy and $ 40 million for the Rubber Stabilization Programme; none of which were provided for in the 1975 budget. Added to these the development expenditures also exceeded estimates by $ 235 million. The deficit will be covered by borrowing.

3. With a brighter forecast for the world economy for 1976 Malaysia's economy is also expected to improve in the coming year. Rubber prices are on an upward swing, and the demand for rubber is on the increase. Thus our exports are estimated to grow by about 9%, while a 5% increase is estimated for imports.

4. *Budget Proposals:*
The deficit will be financed mainly by domestic borrowing and foreign projects and market borrowing. Modifications in these estimates are expected, since the 1976 Budget will be managed flexibly, and new taxes will be raised in the 1976 Budget.

5. *The Proposals for 1976:*
The object of a tax policy is not only to provide adequate revenue for the Government, but also among other things to achieve a more equitable income distribution, which is one of the objectives of our new economic policy.

6. *Direct Taxes:*

(a) *Individual Income Tax:*
Income of resident individuals is subject to graduated tax rate starting from a rate of 6% on a chargeable income of $ 2500 to 55% on a chargeable income exceeding $ 75,000. The rate structure has also been amended increasing the rate of 23% to 25%, 25% to 30%, and 30% to 35%. Other rates remain unchanged.

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(b) *Development Tax:*
Will continue to be imposed at the rate of 5% on an income derived from trade, business, profession or vocation and rent from the letting of properties. This tax however does not apply to salary and wages, dividend and interest.

(c) *Excess Profits Tax:*
Will continue to be imposed to 5% on chargeable income in excess of $ 75,000.

(d) *Real Property Gains Tax:*
At present, gains derived from a disposal of lands and buildings situated in Malaysia and any interest, option or other rights in or over such lands and buildings are liable to tax at the rate of 50%, if such a disposal is made within 2 years after the date of acquisition of the property. However, if the amount of value of the consideration for the disposal does not exceed $ 100,000 it is exempted from the tax. This Tax is provided for in the *Land Speculation Tax Act 1974.* It is proposed to introduce a new legislation to be called *"Real Property Gains Tax Act, 1976"*, and to repeal the existing Land Speculation Tax Act, 1974. Under this proposal, gains from a disposal of real property are to be taxed on a diminishing scale of rates in accordance with the length of the holding period as follows:—

50% if the property is disposed of within the first or second year after the date of its acquisition. Thereafter decreasing by 10% every year upto the 6th year.

Where the disposal value of a property is less than $ 50,000, it is exempted from the tax.
Gains on disposal of one private residence will subject to certain conditions be exempt.
Tax relief for losses will be allowed as a deduction against tax on chargeable gains.

(e) *Estate Duty:*
It is now proposed to increase the dutiable value of an estate from $ 25,000 to $ 50,000. The marginal rate of 5% is abolished and the lowest marginal rate will now be 7½% which applies to the next $ 50,000 as at present. The existing maximum rate of 50% will now apply only where the value exceeds $ 2 million but does not exceed $ 4 million. On the next $ 2 million the rate will be 55% and on the balance 60%. These rates will apply in respect of deaths occurring on and after 1st January 1976.

(f) *Bonus Payment by an employer to an employee:*
For the purposes of tax the deduction of such bonus payment will be limited to $ 1000.00 or $^2/_{12}$ths of the wage or salary paid to each employee, whichever is the greater.

7. *Indirect Tax:*

(a) *Import Duties:*
As a revenue measure, it is proposed to increase import duties on a number of categories of luxuries and largely non-essential goods. These changes are contained in the Customs Order. Briefly, import duties on fresh and dried fruits will be increased by 50% from $ 896 per ton to $ 1344 per ton or by -/20 cents per pound. Preserved fruits which fall under headings Numbers 08.10 and 08.11 and which are subject to import duty on $ 1344 per ton and those under heading No. 08.13 which attract a duty on $ 224 per ton will now be made dutiable at $ 1680 and $ 336 per ton respectively. These represent an increase of 25% and 50% respectively.

Import duties on motor cars and motor cycles are also to be increased. It is proposed to change the present flat rate of 60% to a progressive rate of 60% on the value not exceeding $ 20,000 with an increase of 10% for every additional $ 5,000 till it reaches 100%.

Import duties on musical instruments, gramophones, dictating machines and other sound recorders and reproducers will be increased by 20%, from 25% to 45%. Electrical appliances, such as refrigerates, washing machines, calculating machines etc., will also attract higher duties. In the case of refrigerators and other refrigerating equipment the duties will be increased from 35% to 45% and those under heading No. 84.15 450 the duty will be increased from 35% or $ 280 per unit whichever is the higher, to 45% or $ 360 whichever is the higher. Machines for washing dishes and those for washing clothes will now be liable for duties at higher rates of 25% and 35% respectively representing in each case an increase of 10%. Duties on calculating and data processing machines will be increased by 5% to 25%.

Perfumery, cosmetics and toilet preparations will be subject to duties at 60%. Duties on carpets and rugs 50%; watches 15%, clocks 30%. With higher duties imposed on precious and semi-precious stones, jewellery, articles made of leather and fur, glass-ware and articles made of metal.

(b) *Surtax:*

At present a surtax at the rate of 4% is imposed on all imports, except on certain goods including essential commodities. As a measure to raise additional revenue it is proposed to increase it by 1% to 5%. As an incentive to encourage industrial development, partial exemption of 2% is presently granted on imports of raw materials needed by industries for the manufacture of their products. Partial or full exemption is given from the surtax on machinery depending on the merit of the case. In respect of raw materials it is proposed to grant exemption of the 1% increase in the surtax on raw materials used for the production of essential goods and goods for export only.

(c) *Excise Duties:*

At present the excise duty structure is as follows:—

25% on the value not exceeding $ 7,000, thereafter increasing by 5% for every $ 3,000 and 45% on the value exceeding $ 16,000 but which does not exceed $ 20,000.

It is now proposed to make this structure more progressive by adding two more marginal rates at the upper end of the scale as follows:—

50% on the value $ 20,000 to $ 25,000; and

55% on the value exceeding $ 25,000.

8. *Overall Deficit:*

With the additional revenue of $ 108 million is expected to raise from the revenue measures, a current deficit of $ 82 million and an overall deficit of $ 2065 million are anticipated for 1976.

9. *Conclusion:*

In accordance with the Government's commitment to the creation of a just society, the Budget aims at promoting economic growth and income distribution within the framework of financial stability. Success can be certainly achieved with the cooperation of the whole nation, by striving towards a higher standard of discipline, dedication to duty, responsibility to the country and a sense of honesty.

DR. ERWIN SPIRO *:

THE 1976 INCOME TAX CHANGES IN THE REPUBLIC OF SOUTH AFRICA

While admitting that the budget for 1976 was not deliberately stimulatory nor inviting popularity, Senator O. P. F. Horwood, the Minister of Finance, tried to maintain the necessary balance between three objectives, viz. 1. to make adequate provision for the defence of the country; 2. to maintain the economic strength of the country and in particular to safeguard its balance of payments and to combat inflation; 3. to maintain the economic growth of the country and to care for the interests of the less privileged members of the community.

In the field of income tax this has been achieved mainly, as will be shown later, by increasing the rate of tax. The following changes may be mentioned.

ABATEMENTS

In view of the current inflation rate and its effect on aged persons the Minister of Finance proposed that the special income tax abatement for persons above the age of sixty years should be raised from R600 to R700. It follows that persons in that age group will only be liable for income tax when their income exceeds R1 900 for married persons and R1 400 for single persons; this benefit will only cease to apply when income exceeds R14 500 for married persons and R12 000 for single persons.

NON-RESIDENT SHAREHOLDERS' TAX

The non-resident shareholders' tax is presently *inter alia* not payable if the shareholder who receives the dividend is a non-South African company doing business in the Republic, such dividend being free of tax if the South African business activities of the shareholder-company are negligible. This appeared to the Minister of Finance to be an anomaly, and he, therefore, proposed that with effect from the 31st March, 1976 — the date of the budget speech — all dividends payable to such companies should be subject to the non-resident shareholders' tax.

UNDISTRIBUTED PROFITS TAX

The proposed increase in the rate of company taxation will, in the view of the Minister of Finance, effectively place all operating companies outside the scope of the undistributed profits tax whose aim it is to encourage companies, especially companies controlled by a few shareholders, to distribute profits which are then taxed in the hands of the shareholders. As the result, the tax will in future only be applicable to financial companies. The Minister of Finance nevertheless believed that the proposed increase in the rate of income tax on individuals also required that the rate of tax on undistributed profits should be raised in order to maintain the effectiveness of the latter, particularly in relation to private financial companies which presented an easy vehicle for tax avoidance.

POWER OF MINISTER OF FINANCE TO RAISE OR LOWER LOAN LEVY

The Minister of Finance proposed a provision to empower him, subject to Parliamentary approval during the following

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session, to raise or lower the *loan levy* by not more than 10 per cent of the basic tax. Such a provision appeared to him desirable, especially in view of the length of the Parliamentary recess in South Africa. Further reasons for the desirability of such a provision were, according to the Minister of Finance, the political uncertainty in other parts of Southern Africa and the possibility of an earlier and stronger favourable change in South Africa's export markets or in the gold price than presently expected which might necessitate urgent adjustments of rates, either upward or downward.

RATES OF INCOME TAX (NORMAL TAX)

The rates as such have not changed, but the *surcharge* and *loan levy* have been increased, the latter having been reintroduced in the case of persons other than companies.

Persons other than companies

Persons other than companies are, in respect of the year of assessment ending February 28, 1977 or June 30, 1977, subject to the tax at the rates contained in the two tables annexed to this article. Provided the basic tax is R150 or more, there is added a *surcharge* of now 10 per cent. In the case of a natural person who is over sixty years of age on the last day of the year of assessment and whose taxable income for that year is R5 000 or less the *surcharge* is not payable at all. There is now also a *loan levy* of 10 per cent which is subject to the same conditions as the *surcharge*. The basic tax is in each instance calculated on the taxable amount, that is the amount remaining after deducting from taxable income the abatement applicable.

Due regard being had to the *surcharge* of 10 per cent and the *loan levy* of 10 per cent, the maximum marginal rate is now 72 per cent.

The Minister of Finance did not fail to mention that the proposed rates of taxation were still considerably lower than those applicable in 1971.

Companies

The rates for companies in respect of taxable income derived in the Republic and taxable income derived in South-West Africa for the year of assessment, that is the financial year ending during the twelve-month period from April 1, 1976, to March 31, 1977, are as follows:

(i) *taxable income derived otherwise than from mining:* if derived in South-West Africa 35 cents per R1 and if derived elsewhere than in South-West Africa — that is in the Republic — 40 cents per R1. To the tax so determined is added a *surcharge* of 7½ per cent of such tax and a *loan portion* of 15 per cent of such tax. The effective rate is thus now 42.875 cents (before 37.625) and 49 cents (before 43) in the rand respectively.

(ii) *taxable income derived from gold mining:* on any mine other than a post-1966 gold mine an amount determined in accordance with one of the formulae provided for plus a *surcharge* (which is not payable in the case of certain assisted gold mines) equal to 10 (before 5) per cent of the said amount and a *loan portion* equal to 15 (before 5) per cent of the said amount; on a post-1966 gold mine an amount determined in accordance with one of the formulae provided for plus a *surcharge* of 10 (before 5) per cent of the said amount and a *loan portion* of 15 (before 5) per cent.

(iii) *taxable income in the form of recoupments of capital expenditure accruing to companies which are or have been gold mining companies:* the average rate of tax as determined in accordance with the Act or 35 cents per R1 whichever is higher.

(iv) *taxable income from mining operations (other than mining for gold, diamonds or natural oil):* where derived in South-West Africa 35 cents per R1 and where derived elsewhere than in South-West Africa — that is in the Republic — 40 cents per R1. To the tax so determined is added a *surcharge* of 7½ (before 2½) per cent of such tax and a *loan portion* of 15 (before 5) per cent of such tax.

(v) *taxable income from mining for diamonds:* 45 cents per R1 plus a *surcharge* of 10 per cent of such amount and a *loan portion* of 15 (before 5) per cent of such tax. The surcharge has here not been increased because diamond mines already pay a considerably higher tax than other companies.

RATES OF OTHER TAXES CONTAINED IN THE INCOME TAX ACT

Non-Resident Shareholders' Tax

The non-resident shareholders' tax remains 15 per cent of the amount of the dividend or interim dividend in question.

Undistributed Profits Tax

The undistributed profits tax is 33⅓ (before 25) cents on every rand of the amount by which the distributable income as defined exceeds the amount of dividends distributed during the specified period as defined.

Non-Residents Tax on Interest

The non-residents tax on interest is 10 per cent on the amount of the interest in question.

Donations Tax

The tax is at progressive block rates, the block exceeding R90 000 being taxable at the rate of 25 per cent.

ANNEXURES

TABLE I

Taxable Amount				Rates of tax in respect of married persons
Where the taxable amount—				
does not exceed R1 000				9 per cent of each R1 of the taxable amount;
exceeds R1 000 but does not exceed			R2 000	R90 plus 10 per cent of the amount by which the taxable amount exceeds R1 000;
,,	R2 000	,, ,,	R3 000	R190 plus 10 per cent of the amount by which the taxable amount exceeds R2 000;
,,	R3 000	,, ,,	R4 000	R290 plus 11 per cent of the amount by which the taxable amount exceeds R3 000;
,,	R4 000	,, ,,	R5 000	R400 plus 12 per cent of the amount by which the taxable amount exceeds R4 000;
,,	R5 000	,, ,,	R6 000	R520 plus 14 per cent of the amount by which the taxable amount exceeds R5 000;
,,	R6 000	,, ,,	R7 000	R660 plus 16 per cent of the amount by which the taxable amount exceeds R6 000;
,,	R7 000	,, ,,	R8 000	R820 plus 18 per cent of the amount by which the taxable amount exceeds R7 000;
,,	R8 000	,, ,,	R9 000	R1 000 plus 20 per cent of the amount by which the taxable amount exceeds R8 000;
,,	R9 000	,, ,,	R10 000	R1 200 plus 22 per cent of the amount by which the taxable amount exceeds R9 000;
,,	R10 000	,, ,,	R11 000	R1 420 plus 24 per cent of the amount by which the taxable amount exceeds R10 000;
,,	R11 000	,, ,,	R12 000	R1 660 plus 26 per cent of the amount by which the taxable amount exceeds R11 000;
,,	R12 000	,, ,,	R13 000	R1 920 plus 28 per cent of the amount by which the taxable amount exceeds R12 000;
,,	R13 000	,, ,,	R14 000	R2 200 plus 30 per cent of the amount by which the taxable amount exceeds R13 000;
,,	R14 000	,, ,,	R15 000	R2 500 plus 32 per cent of the amount by which the taxable amount exceeds R14 000;
,,	R15 000	,, ,,	R16 000	R2 820 plus 34 per cent of the amount by which the taxable amount exceeds R15 000;
,,	R16 000	,, ,,	R17 000	R3 160 plus 36 per cent of the amount by which the taxable amount exceeds R16 000;
,,	R17 000	,, ,,	R18 000	R3 520 plus 38 per cent of the amount by which the taxable amount exceeds R17 000;
,,	R18 000	,, ,,	R19 000	R3 900 plus 40 per cent of the amount by which the taxable amount exceeds R18 000;
,,	R19 000	,, ,,	R20 000	R4 300 plus 42 per cent of the amount by which the taxable amount exceeds R19 000;
,,	R20 000	,, ,,	R21 000	R4 720 plus 44 per cent of the amount by which the taxable amount exceeds R20 000;
,,	R21 000	,, ,,	R22 000	R5 160 plus 46 per cent of the amount by which the taxable amount exceeds R21 000;
,,	R22 000	,, ,,	R23 000	R5 620 plus 48 per cent of the amount by which the taxable amount exceeds R22 000;
,,	R23 000	,, ,,	R24 000	R6 100 plus 50 per cent of the amount by which the taxable amount exceeds R23 000;
,,	R24 000	,, ,,	R25 000	R6 600 plus 52 per cent of the amount by which the taxable amount exceeds R24 000;
,,	R25 000	,, ,,	R26 000	R7 120 plus 54 per cent of the amount by which the taxable amount exceeds R25 000;
,,	R26 000	,, ,,	R27 000	R7 660 plus 56 per cent of the amount by which the taxable amount exceeds R26 000;

exceeds R27 000 but does not exceed R28 000	R8 220 plus 58 per cent of the amount by which the taxable amount exceeds R27 000;
„ R28 000	R8 800 plus 60 per cent of the amount by which the taxable amount exceeds R28 000.

TABLE II

Taxable Amount				Rates of tax in respect of persons who are not married persons.
Where the taxable amount—				
does not exceed R1 000				12 per cent of each R1 of the taxable amount;
exceeds R1 000 but does not exceed			R2 000	R120 plus 12 per cent of the amount by which the taxable amount exceeds R1 000;
„	R2 000	„ „	R3 000	R240 plus 13 per cent of the amount by which the taxable amount exceeds R2 000;
„	R3 000	„ „	R4 000	R370 plus 14 per cent of the amount by which the taxable amount exceeds R3 000;
„	R4 000	„ „	R5 000	R510 plus 17 per cent of the amount by which the taxable amount exceeds R4 000;
„	R5 000	„ „	R6 000	R680 plus 20 per cent of the amount by which the taxable amount exceeds R5 000;
„	R6 000	„ „	R7 000	R880 plus 23 per cent of the amount by which the taxable amount exceeds R6 000;
„	R7 000	„ „	R8 000	R1 110 plus 26 per cent of the amount by which the taxable amount exceeds R7 000;
„	R8 000	„ „	R9 000	R1 370 plus 28 per cent of the amount by which the taxable amount exceeds R8 000;
„	R9 000	„ „	R10 000	R1 650 plus 30 per cent of the amount by which the taxable amount exceeds R9 000;
„	R10 000	„ „	R11 000	R1 950 plus 32 per cent of the amount by which the taxable amount exceeds R10 000;
„	R11 000	„ „	R12 000	R2 270 plus 34 per cent of the amount by which the taxable amount exceeds R11 000;
„	R12 000	„ „	R13 000	R2 610 plus 36 per cent of the amount by which the taxable amount exceeds R12 000;
„	R13 000	„ „	R14 000	R2 970 plus 38 per cent of the amount by which the taxable amount exceeds R13 000;
„	R14 000	„ „	R15 000	R3 350 plus 40 per cent of the amount by which the taxable amount exceeds R14 000;
„	R15 000	„ „	R16 000	R3 750 plus 42 per cent of the amount by which the taxable amount exceeds R15 000;
„	R16 000	„ „	R17 000	R4 170 plus 44 per cent of the amount by which the taxable amount exceeds R16 000;
„	R17 000	„ „	R18 000	R4 610 plus 46 per cent of the amount by which the taxable amount exceeds R17 000;
„	R18 000	„ „	R19 000	R5 070 plus 48 per cent of the amount by which the taxable amount exceeds R18 000;
„	R19 000	„ „	R20 000	R5 550 plus 50 per cent of the amount by which the taxable amount exceeds R19 000;
„	R20 000	„ „	R21 000	R6 050 plus 52 per cent of the amount by which the taxable amount exceeds R20 000;
„	R21 000	„ „	R22 000	R6 570 plus 54 per cent of the amount by which the taxable amount exceeds R21 000;
„	R22 000	„ „	R23 000	R7 110 plus 56 per cent of the amount by which the taxable amount exceeds R22 000;
„	R23 000	„ „	R24 000	R7 670 plus 58 per cent of the amount by which the taxable amount exceeds R23 000;
„	R24 000			R8 250 plus 60 per cent of the amount by which the taxable amount exceeds R24 000.

DOCUMENTS

E. E. C.

Commission of the European Communities

TAXES IN THE COMMUNITY*

The Statistical Office of the European Communities has published its 1975 Tax Statistics Yearbook. This publication contains comparable data on taxes and social welfare contributions in the Member States for the period 1969-74.

In 1974 taxes and social welfare contributions rose more sharply than prices in all the Member States. Except in Italy [1], revenue from "direct" taxes (taxes on income and wealth, social welfare contributions) rose more sharply than revenue from "indirect" taxes (mainly turnover and consumption taxes and taxes linked to imports) in line with economic trends in 1974:

(a) the sharp rise in revenue from current taxes on income and wealth was due to the rapid increase in personal incomes in money terms — in 1974 as compared with 1973 the average income of wage and salary-earners [2] rose by 17% for the Community as a whole — combined with a "fiscal drag" effect. In France, Luxembourg and the United Kingdom a further factor was the very substantial increase in the yield from corporation tax;

(b) revenue from social welfare contributions rose less sharply in most countries. Unlike income tax, social welfare contributions are not progressive; the rates of contribution and contribution ceilings were, however, raised in a number of countries;

(c) the main factor governing the trend in indirect taxes, on the other hand, apart from certain special developments (fall in consumption of mineral oil products, lower farm levies, etc.), was the general slowdown in 1974 in economic activity.

In this year tax revenue and social welfare contributions as a proportion of GDP ranged from 31.6% in Italy, where tax yields are particularly low, to 46.2% in the Netherlands, where high social welfare contributions are an important factor. The figures for the other countries are 38.1% in Germany (FR), 36.4% in France, 39.3% in Belgium, 40.4% in Luxembourg, 36.7% in the United Kingdom, 33.4% in Ireland, and 44.5% in Denmark. For the Community as a whole this taxation burden increased from 35.4% to 37.3% between 1969 and 1974.

There was no further alignment of the taxation structures in the Community between 1969 and 1974. In all the Member States, however, direct taxes gained ground at the expense of indirect taxes.

* Press-release Spokeman's Group. Brussels, February 20, 1976.

1. The figures for Italy were partly influenced by the introduction of the Value Added Tax in 1973 and the reform of direct taxes in 1974.
2. At current prices and exchange rates.

CANADA

Non-resident Withholding Tax Rates for Non-Treaty Countries and for Treaty Countries Effective January 1, 1976

Revenue Canada, Taxation recently issued a Release in which new procedures with respect to non-resident withholding tax rates for non-treaty countries effective January 1, 1976 were announced. The Release itself reads as follows:

The move comes in the wake of a 10 per cent increase in statutory rates, effective January 1, 1976. On certain types of investment income flowing from Canada to non-residents, the withholding tax now stands at 25 per cent. Canadians who pay money to non-residents will in future be required to deduct this maximum withholding tax of 25 per cent unless they can prove that the beneficial owner of the income resides in a country with which Canada has a tax treaty that provides a lesser tax rate. Until this year, Canada's statutory withholding tax rates were 15 per cent generally for all countries regardless of tax treaties.

Non-residents of the 16 countries with which Canada has treaties may be eligible for lower non-resident tax rates on specific types of income; residents of non-treaty countries are subject to the 25 per cent withholding tax. Revenue Canada is putting the onus on the Canadian payor, whether this is a trust company, bank, other agent or individual, to retain evidence that the beneficial owner of the income resides in a treaty country before the lower rate can be applied.

The Department has specified "beneficial owner" to differentiate from a "registered owner" who may be receiving the funds in a tax treaty country on behalf of the beneficial owner who may reside in a non-treaty country. Unless exempt by statutory provisions, income such as management fees, interest, dividends, rentals, royalties etc., is subject to withholding tax.

Officials at Revenue Canada are currently working out administrative procedures for enforcing the new ruling but point out that they will expect paying agents to have records available for inspection if tax is being withheld at a rate lower than 25 per cent. They point out that if a person is taxed at the higher rate he can claim for a refund of the surplus if he can substantiate residency in a prescribed country with a lesser rate of tax. Refunds can be claimed through Form NR7R available at the District Taxation Offices.

In addition, another Release contains the following Schedule of non-resident withholding tax rates for treaty countries effective January 1, 1976.

SCHEDULE OF NON-RESIDENT TAX RATES FOR TREATY COUNTRIES EFFECTIVE JANUARY 1, 1976

	United States		United Kingdom		Australia		Denmark		Federal Republic of Germany		Finland		France	
	Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate
Management Fees	XI	15		25		25		25		25		25		25
Interest	XI	15	10	15		25	VI(1)	15	VII	15	VI(1)	15		25
									XIII	25				
Interest—Other (A) . .		15		15		15		15		15		15		15
Estate Income	XI	15		25		25		25		25		25		25
Rentals	XI	15	11	10		25	VI(1)	15		25	VI(1)	15		25
Rentals—Other (B) . .	XI	15	5	25		25	VI(1)	15		25	VI(1)	15		25
Royalties	XI	15	11	10		25	VI(1)	15	VIII(2)	15	VI(1)	15		25
Royalties—Other (C) . .	XI	15	5	25		25	VI(1)	15	XIII	25	VI(1)	15		25
Timber Royalties	XI	15	5	25		25	VI(1)	15		25	VI(1)	15		25
Alimony	XI	15	20	Nil		25		25		25		25		Nil
Patronage Dividends . .	XI	15		25		25		25		25		25		25
Dividends (D)	XI	15	9(3)	15	VII(2)	15	VI(1)	15		25	VI(1)	15		25
									VI(1)	15				
Films	XI	15	11(5)	10		25	VI(1)	15	VIII(3)	10	VI(1)	15		25
Pensions & Annuities .		Nil		Nil		Nil		Nil		Nil		Nil		Nil
Pensions Out of Public Funds		Nil		Nil		Nil		Nil		25		Nil		25
Lump Sum Out of Pensions, Annuities or Similar Payments . .	XI	15		25		25		25		25		25		25

NOTES:

(A) INTEREST—OTHER—Subsection 10(4) of the Income Tax Application Rules, 1971 (ITAR, 1971)

Where an amount is paid or credited by a person resident in Canada to a non-resident person
(a) who is resident in a prescribed country, and
(b) with whom the person resident in Canada was dealing at arm's-length,
as, on account or in lieu of payment of, or in satisfaction of, interest payable on any bond, debenture, mortgage, hypothec, note or similar obligation issued before 1976 by the person resident in Canada to the non-resident person, for the purposes of computing the tax under Part XIII of the amended Act payable by the non-resident person on the amount, subsection 212(1) thereof shall be read as if the reference therein to "25%" were read as a reference to "15%".

CANADA: NON-RESIDENT WITHHOLDING TAX RATES

Ireland		Jamaica		Japan		Netherlands		New Zealand		Norway		Sweden		Trinidad & Tobago		Union of S. Africa	
Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate	Art.	Rate
VI(1)	15		25		25		Nil		25		25		25		25		25
VI(1)	15		25	VII(1)	15	VIII(2)	15		25	10(2)	15	VI(3)	15	IX(1)	15		25
						III	25										
	15		15		15		15		15		15		15		15		15
VI(1)	15		25		25	Protocol	25		25	12(2)	15		25		25		25
VI(1)	15		25		25		25		25		25	VI(3)	15	X(1)	15		25
VI(1)	15		25		25	III	25		25		25	VI(3)	15		25		25
VI(1)	15		25	VIII(1)	15	IX(2)	15		25	11(3)(b)	15	VI(3)	15	X(1)	15		25
VI(1)	15		25		25	III	25		25	5(1)	25	VI(3)	15		25		25
VI(1)	15		25		25	III	25		25	5(1)	25	VI(3)	15		25		25
VI(1)	15		25		25		Nil		25	20	Nil		25		25		25
VI(1)	15		25		25		Nil		25		25		25		25		25
VI(1)	15	3(1)	22½	VI(1)	15	VII(2)	15		25	9(2)	15	VI(1)	15	VIII(1)	15		25
VI(2)	Nil					VII(3)	Nil										
VI(1)	15		25	VIII	15	IX	15		25	11(3)(c)	10	VI(3)	15	X(1)	15		25
	Nil		25		25		Nil		Nil		Nil		Nil		Nil		25
	Nil		25		25		Nil		Nil		Nil		Nil		Nil		25
VI(1)	15		25		25		Nil		25		25		25		25		25

(B) RENTALS—OTHER—refers to payments made for the use of or the right to use real or immovable property in Canada.

(C) ROYALTIES—OTHER—refers to payments made for the use of or the right to use real or immovable property in Canada.

(D) For Corporations which qualify for a degree of Canadian Ownership, the rate specified in the schedule will have to be further reduced by 5 percentage points in accordance with subsection 212(3) of the Income Tax Act.

(E) No withholding on copyright royalties (Subparagraph 212(1)(d)(VI).

(F) The rates shown are based on the provisions of the Tax Agreements in effect on December 31, 1975, and when applicable subsection 10(6) of ITAR, 1971.

(G) For all non-treaty countries the rate is 25% generally.

Editor's note

Except from several exemptions from Canadian non-resident withholding tax, particularly on interest and royalties, a very important new exemption was recently provided for in Sec. 212(1)(b)(vii). According to this provision an exemption applies to:

interest payable by a corporation resident in Canada to a person with whom that corporation is dealing at arm's length on any obligation where the evidence of indebtedness was issued by that corporation after June 23, 1975 and before 1979 if, under the terms of the obligation or any agreement relating thereto, the corporation may not, under any circumstances, be obliged to pay more than 25% of the principal amount thereof within 5 years of the date of its issue except in the event of a failure or default under the said terms or agreement.

* * * BIBLIOGRAPHY * * *

SPECIAL BOOK REVIEW

International tax treaties of all nations; containing English language texts of all tax treaties between two or more nations in force on July 1, 1975

by DIAMOND, W. H. and DIAMOND, D. B.

Dobbs Ferry, New York, 10522, Oceana Publishers, Inc., 1975
Volume I, Treaties 1-125
565 pp., $ 50 per volume

This is Volume I of a projected 10 volume series to be published during 1976. This series will reprint the more than 900 tax treaties published by the League of Nations and by the United Nations. The publication does not only contain conventions for the avoidance of double taxation of income and capital, but also conventions concerning death duties, taxation of income from sea, air, and rail transport, conventions for administrative and legal protection or asssistance, agreements about motor vehicle taxes, and turnover taxes, etc.

In their introduction, the Editors point out that each treaty is preceded by a short editorial note indicating the characteristics of the treaty and, furthermore, that a detailed table of contents and a subject matter index plus a cumulative country-by-country alphabetical index (in a loose-leaf volume) will assist the reader in the use of this publication.

The Editors' initiative to bring together all tax treaties in one publication would seem to meet the demands of many tax experts. Whether the latter will find it useful depends upon their requirements. If they wish to consult the text of a particular treaty the existence of which is known to them, this publication is of great value. Those who want to find out whether a treaty exists and whether it is still applicable may have difficulty in solving their problem unequivocally. This is a consequence of the system chosen for reproducing the treaties, which is the chronological order in which they have been published by the League of Nations and the United Nations, and this in bound rather than loose-leaf volumes. This system precludes the possibility of indicating whether a particular treaty is still effective as such, whether it has been amended or replaced altogether. The very succinct Editors' notes are not always clear in this respect and indeed, quite a few texts reproduced are no longer valid. This drawback is bound to become more serious with the increasing number of amended of new superseding treaties. The consecutive numbering in the publication does not coincide with the League of Nations or United Nations numbering (and cannot be in fact, which can confuse users of it).

The same applies to the classification of the types of treaties used originally by both international bodies; the Editors cannot be blamed for this but finding the same main headings again and again throughout a volume is somewhat confusing.

It might have been easier for the user if all treaties belonging to a particular group had been published together, and it would even have been better if, in addition, all treaties had been grouped by country; in order to avoid duplication, references would than be necessary under the "other" country's name. Such a system would have required a much bigger effort from the Editors and one might have had to wait a much longer time before a publication of this kind could have appeared.

v. H.

BOOKS RECEIVED

Any inquiries concerning books on this list should include the reference numbers listed.

ARGENTINA

LOS IMPUESTOS Y LA INFLACION

By R. A. Halperin. Buenos Aires, Editorial Cangallo S.A.C.I., Av. Belgrano 609, 1975. 102 pp.
An analysis of the effects of inflation on the corporate tax burden. Several micro-economic models are incorporated into the text. (B 15.526)

MANUAL PRATICO DEL CONTADOR Y DE LA EMPRESA

By A. E. Lema. Buenos Aires, Editorial Cangallo S.A.C.I., 1975. 498 pp.
An extensive practical manual designed to familiarize public accountants with the general corporate structure as well as to instruct them on the various norms to be applied when acting in the role of corporate auditor. (B 15.527)

BANGLADESH

GUIDE TO INVESTMENT IN PRIVATE SECTOR INDUSTRIES IN BANGLADESH

Bangladesh, Government Printer, 1975. 13 pp.
Information booklet to assist foreign investors interested in exploring the possibility of investing in Bangladesh. (B 50.175)

BELGIUM

ELSEVIERS BELASTING ALMANAK 1976

B. A. Wiams and R. Schollaert. Brussels, Elsevier Séquoia, 1976. 144 pp., Bfrs. 165.—.
Tax Almanac Guide 1976 containing necessary information to file the 1976 individual income tax return for 1975 income. There is a French version of this edition. (B 9486)

UITEENZETTING OVER: INVOERRECHT EN INDIRECTE BELASTINGEN; HET BEGRIP OORSPRONG UIT ECONOMISCH EN UIT FISCAAL OOGPUNT; DE FACILITEITEN DIE VERLEEND WORDEN AAN IN BELGIE GEVESTIGDE ONDERNEMINGEN DIE EEN DEEL VAN HUN PRODUKTEN UITVOEREN

Brussels, Belgische Dienst voor de Buitenlandse Handel, 1975. 11 pp.
Summary of the provisions concerning import duty and indirect taxes (including value added tax) in the EEC countries with emphasis on Belgium. (B 9426)

BRAZIL

INCENTIVOS E DESENVOLVIMENTO INDUSTRIAL

2o. Congresso Interamericano de Direito Tributário - 1975. By A. J. Franco de Campos. São Paulo, Editorial Resenha Tributária Ltda., R. Cel. Xavier de Toledo 210, 1975. 38 pp.
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ARTICLES

JAMES H. DOBSON*:

AN ANALYSIS OF EUROPEAN WEALTH TAXES

The wealth tax[1] is a widely used fiscal measure. As the name implies, it is a tax levied on the wealth of the taxpayer. However, "wealth" is a term of art for the purposes of this tax. The types of property ownership that give rise to tax liability vary widely among the European tax systems. This variance could be explained entirely in terms of different purposes for instituting the different wealth taxes. It is also possible, though, that differences have been created by confused and ineffective legislation. The purpose of this article is to determine to what extent such confused legislation exists and to propose properly structured wealth tax systems to serve each of the purposes for instituting a wealth tax.

To begin this analysis, there must first be a consideration of the possible purposes that a wealth tax can serve. Each of these purposes requires its own tax structure. These tax "structures" are in reality combinations of features found in the law which determine the applicability and effects of the wealth tax. Each of these features, ideally, will maximize the furtherance of the aims of the law and will minimize its unintended and undesirable effects. To determine the model wealth tax system for each purpose, these potential features must be considered in detail. The range of effects produced by each feature and by changes in that feature must be considered. Then it will be possible to analyze the results from a combination of these features. In this manner it will be possible to determine what structure best serves each of the alternative tax goals.

Once the model systems have been derived, one can compare them with existing and proposed wealth tax systems. However, a problem does arise in determining the purpose behind the creation of an existing tax. It is rarely clearly stated. Instead, the purpose must be determined inductively, if possible. Yet, this inductive exercise is not destructive to the analysis of the systems. Rather, it tends to answer our principal question. The more difficult it is to find the pattern behind a system's structure, the more confused and internally disharmonious that system probably is. By comparing the existing and model systems with each other, one should get a good idea of the valid, and the flawed, designs of a wealth tax system.

PURPOSES

There are four main purposes which are advanced to justify the establishment of a wealth tax:

(1) Maximization of resource use efficiency.

Proponents of this purpose argue that income taxes encourage a socially undesirable activity — the investment of wealth in non-income-producing property[2]. The wealthy person is encouraged to invest in assets that

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1. While some systems use the term "net worth tax" instead of wealth tax, there is no difference between the two and "wealth tax" will be used in this article to refer to all such systems.

2. For the purposes of this discussion, the term "income" will refer only to gains which are currently realized by the taxpayer. Appreciation gains are not included in the term.

produce an appreciation gain which will not be taxed until disposition of the asset, if at all, and then at a special reduced rate. The objection to this type of investment is that it produces no jobs and creates no circulation of money. Income-producing assets, such as bonds, and the choice to use other assets to produce income, such as the development of a tract of land, are said to be more socially and economically desirable uses of wealth. To encourage such investment, persons should be taxed as if they were making efficient use of their wealth whether or not they are in fact. If a person is taxed on wealth sitting idle[3] he will have an incentive to put that wealth back into the economic mainstream and to get some income out of it, provided, of course, that the income tax consequences of doing that will not negate the wealth tax advantages created by such investment.[4] Properly applied, the wealth tax will make the most socially effective use of wealth the most economically rewarding use for the owner of the wealth as well.

(2) Creation of an equitable tax system. Proponents of this purpose believe that income alone does not accurately measure a person's ability to pay taxes. An often-cited illustration of this viewpoint is Professor Lord Kaldor's example of the Maharajah and the beggar.[5] Imagine a Maharajah who keeps all his wealth in the form of a magnificent palace, gold and jewels. Now consider the beggar who sleeps outside the Maharajah's gate. Both have zero income, but one would hardly argue that they have the same taxable capacity. Accordingly, a wealth tax must be combined with an income tax to distribute the tax burden fairly among all the citizens. The income tax would be used to tax actual income, and the wealth tax could be used to tax the imputed income and appreciation gain from the ownership of property.[6] For property producing actual income the wealth tax can be considered to function as a surtax on investment income. Alternatively, the wealth tax could be considered as a tax on some quality unrelated to income.[7]

A necessary corollary of advocating this tax structure is a certain ordering of the taxability of the various forms of income and wealth. One must accept that income from capital is not a proper measure of the taxable capacity resulting from the ownership of the capital, that an added charge or surtax is needed. One must also determine what treatment is required where a prudent man saves his earnings and increases his wealth while a prodigal man who earns as much squanders his wages.

3. The term "idle wealth" will be used to refer to assets which do not produce a current flow of income.

4. It is highly unlikely that the income tax on his investment income will make the investor poorer than if he had not invested. Income tax systems rarely take 100 percent of the income, so the taxpayer can generally expect to make some profit on any income received from the property. However, the possible profit may be so small that it will not encourage the taxpayer to accept the risks of the investment nor to exchange property that he has and likes for income-producing property which does not suit his tastes as well.

5. N. KALDOR, INDIAN TAX REFORM (Ministry of Finance, Government of India, New Delhi, 1956).

6. To properly serve this purpose, a coordination between the wealth tax and the capital gains tax would be imperative.

7. For a discussion of the advantages of wealth besides its ability to produce income see G. Macdonald, *The Wealth Tax — The Wrong Tool for the Job*, 1975 BRITISH TAX REVIEW 283. The advantages pointed out by Mr. Macdonald include economic freedom and security, psychic benefits such as the enjoyment of ownership, and political power.

Finally, one must consider whether taxable capacity is equally increased by wealth in a readily usable and by wealth in an unusable form. Fairness is the central theme of proponents of this purpose of a wealth tax, and that fairness is achieved by using the wealth tax as a means of reaching assets that cannot be easily taxed by an income tax alone.

(3) Redistribution of wealth.
Proponents of this wealth tax purpose argue that the current distribution of wealth is unjustifiably concentrated in a few hands. For instance, according to J. R. S. Revell [8], of the wealth held by persons over the age of 25 in England and Wales in 1960, the wealthiest 1% of the population owned 42% of the wealth. If one finds this situation socially undesirable he may wish to use the tax structure to decrease the disparity between the extremely wealthy and the average citizen. A wealth tax is easily adapted to this purpose. By subjecting those people with an unacceptable amount of wealth to a special tax, a government can force the rich to give an extra amount to support programs that benefit the entire population. In addition, if the wealth tax rate is high enough, the tax can result in a reduction of the property holdings of the wealthy as well as serving as a special government support payment.

(4) Production of revenue.
Under this approach, a wealth tax is instituted primarily to provide revenue for governmental expenditures. While subsidiary policy decisions are reflected in the structure of the system and can result in some of the previously-mentioned purposes also being served, the principal design of a revenue production system is a maximation of revenue produced.

FEATURES

Some of the principal features in any tax system are those which determine who is to be subject to the tax. Wealth tax systems limit their applicability through two main means. The first is by limiting the applicability of the tax according to the category of taxpayer. Wealth is owned by legal entities other than natural persons; trusts, estates and corporations all may own property. But wealth taxes often exclude some or all of these non-natural tax entities. The result of such an exclusion is to change the nature of the tax. The tax ceases to be a tax merely on the ownership of wealth and becomes instead a tax on the ownership of wealth by a certain category of taxpayer — usually individuals.
A number of decisions follow the determination of which categories of legal entities will be subject to the tax. Foremost is the question of whether other features of the system will apply equally to the different categories of taxpayer. For example, exemptions for assets of a personal nature; i.e., a taxpayer's house, will apply to individuals but not to corporations. This discussion will focus on the features as they affect individuals.
A second question is whether a nonresident taxpayer should be treated the same as a resident taxpayer. Since he is subject to tax only on the wealth he possesses in the taxing country, the nonresident is not equally entitled to such features as the standard exemption. It is reasonable to assume that the exclusion of

8. J. R. S. Revell, *Changes in the Social Distribution of Property in Britain during the Twentieth Century,* cited in SANDFORD, WILLIS, IRONSIDE, AN ANNUAL WEALTH TAX (Heinemann Educational Books, London, 1975) at 297.

all his assets at his place of residence adequately serves the function of a standard exemption.

The third question concerns the taxation of legal entities other than natural persons. Since their value is ultimately owned by natural persons, one solution is to tax the individual on his interests in estates, trusts and corporations and to exclude those entities from the tax. Another solution is to tax some or all of the legal entities other than natural persons, but to exclude the value of his interest in such an entity for the individual. For the corporation the taxation of both the entity and the individual may be reasonable, since the value of the stock to the individual, at least for publicly traded shares, is often very different from the stock's pro rata part of the value of the business. However, for estates and trusts one would expect to find taxation on an either/or basis.

Once the categories of taxpayers to be taxed have been decided, the next major decision that limits the number of entities subject to tax is the establishment of a tax "floor". This floor is simply any measure that makes the tax inapplicable to persons with wealth below a set amount. It can take the form of a standard exemption or of a threshhold of liability. In either case, it operates with the asset exclusions discussed below to limit the scope of the tax to persons who have a certain level of affluence. The potential of this feature for affecting the nature of the tax should be obvious, as the height of this floor decides whether the tax applies to 80% of the persons in the taxable categories or to 1%.

Another major feature is whether all wealth will be taxed. It is common to find that it is not. Every European system excludes some assets in computing the taxable wealth of the individual. (Generally, corporations are not given specific exemptions.) However, the specifying of which assets are excluded requires decisions directly connected to the question of the purpose of the tax. Are individuals expected to pay a wealth tax on the ownership of items necessary for existence — clothes, a home? Or is the tax meant to tax only ownership of property which might be called luxury property? The European systems unanimously agree that some personal and household effects are to be exempted. However, there is no unanimity on the exclusion of other assets. The decision as to what assets are luxury items is one cause of the variation. This decision serves to indicate what acquisitions and types of ownership of assets for personal use are implicitly encouraged by the wealth tax system. For example, if a car is included in taxable wealth but a savings account is not, this suggests that a secondary purpose, at least, is to encourage savings.

In addition to the possible division of excluded and included goods based on the distinction between normal possessions and luxuries, another often used distinction exists — the division of property into enjoyment and investment property. Under this standard, the issue is not whether the asset is a necessity but whether the asset is held with the intention of increasing the taxpayer's wealth. If the wealth tax is intended to tax economic gain not currently taxable as income, one might exclude assets held only for personal enjoyment. On the other hand, if the system is meant to discourage the holding of idle wealth or to tax the pleasures of the well-to-do, one might tax the enjoyment assets and exclude the investment assets.

A particularly interesting question in the issue of excluded assets is the question of works of art. Using the first standard suggested above, works of art would clearly be taxed as luxuries. Yet, they certainly are a different sort of luxury from yachts and jewelry. If one accepts the premise that there is such a thing as a national heritage in the area of art, then this element must be considered when one looks at the effects of taxation of works of art. Taxation of the private ownership of art would surely discourage the private ownership of art, since unlike many other assets, art objects do not produce a current flow of income to pay for the cost of owning them. The result to be expected is that the art will be sold to a collector in another country, since that person would not suffer a tax disadvantage by such ownership.[9] In terms of a national art heritage, the result would be a loss of works of art potentially available to the public. Sir Alexander Glen, the chairman of the British Tourist Authority, has expressed the opinion that a wealth tax on art in his country would have an extremely negative effect on British art holdings. He concluded that "there would be no way back from the destruction".[10] If only the normal necessity/luxury test is used, one can expect the national heritage interest to be thwarted.

The difficulty is not resolved by applying the investment/enjoyment test. For one thing, a work of art can be both, purchased for the owner's enjoyment but with an eye toward holding it for appreciation. There is no effective, non-arbitrary way to determine what works of art should be subject to tax under this test. Furthermore, if works of art were to be considered enjoyment property, it is clear that the enjoyment is of a quite different nature from that received from ownership of a yacht. Unlike most assets, enjoyment consists only of viewing and involves no physical use of the work, no cost to the user, and no depletion of the value or useful life of the asset. These particular features, along with the national heritage issue discussed above, suggest that deciding the question of exclusion from tax for works of art requires special considerations.

Possible special treatment for these assets exists. In addition to the alternatives of automatic taxation or automatic exclusion of works of art, there is a middle ground. Exclusion from taxation could be conditioned upon making the art available for viewing by the public. Because of the unique nature of enjoyment of art, this requirement would cost the owner little. Also, public viewing would serve the national heritage interest better than the likely results of either of the other two alternatives. To deter the use of this exclusion as a tax haven, the transfer of works of art could be subject to a compensating tax. In any case, the presence of the special issues surrounding the exclusion of works of art indicates that this question should be dealt with separate from the general question of excluded assets.

Major controversies also exist concerning the inclusion of other specific assets, most notably, life insurance, pension rights, residences and future earnings. As in the case of the exemption for art, these questions are quite complex and involve the consideration of issues peripheral to the principal question of what type of wealth tax system is desirable. The discussion of the art question should give some insight into the accommodation of special factors into

9. It should be pointed out in passing that attempts to prevent passage of art treasures out of the country by a transfer tax violates the EEC charter. See Case 7/68, EEC Commission v. Italy.
10. Quoted in The Financial Times, October 14, 1975, at 8.

the overall structure of the system. However, this article will make no attempt to analyze and resolve these other special controversies.

A feature of every wealth tax system is the tax rate to be imposed on persons liable to the tax. The effect of this decision is clear. The higher the tax, the greater the burden imposed on the taxpayer. It is also important to decide whether the tax rate will be proportionate or progressive. This determines whether the basic effect is to impose a tax on the property itself or on the taxpayer. A proportionate tax is aimed at producing a certain tax revenue from any piece of qualifying property without regard for the ownership of the property. An argument can be made that this is the fairer system, since tax treatment for the ownership of a particular asset will be the same for all persons subject to tax who own such an asset. The progressive rate, on the other hand, looks to the total holdings of the taxpayer to determine the tax on a particular piece of property. Under such a system it costs a wealthy person more to own an asset than it costs a person of more moderate means. Proponents of this structure argue that as wealth increases, the taxpayer's advantages increase disproportionately. Whether one accepts this argument or the one favoring the proportionate rate structure, the difference in effect between the two systems is apparent. The first is a property tax with no regard for the individual owning the property. The second is an individual tax with the ownership of property as the measure of liability.

The issue of rates brings up a related feature found in some wealth taxes. It was mentioned that increasing the rate increases the burden on the taxpayer. The question is, Should there be a limit on that burden' It is clear from what has been discussed so far that a wealth tax may require a person to pay tax on property that produced no current flow of income. This would mean that the tax on that property would have to be paid out of income from other property, or income earned through the labor of the taxpayer, or money from the sale of property. These three possible sources of income indicate the three possible approaches to the question of a limit or ceiling provision. One possible attitude is to limit the tax on ownership of property to the income, after income taxes, or a fixed percentage of that income, derived from the ownership of the property. The effect of such a provision is to make the wealth tax a form of investment income surcharge. This could be expected to encourage consumption and investment in non-income-producing assets.

A second possible ceiling is one based on the total amount of income received by the taxpayer during the tax year. The effect of the ceiling would be to allow taxpayers whose income is largely derived from low-yield investments to maintain these investments undiminished by the wealth tax. All other taxpayers would be given an incentive to invest their wealth in high income assets, since to do otherwise would simply mean that more of their earned income would go to the tax authorities. Wealth that was not "pulling its own weight" in regard to the taxes imposed on it would not automatically mean less revenue for the government, as under the first ceiling, but would generally mean less net income for the owner. So this second ceiling would encourage investment in high-yield assets and the development of the income potential of property held. However, it would also insure that if a person with a great deal of wealth decided to have a low personal income, that person would not have to sell property to pay his taxes. Taxes would never exceed current income.

The third possible answer to the question of limitation of total tax is to impose no limitation at all. This could have either of two possible effects, depending on the income and wealth tax rates in effect. If the combined tax rates are such that they can be met by most taxpayers out of current income, then the result is much the same as discussed immediately above. There will be an incentive toward development of the income potential of existing assets and toward investment in income-producing property. However, it will still be a choice. The taxpayer can decide for himself whether he would rather change his holdings so that they will pay the tax costs of their ownership or would rather absorb the cost of low income assets by selling some of his property to pay the wealth tax. And the choice between high and lesser yield assets would still be a question of whether the potential extra return was worth the extra risk.

A far different effect is produced by a no-limit system under which it is impossible for a person to invest his wealth in such a manner that the income from the property will pay for the tax on the property. For taxpayers with a great deal of property relative to earned income, the result would be a tax in excess of 100% of income; that is, a tax that could only be met by the sale of assets. The effect would be the dissipation of the wealth of even the most frugal of these "landed" taxpayers. Whereas the first no-limit system is in effect a structure to influence the use of wealth, this second system is a structure to reduce wealth. While it may have some of the same effects as the first, since people may turn to high-yield investments to postpone the demise of their fortunes as long as possible, that is certainly not a major part of this structure. It is confiscatory in nature, with a principal effect of reducing the property holdings of the wealthy. However, a probable secondary effect of such a system should be mentioned. One can not expect a taxpayer to be very pleased about any tax, but a tax designed to take away what the taxpayer already owns can be expected to be particularly distasteful. It seems a very real possibility that wealth taxpayers would respond to such a tax by removing their property, and possibly themselves, from the view of the taxing authorities.

RELATION OF PURPOSES AND FEATURES

Now that the features found in wealth tax systems have been discussed it is possible to consider how these features should be combined to create a tax structure best suited to produce each of the goals previously mentioned.

Maximization of Resource Use Efficiency

Proponents of this goal want to use the wealth tax to encourage taxpayers with idle wealth to put that wealth to a more efficient use. Taxpayers are given an incentive to use their wealth to produce income, or, more precisely, they are subject to a disincentive for failing to make such a use of their wealth. Under a system with such a purpose one would expect to find features as follows:

(a) Persons subject to tax

Individuals and estates should be subject to such a wealth tax because these entities can hold non-productive assets that should be converted to productive assets. While it is true that a corporation can hold non-productive assets, too, one expects a corporation to make its decisions based on sound business judgment and economic conditions. That is, one can expect a business to try to make as much profit as is possible. Since proponents of the use of the wealth tax to promote resource efficiency consider maximum income as an indicator of optimal use of property, then the corporate and the tax system goals coincide. A tax on corporations would not strengthen this goal and might even have a negative effect on corporate resource use, since it would change the economic conditions affecting business decisions.

(b) Tax floor

The tax is meant to fall on all people with idle wealth and to influence their uses of their "extra" wealth. People with some wealth but not enough to have money for investment purposes should be excluded from the tax. While someone who owns his own house is better off than someone who does not, he does not have the type of wealth the use of which is intended to be influenced by such a wealth tax. Thus, a moderate floor should be used under this system.

(c) Exempt assets

The purpose of this system is to encourage a taxpayer with wealth that is not committed by necessity to any particular use to put that wealth into income-producing property. With such a goal, the determination of exempt assets could be properly made using the distinction between necessities and luxuries. People whose wealth is in necessary assets are not meant to be influenced or punished, but the people with luxuries are to be taxed. The investment/enjoyment test could also be used, but it is not as fitting as the first test. If used, the goal would be to discourage ownership of enjoyment assets. Such assets would be subject to the tax. As for investment assets, while their ownership is to be encouraged, a blanket exclusion does not seem proper. Rather, exclusions should be limited to necessities.

(d) Works of art

These assets produce no income and do not add to the circulation of money in the country. Normally, one would expect to find these assets included in taxable wealth. However, a government could decide that though it produces little or no income the preservation of the national heritage is a more desirable use of these particular assets than is an exchange for income-producing property. This system would be concerned only with promoting an efficient use of such assets. Therefore, a tax exemption conditioned upon the public display of the art would be proper. The wealth tax would then encourage the best utilization of the potential of the resource from the point of view of society as a whole.

(e) Tax rate

The proper wealth tax rate would depend on a number of factors: the rate of income taxation; the rates of return available from the various types of investment prevailing in the country; and the types of investments meant to be encouraged by the tax. All of these factors must be considered to set the tax at a rate that will be high enough to provide a real incentive to invest but not so high that the total tax will punish the ownership of wealth. For example, consider a taxpayer subject to income tax at the rate of 50 percent who invests in a bond paying 5 percent. If the wealth tax is 1 percent of the bond's value, the total tax burden is 70% of the bond's income. If the wealth tax is 3%, the tax burden rises to 110% of the bond's income. Thus, the encouragement of investment in 5% bonds would be served by a 1% wealth tax but hindered by a 3% tax.

In determining the tax rate the government must also consider how much an investment's high return is a result of high risk. That is, high interest payments may mean that the enterprise must pay more to attract investment because its chances of success are relatively small. If the wealth tax encourages investment in such speculative ventures it could result in a less efficient rather than a more efficient use of resources. This possibility must be taken into account, along with income tax rates, to decide the wealth tax rate.

(f) Progressivity

One would expect little or no progressivity. Since the goal is efficiency, the system is concerned with the *use* of the wealth and not the ownership of it. The same tax should be imposed for the use of wealth to purchase a particular asset no matter who makes the decision to put his wealth to that use.

(g) Tax ceiling

Of the three possible approaches to this question discussed above, the first approach, the ceiling based on income from capital, is clearly improper. If a person could avoid the wealth tax by putting his wealth into non-income-producing property, then the tax would serve to encourage rather than to discourage this sort of investment. However, a ceiling based on a percentage of total income that could be taken by the combination of wealth and income taxes might be proper. Such a ceiling would help only those people who derive almost all of their income from low-yield investments. If one believes that the government should protect a person's economic self-sufficiency, then one might object to the use of the wealth tax to push these people into higher-risk investments. Thus, for people dependent on investment income for support, the protection of a ceiling seems reasonable. However, if the desire to protect secure incomes is less important than the need for investment in high-yield assets, then a system without a ceiling might be the most desirable.

Equitable tax system

Proponents of this goal want to use the wealth tax in conjunction with the income tax to arrive at a tax system based on the taxpayer's total taxable capacity. The two taxes are combined in such a way that the income tax reflects the taxable capacity arising from income from services; the wealth tax indicates the taxable capacity arising from the ownership of property; and the combination of the two taxes provides a measure of the taxable capacity resulting from income from capital. Under such a system one would expect to find features as follows:

(a) Persons subject to tax

The purpose of this system is to produce a fairer tax structure by taxing "taxable capacity" regardless of the nature of the entity which has such capacity. Therefore, all categories of taxpayers should be subject to the tax.

(b) Tax floor

The wealth tax works in conjunction with the income tax to tax the total ability of the person to pay. The floor should be low so that it will have as general an applicability as the income tax. The floor should only exclude persons considered too poor to tax.

(c) Exempt assets

The question here is not one of necessity versus luxury. The principal issue is not the use of the wealth but the amount of the wealth. There might be an exclusion of some enjoyment assets where they are of a personal, nonmarketable nature. (These assets arguably add little to a person's ability to pay.) However, as a general rule one would expect little exemption of assets.

(d) Works of art
One would expect an exclusion of these assets if viewing is made available to the public. The system is based on the idea of fairness, and fairness dictates that an asset enjoyed by all should not be taxed to just one. The owner who shares such assets with the public should be afforded a total or partial exemption.

(e) Tax rate
This would depend on two principal factors. The more obvious is the income tax rate. Since the two taxes are both tools in an effort to tax according to taxable capacity, the effects of each must be considered in arriving at proper tax rates. However, before rates can be set, one must also consider the second factor: how one wishes to define the taxable capacity that arises from the ownership of wealth. If wealth increases ability to pay because it can be used as a source of income, then the two taxes can be considered simply a fairer income tax. A guideline for the wealth tax rate would be the income tax rates that were in effect before the introduction of the wealth tax. One would expect the total wealth and income taxes on an investment with a reasonable rate of return to approximate the income tax and any investment surcharges that would have been paid on the investment income in the pre-wealth-tax period. For property which produces no taxable income in a tax year, the wealth tax would serve as a tax on imputed income, in keeping with the view that wealth increases taxable capacity because it has income potential.

However, it is also possible to argue that wealth increases taxable capacity simply because the owner is better off than people without as much wealth. Then the wealth tax rate is not meant to reflect the potential earnings of the wealth but to reflect the government's determination of the value of the advantages that wealth provides to the taxpayer.[11] Under such a view, the wealth tax rate would not be related to the prior income tax rate, since the two taxes are measuring entirely different types of "ability to pay".

(f) Progressivity
Income taxes are almost uniformly progressive for individuals and are usually proportional for companies. If the wealth tax is intended to result in a better income-type tax, then it should be progressive for individuals, too. If the wealth tax is measuring something other than income potential, then the income tax structure is not determinative. However, one would still expect progressivity for individuals. In creating the income tax the government decided that as the taxpayer's base for this tax, i.e. his income, increases his ability to pay increases disproportionately. Although the wealth tax may be taxing a different sort of taxable capacity, it would still seem likely that the government would conclude that increases in wealth produced a disproportionate increase in ability to pay the wealth tax.

(g) Tax ceiling
Here one finds the same arguments that were discussed under the subsection on tax rates. If taxation of wealth is based on the

11. For a partial list of these advantages see footnote 7.

advantages it confers on its owner, then there should be no tax ceiling. Where taxable capacity results from the enjoyment of the benefits of wealth, there should be no arbitrary limit to prevent these taxpayers from paying their proper share. However, if one considers the wealth tax as an adjunct to the income tax, then a ceiling roughly equivalent to the pre-wealth-tax "ceiling" on income taxes would be proper. All income taxes have a maximum marginal rate of taxation. This functions as an uppermost limit of the amount of income that can be taken by the government. Incorporation of a wealth tax with the income tax simply produces a more comprehensive tax structure. It does not make a limiting of the tax burden any less appropriate.

Redistribution of wealth

Proponents of this goal want to use the wealth tax to take wealth from those they consider to be excessively rich and to use the money to increase the wealth of poorer people, thereby decreasing the gap between rich and poor. In its most burdensome form, the tax would not only raise the wealth of the lower class but would also take away the property of the well-to-do rather than merely to reduce their income and would leave them poorer in absolute terms. For such goals one would expect to find features as follows:

(a) Persons subject to tax
The tax should apply only to individuals, since it is the inequities in the distribution of personal wealth that this system seeks to correct. Differences in the net worth among companies and trusts are important only in so far as they create differences in individual wealth and their value should be taxed only in the hands of the owners or beneficiaries.

(b) Tax floor
This system would feature a high tax floor. The tax is intended to place a special burden on those individuals with an unacceptable accumulation of wealth. Other taxpayers are not intended to be affected by this tax. A high tax floor would be a necessity to insure that the tax burden fell only on the excessively rich.

(c) Exempt assets
The particular thing that creates tax liability under this system is the ownership of an excessive share of the nation's wealth. The exclusion of enjoyment assets would be improper here since those are certainly as much a part of the advantage of wealth as investment assets. However, the exclusion test based on necessity would be proper. The taxpayer is not intended to be taxed for having assets that are necessary for a decent life; instead, he is to be taxed on the "extra" wealth that he owns. The inclusion of only luxuries in computing the tax base is appropriate for such a system.

(d) Works of art
One would not expect an exemption for such assets. Otherwise, the wealthy could use such assets as a tax shelter and thereby thwart the purposes of the system. Professor Robert Neild of Cambridge University has criticized special tax treatment for art objects, as well as for forestry and agricultural lands, as providing a benefit principally for the wealthy. "It is an interesting commentary on the British class structure and capacity for humbug that there are concessions only for these assets of the landed gentry and that the Establishment regularly defends those concessions by ignoring their inequity and class implications and referring instead to aesthetic arguments or the economic objectives which might equally well be met by other

means."[12] However, if one disagrees with Professor Neild about the class prejudice involved in the protection of art, one might favor a conditional exemption for works of art of primary significance. This would redistribute the enjoyment of the national art heritage if not the ownership. A tax on transfer could be incorporated to reduce the advantages of the exemption as a shelter of excessive wealth.

(e) Tax rate

The rate of taxation should be higher than found in systems established for the two previous purposes. The tax is meant to be a real burden for those people subject to it. If the goal is to decrease the amount of property owned by the taxpayer, the rate should be higher than the rate of return that the property can be expected to produce.

(f) Progressivity

Tax is imposed for having wealth too much in excess of the wealth of the average person. Under such reasoning, if being wealthy is bad, then being wealthier is worse because it means a greater gap between the taxpayer and the average person. A progressive tax structure is clearly called for to provide a greater tax as the distance from the mean increases.

(g) Tax ceiling

This system should operate without a ceiling. It is intended to give the wealthy no choice about contributing extra money to help others improve their situation. Any restriction on the amount to be paid would only lessen the effectiveness of this system as a means of redistributing wealth. And if the tax is intended to leave the taxpayer poorer in absolute terms, then a tax ceiling would be completely out of place.

Production of revenue

This purpose is not a significant goal of any existing or proposed wealth tax system in Europe. In no country does it produce even 2 percent of the total tax revenues.[13] Such being the case, this purpose will not be discussed here except to note that such a goal would be served by taxation of all entities, few exclusions, a low floor and a high rate of taxation.

ANALYSIS OF EXISTING AND PROPOSED SYSTEMS[14]

Now that a theoretical prototype system has been advanced for each wealth tax goal, one can compare the tax in theory and in practice. For each European country with an existing or a proposed wealth tax, the system will be briefly described; then it will be analyzed for conformity with the abstract wealth tax systems. An effort will be made to determine if the real tax seems logically ordered to produce a goal or combination of goals, or if it seems to be the product of confused or special-interest legislating.

Austria

The Austrian wealth tax taxes individuals and corporations. It features a low floor. Exempt assets include the first $2,800 of savings and a like amount of bonds, the first $7,400 of life insurance, and the first $5,600 of jewelry and luxuries. Art collections are excluded up to a value of $16,800 with no requirement of public display. The

12. Quoted in The Financial Times, October 16, 1975, at 13.

13. SANDFORD, WILLIS, IRONSIDE, AN ANNUAL WEALTH TAX, at 302, 303.

14. A summary of the features of these systems can be found in the Journal of European Taxation, Vol. 14, No. 11, at 374-378.

tax rate is moderately low and is proportional. There is no tax ceiling.

The general impression one gets from looking at this system is one of confusion. The taxing of corporations and the low tax floor both suggest a goal of more equitable taxation. However, the limited exemption on savings and bond holdings and the proportional rate suggest an intent to tax for reasons of resource efficiency. But this does not fit at all with the high amount of exempt jewelry and luxuries, nor with the high exclusion for private art collections. Overall, the system seems to be designed to tax a wide segment of the population and to grant exemptions chiefly for assets most likely to be held by the wealthier citizens. One cannot help but wonder if this is a well-constructed wealth tax system.

Denmark

This system taxes individuals only. It also has a high floor for resident individuals, about $78,000. Jewelry, life insurance sums not yet due, and collections of art and books are the principal exempt assets. There is no display requirement for the art exemption. The tax is at a moderate rate and is slightly progressive. The tax has a ceiling based on the total amount of taxable income, but the taxpayer must always pay at least 20% of his wealth tax assessment.

Again the system is hard to analyze. The high floor and the fact that few assets are exempted suggests a redistribution purpose. However, the tax rate is not particularly burdensome and the ceiling provision provides further protection from confiscation. The art and jewelry exemptions seem to refute a efficient use of resources goal. Perhaps the tax is meant to be a kind of investment surcharge for the wealthy, but one would think that such a goal could be accomplished through the income tax.

Finland

This system taxes individuals and non-resident corporations. There is a low floor for resident individuals and no standard exemption for non-residents. Cars, boats and jewelry are specifically excluded from the exemption for personal and household effects. An exemption is given for rights to a dwelling and for shares in a partnership. There is no exclusion for works of art. The tax rate is progressive for individuals and varies from low to high. The maximum tax and social contributions burden is 90% of the taxable income of resident individuals.

Looking at the low floor and the sharply progressive tax rates, one suspects that this system was intended to create a more equitable distribution of the tax burden. But such a conclusion leads one to wonder why resident corporations and shares in partnerships are not subject to the tax. Perhaps it was believed that resident corporations and partnerships were adequately taxed by the company tax. However, it does seem anomalous to tax assets in the hands of a sole proprietor when such assets would be exempt in the hands of a partnership. This system is no more exempt from criticism than the Austrian and Danish systems.

German Federal Republic

All individuals and corporations are subject to this tax. The floor for liability is rather high for resident individuals. Exempt assets include a small amount of savings and a larger amount of jewelry and luxuries (about $4,000 of the latter). A $8,000 exemption for works of art is granted to each family member without any display requirement. The tax rate is moderately low and the tax is proportional. No ceiling is provided.

The rate of tax, the fact that it is proportional, and the lack of a ceiling all suggest an intent to encourage resource efficiency as the principal goal of this system. However, that leaves the rather high tax floor and the exemption of such a large amount of jewelry unexplained. Perhaps both of these features can be explained as "ease of enforcement" measures, but it seems more likely that they show a confusion on the part of the legislators concerning whether the goal of the tax was efficiency of resource use or redistribution of wealth. The result is a system not very apt at either.

Ireland

The Irish wealth tax applies to individuals, discretionary trusts and private non-trading companies. The tax floor is extremely high. The principal exemptions are for a dwelling house and up to one acre of the land on which the dwelling is situated, and for livestock. A reduced basis is provided for shares in a trading company, property used directly in providing employment in the Republic of Ireland, farms, fishing boats and hotel premises. Art and objects of historical, natural, scientific, or artistic interest are exempt if open to the public. The tax is levied at a moderate rate and proportionally. Normally, the combined tax burden cannot exceed 80% of taxable income, but in no case will the wealth tax burden be reduced by more than one half.

This system looks like a resource efficiency system. It taxes discretionary trusts and private non-trading companies, entities that make investment decisions. The reduced valuation for certain economic assets and the exemption for livestock fits with a desire to encourage income-producing use of assets without penalizing ownership of assets that have a valid business purpose. However, the high floor indicates that the tax is not intended to influence the use of wealth in the middle classes except where the wealth is held by a discretionary trust or a private, non-trading company. One would think that this aspect of the tax would render it less efficient at achieving its goal.

Luxembourg

The tax is imposed on corporations except Luxembourg holding companies and on individuals. There is a very low floor. Small amounts of savings, life insurance and luxuries are exempt. All art objects by Luxembourg artists are excluded as well as $13,000 worth of other art objects. The rate is low with a moderate extra tax on corporations. The rate is proportional and there is no ceiling.

The low tax floor and the small amount of asset exemption suggests a goal of equitable taxation. The only anomalous feature is the proportional tax rate. One could conclude that this system was created without a complete analysis of its intended purpose.

Netherlands

The Netherlands tax applies to individuals only. It features a moderate tax floor. Exemption is granted for $2000 worth of jewelry, certain life insurance policies, and household effects. Objects of artistic or scientific interest are excluded without a display requirement. The rate is moderate and proportional. A ceiling is imposed limiting the total of income and wealth taxes to 80% of taxable income.

This is one of the most consistent systems to be considered. One finds virtually all the features to be expected in a system meant to promote resource use efficiency. The moderate rate and tax floor, the applicability to individuals only, the proportionality of the tax, and the few exemptions all conform to this goal. The only question raised by a study of this system is why there exists an exclusion for art objects. While it might be explained as a desire to preserve the national heritage, the absence of a display requirement makes this a less-than-totally effective method of pursuing this goal.

Norway

This system taxes individuals and non-resident corporations. There is a moderate floor. There is a $7400 limit on the exemption for personal and household effects. Works of art, jewelry and other luxuries are considered personal effects. Cars and boats are not considered personal effects and receive no exemption. Separate exemptions exist for small amounts of savings ($1,350) and life insurance ($8,400). There is a progressive tax rate that ranges from low to high, plus a substantial proportional local tax. No tax ceiling exists.

The sparce exemption of assets, the progressive rates which reach a quite high level, and the absence of a tax ceiling indicate redistribution as the primary function of this tax system. However, the moderate tax floor and the inclusion of non-resident corporations suggest that there may be an equity function as well. There exists a real question, however, whether a system can serve both purposes at once. Since the idea behind a redistribution tax is to put a disproportionate burden on the rich, this seems incompatable with a goal of taxing everyone according to taxable capacity. But the low threshhold tax rate may provide a fair tax burden for those of moderate wealth while the high maximum rate may mean a more-than-fair burden for the very wealthy. The Norwegian system seems to promise the furthering of both purposes.

Sweden

The Swedish system features a low tax floor and taxes individuals and non-resident corporations. There is exemption of $200 of jewelry and certain beneficial interests in capital yielding less than $200 per year. All life insurance is exempt, and art is exempt without condition. The tax rate is progressive and ranges from moderate to high. There is a ceiling for total tax burden of 80% of taxable income or 85% of income over $45,000, whichever is greater. However, the ceiling cannot reduce the wealth tax below 50% of the assessed tax.

This system looks like a model equity system. It features a low floor, a progressive rate and a tax system based on the total tax burden. The exemption for art is surprising in this system, but it can be explained as a decision that art is a special kind of wealth that does not increase a person's ability to pay. The only feature that does not readily fit into the equity model is the exclusion from tax of the resident corporations.

United Kingdom

The proposed United Kingdom wealth tax would apply to individuals only. It would feature a very high tax floor. Few exemptions are being considered except for exempting personal effects. The issue of art objects is still under debate. There are some who favor a deferral of the tax as long as the work of art is on public display. While this would provide a temporary incentive to hold one's works of art for the public, the taxpayer will know that he is building an ever-increasing tax liability. It would seems that this solution would still have many of the undesirable effects of providing no exemption. Having no exemption has some supporters, who feel that the protection of art holdings is a perpetuation of the preferential tax treatment of the wealthy. At present, it appears that the most favored treatment is an exemption conditioned on public display, similar to the system employed in Ireland.

The tax rate will be progressive and will start at a moderate rate. Depending on which proposal is adopted, the maximum rate will either be high or very high. The question of a tax ceiling is under consideration.

This system seems to have a redistributive nature. This is clearer when one looks at the proposed changes to the income tax system if the wealth tax is enacted. It has been proposed that the added wealth tax be used to reduce the tax on the lowest incomes. The investment surcharge will remain, under this proposal, with an offset of this tax against the wealth tax on the income-producing property. Such a change would use the wealth of the wealthiest to increase the wealth of the poorest. Another proposal would reduce the maximum tax on income. This would produce a equity-type distribution of tax between the income tax and the wealth tax, but the system would still produce an extremely high burden on the wealthiest. And since most of the taxpayers would not be liable for the wealth tax, one would still have a tax on the wealthy that benefited those with less wealth. Though not as extreme a redistribution as the first proposal, the redistributive effect is still unarguable. And if the higher tax rates and the inclusion of art objects are incorporated into the wealth tax, the tax should serve to reduce the wealth of the taxpayer in absolute terms.

CONCLUSION

The principal conclusion to be drawn from the examination of European wealth tax systems is that there is a great deal of confusion and inefficient design in most of the systems. This might be seen as support for the opponents of the wealth tax. Their primary claim is that whatever can be done by a wealth tax can be done better by some other means. Resource use efficiency, they contend, can be produced by granting favorable income tax treatment for investment income while taxing appreciation gains heavily. To create a fairer tax system, the solution is to eliminate preferential tax treatment for certain types of gains, such as capital appreciation. By instituting the proper taxes on capital gains and investment income, the system can reach a structure where taxation is based on taxable capacity. For redistribution of wealth, opponents of the wealth tax suggest that transfer taxes and death duties could be used to break up these holdings of the very wealthy within one generation. The key would be to make the taxes rise progressively based on the level of wealth of the recipient. This would prevent the perpetuation of wealth through inheritance, but would not punish the individual who amassed a fortune through his own diligence and economy.

However, even assuming that these alternatives could in practice operate effectively, a far from certain conclusion, it still would not render the wealth tax inapposite for accomplishing these goals. There is no evidence that the wealth tax systems are inherently clumsy tools for fiscal management; rather, the Dutch and Swedish systems demonstrate that a wealth tax can be clear and effective. The conclusion to be drawn is that, to paraphrase Shakespeare, "A good wealth tax is a good, familiar tax tool if it be well used". The emphasis should be on clearly defining the purposes of the tax; then the proper design can be easily achieved. In both theory and practice, a wealth tax can be a very useful element of a country's overall fiscal structure.

GUYANA

ERRATA

The Structure of Major Taxes in Guyana at p. 47, Bulletin XXX, February No. 2, 1976.

Page 47. The footnote * the name ABRAHAMS is incorrect. It should be ABRAMS.

Page 59. The rates of export duties given there are incorrect. The correct rates are as follows:

When the f.o.b. export price per ton		*The tax payable per ton is*
Exceeds	But does not exceed	
G$365.00	G$521.00	55 percent of the excess above G$365.00
G$521.00	G$625.00	G$85.80 *plus* 70 percent of the excess above G$521.00
G$625.00		G$158.60 *plus* 85 percent of the excess above G$625.00

DEVELOPMENTS IN INTERNATIONAL TAX LAW

UNITED KINGDOM

Some Highlights from the Budget Speech April 6, 1976

... my Budget must not on balance add much to demand or change its pattern. Instead, my Budget will have two overriding objectives, both concerned with the essential improvement in our industrial performance. First, to create the conditions in which output and productivity are most likely to increase and second, to create the conditions in which wage costs can be kept as low as possible without unnecessarily reducing the real value of the workers' take-home pay.

So far as industrial efficiency is concerned I am proposing a series of measures which I believe will encourage industry to maximize its output and productivity. So far as industrial costs are concerned, I am proposing two sets of measures — the first will take effect immediately, since I believe they will help to create a suitable climate for the coming discussions on the next wage round. But I shall ask Parliament to approve the second set of measures only when the TUC has made its recommendation on the new pay limit later in the summer.

Industrial Policies

...

My first objective, therefore, in this field is to strengthen the stability of the tax environment. There are three areas where I can today offer a new degree of certainty.

Stock Relief

The special tax relief for increases in stocks which I introduced in November 1974 has been of great benefit to industry. However, some businessmen believe the temporary nature of the scheme reduces the value of the relief, and others fear that the scheme may be withdrawn without anything to replace it so that all the tax which has been deferred on increases in stock will suddenly have to be paid. In particular, it is said that the need to create balance sheet reserves against the possibility of the relief being withdrawn is reducing some companies' ability to borrow.

In our debate on employment on 29 January I did my best to dispel fears of this kind.

Now I can go further. I am anxious to introduce, as soon as I can, a scheme of relief which will be a permanent feature of the tax code. It is, however, clear from recent discussions between the Inland Revenue and representatives of industry and the accountancy profession that there are differences of view about the form which a permanent relief should take. I am naturally anxious to carry industry and the accountancy profession with me in this matter if I can; and since what we are considering will be a permanent part of our tax system with important implications for the operations of British industry, I think that it is worth taking a little time to get it right.

I therefore propose that the relief should continue in substantially its present form for two more years while the Inland Revenue is consulting industry and the professions about its permanent form. But I do propose one change. Its purpose is to strengthen the incentive for investment. There has been increasing criticism that the profits deduction operates unfairly against companies investing in fixed assets, because the profits base to which it applies is calculated before deducting depreciation allowances. I therefore propose that, in future, profits for this purpose shall be calculated after deducting allowances for depreciation. This change would be an expensive one unless I sought to compensate for it in some way, and I therefore propose to do that by increasing the size of the profits deduction from 10 per cent to 15 per cent. Even so, the benefit of stock relief to the company sector as a whole will increase by some £65 million in a full year. The real importance of the change is that the relief will now be concentrated more heavily on firms which are expanding and investing.

As a result of what I have just said it must be clearly understood that there will be no question of any claw-back with respect to tax relieved under this scheme in the case of all those companies whose stock valuations and rates of investment are maintained or increased. This means that for the great majority of companies stock relief really implies a deferral of tax not only for some short or limited period but into the indefinite future. I can also give an assurance that if we decide ultimately on a different form of relief we shall ensure as far as possible that the transition from one system to the other will not significantly affect the cash-flow of individual companies.

Depreciation

The Sandilands Committee on Inflation Accounting strongly recommended that the present system of 100 per cent capital allowances should be continued, and suggested that the commitment to the system which was given by my predecessor in 1972, and which runs to the end of 1977, should now be extended. I accept this recommendation and I propose that the main structure of the present system of capital allowances for fixed investment should continue in its present form. This is not to rule out any minor changes that may be necessary; but I cannot accept the representations that have been made to me for extending capital allowances to commercial buildings. I do not believe the benefit from such a change would justify its heavy cost to the Exchequer.

Corporation Tax

The continuation of stock relief and the present system of capital allowances means that substantially the whole of any profits which a manufacturing company reinvests in its business, whether in fixed or in working capital, will effectively be relieved from corporation tax. Given the importance of expanding and strengthening our manufacturing base this is, I am sure, a development which the whole House will welcome.

Uncertainty about the future structure of corporation tax is one of the factors which have unsettled business confidence. The present imputation system is not the one which I would have preferred, but I have to take account of the high cost of any change in terms of disruption and diversion of effort in industry. For these reasons I have decided not to pursue further the idea of a return to the so-called classical system of the corporation tax — the more so since the arrangements we now have provide in effect the same powerful incentives for the retention of profits for the purpose of investment as the original corporation tax introduced by my Rt Hon. friend in 1965.

I also do not propose any change in the rates of corporation tax. Given the improved financial prospects for the company sector, I see no case for reducing the rates. But I am anxious to assist small companies where I sensibly can and I therefore propose to increase the profit level by which small companies are defined for the purpose of the preferential rate of corporation tax from £25,000 to £30,000. The limit for marginal relief will be increased from £40,000 to £50,000.

. . .

Taxation of Motoring

I now turn to tax instruments which affect particular sectors of industry, beginning with the taxation of motoring. One way in which the Government must demonstrate the priority it gives to manufacturing industry is by forgoing changes which might otherwise have been desirable if they are likely to inflict damage on important sections of industry.

As the House will be aware, the Government has been considering the possibility of abolishing Vehicle Excise Duty on passenger cars and recouping the lost revenue by raising the tax on petrol. Since I rejected this change a year ago, I am bound to confess that it has appeared increasingly attractive when looked at in isolation from its industrial consequences.

But in reaching a decision I also had to take account of the powerful industrial arguments which point to retaining the duty. To abolish it and make a compensating increase in petrol tax would immediately encourage people to change their present cars for smaller ones, or at least to prefer a smaller model when the time comes to buy a new car; and it is amongst the smaller models that our car industry is particularly vulnerable to imports. I cannot make a change, whatever its merits on other grounds, which would further expose us to imports of foreign cars and to the loss of jobs in our own industry, and on these grounds I have decided against abolishing the duty. Our industrial policies must have first priority.

I propose however to make some minor changes in the relevant legislation; in particular I am altering the criteria for exemption for disabled passengers because the Mobility Allowance scheme was designed to supersede other forms of mobility assistance to the disabled.

Again reflecting the priority we must give to industrial policy, I have decided against relaxing hire-purchase restriction on motorcars in present circumstances since this would be most likely to stimulate imports. The Government have, however, decided to abolish hire-purchase restrictions on motor caravans, where similar considerations do not apply. An Order will be made by my Rt Hon. friend bringing this into effect from midnight tonight.

VAT Higher Rate[1]

I . . . propose to reduce the higher rate, as from Monday next, to 12½ per cent. In choosing this figure I have taken account of the needs of smaller businesses, including retailers. It has been pressed on me for example that the 25 per cent rate has had a particularly adverse effect on smaller businesses such as boatbuilders and firms which service electrical appliances. The reduction I propose should be of great help to them — and particularly to poorer people who may have refrained from getting their appliances serviced when the rate was 25 per cent. I also understand that the many thousands of retailers who sell higher rated goods prefer VAT rates which pro-

1. The previous higher rate was 25 per cent.

vide convenient fractions for calculating. Twelve-and-a-half per cent gives such a fraction — one-ninth of the tax inclusive price. At the same time it is a rate which is more than 50 per cent higher than the standard rate and therefore produces a useful amount of additional revenue — about £140 million in a full year.

The reduction to 12½ per cent will apply to all goods and services at present covered by the higher rate. Leaving aside petrol, the cost will be £175 million in a full year.

For a number of hard-pressed sectors of United Kingdom industry this will provide a welcome boost to their domestic market. Notably in the important market for television sets, I am concerned that the United Kingdom manufacturers should benefit. For colour sets, where Japan is the main source of imports into the United Kingdom, the need for a continuity of restraint is well understood between the Japanese and ourselves. But we imposed surveillance licensing on imports of television sets last December, and we shall be watching the position closely in case this understanding proves insufficient.

Taxation of Petrol

The higher rate of VAT applies to petrol, and if I did not take offsetting action on petrol duty the reduction to 12½ per cent would reduce the price of petrol to the motorist. At a time when it is essential to conserve oil I cannot allow this to happen; indeed I believe I should go further and more than offset the reduction of VAT. I therefore propose to raise the hydrocarbon oil duty on all road fuel by 7½p a gallon. This will mean a net increase of about 1p a gallon on petrol for the private motorist. It will have two other consequences. First, the way VAT operates makes it very advantageous to misuse petrol bought on business account for private motoring. My proposals will greatly reduce this advantage. Second, the duty on fuel for diesel-engined road vehicles — derv — will also rise bij 7½p a gallon. However, since the increase in oil prices began two-and-a-half years ago the incidence of taxation on derv has fallen sharply, so that the incentive for users of this particular road fuel to economize has not been strengthened by taxation. The proposed increases will come into effect at 6 p.m. on Friday, 9 April, but it is not expected that prices will go up before Monday, 12 April. This increase will not cause increases in the cost of stage bus services. Under existing legislation, there will be an increase in the rebate of duty paid to stage bus operators equivalent to the full amount of the duty increase.

The cost of the reduction in the higher rate of VAT on petrol will be £185 million in a full year. But my proposals for road fuel duty will offset this and produce a further net increase in revenue of £265 million in a full year. Overall, my proposals for the higher rate of VAT and for road fuel duty will therefore produce a net revenue increase of £90 million in a full year.

Other Indirect Tax Changes

...

For beer I propose an increase which — together with the consequential VAT — will result in a price increase equivalent to 1p a pint on average. For sprits my proposal will represent an additional 32p, including VAT, on a standard bottle of whisky or gin. For wine I propose increases which will represent an addition, including VAT, of up to 12p a bottle on fortified wines, and of 6p on a standard bottle of table wine and of most made-wine. These changes will be brought into effect for goods which are cleared from midnight tonight.

I also propose a small but nevertheless worth-while new excise tax. Most ciders and perries are not at present taxed and I think it only right that they should bear some duty like other alcoholic drinks. I therefore propose that from 6 September, these ciders and perries should be charged with a new excise duty of 22p a gallon. Allowing for consequential VAT, this will be equivalent to about 3p a pint. I propose to exempt small farmer producers from the new duty.

. . .

There is a strong case on health grounds as well as revenue grounds for increases in the taxation of tobacco. I propose both some increases in the level of taxation and a first step in a restructuring of the duty system. Our present duty is charged basically on the weight of unmanufactured leaf. This is a system which has served us well for many years, though it has two disadvantages. First, the real burden of the specific duty falls at times of inflation, giving an unwelcome boost to consumption of a product dangerous to health. Second, because the duty falls on the unmanufactured leaf, it has not been possible to discriminate between different types of smoking product.

When we joined the E.E.C. we accepted an obligation to replace this duty, by the end of 1977, with a duty falling not on the raw material but on the finished product. So far as cigarettes are concerned, the duty is to be levied partly as a proportion of the retail price and partly on the number of cigarettes. However, this is a major change, and if we introduced it over-night at the end of 1977 there could be a degree of disturbance to our existing market which I would find unacceptable. I have therefore decided to make a start in moving to the new system now, and in this Budget a part of the existing specific duty will be replaced by a new excise duty on the finished product.

I envisage that at the final stage the duty on cigarettes should be predominantly *ad valorem*. For a start, I am setting the new duty at a rate of 20 per cent of the retail price, and reducing the existing leaf duty by such an amount as will produce a net increase in the total yield. Because of the change in the system it is difficult to provide precise figures for the effects of the increase on the whole range of different kinds of cigarettes; but I expect the total tax burden on the most popular sizes will rise by 3p or 3½p for a packet of twenty. I make no apology for this increase. Many people who are rightly concerned about the health of our nation will regard it as inadequate. However, I had to pay some regard to the level of prices and to the burden on those, particularly the poorer, who find it difficult to cut back on their smoking.

There are administrative difficulties about charging an *ad valorem* duty at this stage on other forms of manufactured tobacco, and for these the new end-product duty will be based on weight. For cigars and hand-rolling tobacco, I am proposing to set the balance of the old and new duty rates at levels such that there will be increases in line with those for cigarettes. However, there will be no overall increase in the average tax burden on pipe tobacco. This is propably the least hazardous form of smoking and in addition many pipe smokers are retired or about to retire and may therefore face financial problems.

In order to allow time for the administrative arrangements for the new duty to be worked out, these changes will come into effect from 10 May. The net increase in the yield, including the consequential VAT, will be £115 million in a full year.

Avoidance and Evasion

Nothing is more offensive to the vast majority of men and women who pay their income tax automatically through P.A.Y.E. than the knowledge that a small minority have scope for evading and avoiding taxation either through limitations in the powers of the Revenue or through loopholes in the law. I propose to take steps to deal with both these problems.

First, tax evasion. By that I mean tax-dodging which involves breaking the law of the land. Evasion is not only unfair to the many millions of taxpayers who pay their tax bills honestly; it brings the whole system into disrepute. I am aware of the anxiety that has been expressed about the current extent of evasion and I have now decided that the Inland Revenue should be given additional powers to enable them to uncover evasion more effectively.

It is important in this area to weigh the requirements of an effective and fair tax system with the proper concern — shared by members on both sides of the House — for the privacy of the citizen.

I believe that the proposals I shall make strike the right balance. My main proposals are as follows. I have decided to strengthen the powers which require a person to produce for inspection documents in his power or possession which bear on his liability to tax. There will be a parallel power to obtain from a taxpayer's spouse and children documents bearing on his own liability. Where a person is carrying on a business the Inspector of Taxes will be given power to require the production of relevant documents from other businesses, including banks, in order to determine that person's tax liability. But the power to approach any person other than the taxpayer himself will be exercisable only with the consent of a General or Special Commissioner of Income Tax.

These proposals represent the minimum that is needed to help the Inland Revenue to deal with evasion and to be fair to ordinary working people who pay their tax under P.A.Y.E.

In other democratic countries in Europe and North America the Revenue Authorities already have such powers. Indeed the powers available in the United States, Canada and Australia are a good deal wider than those I now propose. I think the vast majority of taxpayers will feel it was high time that in this respect we were brought more into line with our friends and competitors.

Leasing Partnerships

The Finance Bill will also contain measures to deal with an avoidance scheme by which wealthy individuals have been able, by contrived arrangements, to use the 100 per cent first year allowance given for capital investment simply as a means of minimizing tax on their personal incomes. My Hon. friend the Financial Secretary to the Treasury explained last December in a written answer that where the asset giving rise to the relief is leased or chartered by certain kinds of partnership the relief would be allowable only against the rental income. I propose to apply the same restriction in other circumstances where wholly artificial arrangements have been entered into for tax avoidance purposes and the relevant expenditure is incurred after today.

Fringe Benefits

I undertook last year to review the legislation on fringe benefits, following the start we made in last year's Finance Act with the legislation on medical insurance and vouchers.

As the Diamond Commission showed in their report on Higher Incomes from Employment, the two main benefits provided by firms for their employees are cars and loans at a nil or low rate of interest. The provision of a company car for a director or an employee earning over £5,000 is already taxable; but the rules for measuring the benefit derived from its use for non-business purposes do not in most cases bring into liability anything like the real value to the beneficiary. I propose therefore that this benefit should in future be measured by a scale which will vary with the size of the car and will reflect standing charges and running costs borne by the employer in respect of the employee's private use of the car. The substitution of a scale for the present rather cumbersome method of measuring car benefits will bring a much-needed simplification into this part of the tax system and will also make it more equitable. The scale will not take effect until 1977-78, and in view of the importance of not adding to the difficulties of the British car industry it will be phased in over a period of two years, so that its full effect will not be felt until 1978-79. In the meantime my Rt Hon. friend the Secretary of State for Industry will be consulting the motor industry on the industrial implications of this decision.

The benefit of low interest or interest-free loans is not at present taxable. I accept the view of the Diamond Commission that there is no tax advantage from such loans where the interest on them would be eligible for tax relief. But where it would not be, I propose to make the benefit of these loans liable to tax. This will mean, for example, that house mortgages provided cheaply will not attract liability so long as they do not exceed the ceiling for tax relief; but loans made, say, for buying shares in a public company or for paying school fees will be taxable to the full extent of the benefit conferred by the remission of interest.

In addition to my proposals on cars and loans, I intend to strengthen the 1948 legislation on benefits in some other respects including its extension to employees in the public sector and non-trading organizations. My Rt Hon. friend will give details of these in the course of the debate.

I propose that all these changes in the treatment of fringe benefits should take effect from 1977-78 (with the exception of certain anti-avoidance provisions which will take effect immediately) and that they should at the outset apply only to directors and employees earning over £5,000. But I am well aware that some of the benefits I have referred to are not confined to those on over £5,000 a year, and in due course, when staffing in the Inland Revenue permits, I intend that the provision of car and loan benefits at least should be taxable in the hands of all employees whatever their salary.

Capital Transfer Tax

. . .

I will mention now only some of the more important changes.

The first, and most important, concerns the impact of the tax on businesses and farms. I have decided to introduce a new relief for businesses which will go wider than the old estate duty relief for industrial buildings and plant and machinery. Where a transfer relates to a sole proprietor's or partnership business, or to a controlling unquoted shareholding in a company, the value transferred will be reduced by 30 per cent.

The new relief will apply to businesses generally, not restricted to the manufacturing sector; but investment concerns and dealers in land and shares will be excluded. This is a very important change, particularly for small businesses. It will substantially lighten the burden on transfer of businesses and go a considerable way to meet the representations which have been made about the inhibiting effect of capital transfer tax on the small firms sector. I believe it will give the proprietors of small businesses greater confidence to invest and expand their activities.

As a further help to the small businessman, I propose to increase from £1,000 to £2,000 the annual amount which a person may give away in life tax-free after using up any other exemptions. This will produce a further lightening of the burden on lifetime gifts over and above the existing concession of special lifetime rates. While the relief will be of general application, it will be particularly helpful to the small businessman transferring his business over a period to his successors.

If we add to these changes in capital transfer tax what I have already said about the increase in profit levels for the small company rate of corporation tax, and about the provision of medium-term finance for industry, this Budget has gone a long way to meet the Government's undertaking to cater for the special needs of small businesses.

The new 30 per cent relief will also apply to farmers. Here I have taken account of the work of the Interdepartmental Working Party on Capital Taxation and Agriculture, which was foreshadowed in the 1975 White Paper "Food from Our Own Resources". The 30 per cent relief will apply to the assets, including land, which are used in farming as it does to other businesses. In respect of his land the full-time working farmer will still be able to claim instead his existing special relief. However, I am taking the opportunity to adapt the form of the present multiplier relief for full-time working farmers to that of the new business relief, that is, to a straight percentage reduction. In this special case the reduction will be 50 per cent, which will achieve broadly the same effect as the present multiplier relief. I am not proposing to reinstate relief for agricultural landlords, which was a justly criticized feature of estate duty.

The new relief, which will cost an estimated £15 million in the first full year, will apply to all qualifying transfers after today. The present exemption on death, for works of art, historic houses and other property of importance to the national heritage will, subject to certain conditions, be extended to lifetime gifts and to property held in discretionary trusts, but at the same time I propose to toughen up the conditions for the relief.

I shall be introducing new provisions to govern the treatment of property passing under survivorship clauses in wills; and to stop from today what the Press has labelled "The General Franco device".

Capital gains tax

In my Budget Statement last year I said that I was not persuaded that it would be right to introduce indexation for capital gains tax but that I proposed to review the incidence of the tax in the ensuing year.

The issue is whether I should alter capital gains tax to take account of the fact that someone who sells a chargeable asset has to pay tax on a gain measured in money terms although inflation may have reduced the real gain or indeed even turned it into a loss. Different suggestions have been put forward for dealing with this problem. Some people propose that the cost of the asset should be written up on an index; others that the gain should be scaled down according to how long the asset has been owned. It has even been suggested that because of inflation capital gains tax should be abolished altogether.

The crucial question is whether those people with chargeable assets should have their tax liabilities insulated from the effect of inflation. I have come to the conclusion that this would not be right. For income tax, although I have increased the personal allowances during my two years as Chancellor I have not been able to do so sufficiently to eliminate fiscal drag completely. Income tax liabilities have not therefore been insulated from inflation. Then there are the millions of investors who have no prospect of any capital gains on their assets: those who put their money into building societies, savings banks and the like. If assets such as shares and land are to be indexed for capital gains tax, logic requires that these millions of other investors should be treated as having incurred losses on their assets. We cannot afford to go down this road.

I have therefore concluded that there should be no change in the structure of capital gains tax. The right answer to inflation is not to tinker with the effects but to cure the disease and this we are doing. However, I propose to increase, with effect from 1975-76, the total amount of disposals than can be made annually without any charge to capital gains tax from £500 to £1,000. This will mean that those with modest amounts of capital are unlikely to become chargeable to capital gains tax so that they at least will be protected from the effects of inflation. This change will cost about £¾ million in a full year.

Exchange Losses

Finally, I should mention that I have received many representations that the extra cost to companies of repaying foreign currency loans when sterling has fallen in value should rank for tax relief. This is a complex matter on which the arguments are finely balanced. I will announce my decision on this in next year's Budget. Meanwhile the Inland Revenue will consult those affected to see whether a scheme for tax relief can be devised which is workable, fair to taxpayers and the Exchequer and reasonably free from risk of avoidance. I should make it clear that these discussions will be entirely without commitment on my part.

...

Incomes Policy and Direct Taxes

I now turn to my proposals for carrying forward our attack on inflation and for encouraging the greatest possible reduction in the growth of wage costs. I hope to achieve this through relating tax concessions to a lower limit on earnings during the next pay round.

The experience of the last twelve months has brought it home to all sections of the community that inflation is the great enemy of full employment. For a country in Britain's present economic situation, the number of people who have a job will depend directly on the level of pay received by those in work.

I have seen reports of people who have actually accepted lower wages so as to save jobs. The relationship between jobs and wages is seen at its starkest in some of the nationalized industries, like the Post Office and the Railways, where the price increases generated by higher wage costs are already driving away custom and putting jobs at risk.

The nation as a whole has to draw a similar lesson from the experience of the last few years. As I have already argued, unless we can improve our ability to compete on price, the balance of payments will set a limit on the speed at which we can return to full employment. Moreover, we will be unable to finance our external deficit in the period before we achieve a surplus on our current account unless we succeed in getting our rate of inflation down. If wages had continued to rise at the rate they were rising last summer, the collapse of foreign confidence in Britain would have brought the collapse of our economy.

The agreement with the unions saved the situation. The £6 pay limit which emerged from the crisis in July last year has not cured unemployment in Britain. But it has ensured that hundreds of thousands of men and women are now in work who would otherwise have lost their jobs in the inevitable collapse of confidence at home and abroad and the deflationary measures which would have had to follow it.

Effects of Excessive Pay Increases

Excessive pay increases are not only bound to increase unemployment. They are self-defeating even for those who manage to keep their jobs, since they cause rising prices which swallow up most of their value within six to twelve months and nearly all of it in one to two years. Yesterday's figures show that over last year as a whole, although pay rose by a record 29 per cent, living standards stayed virtually unchanged. In addition the inflation such pay increases generate reduces the international value of our currency, thus adding further fuel to inflation. There is no end to this vicious circle except to get inflation down at least to the level of our international competitors. That is why the fight against inflation must remain our first priority. Winning the battle against rising prices is the first condition for our return to full employment. If our industries cannot finance their operations, cannot invest, cannot compete at home or abroad, if we cannot finance our overseas deficit, then jobs are at risk on a massive scale.

The progress we can expect to make this year in the fight against inflation depends above all on the pay limit devised last summer by the trade union movement itself in full knowledge and acceptance of the nation's economic needs. We need a similar voluntary policy for incomes when the £6 limit expires at the end of July. Let me stress at the outset that what I am seeking is a voluntary policy — that is a policy which the General Council of the TUC and the Congress agree willingly to recommend to their members as something good for themselves and good for the country. The Government's overriding purpose is to reach a fresh agreement with the trade unions on a voluntary policy for the next pay round — an agreement which will help to bring the rate of inflation down still further in the coming year. In their Economic Review for 1976, the TUC have suggested a target which the Government fully endorses. It is to reduce the rate of inflation next year to a figure well below 10 per cent. The TUC stresses that this target cannot be achieved by a policy for incomes alone. The Government agrees. A major contribution must also be made through policies for prices, taxation and public finance. But in my view, the key to achieving a rate of inflation which is well below 10 per cent by the end of 1977 is to relate our tax policy in the coming year to the next policy for incomes.

I am prepared to use my powers as Chancellor of the Exchequer to help the TUC to get the next pay limit as low as possible by reducing the amount of income tax which is taken from the pay packet. I intend to guarantee that the working population as a whole does not suffer by accepting a lower pay limit rather than a higher one; indeed, I would ensure that a lower pay limit leaves those who most need help — families with children — a good deal better off. Let me explain.

It is clear that the next pay limit will need to be well below this year's limit of £6 a week. If the limit were only a little less than the present £6 — say £5 — it would produce little, if any, further reduction in the rate of inflation by the end of 1977. Our objective must be more ambitious. The £6 limit should have helped to cut our inflation rate by well over half by the end of this year compared with December 1975.

...

It will, of course, be for the TUC to judge the size of the pay increases to which they can secure the agreement of their members. I emphasize again I am not seeking to dictate or impose a particular figure. But I want to prove that the majority of working families would gain by agreeing to a lower limit rather than a higher one.

The proposals for income tax reliefs which I will now set out show how this result could be achieved. Part of the reliefs would have to be conditional on a low pay limit and I must state clearly the level on which these particular reliefs would depend. The House will want to know on what assumption it would be asked to approve them and the trade unions will want to know what tax benefits would flow from a particular limit.

But, as I said before, my overriding purpose is to get a fresh agreement with the TUC on pay which will at least guarantee further progress in the fight against inflation. If in the end the TUC found they were unable to agree to a figure as low as that on which these tax reliefs are based I would, of course, have to reduce the amount of the reliefs accordingly. If, on the other hand, they could go lower still, I would more than compensate with still greater tax reliefs and the nation as a whole would benefit still more.

I have based the tax reliefs I will now describe on the assumption that the pay limit in the next wage round will be in the area of 3 per cent. I cannot be absolutely precise because much will depend on the way in which the new policy is structured — for example whether it is a flat sum or a percentage, or a mixture of the two. A limit of 3 per cent is the basis of my proposals because I do not believe that in the circumstances of the coming year a higher limit could be relied on to bring down our rate of inflation to that of our principal competitors.

Allowances and Reliefs

My proposals are in two parts. The first part will take effect at once, and I commend it to the House unconditionally. It is intended primarily to help sections of the population, like the old and children, who are not going to be involved in the coming negotiations on incomes policy. The second part, as I have just explained, must be conditional upon agreeing — I hope at the latest by early June — a pay limit which is consistent with a further halving of our inflation rate in the coming year.

First, the unconditional set of income tax reliefs. Besides the increase in pensions I have announced, I propose to increase the age allowance for single people by £60 to £1,010 and for married people by £130 to £1,555 and also to raise the ceiling for the allowance by £250 to £3,250. These increased allowances will be substantially above the rates of retirement pension which will be payable after the uprating in November and this will enable old people to continue to supplement their pension without paying tax.

Next, children. For a number of reasons, the real incomes of families with dependent children have fallen behind in the last few years, relative to those of the majority of single people. Since 1972 policy on low pay and equal pay has tended to help single people more than married people and married people with children least of all. Although last year I made the first increase in family allowances since 1968, the child tax allowances have not been increased since 1974. As a result families with children have been bearing a disproportionately high part of the total tax burden.

I propose therefore to increase child tax allowances by £60 so that they will become £300 for children under 11, £335 for children between 11 and 16 and £365 for children over 16. This improvement will cost £300 million in a full year. I must regard it as part of the compensation for accepting a low pay limit which I am offering to the TUC. Nevertheless, in the confidence that we shall in fact achieve a low limit, I propose to include it in the first part of the package and give effect to it immediately. Like the increase in the allowances for the elderly, it will be implemented through P.A.Y.E. as soon as the Inland Revenue can make the necessary changes.

I now turn to the second part of the income tax package which must be conditional on our achieving the low pay limit. I propose to improve the personal allowances for single and married people and, as part of my policy to give as much relief as possible to families, I propose to give a greater increase this year to the married than to single persons. Among the married for this purpose I include single parents because as I made plain last year I intend to raise the additional personal allowance so that the allowance for one-parent families is kept in line with that for two-parent families.

I propose therefore, once the low pay limit is agreed, to increase the single persons allowance and the allowance for wives' earnings by £60 to £735, the married persons allowance by £130 to £1,085 and the additional personal allowance by £70 to £350. These increases in allowances, if the pay limit enabled me to implement them, would keep 670,000 out of tax altogether and would help to reduce the administrative cost of collecting taxes.

The single allowance is given to widows as well as single women pensioners under the age of 65 and, if I am able to increase it as I hope, it will be sufficient to cover the standard rate of national insurance pension payable in 1976-77. If not, when these women have only the standard pension and no other income, they will still be kept out of liability. This is because the Inland Revenue do not in these cases assess small amounts of tax. To save administrative costs they are now proposing to increase the limit of this assessing tolerance from £10 to £30. The new limit will be sufficient to cover the difference between the standard pension and the single allowance. This will mean in practice that even if I am unable to make the proposed increase in the single allowance, assessments will not be made on this class of pensioners if they have no other income. Thus these widows and single women pensioners under the age of

65 with no other income will have their tax anxieties relieved. I believe the whole House will welcome this decision.

. . .

Rates of Tax

I come finally to the higher rate tax structure. The threshold for higher rate tax has been eroded by inflation so that it now lies between 1½ times and twice average earnings. Unless I adjust it this year, the numbers subject to higher rate tax will rise from 1·3 million in 1975-76 to 1·9 million in 1976-77, including very large numbers of skilled workers. This would impose a very heavy new administrative burden on the Inland Revenue.

As I made clear earlier in my speech, I believe it is desirable in any case to reduce the extent to which fringe benefits are used as a substitute for pay increases at the higher levels. We have far more of these fringe benefits than other comparable countries. I have already described how I propose to limit the value of fringe benefits through action on business cars, cheap loans and so on. Nevertheless, the counterpart of action on fringe benefits must be some reduction in the income tax burden, particularly on middle managers in industry who have seen their net pay severely reduced in real terms over recent years by inflation and the incomes policy of successive Governments. The Diamond Report on higher incomes gives compelling evidence of this. I believe that middle management must play a key role in our industrial and economic recovery.

Taking all this into account I have decided that the second, conditional, stage of the income tax package should also include an increase of £500 in the higher rate threshold and a similar increase of £500 in the next four thresholds up to a taxable income of £8,500 a year. The starting point for the higher rate at 40 per cent would therefore be £5,000 instead of £4,500 and so on; but the 65 per cent rate would continue to start at £10,000. This would fall a long way short of restoring the real value of these five higher rate thresholds to what it was two years ago, but it is the most I now feel able to propose.

The total cost of these income tax reliefs, if both stages are fully implemented, would be about £1,300 million in a full year. Of this, £370 million is included unconditionally in the first part and the balance will be held over to the second part, since it is conditional on the low pay limit. The revenue from the increased duties on alcoholic drink, tobacco and petrol will broadly cover the cost of the unconditional £370 million which is concentrated on the old and children. I believe the House will feel that this reflects the right social priorities.

. . .

Conclusion

These then are my proposals. This is an almost neutral Budget. I have said all along that we cannot base expansion on a general reflation of domestic demand. The unconditional part of my Budget is neutral both in financial and demand terms, and does not reduce the overall burden of taxation, although I believe it distributes that burden more fairly. If we can achieve the low pay limit the effects this would have on confidence would enable me to implement the additional tax reliefs, which would go a little beyond what is necessary to offset the temporary demand effects of such a limit. The net effect might be to increase output in the first half of next year by about £400 million or about one-third of a per cent.

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CUMULATIVE INDEX 1976
Nos. 1, 2, 3, 4 and 5

I. ARTICLES

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of the July 1976 issue

ARTICLES

JAMES S. MACLEOD *:

CAPITAL TRANSFER TAX IN THE UNITED KINGDOM

INTRODUCTION

The United Kingdom capital transfer tax came into operation on 26th March 1974. It applies to gifts made by an individual during life, and to assets transferred in consequence of an individual's death. It only applies to transactions which are gratuitous, that is to say, where the person who transfers the asset wishes to confer a benefit on the person who receives the asset. The tax does not, as a general rule, apply to commercial transactions.

Prior to the introduction of capital transfer tax, the main tax on capital was estate duty, which had been in force since 1894. Estate duty was a tax payable on assets transferred on the death of an individual, and assets gifted within seven years before an individual's death were treated as transfers on death. Assets gifted more than seven years before a death were not normally subject to estate duty. However, the exemption of gifts made more than seven years before a death has now been removed, because capital transfer tax applies to all gifts made after 26th March 1974.

SCOPE

An individual becomes liable to capital transfer tax when he makes a "transfer of value", that is, any transaction which reduces the value of his "estate", other than a commercial transaction. Every "transfer of value" is a "chargeable transfer", that is, a transfer chargeable to capital transfer tax, unless it is covered by an exemption.

An individual's "estate" consists of all the assets which he owns absolutely, after deducting his liabilities. Where an individual has an "interest in possession" in a trust, that is, where he is entitled to receive the income from a trust, he is regarded as owning the trust assets, or a share of them corresponding to his income rights. Thus if two individuals are jointly entitled to all the income from a trust, each is regarded as owning half the trust assets, and these assets form part of his estate.

Certain assets do not form part of an individual's estate. These assets are called "excluded property". The main item of "excluded property" relates to property situated outside the United Kingdom. Property situated outside the United Kingdom is "excluded property" if it is beneficially owned by a person who is not domiciled in the United Kingdom. Thus the limits of the jurisdiction of capital transfer tax are:—

1. Assets situated in the United Kingdom irrespective of the domicile [1] of the owner, and
2. Assets situated outside the United Kingdom if the owner is domiciled in the United Kingdom.

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1. The term "domicile" indicates the legal system to which an individual regards himself as being subject. A person acquires a domicile at birth, and this is usually the domicile of his father. Once an individual has become legally independent, he may change his domicile of

The place where an asset is situated is a matter for international private law, but may be affected by a double taxation convention. The existing Estate Duty conventions made by the U.K. are to remain in force for capital transfer tax purposes, despite the fact that estate duty is no longer payable. The legislation contains provision for the U.K. to enter into new conventions covering capital transfer tax, but so far none has been made.

An individual's "domicile" is another matter which has to be decided on by reference to international private law, but there are a number of special rules which apply in deciding on an individual's domicile for capital transfer tax purposes. An individual formally domiciled in the United Kingdom is regarded for capital transfer tax purposes (not for other U.K. tax purposes) as having retained his U.K. domicile if he has acquired a domicile of choice in the Channel Islands or the Isle of Man after 10th December 1974. A domicile of choice acquired in some other country after 10th December 1974 is regarded as invalid for capital transfer tax purposes until three years have elapsed. During that three year period, the individual is still regarded, for capital transfer tax purposes, as domiciled in the U.K. Finally, special rules apply to an individual who is domiciled outside the United Kingdom, but has lived here for a long period. An individual who was resident[2] in the U.K. for income tax purposes on or after 10th December 1974, will be regarded as domiciled in the U.K. for capital transfer tax purposes if he is resident here in seventeen out of twenty fiscal years (that is, years ended 5th April). Thus, where an individual chooses to acquire a domicile of choice outside the U.K., his foreign assets will be treated as excluded property once three years have elapsed provided that throughout the three years following the change in domicile, he is not regarded as resident in the U.K. for U.K. income tax purposes.

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origin to a domicile of choice by residing in the country in which he wishes to establish his domicile, indicating that he wishes to reside there permanently, and indicating that he wishes to sever his legal ties with the country of his domicile of origin. A woman usually acquires the domicile of her husband on marriage, but it is now possible in the U.K. for husband and wife to have separate domicile. Domicile is a general legal concept and not special to tax law. It follows that many of the leading British decisions on domicile are not concerned with taxation but with other legal questions, such as matrimonial questions.

The terms "residence" and "ordinary residence" are concerned with taxation questions only. A person is treated as resident in the U.K. if:—

1) He is physically present in the U.K. for six months in a fiscal year (i.e. year to 5th April) or,

2) He visits the U.K. for periods of less than six months in a fiscal year but his visits are for substantial periods and are habitual. Periods in aggregate of three months in a fiscal year are regarded as substantial, and these visits are treated as becoming habitual after four years.

3) A person who has been resident in the U.K. is regarded as continuing to be resident here if he goes abroad for some temporary purpose only. However, special rules apply to individuals resident in the U.K. who go abroad to work under a foreign service contract.

4) An individual who maintains a house in the U.K. is regarded as resident here if he comes to the U.K. in any year for whatever period, although this rule does not apply to individuals working full-time abroad.

The term "ordinary residence" means habitual residence. A person who is physically absent from the U.K. throughout a fiscal year is not regarded as resident in the U.K. for that year. However, if he has been ordinarily resident in the U.K. he will still be regarded as ordinarily resident here even if he is outside the U.K. for a full fiscal year. Again, special rules apply to individuals working full-time abroad under foreign service contracts.

2. See supra note 1.

Certain other assets are also regarded as "excluded property". These are:—

1. Certain British Government securities, provided they are beneficially owned by an individual neither domiciled nor ordinarily resident in the U.K. The special definition of "domicile" for capital transfer tax purposes, does *not* apply here.
2. Certain saving certificates and bank deposits of individuals domiciled in the Channel Islands and the Isle of Man and, again, the special definition of domicile does not apply here.
3. The property of visiting forces and ancillary staff, and
4. A reversionary interest in a trust. For example, if property is held in trust for X during his lifetime, and thereafter for Y, Y's reversionary interest in the capital of the trust is excluded property (unless he acquired it by purchase), and if he gives away his reversionary interest, no charge to capital transfer tax will arise.

The general rules as to "excluded property" do not apply to assets held in a trust. Assets which are held in a trust are treated as excluded property provided the assets are situated outside the U.K., and the person who created the trust was not domiciled in the U.K. when he set the trust up. The fact that the beneficiaries are domiciled in the United Kingdom is not relevant.

RATES OF TAX

Capital transfer tax is a cumulative tax and a progressive tax. It is a cumulative tax because each transfer made by way of gift is added to all previous transfers to decide the rates of tax payable, and all transfers made by way of gift during life are added to assets transferred as the result of the individual's death to calculate the rates of tax payable on the assets transferred on death. It is a progressive tax, because the rates of tax go up with successive transfers. There are two scales of rates of capital transfer tax. The first scale applies to transfer made by way of gift during life. The second scale applies to assets transferred as the result of a death. Where an individual has made the gift of an asset during his life and dies within three years of that gift, the second scale of rates, applicable to death, is substituted for the lifetime gift scale. It will be noted that the rates of tax payable on lifetime gifts are considerably lower than the rates payable on assets transferred on death.

Rates on death

The rates of tax payable on chargeable transfers made on death or within three years prior to death are as follows:—

Portion of value		Rate of tax
Lower limit	Upper limit	Per cent
£	£	
0	15,000	Nil
15,000	20,000	10
20,000	25,000	15
25,000	30,000	20
30,000	40,000	25
40,000	50,000	30
50,000	60,000	35
60,000	80,000	40
80,000	100,000	45
100,000	120,000	50
120,000	150,000	55
150,000	500,000	60
500,000	1,000,000	65
1,000,000	2,000,000	70
2,000,000	—	75

It should be noted that a transfer covered by an exemption is not subject to C.T.T.

Rates on lifetime gifts

The rates of tax payable on other transfers, including transfers by way of gift, are as follows:—

Portion of value		Rate of tax
Lower limit	Upper limit	Per cent
£	£	
0	15,000	Nil
15,000	20,000	5
20,000	25,000	7½
25,000	30,000	10
30,000	40,000	12½
40,000	50,000	15
50,000	60,000	17½
60,000	80,000	20
80,000	100,000	22½
100,000	120,000	27½
120,000	150,000	35
150,000	200,000	42½
200,000	250,000	50
250,000	300,000	55
300,000	500,000	60
500,000	1,000,000	65
1,000,000	2,000,000	70
2,000,000	—	75

The value of a chargeable transfer made by way of gift during life is not simply the value of the asset given away. It is the value of the asset plus the capital transfer tax payable on the gift. This rather confusing principle comes about because of the general rule that the value transferred by a chargeable transfer is the amount by which the transferor's estate is reduced as the result of the transfer. Since the transferor's estate is reduced not only by the asset which he has given away but by the capital transfer tax payable, the value of the transfer is the value of the asset "grossed up" for the amount of the tax. The principle of "grossing up" does not apply where assets are transferred in consequence of a death, because the capital transfer tax is payable out of the assets left by the deceased and the assets remaining after paying the tax go to the beneficiaries. In addition, "grossing up" does not apply where a person receiving a gift agrees to pay the capital transfer tax, because then the estate of the person making the gift is not reduced by the capital transfer tax payable.

Example

Suppose an individual makes a gift of an asset worth £3,000 to a donee. If the gift is subject to tax at 20%, the value of the gift (£3,000) represents 80% of the total value of the chargeable transfer. The value of the transfer is thus:—

$$£3{,}000 + \frac{3{,}000 \times 20}{80} = £3{,}750$$

C.T.T. payable at 20%	750
Value taken by donee	£3,000

EXEMPTIONS AND RELIEFS

The main exemptions and reliefs from capital transfer tax are as follows:—

1) Transfers made by an individual to maintain his spouse, a dependent relative of his or his spouse, and to maintain and educate his children, are exempt from capital transfer tax.

2) Transfers between spouses are exempt from capital transfer tax whether the transfers are made during life or in consequence of a death. Since the assets of a husband and wife are not added together for capital transfer tax purposes, it is often possible to save capital transfer tax by dividing assets equally between spouses. The general rule that transfers between spouses are exempt

from capital transfer tax does not apply where the person making the transfer is domiciled in the U.K., but the recipient spouse is not domiciled in the U.K. In such a case only the first £15,000 of transfers in total are exempt.

3) Gifts not exceeding £1,000 in any fiscal year are exempt from capital transfer tax, and if the £1,000 is not fully used up, the amount not used may be carried forward for one year only.
4) Gifts not exceeding £100 per recipient in any fiscal year are exempt from capital transfer tax.
5) A gift made out of a transferor's income is exempt from capital transfer tax if it is made from income which is surplus to normal living requirements.
6) A gift made in consideration of a donee's marriage is exempt from capital transfer tax, within certain limits.
7) Gifts to charities, political parties, and transfers of works of art etc. to museums and galleries, are exempt from capital transfer tax within certain limits.
8) A special relief applies to agricultural property situated in the U.K., the Channel Islands or the Isle of Man. Provided that the agricultural land has been occupied by a farmer, wholly or mainly engaged in farming, the value of the land may be reduced to twenty times its open market rental.
9) In certain circumstances, capital transfer tax payable on growing timber may be postponed where the timber is transferred in consequence of a death.

TRUSTS

Trust law is more highly developed in England and Scotland than in most other European countries, and it is therefore sometimes difficult for continental European professional people to have a clear understanding of what a trust involves. Briefly, a trust is a situation where assets are held by persons known as trustees for the benefit of other persons known as beneficiaries. Thus the ownership of the assets is divided. The trustees own the assets but must use them according to directions given by the person who created the trust, called the settlor or truster, and these instructions are usually contained in a trust deed. The beneficiary is the person for whose benefit the assets are to be held, but his rights to enjoy the assets are those contained in the trust deed. The original purpose of a trust was to enable a person to give the benefit of assets to persons without giving them the actual control of the assets. However, trusts have become very popular in tax planning, and for this reason, U.K. tax law affecting trusts is usually complicated. The capital transfer tax rules on trusts are no exception. Trusts are divided into two classes. The first class consists of trusts where the income is to be paid to the beneficiaries. These trusts are usually called "fixed" trusts, and the right of a beneficiary to receive income is called "an interest in possession". The second class of trusts includes trusts where the beneficiaries have no rights to receive income, and where the income is paid out by the trustees as they in their discretion decide, or alternatively is held back by the trustees and accumulated within the trust. These are called "discretionary" trusts.

Where a person is entitled to receive income from a trust, and therefore has an "interest in possession" in the trust, he is regarded as owning the trust assets corresponding to his income entitlement. Thus, if an individual is entitled to one-third of the income from a trust, he is regarded as owning one-third of the assets. If he gives away his entitlement to receive the income while he is alive, he is regarded as having gifted the trust assets which he is treated as owning. If he dies, his entitlement to receive income comes to an end, and the trust assets are treated as assets transferred on his death. The rules for discretionary trusts are different, because no beneficiary is entitled to receive income at all. Thus it is not possible to treat beneficiaries as owning trust assets corresponding to the income which they receive. Instead, the trustees of a discretionary trust become liable to capital transfer tax when they pay assets out of the trust. Obviously, trustees could avoid paying capital transfer tax by never paying assets out, and so in addition to the charge to tax when assets are actually paid out, trustees become liable to capital transfer tax once every ten years, on the assets still within the trust, and the amount of the "periodic charge" every ten years is 30% of what the tax would have been if the assets had actually been paid out.

A special rule applies to discretionary trusts which are liable to capital transfer tax but are administered abroad. These trusts are liable to an annual capital transfer tax charge equal to 3% of the tax which would have been paid if all assets had been distributed.

The capital transfer tax consequences of discretionary trusts are so severe that many trusts are being brought to an end. In order to give some relief for discretionary trusts which are being terminated, the capital transfer tax payable on assets paid out of discretionary trusts before 1st April 1980 is much lower than the tax payable on distributions after that date, and the ten year periodic charge is not to operate before 31st March 1980.

CONCLUSION

This article contains no more than a brief outline of what is a complicated new tax, which will have important repercussions not only for persons domiciled in the U.K. but also for persons domiciled outside the U.K. who have assets here. It is expected that there will be a number of important changes in the tax in the next U.K. Finance Bill, to be published at the end of April 1976, and it is hoped to deal with the major changes in a forthcoming article.

H. W. T. PEPPER:

FISCAL TREATMENT OF CHARITIES

Introduction

1. From time immemorial individuals have made donations or bequests for the public benefit rather than merely for the comfort or enrichment of their own families. In what is probably the best-known Will in history, thanks to the publicity given by Shakespeare in his play "Julius Caesar", Caesar made generous bequests to the people of Rome. When making his Will, Caesar was not immediately contemplating death which befell him by the daggers of assassins, and since he lived in the pre-Christian era, it is obvious he was not seeking to store up credit in the world to come in the Christian sense.

2. The charitable impulse is indeed not necessarily based on the Christian concept of a man doing good works during his lifetime for the benefit of his everlasting soul after death. Charitable works have been done by individuals whose religions did not embrace the concept of one's fate after death being dependent on the quality of one's earthly life. Not every donor even seeks credit for his good works during his own lifetime, a fact which is evidenced by donations given anonymously.

3. Nevertheless, the desire to be remembered after death, and in what better way than by work for the public good, is a fairly common human attribute, although perhaps it is less strong than the wish to receive credit during one's lifetime for charitable works. It may perhaps be argued that only the anonymous donor is a truly saintly person, but the fact remains that donations for charitable purposes are often easier to obtain where there is a visible recognition of the donor's beneficence.

4. In Western countries it is fairly common for donation lists to be published so that all may read of whom among the community has contributed to specific causes. Both in the West and also in Eastern countries public recognition of beneficence is sometimes taken several stages further, so that anyone who donates sufficient to provide for a bed in a hospital, a bench in a park or at a beauty spot, a room in an old people's home, a new classroom in a school, or at a higher level, a whole ward or wing of a hospital or clinic, or even the whole building, may often expect to have his name recorded for all time as the sponsor of the item in question. Where a person is wealthy enough to set up a charitable foundation, trust, scholarship fund, etc., he may also secure "permanent" recognition so long as it is merely the income of the Trust, etc., which is used for the purposes laid down, the capital remaining intact in perpetuity if a wise investment policy is followed.

5. Many religions make specific provision for levies or donations from their adherents, the old Christian idea of the "tithe", or one-tenth of the produce from land, and the Muslim levies of żakrat and fitrah, are merely examples of ancient dues which have lost some of their significance in modern times. The dues payable by the followers of some less well known religions are much more significant and some of the evangelists from eastern countries

presently propagating contemplative religions in the industrialised countries of the West have evolved their own systems of levies on a voluntary basis among the faithful; in one case the suggested donation was 1% of a person's capital.

Taxation

6. Where rates of direct personal taxation on income and wealth are high there is obviously a need to consider at least partial relief from tax in respect of charitable donations which are given for objects compatible with Government social policy generally. In earlier centuries when religion held a more important place in society, the religious, or "charitable", levy upon its followers was itself the equivalent of taxation. Accordingly, there is some historical logic in present times for offsetting charitable contributions against secular tax, particularly recurring donations against recurring taxes such as income tax.

: Justification for Relief

7. If charitable organisations undertake work in the social and religious spheres which usefully complements the social work of the Government there is obviously a case for some kind of official encouragement and a number of countries allow income tax deductions, usually on some kind of restrictive basis, in respect of charitable contributions by individual and corporate donors.

8. There is an obvious limit to what may be allowed. On general principles it is the Government rather than individuals who should decide how the national revenue should be spent. If an individual is allowed to opt completely out of personal taxation by making donations, relief for which would entirely relieve him of tax, he is to some extent usurping the State's authority because he himself is deciding how the money, which would otherwise be tax revenue, should be spent, or at least the proportions in which the money should go to particular charitable channels.

: Selective Approval of Charities for Tax Relief Purposes

9. Some countries, in formulating tax relief provisions, have distinguished between money spent on institutions and funds which are for the benefit of the general public, e.g., the advancement of education, the relief of poverty, the succour of victims of natural disasters, and other purposes beneficial to the community in general, and those purposes which are for the benefit of the individual himself, even though the benefit is one he expects to enjoy only in the next world. Accordingly, donations to a church, mosque or temple where people worship mainly for the benefit of their own souls, would be excluded from relief. On the other hand, donations devoted by the same religious organisations to the charitable side of their work in the shape of the running of orphanages, clinics, hospitals, old people's homes, schools, and other work for the general public good, would be tax-deductible.

10. Many countries, however, take a broader view and grant relief for all religious donations, no doubt on the basis that while a man's personal religion may be something which he should in theory pay for out of his taxed resources, in general the promotion of religion as a force for good in the community is worthy of encouragement, since the religious-minded community is likely to be a better behaved community than one where there are no religious values.

: Nature of Tax Relief to Charities

11. There are several aspects of the subject of tax relief to the charitable body itself. A "charity" usually has income of two kinds, (a) that arising from its investments, and (b) that from donations and subscriptions. In addition a charity may derive (c) income from "trading" operations of one kind or another.

12. It is usual to exempt income in category (a) while as far as items in category (b) are concerned, under most tax codes money received from voluntary donations is not regarded as "income" for tax purposes. Where donations are convenanted as annual payments for a period of years this type of income is also exempted.

13. On the other hand it is not so usual for the income which a charity derives from ordinary trading to be exempted. Once it enters trade or business a charity is competing with ordinary traders who are subjected to tax and exemption would confer an unfair trading advantage whether it related to sales and other taxes on gross receipts, or taxes on profits.

14. Exemption of "trading" profits may nevertheless be granted if the trade is in articles produced in the course of carrying out the avowed purposes of the charity (such as occupational therapy for the blind or disabled). In addition a charity may continue to achieve de facto exemption from sales or value added tax where fund-raising operations involving "trade" are conducted separately by the territorial branches of the charity in circumstances such that different individuals take separate responsibility for the operations (such as jumble sale, bring and buy sale, or fete). The individual would conduct the operation in his or her own name, merely indicating that any profit would go to the charity in question. Freedom from sales tax or V.A.T. would arise where the total proceeds of the venture fell below the exemption limit (e.g., £5,000 p.a. for V.A.T. in Britain). If the charity itself organised all the activities and the total takings exceeded the taxable limit, the sales tax or V.A.T. would apply.

15. Tax relief to a donor in respect of his donations is a separate issue which is dealt with below under the heading "Tax Relief to Donor".

: Tax Relief to Donor

16. In general one would expect to find in practice that more liberal relief would be granted for charitable contributions in a less-developed economy where it makes good sense for a Government to encourage private beneficence and charity at least in limited spheres such as the provision of educational and medical facilities, and at least in a transitional period before the State can take over fully the costly social burdens involved. In industrialised countries welfare activities have usually been developed over a very lengthy period during which the social services have slowly been evolved and perfected.

17. In a so-called "Welfare State" where there is less need for public charity and perhaps where the wealthier members of the community may support private hospitals and other institutions so as to obtain a higher quality or a more select type of treatment or education than the mass of the people, the question of what tax relief should be given is obviously a more complex question. In general, while even the more developed countries have sections of population who are below the poverty line,

there is probably still ample scope for the encouragement of charitable endeavours. Even where higher quality facilities are provided by the wealthier sections of the community largely for the use of themselves and their relatives, there may still be a case for some encouragement, since any private provision for burdens which would otherwise fall upon the State must be of some help in enabling the State to make better provision for others, especially where those who make such provisions are unable to opt out of their liability to contribute to state-run schemes for the community at large.

Restrictions on Relief

18. In Britain, which has a long and honourable history of charitable endeavour, tax relief is somewhat restrictive. Until recently there was no relief from death duties for bequests to charity. Donations during the taxpayer's lifetime are deductible only for income tax purposes (at the rate of 35%) and only by the medium of so-called "7 year covenants". Surcharges and the higher tax rates which are now applied instead of surtax, rise to a maximum of 98% on investment income and would still be payable even if the whole income had been covenanted to charity. Although there is no upper limit on the amount of one's income which may be covenanted to charities there is clearly a practical limit imposed by the fact that the tax may by payable on the covenanted income at 98% thereof while the tax relief only extends to 35%.

19. There have, however, been recent relaxations in that bequests by deceased persons to charity are now exempted from capital transfer tax, up to a ceiling of £50,000. Charitable donations inter vivos are exempted from capital gains tax.

20. In other countries the pattern is usually in the form of allowing relief by way of making deductions for the full donation from the taxable income. Effectively relief is then given at the top rate of tax which applies to the income. There is often, however, a ceiling on the relief in the shape of a limitation on the total donations in a year expressed as a percentage of the total taxable income for that year. For example, Belgium allows a deduction for donations up to 5% of income or B.Fr. 5m, whichever is less, and Holland deducts donations which exceed 1% but are not in excess of 10% of taxable income, while the U.S.A. allows corporations to deduct donations up to 5% of income and individuals up to 20%, plus a further 10% (maximum) for gifts to churches, hospitals and educational establishments. The U.S.A. allows a carry-forward for corporations; where a charitable donation exceeds the limit for one year the surplus may be allowed as a deduction in the following year or years up to a 5-year limit.

21. Although most religions enjoin their adherents to give to the poor, it is a curious aspect of many tax systems which include gift taxation, capital transfer taxes, or the aggregation of inter vivos gifts of deceased persons for death or succession taxes, that even the purest and most generous benevolence is subject to tax once the exemption limit is exceeded. A believer who heeds the injunction to "Go and sell that thou hast, and give to the poor, and thou shalt have treasure in heaven!", soon finds that he must also heed the command "Render therefore unto Caesar, the things which are Caesar's!"

International Aspects of Charity

22. In general, countries approve donations to charities and funds within their

own borders, this principle being extended where a native charity collects money for relief of some great natural disaster, such as a flood, famine, or earthquake, in a foreign country. In general, however, tax recognition has not hitherto been freely given in respect of direct donations by a country's nationals to a foreign charitable organisation or fund. This principle is now to be liberalised as far as Europe is concerned as a result of the formulation of the INTERPHIL Draft European Convention on the tax treatment of certain nonprofit organisations.

23. The new Convention is to come into effect as soon as it has been ratified by four countries, and INTERPHIL (International Standing Conference on Philanthropy) will continue in existence for the purpose of considering at periodical conferences any points which crop up in connection with the international tax recognition of charitable organisations.

Internationalisation of Relief

24. Broadly speaking, the Convention provides for the mutual recognition of the signatory nations of each others' charitable organisations, so the donation by a taxpayer in any country will be recognised for tax purposes by that country if it is made to an approved charitable body in any of the other signatory countries. Article 9 provides escape clauses where the country giving the tax relief considers, for example, that the aims and activities of the foreign organisation are not compatible with its own public policy, security, or any other essential interest. The general objective is to remove juridical and fiscal obstacles to increased international activities by nonprofit organisations with a view to promoting greater European solidarity.

25. The administrative provisions of the Convention lay down that there should be one place where an organisation may deposit the information necessary to ascertain that it qualifies for approval under the Convention and that the information to be called for should be essentially sufficient for the requirements of each contracting State. These requirements will be set down by the Secretary General of the Council of Europe in consultation with the individual contracting States.

26. Where an organisation is approved, then a donor in any of the signatory countries will be able to obtain not less favourable treatment for his contributions to that organisation than those to any approved organisation in his own country.

27. This limited international extension of tax relief among member states of the Council of Europe is clearly likely to be followed by further extensions in other areas of the world until eventually one may expect to see full international agreement on the subject. This is compatible with the resolutions of the United Nations, that the industrial member nations should aim at providing 1% of their GNP for the benefit of less developed countries.

Future Trends

28. With the growth of affluence in the world and the greater knowledge of the existence and of the problems of the poor and distressed in all countries it is probable that money and resources devoted voluntarily to charity will increase from year to year.

29. There are, however, still some problems and even conflicts to be resolved before the wells of charity can be fully tapped and used for beneficent "irrigation" of the

deserts of want and despair, avoiding spillage, leakage, or contamination of the precious water. These will be referred to briefly below.

Advertising

30. All advertising for charitable donations may fairly be regarded as competitive. That is to say in general a person who is cajoled into contributing to a particular charity by an appeal will probably give less to other charities or may perhaps confine his charitable impulses solely to the particular one which has attracted him.

31. This does not mean that advertising is wrong. Obviously it is necessary to publicise particular forms of human need and charitable endeavour. Further, it is certain that a greater total amount will be donated to charitable objects if there is advertising than if there is not. Nevertheless, there is also certain to be some "wastage" if a number of different organisations with broadly similar objects (for example, the relief and cure of cancer) each advertises separately for funds. The position may even be reached where because one particular organisation has spent an unusually large amount on successful advertising the donations ordinarily available to other charities in similar fields may fall short, thus compelling these organisations in turn to devote a larger proportion of their resources to further advertising campaigns.

32. The obvious "cure" for an extreme situation where more and more is spent on competitive advertising to raise broadly the same total of donations would be for the organisations concerned to come together and run joint advertising campaigns, or perhaps even amalgamate some of their activities and resources. Insofar as advertising is merely one of the management expenses of a charity the matter is referred to below under the headings "Expense Ratio" and "New Charities".

Administration

33. The need for good administration of charities is evident because there is nothing more irritating to a donor than to find that the money which he has subscribed, perhaps at some sacrifice, has been spent unwisely or partly dissipated in unnecessary expenditure.

34. A country's ordinary laws normally deal adequately with cases of pure fraud, but incompetence, possibly by individuals who are both worthy and dedicated to the charitable cause they have espoused, is more difficult to cope with. Some countries set up authorities which are specifically charged with supervising charities by examining their bona fides when they commence (often by initially soliciting donations from the public) and where there is tax relief available only in respect of donations to approved institutions the tax authorities will usually be involved in examining and approving the charity for tax purposes. In the latter case also the donors may be required to produce official receipts from the charity for the donation and this requirement also affords some form of indirect check on the efficient running of the charity.

35. Some countries link the granting of tax relief to the maintenance by the charity of an expense ratio (see below) below a certain percentage of gross donations and/or income.

36. It is, however, often a matter of some difficulty to administer a charity in strict accordance with the wishes of those who set it up, especially when the charity has

been in existence for some decades and the conditions of life have changed from what they were when the fund was first set up. Moreover, applicants for charitable assistance often require careful vetting to ensure that their claims are not bogus, but this process must also be done with due regard to the sensibilities of the applicants, so that professionally qualified staff are needed to undertake the examination.

Expense Ratio

37. Although it may seem desirable to set a ceiling on the administration expenses of a charity, there are some limits to what restrictions may reasonably be imposed. The percentage may be unusually high in the year when a fund-raising campaign is undertaken and comparatively low in other years, especially where those who have consented to donate do so by deeds of covenant which run for 7 or more years. Administration of a high order of competence is necessary to ensure that the assets of the charity are invested in the most favourable way possible, and that the causes which the charity is supporting are thoroughly examined to ensure that they are worthy ones. In some large charities where much trouble and research is undertaken to identify suitable persons or objects to aid or endow, the expense ratio may even be as much as 10%. Such a percentage would be considered outrageously high in the case, say, of collection of taxes by a government upon its taxpayers but not if the cost of rendering the services for which the taxes are to provide the money was also taken into account as an administrative cost.

38. Some charitable bodies (for example, the National Association of Charitable Activities in Britain) act as advisory and administrative organisations to assist other charities, so that the resources of such bodies are spent 100% on administration.

39. On the other hand some well-run charities achieve a much lower expense ratio even than 10%, particularly where prominent people, including members of the professions, give their services free to help with the administration so as to preserve the funds as intact as possible so that they may be fully devoted to the causes for which they were subscribed.

Deeds of Covenant

40. Britain is more or less unique in having a tax system under which relief for charitable donations is only available for income tax purposes if the donor is willing to contribute annually for a period of more than 6 years. This system obviously deters some would-be donors who would be willing to make spot donations at the time when their hearts have been moved by some particular charitable cause but are not willing to tie themselves down, for a period of more than 6 years, to annual donations. On the other hand, where donors are ready to sign deeds of covenant, this is obviously a boon to the charity concerned in that it can expect a steady flow of revenue from such deeds for a number of years to come.

41. Because, however, of the inflexibility of the system it seems likely that in the future there may be a change in the British tax laws so as to make it possible to obtain relief for a single donation, particularly where the charitable appeal for funds is connected with some international cause where the relief has to be given immediately and not spread over a 7-year or longer period. Since most countries give relief for ad hoc donations and the trend is likely to be towards harmonisation of charitable reliefs in tax laws it seems almost inevitable

that Britain will eventually provide such relief, though it also seems probable that the old form of relief for deeds of covenant will remain, at least for a transitional period.

Rationalisation of Charitable Exercises

42. There are a number of taxpayers who are willing to subscribe to charitable objects in general but are not able to choose the most worthy among the myriad calls upon their beneficence. Moreover, the most worthy charitable cause of a particular year may be replaced in subsequent years' league tables of worthiness by other new causes. In Britain some flexibility has been provided by the creation of the Charities Aid Fund, a charitable body set up by the National Council of Social Service. The taxpayers may make annual covenanted contributions to the Aid Fund, for which tax relief is obtainable, and may then direct from year to year to which charities they would wish the money to go, and they may request advice from the Fund on the subject of what charities are most needy or deserving.

43. One of the most difficult decisions for a donor to make is how to choose between various worthy charities. There have been innumerable cases of charities being under-supported but nevertheless there are also cases where there has been obvious and gross over-subscription where some disaster has touched the public heart, so that enormous donations have been made although comparatively few persons will stand to benefit from the sums raised. Nevertheless, charity is often a personal thing and the donor likes to have some say in the manner in which his money is spent, so that the problems of over- and under-subscription to particular causes is likely to exist for some time.

Withdrawal of Relief

44. The remedy lies in the amalgamation of charities, or in the broadening of the objects and scope of the individual charity which finds itself with an overabundance of funds. A possible future development is that where a charity passively "sits on" funds which have become excessive for the purpose for which they were originally subscribed, tax relief might be withdrawn where the percentage of charity income devoted to the cause falls below a certain level. One could perhaps envisage a charity set up to succour soldiers who lost their hearing during World War I but where the inmates of the Home set up to house, say 100 persons, have now dwindled in numbers to one or two, as being the sort of case to which the above notes would apply.

New Charities

45. The setting up of a new charity usually means that there has been a new flowering of benevolence towards mankind and the emergence of a new batch of enthusiasts eager to donate time and money, probably to a new and worthy cause. Obviously it is right that the enthusiasm should be encouraged but equally it is at the inception that the authorities may best ensure that proper accounting procedures are followed so that the funds collected are handled properly and are likely to reach the intended recipients.

46. As far as the objects, and the legal form in which the charity is formed, are concerned it is possible in Britain to submit draft documents to the Charity Commission (a statutory body set up by the Government to supervise charities) for approval. The Commission will also clear the drafts with the Income Tax Department so that the applicant, or would-be benefactor, may

know not only whether the "charity" is within the legal definition of charity but whether it will qualify for income tax relief. This service is not, however, available in all countries.

47. It is, however, comparatively rarely that this desirable "vetting" operation takes place compulsorily at the inauguration of a new charity. Few countries have formal approval regulations which apply at the time of conception of a charity, although it is fairly usual for permission to be required of local or police authorities before money may be collected in the streets and public places.

48. Where a country provides tax relief for ad hoc charitable donations on production of receipts, it is common for taxpayers making substantial donations to make sure that the charity has been formally approved for tax purposes. Collectors of funds for new charities accordingly seek early approval so that the fact of approval and the reference number may be duly printed on appeal literature and receipts.

Tax Avoidance

50. The act of giving away capital or income so that it can never thenceforward benefit the donor will, of course, result in a reduction of the donor's tax liability. It may, however, be mentioned that in some countries a gift of capital may be disallowed for death duty purposes where the donor dies within a year of making the gift and that there are usually limitations or ceilings on tax relief when donations are made out of income.

51. Subject to the relief restrictions, when gifts are made within a short period of death, a gift of capital may produce the more substantial reduction in tax liability though the act of transferring funds to a charity can hardly be fairly described as "tax avoidance". (This would be equivalent to a man claiming to have "got away with murder" because he managed to commit suicide before the Police arrived!)

52. When a man reaches an age and a position of wealth such that he feels able to transfer assets to charity and still have ample means to provide for the rest of his life, he may adopt this more civic-minded course instead of resorting to ordinary legal avoidance procedures.

53. By putting funds into a charity of his choice, for which perhaps he may have been a voluntary worker, or by setting up his own charity or foundation, he will be fulfilling his own wishes to a degree. Where he founds his own charity the money he donates will produce the maximum advantage where there is no residual tax liability in his own case and the charitable foundation or trust receives the income derived from investing the gift without tax liability.

54. Moreover if a new charitable foundation is approved for tax purposes it may be possible for the donor to be one of the trustees. He may then retain some limited control of his funds but only to the extent of choosing, or helping to choose, to which of the approved charitable objects of the foundation the funds shall be devoted. If he takes this course the donor is achieving somewhat the same position as if he made donations out of income, though varying the direction and quantum each year, as circumstances demand. His tax position is, however, normally much more favourable when he is the trustee of an independent fund.

55. If a millionaire wished to set up such a fund, say, for the welfare of spastic

children, and had a particular interest in the subject because one of his own grandchildren was spastic, it would presumably be possible for the trustees of the charity to make provision for this particular child to benefit along with others in the same unfortunate predicament. The benefit, however, would hardly rank among the more reprehensible forms of tax avoidance!

56. Some wealthy persons, attracted to the idea of commemorating the family name by setting up a charitable foundation, may prefer to stand aside and appoint their children trustees, or utilise the services of some professional body to administer the funds. In Britain, the Charities Aid Fund of the National Council of Social Service will undertake for no fee the work of administering the funds of a charity and will do so in accordance with the wishes of the trustees as expressed from time to time.

Donations to State

57. To give money or property voluntarily to the State, which takes so much from him in taxation, is not usually the first thing that comes into a person's head when he has charitable impulses.

58. Nevertheless it may sometimes make sense to donate amenity land which produces little, if any, income but is expensive to maintain, either directly to the government or to some "national trust" or charitable body, set up to hold and administer such amenities for the public at large. The same applies to buildings of historic value such as castles, mansions, or even ruins, or perhaps to works of art which may be expensive to preserve and insure against damage or loss.

59. A person in high tax brackets may gain merely by making the gift, because of savings in unproductive expenditure and in taxes if there are wealth or property taxes on the living, as well as estate or inheritance taxes on death.

60. Sometimes this kind of benevolence is encouraged by tax relief, sometimes the gesture must be its own reward, although it may be possible for the donor to bask in the glory of having his name commemorated, i.e., property or money donated (or bequeathed) for a specific purpose by a Mr Smith might be labelled thereafter as the Smith Foundation (or Smith Bequest).

61. Where tax relief is given, benevolence will usually be encouraged, but it is wise to have some ceiling on relief so that tax yields are not inordinately reduced by wealthy taxpayers giving away property each year (the value of which would no doubt have increased since acquisition by the donor) sufficient more or less to wipe out their tax liability. On the other hand where a substantial donation is necessarily made on a single occasion, it is reasonable to allow the unused part of the relief to be carried forward if it cannot be wholly granted in the year of donation (because, e.g., of a ceiling on the relief (see para. 20 above).

Payments of Taxes in Kind

62. Sometimes death or inheritance taxes cannot be readily paid in cash — particularly where the taxable property has historic or artistic value, but is difficult to sell at the appropriate price. In these circumstances the Government may accept property at an agreed valuation in payment of tax.

63. Where a "national trust" or other charitable organisation exists for the purpose of holding, and making available

amenities such as land, and property of historical or aesthetic interest, governments are usually involved in giving support so that property received in payment of taxes may form suitable contributions by a government to that excellent cause.

Conclusion

64. There is scope, even in comparatively affluent countries, for some of the cost of social welfare, medical research, etc., to be borne by private "charitable" contributions.

65. Such contributions may be encouraged by tax relief provided there are suitable safeguards to prevent excessive erosion of tax revenue.

66. Properly managed, the net effect of a fiscal policy to stimulate "charitable" and "social" efforts by the private sector should be a comparative reduction in the tax burden combined with the social benefit of a greater involvement of and self-help by the private sector in the field of human welfare.

* * * DOCUMENTS * * *

ERRATUM DOCUMENTS

In the *May* 1976 issue the following Documents mentioned in the Contents were erroneously omitted:

E.E.C.: Harmonization of the Structure of Excise Duties on Manufactured Tobacco.

Canada: Exemption for Dividends Received from Foreign Affiliates.

The above Documents are published in this issue.

E. E. C.

Harmonization of the Structures of Excise Duties on Manufactured Tobacco (COM (76) 22) *

The Commission has approved a proposal for a Council directive on taxes other than turnover taxes which affect the consumption of manufactured tobacco.

A Council Directive of 19 December 1972 introduced the first stage in harmonizing the structures of excise duties on manufactured tobacco. This stage, which concerned the duty on cigarettes only, covered the period from 1 July 1973 to 30 June 1975. The excise duty comprises a specific component calculated per cigarette and a proportional component calculated by reference to the retail price. The ratios between the specific and proportional components were fixed for the first stage, the specific duty ranging between 5 and 75% of the total duty, excluding VAT. The criteria to be applied during the following two stages were to have been laid down by the Council before 1 July 1974, but the enlargement of the Community made it impossible to keep to this deadline and the first stage was twice extended by the Council on proposals from the Commission — first until 30 June 1976 and then until 30 June 1977.

The Council must approve criteria for the second stage by 1 July 1976, or the first stage will have to be extended once again. Discussions held at expert level and a recent study have shown considerable differences of opinion on what the ratio between the specific and proportional components of the duty should be during both the second and final stages. There is disagreement too on whether or not VAT should be incorporated in the proportional component.

The Commission is transmitting to the Council a proposal for a directive providing for the introduction of a second stage lasting three and a half years from 1 July 1977. During this stage, the specific component would be not less than 15% and no more than 50% of the total tax charged, i.e. specific and proportional duty plus VAT.

* Information memo Spokeman's Group. Brussels, February 1976.

CANADA

Exemption for dividends received from foreign affiliates

The following Release on the subject of exemption for dividends received from foreign affiliates was issued by the Department of Finance on December 30, 1975.

Finance Minister Donald S. Macdonald today announced the list of countries which will be prescribed for the purposes of exempting dividends received by corporations resident in Canada from their foreign affiliates.

Prior to the 1971 tax reform, dividends received by a corporation from a non-resident company in which it owned 25 per cent or more of the share capital were deductible for the purposes of determining the taxable income of the receiving corporation. Under transitional rules, this general exemption was continued until the 1976 taxation year for dividends received by a corporation resident in Canada from a foreign affiliate. Commencing with the 1976 taxation year, such dividends will be deductible in computing the corporation's taxable income only if the following two conditions are met: the foreign affiliate must be resident in a foreign country listed in the relevant Part of the Income Tax Regulations and the dividends must be paid out of the exempt surplus of the foreign affiliate.

The Minister announced that the following countries will be listed in the Income Tax Regulations as of January 1, 1976:

Australia	Norway
Austria	Pakistan
Belgium	Philippines
Brazil	Portugal
Denmark	Romania
Dominican Republic	Singapore
Finland	South Africa
France	South Korea
Indonesia	Spain
Ireland	Sweden
Israel	Switzerland
Jamaica	Trinidad and Tobago
Japan	Tunisia
Liberia	United Kingdom
Malaysia	United States
Morocco	West Germany
Netherlands	Zambia
New Zealand	

The Minister indicated that Canada has a double taxation convention in force with these countries or has reached general agreement on the contents of a tax treaty.

The list will be expanded to reflect progress in the negotiation of double taxation conventions with other countries.

UNITED STATES

French and U.K. Treaties: Taxation of Earnings of Boxers, Managers and Trainers [1]

The purpose of this Revenue Ruling is to state the Federal income tax treatment under the Internal Revenue Code of 1954, the United States—United Kingdom Income Tax Convention, T.D. 5569, 1947-2 C.B. 100, as amended by the Protocol of September 9, 1966, 1966-2 C.B. 582, (United Kingdom Convention) and the United States—France Income Tax Convention, 1968-2 C.B. 691 (French Convention), of amounts earned in the United States by foreign boxers, managers, and trainers in the examples described below.

Example (1).
B, a boxer, and C, an individual who manages boxers, are residents of the United Kingdom and non-resident aliens of the United States who come to the United States to engage in professional prize fights. C is an independent contractor acting on C's own behalf.

B enters into an exclusive service contract with C. It is agreed that the services to be performed by B are extraordinary, exceptional, and unique. C is to act as B's manager and to use his best effort to secure remunerative purses for B's participation in prize fights. B agrees to box solely and exclusively for C and not to box in any manner or place except as directed by C. B is to receive two-thirds of the money received from the performance of B's duties under the contract after the deduction of all training and transportation expenses. C is to receive one-third of the amount so computed.

C hires D, a resident of the United Kingdom and a non-resident alien of the United States, to act as B's trainer. D is responsible for developing B's talents as a boxer.

Example (2).
The facts are the same as in Example (1), except that B, C, and D, are residents of France.

Article XI(1) of the United Kingdom Convention provides that an individual who is a resident of the United Kingdom shall be exempt from United States tax upon compensation for personal (including professional) services performed during the taxable year within the United States if (a) the individual is present within the United States for a period or periods not exceeding in aggregate 183 days during such taxable year, and (b) such services are performed for or on behalf of a person resident in the United Kingdom. Services are performed for or on behalf of a resident of the United Kingdom if such services are performed in connection with an employment relationship.

Article 14, of the French Convention provides, that income derived by a resident of a Contracting State in respect of independent activities shall be taxable only in that State unless such activities were performed in the other Contracting State. Income in respect of independent activities performed within such other State may be taxed by such other State. Notwithstanding the foregoing provisions, income derived by a resident of a Contracting State in respect of independent activities performed in the other Contracting State shall not be tax-

1. United States Revenue Ruling 75-503, 47 I.R.S. BULL. 12 (November 24, 1975).

able in such other State if: (a) The recipient is present in the other State for a period or periods not exceeding in aggregate 183 days in the fiscal year concerned and (b) The recipient does not maintain a fixed base in the other State for a period or periods exceeding in the aggregate 183 days in such year.

Article 15, of the French Convention provides, in part, that salaries, wages, and other similar remuneration paid to a resident of a Contracting State for labor or personal services shall be taxable only in that State unless such labor or personal services were performed in the other Contracting State. Remuneration received for labor or personal services performed within such other State may be taxed by such other State. Notwithstanding the foregoing provisons, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall not be taxable in such other State if: (a) The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned, (b) The remuneration is paid by or on behalf of the employer who is not a resident of the other State, and (c) The remuneration is not borne by a permanent establishment that the employer has in the other State.

At issue in each of the above examples is whether the amounts received by each boxer for prize fights in the United States are subject to Federal income tax or whether all or part of these amounts is exempt from tax under the above-named Conventions. Thus, whether the boxer in each example is performing services in the United States as an employee of the manager affects the manner in which the respective boxer is to be taxed.

For Federal income tax purposes and for the purpose of applying the United Kingdom and the French Conventions, an employer-employee relationship depends upon the examination of all the facts and circumstances pertaining to the relationship among the parties.

Rev. Rul. 74-330, 1974 C.B. 278, discusses the factors that indicate whether or not an employer-employee relationship exists between a foreign entertainer performing personal services in the United States and a United Kingdom corporation. The factors mentioned are control, duration of the contract, regular business activities, veto arrangements, responsibility for performance, basis of computing salary, and financial risk.

Rev. Rul. 74-330 provides that of the foregoing factors, the right to control the foreign entertainer's performance of his or her services is generally the most important and that an employment relationship does not exist where the United Kingdom corporation merely acts as an agent. The Revenue Ruling holds, with respect to the first two examples set forth therein, that the foreign entertainer is not an employee of the United Kingdom corporation because the entertainer's salary is measured by profits, and the corporation does not assume the financial risk of the performer's performance, does not furnish the entertainer with tools to perform and the place of performance, and does not control the details of the performer's work. Rev. Rul. 74-330 indicates that the fact that the corporation retains only a fee for its services, and has obligated itself to pay the entertainer a salary measured by profits is evidence that the entertainer and not the corporation assumes the financial risk of payment. That

Revenue Ruling concludes that the entertainer is not performing services for or on behalf of the corporation and that the corporation is merely the entertainer's agent.

Accordingly, in Example (1) the personal service contract entered into by B and C does not make B an employee of C because B's salary is measured by the purses received from the prize fights, and C does not assume the financial risk of B's performance, does not furnish B with the tools to perform and the place of performance, and does not control the details of B's work. C's retention of one-third of the money earned by B's boxing efforts after the deduction of specified expenses for his services, and B's entitlement to two-thirds of the money earned indicates that B and not C, assumes the financial risk. B, is not performing the services for or on behalf of C. Rather, C, is merely B's agent.

Under Article XI of the United Kingdom Convention the purses earned by B constitute compensation for personal services performed in the United States and are not exempt from United States tax because the services are not performed for or on behalf of a person resident in the United Kingdom. The promotor is required to withhold 30 percent of the amount due B pursuant to section 1441 of the Code and the regulations thereunder because B is a self-employed individual and not an employee. See Rev. Rul. 70-543.

C's share of the money is considered compensation for personal services rendered in the United States, and since as an independent contractor, acting on C's own behalf, C did not perform services for or on behalf of a resident of the United Kingdom, C is not exempt from United States taxes and the promoter must withhold 30 percent of the amount due C. However, in a situation where C is an employee of a United Kingdom resident and is not present in the United States for more than 183 days during the taxable year, the payments made to C will be exempt from United States taxes. See Article XI(1) of the United Kingdom Convention.

The compensation paid to D, as a trainer, will be exempt from United States taxes under Article XI(1) of the United Kingdom Convention provided D is not present in the United States for more than 183 days during the taxable year. D is considered to have performed services for and on behalf of a resident of the United Kingdom.

In Example (2), B is not considered an employee of C for the same reasons set forth in Example (1). B's activities while in the United States are considered as independent activities under Article 14 of the French Convention. Thus, B is exempt from United States taxes on the purses earned while in the United States if B is not present in the United States for more than 183 days in the year concerned and has not maintained a fixed base in the United States fore more than 183 days during such year. See Rev. Rul. 75-131, 1975-15 I.R.B. 20,[2] for definition of a fixed base.

The amounts received by C from sources within the United States as the result of the prize fights entered into by B will be exempt from United States taxes under the provisions of Article 14 of the French Convention since C is an independent contractor, if C is present in the United States for not more than 183 days during the

2. See 15 EUROPEAN TAXATION 284 (August 1975).

taxable year, and does not maintain a fixed base in the United States for more than 183 days during the year. To determine whether a person such as B or C has a permanent establishment in the United States, see Rev. Rul. 67-321, 1967-2 C.B. 470.

D is considered to have performed services for or on behalf of a resident of France and is exempt from United States taxes under Article 15 of the French Convention provided that D is present in the United States for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned and that the compensation is not borne by a permanent establishment that D's employer has in the United States.

DIE SCHWEIZ

Botschaft des Bundesrates an die Bundesversammlung über die verfassungsmässige Neuordnung des Finanz- und Steuerrechts des Bundes (Vom 24. März 1976 (auszugsweise))

8 STEUERHARMONISIERUNG

81 AUSGANGSLAGE

Gemäss dem föderalistischen Aufbau des schweizerischen Bundesstaats kommt die originäre Fiskalhoheit innerhalb der verfassungsrechtlichen Schranken sowohl den Kantonen als auch dem Bund zu. Auf dem Gebiet der direkten Steuern haben die Kantone zuerst legiferiert. Die historisch bedingten Unterschiede in der Ausgestaltung der einzelnen kantonalen Steuergesetze wurden unter dem Einfluss der ab 1915 auf diesem Gebiet ebenfalls einsetzenden Gesetzgebung des Bundes (insbesondere Krisenabgabe 1934-1940, Wehrsteuer ab 1941) zwar etwas gemildert, sind aber auch heute noch erheblich. Sie werden mit der zunehmenden Mobilität der Steuerpflichtigen und der interkantonalen Verflechtung der Wirtschaftsunternehmungen je länger, je mehr als unzeitgemäss empfunden. Immer intensiver, besonders seit Mitte der sechziger Jahre, wurde deshalb der Ruf nach einer Harmonisierung der schweizerischen Einkommens- und Vermögenssteuern laut.

Konkrete Schritte in dieser Richtung wurden zuerst von seiten der Kantone unternommen. 1968 erteilte die Konferenz der kantonalen Finanzdirektoren einer Arbeitsgruppe (Kommission Ritschard) den Auftrag, ein Mustergesetz über die direkten Steuern der Kantone und Gemeinden sowie den Text für ein interkantonales Konkordat zur Vereinheitlichung der kantonalen Steuern vom Einkommen und Vermögen auszuarbeiten. Dieser Auftrag war im Herbst 1972 erfüllt.

An einer Arbeitstagung vom 14./15. Juni 1973 stimmte die Konferenz der kantonalen Finanzdirektoren dem Mustergesetz der Kommission Ritschard grundsätzlich zu und empfahl es als Grundlage für die weiteren Arbeiten zur Steuerharmonisierung unter den Kantonen, für Revisionen kantonaler Steuergesetze und für den Erlass eines Gesetzes über die direkte Bundessteuer. Bezüglich der Durchsetzung der Harmonisierung kam die Konferenz zum Schluss, dass hiefür der Weg des interkantonalen Konkordats allein nicht genüge. Sie befürwortete deshalb unter gewissen Voraussetzungen die Schaffung einer auf die Grundsatzgesetzgebung (Steuerpflicht, Steuerobjekt, zeitliche Bemessung, Verfahrensrecht und Steuerstrafrecht) beschränkten Bundeskompetenz. Soweit die Grundsatzgesetzgebung des Bundes keine Regelung trifft, sollte es Sache der Kantone bleiben, die kantonale Steuergesetzgebung auf dem Wege der interkantonalen Vereinbarung zu harmonisieren. Mit ihrer Zustimmung zur erwähnten Kompetenzübertragung an den Bund hat die Konferenz der kantonalen Finanzdirektoren die Erwartung verbunden, dass die Verfassungsgrundlagen für die Steuerharmonisierung, den Ausbau der Verbrauchssteuern (Mehrwertsteuer), einen höheren Anteil der Kantone an der direkten Bundessteuer (evtl. deren Umwandlung in eine Finanzausgleichssteuer) sowie für erste wesentliche Änderungen in der Aufgabenteilung zwischen Bund und Kantonen gleichzeitig geschaffen werden. Die Steuerharmonisierung könne nur Teil einer umfassenden Finanz-, Finanzausgleichs- und Steuerreform sein und dürfe deshalb nicht isoliert behandelt werden.

Auch auf Bundesebene blieben konkrete Vorstösse im Hinblick auf eine Harmonisierung der Besteuerungsgrundsätze nicht aus. Bei der Beratung der Vorlage des Bundesrates vom 10. September 1969 zur Finanzordnung des Bundes beschloss der Nationalrat anfänglich — allerdings knapp mit 69 gegen 65 Stimmen — die Verankerung einer Bundeskompetenz zur Steuerharmonisierung in Artikel 41quater Bundesverfassung. Im Differenzbereinigungsverfahren einigten sich die Räte auf gleichlautende Motionen, worin der Bundesrat beauftragt wurde, eine Verfassungsbestimmung vorzulegen, die dem Bund die Befugnis gibt, Vorschriften zur Verwirklichung der Harmonisierung der Einkommens- und Vermögenssteuern des Bundes, der Kantone und der Gemeinden zu erlassen (Amtliches Bulletin der Bundesversammlung, Sommersession 1970, Nationalrat S. 357, Ständerat S. 163). Weitere parlamentarische Vorstösse in dieser Richtung wurden durch Nationalrat Conzett und Ständerat Herzog im Jahre 1969 und durch Nationalrat Letsch und Ständerat Luder 1972 unternommen.

Am 17. März 1971 reichte Nationalrat Stich eine parlamentarische Einzelinitiative ein. Darin soll der Bund in einem neuen Artikel 42quinquies Bundesverfassung ermächtigt werden, zur Förderung der Steuerharmonisierung unter den Kantonen „Vorschriften über die objektive und subjektive Steuerpflicht sowie das Verfahrensrecht zu erlassen". Ferner kann die Besteuerung der Holding- und Domizilgesellschaften durch die Bundesgesetzgebung einheitlich geregelt werden.

Der Nationalrat bestellte in der Sommersession 1971 eine Kommission zur Prüfung der Einzelinitiative Stich. Der Kommission wurde in der Folge auch eine Einzelinitiative von Nationalrat Butty vom 14. Dezember 1973 zur Behandlung zugewiesen. Diese Initiative bezweckt die Schaffung eines neuen Artikels 41quater Bundesverfassung und enthält im wesentlichen folgende Vorschläge:

- Für die natürlichen Personen ist eine Bundeseinheitssteuer einzuführen.
- Die juristischen Personen werden wie bisher durch Bund, Kantone und Gemeinden besteuert.
- Der Finanzausgleich aus dem Ertrag der direkten Bundessteuer ist in dem Sinn neu zu regeln, dass höchstens ein Viertel dem Bund zukommt, sofern seine übrigen Einnahmen die Ausgaben nicht decken, während der Rest unter die Kantone zu verteilen ist im Verhältnis ihrer Wohnbevölkerung nach der letzten eidgenössischen Volkszählung.
- Jeder Kanton kann Zuschläge erheben, deren Ertrag ihm zukommt.
- Die Kantone behalten das Recht zur ausschliesslichen Legiferierung auf dem Gebiet der Gemeindesteuern.

Die nationalrätliche Kommission für die Behandlung der Einzelinitiativen Stich und Butty erstattete am 29. Januar 1974 einen vorläufigen Bericht und schlug darin mehrheitlich die Schaffung einer Bundeskompetenz für die Steuerharmonisierung im Sinne der Vorschläge der Finanzdirektorenkonferenz vor. In einem 1974 bei den Kantonsregierungen, politischen Parteien und interessierten Organisationen durchgeführten Vernehmlassungsverfahren fand der Gegenvorschlag weitgehende Zustimmung, während die beiden Einzelinitiativen nur wenige Befürworter fanden. Die Kommis-

sion nahm von den Ergebnissen aufgrund eines zusammenfassenden Berichts der Eidgenössischen Steuerverwaltung vom 30. November 1974 Kenntnis und nahm an ihrem Gegenvorschlag einige Änderungen nicht grundsätzlicher Art vor. An der Schlusssitzung vom 17. März 1975 verabschiedete sie ihren Bericht, der folgende Anträge zuhanden des Ratsplenums enthält:
Die Kommissionsmehrheit beantragt die Initiativen Stich und Butty abzulehnen und auf folgenden Verfassungsartikel einzutreten:

Art. 42quinquies (neu)
1 Der Bund sorgt in Zusammenarbeit mit den Kantonen für die Harmonisierung der direkten Steuern von Bund, Kantonen und Gemeinden.
2 Zu diesem Zweck erlässt er auf dem Wege der Bundesgesetzgebung Grundsätze für die Gesetzgebung der Kantone und Gemeinden über Steuerpflicht, Gegenstand und zeitliche Bemessung der Steuern, Verfahrensrecht und Steuerstrafrecht und überwacht deren Einhaltung. Die Bestimmung der Steuertarife, Steuersätze und Steuerbeträge ist Sache der Kantone.
3 Gegen kantonale Entscheide in Anwendung der Grundsatzgesetzgebung des Bundes steht die Verwaltungsgerichtsbeschwerde an das Bundesgericht offen.
4 Beim Erlass der Grundsatzgesetzgebung für die direkten Steuern der Kantone und Gemeinden sowie beim Erlass der Gesetzgebung über die direkte Bundessteuer hat der Bund auf die Bestrebungen der Kantone zur Steuerharmonisierung Rücksicht zu nehmen. Den Kantonen ist eine angemessene Frist für die Anpassung ihrer Steuergesetzgebung einzuräumen.
5 Die Kantone wirken bei der Vorbereitung der Bundesgesetze mit.
Eine erste Kommissionsminderheit beantragt, auf die Initiative Stich einzutreten und den Vorschlag der Mehrheit und die Initiative Butty abzulehnen.
Eine zweite Kommissionsminderheit beantragt, auf die Initiative Butty einzutreten und den Vorschlag der Mehrheit und die Initiative Stich abzulehnen.
Der Kommissionsbericht wurde gemäss Artikel 21septies Absatz 2 des Geschäftsverkehrsgesetzes dem Bundesrat zur Stellungnahme überwiesen. Er ist im *Bundesblatt 1975* II 1748 veröffentlicht.

82 STELLUNGNAHME DES BUNDESRATS

821 *Grundsatzfrage der Schaffung einer Bundeskompetenz für die Steuerharmonisierung*

Alle unter Abschnitt 81 erwähnten Vorschläge wollen die Steuerharmonisierung durch Schaffung einer Bundeskompetenz in der Verfassung erreichen. Die Variante wäre der Abschluss eines interkantonalen Konkordats gemäss Artikel 7 Bundesverfassung, eine Lösung, die die Finanzdirektorenkonferenz zunächst befürwortete, an der Tagung vom 14./15. Juni 1973 jedoch als — jedenfalls auf dem Gebiet der direkten Steuern — wenig erfolgversprechend aufgab.
Die Wünschbarkeit und Dringlichkeit einer gewissen Harmonisierung des schweizerischen Steuerrechts und die Schaffung einer Bundeskompetenz zu diesem Zweck sind heute — wie sich auch aus dem hievor (Abschn. 81) erwähnten Vernehmlassungsverfahren ergeben hat — fast allgemein anerkannt und brauchen hier nicht weiter begründet zu werden. Auch die Reichtumsteuer-Initiative enthält in ihrem Artikel 41quater Bundesverfassung eine Harmonisierungsvorschrift (Abs. 2), die der von der nationalrätlichen Kommission mehr-

heitlich vorgeschlagenen Bestimmung (vgl. Abschn. 81 hievor) weitgehend entspricht. Die Meinungen gehen jedoch bei der Frage auseinander, wie weit die Bundeskompetenz gehen soll. Darauf ist im folgenden näher einzutreten.

822 Gegenstand der Steuerharmonisierung

Es geht hier um die Frage, ob der Bund befugt sein soll, alle Steuern zu harmonisieren (Initiative Stich) oder nur die direkten Steuern (Initiative Butty und Gegenvorschlag der nationalrätlichen Kommission).

Wie das unter Abschnitt 81 erwähnte Vernehmlassungsverfahren über die Steuerharmonisierung gezeigt hat, besteht ein weitgehender Konsens darüber, dass die Bundeskompetenz sich auf die Harmonisierung der direkten Steuern zu beschränken habe, wobei unter diesem Begriff die Steuern auf dem Einkommen und Vermögen der natürlichen Personen sowie auf dem Gewinn (Reinertrag) und dem Kapital oder Vermögen der juristischen Personen verstanden werden. Es sind dies die Haupteinnahmequellen der Kantone und Gemeinden und gleichzeitig eine wichtige Einnahmequelle des Bundes. Das Nebeneinander von 25 kantonalen Steuerordnungen, die unter sich und im Vergleich zur direkten Bundessteuer teils erheblich voneinander abweichen, ruft hier in besonderem Mass einer einheitlichen Regelung. Demgegenüber kommt beispielsweise den Erbschafts- und Schenkungssteuern eine eher untergeordnete Bedeutung zu, so dass sich hier eine Harmonisierung mittels Bundesrechts nicht aufdrängt. Die Harmonisierung dieser — vom Bund nicht erhobenen — Steuerarten kann dem interkantonalen Konkordat vorbehalten bleiben. Bei den Verbrauchssteuern anderseits tritt der Bund in fast ausschliesslicher Weise in Erscheinung; soweit er Regelungen aufstellt, insbesondere auf dem Gebiet der Umsatzsteuer, ist für konkurrierendes kantonales Recht und somit für eine Harmonisierung kein Raum. Wir sind deshalb der Auffassung, dass für eine über die direkten Steuern im dargelegten Sinn hinausgehende Harmonisierungskompetenz des Bundes kein dringendes Bedürfnis besteht.

823 Umfang der Steuerharmonisierung

Der Kommissionsvorschlag sieht lediglich die einheitliche Regelung der Besteuerungsgrundsätze vor (formelle Harmonisierung), unter ausdrücklicher Ausklammerung einer einheitlichen Steuerbelastung (materielle Harmonisierung). Die Initiative Stich steht grundsätzlich auf dem gleichen Standpunkt (vgl. dazu die dem Kommissionsbericht beiliegenden Erläuterungen), mit Ausnahme der Besteuerung der Holding- und Domizilgesellschaften, die „durch die Bundesgesetzgebung einheitlich geregelt werden kann"; auf diesem beschränkten Gebiet wird also auch eine materielle Harmonisierung angestrebt. Die Initiative Butty schliesslich geht über die beiden andern Vorschläge in dem hier interessierenden Punkt weit hinaus, indem für die natürlichen Personen eine umfassende und ausschliessliche Bundesregelung (Bundeseinheitssteuer) mit Vorschriften über die Verteilung des Ertrags auf Bund und Kantone postuliert wird.

Wie der Bundesrat in seiner Botschaft vom 9. Dezember 1974 über das Volksbegehren für gerechtere Besteuerung und die Abschaffung der Steuerprivilegien (Initiative des Landesrings der Unabhängigen) dargelegt hat, wäre der Übergang zum System einer Bundeseinheitssteuer mit enormen Schwierigkeiten verbunden und würde eine zu weitgehende Abkehr von der bisherigen föderalistischen Konzeption der schweizerischen Steuerordnung bedeuten (..., BBl *1975* I 288). Die Beratung dieses Volksbegehrens in den eidgenössischen Räten und der negative Ausgang der Volksabstimmung vom 21. März 1976 haben diese Auffassung bestätigt. Die Initiative Butty geht zwar weniger weit, indem sie die juristischen Personen von der Bundeseinheitssteuer, ja sogar von der Steuerharmonisierung ausnimmt. Im grundsätzlichen bestehen die gegen die Landesring-Initiative vorgebrachten Bedenken aber auch gegenüber der Initiative Butty. Sie ist denn auch im Vernehmlassungsverfahren von 1974 nahezu einhellig abgelehnt worden (vgl. Bericht der EStV vom 30. Nov. 1974, der dem Kommissionsbericht beiliegt). Im Kommissionsbericht wird dargetan, aus welchen Gründen Eingriffe in die kantonale Finanzhoheit, wie sie die Initiative Butty mit sich bringen würde, abzulehnen sind. Der Bundesrat schliesst sich diesen Erwägungen an.

Die Initiative Stich geht in ihrem Absatz 1 in der hier interessierenden Frage nicht weiter als der Gegenvorschlag der nationalrätlichen Kommission. Die Initiative behält die Festsetzung der Tarife, Steuersätze und Freibeträge durch die Kantone zwar nicht ausdrücklich, wohl aber sinngemäss vor (vgl. die Erläuterungen in der Beilage zum Kommissionsbericht). Eine einheitliche Besteuerung durch die Bundesgesetzgebung sieht die Initiative hingegen für die Holding- und Domizilgesellschaften vor (Abs. 2). Indessen ist von einer Sondervorschrift für die Besteuerung einer bestimmten Gruppe von juristischen Personen im Verfassungstext abzusehen. Die Frage der steuerlichen Behandlung von Holding- und Domizilgesellschaften, die heute in den meisten Kantonen noch einen bevorzugten steuerlichen Status innehaben, ist, wie der Kommissionsbericht zutreffend ausführt, auf der Stufe der bundesrechtlichen Ausführungsgesetzgebung zum Harmonisierungsartikel zu regeln.

Der Bundesrat ist mit der Mehrheit der nationalrätlichen Kommission und der Meinungsäusserungen im Vernehmlassungsverfahren der Auffassung, dass sich die Steuerharmonisierung, jedenfalls in einer ersten Phase, auf eine Harmonisierung der Besteuerungsgrundsätze zu beschränken hat. Insoweit als die Initiativen Stich und Butty über diese Begrenzung hinausgehen, sind sie abzulehnen. Die *Belastungsangleichung* bleibt zwar ein anzustrebendes Ziel, doch ist sie nicht durch einheitlich festgelegte Tarife und Freibeträge zu verwirklichen. Eine derartige Lösung bedeutete einen Einbruch in die kantonale Finanzhoheit und stellte zudem nur ein beschränkt taugliches Mittel für eine Belastungsharmonisierung dar, da, wie die Ausführungen zur Initiative des Landesrings der Unabhängigen und zur Reichtumsteuer-Initiative zeigen, die einzelnen Kantone und Gemeinden sehr unterschiedliche Finanzbedürfnisse haben; der bundesrechtliche Einheitstarif müsste deshalb ohnehin durch kantonale und kommunale Zuschläge ergänzt werden; eine Belastungsharmonisierung würde nicht erreicht. Besser und dem föderalistischen Staatsaufbau angemessener ist es, eine gewisse Belastungsangleichung durch eine Verbesserung des bundesstaatlichen Finanzausgleichs anzustreben. Dieser setzt indessen eine Harmonisierung der Besteuerungsgrundsätze voraus; denn nur wenn einmal alle Kantone die gleichen Steuern nach denselben Grundsätzen erheben, kann Gleiches mit Gleichem verglichen, können die Unterschiede der Finanzkraft zwischen den Kantonen auf zureichender Grundlage festgestellt werden.

824 Durchsetzung der Steuerharmonisierung

Gemäss Absatz 2 des Vorschlages der nationalrätlichen Kommission erlässt der Bund „Grundsätze für die Gesetzgebung der Kantone und Gemeinden". Dieser Wendung liegt eine Durchsetzungskonzeption zugrunde, die man als mittelbar rechtsetzend bezeichnen kann: der Bund erteilt den kantonalen Gesetzgebern den Auftrag, auf dem Gebiet der direkten Steuern in einem bestimmten Sinn zu legiferieren. Für die entsprechende Anpassung ihrer Steuergesetze wird den Kantonen gemäss Absatz 4 eine angemessene Frist eingeräumt. Den Steuerpflichtigen erwachsen aus dem Bundesgesetz keine direkten Rechtsfolgen, sondern erst durch das kantonale Steuergesetz. Demgegenüber verlangen sowohl die Initiative Stich wie auch die Reichtumsteuer-Initiative, dass der Bund „einheitliche Vorschriften" erlässt; diese wenden sich nicht an den kantonalen und kommunalen Gesetzgeber, sondern sind für die Erhebung der durch sie geregelten Steuern direkt anwendbar (unmittelbar rechtsetzendes Gesetz).

Mit der mittelbar rechtsetzenden Methode bleibt die formelle Gesetzgebungskompetenz der Kantone uneingeschränkt erhalten, ein Umstand, der aus föderalistischer Sicht positiv zu werten ist. Zwar erfordert diese Methode ein verhältnismässig kompliziertes Rechtsetzungsverfahren: dem Erlass eines Bundesrahmengesetzes müssen auf kantonaler und teilweise auf kommunaler Ebene weitere Gesetzgebungsverfahren folgen. Dazu tritt das Risiko, dass einzelne Kantone nicht fristgemäss bundesrechtskonform legiferieren können. Die unmittelbar rechtsetzende Methode hätte demgegenüber den Vorteil, auf einfachere Weise zum Ziel einheitlicher Besteuerungsgrundsätze zu führen. Anderseits bedeutet sie eine weitgehende Aufhebung der kantonalen Gesetzgebungshoheit auf dem Gebiet der direkten Steuern.

Wir sind der Auffassung, dass der mittelbar rechtsetzenden Methode aus föderalistischen Überlegungen grundsätzlich der Vorzug zu geben ist. Sie darf aber nicht dazu führen, dass die Steuerharmonisierung Stückwerk bleibt. Im Bundesrahmengesetz wird deshalb eine Vorschrift aufzunehmen sein, wonach die Bestimmungen dieses Gesetzes — oder allenfalls sinngemäss diejenigen des Bundesgesetzes über die direkte Bundessteuer — auf die Veranlagung der kantonalen Steuern unmittelbar anwendbar sind, soweit ihnen das kantonale Recht nach Ablauf einer noch festzulegenden Frist widerspricht. In diesem Sinn beantragen wir Zustimmung zu der von der Kommissionsmehrheit vorgeschlagenen Durchsetzungskonzeption.

825 Einbezug der direkten Bundessteuer in die Steuerharmonisierung

Sowohl der Textvorschlag der nationalrätlichen Kommission (Abs. 1) wie auch die Harmonisierungsvorschrift in der Reichtumsteuer-Initiative (Art. 41$^{\text{quater}}$ Abs. 2) sehen mit der Wendung „Harmonisierung der direkten Steuern von Bund, Kantonen und Gemeinden" den Einbezug der direkten Bundessteuer vor. Die Initiative Stich spricht hingegen lediglich von einer „Steuerharmonisierung unter den Kantonen".

Stellt der Bund für die kantonalen und kommunalen direkten Steuern einheitliche Regelungen auf, so erscheint es als selbstverständlich, dass er sich bei der Ausgestaltung seiner eigenen direkten Steuer ebenfalls daran hält, soweit die verfassungsrechtlichen Bestimmungen über die direkte Bundessteuer dies sachlich erlauben. Immerhin erscheint es nützlich, diese Verpflichtung des Bundes in der Harmonisierungsvorschrift ausdrücklich festzuhalten.

Die Vorarbeiten zu einer möglichst übereinstimmenden Gesetzgebung für die direkten Steuern der Kantone und Gemeinden einerseits und für die direkte Bundessteuer anderseits sind übrigens auf der Stufe der Expertenkommission praktisch abgeschlossen. Die vom Eidgenössischen Finanz- und Zolldepartement und der Konferenz der kantonalen Finanzdirektoren gemeinsam ins Leben gerufene Koordinationskommission für die Steuerharmonisierung hat Entwürfe für ein Gesetz über die direkten Steuern der Kantone und Gemeinden (Mustergesetz) und für ein Bundesgesetz über die direkte Bundessteuer ausgearbeitet. Diese wurden 1974 gleichzeitig mit den unter Abschnitt 81 erwähnten Vorschlägen für eine Verfassungsbestimmung in ein Vernehmlassungsverfahren bei den Kantonen, politischen Parteien und interessierten Organisationen geschickt. Die Koordinationskommission ist daran, ihre Gesetzesentwürfe aufgrund der Ergebnisse des Vernehmlassungsverfahrens zu überarbeiten. Ferner bereitet sie einen Entwurf für ein Bundesgesetz über die Harmonisierung der direkten Steuern der Kantone und Gemeinden vor (Rahmengesetz).

826 *Mitwirkung der Kantone*

Der von der nationalrätlichen Kommission vorgeschlagene Verfassungstext sieht in den Absätzen 1 und 5 ein Mitwirkungsrecht der Kantone bei der Vorbereitung des Bundesgesetzes über die Harmonisierung der direkten Steuern der Kantone und Gemeinden und des Gesetzes über die direkte Bundessteuer vor. Eine entsprechende Bestimmung fehlt in der Initiative Stich und in der Reichtumsteuer-Initiative. Gemäss Vorschlag der nationalrätlichen Kommission in Absatz 4 hat der Bund ferner „auf die Bestrebungen der Kantone zur Steuerharmonisierung Rücksicht zu nehmen"; eine entsprechende Bestimmung ist auch in der Reichtumsteuer-Initiative enthalten.

Es ist naheliegend und vernünftig, wenn sich der Bund bei der Ausarbeitung der Harmonisierungsgesetzgebung an die Vorarbeiten der Kantone, insbesondere der hievor erwähnten Koordinationskommission, hält; diese Vorarbeiten beruhen auf einem weitgehenden interkantonalen Konsens, von dem nicht ohne Not abgewichen werden sollte. Es kann sich jedoch naturgemäss nur um eine angemessene, niemals um eine absolute Berücksichtigung der kantonalen Vorarbeiten handeln.

Was es mit dem besonderen Mitwirkungsrecht der Kantone gemäss Absatz 5 des Vorschlages der nationalrätlichen Kommission für eine Bewandtnis hat, ist nicht ohne weiteres ersichtlich und wird auch im Kommissionsbericht nicht ausgeführt. Offenbar wird dadurch eine Institutionalisierung der Koordinationskommission angestrebt, also eines aus Steuerexperten des Bundes, der Kantone und der Wirtschaft zusammengesetzten Gremiums, das die Harmonisierungsgesetzgebung vorzubereiten hat und auch bei späteren Änderungen je nach den Umständen eine vorbereitende oder beratende Rolle zu spielen hat. Einem in diesem Sinn auf das vorparlamentarische Stadium beschränkten Mitwirkungsrecht der Kantone könnte der Bundesrat zustimmen. Im übrigen hält er dafür, dass die bestehenden Möglichkeiten der Kantone zur Einflussnahme auf die Bundesgesetzgebung auch im vorliegenden Bereich ausreichen, um die Interessen der Kantone zur Geltung zu bringen. Die wichtigsten unter diesen Möglichkeiten sind das Recht, im vorparlamentarischen Gesetzgebungsverfahren angehört zu werden (Vernehmlassungsverfahren), die Einflussnahme auf das parlamentarische Gesetzgebungsverfahren über den Ständerat und das Referendum der Kantone im Sinne der Artikel 89 Absatz 2 und 89bis Absatz 2 Bundesverfassung. Für einen Ausbau der kantonalen Mitwirkungsrechte über diesen Rahmen hinaus besteht nach Auffassung des Bundesrates kein Bedürfnis.

827 *Harmonisierung der Rechtsprechung*
Gemäss Absatz 3 des Vorschlages der nationalrätlichen Kommission steht gegen kantonale Entscheide in Anwendung der Grundsatzgesetzgebung des Bundes die Verwaltungsgerichtsbeschwerde an das Bundesgericht offen. Damit soll — laut Kommissionsbericht — eine einheitliche Rechtsprechung gewährleistet werden, indem letztlich immer die gleiche Instanz zur Beurteilung zuständig ist.
Unter dem Gesichtspunkt der Steuerharmonisierung ist es in der Tat wichtig, dass die Kantone nicht nur bundesrechtskonform legiferieren, sondern dass die Anwendung der harmonisierten Gesetze vom Bundesgericht frei überprüft werden kann. Hiefür bedarf es jedoch keiner speziellen Verfassungsvorschrift, da nach Absatz 2 auch das Verfahrensrecht in die bundesrechtliche Harmonisierungskompetenz einbezogen wird. Kraft dieser Bestimmung kann die Harmonisierung der Rechtsprechung in der Ausführungsgesetzgebung sichergestellt werden, ohne dass hiefür eine weitere verfassungsrechtliche Grundlage geschaffen werden müsste. Deshalb kann auf Absatz 3 des Vorschlages der nationalrätlichen Kommission verzichtet werden.

828 *Einreihung des Harmonisierungsartikels*
Die Initiative Stich und der Vorschlag der nationalrätlichen Kommission sehen einen neuen Artikel 42quinquies vor. Die Einreihung erscheint als sachgemäss da bereits Artikel 42quater mit dem Verbot von Steuerabkommen in einem gewissen Sinn der Charakter einer Harmonisierungsvorschrift zukommt.

829 *Schlussfolgerungen und Antrag*
Aus den vorstehenden Erwägungen ergibt sich, dass wir sowohl die Initiative Stich als auch die Initiative Butty ablehnen. Dem Gegenvorschlag der nationalrätlichen Kommission stimmen wir grundsätzlich zu (mit den Vorbehalten in Abschn. 824 und 826 hievor), beantragen jedoch Streichung von Absatz 3 (vgl. Abschn. 827).

83 AUSFÜHRUNGSGESETZGEBUNG

831 *Vorarbeiten*
Im Anschluss an die Schaffung einer Bundeskompetenz für die Steuerharmonisierung werden Ausführungsgesetze zu erlassen sein, nämlich ein Bundesgesetz über die direkte Bundessteuer und ein Bundesgesetz über die Harmonisierung der direkten Steuern der Kantone und Gemeinden (Rahmengesetz).
Wie unter Abschnitt 825 hievor erwähnt, stehen die Vorarbeiten hiezu auf der Stufe der Expertenkommission vor dem Abschluss. Der Bundesrat wird deshalb in der Lage sein, innert verhältnismässig kurzer Zeit nach Annahme des Harmonisierungsartikels durch Volk und Stände dem Parlament Bericht und Antrag für die Schaffung der Ausführungsgesetze zu übermitteln.

832 *Neuerungen auf dem Gebiet der direkten Bundessteuer*
Der Entwurf der Koordinationskommission für ein Gesetz über die direkte Bundessteuer sieht im wesentlichen Neuerungen auf folgenden Gebieten vor:
— zeitliche Bemessung;

— Besteuerung der natürlichen Personen: Steuerliche Behandlung der Kapitalgewinne, insbesondere im Bereich des beweglichen Privatvermögens, steuerliche Behandlung der Vorsorge, Familienbesteuerung;
— Besteuerung der juristischen Personen: Tarifgestaltung;
— Quellensteuer für bestimmte Kategorien von Steuerpflichtigen (ausländische Gastarbeiter, gewisse beschränkt steuerpflichtige natürliche und juristische Personen);
— Steuerstrafrecht.

833 *Das Bundesgesetz über die Harmonisierung der direkten Steuern der Kantone und Gemeinden (Rahmengesetz)*

Der Entwurf der Koordinationskommission zum Rahmengesetz enthält weitgehend die gleichen Regelungen wie der Entwurf eines Bundesgesetzes über die direkte Bundessteuer, jedoch unter Ausschluss der Belastungselemente (Tarife, Höhe der Freibeträge und der Sozialabzüge) und der Behördenorganisation. In einzelnen Punkten sieht es Wahlmöglichkeiten für den kantonalen Gesetzgeber vor. Anderseits enthält das Rahmengesetz Bestimmungen, die im Gesetz über die direkte Bundessteuer fehlen, insbesondere über die Grundstückgewinnsteuer, die Vermögensteuer natürlicher Personen und über interkantonale Verhältnisse.

* * * IFA NEWS * * *

ACTIVITES DU GROUPEMENT FRANÇAIS DE L'IFA

Le Groupement Français de l'I.F.A. s'est réuni le 18 mai 1976 en une soirée d'études présidée par M. Max LAXAN, Président du Groupement.

Cette soirée était consacrée à l'étude des sujets du congrès qui aura lieu à Vienne en octobre 1977.

Les deux rapporteurs français à ce congrès ont donné les grandes lignes de leur rapport:

M. MEARY: « L'inflation et la Fiscalité ».

M. REIGNON: « La détermination du bénéfice imposable des sociétés de capitaux ».

Les débats ont été animés et entrecoupés par un buffet dinatoire. Près de 70 personnes y ont participé.

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AUSTRALIA

1976 AUSTRALIAN MASTER TAX GUIDE

North Ryde, CCH Australia Limited., 1976. 535 pp.
Annual guide designed to help taxpayers to prepare their income tax returns for the 1976 income year. In addition it also provides information on the highlights facing the taxpayer in the 1977 income year with reference to the law, official rulings and case law. (B 9695)

AUSTRIA

DIE EINKOMMENSTEUERRICHTLINIEN 1975

By F. Weiler. Schriftenreihe der Österreichischen Steuer- und Wirtschaftskartei, No. 36. Vienna, Industrieverlag Peter Linde, 1976. 160 pp., S. 99.—.
Annotated text of the 1975 individual income tax regulation as implemented by the federal ministry of finance for the assessment year 1975. (B 9500)

CANADA

DOMINION TAX CASES

Volume 29, 1975. Don Mills, Ont., CCH Canadian Ltd., 1975/76. 800 pp.
Bound volume containing the full text of all reported judgments on federal tax questions. Topical index is appended. (B 9503)

CHILE

PRINCIPIOS DE DERECHO TRIBUTARIO

By P. M. Parodi. Valparaíso, EDEVAL, 1975. 384 pp.
A study of the basic principles of tax law in Chile, including such topics as determination of tax liability and penalties for tax evasion. (B 15.548)

DEVELOPING COUNTRIES

LE SECTEUR DES SERVICES DANS LES PAYS EN VOIE DE DEVELOPPEMENT; UNE ANALYSE BASE SUR LES COMPTES NATIONAUX

By D. W. Blades, D. D. Johnston and W. Marczewski. Paris, O.E.C.D., 1974. 280 pp., Ffrs. 35.—.
Study on the service industries in developing countries based on published national accounts by major developing countries. (B 9507)

EASTERN EUROPE

SYSTEMY DOCHODÓW BUDZETOWYCH

By M. Weralski. Warsaw, Instytut Administracji i Zarzadzania Uniwersytetu Warszawskiego Instytut Finansów, 1975. 312 pp.
Study in the Polish language examining the taxes applied to state enterprises in seven Eastern European countries. (B 9483)

EUROPE

THE ADJUSTMENT OF PERSONAL INCOME TAX SYSTEMS FOR INFLATION

A report by the Committee on Fiscal Affairs. Paris, O.E.C.D., 1976. 71 pp., Ffrs. 15.—.
Report summarizing the likely effects of inflation on the personal income tax system with reference to adopted solutions taken by some OECD member countries (Denmark, Canada, the Netherlands, Switzerland). (B 9642)

FRANCE

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By J. Cathelineau. Paris, Librairie Générale de Droit et de Jurisprudence, 1976. 235 pp., Ffrs. 63.—.
Monograph on public finance with emphasis on development in France and in connection with French literature in this subject. (B 9512)

LAMY FISCAL

Tome I: taxes sur le chiffre d'affaires; enregistrement et timbre; taxes sur les véhicules; fiscalité immobilière. Tome II: impôts directs; taxes diverses, impôts locaux; contrôle, contentieux, pénalités. Paris, Lamy S.A., 1976. 800 + 900 pp., Ffrs. 459.—.
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ing an explanation of the French tax legislation; supplements are issued regularly in order to keep these two volumes up to date. (B 9574)

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GERMANY (FED. REP.)

BILANZFRAGEN; EINE FESTSCHRIFT FÜR ULRICH LEFFSON

Düsseldorf, IdW-Verlag, 1976. 344 pp.
Special publication entitled: balance sheet questions containing essays by various authors on the issue presented to Professor Ulrich Leffson on his 65 birthday. (B 9665)

HANDBUCH ZUR EINKOMMENSTEUERVERANLAGUNG 1975

Munich, Verlag C. H. Beck, 1976. 1040 pp., DM. 31.50.
Annual handbook containing material for filing individual income tax return 1975. (B 9715)

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By E. Pfeil. Backnang, Erwin Pfeil, 1976. 250 pp. Thesis concerning an assessment on the international tax management policy of German multinationals with emphasis on investments in South Africa and its implications to taxation. The double taxation treaty between Germany and South Africa is reckoned with in connection thereto. (B 9631)

DIE VERDECKTE GEWINNAUSSCHÜTTUNG NACH DEUTSCHEM UND SCHWEIZERISCHEM STEUERRECHT

By R-J. Prym. Bern, Verlag Paul Haupt, 1976. 250 pp.
Thesis on disguised profit distribution according to German and to Swiss tax law. (B 9704)

HUNGARY

THE SOCIALIST STATE ENTERPRISE

By L. Ficzere. Budapest, Akadémiai Kiadó, 1974. 160 pp.
The legal status of the socialist state enterprise and the legal order of enterprise management within the scope of the reform of economic management involve a number of questions, which are discussed in this book. A chapter on regulation of income and taxation is included. (B 9573)

INDONESIA

A GUIDE TO THE INDONESIAN TAXATION

A popular information for foreigners on the tax system of Indonesia. By S. Hadikusumo and S. Budiadji. Jakarta, Berita Pajak, 1975. 71 pp.
An outline of Indonesian taxes and tax administration system described. (B 50.306)

INTERNATIONAL

CONVENTIONS FISCALES ENTRE PAYS DEVELOPPES ET PAYS EN VOIE DE DEVELOPPEMENT

Cinquième rapport. New York, United Nations, 1975. 240 pp.
French version of the fifth report on double taxation treaties between developed and developing countries prepared by the ECOSOC (UN). (B 9577)

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The additional agreements contained in this volume signed on resp. October 28, 1950, March 9, 1971, March 10, 1971. (B 9694)

TAXING THE BRAIN DRAIN: A PROPOSAL

Edited by J. N. Bhagwati and M. Partington. Amsterdam, North-Holland Publishing Company, 1976. 222 pp., Dfl. 45.—.
The present volume describes the proposal to tax the brain drain for purposes of lay reader audience. A companion second volume entitled "The Brain Drain and Taxation: Theory and Empirical Analysis" is addressed principally to economists. The professional immigrants from developing countries working in developed countries would be taxed and collected in the developed countries on their income and the revenues so collected would be transmitted to the developing countries for developmental spending. Other than the Soviet Union imposition of a tax on emigrants scaling it up by the level of educational attainment is levied at the point of departure. The brain drain tax is, by contrast, related to the income actually accruing to the professional emigrant, after the act of emigration out of the developing countries. (B 9629)

MIDDLE EAST

MAJOR COMPANIES OF THE ARAB WORLD & IRAN

Editorial Manager Giselle Bricault. London, Graham & Trotman Limited, 1975. 535 pp.
Databank of information on Arab and Iranian firms. The countries contained are as follows: Algeria, Bahrain, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somali, Sudan, Syria, Tunisia, United Arab Emirates, Yemen (Arab Republic), Yemen (People's Democratic Republic). (B 50.363)

THE NETHERLANDS

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By F. C. Wijle. Deventer/Alphen a. d. Rijn, Kluwer/Samsom, 1976. 65 pp.
Printed results of a set up inquiry concerning personal income taxation in the Netherlands entitled "Citizen versus Taxation". Appended as a separate supplement is a brochure containing inquiry forms and introductory note entitled "Ver-Antwoord-Ing" (Res-Ponsibili-Ty). (B 9673)

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SINGAPORE

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Incorporating all 1972, 1973 and 1974 amendments. Second edition. By Brij S. Soin. North Ryde, CCH Australia Limited, 1974. 489 pp.
Revised and extended second edition of guide designed primarily to help taxpayers in preparing their income tax returns. In addition it is a textbook explaining the rules affecting every day personal and business income tax based on statutes, rules and case law as of the end of 1974. (B 50.404)

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Current text of the Internal Revenue Code, reflecting changes through the end of 1975, with notes on the history of each code section. The non-income tax provisions of the code are not included in this printing. Topical index is provided. (B 9505)

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  II releases 138, 139

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CUMULATIVE INDEX 1976
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F. AKIN OLALOKU *:

FISCAL POLICY OPTIONS FOR EMPLOYMENT PROMOTION IN NIGERIA'S MODERN MANUFACTURING SECTOR

I. INTRODUCTION

One of the most perplexing economic problems of recent years in most of the developing countries, is the persistently rising rates of unemployment, despite what by all standards, appears to be very impressive growth rates in the level of output, in the atmosphere of vigorous and rapid industrialization that has characterised the economies of these countries in the recent past.

The perplexity of the problem of high rates of unemployment derives from the fact that it is highly concentrated in the urban areas, which, ironically, are also the centres of the rapidly growing manufacturing industries — the modern sector that is supposed to provide the employment opportunities for the rapidly expanding labour force resulting partly from natural increases in the population, but more significantly from the rural-to-urban population drift.

The failure of modern manufacturing industries in the urban centres of developing countries to adequately provide employment opportunities for the rapidly expanding labour force, is due not only to the relatively small but rapidly growing urban industrial base, but also to the nature of technology in modern manufacturing as well as the tendency, given the relatively high capital bias, for labour productivity to rise much faster in the modern manufacturing sector. Consequently, employment tends to grow at a much slower rate than out-put in this sector. This phenomenon is what some writers have referred to as the low elasticity of industrial employment with respect to output.[1] In other words, while modern manufacturing industries in developing countries have been generating employment opportunities, these are far from meeting the needs of a fast growing labour supply from the country side. In the words of a recent writer,

> .... modern industry, even if it grows at an extremely rapid rate, cannot absorb more than a small fraction of the natural increment in the labour force for decades ahead. In the initial stages of industrialization, it may even be difficult to keep the absolute size of the labour force engaged in all types of manufacturing from falling, only at a much later stage can modern industry begin to increase its claim on the labour force.[2]

This observation which was made with particular reference to the developing countries of South East Asia is of great relevance to the current situation in Nigeria where another recent observer concluded that

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* Department of Economics, University of Lagos. This paper is based on an earlier version originally presented to the Conference on Economic Development and Employment Generation in Nigeria jointly sponsored by the Nigerian Institute of Social and Economic Research, University of Ibadan and the Human Resources Research Unit, University of Lagos which was held in Ibadan from 2nd to 7th November 1975. Helpful comments and suggestions by participants at the Conference are gratefully acknowledged.

1. See for example, Werner Baer and Michel E. A. Herve, "Employment and Industrialization in Developing Economies", *Quarterly Journal of Economics*, Vol. 80, No. 1 (February 1966), pp. 88-107.
2. Gunnar Myrdal, *Asian Drama: An Inquiry into the Poverty of Nations*, Vol. II (New York: Pantheon, 1968), pp. 1202-1203.

modern sector employment cannot "... be expected to fully absorb the current growth of the urban labour force ... an attempt to reduce unemployment by stimulating the growth of employment opportunities is not likely to meet with much success".[3]

Although the foregoing remarks paint a rather gloomy picture of their employment generating potential, manufacturing industries have a great role to play in the attempts to reduce the high rate of unemployment in developing countries, if the correct fiscal policies are pursued to stimulate their expansion. This paper will argue that the relatively low growth rate of employment generated in the modern manufacturing industrial sector of the Nigerian economy was due in part to the kind of inappropriate fiscal policies used to promote industrial development.

II. BACKGROUND TO THE PROBLEM

Quite a large body of the recent literature on the subject of the problem of unemployment in developing countries has been devoted to an explanation of the relatively small labour — absorptive capacity of modern manufacturing industries as one of the reasons for the existing high rates of unemployment especially in the urban areas.[4] We shall abstract from a further consideration of this aspect of the problem in this paper. We here start by taking as given, the chronic unemployment situation that has arisen in these countries and concentrate on how policy makers, in the narrower context of the Nigerian economy, have aggravated the problem by their policy of vigorous industrialization largely through the granting of a wide variety of fiscal incentives which have led to the encouragement of what can now be regarded as a relatively highly capital-intensive manufacturing sector largely concentrated in selected urban centres.

The vigour with which the industrialization policy has been pursued in Nigeria is attested to by the fact that since the early 'sixties', manufacturing has been one of the fastest growing sectors of the economy, second only to the petroleum sector. In this period, manufacturing experienced an average expansion rate of 11.0 per cent per annum while an annual average growth rate of 18.0 per cent has been projected for the 1975-80 Plan period.[5] This growth rate compares with an annual average of about 6.0 per cent for the economy as a whole in the same period. With respect to its relative importance in the national economy, manufacturing increased from 5.8 per cent of the GDP in 1962 to 7.4 per cent in 1967.[6] In 1970, its share of contribution to the G.D.P. at 7.6 per cent was only slightly higher than in the former year,[7] while the estimate for 1975 puts it at a somewhat

3. Charles R. Frank Jr., "Industrialization and Employment Generation in Nigeria", *The Nigerian Journal of Economic and Social Studies*, Vol. 9, No. 3 (November 1967), p. 289.

4. See for example, Michael Todaro, "An Analysis of Industrialization, Employment and Unemployment in Less Developed Countries", *Yale Economic Essays*, Vol. 8, No. 2 (Fall 1968), pp. 329-402 and Gustav Ranis, "Industrial Sector Labour Absorption," *Economic Development and Cultural Change*, Vol. 21, No. 3 (April 1973), pp. 387-408.

5. Federal Republic of Nigeria, *Third National Development Plan, 1975-80*, (Lagos: Central Planning Office, Federal Ministry of Economic Development 1975), p. 49.

6. Federal Republic of Nigeria, *Second National Development Plan, 1970-74*, (Lagos: Federal Ministry of Economic Development, 1970), p. 51.

7. Federal Republic of Nigeria, *Second National Development Plan: Second Progress Report*, (Lagos: Central Planning Office, Federal Ministry of Economic Development, 1974), p. 6.

lower figure of 4.9 per cent — a reflection of the increased dominant role of petroleum.[8]

Despite the decade or so of rapid industrial growth in this country described briefly above, the modern industrial manufacturing sector is, as at present only able to provide employment to less than 5.0 percent of total gainful employment in the economy.[9] This shows that policy makers, in their pursuit of the policy of industrialization, aimed at the maximization of output as well as self sufficiency in goods originally imported (import substitution), completely ignored the serious unemployment consequences of such a policy which inevitably emerged. Although the capital-labour ratio is fairly low in the somewhat small-scale industries, in most of the newer, large-scale and more productive industries established in the last couple of years, the capital-labour ratio is relatively high, with the result that they offer very limited potential for absorbing unemployment. Thus, for most of the last decade or so, policy makers have given priority to the objective of increasing the level of output rather than that of employment.[10] The relatively high capital bias which is presently characteristic of modern manufacturing industries in this country and their corresponding low labour-absorptive capacity is partly the direct result of the encouragement given to capital investment in manufacturing by the use of various incentive measures, particularly fiscal measures which will be the main focus of attention in this paper.

In Section III below, we shall undertake a discussion of the country's existing fiscal policy measures for the encouragement of manufacturing industries and their pervasive effect on employment promotion. This will be followed in Section IV by an examination of alternative fiscal policy measures which could be used to encourage a greater rate of labour utilization and thus employment promotion. Finally, in Section V, we try to summarise and draw implications from the conclusions emerging from the earlier discussions in the paper.

III. A REVIEW OF THE EXISTING SYSTEM OF FISCAL INCENTIVES IN RELATION TO EMPLOYMENT GENERATION

One of the major ways by which policy makers can influence resource used (the allocation of factors of production) in order to fulfill certain policy objectives is through the adaptation of the fiscal system. For example, taxes can be used as an incentive or penalty device to encourage or discourage the use of either labour or capital. It is also possible to influence the allocation of these resources through government expenditure either in the form of subsidy payments or direct spending on selected areas of public activity. Essentially, the theoretical basis underlying such policy actions is that, given some degree of substitutability between factors of production, particularly labour and capital, and given the fact that private decisions to employ these factors in varying amounts depend on profitability, policy makers have considerable lee way in influencing their use one way or the other in the private sector simply by altering their price ratios either through tax changes or subsidy payments.

8. *Third National Development Plan, 1975-80, op. cit.*, p. 22.
9. *Ibid.*, p. 380.
10. Although this situation was clearly recognised as early as about the mid-'sixties, no positive action has, as of now been taken to correct it. Cf. Federal Republic of Nigeria, *National Development Plan: Progress Report, 1964,* (Lagos: Federal Ministry of Economic Development, 1964), pp. 12-13.

In the last ten to fifteen years, policy makers in Nigeria, under the influence of the common belief that industrialization is the solution to all the problems of under-development have adopted the policy of encouraging foreign capital investment in manufacturing industries through various forms of the tax variety of the fiscal devices discussed above.[11] The existing ones in use are operated within the framework of the following special enabling legislations:—

(1) Aid to Pioneer Industries Ordinance of 1952 later replaced by the Industrial Development (Income Tax Relief) Act of 1958,
(2) The Industrial Development (Import Duties Relief) Act of 1957,
(3) The Customs Duties (Dumped and Subsidised Goods) Act of 1958 and
(4) The Customs (Draw Back) Regulations of 1958.

The titles of these enabling legislations, describe briefly the nature of the existing system of fiscal incentives. Aid to pioneer industries in the form of income tax relief consists of tax exemption for periods of two to five years granted to industries of pioneer status.[12] This relief, otherwise known as a tax holiday, is about the earliest and the most significant of all the fiscal incentives granted to encourage investment in manufacturing industries. It is granted in relation to the amount of capital expenditure undertaken by a firm with N10,000 being the minimum below which a firm does not qualify. One secondary incentive embodied in this scheme is the encouragement given to equity investment in industries of pioneer status through the exemption of tax on dividends received by shareholders of such industries.

A related incentive somewhat similar to income tax relief, is the small companies relief which, like the former grants relief in the form of exemption from the company income tax, but it applies only to private, non-pioneer and relatively small companies whose incomes do not exceed N2,000 a year.[13] This relief which may be granted for the first six years of a company's operations gradually declines over the period: there is full exemption during the first two years, thereafter the relief is scaled down to two-thirds in the next two years and further to one-third in the last two years. Once a company's income in any one year during the period of relief, exceeds the prescribed figure of N2,000, relief takes the form of a reduction in taxable income rather than in the *rate* of taxable income. In this case, the amount of tax-free income is computed by subtracting half the excess from the prescribed income of N2,000.[14]

Finally, one more important relief that is closely related to the foregoing, in that they

11. This conforms to the general practice in most other developing countries to rely exclusively on tax rather than subsidies or expenditure incentives for encouraging manufacturing industries.

12. For a detailed analysis and a well reasoned appraisal of this scheme, see A. O. Phillips, "Nigeria's Experience with Income Tax Exemption—A Preliminary Assessment," *The Nigerian Journal of Economic and Social Studies*, Vol. 10, No. 1 (March 1968), pp. 33-62.

13. This incentive is essentially designed to help indigenous companies because most of them are in this category.

14. Suppose a particular company's income is N4,000 in any one year, then its tax-free-income is equal to N1,000, i.e. [(4,000—½ (4,000—2,000)]. This leaves the company with a taxable income of N3,000 to which the normal rate of tax is applicable. Cf. A. O. Phillips, "Nigerian Industrial Tax Incentives: Import Duty Relief and Approved User Scheme", *The Nigerian Journal of Economic and Social Studies*, Vol. 9, No. 3 (November 1967), pp. 315-327.

all impinge on the company income tax, is accelerated depreciation. This is in the form of initial and annual allowances on the costs of assets such as industrial buildings, plant and machinery to which all companies are entitled under on the Income Tax Law.[15] These allowances which vary with the type of asset, enable a firm to write off its assets in a much shorter period than otherwise. Following a period of generously high allowances in the earlier years of the scheme, at which time rates as high as 73 per cent were enjoyed by companies, considerable scaling down of rates was effected in December 1966.[16] Rates of initial allowances now range from 20 per cent on mining equipment to 15 per cent on plant and machinery and 10 per cent on buildings. Rates of annual allowances are somewhat lower, ranging from 2 per cent on ordinary buildings to 10 per cent on plant and machinery.

Import duty relief is another major tax incentive that has been used to stimulate manufacturing activities. It operates through the granting of concessionary rates of duty on industrial raw materials imported into the country. The relief granted in this case, unlike the income tax relief, is not in the form of import duty exemption, but a refund of duty already paid. A firm, to enjoy this relief must be able to show that (i) the cost-increasing effect of high rates of duty will render its product uncompetitive with imported equivalents and (ii) the import duty on imported finished equivalents is lower than the duty which the imported raw materials carry. A rather undesirable aspect of the scheme which has been the subject of serious criticisms by analysts[17] is the opportunity cost factor in terms of money and time involved in the long administrative procedures for processing applications in respect of refunds of duty already paid. An opportunity cost element is also involved in importers' funds which are tied up for periods ranging from six months to a year. The Approved User Scheme which is a modification of the import duty relief was introduced to overcome the defect already noted in the case of the latter. Essentially, it is a scheme whereby manufacturers pay straigh-forward concessionary low rates of duty and in some cases no duty at all on imported inputs. Thus, the problem of having to go through the cumbersome administrative process of getting back refunds of duties already paid and the cost incurred in the unnecessary tying up of working capital is avoided by manufacturers.[18]

Two other closely related incentives that involve the use of import duties to encourage manufacturing industries are those relating to customs duties on dumped and subsidised goods on the one hand and customs duties on imported inputs on the other. With respect to the former special rates of duty are imposed on goods that are dumped in Nigeria or subsidised by an authority outside the country. This is a device to enable home industries to compete favourably. In the case of the latter, repayment of import duties is allowed either in cases where goods are exported in the same condition as they are imported

15. Pioneer companies which normally enjoy income tax relief are not entitled to capital allowances during their tax holidays. However, they may take up the allowances at the end of the period.

16. Cf. P. C. Asiodu, "Industrial Policy and Incentives in Nigeria," *The Nigerian Journal of Economic and Social Studies*, Vol. 9, No. 2 (July 1967), pp. 166-173.

17. See for example, A. O. Phillips, "Nigerian Industrial Tax Incentives", op. cit., p. 319.

18. The Approved User Scheme was abolished in the 1972/73 Federal Government Budget.

or where imported materials are used for the manufacture of exports.

These tax incentives have no doubt had a considerable impact on the growth of manufacturing industries as they exist at present. In fact the establishment of many manufacturing enterprises is not unconnected with attempts on their part to take advantage of the tax holiday enjoyed by companies with pioneer status. For example, it was estimated that since the adoption of the income tax relief (tax holiday) scheme in 1958 until about the mid-sixties, about 140 companies in some 60 odd industries had benefited.[19] Private investments in these companies also increased correspondingly. According to the available estimates investments in new manufacturing companies increased rather phenomenally. For instance, they rose from the relatively low level of a bare N44,000 in 1958 to an average of N10.6 million per annum thereafter until about the mid sixties.[20] Private investments in other manufacturing companies with non-pioneer status must have also received a considerable boost by the granting of relatively generous initial and annual allowances which in the words of a commentator represented concessions which "... were important factors in stimulating the large amounts of private investment attracted during the past decade".[21]

The foregoing positive effects notwithstanding, many analysts have questioned seriously the validity of their resulting directly from fiscal incentives. They have, on the other hand, thought that the relatively rapid rate of industrial growth that has taken place in the developing countries in general and in Nigeria in particular, would have occurred anyway in the absence of such incentives,[22] given the relatively large size of the domestic market which in the case of Nigeria for example, has been described as the greatest and most important of all incentives.[23] If one agrees with this kind of reasoning, the claim that tax incentives for industrial development in these countries have not only been very costly in terms of revenue lost to the various governments, but also that they have led to a considerable distortion in resource allocation because of their inherent bias to favour capital-intensive operations seems to be fully justified.[24] The second cost of tax incentives mentioned above, i.e. resource misallocation in favour of capital-intensive production, which is more relevant from the point of view of this paper, is a result of the non-selectivity of their application in relation to their contribution to the economy. For instance, tax incentive laws as can be seen from our review of their operations above, do not specify targets with particular objectives like the

19. P. C. Asiodu, *op. cit.*, p. 163.
20. Figures are calculated from A. O. Phillips, "Nigeria's Experience with Income Tax Exemption", *op. cit.*, Table 9 in the Appendix, p. 55.
21. P. C. Asiodu, *op. cit.*, p. 166.
22. A. O. Phillips, "Nigeria's Experience with Income Tax Exemption", *op. cit.*, p. 47. See also *Second National Development Plan, 1970-74, op. cit.*, p. 285.
23. P. C. Asiodu, *op. cit.*, p. 167 and A. O. Phillips, *Ibid.*, p. 45.
24. A. O. Phillips, "Nigeria's Experience with Income Tax Exemption", *op. cit.*, p. 43-44. See also United Nations, "The Role of Fiscal Incentives for Employment Promotion in the Manufacturing Industries in Central America and Selected Countries in the Caribbean", in ILO, *Fiscal Measures for Employment Promotion in Developing Countries*, (Geneva: International Labour Office, 1972), pp. 183-211. Looking at it from the point of view of costs and benefits, these inherent shortcomings of tax incentives are decisive disadvantages which are not compensated for at all if, as was already suggested, industrial development would have taken place in their absence.

creation of employment in mind. In other words, these tax incentives are not directly and specifically linked to employment creation.[25] It is not surprising therefore to notice that their contribution to employment generation, at least in the case of the Nigerian economy has been rather insignificant.[26] This, from the point of view of the subject matter of this paper is about the most serious weakness of the various existing tax concessions being granted for the development of manufacturing industries. It is precisely this weakness which makes them inappropriate for use as weapons of industrial policy in a situation of labour surplus which is characteristic of most developing countries. Given this strong weakness, a reformulation of the whole system of fiscal incentives in a way favourable to employment creation becomes of utmost importance.

IV. ALTERNATIVE FISCAL MEASURES TO PROMOTE EMPLOYMENT

From the review of the existing system of fiscal incentives in the country which was undertaken in the last section, it is quite evident that if the manufacturing sector of the economy is to be expanded in a way to provide employment opportunities for absorbing the large number of unemployed in the economy, the existing system of fiscal incentives should be modified and new ones introduced in order to make the resulting system more relevant to the country's employment situation. In this connection the direction of policy should be towards fiscal measures which will encourage a greater utilization of labour. Put somewhat differently, policy makers should strife to encourage a complete shift from the existing highly capital-intensive technologies to more labour-intensive methods of production in the manufacturing sector. In what follows, we shall consider some of the fiscal policy measures that can be used to achieve this.

One way by which the existing tax incentives can be modified is to link them up specifically with employment targets. For example, in the case of the income tax relief, the period of the tax holiday can be related to the volume of employment or the degree of labour-intensity in the relevant business benefiting from the relief, rather than to the volume of investment as at present. Also, the high rates of depreciation or investment allowances which are at the moment granted indiscriminately should be tied to the volume of employment generated by the investment. Similarly, concessionary rates granted for the importation of machinery and industrial raw materials could be related in a way to the volume of employment. The scope for success in promoting employment through such modifications of the existing system is rather wide in view of the limited effectiveness of tax concessions as an inducement to investment. In other words, modifying existing incentive laws to make them more relevant to employment promotion will not necessarily impair capital investment.[27]

25. Although it has been suggested that a company which applies to set up as a pioneer company with a relatively small planned volume of investment, output and employment may not have its application approved. There is however no hard and fast rule about reaching a decision on the basis of these criteria. Cf. "Nigeria's Experience, etc., *op. cit.,* p. 37.

26. *Ibid.,* p. 43.

27. George, E. Lent, "Tax Incentives for the Promotion of Industrial Employment in Developing Countries", in ILO, *Fiscal Measures for Employment Promotion in Developing Countries, op. cit.,* p. 156; also in IMF *Staff Papers,* Vol. 18, No. 2 (July 1971), p. 409.

In addition to modifying the existing fiscal incentives, there are a few other fiscal measures, which are not in use at present, but which, if introduced would help employment promotion in manufacturing industries considerably. One possibility in this connection is the introduction of a labour subsidy. Since the cost of labour is such an important element in the total cost of production, anything done to lower this cost, like a subsidy for example, is likely to increase the rate of labour utilization. This is of particular relevance in the case of a developing economy like ours, where the problem of the high cost of labour is the result of trying to maintain artificially high wage rates and make certain obligatory payments for labour employed in conformity to minimum wage and social security legislations. These additional costs clearly put the use of labour at a great disadvantage vis-à-vis the use of capital. A subsidy to labour by cheapening its cost is therefore likely to remove this disadvantage as well as produce the effect of encouraging labour-intensive methods. Such a subsidy to labour would take the form of direct payments to the enterprises concerned relating such payments to the size of the wage bill and the volume of employment.

Quite a number of objections have been raised against the use of a labour subsidy to boost employment. One such objection is the high cost of the scheme to the government in the form of the subsidy itself plus the cost of administering it.[28] While the argument in support of this objection is very strong for those developing countries operating under big budget constraints it is rather weak in the case of a country like Nigeria where rapidly growing revenue from oil has eased the tight budget constraint very considerably.

Other objections to a labour subsidy are those connected with the most common problems of developing economies which would make the application of the scheme difficult. For example, it is thought that the administrative difficulties of trying to keep track of the volume of employment in the numerous small enterprises would be formidable.[29] But such difficulties could be avoided by limiting the scheme to large and well established enterprises. Another objection is that a subsidy to labour by increasing the rate of labour utilization may push up wage rates in the industries concerned and this is likely to induce further the rural-to-urban migration of labour and thus aggravate the problem of open unemployment in the urban areas. But as some observers have pointed out, this is very unlikely to happen given the relatively high elasticity of supply for labour made possible by the large pool of unemployed already existing in the urban area.[30]

The foregoing objections to the introduction of a labour subsidy are all indicative of the fact that there are bound to be problems in implementing such a scheme, but these could be minimized given the possibilities already enumerated.

The probable limited effectiveness of a labour subsidy would seem to suggest that policy makers should combine it with other measures in order to achieve more positive results. One such measure that may be worth trying and which has been suggested

28. Alan Peacock and G. K. Shaw, "Fiscal Measures to Create Employment: The Indonesian Case", *Bulletin for International Fiscal Documentation*, Vol. 27, No. 11 (November 1973), pp. 443-453.

29. A. R. Prest, "The Role of Labour Taxes and subsidies in Promoting Employment in Developing Countries", in ILO, *Fiscal Measures for Employment Promotion in Developing Countries*, *op. cit.*, pp. 163-181.

30. *Ibid.*, p. 176-177.

in the literature is a discriminatory tax against the output of capital intensive industries.[31] Such a measure, by shifting expenditures from capital-intensive to labour-intensive goods, it is argued, would discourage activities in the former and increase it in the latter.[32] But it must be emphasised that the success of such a measure would very much depend on the degree of selectivity of the capital-intensive industries whose output should be taxed. For example, if a discriminatory tax is imposed on a capital-intensive good whose price elasticity of demand is very low, one may end up with reducing expenditures on labour-intensive goods — the exact opposite of the result which is desired.[33]

A closely related measure that is also worth considering is a discriminatory tax against imported labour-intensive goods in the form of heavy import duties. This would produce two desirable effects favouring employment creation: it would discourage competition against labour-intensive goods produced domestically and it may at the same time encourage the climbing of high tariff walls by foreign enterprises to set up in the country.

The problem of urban unemployment in developing countries is two-faceted — the demand side on the one hand and the supply side on the other. The measures we have discussed so far are aimed at a solution on the demand side. But as was remarked earlier on in this paper, no matter how positive the results of the measures taken to increase the demand for labour in manufacturing industries are, there is a limit to the labour-absorptive capacity of these industries. Thus, supplementary measures would need to be taken in order to limit the supply of labour to manufacturing industries at source, i.e. in the rural areas. In this connection, policy measures should aim at weakening the "pull" of labour from the urban areas and the "push" of it from the rural areas. Among such fiscal measures that have been suggested to achieve this are:—

(i) increased government expenditure on infrastructural facilities to raise the standard of living in the rural areas,
(ii) improvement in the lot of the farmers by increasing their incomes through such measures as the adoption of higher producer prices for their products and the abolition of export taxes on primary products.[34]

V. SUMMARY AND CONCLUSION

In this paper, attempt has been made to show clearly that fiscal policy measures, if appropriately used, have a great role to play in increasing the labour-absorptive capacity in the manufacturing industries in this country with a view to reducing the high rate of urban unemployment. It has also been shown that the way in which existing fiscal incentives have been used in the past for the expansion of manufacturing industries has produced a pervasive effect on employment generation. This conclusion would seem to suggest that, given the elimination of unemployment as an overriding objective of policy alternative fiscal measures should be taken to reverse this trend. Accordingly, suggestions have been made for a modification of existing fiscal

31. Alan Peacock and G. K. Shaw, *op. cit.*, p. 449.
32. This type of measure is actually in force in Indonesia, Cf. *Ibid.*
33. *Ibid.*, p. 449.
34. It is gratifying to note that these measures were announced in the 1973/74 and 1974/75 Federal Government Budgets.

incentives in a manner to make them more oriented towards employment promotion. In addition, policy makers have been urged to consider seriously the introduction of new fiscal measures geared to employment creation. Two measures in particular have been suggested. These include a subsidy to labour and the imposition of discriminatory taxes in favour of domestically produced labour-intensive goods and against the importation of labour-intensive goods.

Finally, given the fact that there is a limit to the labour-absorptive capacity of manufacturing industries, it should also be the objective of policy to limit the supply of labour to them.

★ ★ ★

DR. GERT SASS*:

AUSTAUSCH VON AUSKÜNFTEN AUF INTERNATIONAL-STEUERLICHEM GEBIET

I. *Was ist unter „Steuerflucht" zu verstehen?*

Es handelt sich um einen sehr umfassenden Komplex, der nicht nur die strafrechtlich zu ahnende Steuerhinterziehung (Steuerbetrug) einbezieht, sondern bis zu Fällen der Steuerumgehung reicht, also die nicht notwendigerweise unter Strafe gestellte, wohl aber gemeinhin ein Missbrauchselement enthaltende Steuerersparnis. In der Praxis werden als hierunter fallend angesehen Fälle der Einschaltung sogenannter „Basisgesellschaften" in „Niedrigsteuerländern", aber auch bestimmte Formen des sogenannten „transfer pricing" im Rahmen von Geschäftsbeziehungen zwischen verbundenen Unternehmen.

II. *Warum greift die EG-Kommission diese Thematik auf, die eher die Mitgliedstaaten anzugehen scheint als die Gemeinschaft?*

Diese Problematik beschäftigt die Gemeinschaft bereits seit den frühen 60er Jahren. Politisch hat sich die Kommission in ihrem Bericht über die Steuerregelungen für Holdinggesellschaften vom 18. Juni 1973 (KOM(73)1008 endg.) wie auch in ihrem Vorschlag einer Entschliessung des Rates über multinationale Gesellschaften vom 8. November 1973 (ABl. Nr. C 114 vom 27.12.1973 S. 28) dazu geäussert. Auch im Steuerpolitischen Aktionsprogramm vom 30. Juli 1975 sind Massnahmen in diesem Bereich vorgesehen.

Unter den Aspekten des Gemeinsamen Marktes geht es um die Eindämmung faktischer Verzerrungen auf steuerlichem Gebiet. Nachdem die Kommission eine Reihe von materialrechtlichen Harmonisierungsvorschlägen auf dem Gebiet der direkten Steuern gemacht hat (Vorschlag einer Richtlinie für Mutter-Tochtergesellschaften vom 16.1.1969, ABl. C 38 vom 22.3.69 S. 7, und für Fusionen vom 16.1.1969, ABl. Nr. C 39 vom 22.3.69 S. 1, steuerliche Bestimmungen im Statut für eine europäische Aktiengesellschaft — Vorschlag einer Verordnung des Rates vom 30.6.1970, ABl. Nr. C 124 vom 10.10.1970, geänderter Vorschlag vom 30.4.1975, Beilage des EWG-Bulletins Nr. 4/75, Vorschlag einer Verordnung des Rates vom 17.9.1971 zur Gründung von gemeinsamen Unternehmen im Geltungsbereich des EWG-Vertrages, ABl. Nr. C 107 vom 25.10.71, S. 15, Vorschlag einer Verordnung des Rates über die Europäische Kooperationsvereinigung (EKV) vom 21.12.1973, ABl. Nr. C 14 vom 15.2.74, S. 30 und im Sommer letzten Jahres der Richtlinienvorschlag zur Harmonisierung der Körperschaftsteuersysteme und der Regelungen der Quellensteuer auf Dividenden, ABl. Nr. C 253 vom 5.11.1975, S. 2), glaubt sie, die Problematik der faktischen Steuerverzerrung nicht ausser acht lassen zu können. Sie kommt damit der Entschliessung des Rates vom 10.2.1975 über Massnahmen der Gemeinschaft zur Bekämpfung der internationalen Steuerflucht und Steuerumgehung, ABl. Nr. C 35 vom 14.2.1975, S. 1, entgegen.

III. *Wie kann der Problemkomplex in seinen Einzelaspekten von der Gemeinschaft aufgegriffen werden?*

1) Es bieten sich "grössere Lösungen" des

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Typs der US-Gesetzgebung unter Kennedy aus dem Jahre 1962 („Subpart F") oder des deutschen Aussensteuergesetzes von 1972 an, die das nichtausgeschüttete Einkommen der „Basisgesellschaften" dem dahinterstehenden Inländer steuerlich zurechnen.

Es liegt auf der Hand, dass so komplizierte Gesetze in der Gemeinschaft auf erhebliche Schwierigkeiten bei der Anwendung in der Praxis stossen würden, so dass mit einer „grossen Lösung" auf absehbare Zeit nicht zu rechnen sein dürfte. In der Diskussion sind begrenzte Teillösungen, wie sie in Belgien und Frankreich bestehen (Beweislastumkehr über Grund und Angemessenheit bei Zahlungen in „Niedrigsteuerländer" sowie Quellensteuern in solchen Fällen). Auch über solche Massnahmen lassen sich jedoch keine konkreten Vorhersagen treffen.

2) Zum „transfer pricing" geht es zunächst einmal für die hauptsächlichen Fälle der Transaktionen über unkörperliche Gegenstände (Lizenzgebühren, Dienstleistungen, Konzernregiekosten usw.) sowie des Ölsektors um ein besseres „fact finding", wozu ein ständiger Erfahrungsaustausch vorgesehen ist (vergleiche Artikel 10 des unten erwähnten Richtlinienvorschlags vom 5. April 1976).

3) Hauptansatzpunkt für den Gesamtkomplex der Steuerflucht kann daher zunächst nur eine Verstärkung der Zusammenarbeit zwischen den Steuerverwaltungen sein, die in der erwähnten Entschliessung des Rates als Gemeinschaftsaufgabe anerkannt ist. Die Einzelpunkte der Entschliessung, mit der sich der nachfolgende Richtlinienentwurf inhaltlich im wesentlichen deckt, sollen zur Vermeidung von Wiederholungen erst im Zusammenhang mit der Richtlinie erörtert werden. Hier ist hervorzuheben nur, dass die Entschliessung auch eine Harmonisierung der internen Kontrollmöglichkeiten der Steuerverwaltungen anspricht — Untersuchungen, die sich naturgemäss über einen längeren Zeitraum hinziehen werden.

IV. *Inhalt des Vorschlags einer Richtlinie des Rates vom 5. April 1976 über die gegenseitige Amtshilfe zwischen den zuständigen Behörden der Mitgliedstaaten im Bereich der direkten Steuern*

1) Der Richtlinienentwurf sieht den Austausch von Auskünften zwischen den Steuerverwaltungen vor, die zur zutreffenden Steuerfestsetzung geeignet sind. Er geht damit zwar über die bestehenden Doppelbesteuerungsabkommen, die im allgemeinen nur den Auskunftsaustausch zu ihrer *Anwendung* vorsehen, hinaus, aber auch die Arbeiten zur Neufassung des Artikels 26 des OECD-Musterabkommens gehen in die gleiche Richtung.

2) Der Auskunftsaustausch bezieht sich im wesentlichen auf die gleichen Steuern, die auch bereits Gegenstand der Doppelbesteuerungsabkommen sind.

3) Für den Auskunftsaustausch sind mehrere Methoden vorgesehen, die ebenfalls für den künftigen Auskunftsaustausch nach Artikel 26 des OECD-Musterabkommens in Betracht gezogen werden.

a) Schon die herkömmlichen Doppelbesteuerungsabkommen sehen den Auskunftsaustausch *auf Ersuchen* vor. Er kann verweigert werden, wenn der ersuchende Staat nicht seine eigenen üblichen Aufklärungsmöglichkeiten ausgeschöpft hat. Hat die Steuerverwaltung die verlangten Auskünfte für ihre eigenen steuerlichen Zwecke nicht präsent, so wird von ihr erwartet, dass sie — im Rahmen ihrer Gesetzgebung und ihrer Verwaltungspraxis — die erforderlichen Ermittlungen anstellt — eine logische Konsequenz, wenn man dem Grunde nach den Auskunftsaustausch bejaht. Daneben sind zwei Formen des Auskunftsaustausches ohne Ersuchen vorgesehen:

b) Der automatische Auskunftsaustausch bezieht sich auf eine bestimmte Gruppe von Einzelfällen, deren Konkretisierung später den Bedürfnissen der Praxis überlassen bleibt.

c) Die spontane Auskunftsübermittlung bezieht sich auf ganz bestimmte, besonders krasse Einzelfälle, von denen einige typisierend hervorgehoben sind:

— bei einer naheliegenden Steuerverkürzung, d.h. wenn ein Staat Tatsachen aufdeckt, die es nahelegen, dass in einem anderen Staat die Steuer zu gering festgesetzt wird, auch ohne dass der entdeckende Staat — was ihm häufig unmöglich sein wird — Anhaltspunkte für eine Betrugsabsicht hat;
— der Steuerpflichtige macht in einem Staat einen Sachverhalt geltend, der zur Steuerbefreiung oder -ermässigung führt, während er in einem anderen Staat das Gegenteil behauptet;
— Geschäftsbeziehungen zwischen zwei Personen werden über ein Drittland, meist ein „Niedrigsteuerland", geleitet;
— bei anomalem „transfer pricing", das, — angesichts des normalerweise zu geringen Steuergefälles in der Gemeinschaft — um steuerliche Motive zu rechtfertigen, per *Saldo* (also unter Berücksichtigung der Steuern in beiden Staaten) zu einer Steuerersparnis führt;
— die Auswertung erhaltener Auskünfte führt zur Aufdeckung weiterer Tatsachen, die wiederum den anderen Staat interessieren können, der die ersten Auskünfte gegeben hat.

Dieser Katalog kann zwischen den Mitgliedstaaten ergänzt werden.

Darüber hinaus ist jeder Staat gehalten, Auskünfte auch in weiteren einschlägigen Einzelfällen zu geben.

4) Die Entsendung von Steuerbeamten zwischen den Mitgliedstaaten ist nur fakultativ, nicht obligatorisch, vorgesehen; es sollen zunächst versuchsweise zwischen einigen interessierten Staaten Erfahrungen auf diesem Gebiet gesammelt werden, um dem einschlägigen Prüfungsauftrag des Rates in der Entschliessung zu entsprechen.

5) Auf der anderen Seite ist eine denkbar enge Geheimhaltungsvorschrift vorgesehen (vergleiche im einzelnen Artikel 7 des Richtlinienentwurfs).

6) Darüber hinaus ist sich die Kommission des faktischen Zusammenhangs bewusst, der zwischen einerseits dem vorgesehenen Auskunftsaustausch und andererseits der Zunahme von Doppelbesteuerungen bei Gewinnberichtigungen im Falle von „transfer pricing" besteht. Sie hat dazu in Ziffer 10 der Allgemeinen Erwägungen in der Begründung zum Richtlinienentwurf der Erwartung Ausdruck gegeben, dass der Rat den vorliegenden Richtlinienvorschlag gleichzeitig mit einem in Kürze vorzulegenden Richtlinienvorschlag zum Problem der genannten Doppelbesteuerungen annehmen wird.

ELIZABETH A. DE BRAUW-HAY*

SUDAN: THE PROMOTION OF AGRICULTURAL INVESTMENT ACT, 1976

The Promotion of Agricultural Investment Act, 1976 which was recently passed fills a gap in the fairly comprehensive legislation which already exists on the subject of investment in the Sudan. The already existing laws on the subject are the Organisation and Encouragement of Investment in Economic Services Act, 1973[1] and the Development and Encouragement of Industrial Investment Act, 1974.[2] The latter, as its name suggests, encourages investment in the industrial field while the former aims at encouraging investment in tourism, transportation, warehousing and anti-pest control. Now, added to these laws is a comprehensive law on investment in the field of agriculture.

Objectives of the 1976 Act (Article 4)

The Aim of the Act is to encourage both domestic and foreign capital investment in the field of agriculture in order to bring about agricultural development.

The goals of agricultural development as stated in the Act are:

a) agricultural self-sufficiency;

b) achievement of the greatest possible volume of production of those agricultural products which the Sudan exports in order to increase its foreign exchange reserves;

c) diversification of agricultural production so as to safeguard the Sudan's economy against the danger of relying on one main cash crop;

d) fair distribution of agricultural development throughout the Sudan in order to raise the standard of living and increase per capita income in all parts of the country;

e) qualitative integration between agricultural and animal production and functional integration between agriculture and industry.

Tax concessions available under the Act (Articles 8, 9, 17 and 19)

Any project or undertaking which conforms to the objectives of the Act will be eligible for the following tax concessions:

a) Exemption from the business profits tax for a maximum period of five years from the date of commencement of production. This exemption may be extended for a further period of five years if total annual profits do not exceed 10 percent of the capital invested in the project or undertaking. Business profits tax will, however, be levied on profits that exceed the 10 percent figure as follows:
(i) at the rate of 25 percent of business profits tax rate on the first 30 percent of the extra amount;
(ii) at the rate of 50 percent of that rate on the next 30 percent;
(iii) at the full rate on the remaining

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1. For a short description of the provisions of that Act see the section on the Sudan in "African Tax Systems" published by the International Bureau of Fiscal Documentation at p. 6.

2. For a discussion of the provisions of the 1974 Act see Bulletin for International Fiscal Documentation, June 1975, no. 6, pp. 243-244.

40 percent. The Minister of Finance, Planning and National Economy may, however, exempt the project or undertaking from payment of business profits tax on this last percentage if these profits are reinvested in the project or undertaking concerned.
Losses incurred during the exemption period will be deemed to have been incurred in the last year of such period; in this connection expenses arising before commencement of production and depreciation deductions arising within the exemption period will be deemed to be losses.

b) The Act states that exemption will be given from all "additional" customs duties on plant and machinery, raw materials, semi-manufactured materials, livestock, seeds fertilisers, pesticides and drugs not locally available in sufficient quality or quantity and imported by the project or undertaking concerned.
It is not clear from the Act, however, what is meant by "additional" customs duties.

c) Exemption from excise duties on domestic materials used by the project or undertaking.

d) The Act also provides for further (unspecified) facilities or concessions being granted to projects or undertakings established in certain parts of the Sudan and to those which are of special importance to the national economy.

Transfer of profits abroad
(Article 11)
Profits from the investment of foreign capital in any project or undertaking may be transferred abroad in the currency in which the capital was imported or in any other agreed currency.

Transfer of imported capital abroad
(Article 12)
The Act likewise contains a guarantee for the transfer abroad of the net value of any capital imported from abroad and registered at the Bank of Sudan in the currency in which it was imported or in any other agreed currency.

Guarantees against nationalisation and confiscation
(Article 20)
Capital invested in a project or undertaking may not be confiscated except after a decision by a court which has jurisdiction under existing law. Neither may such capital be nationalised unless "the high interest of the State so requires".
If nationalisation does occur adequate compensation will be paid based on valuation of the property involved at prices current at the time of nationalisation. Any such compensation will be paid in annual instalments over a period not exceeding five years in the same currency in which it was brought into the Sudan. Provision is made for arbitration where the amount of compensation is disputed and the panel of arbiters will consist of one member representing the investor, another representing the government of the Sudan and a third to be chosen by agreement by the other two members or, failing which, by the President of the Supreme Court of the Sudan.

DOCUMENTS

FRANCE

Exposé des motifs
Convention fiscale franco-polonaise du 20 juin 1976

(Projet de Loi No. 73. Assemblée Nationale 1975-1976)
(Official explanation to the French-Polish Tax Treaty of June 20, 1975. See also Supplement D 1976)

Mesdames, Messieurs,

Des négociations commencées en juin 1974 à Varsovie, puis reprises en novembre 1974 à Paris, ont abouti à la signature à Varsovie, le 20 juin 1975, d'une Convention fiscale.

Avant d'examiner les dispositions de cette Convention, il semble opportun de donner quelques indications sur les relations franco-polonaises dans le contexte desquelles cet Accord est appelé à s'insérer.

Les échanges commerciaux franco-polonais ont connu, ces dernières années, un développement constant, ce qui correspond à la volonté souvent réaffirmée des deux gouvernements, volonté qui s'est notamment traduite par la signature d'un important accord de coopération économique, industrielle, scientifique et technique, le 5 octobre 1972.

Les chiffres ci-après montrent cette expansion des échanges, dont le solde a toujours été nettement favorable à la France:

	Exportations	Importations
	(En millions de francs.)	
1970	373	298
1971	573	407
1972	641	498
1973	937	653
1974	1 553	1 109

Source: Banque de France.

Si la balance commerciale est excédentaire au profit de la France, la balance des paiements l'est également.

Poste	Année 1974 Recettes	Dépenses	Solde
	(En millions de francs.)		
Coupons et dividendes	—	—	—
Revenus d'investissements directs	—	—	—
Intérêts sur prêts de la clientèle	6	—	+ 6
Intérêts de placements et crédits bancaires	41	28	+13
Brevets et redevances	5	—	+ 5
Frais d'études et de coopération technique	6	5	+ 1
			+25

Source: Banque de France.

Les investissements français en Pologne se sont élevés à 2 millions de francs en 1974. La faiblesse de ce chiffre s'explique par les formes particulières d'organisation de la production dans ce pays.

Enfin, au 1er janvier 1975, 1 687 Français étaient établis en Pologne, alors que 102 637 Polonais étaient établis en France, formant ainsi la septième colonie étrangère par le nombre.

Ces quelques chiffres montrent l'importance des relations franco-polonaises. De plus, les perspectives de développement de ces relations sont excellentes, la Pologne souhaitant voir la France, pays ami par la culture et l'histoire, devenir l'un de ses partenaires économiques occidentaux privilégiés. Ces éléments permettent d'apprécier l'intérêt que présente pour les deux pays la Convention fiscale qui vous est soumise.

Bien que la Pologne ne soit pas membre de l'O.C.D.E., le modèle de convention mis au point par cette organisation a, en fait, été retenu comme base de travail par les négociateurs. Le projet paraphé s'inspire largement, tant dans sa structure générale que dans nombre de ses dispositions, de ce modèle. La plupart des clauses du modèle O.C.D.E. sont suffisamment connues, aussi s'attachera-t-on surtout, dans le présent exposé, à commenter les dispositions qui ont un caractère particulier ou un intérêt essentiel et qui donnent à la Covention entre la France et la Pologne ses traits originaux.

Il faut noter, tout d'abord, que le préambule de la Convention franco-polonaise se réfère au désir des deux parties de poursuivre et de faciliter le développement de leurs relations économiques. Un tel énoncé figure dans d'autres accords conclus entre les deux pays.

Les articles 1 et 2 définissent le champ d'application de la Convention quant aux personnes et aux impôts. Les impôts polonais visés sont l'impôt sur le revenu, l'impôt sur les salaires et l'impôt complémentaire à ces deux impôts. Du côté français, la Convention s'applique à l'impôt sur le revenu, à l'impôt sur les sociétés, mais aussi à la contribution des patentes. Cette disposition aura essentiellement pour conséquence pratique d'exonérer de cette contribution la compagnie aérienne polonaise L. O. T. pour les installations qu'elle possède en France. Cette exonération a été acceptée dans un souci de réciprocité, aucune contribution analogue n'existant en Pologne.

L'article 3 reprend les définitions habituelles d'un certain nombre de termes ou d'expressions.

L'article 4 fixe les règles permettant de déterminer l'Etat de résidence d'un contribuable d'une façon générale et dans l'hypothèse où un contribuable serait considéré comme résident des deux Etats.

L'article 5 précise les conditions dans lesquelles une entreprise d'un Etat contractant qui exerce son activité dans l'autre Etat contractant, est réputée y posséder un établissement stable. A cet égard, les dispositions habituelles de la convention modèle de l'O. C. D. E. ont été reprises. Toutefois, le Protocole annexé à la Convention précise que, pendant la période d'application de l'Accord sur le développement de la coopération économique, industrielle, scientifique et technique entre la France et la Pologne, signé le 5 octobre 1972 pour une durée de dix ans mais qui peut être prolongée, un chantier de construction ou de montage ne sera considéré comme un établissement stable que si sa durée dépasse dix-huit mois. Cette disposition s'appliquera en particulier aux entreprises françaises qui construisent des usines ou des hôtels en vue de leur livraison «clé en main», ou qui procèdent à des installations industrielles.

Les articles 6 à 21 fixent les règles d'imposition des différentes catégories de revenus.

Les dispositions de l'article 6, relatif aux revenus immobiliers, n'appellent pas de commentaires particuliers.

Les règles d'imposition des entreprises, à l'article 7, ne sont pas différentes de celles adoptées avec d'autres pays.

Toutefois, des précisions sur l'imposition des établissements stables ont été apportées dans le Protocole. Il y est prévu que lorsqu'une entreprise d'un Etat vend des marchandises ou exerce une activité dans l'autre Etat par l'intermédiaire d'un établissement stable qui y est situé, le résultat de cet établissement n'est pas déterminé à partir du montant total du chiffre d'affaires ou de la rémunération de l'entreprise, mais est calculé à partir de la rémunération attribuable à l'intervention propre de l'établissement stable dans la vente ou l'activité en question. Cette précision a pour but d'éviter que les établissements stables en Pologne d'entreprises françaises n'y soient imposés sur la base d'un pourcentage du chiffre d'affaires ou de la rémunération de l'entreprise correspondant à la totalité de ses ventes ou son activité en Pologne.

Conformément à l'article 8, les bénéfices que les entreprises de transport retirent du trafic international ne sont imposables que dans l'Etat où est situé le siège de la direction effective de l'entreprise. Cette règle s'applique aux entreprises de navigation maritime et aérienne, mais également aux entreprises de transport ferroviaire ou routier. Il en est de même dans la Convention franco-roumaine qui a été signée le 27 septembre 1974. Cette règle s'applique aussi, en vertu du paragraphe 5, dans le cas où l'entreprise loue les navires, aéronefs ou véhicules qu'elle exploite. Par ailleurs, la définition, figurant à l'article 3, de l'expression «trafic international» est précisée dans le Protocole. Il est ainsi entendu qu'elle comprend également les transports effectués par conteneurs, par barges embarquées sur des navires, ou par tout autre équipement lié à l'exploitation de navires, d'aéronefs ou de véhicules, que ces matériels soient possédés par l'entreprise ou pris en location.

L'article 9, relatif aux entreprises associées, reprend les dispositions habituelles et n'appelle pas de commentaires.

En ce qui concerne les dividendes, l'article 10 reprend tout d'abord une disposition habituelle qui prévoit que les dividendes sont imposables dans l'Etat de résidence du bénéficiaire. Une autre disposition, complémentaire de la première, prévoit que l'Etat d'où proviennent ces dividendes peut prélever une retenue à la source limitée à 5% de leur montant si le bénéficiaire est une société qui dispose d'au moins 10% du capital de la société distributrice et à 15% dans tous les autres cas. Les autres dispositions de cet article (définition des dividendes, dividendes rattachés à un établissement stable) n'appellent pas de remarques.

L'article 11, relatif aux intérêts, prévoit, contrairement à la clause de l'O.C.D.E. qui comporte un partage d'imposition, leur imposition exclusive dans l'Etat de résidence du bénéficiaire. La suppression de toute retenue à la source dans l'Etat d'où proviennent les intérêts ne peut que favoriser la conclusion de prêts et la vente à crédit de biens et d'équipements français en Pologne. Mais elle jouera également quand des entreprises françaises acquerront à crédit des biens d'équipement en Pologne. Ce cas s'est déjà présenté lors de l'achat par des armateurs français de navires de pêche polonais. Les autres dispositions de l'article 11 (définition des intérêts, intérêts rattachés à un établissement stable, intérêts versés entre des sociétés apparentées) n'appellent pas de remarques.

S'agissant des redevances, l'article 12 reprend la règle d'imposition dans l'Etat de résidence du bénéficiaire et la possibilité pour l'Etat d'où elles proviennent d'imposer une retenue à la source limitée à 10% de leur montant. Toutefois, dans le souci de maintenir et de renforcer les relations culturelles traditionnelles entre la France et la Pologne, les deux Parties sont convenues qu'aucune retenue à la source ne serait prélevée sur les redevances à caractère culturel. Il faut noter, par ailleurs, que la définition des redevances, telle qu'elle est précisée par le Protocole, exclut les rémunérations versées pour l'usage ou la concession de l'usage d'un équipment commercial, industriel ou scientifique (contrats de location de type «crédit bail»), ainsi que celles versées pour des services consistant en études ou recherches d'ordre scientifique ou technique ou pour des services de conseil, de contrôle ou de supervision. De telles rémunérations versées à un résident d'un Etat et provenant de l'autre Etat, ne seront donc imposables dans cet autre Etat que dans le mesure où elles peuvent être rattachées, si elles sont perçues par une entreprise, à un établissement stable de cette entreprise dans cet autre Etat, ou, si elles sont perçues par une personne physique, à une base fixe dont cette personne dispose dans cet autre Etat. Les autres dispositions de l'article 12 (redevances rattachées à un établissement stable, redevances versées entre sociétés apparentées) n'appellent pas de commentaires.

A propos de l'imposition des gains en capital, qui est traitée à l'article 13, on peut noter que, comme dans la plupart des autres conventions signées par la France, la règle d'imposition des plus values immobilières dans le pays du situs s'appliques également aux parts ou droits analogues dans les sociétés dont l'actif est composé principalement de biens immobiliers. Cette règle, ainsi que celle qui, à l'article 6, précise que les biens immobiliers sont définis conformément à la législation fiscale de l'Etat où ces biens sont situés, a pour objet de permettre à la France d'appliquer les règles particulières de sa fiscalité immobilière.

Les articles 14 et 15 règlent, selon les dispositions habituelles, l'imposition des revenus provenant de l'exercice d'activités indépendantes ou salariées. Il faut noter que, compte tenu des dispositions de l'article 8, les rémunérations versées au titre d'un emploi salarié exercé à bord d'un navire ou d'un aéronef, mais aussi d'un véhicule ferroviaire ou routier en trafic international, ne sont imposables que dans l'Etat où le siège de la direction effective de l'entreprise est situé.

L'article 16, relatif aux tantièmes et revenus assimilés, n'appelle pas de commentaires.

L'article 17 prévoit l'imposition des revenus des artistes et des sportifs dans l'Etat où ils exercent leurs activités en cette qualité, ainsi que l'application de la règle, qui tend à entrer dans la partique internationale et qui est destinée à combattre un procédé d'évasion fiscale, selon laquelle l'artiste ou le sportif peut être imposé dans l'Etat où il exerce son activité, même si ses services sont fournis par une tierce personne. Par ailleurs, les revenus que les artistes ou les sportifs reçoivent pour des activités exercées dans le cadre des échanges culturels approuvés par l'Etat où ils résident, ne sont imposables que dans cet Etat.

Les pensions, autres que les pensions versées en considération de services antérieurs de caractère public, ne sont, en vertu de l'article 18, imposables que dans l'Etat de résidence du bénéficiaire. Par contre, l'article 19 dispose que les rémunérations et pensions versées par un Etat au titre de services de caractère public ne sont imposables que dans cet Etat. Toutefois, cette règle ne s'applique pas aux rémunérations et pensions publiques versées par un Etat à un résident de l'autre Etat qui en possède la nationalité.

L'article 20 traduit le souci de faciliter le séjour dans un Etat des enseignants, chercheurs et étudiants résidents de l'autre Etat. A cet effet, les professeurs et les chercheurs sons exonérés d'impôt pendant deux ans dans l'Etat où ils séjournent, sous la réserve, en ce qui concerne les chercheurs, que leurs travaux soient entrepris dans l'intérêt public. Par ailleurs, les étudiants et stagiaires sont exonérés dans l'Etat où ils séjournent, d'une part pour les sommes qu'ils reçoivent de sources situées hors de cet Etat, d'autre part pour les rémunérations qu'ils perçoivent dans cet Etat à condition qu'elles soient nécessaires à leur entretien ou que les services à raison desquels elles sont versées soient en rapport avec leurs études.

L'article 21 prévoit que, sauf s'ils sont rattachés à un établissement stable ou à une base fixe, les revenus qui ne sont pas traités dans d'autres articles de la Convention, ne sont imposables que dans l'Etat de résidence du bénéficiaire.

L'article 22 reprend les dispositions habituelles concernant la fortune.

L'article 23 fixe les règles permettant d'éliminer les doubles impositions. La France accorde à un résident de France recevant des revenus visés aux articles 10, 12, 14, 16 et 17 provenant de Pologne et imposables en Pologne conformément à la Convention l'imputation de l'impôt polonais payé sur l'impôt français exigible au titre de ces revenus. Les autres revenus qu'un résident de France reçoit de Pologne, sont exonérés en France lorsqu'ils sont imposables en Pologne. Par ailleurs, la possibilité d'appliquer la règle du taux effectif est prévue. La Pologne applique, quant à elle, des règles systématiques.

L'article 24 comporte les clauses habituelles de non-discrimination. Toutefois, le Protocole précise que les dispositions de cet article ne visent pas, en ce qui concerne la Pologne, la taxe de déclaration et la taxe pour la permission d'ouverture d'un établissement. Les résident français pourront donc avoir à acquitter en Pologne ces taxes qui sont, d'ailleurs, de faible montant, à un taux différent de celui applicable aux résidents polonais. Il est également précisé au Protocole que les entreprises françaises ne pourront se prévaloir des dispositions de l'article 24 pour réclamer l'application du régime fiscal particulier existant en Pologne pour les entreprises du secteur socialisé de l'économie.

Les articles 25 (procédure amiable) et 26 (échange de renseignements) n'appellent pas de commentaires.

L'article 27, relatif aux fonctionnaires diplomatiques et consulaires et aux organisations internationales, reprend les règles habituelles. Il est complété, dans le Protocole, par une disposition prévoyant l'extension du bénéfice de la Convention aux fonctionnaires diplomatiques et consulaires ressortissants d'un Etat et en poste dans l'autre Etat ou dans un Etat tiers.

Selon un dispositif adopté dans certaines conventions récemment négociées, l'article 28 définit le champ d'application territorial de l'accord qui est ainsi limité, en ce qui concerne la France, aux départements européens et d'Outre-Mer, seules parties du territoire de la République française où s'appliquent les impôts visés par la Convention.

L'article 29, relatif à l'entrée en vigueur, prévoit une application rétroactive de la Convention au 1er janvier 1974. Cette disposition permettra de régler un certain nombre de cas particuliers de double imposition actuellement pendants. L'article 30, relatif à la cessation d'application, n'appelle pas de remarques.

Enfin, le texte même de la Convention est complété par un Protocole qui apporte des précisions concernant les articles 3, 5, 7, 12, 24 et 27. On ne reviendra pas sur ces précisions qui ont déjà été évoquées dans le présent exposé.

S'ajoutant aux conventions déjà signées avec la Tchécoslovaquie, la Yougoslavie et la Roumanie, la Convention fiscale avec la Pologne constitue un élément de la politique française à l'égard des pays de l'Europe orientale. Elle facilitera l'activité des entreprises françaises dans un pays désireux de bénéficier de l'apport de capitaux étrangers et de technologie industrielle pour son développement économique et avec lequel certaines de ces entreprises ont déjà passé d'importants contrats. Nos entreprises y bénéficieront ainsi d'un régime équivalent à celui des entreprises d'autres pays industriels ayant déjà signé un accord de même nature avec la Pologne, comme l'Allemagne (Convention du 18 décembre 1972) et les Etats-Unis (Convention du 8 octobre 1974). Cette Convention marque, en outre, la volonté des deux Pays de raffermir leurs traditionnelles relations d'amitié, et supprimera les obstacles d'ordre fiscal aux échanges culturels avec un pays où l'influence de la langue et de la culture française demeure très importante.

Telles sont les principales dispositions du texte qui vous est soumis aujourd'hui en vertu de l'article 53 de la Constitution.

UNITED STATES OF AMERICA

Taxation of the undistributed income of controlled foreign corporations*

I. ISSUE

Since the introduction of the Federal income tax in 1913, the United States has employed a "classical" system of taxing corporations and their shareholders. Under a classical system, corporations and their shareholders are separately taxed. A corporation's tax liability is not affected by the amount of dividends it distributes to its shareholders, and conversely (with limited exceptions) a shareholder's tax liability depends on dividends received, and is not affected by either the amount of tax paid by the corporation or by the corporation's retained earnings and profits.

These principles extend to a U.S. shareholder in a foreign corporation. No U.S. tax is imposed on the U.S. shareholder until (and unless) the shareholder receives dividends from the foreign corporation. This consequence of a classical system of taxation is called deferral, because the U.S. tax on the income of a foreign corporation is deferred until dividends are paid.

The bulk of U.S. investment in foreign corporations is undertaken, not by individual shareholders, but by U.S. based multinational enterprises. So long as earnings are retained abroad by foreign corporate subsidiaries, the U.S. parent corporation pays no U.S. tax on the foreign income.[1] If taxable corporate earnings are defined the same way abroad as in the United States, and if the host government applies a tax rate lower than the U.S. corporate tax rate of 48 percent, the difference in rates represents a temporary tax saving to the parent corporation.

Multinational firms based in the United States argue that deferral is necessary to allow them to compete on even terms with foreign firms. In their view, tax neutrality requires the same rate of taxation on all firms operating in the same country. The U.S. multinational firms suggest that the termination of deferral would bring about changes in foreign tax practices and dividend distribution rates that would erode or eliminate U.S. tax revenue gains, and that, without deferral, the foreign expansion of U.S. firms would be curbed, profits and U.S. tax revenues might decline, and U.S. exports to foreign markets might fall.

Others object that deferral enables foreign investment to enjoy tax advantages not available for domestic investment. In this view, tax neutrality requires the same taxation of investment at home and investment abroad. Expressing concern for the impact of foreign investment on American jobs, and the loss of potential tax revenue, labor groups in particular have questioned the continuance of deferral. This concern was expressed most strongly in the late 1960s and early 1970s. Since 1972, a system of flexible exchange rates and the DISC legislation have, to some extent, answered the concern over foreign tax advantages.

II. PRESENT LAW

1. *Classical system of taxation*

Under present law, a corporation and its shareholders are taxed separately. The cor-

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* Preliminary analysis of the U.S. Treasury Department prepared by the Treasury's Office of International Tax Affairs for the House Ways and Means Committee Task Force on Taxation of Foreign Income.

1. The foreign subsidiary may pay interest, royalties, and management fees to the U.S. parent corporation, and these types of income would, of course, be taxed currently by the United States.

poration is taxed on its earnings; the shareholders are taxed on distributed dividends. This is known as a "classical" or separate entity system of taxation. By contrast, under an "integrated" system of taxation, either the taxes imposed on the corporation are claimed (in whole or part) as a tax credit by the shareholder, or the corporation is allowed a reduced tax rate on dividends paid. Britain, France, Germany, Canada, Japan, and other industrial countries have adopted various types of integrated tax systems. The Administration has proposed an integrated system for the United States, and the proposal is now under Congressional consideration.

Over the years, the United States has made limited exceptions to its separate entity system of taxation. Certain exceptions are intended to recognize the economic unity of an affiliated group of corporations within the United States, to avoid double taxation when dividends are distributed from one corporation to another, or to encourage small business. Other exceptions are intended to discourage tax abuse by individuals investing in domestic or foreign corporations. Subpart F is principally designed to discourage tax abuse by U.S. corporations which control foreign corporations.

2. *Exceptions to recognize economic reality and avoid double taxation.*

(a) *Consolidated return.* Under specified circumstances (Section 1501), related domestic corporations are permitted to file a consolidated return. The consolidated return recognizes the economic unity of a corporate group. Through the mechanism of a consolidated return, the profits of one domestic corporation may be used to offset the losses of another. In this way, related corporations can share their investment risks.[2] A foreign corporation cannot, however, join a consolidated return.[3]

(b) *Dividends received deduction.* Dividends distributed from one domestic corporation to another are entitled to an 85 percent or 100 percent dividends received deduction, depending on the extent of affiliation between the two corporations (Section 243). The purpose of the dividends received deduction is to avoid double taxation at the corporate level. Dividends received by a domestic corporation from a foreign corporation are not eligible for the deduction.[4]

(c) *Subchapter S.* Under Subchapter S (Sections 1371-1379) certain small corporations can elect to be treated for tax purposes much like a partnership. If an election is made, there is no corporate tax, all earnings (whether or not distributed) are taxed to the shareholders, and losses can be claimed as a deduction by the shareholders. The purpose of Subchapter S is to encourage small business.

3. *Exceptions to discourage tax abuse by individuals.*

(a) *Accumulated earnings tax.* The Revenue Act of 1913 contained the antecedents of today's accumulated earnings tax (Section 531). This is a penalty tax imposed on a corporation when it unreasonably accumulates earnings for the purpose of shielding shareholders from personal income taxation.

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2. Only one surtax exemption can be claimed on the consolidated return.

3. Certain contiguous country corporations, defined under Section 1504(d), are allowed to join a consolidated return.

4. The dividends received deduction is available for dividends paid by a foreign corporation which earns at least 50 percent of its gross income from a U.S. trade or business (Section 245).

(b) *Personal holding company tax.* In 1934, Congress enacted the personal holding company tax (Sections 541-547). This is a penalty tax on the undistributed personal holding company income of a corporation that receives at least 60 percent of its adjusted ordinary gross income from passive investment sources and certain types of personal services, and is owned to the extent of more than 50 percent in value by five or fewer individuals. The tax applies to the corporation and not to the shareholders. The tax can be mitigated if the corporation declares a "deficiency dividend."

(c) *Foreign personal holding company.* In 1937, Congressional investigation brought to light the formation of "incorporated pocketbooks" abroad by United States citizens. These corporations, designed to collect and retain passive investment income, were domiciled in countries, such as the Bahamas and Panama with little or no corporate income tax. As foreign corporations, they could not be effectively taxed either on their accumulated earnings or as personal holding companies.

The Congressional remedy was to enact the foreign personal holding company legislation (Sections 551-558) which taxes each U.S. shareholder on his pro rata share of the foreign corporation's undistributed income. Certain tests must be met before the foreign corporation is characterized as a foreign personal holding company. At least 60 percent of its gross income must be derived from passive sources (dividends, interest, rents, royalties, capital gains, income from an estate or trust, personal service income and certain other items), and more than 50 percent in value of the stock must be owned by not more than five U.S. individuals. When these tests are met, each shareholder is deemed to receive a distribution from the foreign personal holding company, and deferral of U.S. tax liability on the foreign income is effectively precluded.[5]

The foreign personal holding company legislation did not reach foreign investment companies that sold shares widely among U.S. individuals. Such companies, domiciled in low-tax jurisdictions, could thus retain their dividend and interest income free from U.S. tax. The shareholders could later realize the income in the form of capital gains, if and when the shares were sold.

The Revenue Act of 1972 abolished this device in one of two ways. Either the gains realized by the shareholder on disposition of the stock would be taxed as ordinary income to the extent of accumulated earnings (Section 1246), or the foreign investment company could enter a binding election to distribute at least 90 percent of its income annually (Section 1247).

4. *Exceptions to discourage tax abuse by corporations.*

(a) *Section 367.* The Internal Revenue Code permits numerous types of tax-free corporate reorganizations. One corporation may acquire another, a subsidiary may merge into a parent, or a corporation may divide into several parts, all without creating a taxable event. The underlying philosophy is that, so long as assets remain in "corporate solution", and are not distributed to individual shareholders, reorganization is a matter of economic convenience for the firm and need not provide an occasion for taxation.

Reorganizations that involve foreign cor-

5. The individual shareholders are not permitted to claim a credit for any foreign corporate income tax paid. The deemed paid credit (Section 902) is only available to U.S. corporations.

porations create an exception to this basic philosophy. The concern arose very early that domestic or foreign corporate income that had not previously been taxed by the United States could forever leave its tax jurisdiction through corporate reorganization. In 1932, the predecessor of Section 367 was enacted. It prevents tax-free exchanges involving foreign corporations unless "it has been established to the satisfaction of the Secretary or his delegate that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes."

In any reorganization involving a foreign corporation, the U.S. taxpayer must first obtain a Section 367 ruling from the Internal Revenue Service that the exchange is not in pursuance of such a plan, or the transaction will be treated as a taxable event. Often the taxpayer must pay a "toll charge," involving partial recognition of the gain, in order to receive a favorable Section 367 ruling. The ruling might also be accompanied by a closing agreement which preserves the U.S. tax base (Revenue Procedures 68-23 and 75-29).

(b) *Subpart F and its exclusions.* The early anti-abuse provisions were addressed to situations where an individual U.S. shareholder took advantage of lower U.S. or foreign corporate tax rates, or where a U.S. corporation took advantage of the tax-free reorganization provisions. The Revenue Act of 1962 partially terminated deferral in answer to the tax abuse which may arise when a U.S. parent corporation takes advantage of lower foreign corporate tax rates on ordinary income in tax haven countries.

The Kennedy Administration originally sought the complete termination of deferral, but Congress adopted a more focused approach. The history and drafting of subpart F (Sections 951-964) indicate that it represents a compromise between the complete termination of deferral and the classical system of taxing foreign corporate income. The purpose of subpart F is to terminate deferral in tax abuse situations, yet otherwise retain the separate taxation of a foreign corporation and its U.S. shareholders.

Subpart F, was enacted in 1962, taxes U.S. shareholders currently on the income of a controlled foreign corporation when the nature of the corporation and its sources of income combine to exhibit tax haven characteristics. The foreign corporation is potentially subject to subpart F if it is a controlled foreign corporation (CFC), that is to say, if the voting stock is more than 50 percent owned by U.S. "shareholders," defined as individuals or corporations each controlling at least 10 percent of the voting stock.[6]

If the foreign corporation can establish that it did not have as one of its purposes a substantial reduction in taxes (Section 954 (b)(4)), it will not fall within Subpart F. The substantial reduction test is not defined with reference to U.S. taxes. Rather the test is whether taxes have been reduced by comparison with the taxes that would have been imposed by the buying or selling country, or the paying or receiving country, if a third country corporation had not been interposed in the transaction (Regulations 1.954-1(b)(4), example (1)). A company which was not organized with tax reduction as one of its significant purposes can, however, still have subpart F income on individual transactions undertaken for the purpose of tax avoidance.

6. In the case of a controlled foreign corporation that insures U.S. risks, the test is whether more than 25 percent of the voting stock is owned by U.S. shareholders. (Section 957(b)).

A controlled foreign corporation's income is subject to subpart F if it is derived from the insurance of U.S. risks, or if it is characterized as foreign base company income. Foreign base company income includes: (1) foreign personal holding company income (interest, dividends-rents, and similar categories of passive income); (ii) foreign base company sales income (income derived by the CFC from selling or buying personal property to or from a related person, if the property is both produced and sold for use outside the country in which the CFC is incorporated); and (iii) foreign base company services income (income derived from the performance of technical, managerial, or similar services or on behalf of a related person outside the country of CFC incorporation).

When the foreign corporation and the composition of income meet these statutory tests, the U.S. shareholders are generally deemed to receive a distribution of retained earnings and are taxed accordingly, with provisions for a foreign tax credit (Sections 960 and 962). As a backstop to subpart F, the Revenue Act of 1962 required that when a U.S. shareholder disposes of shares in a controlled foreign corporation, the gains must be reported as ordinary income to the extent of earnings and profits accumulated after 1962 (Section 1248).[7] This provision forestalls the accumulation of earnings in a CFC not subject to subpart F, and the taxation of that income at more favorable capital gains rates.

The Revenue Act of 1962 provided several exclusions to the general rule of current U.S. taxation of subpart F income. The Tax Reduction Act of 1975 repealed or modified four of the exclusions and added one new exclusion.

(i) *Minimum distribution.* The parent corporation could elect a so-called "minimum distribution." The minimum distribution was a constructive distribution of earnings from CFCs with and without subpart F income. If the minimum distribution showed that average foreign taxes were equal to a certain percentage or within certain percentage points of the U.S. tax rate, the deemed distributions under subpart F were reduced or eliminated. The minimum distribution election was repealed by the Tax Reduction Act of 1975.

(ii) *Less developed country corporations.* The subpart F income of a CFC derived from and reinvested in "qualified investments" in less developed countries was excluded from the definition of foreign base company income. Less developed countries were broadly defined to include all nations outside of industrial Europe, Canada, Japan, Eastern Europe, and the Sino-Soviet bloc. This exclusion was replaced by the Tax Reduction Act of 1975.

(iii) *30-70 rule.* If less than 30 percent of CFC income was characterized as foreign base company income, then a special rule provided that none of the income would retain that character and no deemed distribution was required. If between 30 and 70 percent of the income was characterized as foreign base company income, then the actual percentage would have that character and that percentage would be subject to a deemed distribution. Above 70 percent, the entire CFC income would be characterized as foreign base company income and would be deemed distributed. The Tax Reduction Act of 1975 changed the 30 percent rule to a 10 percent rule.

(iv) *Shipping income.* As originally enacted, subpart F provided an exclusion from

7. An exception was made for the disposition of shares in a less developed country corporation (Section 1248(d)(3)).

foreign base company income for income derived from, or in connection with, the use of any aircraft or vessel in foreign commerce. The Tax Reduction Act of 1975 required that shipping income be reinvested in shipping operations to qualify for this exclusion.

(v) *Agricultural sales.* The Tax Reduction Act of 1975 modified the definition of foreign base company sales income to exclude income from sales of agricultural commodities which are not grown in the United States in commercially marketable quantities. The Tax Reform Act of 1975, H.R. 10612, passed by the House and now under consideration by the Senate, would broaden this exclusion to cover agricultural products which are significantly different in grade or type from agricultural products grown in the United States.

III. ANALYSIS

1. *International tax neutrality.*

Tax neutrality is a broad concept which is often defined in conflicting ways. Whether foreign corporate income is taxed by the United States currently or only when dividends are distributed is one element in a definition of international tax neutrality, but it is not the only element. The relationship between deferral and international tax neutrality must be viewed in the overall contest of U.S. and foreign tax rules.

Tax neutrality at the corporate level[8] for foreign investment can be defined either with reference to the taxation of domestic profits, or with reference to the taxation of the profits of competing foreign firms. These alternative standards are usually designated as "capital-export neutrality" and "capital-import neutrality". In their pure forms, the concepts of capital-export neutrality and capital-import neutrality say nothing about the division of tax revenue between home and host country tax authorities. In principle, either type of neutrality could be reached consistent with various revenue sharing arrangements between the taxing authorities. In practice, under present international rules, each type of neutrality tends to be associated with a certain division of revenue.

Capital-export neutrality is achieved when the *total* rate of corporate tax on foreign profits is the same as on comparable domestic profits. For example, if the French subsidiary of an American firm pays 40 percent of its profits in tax to France, and if the United States corporate tax rate was a uniform 48 percent, capital-export neutrality would be served by a current U.S. corporate tax of 8 percent on the French subsidiary's profits.

In order to achieve capital-export neutrality under existing domestic tax law, several underlying conditions must be met.

First, host country taxes paid should be credited against the home country tax liability, with the refund of excess foreign taxes; alternatively, home country taxes should be credited against the host country tax liability;

Second, foreign income, including undistributed subsidiary earnings, should be taxed currently to the parent corporation by the home country;

Third, the home country should employ the same accounting practices in calculating domestic and foreign profits (in particular, the same depreciation conventions should be used);

Fourth, any capital subsidies provided for investment in the home country (for example, an investment tax credit) should be available for investment

8. This paper does not analyze tax neutrality at the individual level.

abroad. Similarly, preferential taxation of export earnings, such as the DISC, should be extended to foreign production;

Fifth, the same treatment should apply to sub-Federal income taxes levied at home and abroad. If state and local taxes are deductible at home, then to the same extent they should be deductible in computing taxable foreign source income;

Sixth, losses of foreign subsidiaries should be deductible to the same extent as the losses of the parent companies.

Capital-export neutrality could alternatively be achieved under a domestic tax law which was free of all corporate tax preferences, and instead taxed corporate income at a uniformly lower rate. In order to achieve capital-export neutrality under such a neutral domestic tax law, several conditions must be met, many the same as before.

First, (and this is the main difference), tax preferences for domestic corporate income must be repealed, and nominal corporate tax rates must then be lowered so that there is no net revenue change from the taxation of domestic income;

Second, host country taxes paid should be credited against the home country tax liability, with the refund of excess foreign taxes; alternatively, home country taxes should be credited against the host country tax liability;

Third, foreign income should be taxed currently by the home country;

Fourth, the home country should employ the same accounting practices in calculating domestic and foreign profits;

Fifth, the same treatment should apply to sub-Federal income taxes levied at home and abroad;

Sixth, losses of foreign subsidiaries should be deductible to the same extent as the losses of the parent companies.

A regime of capital-export neutrality, whether achieved under existing domestic tax law or under a neutral domestic tax law, would, unlike present law, encourage U.S. firms to locate their productive facilities wherever pre-tax returns promised to be greater. A firm would be indifferent between a 20 percent pre-tax rate of return on investment in Canada, in Brazil, or in the United States, for it would receive the same after-tax return in all cases. Tax considerations would play no role in investment decisions, pre-tax returns on U.S. investments of equivalent risk would ultimately be equalized around the world, and the United States capital stock would be allocated in a manner designed to maximize world production.[9]

Capital-import neutrality for corporate investment is achieved when firms of all nationalities operating in one industry — for example, the Italian office equipment industry — pay the same total tax rate on profits earned in the country where the industry is located — in this case Italy.[10] Pure capital-import neutrality in this situation would emerge if Italian tax law made no differentiation among enterprises of diverse national origin. For example, Italy could not withhold tax on dividends, interest, and royalties paid to foreign corporations unless it also withheld tax on such payments to Italian corporations. Furthermore, foreign nations should make no attempts to impose an additional tax on corporate earnings arising in Italy. Indeed, one

9. This statement ignores the misallocation caused by tariffs, quotas, and other impediments to free international trade.

10. When a host country has an integrated system of taxing corporations and their shareholders, the analysis of capital-import neutrality can become more complicated. This discussion envisages a host country with a classical separate entity system of taxation.

way of achieving capital-import neutrality is through the unilateral exemption of corporate foreign source income from domestic taxation, as is virtually done by France and the Netherlands.[11] Under territorial taxation, as this approach is called, the home government relinquishes all tax claims, and the host government collects all the tax revenues arising from the enterprise. However, a revenue sharing arrangement between the host and home countries would equally be consistent with capital-import neutrality.

Capital-import neutrality is sometimes called "competitive" neutrality, because firms of diverse national origin compete on an equal tax basis in any particular country and industry. Because tax considerations do not distort competition, capital-import neutrality promotes the most efficient use of resources between firms in that country and industry.

Both in legislation and in bilateral tax treaties, the United States has attempted to ensure the type of tax neutrality appropriate to different situations, while at the same time protecting U.S. sources of tax revenue. Thus, United States taxation of the foreign income of U.S. owned firms embodies a mixture of capital-export neutrality, capital-import neutrality, and revenue protection clauses.

The keystone of U.S. taxation of American enterprise abroad is the foreign tax credit. Subject to certain limits, U.S. firms may take a credit against their tentative U.S. tax for the foreign income tax levied on the repatriated earnings of foreign corporate subsidiaries,[12] on the total earnings of foreign branches, and on interest, rents, royalties and fees paid from foreign sources. The foreign tax credit essentially cedes to the host country the first slice of tax jurisdiction, and hence most of the revenue. To the extent that a U.S. firm repatriates dividends, interest, rents, royalties or fees from its foreign corporate subsidiary, or operates abroad through foreign branches, the foreign tax credit may come close to ensuring capital-export neutrality.

There are several reasons why the foreign tax credit does not achieve capital-export neutrality under existing law. The U.S. foreign tax credit limitation rules operate so that when foreign taxes exceed the tentative U.S. tax on foreign source income, the excess foreign tax credit cannot be claimed currently (but it can be carried forward or carried back to other taxable years). If the excess credit could be claimed without limit, foreign governments could erode U.S. tax revenues on domestic source income. But because the excess foreign tax credit cannot be claimed, capital-export neutrality disappears whenever the foreign tax rate exceeds the U.S. rate. Foreign investment offering a given pre-tax return then becomes less attractive than domestic investment offering the same return.

In addition to the foreign tax credit limit, other features of the law reduce the extent of capital-export neutrality. U.S. parent corporations cannot offset the losses of foreign subsidiaries against domestic income, although the losses of foreign branches of U.S. corporations may be offset against domestic income. The investment tax credit is not available for capital expenditures abroad,[13] and the asset depreciation range (ADR) cannot be used for computing earnings and profits of a foreign subsidi-

11. France and the Netherlands do tax a small portion of corporate foreign source income.

12. There is both a direct credit (Section 901) for foreign withholding taxes on dividends, and an indirect credit (Section 902) for foreign taxes paid on the underlying corporate earnings.

13. Section 48(a)(2).

ary.[14] DISC is not available for exports by foreign subsidiaries. Like the limit on applying the foreign tax credit, these measures shield the U.S. Treasury and promote domestic investment, at the expense of capital-export neutrality. Two asymmetries, however, favor foreign over domestic investment: U.S. taxation of foreign subsidiary earnings is deferred until dividends are declared, and foreign sub Federal taxes may be credited against the tentative U.S. tax, whereas U.S. state and local taxes can only be deducted from earnings.

To the extent that the earnings of a foreign corporate subsidiary are not remitted as dividends, United States tax practice comes close to achieving capital-import neutrality. No current U.S. tax is levied on those earnings; instead U.S. taxation is deferred until repatriation. (Under the foreign personal holding company legislation and subpart F, certain kinds of tax haven income may be taxed currently, whether or not repatriated.) When earnings are retained abroad, deferral places the American-owned foreign subsidiary on much the same tax footing as its local competitors. Pure capital-import neutrality cannot be achieved, however, unless the United States (and other countries) abandon their claim to tax foreign source income (although home countries could seek revenue sharing arrangements with host countries) and host countries pursue a strict policy of non-discrimination.

In essence, an American multinational enterprise can elect to have its foreign ventures taxed either under a modified form of capital-export neutrality (by operating through a foreign branch or by distributing the earnings of a foreign subsidiary), or under a modified form of capital-import neutrality (by operating through a foreign subsidiary and retaining the earnings abroad). In neither case is the neutrality pure, and the level of purity partly depends on the host country.

The 1976 revenue consequences of present law, and of possible changes, are summarized in Table 1 for the non-extractive industries.[15] Corporate pre-tax foreign earnings were about $24.9 billion, foreign taxes claimed about $10.3 billion (41 percent of earnings) and U.S. tax collections were about $2.0 billion (8 percent of earnings).

A standard of pure capital-import neutrality at the corporate level would require zero U.S. tax collections on corporate foreign source income. The adoption of a territorial system would thus involve a 1976 revenue loss of nearly $2.0 billion by comparison with present collections. This revenue loss could be unilaterally absorbed by the United States, or it could be shared between the United States and various host countries. Capital-import neutrality, in whatever manner achieved, would not of course answer those critics of deferral who wish to increase U.S. tax revenues and promote domestic investment.

A standard of capital-export neutrality under existing domestic tax law would also reduce the revenue collections of U.S. and foreign tax authorities (assuming the revenue loss is shared). In 1976, the net revenue loss from a system of pure capital-export neutrality would have been almost

14. The tax rules provide that guideline periods, but not the asset depreciation range, may be applied to property predominately used outside the United States (Revenue Procedure 72 - 10; Regulation 1. 964-1(c)(i)(iii)).

15. The taxation of petroleum and hard minerals involves special considerations which do not easily fit into the concepts of capital-export neutrality and capital-import neutrality. For this reason, Table 1 is confined to the non-extractive industries.

TABLE 1

Estimated Tax Revenue Consequences in 1976 of Achieving Alternative Standards of International Tax Neutrality with Respect to U.S. Corporations in Non-Extractive Industries

(Millions of Dollars)

	Capital-export neutrality		
	With extension of U.S. domestic tax preferences to foreign investment	With removal of U.S. tax preferences for domestic investment	Capital-import neutrality
Foreign source income of U.S. corporations, before taxes	24,900	24,900	24,900
Present total taxes on the foreign source income of U.S. corporations under current law	12,270	12,270	12,270
Net U.S. taxes	1,970	1,970	1,970
Foreign taxes	10,300	10,300	10,300
Change in total taxes on the foreign source income of U.S. corporations in non-extractive industries	—1,590	—2,990	—1,970
Remove U.S. tax preferences for foreign investment	890	890	
Western Hemisphere Trade Corporation deduction	20	20	
Non gross-up of dividends from LDC corporations	55	55	
Deferral of tax on retained profits of foreign subsidiaries	365	365	
Allowance of credit for foreign taxes comparable to state income taxes	450	450	
Allow credit (or refund) for foreign taxes in excess of overall limitation	—180	—180	
Remove U.S. tax preferences for domestic investment and reduce U.S. corporate tax rate on domestic and foreign source income to 33 percent[1]		—3,700	
Extend U.S. domestic investment tax preference to foreign investment	—2,300		
Investment tax credit	—1,000		
Asset depreciation range	—300		
Domestic International Sales Corporation (DISC)	—1,000		
Adopt territorial income tax			—1,970
Hypothetical total taxes on the foreign source income of U.S. corporations in non-extractive industries	10,680	9,280	10,300

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1. After the hypothetical repeal of all U.S. tax preferences for domestic investment by the non-extractive industries, the U.S. corporate tax rate could be reduced from 48 percent to about 33 percent (on a broader base) with no change in tax revenue on domestic source income. However, there would be a revenue loss on foreign source income, since the applicable tax rate on that income would also drop from 48 percent to 33 percent.

$1.6 billion. The net loss represents a combination of revenue effects. If the law were changed to end deferral, to provide a deduction rather than a credit for that portion of foreign taxes which correspond to U.S. state and local taxes, and to eliminate certain minor non-neutralities, there would be revenue gains. But these gains would be more than offset if the law were also changed to compensate for foreign taxes in excess of the tentative U.S. tax, and to extend the investment tax credit, the asset depreciation range and DISC to investment abroad.

A standard of capital-export neutrality under a neutral domestic tax law would likewise reduce the revenue collections of U.S. and foreign tax authorities on U.S. investments abroad. After the repeal of domestic tax preferences, and a compensating reduction in rates so that the corporate tax on domestic income remained unchanged, the nominal U.S. corporate tax rate could be reduced from 48 percent to 33.2 percent. As a result, however, current U.S. revenues from foreign source income would decline by $3.7 billion. This would be partly offset by higher revenues from the termination of deferral, from the repeal of the WHTC, from gross-up of dividends from less-developed country corporations, and from other changes. But a net revenue loss of $3.0 billion on foreign source income would remain after all adjustments.

Few would argue that the United States should unilaterally implement a standard of capital-export neutrality and incur all the associated revenue costs. Such a standard would require tax cooperation between the United States and foreign governments. On the other hand, legislation by the United States to end deferral would not, by itself, move the international tax system closer to a standard of capital-export neutrality. Rather, it would reinforce the existing preferential taxation of corporate profits earned within the United States.[16]

2. *Constitutional problems.*

The taxation of a shareholder on the constructive receipt of a corporation's undistributed earnings raises constitutional issues. Can such earnings properly be viewed as "income" under the terms of the Sixteenth Amendment? This issue has recently been litigated in connection with subpart F. The court decisions upholding subpart F provide some indication of the potential reach of U.S. law if a wider termination of deferral is sought.[17]

The Sixteenth Amendment gives Congress the power to impose income taxes. If a tax is not levied on "income", it would be considered a "direct tax" under the ruling in *Pollock v. Farmer's Loan and Trust* (157 U.S. 429, 158 U.S. 601, 1895), and would require apportionment among the states according to population. The opponents of subpart F have relied on the *Pollock* opinion to argue that the current taxation of each CFC shareholder's portion of undistributed earnings and profits cannot possibly constitute a tax on "income" and must, therefore, be apportioned among the states

16. It should be emphasized that the investment tax credit or DISC can exert a very different impact on investment per dollar of revenue cost than, for example, deferral or the foreign tax credit. Therefore, an examination of total revenue gains and losses under alternative tax systems provides only a rough guide to their impact on the location of investment.

17. Subpart F has withstood legal attacks based on the due process clause of the Fifth Amendment, the principles of international law, and the Sixteenth Amendment. The Sixteenth Amendment issues are most important, and they are the only ones discussed here. The discussion draws on a paper by Howard Liebman.

as a "direct tax." The basis for this reasoning lies in the decision of *Eisner v. Macomber* (252 U.S. 189, 1920) holding that a stock dividend on accumulated profits is not "income" under the Sixteenth Amendment. But *Macomber* was a close decision and has since been undercut by numerous judicial exceptions. Thus, in 1961, the Treasury Department's General Counsel concluded that, "enactment of [subpart F] is appropriately within the constitutional powers of the Congress both to lay and collect taxes and to regulate commerce with foreign nations."[18]

This view has been upheld by the Tax Court:

> The Supreme Court's pronouncements have been to the effect that taxation of undistributed current corporate income at the stockholder level is within the Congressional power.[19]

Although the Supreme Court has not ruled on subpart F, other courts have endorsed the Tax Court's position. There appears to be no constitutional barrier to the termination of deferral for a wider class of income than that presently defined in subpart F.

A more general termination of deferral would, however, provide an incentive for U.S. shareholders to "decontrol" their existing controlled foreign corporations and to take minority positions in new ventures rather than establish new controlled foreign corporations. The incentive to escape current taxation might be mitigated if the ownership threshold used to define a controlled foreign corporation were reduced to 50 percent or less. However, a lower threshold might conflict with the "constructive receipt" doctrine underlying both subpart F and the foreign personal holding company legislation. If the U.S. shareholders are not a closeknit, controlling group that can force the declaration of a dividend, the constitutionality of a lower threshold under the Sixteenth Amendment and the due process clause of the Fifth Amendment must once again be assessed. How can the United States tax a shareholder on an undistributed gain? It may seem "patently unfair and un- of control required to realize the imputed gain? It may seem "patently unfair and unjust to tax anyone on income which he has not received and which is not within his control."[20]

The most recent cases dealing with subpart F have indicated that actual control rather than numerical control is the key issue. In *Garlock* (58 T.C. 423, 1972) "actual control" by U.S. shareholders in a reorganized Panamanian subsidiary was found where the U.S. shareholders only owned 50 percent, and foreign investors, chosen for their sympathy towards the management, owned callable cumulative preferred stock. *Hans P. Kraus* (59 T.C. 681, 1973; affirmed, 490 F. 2d 898, 2d Circuit 1974) presented similar facts. The court looked to substance rather than form and concluded that divestment in order to avoid the impact of subpart F must result in actual decontrol. These and other cases suggest that subpart F could be extended to situations where U.S. shareholders own less than 50 percent

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18. Memorandum from Robert H. Knight to Treasury Secretary Dillion, June 12, 1961, in President's 1961 Tax Recommendations, Hearings before the House Committee on Ways and Means, 87th Congress, 1st Session (1961), Volume 1, p. 322.

19. *Estate of Leonard E. Whitlock,* 59 T.C. 490, 507 (1972); affirmed 494 F. 2d 1297 (10th Circuit, 1974).

20. Statement of Randolph W. Thrower, Hearings before the Senate Committee on Finance, 87th Congress, 2d Session (1962) part 6, p. 2251.

of the foreign corporation, provided that U.S. shareholders exercise actual control.[21]

3. *Foreign reaction.*

Any significant change in the U.S. approach to deferral would raise tax treaty questions and might prompt offsetting foreign tax legislation.

(a) *Tax treaties.* The United States has in force tax treaties with 37 countries. (including extensions to former colonies). Four treaties have been signed and await ratification by the U.S. Senate and foreign parliamentary bodies. Eleven tax treaties are in various states of active negotiation.

The deferral of U.S. tax on the income of controlled foreign corporations is not specifically addressed in these treaties. The U.S. has made no treaty commitments which would preclude partial or total elimination of deferral. However, the classical U.S. system of taxation and the consequent deferral of U.S. taxation of retained foreign corporate earnings are well understood by foreign tax officials, and these elements of U.S. law play an important role in treaty negotiations.

Less developed countries frequently raise the issue of a tax sparing credit. The tax sparing credit is a home country foreign tax credit for taxes waived by the host country, usually through a tax holiday or preferential tax rates designed to encourage a particular industry. The United Kingdom, France, Germany, Japan, Canada and most other industrialized countries grant a tax sparing credit in their bilateral tax treaties with less developed countries. During the 1950's and 1960's, the United States negotiated seven treaties with either a tax sparing credit (Pakistan, India, Israel, and the UAR) or, as a substitute, an investment tax credit (Brazil, Thailand, Israel). In none of the seven cases, did the credit provisions receive Senate approval. The United States Treasury no longer negotiates treaties with either a tax sparing credit or an investment tax credit.

However, in negotiations with less developed countries, the United States has emphasized that deferral does not frustrate local tax incentives. If the host country chooses to reduce its corporate tax rates as an investment incentive measure, the United States will not absorb the incentive through offsetting taxation so long as the foreign subsidiary reinvests its earnings abroad. Moreover, the U.S. ordering rule for associating dividends with earnings and profits ensures that U.S. taxes need never erode the foreign tax relief, even if earnings are distributed during the post-tax relief period. The United States follows a last-in-first-out rule in tracing dividends to the underlying earnings and profits. Thus, suppose Country X grants a five year tax holiday, and in the sixth year imposes a 45 percent tax on current earnings. During the tax holiday period, the controlled foreign corporation accumulates earnings and profits of $12 million, but distributes no dividends. In the sixth year, the corporation earns $3.63 million (before tax), pays foreign taxes of $1.63 million, and therefore has after-foreign-tax earnings of $2.0 million. A dividend of $2.0 million is distributed to the U.S. parent. The entire dividend is deemed to be paid out of current earnings,

21. Income from the insurance of U.S. risks earned by a foreign corporation which is owned more than 25 percent by U.S. shareholders is presently taxed under Subpart F (Section 953 and 957(b)). The 25 percent test has not been litigated, and it is not clear whether it furnishes a precedent for a less than 50 percent ownership test in the absence of actual control.

TABLE 2

Comparison Between Foreign Tax Relief and Foreign Input Subsidies

	Case A	Case B
	U.S. taxation with deferral	U.S. taxation without deferral
	Foreign tax holiday	Foreign corporate tax of 50% plus wage subsidy
Sales	1,000	1,000
Raw materials	400	400
Wages	500	500
Less: wage subsidy	—	(100)
Income before tax	100	200
Foreign tax	—	100
Income after foreign tax	100	100
Deemed or actual dividend distribution	—	100
U.S. tax after foreign tax credit	—	—
Income after all taxes	100	100

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and none of the dividend is deemed to be paid out of accumulated earnings. The grossed-up dividend for U.S. tax purposes will be \$3.63 million.[22] The net U.S. tax on the dividend, after allowance for the foreign tax credit of \$1.63 million, would be \$0.11 million.[23]

The combination of deferral and the dividend inventory rule has proven satisfactory to many of our tax treaty partners. Developed countries have not had to negotiate the U.S. tax treatment of their own tax relief provisions for particular regions or industries. Less developed countries have often dropped their initial demands for a tax sparing credit or similar provisions. If the United States were to terminate deferral, some treaty countries would no longer be satisfied with existing arrangements. They might seek new negotiations with a view toward provision of deferral by treaty. Alternatively, they might take unilateral statutory steps along the lines discussed below.

22. Under present law, dividends for a less developed country corporation are not grossed-up, and a different formula is used to calculate the foreign tax credit. H.R. 10612 would require the gross-up of such dividends.

23. In this case, the deemed paid foreign tax credit is calculated as:

$$\frac{\text{Dividend}}{\text{Earnings after foreign tax}} \times \left\{ \begin{array}{l}\text{Foreign}\\ \text{corporation}\\ \text{income tax}\end{array}\right.$$

$$= \frac{\$2.0}{\$2.0} \times \$1.63 = \$1.63$$

The tentative U.S. tax before the credit would be 48 percent of \$3.63 million, or \$1.74 million. After the foreign tax credit of \$1.63 million, the net U.S. tax would be \$0.11 million.

(b) *Foreign statutory change.* If the United States limits the extent of deferral, countries which provide tax relief as an incentive measure might narrow the scope of that relief to exclude companies which would be subject to current U.S. taxation. The result could be heavier foreign taxation of U.S. controlled foreign corporations, by comparison with competing firms either owned locally or by third country parent firms. In selected instances, heavier foreign taxation might serve to equalize the taxation of U.S. investment at home and abroad, but it would erode the potential gains in U.S. tax revenue from the termination of deferral, and it might put U.S. firms at a severe competitive disadvantage.

There are several ways foreign taxes on U.S. controlled foreign corporations could be selectively increased. Subsidiaries of U.S. corporations might no longer be eligible for special tax holidays and investment tax credits. Egypt, for example, under present law provides tax relief for foreign investors only if the home country does not tax the income either when earned or distributed. Alternatively, withholding taxes could become payable on deemed dividend distributions, as well as on actual dividend distributions, and withholding tax rates could be increased.

In cases where the foreign country wished to encourage U.S. firms, methods could be found which would circumvent the U.S. termination of deferral. The foreign country could provide tax relief for joint ventures in which the U.S. corporation held a minority interest, and therefore was not subject to current U.S. taxation. Alternatively, the foreign country could provide U.S. controlled corporations with input incentives — for example wage or energy subsidies — while taxing the CFCs at rates close to the U.S. corporate rate. This possibility is illustrated in Table 2.

In both situations, the firm has sales of 1,000, raw material costs of 400, and wage costs of 500. In Case A, with U.S. deferral, a tax holiday in the foreign country ensures that the firm realizes after-tax income of 100. In Case B, without U.S. deferral, a wage subsidy of 100 coupled with a foreign corporate tax of 50 percent ensures that the firm still realizes after-tax income of 100.[24] In the eyes of the firm, little has changed.[25] In both cases, the foreign government collects no tax, in the second case, the wage subsidy just offsets the tax, and in both cases the United States collects no tax. It is not clear what the United States would gain by encouraging foreign countries to undertake this sort of fiscal subterfuge.[26]

(c) *Average foreign tax rates.* With the termination of deferral, many foreign countries would be concerned about the U.S. tax status of subsidiaries engaged in particular industries and regions. Although national average tax rates often conceal the situation for individual industries and regions, they do perhaps indicate the most seriously affected nations.

24. The wage subsidy cannot be conditioned on the payment of tax, or it would be regarded as a tax refund for purposes of calculating the U.S. foreign tax credit. On average wage subsidies might equal corporate tax payments for a group of firms, but (unlike the example) they would not be identical for each firm.

25. In the long run, however, the firm may respond differently to a wage subsidy than a tax holiday. For example, a wage subsidy might induce the firm to use more labor and less capital to produce a given level of output.

26. It should be noted that the foreign tax credit mechanism generally encourages foreign governments to tax dividends, interest, rents, royalties, and other foreign income paid to U.S. corporations at a rate near 48 percent.

Table * shows 1974 statutory and realized corporate tax rates, the withholding rate applied to dividends payments to the U.S., and the total (corporate and withholding) realized tax rate on grossed-up dividends for more than 60 countries. Realized corporate tax rates are computed as the ratio of taxes paid to the U.S. definition of pre-tax earnings and profits, which is the base from which the deemed paid foreign tax credit is computed.[27] The realized rates are estimated from 1968 data, adjusted for changes in statutory rates between 1968 and 1974.

The figures in Table 3 are confined to the manufacturing sector. Termination of deferral would have its greatest impact on manufacturing. Realized foreign tax rates on mineral income frequently exceed the U.S. tax rate, so deferred U.S. taxation makes no difference. Undistributed corporate earnings arising in the trade, finance, and insurance sectors are to some extent taxed currently under subpart F (as amended by the Tax Reduction Act of 1975). Thus, low foreign tax rates applied to those sectors are already partly offset by current U.S. taxation.

Table 3 reveals that realized corporate tax rates on manufacturing are generally well below the statutory rate. The median ratio of realized to statutory tax rates in 1974 was approximately 80 percent; in only 11 of the 63 countries did the realized rate exceed the statutory rate.

For purposes of evaluating the consequences of terminating deferral on a country-by-country basis, the correct procedure is to compare foreign total realized tax rates on grossed-up dividends with the U.S. statutory corporate rate of 48 percent.[28] The U.S. foreign tax credit is so designed that the termination of deferral would usually result in higher U.S. taxation of retained corporate income in those countries with realized tax rates below the U.S. statutory rate.[29] Table 3 reveals that in 1974, 26 countries imposed a total realized tax rate on grossed-up dividends above the U.S. statutory rate of 48 percent, while 37 countries imposed total realized rates below the U.S. statutory rate. The partial or complete termination of deferral would principally affect U.S. investment in the 37 countries in the latter category.[30] Of these 37 countries, 27 were less developed countries which presumably rely on tax relief to promote development.

(to be continued)

* See for Table 3 pages 355 and 356.

27. The term "realized tax rate" indicates the ratio between taxes paid and earnings and profits, as reported for U.S. tax purposes. By contrast, the term "effective tax rate" often refers to the ratio between taxes paid and book income, as reported for financial purposes. Foreign effective rates for selected countries are reported in *Survey of Current Business*, May 1974 (Part I).

28. The realized U.S. corporate tax rate on domestic source income was about 41 percent in 1974, but the U.S. statutory rate and not the realized rate applies to foreign source income.

29. This generalization does not apply to U.S. firms which use the overall limitation in reporting the foreign tax credit, and also have excess foreign tax credits.

30. This statement assumes that the termination of deferral would lead to the imposition of withholding taxes on the deemed distribution, or that companies would distribute 100 percent of their earnings. To the extent earnings are retained abroad, and no foreign withholding taxes are imposed, the better comparison is between the realized foreign corporate tax rate and the U.S. statutory rate of 48 percent.

TABLE 3

Statutory and Realized Corporate Income Tax Rates on Manufacturing Firms, 1974

Country	Statutory Tax Rates				Withholding tax rates on dividends distributed to U.S.		
	Corporate Tax Rate[1]	Distributed profits tax rate, if different[2]	Local Income taxes	Realized Corporate tax rate[3]	Statutory or Treaty Rate	Realized Rate on grossed-up dividends	Total realized tax rate on grossed-up dividends
Canada	48.0		13.0	41.1	15.0	8.8	49.9
Europe:							
Austria	55.0	27.5	15.0	53.4	5.0	2.3	55.7
Belgium	42.0	0[4]		37.5	15.0	9.4	46.9
Denmark	36.0			32.5	5.0	3.4	35.9
France	50.0	25.0		48.0	5.0	2.6	50.6
Germany	51.0	15.0	13.0	43.0	15.0	8.5	51.5
Greece	38.2	0[4]		11.9	30.0	26.4	38.3
Ireland	50.0	27.0		12.7	5.0	4.4	17.1
Italy	43.8		[5]	41.9	5.0	2.9	44.8
Luxembourg	40.0		14.0	17.1	5.0	4.1	21.2
Netherlands	48.0			36.0	10.0	6.4	42.4
Norway	26.5	0[4]	21.3	40.5	15.0	8.9	49.4
Spain	32.8			30.3	15.0	10.5	40.8
Sweden	40.0		25.0	43.1	5.0	2.8	45.9
Switzerland	8.8		28.0	27.1	5.0	3.6	30.7
United Kingdom	52.0	26.2		44.6	15.0	8.3	52.9
Oceania:							
Australia	47.5			42.9	15.0	8.6	51.5
New Zealand	45.0			51.7	5.0	2.4	54.1
Latin America:							
Mexico	42.0			42.2	20.0	11.6	53.8
Argentina	42.9			28.2	12.0	8.6	36.8
Brazil	96.7	33.5		30.3	25.0	17.4	47.7
Chile	41.7			39.4	40.0	24.2	63.6
Columbia	36.0			47.3	20.0	10.5	57.8
Ecuador	20.0	40.0		18.7	40.0	32.5	51.2
Peru	55.0			47.7	30.0	15.7	63.4
Uruguay	37.5			25.2	25.0	18.7	43.9
Venezuela	50.0			30.0	15.0	10.5	40.5
Costa Rica	40.0			33.7	15.0	9.9	43.6
El Salvador	15.0			7.6	38.0	35.1	42.7
Guatemala	52.8			21.0	10.0	7.9	28.9
Honduras	40.0			25.2	5.0	3.7	28.9
Nicaragua	30.0			1.8	0.0	0.0	1.8
Panama	50.0			15.4	10.0	8.5	23.9
Africa:							
Algeria	50.0			0.0	18.0	18.0	18.0
Morocco	48.0			54.5	25.0	11.4	65.9
Liberia	45.0			5.7[6]	15.0	14.1	19.8

U.S.A.: UNDISTRIBUTED INCOME OF CONTROLLED FOREIGN CORPORATIONS

Country	Statutory Tax Rates				Withholding tax rates on dividends distributed to U.S.		
	Corporate Tax Rate [1]	Distributed profits tax rate, if different [2].	Local Income taxes	Realized Corporate tax rate [3]	Statutory or Treaty Rate	Realized Rate on grossed-up dividends	Total realized tax rate on grossed-up dividends
Ethiopia	40.0			38.6	0.0	0.0	38.6
Kenya	40.0			19.0	12.5	10.1	29.1
Nigeria	45.0			4.7	15.0	14.3	19.0
Rhodesia	40.0			30.9	15.0	10.4	41.3
South Africa	43.0			41.9	15.0	8.7	50.6
Zambia	45.0			28.0	15.0	10.8	38.8
Middle East:							
Iran	10.0	55.0	3.4	10.5	60.0	53.7	64.2
Israel	56.5	42.0		44.7	30.0	16.6	61.3
Lebanon	42.0		15.0	15.1	10.0	8.5	23.6
Asia:							
Sri Lanka	60.0	33.3		21.2	39.3	31.0	52.2
India	60.0			57.0	25.7	11.1	68.1
Malaysia	40.0			27.9	40.0	28.8	56.7
Pakistan	60.0			52.6	15.0	7.1	59.7
Phillippines	35.0			29.6	35.0	24.6	54.2
Singapore	40.0			26.9	40.0	29.2	56.1
Taiwan	25.0			6.0	10.0	9.4	15.4
Thailand	30.0			14.9	25.0	21.3	36.2
Hong Kong	15.0			15.5	0.0	0.0	15.5
Japan	40.0	28.0	12.0	47.4	10.0	5.6	53.0
Indonesia	45.0			36.4 [6]	20.0	12.7	49.1
Other Western Hemisphere:							
Bahamas	0.0			5.1	0.0	0.0	5.1
Bermuda	0.0			0.3	0.0	0.0	0.3
Netherlands Antilles	34.0		15.0	4.5 [6]	0.0	0.0	4.5
Dominican Republic	41.1			21.7	18.0	14.1	35.8
Jamaica	45.0			22.6	37.5	29.0	51.6
Puerto Rico	40.0			12.2	15.0	13.2	25.4
Trinidad & Tobago	45.0			36.7	10.0	6.3	43.0

Office of the Secretary of the Treasury
Office of Tax Analysis

April 6, 1976

Notes: 1. For some countries, 1974 rates were unavailable and 1973 rates were used.
2. The distributed profits tax rate reflects both split rates and imputation systems.
3. Estimated by increasing (or decreasing) the 1968 realized corporate rate for manufacturing by the percentage change in the statutory corporate rate.
4. Dividends are fully deductible from earnings in Greece and Norway; in Belgium, they are deductible within limits.
5. Included in the corporate rate.
6. This is the realized rate for all industries.

Sources: M. E. Kyrouz, "Foreign Tax Rates and Tax Bases," *National Tax Journal,* March 1975; unpublished data.

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I. ARTICLES

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ARTICLES

AHMAD IMAM *:

LE DROIT DE SUCCESSION DANS LA RELIGION ISLAMIQUE

La religion islamique est la religion basée principalement sur le livre sacré qui s'appelle le «Coran». Ce livre est non seulement une source de religion, mais aussi de droit commun, qui régit tout le monde musulman. Quand on analyse ce livre, on trouve qu'il a réglé trois sortes de relations:

1) Les relations entre l'homme et Dieu,
2) Les rapports de l'homme avec lui-même,
3) Les relations entre l'homme et la société.

Ce qui nous intéresse dans ce livre comme source de droits sociaux, ce sont les relations entre l'homme et la société, et spécialement le domaine des droits de succession. Ce qui nous pousse à traiter ce sujet, c'est le fait que le droit musulman n'est pas encore été étudié d'une manière étendue et approfondie en Europe occidentale.

En effet, l'étude du droit musulman dépasse le domaine de la pure érudition pour entrer dans celui de la science d'application immédiate, et il s'est formé à cet égard une vaste littérature.

Pourtant, la littérature juridique arabe est peu accessible aux juristes internationaux en raison de ses difficultés linguistiques. Beaucoup de travaux qui ont été consacrés à ce problème se sont inspirés de simples traductions ou d'ouvrages de seconde main. Notre intention est de voir comment les peuples islamiques ont pratiqué le Coran en tant que loi positive. Voici un bref aperçu du droit successoral applicable aux musulmans.

CARACTERISTIQUES GENERALES DU DROIT DE SUCCESSION DANS LA RELIGION ISLAMIQUE

L'Islam a à cet égard une conception particulière, différente de celle des pays européens.

A) *L'inégalité des sexes dans le droit à la succession*

— Le droit musulman ne reconnaît à un successible de sexe féminin venant en concours avec un successible de sexe masculin qu'une part égale à la moitié de la part de celui-ci.
— Dans le système successoral islamique, lorsqu'une fille est seule successible à un degré déterminé, elle ne peut jamais absorber toute la succession, elle n'a droit qu'à la moitié de l'héritage (ou aux deux tiers en cas de pluralité), le reste allant à d'autres successibles rattachés au de cujus par un lien de parenté par les mâles.
— Les parents des deux sexes, tant par les mâles que par les femmes jouissent des mêmes droits.

Dans le même ordre et au même degré, tout successible, quelle que soit la nature de son lien de parenté avec le de cujus, hérite dans les mêmes conditions.

Evidemment de telles règles se justifient par les diverses obligations mises à la charge de l'homme. Pourtant, elles apparurent depuis le début de notre siècle en contradiction avec les nouveaux principes démocratiques. Leur abrogation était im-

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possible puisqu'elles etaient expressément formulées dans le Coran (Coran IV, 12). Pourtant il y a une tendance dans quelques pays arabes, dans leurs lois positives, (l'Egypte par exemple) à restreindre leur domaine d'application.

Cette tendance se manifeste dans les lois relatives à la transmission successorale de la pension du défunt. Sous le prétexte que la nue-propriété de ces revenus appartient à l'Etat et que, de ce fait, ils ne font pas partie à proprement parler du patrimoine du défunt, la loi les soumet à des règles de dévolution particulières, qui admettent, entre autres, le principe de l'égalité de la part successorale entre l'homme et la femme.

B) *Reconnaissance d'un droit de succession aux enfants naturels et adoptifs*

I) *Enfants naturels*

En droit musulman, la situation de l'enfant naturel est réglée différemment suivant qu'il s'agit des rapports avec le père ou des rapports avec la mère.

1) A l'égard du père, la filiation naturelle n'est absolument pas reconnue. Mais, un homme peut reconnaître volontairement un enfant non issu d'un mariage régulier et cette reconnaissance confère à l'enfant la qualité d'enfant légitime. Cette règle s'explique par l'admission des rapports hors mariage, avec les femmes esclaves. Les enfants issus de ces rapports sont attribués au père en tant qu'enfants légitimes, s'il veut bien les reconnaître.

2) A l'égard de la mère, la situation est différente. La filiation naturelle à son égard est pleinement admise, ou, plus exactement, elle est légalement imposée en ce sens que les enfants naturels d'une femme lui sont, par le seul fait de leur naissance, nécessairement attribués. Ils sont assimilés à des enfants légitimes et ils ont les mêmes droits — dont le droit de succession.

Mais le droit de l'enfant naturel est limité à la succession de la personne qui l'a engendré ou reconnu.

II) *L'enfant adoptif*

L'adoption n'est pas reconnue en droit musulman, elle y est même formellement interdite par des textes du Coran et, par conséquent, il ne peut être question pour les enfants adoptifs de droits successoraux. On rencontre dans les droits positifs de quelques pays arabes des dérogations à ces principes (Egypte per exemple). Ainsi, une mère peut par tous les moyens acceptables par le juge civil prouver la paternité de son enfant vis-à-vis d'un homme déterminé. Un tel jugement peut donner à l'enfant tous les droits sur la succession de son père, comme un enfant issue du mariage légal. Mais la femme n'a aucun droit de succession, puisqu'il n'y a pas de mariage légal dans ce cas.

C) *L'empêchement à succession résultant de la différence de religion*

Dans la religion islamique, la différence de religion entre le de cujus et les héritiers est un empêchement à succession, tout au moins dans les rapports entre la religion islamique et les autres religions. Dans les rapports de ces dernières entre elles, il n'y a pas d'empêchement, car au regard de l'Islam, les non-musulmans, se confondent en une même infidélité.

D) *L'empêchement résultant de la différence de nationalité*

La conception de la nationalité en droit musulman ne coïncide pas exactement avec la conception moderne. Le droit public musulman distingue deux parties dans le monde, celle qui est soumise à l'autorité islamique et celle qui lui échappe. Les ressortissants des divers Etats musulmans, si indépendants qu'ils soient, ne sont pas considérés comme des étrangers les uns par rapports aux autres, et cela en raison du principe théorique de l'unité du monde musulman. Par conséquent, il n'existe pas d'empêchement à succession entre deux. D'autre part, les ressortissants musulmans de puissances non islamiques sont considérés comme partie du monde musulman, et par conséquent, il n'existe pas d'empêchement à succession avec eux.

L'empêchement ne peut donc jouer qu'en ce qui concerne les non-musulmans, ressortissants de puissances infidèles, et les non-musulmans, ressortissants de puissances musulmanes, les uns par rapport aux autres.

E) *La liberté de transmettre par testament et par donation*

Le legs au profit d'héritiers venant utilement à la succession est interdit et, d'autre part, la liberté de tester au profit d'autres personnes est limitée uniformément au tiers de l'héridité. En revanche, aucune restriction n'est apportée quant aux libéralités par actes entre vifs.

F) *Conception de la succession aux biens ou de la succession à la personne*

La conception de la succession est limitée. La saisine héréditaire ne se produit pas de plein droit, par le fait du décès, mais après la liquidation de la succession par l'acquittement du passif.

On ne devient héritier, il n'y a transmission héréditaire, qu'après paiement des dettes. Aussi bien, tant que cette opération n'est pas accomplie, il ne peut être question de succession à proprement parler; c'est ce qu'exprime l'adage célèbre «pas de succession avant l'acquittement de dettes». Entretemps, la succession constitue une masse autonome de biens appartenant toujours fictivement au défunt. Le rôle juridique du successible consiste à représenter le défunt, à représenter la succession, considérée comme entité juridique pour les besoins de la liquidation.

SUCCESSION TESTAMENTAIRE

Le testament est un acte juridique unilatéral qui devient obligatoire à la mort du testateur. Dans la religion islamique, on trouve deux sortes de testaments:

1) Le testament en faveur d'autres que les héritiers
2) Le legs nécessaire

1. *Le testament optionnel*

Dans la religion islamique, il existe un principe qui défend au testateur de tester en faveur d'un héritier. La raison est claire et peut s'expliquer par l'assurance de l'égalité entre tous les héritiers, pour la stabilité de bonnes relations entre eux après le décès du défunt. Le droit du testateur est limité aux tiers de son héritage.

Si le de cujus a fait plusieurs testaments à plusieurs personnes avant sa mort, la quotité disponible du tiers doit être calculée eu égard à ce qui reste de la succession, une fois réglés les droits qui ont priorité sur les legs.

Si le tiers disponible ne peut suffire à couvrir tous les legs, les légataires se le partagent au prorata de leur quote-part.

2. *Le legs nécessaire*

Pour bien comprendre ce principe, voici un exemple. Il arrive souvent qu'une personne ait des petits enfants issus d'un fils prédécédé ou décédé en même temps qu'elle. Ces descendants n'ont normalement pas de droit de succession direct, spécialement s'il se trouve d'autres fils ou filles du défunt. Pourtant, la loi islamique, c'est-à-dire le Coran, a donné à ces descendants le droit de bénéficier dans la limite du tiers disponible d'un legs obligatoire, dans la mesure et les conditions suivantes:

1) Ces descendants ont droit au legs obligatoire dans la mesure de la quote-part des biens que leur père aurait recueillie de son auteur s'il leur avait survécu, toutefois, leurs droits ne peuvent dépasser le tiers de la succession de leur père.

2) Ont droit à ce legs obligatoire les enfants du fils, quel que soit leur nombre.

3) Ce legs obligatoire est considéré comme la succession du père et est partagé conformément à la règle générale, l'héritier de sexe masculin recevant une part double de celle de l'hériter de sexe féminin.

4) Evidemment, si le de cujus a testé au profit de ces descendants une part égale à celle à laquelle ils pouvaient prétendre au titre du legs obligatoire, dans ce cas ces descendants n'ont pas droit à ce legs obligatoire.

5) Le legs obligatoire n'est pas applicable aux enfants de la fille décédée avant son père.

QUELLE EST LA FORME DU TESTAMENT?

Dans le Coran, on ne trouve pas de forme déterminée pour faire un testament. Par conséquent il dérive des rites islamiques. Ils sont d'accord sur les formes suivantes:

1) Le testament verbal, mais pour être valable, il est indispensable qu'il ait l'assistance de deux témoins musulmans.

2) Le testament écrit, soit de la main du testateur, soit dicté au cadi. En ce qui concerne les autres formes comme le testament par signe, il n'est pas admis en rite hanéfite ni honbalite.

Evidemment, le testateur peut toujours révoquer son testament, sauf, lorsqu'il s'agit de l'affranchissement d'un esclave à cause de mort. La révocation peut être faite dans les mêmes formes que le testament c'est-à-dire verbale ou par écrit.

Quant aux effets du testament, il est nécessaire que:

1) il ne soit pas entaché de nullité comme par exemple pour défaut de capacité;

2) il soit possible de l'exécuter, par exemple, la perte de la chose testée rendra le testament sans valeur.

CONDITIONS D'OUVERTURE DE LA SUCCESSION

Dans la religion islamique comme dans la loi positive des pays d'Europe, la vocation successorale est soumise aux conditions suivantes:

1) La certitude de la mort réelle ou judiciairement présumée du de cujus
2) L'existence d'un héritier au moment du décès réel ou présumé et du lien qui confère la qualité de successible
3) L'existence d'une hérédité

En voici les explications:

1. *Le défunt:* il s'appelle en droit musulman «mouareth». La succession s'ouvre par son décès réel, présumé ou déclaré. Le décès est réel lorsqu'on en a la preuve matérielle. Elle est présumée dans:

a) une longue absence sans aucune preuve de sa mort ou de sa vie;
b) l'absence dans une circonstance qui donne un caractère vraisemblable à la mort, comme par exemple dans le cas de la guerre, le défunt n'est pas retourné après la fin d'une guerre.

Dans ces cas, il ne suffit pas que la mort d'une personne paraisse vraisemblable pour qu'elle puisse être présumée, il faut que cette vraisemblance ait fait l'objet d'une constatation et c'est le juge seul qui a qualité pour y procéder.

2. *L'héritier:* il est désigné en droit musulman par le mot «warith». La vocation successorale résulte soit du mariage, soit de la parenté; cependant, le mariage ne crée de droits successoraux entre époux qu'à condition qu'il ait été régulièrement contracté, et qu'il n'ait pas été définitivement dissous. La parenté comprend à la fois la parenté légitime et la parenté naturelle, cette dernière ne créant de droits successoraux qu'entre l'enfant naturel et sa mère, comme nous avons expliqué ci-dessus.
Evidemment, il faut encore que l'héritier existe au moment de l'ouverture de la succession, et qu'il n'y ait pas d'empêchement — comme nous avons mentionné plus haut — qui s'oppose au droit successoral.

3. *L'hérédité:* elle s'appelle en droit musulman «Tarikah». Elle est constituée par la différence entre tous les biens qui appartenaient au défunt, tous les droits que celui-ci exerçait de son vivant à l'exception de ceux inhérents à sa personnalité et les charges qui prennent naissance du fait du décès, à savoir les frais funéraires et les legs. Le solde restant après paiement de toutes ces dettes et charges est considéré comme l'hérédité et est dévolu aux héritiers conformément au principe fondamental «pas de succession avant l'acquittement des dettes». Le droit musulman considère en conséquence les héritiers comme succédant aux biens et non tenus aux dettes du défunt.
En effet, le Coran ne contient que les principes généraux du droit successoral. L'application de ces principes est réglée à toutes les espèces d'héritiers et à donné lieu à des interprétations divergentes. Ces interprétations ont fait l'objet à leur tour d'explications et de commentaires qui ont fait du droit musulman un réseau inextricable.
Ajoutons que dans cette religion ni l'héritier ni son auteur ne peuvent renoncer à la qualité d'héritier ou autre. Ils ne peuvent s'en désister en faveur d'autrui.
L'héritier qui tue volontairement et injustement son auteur n'hérite pas de ses biens. Répétons qu'il n'y a pas de vocation successorale entre un musulman et un non-musulman, ni entre le père et son enfant dans le cas où la loi n'admet pas le lien de parenté, ni entre l'enfant issu de relations illicites et son père.

DEVOLUTION SUCCESSORALE

Le système successoral musulman a un caractère religieux, un grand nombre de ses règles étant contenu dans le Coran même, et les autres découlant d'autres sources également considérées comme religieuses. Le Coran précise les parts d'héritage que chacun doit automatiquement recevoir suivant les liens de parenté qui l'unissent au défunt.
La détermination de la part dévolue à chacun des héritiers obéit à des règles qui tiennent compte de plusieurs facteurs, à savoir le sexe de l'héritier, le degré de sa parenté avec le défunt, le lien qui l'unit à celui-ci et enfin le nombre et la qualité des héritiers venant en concours.
A cet égard, les différents rites du Coran sont d'accord pour diviser les héritiers en trois classes:

1) Acehab-al-fouroud: ce sont les père et mère et leurs descendants des deux sexes à l'infini.
2) Al-Açaba: ce sont les frères et soeurs et leurs descendants des deux sexes, les

grand-mères et grand-pères et leurs ascendants.

3) Zawil-arham: ce sont les oncles et les tantes paternels et maternels.
4) A défaut d'héritier appartenant à l'une des classes précédentes, la succession échoit au Bait al Mal (trésor public).

Les héritiers de chaque ordre ne sont appelés qu'à défaut d'héritiers dans l'ordre précédent. Dans chaque ligne, les héritiers les plus proches écartent les plus éloignés. Ainsi, la présence du grand-père ou de la grandmère exclut de la succession leurs ascendants.

Evidemment, à côté de l'accord des différents rites islamiques sur quelques règles, il y a aussi plusieurs divergences spécialement chez les sunnite, les malqui, les hanafie et les chafi.

Pour éviter toutes ces divergences d'opinions et pour être bref, on peut rappeler les dispositions essentielles d'une manière simple:

1) *Les parts réservées aux acebab-al-fouroud:*

Ces parts sont le plus souvent spécifiées dans les versets, 11, 12 et 175 de la sourate IV du Coran (voir Clavel, Code du statut personnel, t. 11, p. 33). «Dieu vous recommande pour les parts successorales de vos enfants que la part de ceux du sexe masculin soit le double de celle de ceux du sexe féminin. Si ces enfants sont plus que deux filles, elles ont droit aux deux tiers de la succession, s'il n'y avait qu'une seule fille, elle a droit à la moitié de la succession. Les pères et mères du défunt auront chacun le sixième de ce que l'homme laisse, s'il a un enfant; s'il n'en laisse aucun et que ses ascendants lui succèdent, la mère aura un tiers, s'il laisse des frères, la mère aura un sixième après que les legs et dettes du testateur auront été acquittés. Vous ne savez pas qui de vos parents ou de vos enfants vous est le plus utile — telle est la loi de Dieu».

«A vous, hommes, la moitié de ce que laissent vos épouses, si elles n'ont pas d'enfants, et si elles en laissent, vous aurez le quart après les legs qu'elles auront faits et les dettes payées.»

«Elles (les femmes, vos épouses) auront le quart de ce que vous (leurs maris) laissez après les legs que vous aurez faits et les dettes payées, si vous n'avez pas d'enfants, et si vous avez des enfants elles auront le huitième de la succession après les legs que vous aurez fait et les dettes payées. Le frère ou la soeur hérite chacun le sixième de la succession, s'il est seul et si le défunt n'a laissé ni descendants, ni ascendents. Si les frères et soeurs sont plusieurs, ils concourent au tiers de la succession après que les legs et les dettes du défunt auront été acquittés.»

«La soeur unique hérite de la moitié de la succession, si le défunt n'a pas laissé de descendants, et le frère hérite de sa soeur si elle n'a pas d'enfants. S'il y a deux soeurs, elles héritent des deux tiers de la succession, et si les héritiers sont des hommes et des femmes, l'héritier mâle a droit à une part double de celle de l'héritier du sexe féminin.»

Ajoutons, que les droits de succession des aïeux, paternels et maternels découlent de certains «hadith» et de l'interprétation de certaines dispositions du Coran.

Toutefois, l'aïeul paternel n'hérite qu'à défaut du père. En principe l'aïeul a les mêmes droits que le père, c'est-à-dire un sixième de la succession. S'il y a plusieurs aïeules, ce sixième est partageé entre elles.

2. *Les parts des açabat*

Comme nous l'avons expliqué, ce sont les parents par les mâles ou assimilés, qui ont

droit à ce qui reste de la succession quand le prélèvement des açehab-al-fouroud a été opéré.
Ce qui caractérise leur situation, c'est qu'ils ont une vocation éventuelle à la totalité de la succession. Si les héritiers açehab-al-fouroud prennent tout, l'açabat n'a rien, s'ils ne prennent qu'une partie, ils ont droit au tout, parce que ce sont les açabat qui constituent la vraie famille.
Conformément aux rites islamiques les açabat sont divisés en:

a) Açabat par eux mêmes sont les agents mâles dont lien avec le défunt ne comprend pas de femme comme par exemple, le fils du fils, le père, le frère germain, le frère consanguin, l'oncle germain, l'oncle consanguin.
b) Açabat par un autre parent, ce sont des femmes comme la fille, la petite fille, la soeur germaine et la soeur consanguine.
c) Açabat avec un autre parent: Ce sont aussi, comme les açabat par un autre, des femmes: la soeur germaine et la soeur consanguine.

Les acabat sont appelés à la succession d'après leur ordre. A égalité d'ordre, la branche la plus rappochée du défunt prime les autres. Les héritiers au degré le plus proche excluent ceux des autres degrés.
A degré de parenté égal, entre plusieurs héritiers, il y a lieu au partage qui se fait par tête, et en donnant à l'héritier mâle une part double de celle d'une femme.

3. *Les parts successorales des Zawil-arham*

A ces deux premières classes de successible viennent s'ajouter dans le rite hanéfite, les zawil-arham, ou parents par les femmes appelés à défaut de parenté par les mâles. Evidemment, ils ne sont ni héritiers-afard, ni héritiers-açabat.
Ce sont par exemple: le fils de la fille, le grand père maternel, le fils ou la fille du frère utérin ou de la soeur utérine etc. Leur droit d'héritage n'était pas déterminé par le Coran directement mais par un hadith du prophète, selon lequel l'oncle maternel est l'héritier de celui qui n'a pas d'héritier.
Ajoutons, que pour leur attribuer un droit successoral, le rite hanéfite a lié cette parole du prophète (mentionnée ci-avant avec le verset VIII, 76 du Coran qui dit «les hommes unis par les liens du sang sont préférables à autrui, les uns au regard des autres; c'est-à-dire aux autres musulmans, à l'ensemble de la communauté musulmane. Les zawil-arham qui sont par définition des gens unis par les liens du sang sont préférables à la communauté musulmane, ils doivent donc être préférés au trésor.
En ce qui concerne le taux d'impôt sur les droits de succession, on peut constater que le Coran ne connaît pas d'impôt obligatoire sur l'héritage, mais un impôt spécial sur la richesse, dont le taux est de 2,5%. Le juge peut obliger l'héritier à payer ce taux s'il refuse de le faire volontairement.

LA FORMALITE D'OUVERTURE DE LA SUCCESSION, QUI EN FAIT LE PARTAGE?

En ce qui concerne la formalité d'ouverture de la succession, on ne trouve pas en effet de règles dans le Coran.
Evidemment, comme il n'y a pas de textes qui jugent ces cas dans le Coran, on trouve des différences d'opinions chez les différents rites islamiques, mais ce sont les règles les plus courantes dans la pratique, que enous avons mentionnés.
Ajoutons, que d'après le droit islamique, il n'y pas de fusion entre la fortune du défunt et celle de l'héritier. Voila pourquoi les créanciers de la succession ne peuvent faire valoir leurs créances que contre la

succession; d'un autre côté les héritiers n'ont aucun droit sur la succession tant que toutes les dettes de la succession n'ont pas été payés.

Le de cujus peut désigner un exécuteur testamentaire pour y procéder. Mais c'est, en général, le fait des héritiers.

Les héritiers peuvent choisir un d'entre eux pour la liquidation c'est-à-dire de déterminer les actifs et les passifs — avant les partages. Ainsi, les dettes du défunt deviennent immédiatement exigibles comme les frais funéraires les legs jusqu'à concurrence du tiers de l'actif net de la succession. Les héritiers peuvent annuler le mariage du défunt, ainsi que les libéralités consenties par le de cujus durant la période où il se trouvait déjà un état de maladie mortelle. Tout ceci se fait par acte du cadi.

Les mêmes règles s'appliquent concernant le partage de la succession:

1) Si les héritiers sont tous présents, capables, majeurs, ils partagent la succession comme bon leur semble.

2) Dans le cas contraire, le partage est fait par le juge, lequel doit observer l'égalité absolue et les règles coraniques de la part de chaqu'un. Par conséquence s'il y a des absents, leur part est mise en réserve paternelle, soit tuteur ou curateur pour diriger les biens des mineurs, des incapables ou des absents.

L'APPLICATION PRATIQUE DE CES REGLES DANS LES LOIS POSITIVES DES PAYS ARABES

La loi musulmane ne régit que les successions laissées par des musulmans. Le statut successoral est, en effet, une dépendance du statut personnel, or en cette matière, les chrétiens et les juifs conservent, en pays musulman, le bénéfice de leur loi religieuse. Toutefois, il est admis que les héritiers peuvent se mettre d'accord pour décider que la succession laissée par leur auteur soit régie par la loi musulmane, mais il faut l'assentiment de tous les intéressés.

Dans les pays arabes, pour appliquer de telles règles on trouve différentes situations:

1) Le Coran est considéré dans quelques pays arabes comme source directe de droit, comme par exemple en Arabie Séoudite et au Koweit.

2) Dans quelques pays, comme par exemple en Egypte, un essai d'unification du droit successoral a été tenté, il y a une cinquantaine d'années, et les tribunaux doivent appliquer un droit unique pour tous les citoyens au fur et à mesure de sa publication.
   Pourtant, le Coran est considéré comme source de droit résiduaire, c'est-à-dire qui si les lois positieves ou la coutume ne tranchent pas un cas déterminé, le juge est obligé de trouver la solution directement dans le texte du Coran. Ajoutons que, dans la plupart des cas, les pays arabes ont absorbé les jugements du Coran et les ont codifiés comme droit positif.

3) Dans d'autres pays arabes, comme au Liban, on a adopté les textes de la loi européenne, spécialement de droit français.

En ce qui concerne les impôts applicables aux successions dans les pays arabes, on trouve beaucoup de différences:

1) Dans l'Arabie Séoudite, on applique directement les textes du Coran, c'est-à-dire la taxe de 2,5% sur la richesse.

2) En Syrie et au Maroc par exemple, il y un impôt progressif sur la part de chaque héritier. (Voir Annexe I en II.)

3) En Egypte, on trouve deux sortes différentes d'impôts progressifs:

a) Le premier sur la succession avant le partage, avec l'exonération de succession faible qui ne dépasse pas un montant déterminé décidé par la loi. (Voir Annexe III, Tableau no. 1.)

b) Un impôt progressif sur la part de chaque héritier, conformément à un tableau déterminé dans la loi fiscale. Voir Annexe III, Tableau no. 2.)

Ce taux est différent suivant le montant touché par chaque héritier et son lien avec le défunt, c'est-à-dire que le taux est plus élevé si le lien est plus éloigné, et diminue, si le lien est plus proche. Le taux va de 5% à 40% avec exonération de la part d'héritage qui ne dépasse pas une limite déterminée.

NOTRE NOTE

Dans l'estimation de ce droit nous ne pouvons pas oublier l'opinion du doyen Morand qui a dit: «Le système est dans l'ensemble plus facile à saisir que celui des droits français»; également le Professeur Bousquet dans son livre intitulé «Précis de droit musulman» a appuyé le doyen Morand son opinion. Ajoutons que ce dernier, pour appuyer son assertion, a présenté une comparaison pour affirmer que la liquidation des droits successoraux est plus aisée chez les musulmans que chez les français. Voici pourquoi:

Droit français	*Droit musulman*
1) Très souvent la liquidation de la succession se mêle à une liquidation de communauté.	1) Il n'y a pas de régime matrimonial, donc jamais de complication provenant de ce fait.
2) Les dispositions testamentaires peuvent compliquer la liquidation des droits successoraux.	2) Le testament ne peut jamais compliquer la dévolution successorale, les légataires ne sont que des créanciers de l'actief successoral, et les héritiers ne sont jamais légataires.
3) Les donations entre vifs doivent être prises en considération pour l'établissement de la masse partageable et la détermination des droits de chacun.	3) Aucune théorie du rapport, ou de réduction l'actif au jour du décès; les libéralités dans le passé ne comptent pas.
4) Parfois on tient compte de l'origine des biens (successions anormales)	4) Aucune théorie de la succession anormale: ici encore le passé ne compte pas.
5) La question de la succession au passif se pose.	5) Elle ne se pose pas.
6) Complication provenant des enfants naturels reconnus. Très légère complication provenant de la représentation.	6) Il n'y a pas de représentation.

De notre part, nous pouvons appuyer cette idée — la facilité du droit de succession dans la religion islamique vues les considérations qui précèdent, conduisent à penser que le Coran n'est pas seulement un livre religieux mais aussi une source de droit social. La dévolution héréditaire étant fixée par la loi, c'est-à-dire voulue par Dieu et non fondée sur la volonté tacite du de cujus. La volonté humaine ne peut en principe en modifier le régime.

Le Coran n'admet ni l'institution d'héritier, ni la transmission du patrimoine tout entier par le moyen du legs. Il ne laisse à la volonté humaine qu'un pouvoir limité de modifications.

Malgré toutes les critiques contre ses règles, il a sauvegardé à notre avis l'intérêt des héritiers et n'a pas permis au défunt de manifester son outrance ou sa témérité. D'autre part, la détermination de la part de chaque héritier par le Coran a donné un facteur psychologique et par suite diminué les litiges.

Annexe I — Syrie

Tableau no. 1

LE TAUX DE DROIT DE SUCCESSION ET DE MUTATION PAR DECES Y INCLUS L'IMPOT DE LA DEFENSE CONFORMEMENT A LA DECISION No. 1174 DATEE DU 11.5.1957 ET LE PROJET DE LA LOI No. 38 DATEE 25.2.1965

Degré de parenté	La partie de 1-5.000 L.S.	de 5.0001-10.000 L.S.	de 10.001-15.000	de 15.001-20.000	de 20.001-40.000	de 40.001-65.000	de 65.001-100.000	la somme qui dépasse la tranche de 100.000
Les descendants	4	6	9	11	14	16	20	24
Les époux Le père - la mère	8	11	15	18	22	26	30	36
Parents consanguins autre que le pere, la mère, le frère et la soeur	11	16	21	26	32	38	45	53
Les oncles et les tantes paternels et maternels et neveux des neveux	15	21	27	34	41	48	58	72
Les autres héritiers	20	27	34	41	48	60	72	96

Tableau no. 2

LE TAUX DE DROIT DE SUCCESSION ET DE MUTATION PAR DECES SUR LES BIENS TRANFERES AUX AUTRES PAR LA VOIE DE SUCCESSION TESTAMENTAIRE OU DON Y COMPRIS L'IMPOT DE LA DEFENSE CONFORMEMENT A LA DECISION No. 1174 DATEE 11.5.1957 ET LE PROJET DE LA LOI No. 38 DATEE 25.2.1965

Degré de parenté	de 1-5.000 L.S.	de 5.001-10.000	de 10.001-15.000	de 15.001-20.000	de 20.001-40.000	de 40.001-65.000	de 65.001-100.000	plus de 100.000
Les descendants	5	8	10	12	15	17	21	27
Les époux Le père - la mère	9	12	16	20	23	27	32	40
Parents consanguins autres que le père, la mère, le frère et les soeurs	12	17	22	27	34	41	48	58
Les oncles et les tantes paternels et maternels et les neveux et les nièces	17	23	29	35	44	51	60	77
Les autres légataires	24	32	39	46	53	68	77	100

Annexe II — Maroc

LE DROIT D'ENREGISTREMENT DES INVENTAIRES ETABLIS APRES DECES *

En ligne directe et entre époux	0.50%
Entre collatéreaux du 2° an 4° degré	1 %
Pour les autres personnes	4 %

* D'après des derniers documents en notre possession. (Septembre 1973)

Annexe III — Egypte

Tableau no. 1

L'IMPOT SUR LA SUCCESSION AVANT LE PARTAGE D'HERITAGE

LE TAUX EST PROGRESSIF

Date de l'application de la loi	La première tranche 5.000 LE	5.000 LE suivants	15.000 LE suivants	25.000 LE suivants	50.000 LE suivants	Ce qui dépasse la somme précédante
Le projet de la loi No. 159 pour l'année 1957 entre en vigeur le 21.8.1952	exonéré	5%	10%	25%	30%	40%
	5.000 LE premiers	les 5.000 suivants	les 10.000 suivants	les 15.000 suivants	25.000 suivants	Ce qui dépasse la somme précédante
La loi No. 202 pour l'année 1960 entre en vigueur le 10.7.1960	éxonéré	5%	10%	20%	30%	40%

Tableau no. 2

L'IMPOT PROGRESSIF SUR LA PART DE CHAQUE HERITIER

CET IMPOT A ETE IMPOSE SUR LA PART D'HERITAGE DE CHAQUE HERITIER PAR LA LOI No. 142 POUR L'ANNEE 1944. IL EST CALCULE SUR L'HERITAGE DE CHAQUE PERSONNE APRES LA DEDUCTION DE L'IMPOT GLOBAL SUR LA SUCCESSION PAR TRANCHE

LE TAUX DE CET IMPOT A ETE CHANGE PLUSIEURS FOIS. LE DERNIER CHANGEMENT A EU LIEU PAR LA LOI DE 10.7.1960: LES TAUX SONT LES SUIVANTS:

La part nette après la déduction de l'impôt sur la succession	Le taux de l'impôt sur la part de chaque héritier	
de 1 - 5.000 L.E.	5%	*Note.* 1) Le taux de ces impôts qui sont mentionnés dans ce tableau concernent l'héritier de la première classe
de 5.000 - 10.000	6%	
de 10.000 - 15.000	7%	2) Ces taux sont doubles pour l'héritier de la deuxième classe
de 15.000 - 20.000	8%	3) Ces taux sont triples pour l'heritier de la troisième classe
de 20.000 - 25.000	9%	
de 25.000 - 30.000	10%	4) Ces taux sont quadruples pour les héritiers qui n'entrent pas dans une des trois classes mentionnées ci-dessus
de 35.000 - 45.000	12%	5) Il y a des exonérations de tout taux sur la part qui ne dépase pas 500 L.E. Si l'héritier a dépassé cette somme, il y a des exonérations sur la première tranche de 500 L.E. à condition que la totalité d'héritage ne dépasse pas 4.000 L.E.
de 45.000 - 55.000	15%	
de 55.000 - 65.000	18%	
de 65.000 —	22%	6) On ajoute sur cet impôt l'impôt communal d'héritage de 5% calculé sur l'impôt progressif de chaque héritier

M. P. DOMINIC *:

TAXATION OF NON-RESIDENTS' BUSINESS INCOME IN SRI LANKA

The tax treatment of a non-resident's business income differs under the internal tax law and under the treaty provisions. Further, special provisions apply with respect to certain categories of businesses. The internal tax law provisions are analysed in Part A. Part B deals with the treaty provisions. The special provisions relating to foreign contractors, shipping and aircraft and insurance are dealt with in Part C.

A. INTERNAL TAX LAW

1. The permanent establishment criterion is foreign to the Sri Lanka internal tax law. The source principle applies. Non-residents are liable to be taxed in Sri Lanka on profits and income arising in or derived from Sri Lanka. Profits arising from Sri Lanka include, inter alia, all profits and income derived from business transacted in Sri Lanka whether directly or through an agent. (Section 2(2) of the Inland Revenue Act, No. 4 of 1963). °

2. Business includes an agricultural undertaking i.e. an undertaking for the purpose of the production of any agricultural, horticultural or animal produce and includes an undertaking for the purpose of livestock or poultry.

3. The source principle enunciated in section 2(2) is further extended by section 55(1) and section 59 (see 6 and 8 (ix)).

4. The words "business transacted in Sri Lanka whether directly or through an agent" have the same meaning as the words "trade exercised within the United Kingdom" in Schedule D of the United Kingdom Income Tax Act. [1] As in England, the distinction between "trading with" and "trading within" a country applies. [2] The English case law is generally followed.

5. Only a person trading within Sri Lanka is liable to Sri Lanka tax. Profits arising from trading with Sri Lanka are not taxable in Sri Lanka. It is a question of fact whether there is a trade with or within Sri Lanka. An important criterion to determine whether a businesses is transacted within Sri Lanka or only with Sri Lanka is "the place of contract". [3]
If the contract is made outside Sri Lanka

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° The sections hereinafter referred are all from the Inland Revenue Act.

1. *Anglo-Persian Oil Co. Ltd. vs. The Commissioner of Income Tax,* Ceylon Tax Cases, Vol. I p. 82 at 89.
Chivers & Sons Ltd. vs. the Commissioner of Income Tax, Ceylon Tax Cases, Vol. I p. 110.

2. Anglo-Persian Oil Co. Ltd. case at p. 89.

3. "The question whether a trade is exercised is a question of fact, and it is undesirable to attempt to lay down any exhaustive test of what constitues such an exercise of trade, but I think it must now be taken as established that in the case of a merchant's business, the primary object of which is to sell goods at a profit, the trade is (speaking generally) exercised or carried on ... at the place where the contracts are made. No doubt reference has sometimes been made to the place where payment is made for the goods sold or to the place where the goods are delivered, and it may be that in certain circumstances these are material considerations, but the most important and indeed the crucial question is where are the contracts of sale made?" (quoted with approval by Akbar J. in Anglo-Persian Oil Co. case).

and the price is paid outside Sri Lanka, the mere delivery through an agent in Sri Lanka is not equivalent to carrying on business within Sri Lanka. [4]

6. But, as stated above, the scope of section 2(2) is further extended by section 55(1). If the sale is made through the instrumentality of a person residing in Sri Lanka, tax liability arises. "Where a person in Sri Lanka, acting on behalf of a non-resident person, effects or is instrumental in . . . selling or disposing of any property . . . the profits arising from such . . . sale or disposal shall be deemed to be derived by the non-resident person from business transacted in Sri Lanka" (section 55(1)). The source criterion is extended by this section in order to include contracts which have been entered into as a result of the efforts of agents in Sri Lanka of a foreign principal, even when such contracts have been finally concluded outside Sri Lanka. [5]

7. Four elements must be present in order for a transaction to attract this extended liability:

a. The sale must be to a person in Sri Lanka.

b. The sale must have been made through the instrumentality of a person in Sri Lanka. The non-resident person will be liable if his agent in Sri Lanka sells any property on his behalf in Sri Lanka. The non-resident will also be liable although the sale was actually effected by him, if in point of fact a person residing in Sri Lanka acting on behalf is "instrumental in selling" that property. "Instrumental in selling" means aiding or assisting in "bringing about" the contract of such a sale which but for such aid and assistance might never come off. But, the extent of this liability is confined to acts that precede the making of the contract and does not extend to acts that succeed such contract and may be necessary to implement it. [6] Mere delivery is not an integral part of a contract of sale and thus will not be covered by section 55(1). [7]

c. The property must be in Sri Lanka or be brought to Sri Lanka. Goods held in transhipment warehouses are not treated as goods brought to Sri Lanka.

d. The property must be the property of a non-resident person.

8. Business transactions may take various forms:

i. *Direct export to Sri Lanka* — Where goods are imported into Sri Lanka by a Sri Lanka importer the non-resident exporter is liable neither on the export income nor on the profits from sale in Sri Lanka.

ii. *Sale on a consignment basis* — The sale takes place in Sri Lanka. The first requirement is fulfilled. The exporter is liable to be taxed in Sri Lanka.

iii. *Indenting Agents* — The indenting Agents canvass for orders, advertise, stock the goods for the non-resident exporter and arrange the supply to local traders of goods from the non-resident person. The sale is made through their instrumentality. The non-resident is liable to Sri Lanka tax. [8]

iv. *Imports through a Buying House or*

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4. This may not apply to deliveries which affect the transfer of title and therefore constitute a sale.
5. Anglo-Persian Oil Co. case at p. 94.
6. Anglo-Persian Oil Co. case at p. 95.
7. *Ibid.*
8. *Chivers & Sons Ltd. vs. the Commissioner of Income Tax.*

Shipper — This may take two forms and the tax liability differs accordingly.

a) The orders are sent direct to the non-resident manufacturer or merchant and the sale is made by the non-resident manufacturer or merchant to a non-resident buying house. The buying house ships the goods to the Sri Lanka agent of the non-resident manufacturer or merchant. Payment for the goods is collected by the buying house from its own agent in Sri Lanka. It collects its commission form the non-resident manufacturer or merchant. The sale is not made by the non-resident manufacturer to a person in Sri Lanka. He is not liable to be taxed in Sri Lanka.

b) If the dealer in Sri Lanka is an agent of the buying house or shipper, the buying house or shipper is liable to be taxed in Sri Lanka.

v. *Goods for transshipment* — Where goods belonging to a non-resident person are sent to Sri Lanka for sale and are held in the transshipment warehouses in Sri Lanka to be shipped to other countries, the non-resident is not liable to be taxed in Sri Lanka on the sale profits. The third requirement is not fulfilled. Goods must be in Sri Lanka or be brought into Sri Lanka. In this case, the goods are not brought into Sri Lanka through the Sri Lanka customs.

vi. *Branch* — A non-resident selling his goods through a branch is liable to be taxed in Sri Lanka.

If the goods sold are goods manufactured or produced outside Sri Lanka by the non-resident or by a person with whom he is closely connected, the profits liable to be taxed cannot be less than the profits which might reasonably be expected to have been made by a merchant who had bought the same direct from a manufacturer or producer with whom he was not connected. The manufacturing profits are excluded from taxation. Where goods sold are subjected to an ad valorem import duty, the maximum which will be allowed to be deducted as cost of such goods is the value on which such import duty has been paid.

But the branch profits of a pure sales concern (goods sold are not manufactured by it or by an allied concern) cannot be computed by reference to the profits which may be expected to be made by a Sri Lanka merchant. Assessment must be made on the actual profits. Only, where proper computation of the branch profits is not readily ascertained assessment may be made on the absis of a fair percentage of the turnover of that trade or business in Sri Lanka. This percentage is normally computed on the basis of profits made by Sri Lanke merchants-selling similar goods.

vii. *Sale to a subsidiary or a closely connected person* — The sale must be at arm's length. If the course of business between the non-resident concern and its subsidiary or its closely related person in Sri Lanka is so arranged that the sale produces to the resident person either no profit or less than the ordinary profits which might be expected to arise, the sale will be deemed to have been carried on in Sri Lanka and the non-resident is taxable in Sri Lanka in respect of his income from such a sale.

Close connection exists where the

persons are substantially identical or that the ultimate controlling interest of each is owned or deemed to be owned by the same person or persons. The controlling interest of a company is deemed to be owned by the beneficial owners of its shares, whether held directly or through nominees. Shares in one company held by or on behalf of another company is deemed to be held by the shareholders of the last-mentioned company.

viii. *Agency* — A non-resident is liable to be taxed on income arising from a business transacted through an agent in Sri Lanka. Agent in relation to a non-resident person includes (a) the agent, attorney, factor, receiver, or manager in Sri Lanka of such person and (b) any person in Sri Lanka through whom such person is in receipt of any profits or income arising in or derived from Sri Lanka. As stated above, mere instrumentality of a person resident in Sri Lanka in effecting the sale is sufficient to create liability. Such a person will be deemed to be an agent of the non-resident.

Transactions carried through *independen agents* (i.e. persons who do not act on behalf of non-resident person) are not subject to Sri Lanka tax.

The non-resident is assessable either directly or in the name of his agent in respect of all his profits. It is not necessary that the agent must be in receipt of the proceeds. Thus even where the goods are sent on letters of credit to the full value of the goods and the money is deposited in the bank before the goods are brought into Sri Lanka, the agent may be assessed on behalf of the non-resident. The tax may be recovered from the assets of the non-resident person or from the agent. If the non-resident acts through more than one agent, all the agents are jointly and severally liable. This joint liability arises only if all of them are agents with respect to the same business or if they are the non-resident's accredited agents.

ix. *Sale of exported Sri Lanka produce* — As stated above, income arising from business transacted in Sri Lanka is liable to be taxed in Sri Lanka. If contracts are concluded abroad and they were not effected through the instrumentality of a resident in Sri Lanka, no liability will arise. Income from sale abroad of produce exported from Sri Lanka will not be liable to be taxed in Sri Lanka if the contracts are concluded outside Sri Lanka. However, substantial portion of Sri Lanka produce is sold outside Sri Lanka (e.g. London Tea Auctions). Tea is sold in bulk in such auctions and later is blended or packeted by the distributor. Section 59 widens the Sri Lanka income tax net to cover such transactions. "Where a non-resident person carries on in Sri Lanka an agricultural, manufacturing or other productive undertaking and sells any product of such an undertaking outside Sri Lanka or for delivery outside Sri Lanka, whether the contract is made within or without Sri Lanka, the full profit arising from the sale in a wholesale market shall be deemed to be income arising in or derived from Sri Lanka . . ." It is immaterial whether contract is made within Sri Lanka or outside Sri Lanka. In the case of tea no distinction is to be made between manufacturing or merchanting profits. Tea exported from Sri Lanka, either through the Colombo Tea Auctions or the London Tea Auctions, is handled, blended, sorted, packed and disposed at wholesale outside Sri Lanka (mainly in London). The full wholesale profits are taxable in Sri Lanka. But, profits attributable to the value added through "treatment of the product outside Sri Lanka other than handling, blending, sorting, packing and disposal" is not deemed to be income arising in or derived from Sri Lanka. Thus, if exported Sri Lanka produce (rubber, spices etc.) is used in processing, the increased profit attributable to manufacturing is not taxable in Sri Lanka. Even transactions of a non-resident co-operative society whereby the Sri Lanka produce is distributed to its members are subject to this provision. Even though there is no sale in the open market, the profits will be "deemed to be not less than the profits which might have been obtained if such person had sold such product wholesale to the best advantage" (section 59).

9. *Determination of Business Profits*
The direct method of computing the profits is used. All outgoings and expenses incurred in the production of the income may be deducted provided they are not specifically disallowed. But, where the Commissioner-General, in his discretion, considers that the true amount of the Sri Lanka business profits of a non-resident can not be readily ascertained, he may assess the profits on the basis of a fair percentage of the turnover of that trade or business in Sri Lanka (Section 58). The percentage is normally fixed in the light of profits made by the Sri Lanka firms dealing in similar articles. Special provisions apply to cases where the transactions are not at arm's length or where the goods sold are manufactured or produced by the non-resident or by an allied concern.

B. TAX TREATIES

10. *India* — The tax treaty with India is based on the source principle. Each country is entitled to charge in respect of specified sources of income, a percentage specified in the schedule. The percentages are based on the actual conditions of trade and profit making involved in the trade between the two countries. [9] (See table on p. 385.)
Any other business income (other than the categories mentioned in the schedule nos. 1-7) is taxable only in Sri Lanka if it accrues or arises in Sri Lanka.
Double taxation is avoided by the grant of an abatement of tax by each country. The abatement is different from that of tax credit or tax exemption. The income which is taxable by India is not simply excluded from Sri Lanka tax. Assessment must be made in Sri Lanka under its own laws as if there were no agreement and if Sri Lanka, under its internal laws, charges any income from the sources or categories of transactions specified in column I of the schedule in excess of the amount calculated according to the percentages specified in columns II and III thereof. Sri

9. This rule was based on conditions which applied to textile trade. "In the textile trade between Sri Lanka and India, the Indian exporter and the importer in Sri Lanka were, in many cases, connected to each other, and the apportionment of income presented much difficulty to the tax authorities. The arbitrary rule set out in the Double Taxation Convention eased the work of the administration substantially and facilitated rapid settlement of liability, which outweighed considerations of any loss of revenue". Tax Treaties between Developed and Developing Countries — Fifth Report — p. 129.

Source of income or nature of transaction form which income is derived	Percentage of income which each country is entitled to charge under the Agreement	
I	II	III
(a) Goods manufactured or purchased in one country and sold to a buyer in the other country without having a branch or regular agency in the latter country	100 per cent. by the country in which the goods are manufactured or purchased.	Nil by the other.
(b) Goods manufactured by or on behalf of a person in one country and sold by him in the other country through a branch or regular agency.	50 per cent. by each country.	50 per cent. by each country.
(c) Goods purchased by a merchant in one country and sold through a branch or regular agency in the other country.	33⅓ per cent. by the country in which the goods are purchased.	66⅔ per cent. by the other.
(d) Goods purchased through a buying establishment in one country and sold by a merchant in the other country.	12½ per cent. by the country in which the goods are purchased.	87½ per cent. by the other.
(e) Metal ores, minerals, mineral oils and forest produce extracted in one country and sold to a purchaser in the other without any further manufacturing process and without a branch or regular agency in the latter country.	100 per cent. by the country in which minerals are extracted.	Nil by the other.
(f) As above but sold in the other country through a branch or regular agency in that country.	75 per cent. by the country in which minerals are extracted.	25 per cent. by country in which sales are made.
(g) Films produced in one country and sold to a purchaser in the other without any further process and without having an agency in the latter country.	100 per cent. by the country of production.	Nil by the other.
(h) Films produced in one country and exhibited by the producer in the other country through a regular agency in that country.	50 per cent. by each country.	50 per cent. by each country.
(i) Films exhibited in one country by distributors (other than producers) in the other country.	75 per cent. by the country in which they are exhibited.	25 per cent. by the other.

Lanka must allow an abatement equal to the lower of the amounts of tax attributable to such excess in either country (Art. III of the Treaty).

11. *Sweden* — Industrial or commercial profits of a Swedish concern are not subject to Sri Lanka tax unless the concern carries on a trade or business in Sri Lanka through a permanent establishment situated therein. The tax is limited to the profits attributable to the permanent establishment. Industrial or commercial profits include profits from the business of agriculture, mining, banking, insurance, life insurance or dealing in investments and profits from rents or royalties in respect of cinematograph films. The term permanent establishment is defined to mean a branch, management, factory or other fixed place of business, an agricultural or farming estate, a mine, quarry or any other place of natural resources subject to exploitation. It does not include agency unless 1) the agent has a general authority to negotiate and conclude contracts on behalf of the enterprise or 2) has a stock of merchandise from which he regularly fills orders on its behalf. This, in effect, exempts income from trading through an indenting agent. Some of the cases which would be subject to tax under section 55 (1) are excluded.

Further, the profits derived by a Swedish enterprise from the production of tea or other agricultural product in Sri Lanka may be taxed in accordance with the provisions of the law of Sri Lanka at the time of the signature of the convention. This preserves the applicability of Section 59 to tea and other agricultural products. Double taxation is avoided by the use of exemption method.

12. *Denmark* — Same as in the Treaty with Sweden.

13. *Germany* — The term permanent establishment includes a construction or assembly project or the like the duration of which exceeds 183 days. A project which does not exceed 6 months will not be liable to Sri Lanka tax. (Film rentals are not included in the definition of industrial or commercial profits). Section 59 applies to tea alone. In other respects, the provisions are more or less the same as in the treaty with Sweden.

14. *Norway* — The provisions are the same as under the treaty with Germany except for the applicability of section 59 and the inclusion of film rentals in the definition of industrial profits. Section 59 is applicable to tea and other agricultural products, as in the treaties with Sweden and Denmark.

15. *Japan* — Same as in the treaty with Norway.

16. *Malaysia* — The definition of permanent establishment is the same as under the treaty with Norway. The application of Section 59 is restricted to production of tea only.

17. *Pakistan* — Industrial or commercial profits includes profits from business such as mining, banking, insurance and fishing. Film rentals are excluded. A person acting for or on behalf of a Pakistani enterprise will be deemed to be a permanent establishment, if

a. he has and habitually exercises in Sri Lanka a general authority to negotiate and enter into contracts for or on behalf of the enterprise, or

b. he habitually maintains in Sri Lanka a stock of goods or merchandise belonging to the enterprise from which that person regularly delivers goods or merchandise for or on behalf of the enterprise, or

c. he habitually secures orders or habitually effects sales in Sri Lanka, wholly or almost wholly for the enterprise itself, or for an enterprise or enterprises which are controlled by it or have a controlling interest in it.

Thus, the scope of Section 55 (1) is somewhat preserved. But it must be noted that under section 55 (1) the instrumentality in selling need not be habitual. Under the Treaty, the person in Sri Lanka must be habitually instrumental in effecting sales in Sri Lanka.

The applicability of Section 59 is preserved in respect of tea other agricultural products.

Tax is imposed upon the entire income of the Pakistani enterprise from the sources within Sri Lanka and not merely upon profits attributable to the permanent establishment.

The credit method is used to alleviate double taxation.

C. SPECIAL BUSINESSES

18. *Foreign Contractors*

Profits arising from a contract business are liable to be taxed in Sri Lanka. But, under the treaties with Germany, Norway and Japan, a construction or assembly project or the like, the duration of which does not exceed 183 days, is not a permanent establishment. A foreign contractor is not liable to be taxed on the profits arising from such a project.

Under certain conditions, profits arising to a foreign contractor are exempted from income tax (section 6A). The conditions are:

1. The foreign contractor was a non-resident person at the time he entered into such a contract.
2. He did not have, at the time of entering into such a contract, a place of business in Sri Lanka whether directly or through an agent. An exempted contractor who leaves the country after completing the contract is not prevented from applying for exemption of profits for future contracts.
3. The contract must be:

   i. with the Sri Lanka government, or

   ii. with a statutory corporation or institution which is approved by the Minister of Finance for the purpose of this section, or

   iii. with the proprietor of an undertaking which operates approved tourist hotels or provides buildings for the use of an undertaking which operates approved tourist hotels (section 6 (1) (V) and (VI), in respect of the construction of any building for the purpose of such undertakings.
4. The Minister must be satisfied that the contract was entered into for the sum stipulated therein on the basis that the profits will be exempt from tax.
5. The name of the contractor should be gazetted by the Minister of Finance for the purpose of this section.

Government tenders must call for quotations both on the basis that the profits will be liable to tax and on the basis that they are exempt, and bids must contain both quotations. Exemption will be considered only if the tender, which is made on the basis that its profits will be exempt from income tax, is accepted by the Government as being the most favourable after taking into account the loss of revenue. [10]

It appears that, in practice, the exemption is usually granted to major construction

10. The New Tax Structure (1972-73) — p. 76 (Published by the Department of Inland Revenue, Sri Lanka, 1972). The particulars which must be furnished to the Secretary Ministry of Finance are enumerated at p. 77.

works only and not to contracts of advisory, management consultant and technical services, supply of machinery and equipment and erection of small factories etc. But, in certain instances such as oil exploration and Mahaweli diversion scheme the exemption was granted also for management contracts. It is doubtful that exemption will be made available to a contractor who executes the contract in a joint venture with a person who has a place of business in Sri Lanka. This matter is under arbitration, at the moment. If major portions of the local works are subcontracted to persons who have a place of business in Sri Lanka, the exemption may be denied.

Where the profits of the contractor are exempt, the emoluments and foreign income of the foreign personnel brought to and employed in Sri Lanka by such a contractor in connection with the performance of such contract will also be tax exempt.

19. *Shipping and Aircraft*

i) *Aircraft* — All outgoing freights are taxable in Sri Lanka. But the following earnings are exempt:
   1. Earnings from the carriage of goods which are brought to Sri Lanka for transshipment.
   2. Income of an aircraft whose call at a port in Sri Lanka is, in the opinion of the Commissioner-General, casual and the future calls by the particular aircraft or other aircraft in the same ownership are improbable.

The aircraft profits (before deducting an allowance for depreciation) arising in Sri Lanka are determined as follows.

$$\frac{\text{Sri Lanka Gross Outgoing Freight}}{\text{World Gross Outgoing Freight}} \times \left\{ \begin{array}{l} \text{Total profits of the aircraft} \\ \text{business as certified by Tax} \\ \text{authorities in the country} \\ \text{of the assessee's residence} \end{array} \right.$$

In the event that be above method can not for any reason be satisfactorily applied, the profits may be computed on a fair percentage of the outgoing freight earnings. Where the percentage basis is used, the assessee may ask, at any time within three years from the end of the year of assessment, for recomputation of the tax liability on the basis of the method outlined above. (Sections 61-64 of the Inland Revenue Act).

ii) *Shipping* — Earlier, the shipping profits were assessed in the same way as Aircraft profits. But, under the latest amendment to the Inland Revenue Act, the shipping profits will be assessed on the percentage basis only. The profits will be computed on a fair percentage of the outgoing freight earnings.

Under the treaties with Sweden, Denmark, Germany, Norway, Malaysia and Japan the profits may be subject to tax both in the country of residence and in Sri Lanka. However, the Sri Lanka tax must be reduced by an amount equal to 50%. The Indian treaty provides that only the country in which the traffic originates is entitled to tax income from transport by sea or air. The Pakistani enterprises are liable to be taxed in Sri Lanka in respect of shipping profits arising in Sri Lanka. But, under the Pakistani tax treaty the Sri Lanka tax is reduced to 50% in the case of aircraft profits. This applies also to profits derived from participation in pools by enterprises engaged in air transport.

20. *Insurance*

I. *Life Insurance Business* — Non-resident life insurance companies, whether mutual or proprietary, are taxed on the investment income of the Life Insurance Fund less the management expenses (including commission) (Section 65 (2)). The profits are determined as follows:

$$\frac{\text{Sri Lanka Life Insurance Premiums}}{\text{World Life Insurance Premiums}} \times \left\{ \text{Gross Investment Income} \right.$$

Less:

a. Agency expenses in Sri Lanka (including commission).

b. Dividends which do not form part of the investment income of the company.

c. A fair proportion of the head office expenses.

In ascertaining the head office expenses, any income on profits (other than life insurance premiums or investment income) received by the head-office must be set off. The computation of the deductible proportion of the head office expenses depends on the nature of the business organization in Sri Lanka. If the business is well-organized in Sri Lanka and works more or less as an independent unit, the deductible portion will be minimal. On the other hand, if all the questions are referred to the headquarters and decisions are taken by it, the full proportion of the head office expenses will be allowed. The proportion is determined on the basis of the premium received in Sri Lanka.

II. *Insurance other than Life Insurance:* The profits are computed as follows (Section 65 (2)):

Gross premiums from Insurance business in Sri Lanka.

Less:

a. Premiums returned to the insured.

b. Reinsurance premiums.

c. Reserve for unexpected risks at the percentage adopted by the company in relation to its operations as a whole, at the end of the financial year.

Add:

Reserve for unexpected risks at the percentage adopted by the company in relation to its operations as a whole, at the commencement of the financial year.

Less:

a. Actual losses (less the amount recovered under reinsurance policies).

b. Agency expenses in Sri Lanka.

c. Fair proportion of the expenses of the head office of the Company. The receipts of the head office (other than premium) must be set off against the dedectible head office expenses.

III. Where only a limited amount of business is transacted by an insurance company (whether life or other insurance business) and the company is unable to provide the necessary particulars, the Commissioner General may permit determination of profit according to the following formula:

$$\text{World Profits} \times \frac{\text{Sri Lanka Premium}}{\text{World Premium}}$$

or on any other basis which appears to him equitable.

IV. It must be noted that profits arising from any insurance effected through the instrumentality of a person in Sri Lanka is deemed to be profits arising from business transacted in Sri Lanka by the non-resident insurer even if the contract of insurance was made outside Sri Lanka. (Section 55(1)).

Under the treaties with Japan, Denmark, Norway, Sweden and Germany, insurance income is taxable in Sri Lanka according to the provisions of the Sri Lanka laws existing at the dates of signature of the conventions. It is not necessary that there is a permanent establishment in Sri Lanka. Insurance income of an Indian company will be taxed only in Sri Lanka if they actually accrue or arise in Sri Lanka. The Pakistani tax treaty provides for taxation in Sri Lanka, if the Pakistani enterprise carries on *any* trade or business in Sri Lanka through a permanent establishment situated in Sri Lanka.

DOCUMENTS

UNITED STATES OF AMERICA

Taxation of the undistributed income of controlled foreign corporations *

4. *Administrative aspects.*

U.S. "shareholders" in a controlled foreign corporation are required to report the CFC's earnings and profits under U.S. accounting standards. This information is needed to calculate the deemed paid foreign tax credit.[31] In most cases, therefore, the elimination of deferral would require little information not already reported for U.S. tax purposes.[32]

However, in practical terms, the Internal Revenue Service would need to expand its auditing efforts and its staff of international specialists very substantially if deferral were terminated. The present IRS staff includes some 150 international specialists. These specialists are responsible for questions concerning international pricing and allocation of expenses, subpart F, DISC and similar special status corporations, and other international tax issues. In 1974, about 700 international audits were completed.

Under existing law, the direct and deemed paid foreign tax credits are generally more than sufficient to offset U.S. tax liability on dividends from foreign subsidiaries. From a practical standpoint, therefore, it is not rewarding for the Internal Revenue Service to examine the majority of CPC returns (in 1974, about 40,000 CFC returns were filed). But with the partial or complete termination of deferral, the exact calculation of the earnings and profits of a foreign subsidiary would become more important. The IRS would have to increase its international staff very substantially to meet the new demands.

5. *Investment impact.*

With the termination of deferral foreign subsidiary corporations, facing a higher tax rate than competing local firms, might diminish their activities. Out of a given volume of pre-tax earnings, CFC's would have fewer funds available for reinvestment. In order to maintain the same after-tax earnings as a percentage of investment, they might sacrifice less profitable product lines and, where possible, they might raise prices. As a result, CFC sales abroad might contract. But there is a wide range of opinion on the ensuing consequences for investment in the United States.

Some observers believe that investment would be partly shifted back to the United States, thereby increasing U.S. corporate

* Continuation: Preliminary analysis of the U.S. Treasury Department prepared by the Treasury's Office of International Tax Affairs for the House Ways and Means Committee Task Force on Taxation of Foreign Income.

31. The deemed paid credit (Section 902) is calculated as:

$$\frac{\text{Dividends}}{\text{Earnings and profits}} \times \text{Foreign income tax} =$$

Deemed paid credit

The denominator of the first term on the left must be calculated according to U.S. accounting standards. Note that earnings and profits is an after-tax concept.

32. Additional information would be required to the extent that the definition of earnings and profits for purposes of the deemed paid foreign tax credit (Sections 902 and 964) differs from the general definition of earnings and profits. Moreover, CFCs that presently distribute no income would now be required to report earnings and profits.

earnings. These observers contend that foreign and domestic investment are at least partial substitutes, and that, when markets and investment opportunities are lost in one area, multinational firms will reallocate their resources to another part of the globe.

Other observers contend that little or no investment would be shifted back to the United States. They argue that profitable investment and production opportunities are highly specific both in time and place, and that the loss of foreign markets abroad does little to create new investment opportunities in the United States. Indeed, the loss of foreign markets might impair the access of American producers to new foreign technology, and might impede the realization of economies inherent in large scale production and international specialization, with a consequent attenuation of domestic investment opportunities.

Professor Horst has constructed a mathematical model to stimulate the impact of terminating deferral on manufacturing investment in the United States and abroad.[33] In this model, foreign and domestic investment are *assumed* to be partial substitutes for one another. Investment in each location is determined both by relative after-tax rates of return, and by the firm's overall supply of financial resources. The model assumes that a multinational manufacturing firm maximizes its global after-tax earnings. The firm invests both in the United States and in a single foreign country. Its investment can be financed out of its own retained earnings, with new equity capital, or with borrowed funds, raised either in the American or in the foreign capital market. U.S. funds can be transferred to the foreign affiliate either as equity capital or as interest-bearing debt. The division of taxable income between countries depends on investment and sales in each country, and on the level of deductible intrafirm expenses, such as interest payments, royalties, and head-office charges.

A change in tax policy, either in the United States or abroad, will have two conceptually distinct effects: a substitution effect, resulting from any change in the after-tax rate of return on foreign or domestic investment; and a liquidity effect, resulting from any change in after-tax earnings available for reinvestment. The size of the substitution and liquidity effects depends not only on the opportunities for investing and borrowing in the two countries, but also on the firm's own internal use of debt and equity capital.

Although the model is basically simple, it requires more than thirty equations to capture the details of foreign and domestic investment opportunities and tax systems. Many parameters must be estimated before usuble results can be obtained. As in any exercise of this nature, the results are subject to a considerable margin of error.

The results are summarized in Table 4. The estimates portray the investment impact after *complete* adjustment to the termination of deferral. Complete adjustment could, of course, require several years. Both the substitution effect and the liquidity effect are reflected in the estimates.

The estimates in Table 4 suggest that the stock of plant and equipment investment in the United States manufacturing sector might ultimately increase by $2.2 billion (a change of 0.7 percent) with an end to deferral, while the stock of U.S. owned

33. Thomas Horst, "American Multinationals and the U.S. Economy," Fletcher School of Law and Diplomacy, November 1975.

TABLE 4

Estimated Impact of Terminating Deferral on Selected Economic Variables for U.S. Multinational Manufacturing Firms[1]

(Millions of Dollars)

	Initial Values	Estimated Changes
Total domestic assets[2]	314,000	2,200
Total foreign assets[2]	151,000	—3,500
Consolidated after-tax earnings[3]	28,500	—980
U.S. corporate income tax on domestic and foreign income after investment tax credit and foreign tax credit[3]	13,400	1,000[4]
Foreign corporate income and dividend withholding taxes	7,700	—210[5]

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Sources: The estimated changes are adapted from estimates made by Thomas Horst, "American Multinationals and the U.S. Economy," Fletcher School of Law and Diplomacy, November 1975, and unpublished work. The initial values are derived from: U.S. Senate, Committee on Finance, *Implications of Multinational Firms for World Trade and Investment and Labor,* February 1973; *Survey of Current Business,* October 1975; *Statistical Abstract of the United States,* 1975; U.S. Treasury Department, *Statistics of Income 1972: Corporation Income Tax Returns.*

1. The initial value figures refer to the year 1974. The estimated change figures represent the impact after complete adjustment to the termination of deferral. The figures in the estimated change column include the impact resulting from the extension of subpart F in the Tax Reduction Act of 1975.
2. The initial value figures are based on the 1970 estimates for giant multinational manufacturing firms contained in *Implications of Multinational Firms,* p. 432, increased to reflect smaller manufacturing firms with overseas investment (15 percent of total overseas investment), and increased again to reflect growth between 1970 and 1974 (*Statistical Abstract of the United States,* 1975, p. 500; *Survey of Current Business,* October 1975). The foreign asset figures include investment by foreigners in U.S. affiliates. The estimated changes are based on Professor Horst's model.
3. The initial values refer to the consolidated after-tax earnings and U.S. and foreign income taxes for all manufacturing firms claiming a foreign tax credit. The estimated changes are based on Professor Horst's model.
4. This estimate reflects additional U.S. taxes from: (i) subpart F as expanded by the Tax Reduction Act of 1975 ($ 250 million); (ii) termination of deferral with worldwide pooling, an overall foreign tax credit limit, and current dividend distribution rates ($ 365 million); (iii) an increase in U.S. investment and the greater use of equity capital in the United States ($ 385 million). Detail is shown in Table 11.
5. This estimate reflects a decline in foreign taxes resulting from: (i) a decrease in foreign investment; (ii) the greater use of debt capital for foreign affiliates.

manufacturing assets abroad might ultimately decrease by $3.5 billion (a change of 2.3 percent). Consolidated after-tax earnings would decrease by about $980 million. U.S. corporate taxes would increase by about $1,000 million. Foreign corporate income and withholding taxes would decline by about $210 million. These revenue estimates, like the underlying investment impact estimates, are based on the assumptions of the particular model.[34]

Professor Horst's model attempts to capture a variety of interactions between U.S. parent corporations and their foreign subsidiaries. Even so, the model requires many simplifying assumptions. In particular, the following complicating factors are not considered.

The model *assumes* that foreign and domestic investments are partial substitutes, and then proceeds to *calculate* the extent of substitution. Many observers would dispute the assumption of a substitute relationship between foreign and domestic investment. If the assumption is wrong, the estimates of additional investment in the United States and larger U.S. tax revenues are also wrong.

Professor Stobaugh, for example, contends that the termination of deferral could lead to a cumulative decline in the profitability and investment both of foreign affiliates and their U.S. parent corporations.[35] The U.S. multinational firms would have fewer funds available for reinvestment, and in order to maintain the same after-tax rate of return, they might concede some business to competing foreign firms. With slower growth and smaller sales, they might be less able to improve techniques of production, and they would have a smaller base for spreading research, administrative, and other fixed costs. The cumulative effect could be lower profits and a decline in investment, both in the United States and abroad.

Apart from investment changes resulting from corporate decisions, foreign governments might alter their own tax rules in response to the termination of deferral. The changes could be designed not only to offset U.S. revenue gains, but also to counter any shift of investment towards the United States. For example, foreign governments might provide special investment incentives for non-American firms. Through bank financing and other avenues, these incentives could indirectly attract capital from the United States.

These considerations suggest that the changes portrayed in Table 4 should be viewed as upper limit estimates of the investment impact of terminating deferral.

6. *Financial impact.*

Foreign subsidiaries can finance their expansion either by issuing debt or by increasing equity capital (including the retention of earnings). The funds can be provided either by the parent corporation or by unrelated investors. A change in deferral would affect the tax cost of only one source of capital, namely equity funding provided by the partner corporation or by unrelated investors. A change in deferral would affect the tax cost of only one source of capital, namely equity funding provided by the parent corporation. Other sources of capital would be available on the same tax

34. Revenue estimates made under various assumptions are presented in section 7.

35. Robert B. Stobaugh, "The U.S. Economy and the Proposed U.S. Income Tax on Unremitted Earnings of U.S. Controlled Foreign Manufacturing Operations Abroad," Harvard Business School, 1975.

TABLE 5

The Effect of Deferral on the Use of Local Debt by a Hypothetical Foreign Subsidiary[1]

	With U.S. Deferral		Without U.S. Deferral	
	All Equity Finance (1)	Some Local Debt (2)	All Equity Finance (3)	Some Local Debt (4)
Foreign Subsidiary[2]				
1. Foreign earnings before interest charges	100	100	100	100
2. Interest paid locally	0	20	0	20
3. Foreign taxable income	100	80	100	80
4. Foreign corporate tax at 25 percent	25	20	25	20
5. U.S. corporate tax at 50 percent, after credit	0	0	25	20
6. Foreign income after all taxes	75	60	50	40
U.S. Parent				
7. Domestic taxable income	200	230	200	230
8. U.S. corporate tax on domestic income at 50 percent	100	115	100	115
9. Domestic income after tax	100	115	100	115
Consolidated Results				
10. Total income after tax	175	175	150	155
11. Total U.S. tax	100	115	125	135

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1. The following assumptions are made: (a) the foreign interest rate equals 10 percent; (b) the foreign debt in cases (2) and (4) equals 200, and the addition to domestically owned assets also equals 200; (c) pre-tax earnings equal 15 percent of domestically owned assets; (d) no actual distribution of dividends is made from the subsidiary to the parent.
2. The foreign subsidiary is 100 percent owned by the U.S. parent corporation.

terms as before. With a limitation on deferral, the foreign affiliate thus might find it more advantageous to finance expansion through external local borrowing, or through intrafirm debt, rather than through equity capital supplied by the U.S. parent corporation.[36] The net effect is that a larger share of earnings might be paid out as interest and a smaller share might be retained or paid out as dividends.

Table 5 presents a hypothetical example to illustrate the case in which local borrowing is increased after the termination of deferral. For simplicity a U.S. corporate tax rate of 50 percent and a foreign corporate tax rate of 25 percent are assumed. Foreign

36. Financial shifts of this type are included in Professor Horst's model of investment decisions discussed in the previous section.

earnings before interest charges are kept constant throughout the analysis, implying the same real level of foreign activity.[37] No dividends are distributed from subsidiary to parent, and thus no withholding taxes are paid.

The firm can choose between raising a certain amount of debt abroad, limited to 200 in this example, or financing the affiliate entirely with equity capital. If it raises debt abroad, the parent can reduce its equity commitment to the foreign affiliate and increase its use of equity capital in the United States. The interest rate on foreign debt is assumed to be 10 percent, while domestically owned assets are assumed to earn 15 percent before tax. Domestic assets thus earn a higher pre-tax return than the cost of foreign debt. This is a crucial assumption; otherwise it would not be sensible for the firm to incur the risk of borrowing abroad.

Under present U.S. law, the firm would be indifferent between borrowing abroad and financing the affiliate entirely with equity. In both cases, its total after-tax income would be 175.[38]

If deferral is terminated, the picture changes. The firm's total income after tax declines, and U.S. tax collections rise. Equally important, the firm now has an incentive to borrow abroad. Consolidated income after tax is 150 with all equity financing and 155 with some local debt. The hypothetical firm can increase its after-tax income by redeploying some of its assets to the United States. The process of redeployment would increase U.S. tax from 125 to 135. The partial or complete termination of deferral could place some foreign subsidiaries in the position of this hypothetical firm. They might find it advantageous to substitute local borrowing for parent firm equity.[39]

It is difficult to estimate the potential importance of tax-induced changes in means of finance. Many firms may have already borrowed abroad as much as they realistically can. Foreign debt has advantages, but it also has risks — in particular the risk of credit rationing with a change in government policies abroad. Likewise, there may be administrative and other limits on intrafirm debt.

Table 6 illustrates the extent of debt and equity financing by foreign affiliates in 1972. New foreign debt supplied a major part of available funds, ranging between 38 percent in the case of manufacturing affiliates to 57 percent in the case of other industries. Intrafirm debt and other debt from U.S. sources supplied between 8 and 25 percent of available funds. New equity capital from the United States only supplied between 4 and 6 percent, while retained earnings supplied between 16 and 45 percent of available funds. There appears to be little scope for the substitution of fresh debt for fresh equity capital, but fresh debt might, to a limited extent, replace retained earnings.

7. *Revenue impact.*

In general, revenue estimates are made to indicate actual or potential U.S. tax collections resulting from the existing tax structure or a change in that structure. The focus

37. In fact, foreign operations would probably contract in face of the higher tax burden on foreign earnings.

38. The tax authorities of the two countries are not, however, indifferent to the means of finance. The substitution of local debt for equity capital would reduce foreign corporate tax from 25 to 20 and increase U.S. corporate tax from 100 to 115.

39. A similar example could be devised to illustrate the effect of substituting intrafirm debt for equity financing.

TABLE 6

Financing of Foreign Affiliates, 1972[1]

(Percent of Total Funds)

	Petroleum	Manufacturing	Other
Source of funds:			
1. Internal funds:			
Retained earnings	15.6	45.1	23.8
2. External funds:			
Equity capital:			
U.S. owned[2]	4.5	5.5	4.1
Foreign owned	0.1	3.4	3.9
Debt capital:			
U.S. owned:			
intrafirm debt[2]	24.2	5.0	5.9
unrelated financial institutions	0.7	2.8	5.0
Foreign owned:			
related firms	1.9	1.8	20.1
unrelated financial institutions	53.0	36.4	37.2
Total	100.0	100.0	100.0

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Source: U.S. Department of Commerce, *Survey of Current Business* (July 1975).
Detail may not add to totals due to rounding.

1. Estimates are based on a sample of majority-owned foreign affiliates.
2. The apportionment of funds between U.S. owned equity and intra-firm debt was based on the ratio of net-equity to total net capital outflows for 1973 reported in U.S. Department of Commerce, *Survey of Current Business* (October 1975), p. 47.

here is on changes in tax revenue resulting from the partial or complete elimination of deferral, or the selective expansion of subpart F. Background estimates are also given for present tax revenues attributable to subpart F. The Tax Reduction Act of 1975 substantially extended the scope of subpart F, and correspondingly reduced the scope of remaining revenue gains from the termination of deferral. These effects are reflected in the comparison between estimates for 1974 and 1976 in Table 7. Note that the collateral tax changes enumerated in Table 1 which would move the United States closer to a system of capital-export neutrality are not shown in Table 7. Instead, Table 7 focuses on the taxation of undistributed earnings viewed in isolation. The estimates of possible revenue gains from the futher termination of deferral are influenced both by the policy option chosen and by possible behavioral changes.

(a) *Policy options.* The revenue estimates obviously depend on three important policy choices: (i) the extent to which deferral is eliminated or subpart F is extended; (ii)

TABLE 7

Actual Revenue from Subpart F and Potential Revenue from Termination of Deferral, with Overall Limitation on Foreign Tax Credit

(Millions of dollars)

	1974 Calendar Year Tax Liabilities	Changes Resulting from the Tax Reduction Act of 1975	1976 Calendar Year Tax Liabilities [1]
Total actual and potential revenue from current taxation of CFC retained earnings	615	n.a.	615
Potential revenue from the termination of deferral, total [2]	590	—225	365
Mining	0	0	0
Petroleum and Refining	0	0	0
Manufacturing	577	—215	362
Other	13	—10	3
Actual revenue from subpart F, total	25	225	250
Pre-1975 revenue	25	n.a.	25
Tax Reduction Act changes [3]		225	225

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n.a. indicates not applicable.

1. It is assumed that there was no change between 1974 and 1976 in corporate foreign source income affected by deferral.
2. These estimates assume: (1) dividends from less developed country corporations are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) foreign subsidiary losses are fully offset against foreign subsidiary profits; (iii) all firms use the overall limitation in calculating the foreign tax credit; (iv) no behavioral change.
3. The Tax Reduction Act changes were: (i) eliminate minimum distribution ($ 100 million); (ii) eliminate the less developed country corporation exception ($ 15 million); (iii) change the 30-70 rule to a 10-70 rule ($ 75 million); (iv) repeal the shipping exclusion ($ 35 million).

whether the overall or the per-country limitation is applied to the foreign tax credit; (iii) the extent to which foreign subsidiary losses are permitted as an offset against foreign subsidiary profits. The policy options are spelled out in Part IV. Tables 8 and 9 present revenue estimates for the alternative policies. The revenue estimates are based on the standard assumption of no behavioral change, discussed below.

Certain important features should be noted. The great majority of firms elect the overall limitation in calculating the foreign tax credit. Under the Tax Reduction Act of 1975, petroleum firms are required to use the overall limitation for foreign oil related income in taxable years ending after December 31, 1975. The Tax Reform Act of

TABLE 8

Revenue Changes from Alternative Proposals to End Deferral[1]

(Millions of Dollars)

Required Percentage Distribution[2]	1976 Calendar Year Tax Liabilities[3]			
	Earnings and Profits		Earnings and Profits Plus Branch and Royalty Income	
	Overall Limitation	Per-Country Limitation[4]	Overall Limitation	Per-Country Limitation[4]
100	$ 365	$ 630	$ 365	$ 630
75	215	385	150	250
50	55	150	10	50

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1. The estimates assume: (i) dividends from less developed country corporations are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) CFC profits and losses are consolidated on the same basis as the foreign tax credit limitation that is, either on an overall or a per country basis; (iii) no behavioral change, in particular the current dividend distribution rate is maintained.
2. With a 100 percent required distribution, deferral is totally ended. With a 75 percent or 50 percent required distribution, U.S. parent corporations would be deemed to have received the differences between 75 percent or 50 percent of income (defined either as earnings and profits or as earnings and profits plus branch and royalty income) and the amount actually received (either dividends or dividends plus branch and royalty income).
3. These figures represent additions to 1976 revenues collected under subpart F ($ 250 million).
4. These estimates assume that the per-country limitation is already in place, and that deferral is then ended. The revenue changes refer only to the additional impact of eliminating deferral.

1975, HR 10612, enacted by the House and now under Senate consideration, would extend compulsory use of the overall limitation to all firms.[40] The overall limitation permits extensive tax averaging between income from high-tax and low-tax jurisdictions. Thus, the elimination of deferral coupled with the overall limitation produces less revenue than the elimination of deferral coupled with the per-country limitation.

If losses are not allowed as an offset against profits as between related subsidiaries, the revenue estimate becomes very much larger. This reflects the substantial losses experienced by foreign subsidiaries. Contrary to popular belief, it is not true that the bulk of foreign losses are concentrated in foreign branches. Rough estimates for 1975 indicate that foreign subsidiaries experienced losses of $2.2 billion while foreign branches had losses of $0.3 billion.

40. The reason for compulsory use of the overall limitation is to prevent U.S. corporations from offsetting foreign branch losses incurred in some countries against U.S. source income, while claiming a foreign tax credit on foreign source income earned in other countries. However, transition rules would permit continued use of the per-country limitation for selected hard mineral firms. Puerto Rico and the U.S. possessions are not included in the compulsory overall limitation rule.

TABLE 9

Termination of Deferral with Alternative Consolidation Requirements and with Current Dividend Distribution Rate[1]

(Millions of Dollars)

	1976 Calendar Year Tax Liabilities[2]
Overall limitation on foreign tax credit	
Worldwide consolidation of CFCs	365
No consolidation of CFCs	1,100
Per-country limitation on foreign tax credit[3]	
Country consolidation of CFCs	630
No consolidation of CFCs	1,300

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1. These estimates are variants of the estimates in Table 5. The estimates assume: (i) dividends from less developed country corporations are "grossed up"; (ii) no behavioral change, in particular, the present dividend distribution rate is maintained.
2. These figures represent additions to the 1976 revenue collected under subpart F ($ 250 million).
3. These estimates assume that the per-country limitation is already in place, and that deferral is then ended. The revenue changes refer only to the additional impact of eliminating deferral.

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CUMULATIVE INDEX 1976

Nos. 1, 2, 3, 4, 5, 6, 7 and 8

I. ARTICLES

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* * * ARTICLES * * *

LEE FOOK HONG*:

TAXATION IN SINGAPORE

I. INTRODUCTION

Taxation is the most important source of income for all governments and there is no exception for the Government of the Republic of Singapore.

The Singapore Government imposes two kinds of taxes: direct and indirect taxes.

Direct taxation in Singapore comprises:—

(a) Income Tax (which is the best known form of direct taxes);
(b) Property Tax;
(c) Estate Duty; and
(d) Payroll Tax.

There are no capital gains tax, development tax, excess profits tax, wealth tax or gift tax in Singapore.

Indirect taxation includes the following:—

(a) Import Duties;
(b) Excise Duties;
(c) Motor Vehicle Taxes;
(d) Stamp Duty;
(e) Entertainment Duty and
(f) Betting and Sweepstake Duties.

There are no turnover tax, sales tax or export taxes in Singapore.

All revenue matters come under the control of the Revenue Division of the Ministry of Finance. The Revenue Division has two large revenue collecting Departments:—

(a) The Inland Revenue Department; and
(b) The Customs & Excise Department.

These two departments are responsible for collecting the major part of the total Government revenue.

The main sources of revenue of Singapore are:—

(a) Income Tax;
(b) Property Tax;
(c) Payroll Tax;
(d) Customs Duties; and
(e) Taxes on Motor Vehicles.

In Singapore, income tax is the most important direct tax and this paper is concerned only with income tax although other taxes may be mentioned in passing.

II. SOURCES OF TAX LEGISLATION

The sources of tax legislation currently in force in Singapore are as follows:—

	Chapter
1. The Income Tax Act	141
2. The Economic Expansion Incentives (Relief from Income Tax) Act	135
3. The Finance Act (Payroll Tax)	139

4. The Avoidance of Double Taxation Agreement Orders with the following countries: Australia, Belgium, Denmark, France, The Federal Republic of Germany, Israel, Japan, Malaysia, Netherlands, New Zealand, Norway, Sweden, Thailand and United Kingdom.

Agreements with the following countries have been initialled or signed but are not yet in force: Canada, Switzerland.

For avoidance of double taxation, Singapore has signed agreements with other countries so that a taxpayer in Singapore may not have to pay income tax in Singapore and the other country on the same income. Most of these Avoidance of Double Taxation Agreement Orders provide relief either by exemption in one country or by granting tax credit for the tax charg-

* F.C.I.S., F.A.I.A. This article is part of a paper presented at the Seminar on "Financial Development in Singapore" organised by the Nanyang University on 6 and 7 February 1976.

ed in the other country but not exceeding the tax charged on the same income in that country.

III. THE SCOPE OF THE CHARGE

What is Income Tax? Income Tax is a tax on income. What is income is not defined in the Act. The Singapore Income Tax Act provides that Income Tax is payable on the income of any person which accrues in or derived from Singapore or received in Singapore from outside Singapore in respect of:—

(a) Gains or profits from any trade, business, profession or vocation;
(b) Gains or profits from any employment;
(c) Dividends, interest or discounts;
(d) Any pension, charge or annuity;
(e) Rents, royalties, premiums and any other profits arising from property including the net annual value of properties used by the owner or occupied rent free for residential purposes. (An individual taxpayer is, however, exempt from tax on the net annual value of one residence owned and occupied by him. The exemption is limited to one property, the net annual value of which should not exceed \$ 25,000/—. Any excess over and above \$ 25,000/— is liable to income tax).
(f) Gains or profits of an income nature not falling within any of the preceding paragraphs.

The charge under the Income Tax Act is therefore territorial in nature. As Singapore Income Tax is a territorial tax, both residents and non-residents are chargeable to tax on:

(a) Income accruing in, or
(b) Income derived from Singapore.

Resident & Non-Resident

In the case of a resident in Singapore, he is also chargeable to tax on income received in Singapore from outside Singapore.
But in the case of a non-resident, he is not liable to tax on income remitted into Singapore from outside Singapore.
In view of the above, the two terms "residence" and "income" require careful consideration. Unfortunately or fortunately, these two terms are not defined in the Act. The definition given to the term "resident in Singapore" is almost similar to that given in the tax statutes of other countries. Section 2 of the Singapore Income Tax Act provides that any person who has resided in Singapore for 183 days or more in the preceding year is considered a resident. In the case of a company or a body of persons the question of residence is not determined by the number of days the company has carried on business in the country but by the criteria as to the place where its control and management are exercised.

What is "Income"?

The Act makes no attempt to define what income is. However for the purposes of determining what income is, the same relevant factors or rules apply to both companies and individuals although the rates of tax are different.

Tax Rates

For an individual resident in Singapore the tax rate varies from 6% on the first \$ 2,500/— to a maximum of 55% on chargeable income exceeding \$ 100,000/—. For companies the rate of tax is 40% flat, but shareholders receiving dividends are granted tax credit by way of "set-off" or refund if their personal tax rates fall below the company tax rate of 40%.
As mentioned earlier, there is at present no Capital Gains Tax in Singapore although it is not an uncommon practice for the In-

land Revenue Department to regard persons dealing in stocks and shares or properties on a habitual or repetitious basis as dealers or traders and treating the stocks and shares or properties in which they buy and sell as stock-in-trade so that income tax is imposed on the gains or profits derived from the sales of such stocks and shares or properties. The onus of proof that such gains or profits are not chargeable to tax rests with the taxpayers.

What constitutes a trade or business?
The term "trade" or "business' is not defined in the Singapore Tax Act. Whether or not an activity constitutes a "trade" or "business" is a mixed question of law and fact. If there is regular or habitual buying and selling or rendering of services, this is obviously "trading" and the profits or gains derived therefrom are liable to tax. But an isolated or casual transaction may be "an adventure or concern in the nature of trade" if it is of a commercial nature. To quote what the Master of the Rolls said in Erichsen v. Last 4 T.C. 422.

> "There is not, I think, any principle of law which lays down what carrying on trade is. There are a multitude of things which together make up the carrying on of trade, but I know no one distinguishing incident, for it is a compound fact made up of a variety of things."

Only by study of the tax cases on the question whether an activity constitutes "trading" can one identify the factors or the so-called "Badges of Trade" which will distinguish to some extent, if not conclusively, the trading from the non-trading activity. Some of these factors are worthy of consideration and they are briefly mentioned below:

(1) *Profit seeking motive*
The existence of a profit seeking motive is important evidence of trading activity. Certain organisations may be regarded as trading even in the absence of a profit seeking motive in the strict sense. The fact that the taxpayer has no intention of making a profit or carries on activities which are not directed mainly to profit making does not preclude the assessment which in fact emerges.
The question whether or not there is trading must be determined objectively. If normal commercial methods are employed this can be a pointer to the conclusion that there is trading activity.

(2) *The way in which the asset is acquired*
The way in which the asset is acquired must be considered since it may be held that if an acquisition of the asset was by chance for example by gift or inheritance, and not a purchase with the view to subsequent sale at a profit, it will be difficult if not impossible to deduce that a subsequent sale is by way of trade.

(3) *The nature of the asset*
The nature of the asset is important because the commodity purchased may be something like whisky, which can equally be regarded for personal pleasure or for use as trading stock which is bought with the view to subsequent sale at a profit.
The mere act of selling property does not constitute trading. The nature of the asset purchased is important where a property is purchased as an investment or to be used or enjoyed for personal pleasure. A surplus arising on a subsequent sale is not a trading profit even if steps have been taken to obtain the best possible price on resale.

(4) *Adaptations or the Treatment of the Asset*
The trading nature of a transaction may in some cases be deduced from the method of handling or treating its subject matter. The treatment of an asset between purchase and

sale is important as the processing or manufacturing of a commodity is strong evidence of a trading activity. It therefore, follows that it is relevant to consider the question what happens to the asset pending sale.

(5) *The length of the period of ownership*

The interval of time between purchase and sale of an asset must be considered. A person who buys land and holds it for many years before selling it may be in a stronger position to argue that he is realising an investment than if he sells immediately after he has acquired it.

Generally speaking, a quick turn round is more likely to be accepted as evidence of a trade, than is the case of an asset held for a long period of time, especially if the asset is revenue producing, for example stocks and shares or properties.

(6) *Method of selling an asset*

The way in which a sale is secured is an important consideration, since any form of organised activity to promote sales e.g. by advertising, or other means to sell an asset at a profit is strong evidence in favour of deciding that a trade is carried on.

(7) *Frequency or number of transactions*

The number of transactions of a similar nature indicates whether activity is sufficiently organised as to show a pattern of trade. Accordingly, one of the important factors in deciding whether or not a trade is carried on is whether the taxpayer has engaged in its repeated transactions of the same kind. If a particular transaction is found to be one of a series over a period of time, and there is evidence of methodical activity or successive purchases and resales of the assets then the repetitious nature of the transactions is evidence of trading.

(8) *Whether a person already has trading interest in the same field*

If an individual has an admitted trade or has trading in a similar field of activity to the transactions in question, there is strong, if not conclusive, evidence that these further transactions are in fact an extension of, or part of, an existing trade.

(9) *Method of financing*

The way in which finance is obtained to enable an activity to be carried out needs careful examination.

The purchaser may specially borrow money in such circumstances that it is obvious from the outset that he has to sell to repay the loan. This kind of situation will favour the evidence that he was trading. But an individual is unlikely to borrow a large sum of money to finance the purchase of a commodity for his personal enjoyment.

(10) *Destination of the proceeds*

The utilisation of the receipts of a transaction is a relevant factor. An individual who carries on one purchase and sells may be held to be trading, but if the receipts are utilised to buy further assets for resale, the Inland Revenue Department may construe this as additional evidence that a trade is being carried on.

It may be amusing to discuss a few problems in connection with the topic of "What Constitutes Trading":—

(a) *Isolated Transaction or Speculation*

It is wrong to assume that the profit on a transaction escapes tax liability merely because the transaction is "isolated". There are many cases in which decisions have been held that a single speculation or an isolated transaction may constitute a "trade".

(b) *Business Knowledge or Know-how*
The business knowledge or know-how of the taxpayer or his associates may indicate that the transaction is of a trading nature.

(c) *Company Transactions*
A limited liability company formed to hold land or other property as an investment and having as one of its objects in the Memorandum of Association appropriate for this purpose is commonly known as an "investment company" or "investment holding company".
It is distinguished from the "property dealing" company or "finance" company which deals or trades in properties or securities. If a company makes a profit by trading, that profit is chargeable to tax even though such company may be described as an investment company.
Whilst it is true that the objects of a company are relevant to the consideration of the nature of the activities carried out by the company, the fact that a company has always been treated by the Revenue Department as an Investment Company does not prevent the Revenue Department from treating a sale as in the nature of trade. "The revenue are free to revise the position". (See Rellim Ltd. v. Vise 32 T.C. 254)

(d) *Share Transactions*
If the shares of a company are sold at a profit or gain, the share-vendor's profit or gain is not taxable unless there is evidence to show that he is a "dealer" in shares.

(e) *Illegal Trading*
Once it is determined that an activity constitutes trading, and profits from such activity which are illegally obtained are chargeable to tax. The trader cannot rely on the incidental illegality to avoid tax. For this reason, profits derived from ultra vires or illegal trading are taxable. Similarly, earnings from immoral activities such as illegal prostitution are assessable to tax. However, it is open to doubt whether systematic crime can itself constitute a trade, as the courts of law in England had held different views on this point.

IV. COMPUTATION OF INCOME

Deductions
In ascertaining the income of a company from any source for any period, a deduction is allowed for all outgoings and expenses wholly and exclusively incurred in producing the income from that source. Section 14 of the Act provides a list of allowable deductions including interest on money borrowed or employed in producing the income, rent on business premises, cost of repairs to plant and machinery, bad and doubtful debts and contributions by an employer to an approved pension fund in respect of his employees.
Expenses which are of a capital, private or domestic nature are expressly prohibited by Section 15 of the Act.
When there is a doubt or where the Act is silent on an item of outgoing or expense for which deduction is claimed, normal accounting principles will be considered in admitting the claim or otherwise.

Allowances
There is provision in the Act for granting allowances for depreciation or wear and tear on capital assets used in a trade, business or profession, and industrial building allowances in respect of industrial buildings or structure used in certain trades and industries. In the case of plant and machinery, an initial allowance of 20 per cent on the cost of the asset is granted while annual allowances vary between 3 and 20 per cent on the reducing value depending

on the type of asset and the type of trade or business in which the asset is used. In respect of industrial buildings or structures, an initial allowance of 10 per cent on original cost of construction is granted and an annual allowance is computed on a straight line method at a fixed rate of 2 per cent on the original cost of construction. A balancing allowance or charge is made when a plant or machinery or an industrial building or structure is sold, scrapped or demolished.

Accelerated Depreciation

To encourage the growth of local industries, a new Section 19A was introduced in 1965 to provide for accelerated depreciation in respect of plant and machinery used in the manufacturing and processing of goods and materials.

Section 19A provides that an "industrial enterprise" is entitled to claim an annual allowance of 33⅓% on capital expenditure incurred on plant and machinery in lieu of the normal wear and tear allowances provided by Section 19. The capital expenditure incurred on the provision of plant and machinery utilised in the manufacturing and processing of goods and materials can be written off equally over a period of three years.

Any claim for accelerated depreciation must be made at the time the return is lodged or within such further time the Comptroller of Income Tax, in his discretion, may allow.

For the purposes of Section 19A, motor vehicles designed primarily and principally for the carriage of persons do not qualify for accelerated depreciation.

A further alternative is available by way of an accelerated initial allowance of up to 100% of the cost of the plant and machinery which may be written off in one year with the approval of the Minister for Finance.

Losses and Donations

The Act provides that a company is entitled to claim set-off for losses incurred in a trade or business against its other income. Provision is also made for allowing donations to gifts of money to approved institutions of a public character.

The Income Tax (Amendment) Act, 1969 which came into operation on 1st January 1970 and which is effective from the Year of Assessment 1970 has imposed some restrictions on the treatment of trading losses. The advantage which can be gained from the purchase of tax loss companies has now been negatived as a result of the amendment to Section 37 of the Income Tax Act.

Exemptions

What are exemptions?

Exempt income is income, which, although it may normally be liable to tax is specifically made immune from tax. It may occur in two ways:—

(a) certain classes of persons are wholly or partially exempt from taxes.
(b) certain types of income are exempt from taxes.

Exemptions can therefore arise either by way of express exemption under the Income Tax Act or by way of relief under the Economic Expansion Incentives (Relief from Income Tax) Act, or by way of a Double Taxation Agreement.

Express exemptions under the Act are contained in Section 13, Income tax exemptions are granted to interest derived by non-resident persons, interest derived from post office savings bank, income derived from operating ships registered in Singapore and many other items.

The Economic Expansion Incentives (Relief from Income Tax) Act, Chapter 135

To encourage the growth and expansion of manufacturing and export enterprises, various tax incentives are provided by the Economic Expansion Incentives (Relief from Income Tax) Act.

The incentives are:—

(a) Tax holiday for pioneer companies for a period of five years;

(b) Special deductions in respect of additional plant or machinery and exemption from tax of dividends from expanding enterprises;

(c) Exemption from tax for periods of up to 15 years on increased export earnings;

(d) Exemption from tax on interest payable to non-residents in respect of approved loans or credit facilities for productive equipment; and

(e) Reduction of or complete exemption from tax on approved royalties, technical assistance fees or contributions to research and development.

V. COMPANY AND PERSONAL TAXATION

Company Tax & Section 44 Tax Credit

The benefit of the tax paid by a limited liability company resident in Singapore is ultimately returned to a shareholder when a dividend is declared. To illustrate this point, assume a Company has a chargeable income of $ 10,000/— on which it pays 40% tax i.e. $ 4,000/— leaving a balance of $ 6,000/— cash in hand available for distribution to shareholders.

If the Company declaring the dividends is a Company resident in Singapore, it is legally entitled to deduct from the amount of any dividends paid to any shareholder tax at the rate of 40% on every dollar of such dividends.

The Company will therefore declare to its shareholders the gross dividend of $ 10,000/— from which the amount of $ 4,000/— will be deducted in tax.

The shareholders will receive $ 6,000/— in cash and a dividend voucher showing the tax deduction at source in respect of the $ 4,000/—.

The individual shareholder is legally obliged to declare in his own personal return the gross dividend which he has received at $ 10,000/— and will be assessed to tax thereon at the rate applicable to him. If he is an individual the tax rate may be more or less than 40%, depending on his chargeable income. If his rate of tax is 55%, he will have to pay an additional tax of 15% being the difference. If his effective rate of tax is less than 40%, he will be entitled to a refund of the difference.

From the above it can be seen that shareholders are assessed on the gross dividends declared by a resident company but are entitled to claim a set-off for the tax deducted at source against the tax payable by them as individuals on graduated scale. However, care should be taken by the company directors not to declare dividends in excess of the taxable profits as this will result in an assessment, being raised on the company under section 44 (3) of the Income Tax Act.

To avoid the possibility of refund of tax which has not been paid by the Company in the first instance, Section 44 (3) of the Income Tax Act provides that if a Company declares a dividend which involves the issue of dividend warrants showing tax deduction more than the aggregate tax which it has already paid, the difference will become a debt due to the Comptroller

of Income Tax from the Company.
There have been some cases where Section 44 (3) has been overlooked and consequently the companies concerned have been requested to pay the difference.

Personal Income Tax
The income of an individual taxpayer is computed for income tax purposes basically in the same way as the income of a limited liability company. However, in addition to whatever deductions and allowances available to a limited company, there are personal reliefs available such as those for wife, children, earned income, C.P.F. contributions and life assurance premiums.
The income of a married woman living with her husband is deemed to be the income of the husband and assessable in his name.
However if she has earned income derived from a source which is independent from that of a husband, she may elect to be chargeable in her own name on her earned income under Section 51 (4) of the Act.
The amount of income tax payable on the chargeable income of an individual taxpayer resident in Singapore is calculated at the rates laid down in the Second Schedule to the Act. As mentioned earlier, such tax rates for individuals are on a sliding scale ranging from 6% on the first $ 2,500 up to the maximum of 55% on chargeable income exceeding $ 100,000.
The tax rate for non-resident individuals is a flat rate of 40%. However relief may be claimed by the following categories of non-residents.

(a) Non-residents who are citizens of Singapore;
(b) Non-residents who are in receipt of pensions arising from past services from Singapore; and
(c) Non-residents where their country of residence has concluded an Avoidance of Double Taxation Agreement with Singapore;
(d) Non-resident public entertainers.
(e) Non-resident short-term employees, but not non-resident directors.

VI. OTHER TAXES

A discussion of the topic "Taxation in Singapore" will not be complete if no mention is made of other taxes. Whilst this paper is primarily concerned with income tax, it is useful to make some reference, in passing, to the existence of other forms of taxation which affects the financial development in Singapore.
Some of these other taxes which may be of interest to investors and businessmen are as follows:—

1. *Property Tax*
According to the latest annual report of the Inland Revenue Department there has been an increase in property tax collections over the last few years and this can be attributed to the following factors:—
(a) Increase in number of properties;
(b) Increase in the annual value due to up-to-date valuations;
(c) Increase in contributions by the statutory bodies;
(d) Improvements in assessment and collection techniques;
(e) Expiry of tax concessionary period for some urban renewal projects.
Property tax is levied on immovable properties and is payable half yearly in advance and without demand in the months of January and July. It is computed as a percentage of the annual value of all houses, land, buildings, and tenements.
The annual value is the gross amount at which a property can reasonably be expected to be let out from year to year, the

landlord paying the expenses of repairs, insurance, maintenance, upkeep and property tax.

Exemption from property tax is provided:—

(a) for properties with an annual value of less than $ 18/— and also

(b) for buildings or parts of buildings used exclusively for religious, educational or charitable purposes.

The rate of property tax varies from 12% to 36%, depending on the locality and the facilities available in that locality and other factors. To encourage and stimulate private participation in urban re-development, special concessions are given in respect of properties which are approved development projects.

These concessions include waiver of tax generally for a specific period when the building is under construction and thereafter at a reduced rate of 12% instead of 36% for 20 years.

2. *Stamp Duty*

Stamp duty is imposed on various kinds of commercial and legal instruments which are required to be stamped under the Stamp Act. The rate of stamp duty varies from one type of instrument to another. The rates vary from ten cents per instrument to a percentage of the value of the subject of the document.

There is provision for the Minister to reduce or remit stamp duty.

3. *Payroll Tax*

Payroll tax was first introduced in 1965 when Singapore was part of Malaysia. It is levied on employers under the Finance Act (Payroll Tax) at 2% on the payroll of a trade, business or vocation. The tax is applicable to the whole of the remuneration including salaries, wages, commissions, bonus, leave pay, and so forth, paid in cash to employees, but it does not include any contribution by the employer to an approved provident or pension fund.

Payroll tax is also not payable on remuneration to any domestic servant, gardener or driver employed by an individual.

4. *Estate Duty*

The charge to estate duty is divided into two sectors, namely, domiciled estates and non-domiciled estates.

The Commissioner of Estate Duties is responsible for the assessment and collection of Estate Duty.

Estate duty is levied at graduated rates, on the property at ad valorem rates based on the open market value at the date of death. Where the total value of the estate is below $ 50,000/— the duty is remitted.

The rates of Estate Duty applicable to persons who died on or after 1st April 1974 range from 5 to 60%.

Where the principal value of all property which passes on the death of such person exceeds $ 50,000/—, a remission of Estate Duty is allowed in respect of that excess at the rate commencing from 90% to 10%.

Property liable to Estate Duty includes

(a) All property of a deceased person situate in Singapore, whether movable, or immovable, settled or not settled, which passes or is deemed to pass on death; and

(b) In the case of persons domiciled in Singapore, all movable property situate abroad.

Interest in chargeable on the amount of unpaid duty from the date of death to the date of payment.

The rates of interest chargeable on the amount of unpaid duty are

3% p.a. for the first 6 months
6% p.a. for the next 12 months
12% p.a. thereafter
(subject to the Commissioner's discretion to reduce to 6% p.a.)

5. *Betting & Sweepstake Duties*
Betting and Sweepstake Duties are payable on every bet made on any totalisator or parimutuel and every sweepstake promoted by any racing club or association. The duty on bets is 10% of the amount of the bets, and in the case of sweepstakes, the duty is 30% of the amount contributed towards the sweepstakes.

6. *Private Lotteries Duty*
Private Lotteries Duty is payable on lotteries promoted by private clubs and societies and restricted to members only. Permission is required for such lotteries to be held and the general conditions imposed are that no profit shall accrue to any individual person and that no commissions whatsoever are payable in respect of ticket sales. The rate of duty payable is 30% on the gross proceeds of the lottery. Promotors are required to furnish audited accounts relating to the operation of the private lotteries.

7. *Radio & Television Licences*
A licence is required for the use of radio or television sets.
A radio licence enables the licensee, members of his family to use any number of radio receivers including portable sets.
A television licence enables the licensee, members of his family and domestic servants to use any number of television and radio receivers including portable sets. In both cases, members of the family, domestic servants must be residing at the same address as shown in the licence.
A separate licence is required for sets installed in a vehicle, vessel or aircraft registered in Singapore.
A dealer's licence is required for any person who offers for sale radios or television sets.

8. *Customs & Excise Duties*
The most important indirect taxes are customs and excise duties. These duties are levied under Customs Act covering certain dutiable commodities such as liquors, petroleum, tobacco and other import duties on a wide range of products such as motor vehicles, clothing, perfumeries and cosmetics. Other indirect taxes include entertainment taxes, broadcast licences, taxes on tickets for cinemas and other entertainments, and taxes on film-hire.
The Customs and Excise Department is responsible for the collection of import duties, fees and other charges payable under the Customs Act and subsidiary legislation made thereunder.
Cess collection is governed by the Tourist Promotion Board Act.
The collection of cess which is levied on gazetted tourist hotels, tourist food establishments and tourist public houses is undertaken by the Department on behalf of the Tourist Promotion Board.
Industries using dutiable raw materials which are not available locally may apply for exemption from the payment of duty.
Exemptions granted are subject to furnishing of security in the form of bankers' guarantees and full compliance of conditions imposed under the exemption.
Since the separation of Singapore from Malaysia the number of commodities subject to customs duty has increased mainly with the view to protecting the local industries engaged in the manufacturing of goods. At present, such taxes account for the substantial increase in the revenue of the Republic.

DR. APOLONIUSZ KOSTECKI *:

THE TRENDS AND NATURE OF RECENT CHANGES IN THE POLISH TAX SYSTEM

I. *In General*

1. As of January 1st, 1976, the tax system of the Polish People's Republic underwent considerable changes, based on the provisions of the following acts:
- Law of 19th December, 1975 - on inheritance and gift tax,[1]
- Law of 19th December, 1975 - on stamp duties,[2]
- Law of 19th December, 1975 - on equalizing tax,[3]
- Law of 19th December, 1975 - on some local taxes and dues.[4]

These changes, based upon the above-mentioned acts, constitute a part of the considerable greater task of reform of the Polish tax system. At the same time, they improve on present tax legislation and adapt that legislation more adequately to the changing realities of social and political life. This process was initiated on 1st January, 1973, when the following two acts, regarding the objects of the private sector of the national economy, came into force:
- Law of 16th December, 1972 - on turnover tax,[5]
- Law of 16th December, 1972 - on income tax.[6]

These acts have already been discussed in the Bulletin.[7]

This article will not deal with the details of the above Laws of December 1975 but will rather outline the trends and the nature of the changes resulting from their introduction. It will be followed by further articles discussing some of these Laws separately.

II. *Transfer Tax*

2. The most significant changes in the structure of the Polish tax system concern the tax on inheritances and gifts (on gratuitous transfers) and the stamp duties (on transfers for a consideration). At the same time the Decree-Law on the tax on the acquisition of property rights of 3rd February 1947 [8] was repealed. This Decree-Law which had been in force for nearly 20 years has now been partly replaced by the

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1. Dziennik Ustaw (the official periodical publication on laws and regulations) no. 45 item 228. Executive regulations to the Law: Ruling of the Minister of Finance of 30th Dcecember, 1975, re execution of the Law on the inheritance and gift tax (Dziennik Ustaw no. 46 item 256).
2. Dziennik Ustaw no. 45 item 226. Comprehensive executive regulations are included in the Ruling of the Council of Ministers of 29th December, 1975, on the stamp duties (Dziennik Ustaw no. 46 item 241).
3. Dziennik Ustaw no. 45 item 227. Executive regulations: the Ruling of the Council of Ministry of 29th December, 1975, on the equalizing tax (Dziennik Ustaw no. 46 item 242).
4. Dziennik Ustaw no. 45 item 229. Due to the general character of the Law, executive regulations included in the Council of Ministry Ruling of 29th December, 1975, re Execution of the Law and regulations on certain local taxes and dues, are of particular significance (Dziennik Ustaw no. 46 item 243).
5. Dziennik Ustaw no. 53 item 338.
6. Dziennik Ustaw no. 53 item 339.
7. Compare M. Weralski, The new Structure of turnover and income taxes in Poland, Bulletin for International Fiscal Documentation, no. 12 of 1973.
8. The uniform text of the Decree was published in Dziennik Ustaw no. 9 item 74 of 1951; change: Dziennik Ustaw no. 7 item 72, of 1971.

provisions of the newly created inheritance and gift tax Law [9] and partly by the provisions of the stamp duties Law, in such a manner that gratuitous transfers are now covered by the inheritance and gift tax and non-gratuitous transfers by the stamp duties.[10]

3. The Inheritance and Gift Tax Law [11] retains the fundamental elements of the Property Rights Acquisition Law concerning the gratuitous acquisition of property rights. Like its predecessor the Inheritance and Gift Tax Law is a tax which is levied on each beneficiary's share in the estate or on the donation which he receives. For purposes of the computation of the tax, taxpayers are divided into four groups and the tax is based on both the group to which the taxpayer belongs and the amount he receives.

The philosophy underlying the tax is that the closer the kinship between the recipient and the deceased or donor is, the lower the tax should be and the new law has implemented this philosophy in a more consistent manner than its predecessor by regrouping the beneficiaries. For instance, step-children have now been included in the most privileged group (Group I)[12] whereas formerly they belonged to Group III.

The new law also increases the exempt base for Group I (i.e. from 30,000 zloty to 50,000 zloty), but it generally introduces a steeper progression than before. The exempt base for other groups has not been changed. The following gives an indication of the prevailing rates:

Group I:
The first 50,000 zloty are exempt.
The next bracket of 50,000 zloty is subject to 10%.
....
If the income exceeds 1,200,00 zloty the tax is 197,000 zloty plus 24% of the excess over 1,200,000 zloty.

Group II:
The first 30,000 zloty are exempt.
The next bracket of 20,000 zloty is subject to 10%.
....
If the income exceeds 1,200,000 zloty the tax is 297,000 zloty plus 36% of the excess over 1,200,00 zloty.

Group III:
The first 30,000 zloty are exempt.
The next bracket of 20,000 zloty is subject to 15%.
....
If the income exceeds 1,200,000 zloty the tax is 397,000 zloty plus 48% of the excess over 1,200,000 zloty.

Group IV:
The first 30,000 zloty are exempt.
The next bracket of 20,000 zloty is subject to 30%.
....
If the income exceeds 1,200,000 zloty the tax is 702,000 zloty plus 77% of the excess over 1,200,000 zloty.

9. The existing tax under this title is by no means a novelty in the Polish tax system. It has existed since property acquisition tax came into force in 1947, on the basis of the interwar tax regulations.

10. This fact can prove how inadequate are the legal terms "duties" and "tax", when used in the obligatory law.

11. The range of taxable events covered by the inheritance and gift tax is wider than its name indicates. It also includes real property acquisition by means of usucaption prescription as well as transfer of savings made on the instruction of the depositor or on death. This property is not — in this case — included in inheritance.

12. Group I comprises the spouse, descendants, adopted and step-children, sons- and daughters-in-law.

III. *Stamp Duty*

4. The most significant change in the structure of stamp duty was effected by extending its scope to acquisitions for a consideration, i.e. certain civil law activities:

a) non-gratuitous transfer of real property or other property rights effected by an individual or legal entity, which is not a unit of the socialized economy, provided that the transfer does not result from economic activities within the meaning of the turnover tax provisions;
b) loan agreements, when the loan is granted by persons indicated under a) above;
c) lease or rent contracts.

It is immaterial whether the above civil law activities result from a written or oral contract.

When the Law on Stamp Duties 1975 entered into force these activities were not subject to stamp duties but to tax on property rights acquisition. Only in those cases where documents such as bills, bills of exchange, authorizations, guarantees etc. were produced, were stamp duties due. Note that formerly only examples of these documents were given, whereas the new Law gives a complete list.

The present Law, like its predecessor, only provides for the upper limits of the rates of the stamp duties, which vary substantially depending on the nature of the transaction. The new Law even creates a wider range of these rates by establishing a much higher upper limit than previously. It authorizes the Council of Ministers to issue a detailed stamp duty table which has resulted in the Decree-Law of 19th December, 1975 indicated above.

Its characteristic is that the stamp duty rates are highly variable, depending on the nature of the transaction. The fact that part of these transactions was formerly covered by the property rights acquisition tax, reduces the difference between the concept of "tax" and the concept of "duty", which from a theoretical point of view cannot be considered as being proper.

IV. *Equalizing Tax*

5. One of the characteristic elements of the Polish tax system is the equalizing tax which was introduced in 1957 and whose purpose it is to restrict excessive consumption by those persons with high incomes.[13] However, with the passage of time the character of the equalizing tax has changed and this has been reflected twice in the amendments of the provisions of 1957. The subject of equalizing tax — which was initially meant as an additional tax to the salary and income tax — underwent a gradual extension and the Law on the equalizing tax of 19th December, 1975 cited above gave it a new scope. At present the following gains derived by individuals are subject to the equalizing tax:

a) earnings from employment;[14]
b) gross income resulting from agency agreements;
c) income within the meaning of the income tax provisions;
d) income from handicraft activities, which is subject to stamp duty instead of turnover and income tax;
e) income from certain agricultural and livestock production, if it is carried out on a large scale.

An essential feature of the equalizing tax is that tax liability only arises when gross income or net income of an individual taxpayer derived from the sources indicated

13. Dziennik Ustaw no. 62 item 336, of 1957.
14. The majority of salaries is no longer subject to the tax on salaries.

above exceeds the amount fixed by regulation in a particular year.

The main changes in the equalizing tax pertain to:

a) the concepts of gross income and net income (which determine the tax liability and the taxable base);
b) the tax rates.

The amount which will create tax liability for the equalizing tax has been increased from 96,000 zloty [15] to 144,000 zloty,[16] i.e. by 50 percent. A complete new feature is that this amount will be increased if the taxpayer has to support certain persons, i.e. by 24,000 zloty for his spouse if she or he has no other earnings. Similarly, an increase of 12,000 zloty is granted for each child which is supported by the taxpayer as well as for his parents and every related person who is incapable of working and financially dependent on the taxpayer.

The taxable base is the income (as defined above) which exceeds the exempted amount. Thus, the equalizing tax is based on not only the amount of gross or net income derived by the taxpayer but also on the number of dependents he has, which is a new and original feature in Polish taxation.

The changes in the tax rates consist in the introduction of a uniform progressive tax table, which replaces the former multitude of tables, which applied to gross income and net income and which are again subdivided according to the sort of gross or net income involved. The new tax table has a greater number of steps (11 instead of the former 4 or 5) and generally the progression has been reduced. In accordance with Article 10 of the Law, the tax rate on the excess income over 144,000 zloty (increased by the amounts for dependents as indicated above) is 10 percent on the first 24,000 zloty and reaches its maximum and the tax on apartments and consists in, inter alia, the repeal of the so-called rental case the equalizing tax is 387,000 zloty plus 75 percent of the excess amount).

V. *Local Taxes and Dues*

6. The last of the Laws of 19th December, 1975 mentioned above pertains to a number of local taxes and dues and is of a more general character. It deals with a number of taxes and dues, the majority of which were at the beginning of 1951 included in one consolidated Law. At present they include: urban property tax, tax on apartments, tax on dogs, dues on vehicles, market dues and health resort dues. A completely new feature introduced by the Law of 1975 is that city and district councils are granted the authority to levy administrative dues with respect to activities performed by subordinate bodies and which are not otherwise covered by fiscal dues.

The main tendencies of the changes regarding taxes and dues covered by this Law are (i) the simplification of the structure of some of them, (ii) the adoption of various — flexible — methods or regulation of their computation and (iii) generally, an increase of these taxes and dues.

The simplification is primarily effected

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15. For some categories of taxpayers (professors, members of authors' unions, persons receiving income from employment in organs of the nationalized economy etc.) this sum was already increased to 120,000 zloty in 1971.

16. It should be mentioned that from the value of net income or gross income (depending on their nature) certain sums are deductible, for example: the tax on salaries or income tax already paid, the costs of earning certain kinds of gross income, certain kinds of investment in living space for people whose gross income is subject to salary tax, etc.

with respect to the tax on urban property marginal rate of 75 percent when the excess income is over 720,000 zloty (in that value [17] as a basis for taxation with regard to owner-occupied buildings or apartments or any other non-rented property, for instance, if placed gratuitously at someone's disposal. This rental value has been replaced by a taxable base which uses a more objective criterion, i.e. the surface of the building or living space. With respect to the tax on apartments the living space has been retained as the only basis of taxation, since not only the rental value but also the actual rent have been abolished as determining factors for the computation of the taxable base. In this way a number of inconveniences has been removed; for example the need to use multipliers in those cases where exceptionally low rates are fixed by the State. However, after the general rent increase a few years ago the employees had already been exempted and that has not been changed by Law of 1975. The Law of 1975 does not introduce fixed tax rates, but offers a number of flexible solutions under which the power of the Council of Ministry and/or local authorities has been extended. The methods used are the following:

a) with respect to the tax on urban property and tax on apartments maximum rates have been provided for. Within this limit the executive bodies have discretionary power to fix the rates;
b) with respect to the vehicle dues the executive bodies may fix the rate (no upper limit) and with respect to market dues the executive bodies may fix an upper limit while leaving the further implementation to the local authorities;
c) the third method, which is a completely new feature, fully delegates the power to fix the tax or dues to local authorities. This method will be applied in the case of the tax on dogs and administration dues, the application of which has been left to the decision of the local authorities. These taxes and dues have, therefore, become fully optional.

VI. *Tax Allowances Relating to Investments*

7. A summing up of the changes introduced in the Polish Tax legislation from 1st January, 1976 would not be complete if the Law of 19th December, 1975 on the tax allowance relating to investments [18] was not mentioned.

Those persons operating in subjects of the private sector of the national economy are entitled to these tax allowances in respect of activities in the fields of handicrafts and catering as well as persons in the hotel business, where they construct their own buildings for purpose of this activity or buy and use machines and equipment within the framework of this activity. There is a regulation which deprives those taxpayers from the possibility of benefitting from the tax concessions, who in the course of their activities in the field of catering and the hotel business, are engaged in selling drinks containing more than 18% alcohol. The tax concessions are granted if investment outlay exceeds a certain sum, i.e. in the case of buildings — 50,000 zloty and in the case of machines and equipment — 10,000 zloty, and they represent according-

17. The rental value had a character of a notional rent, the amount of which used to be generally fixed by decree of the Minister of Finance.

18. Dziennik Ustaw no. 45 item 230; executive regulations include Ruling of the Council of Ministers of 21st December, 1975, re tax allowances relating to investments (Dziennik Ustaw no. 46 item 244).

ly 30 percent and 15 percent on investment outlay.

8. The changes in the tax system of the Polish People's Republic outlined in this article give an opportunity to become acquainted with the trends and the character of these changes. However, since this article is a mere introduction the author proposes to discuss in more detail at a later stage the inheritance and gift taxes as well as the equalizing tax, which are characteristic instruments of Polish tax policy.

* * * DOCUMENTS * * *

UNITED STATES OF AMERICA

Taxation of the undistributed income of controlled foreign corporations *

(b) *Behavioral change.* Revenue estimates are usually based on a standard assumption of no behavioral change. The standard assumption is useful in two respects: first, it is helpful to know the initial impact of a tax measure before adjustment occurs; second, the nature, extent and speed of behavioral changes are not easily forecast. Yet behavioral changes usually accompany any important tax measure. In the international tax area, not only will multinational firms adjust their dividend distribution rates, investment decisions, and financing policies in response to U.S. tax legislation, but also foreign governments may modify their own tax rules.

(i) Foreign subsidiaries might increase their dividend distributions in order to ensure and accelerate recognition of the foreign tax credit for dividend withholding taxes.

(ii) The extent of investment in foreign subsidiaries might be curtailed. At the same time, U.S. parent firms might increase their investment in the United States. The financing of foreign subsidiaries might be modified to reduce reliance on intrafirm equity, and increase reliance on intrafirm debt, and more importantly, external debt.

(iii) U.S. parent firms might place greater stress on minority participation in new ventures and they might attempt to "decontrol" some existing CFCs.

(iv) Foreign governments might selectively increase their own taxation of U.S. controlled foreign corporations.

Each of these reactions would affect the revenue implications of terminating deferral. Some would increase U.S. revenue; others would decrease U.S. revenue. The following paragraphs summarize the possible revenue consequences of these behavioral changes.

(i) *Change in distribution rates.* U.S. foreign subsidiaries typically distribute approximately 45 percent of their after-foreign-tax earnings. The revenue estimates in Table 7, 8, and 9 are based on this distribution rate. By contrast, Table 10 shows the revenue effect of increasing the distribution rate to 100 percent of foreign after-tax earnings. U.S. revenue gains would be substantially or completely eroded because foreign withholding taxes creditable under section 901 would be larger.[41] In fact, if the termination of deferral induced a 100 percent distribution rate, with an overall limitation on the foreign tax credit and worldwide consolidation of foreign subsidiary income, the U.S. revenue *loss* would be $375 million. Under a per-country limitation, the revenue loss would be $105 million. The revenue losses are calculated by reference to tax otherwise collected under subpart F, as expanded by the Tax Reduction Act of 1975. The reason for these revenue losses is that additional foreign withholding taxes would be credited against existing U.S. taxes collected both on subpart F income and on foreign source

* Continuation: Preliminary analysis of the U.S. Treasury Department prepared by the Treasury's Office of International Tax Affairs for the House Ways and Means Committee Task Force on Taxation of Foreign Income.

41. The same revenue effects would result if foreign governments imposed withholding taxes on deemed distributions of foreign affiliates.

TABLE 10

Revenue Effect of 100 Percent Dividend Distribution Rate

(Millions of Dollars)

1976 Calendar Year Tax Liabilities		
	Overall Limitation	Per-Country Limitation [2]
Total actual and potential revenue from current taxation of CFC earnings	—125	145
Potential revenue from 100 percent dividend distribution rate [1]	—375	—105
Mining	—5	5
Petroleum and Refining	—	115
Manufacturing	—315	—240
Other	—55	15
Actual revenue from subpart F; total	250	250
Pre-1975 revenue	25	25
Tax Reduction Act changes	225	225

Office of the Secretary of the Treasury
Office of Tax Analysis

February 3, 1976

1. The estimates assume: (i) dividends from less developed country corporations are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) CFC profits and losses are pooled on the same basis as the foreign tax credit limitation; (iii) no behavioral change, except that all CFCs increase their actual dividend distribution rates to 100 percent.
2. These estimates assume that the per-country limitation is already in place, and that deferral is then ended. The revenue changes refer only to the additional impact of eliminating deferral.

interest, rents, royalties, fees, and branch income.

The revenue losses would be more than proportional to any increase in dividend distributions from the current rate of about 45 percent to the hypothetical rate of 100 percent. Most of the loss would occur with the first increments in the overall dividend distribution rate, since additional dividends would presumably be distributed first from CFCs paying the highest foreign taxes.

(ii) *Foreign vs. domestic investment.* Tables 11 and 12 present rough and conflicting estimates of the revenue consequences of changes in investment behavior resulting from the termination of deferral. The revenue estimates in Table 11 are based on Professor Horst's model which attempts to measure the investment and financial position of a multinational firm after it has fully adjusted to the termination of deferral. The model, described in section 5, assumes that the firm can to some extent choose between foreign and domestic investment, and between alternative means of financing its assets.

The estimates in Table 11 are made from two starting points: the current dividend

TABLE 11

Termination of Deferral with Assumed Changes in Investment Location and Means of Finance

(Millions of Dollars)

	1976 Calendar Year Tax Liability	
	Current Dividend Distribution Rate	100% Dividend Distribution Rate
Total actual and potential U.S. revenue from current taxation of CFC earnings, with specified investment and financing changes[1]	1,000	260
Actual revenue from subpart F, total	250	250
Potential revenue from termination of deferral with no investment or financing changes	365	—375
Potential revenue from possible changes in investment and financing:[2]	385	385
(1) Effects on foreign source income —		
(a) Decrease in CFC earnings	—15	—15
(b) Decrease in royalties, fees, and interest repatriated to the U.S.A.	—10	—10
(2) Effects on domestic source income —		
(a) Increase in domestic investment	90	90
(b) Increase in use of equity capital in the United States and increase in use of external debt abroad	320	320
Addenda: Change in foreign revenue from corporate income and dividend withholding taxes[3]	—210	630
(1) Effect of 100 percent dividend distribution rate on dividend withholding taxes	—	840
(2) Effect of reduced size and increased use of external debt by CFCs on corporate income tax and withholding tax	—210	—210

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1. The estimates assume: (i) dividends from less developed countries are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) worldwide pooling of CFC profits and losses, and an overall limitation on the foreign tax credit; (iii) specified behavioral changes in dividend distribution rates, investment and financing. The details underlying these figures appear in Tables 7 and 10.
2. The estimates represent the revenue impact after full adjustments to the current taxation of CFC earnings, including adjustments to the Tax Reduction Act of 1975. The adjustments would, in fact, take several years. The estimates are adopted from a model developed by Thomas Horst, "American Multinational and the U.S. Economy," Fletcher School of Law and Diplomacy, November 1975.
3. The estimates assume no change in foreign tax laws.

distribution rate and a 100 percent dividend distribution rate. The dividend distribution rate affects both the division of revenue changes between the United States and foreign governments, and the total amount of these changes.

The potential U.S. revenue gain from changes in the location of investment and the means of finance, after all adjustments have taken place, is very roughly estimated at $385 million whether the dividend distribution rate remains at current levels or increases to 100 percent. The figure of $385 million reflects a revenue loss of about $25 million from smaller CFC earnings and reduced intrafirm payments of interest, rents, royalties, and management fees, and a revenue gain of about $410 million from larger U.S. corporate investment and a shift in the means of finance. Foreign subsidiaries would rely to a greater extent on local debt finance, while U.S. parent corporations would use more equity capital.

These calculations do not take into account possible attempts by foreign governments to offset the shift of investment location and means of finance through modification of their own tax laws.

Under current dividend distribution rates, the model suggests that firms would pay an additional $750 million in U.S. taxes while they would pay $210 million less in foreign taxes. The net increase in corporate tax payments at home and abroad would thus be $540 million. Under a 100 percent dividend distribution rate, the model suggests that firms would pay an additional $10 million in U.S. taxes and an additional $630 million in foreign taxes. The net increase in corporate tax payments at home and abroad would be $640 million under this assumption.

The revenue estimates in Table 12 are based on Professor Stobaugh's model which attempts to measure the long-term consequences of placing U.S. controlled foreign corporations at a competitive disadvantage through the termination of deferral. Again, these calculations do not take into account possible offsetting measures by foreign governments.

The Stobaugh model assumes that higher U.S. taxes on CFCs will, after a period of time, cause a cumulative contraction in their market share, profitability, and the remittance of interest, royalties, and management fees to the U.S. parent corporations. Moreover, CFCs will find it advantageous to distribute a larger share of earnings and rely more heavily on debt finance.[42] The predicted result is a cumulative reduction in U.S. taxes not only on the foreign earnings of CFCs but also on the associated types of foreign income paid to U.S. parent firms. In 1981, five years after the termination of deferral, the model estimates that U.S. taxes on all foreign source income would be $400 million less than under present law. In succeeding years, the adverse revenue impact would be even larger.

(iii) *Minority participation and "decontrol"*. If deferral is terminated, some multinational firms might seek to minimize the impact of current U.S. taxation either by undertaking new foreign investments through minority ownership in joint venture arrangements or by "decontrolling" some of their existing CFCs. Either way, the retained earnings of the foreign corporation would not be subject to current U.S. taxation. However, decontrol of an existing CFC could entail substantial U.S. taxes on accumulated earnings and profits. Moreover, even if decontrol in the tax sense does not involve the total loss of control, it

42. Both the Horst and Stobaugh models envisage a larger role for debt finance if deferral is terminated.

TABLE 12

Termination of Deferral with Assumed Adverse Impact on Competitive Position of U.S. CFCs
(Millions of Dollars)

	Calendar Year Tax Liabilities	
	1976	1981
Estimated U.S. revenue from corporate taxation of all foreign source income with termination of deferral [1]	2,610	3,200
Estimated U.S. revenue from corporate taxation of all foreign source income under current law [2]	2,245	3,600
Estimated change in U.S. revenue with termination of deferral	365	—400

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1. The 1976 figure is based on estimated 1976 revenues plus the potential revenue from complete termination of deferral. The 1981 figure is adapted from a model developed by Robert B. Stobaugh, "The U.S. Economy and the Proposed U.S. Income Tax on Unremitted Foreign Earnings of U.S. Controlled Foreign Manufacturing Operations Abroad," Harvard Business School, 1975.
2. The 1976 figure reflects the Tax Reduction Act of 1975. The 1981 figure assumes an annual growth rate of 10 percent in the foreign source of U.S. corporations.

at least inhibits managerial flexibility, and makes international business decisions more difficult. A new minority ownership arrangement raises similar problems.

While the difficulties associated with decontrol and minority ownership arrangements cannot be quantified, a useful perspective may be gained by comparing the total tax burden on U.S. multinational corporations with and without deferral. In 1976, total U.S. and foreign taxes on foreign source corporate income, other than income earned by the petroleum sector, will be approximately $12.3 billion. The complete termination of deferral might increase the tax burden by as much as $0.6 billion, or by 5 percent.[43] Because this figure is relatively modest, and because the tax costs alone of reorganization are substantial, it seems unlikely that many multinational firms would reorganize their corporate structure as a means of avoiding current U.S. taxation.[44]

Table 13 gives the estimated structure of foreign affiliate earnings classified by the percentage of U.S. ownership in the affiliate. Only 5.2 percent of profits were earned by foreign affiliates owned less than 50 percent by U.S. parent corporations.

43. This figure, from Table 7, assumes an overall limitation on the foreign tax credit and includes subpart F revenue.
44. J. L. Kramer and G. C. Hufbauer, "Higher U.S. Taxation Could Prompt Changes in Multinational Corporate Structure," *International Tax Journal,* Summer 1975.

TABLE 13

Net Earnings by Extent of U.S. Ownership in Foreign Affiliates

(Millions of Dollars or Percent)

U.S. ownership percentage	1973 net earnings[1]	Percent of net earnings	U.S. ownership percentage	1973 net earnings[1]	Percent of net earnings
BY AREA			Africa, Asia and Australia	6,065	100.0
All Areas	17,495	100.0	95 - 100%	5,109	84.2
95 - 100%	14,290	81.7	50 - 94%	514	8.5
50 - 94%	2,290	13.1	25 - 49%	321	5.3
25 - 49%	584	3.3	10 - 24%	109	1.8
10 - 24%	285	1.6	1 - 9%	7	0.1
1 - 9%	46	0.3			
Canada	2,846	100.0	BY INDUSTRY		
95 - 100%	1,904	66.9	Petroleum	6,183	100.0
50 - 94%	781	27.5	95 - 100%	5,475	88.6
25 - 49%	93	3.3	50 - 94%	560	9.1
10 - 24%	44	1.6	25 - 49%	92	1.5
1 - 9%	21	0.7	10 - 24%	29	0.5
Western Europe	5,957		1 - 9%	26	0.4
95 - 100%	4,742	79.6	Manufacturing	7,286	100.0
50 - 94%	815	13.7	95 - 100%	5,668	77.8
25 - 49%	176	3.0	50 - 94%	1,138	15.6
10 - 24%	205	3.4	25 - 49%	300	4.1
1 - 9%	11	0.2	10 - 24%	160	2.2
Latin America and other			1 - 9%	19	0.3
Western Hemisphere	2,628	100.0	All other industries	4,026	100.0
95 - 100%	2,387	90.8	95 - 100%	3,145	78.1
50 - 94%	185	7.0	50 - 94%	592	14.7
25 - 49%	43	1.7	25 - 49%	192	4.8
10 - 24%	9	0.4	10 - 24%	26	2.4
1 - 9%	4	0.1	1 - 9%	1	0.0

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Source: Based on Table B-10 of the Preliminary Draft of *U.S. Direct Investments Abroad 1966 Part I: Balance of Payments Data* (U.S. Department of Commerce, 1970), pp. 83-84; and Table 9 of J. Freidlin and L. A. Lupo, "U.S. Direct Investment Abroad in 1973," *Survey of Current Business,* (August 1974), Pt. II, pp. 16-17.

1. Net earnings are after-foreign tax. Foreign affiliates include foreign branches, counted as 100 percent owned by the U.S. parent corporation.

TABLE 14
Estimated Revenue from Subpart F and Termination of Deferral with Increase of Non-CFC Earnings

	1976 Calendar Year Tax Liability		
	5% of Earnings in non-CFCs	10% of Earnings in non-CFCs	15% of Earnings in non-CFCs
Total actual and potential revenue from current taxation of CFC retained earnings	615	565	515
Actual revenue from subpart F, total	250	250	250
Potential revenue from termination of deferral, total[1]	365	365	365
Change in revenue from new minority participation or decontrol of CFCs[2]	—	—50	—100

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1. These estimates assume: (i) dividends from less developed country corporations are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) foreign subsidiary losses are fully offset against foreign subsidiary profits and all firms use the overall limitation in calculating the foreign tax credit; (iii) no behavioral change other than the specified changes in non-CFC earnings.
2. Assumes that incremental non-CFC earnings are taxed by the foreign government at a 20 percent rate, including withholding taxes. Non-CFC earnings are defined as the earnings of those foreign affiliates which are owned less than 50 percent by "U.S. shareholders."

Even if this percentage doubled or tripled, and the growth were concentrated in low-tax countries, the tax avoidance would be modest. If deferral was terminated, and if the proportion of earnings accounted for by non-CFC foreign affiliates subsequently increased to 10 percent, the revenue gain would be reduced by $50 million; at 15 percent, the reduction in revenue gain would be $100 million (Table 14).

The potential revenue loss could be a greater problem if foreign affiliates owned exactly 50 percent by "U.S. shareholders" generally escape classification as CFCs. Under the *Garlock* and *Kraus* decisions, U.S. ownership of exactly 50 percent of a foreign affiliate, coupled with actual U.S. control of the affiliate, will meet the test of subpart F.

(iv) *Higher foreign taxes.* If deferral were terminated, foreign governments could selectively increase the tax burden on U.S. controlled foreign corporations in situations where the general foreign tax rate is lower than the U.S. tax rate. Alternatively, they could raise withholding tax rates and treat deemed dividend distributions as actual dividend distributions for withholding tax purposes. Such changes in foreign tax practices would take time, and would probably not occur as an immediate response to the termination of deferral, but the long-term result of such changes would be lower U.S. tax collections and higher foreign tax collections. The revenue outcome would be similar to the estimates presented in Table 10 for a 100 percent distribution rate. U.S. taxes collected on the retained earnings of foreign subsidiaries would be diminished as a result of higher foreign taxes.

8. *Summary of the analysis.*

Before turning to the policy options, it might be useful to restate the major issues and findings. The debate surrounding deferral has often lacked a clear definition of objectives. The termination of deferral has been urged at different times by different groups seeking at least five different objectives.

(a) To improve tax neutrality;
(b) To eliminate tax avoidance;
(c) To simplify the tax law;
(d) To discourage foreign investment;
(e) To increase U.S. tax revenues.

These different objectives can lead to conflicting policies.

(a) *Tax neutrality.* The termination of deferral would, of course, be diametrically opposed to the principles of capital-import neutrality. However, current taxation of retained CFC earnings is urged as a step not toward capital-import neutrality, but rather as a step toward capital-export neutrality. But the termination of deferral, would not by itself advance the standard of capital-export neutrality. With the end of deferral, the U.S. tax system would on the whole favor domestic investment even more than it does now. Collateral changes would be required in the investment tax credit, the accelerated depreciation range, DISC, and other tax practices in order to approach capital-export neutrality.

(b) *Tax avoidance.* In the context of foreign corporate investment, tax avoidance is sometimes very broadly defined to occur whenever the realized foreign tax rate is less than the *statutory* U.S. rate of 48 percent. If this broad definition is accepted, then the termination of deferral would eliminate virtually all cases of tax avoidance.

However, tax avoidance is often defined more narrowly, either with reference to *realized* U.S. tax rates or with reference to artificial corporate structures and business arrangements.

When tax avoidance is defined with reference to *realized* U.S. tax rates, then its extent is much less significant. The investment tax credit, asset depreciation range, DISC, and other domestic tax preferences all serve to reduce the realized U.S. corporate tax rate on domestic income which, in 1974, was about 41 percent.[45] However, the termination of deferral would generally subject CFC income to a tax of 48 percent. Tax avoidance would be more than offset, and in fact, foreign corporate income would generally be taxed at a higher rate than domestic corporate income.

When tax avoidance is defined with reference to artificial corporate structures and business arrangement then the appropriate solution might involve an extension and strengthening of subpart F rather than the general termination of deferral.[46]

(c) *Tax simplification.* It has been argued that the termination of deferral would lead to the simplification of tax law and administration. Subpart F could be repealed, since all CFC income would be taxed currently. Moreover, there would be somewhat less pressure on arm's-length pricing rules (Section 482), on the non-recognition provisions involving transfers of capital, tech-

45. The figure of 41 percent does not reflect the base broadening measures contemplated in Table 1.

46. It should be noted that the overall limitation, which permits an averaging of taxes imposed by high-tax and low-tax countries, can create more potential for tax avoidance than deferral.

nology, and other property to foreign corporations (Sections 351 and 367), and on reorganizations involving foreign corporations (Section 367).

However, the partial termination of deferral would introduce numerous new complications into the tax code. These complications include the determination of a minimum percentage distribution and the allocation of a demand distribution between CFCs (in the case of partial termination), the measure of a subsidiary earnings and profits and taxable income according to U.S. accounting standards, the extent of consolidation of CFCs, and rules to deal with attempted avoidance through decontrol. These complications are discussed in Section 3 of part IV.

(d) *Investment and financial impact.* Based on one economic model, it has been calculated that the termination of deferral might, over a period of time, cause U.S. corporations to reduce their foreign assets by as much as $3.4 billion, and increase their domestic assets by $2.2 billion (Table 4). These estimates depend on numerous assumptions, and may represent extreme statements of the investment impact. Other models suggest that U.S. corporations would reduce both their U.S. and foreign investment as a result of the termination of deferral. In general, the estimates do not reflect the possibility of adverse foreign reaction.

In addition to its impact on real investment, the termination of deferral might encourage firms to change their means of finance. Some firms might find it advantageous to substitute borrowing for parent firm equity. The extent of such substitution would depend on a variety of considerations, including tax rules adopted by host countries.

(e) *U.S. tax revenue.* The effect of terminating deferral on U.S. revenue depends on several factors. Under the standard assumption of no change in corporate or foreign government behavior, the revenue gain could be $365 million (Table 7). Other assumptions suggest lower revenue gains, or even revenue losses. For example, under the assumptions that alle CFC earnings would be actually distributed following the termination of deferral, the U.S. loss could be $375 million (Table 10).

IV. OPTIONS

Legislative options on deferral can be grouped into four broad categories: (1) retain the present system; (2) broaden subpart F to include more types of income; (3) partly or completely terminate deferral by requiring that deemed and actual distributions equal some portion of all of CFC earnings; and (4) terminate deferral in the context of repealing domestic tax preferences. Option (3) involves secondary questions as to the extent of consolidation between subsidiaries, and the choice of a per-country or an overall limitation on the foreign tax credit.

1. *Retain present system.*

It can be argued that no further legislation is needed on the deferral issue. The Tax Reduction Act of 1975 substantially extended subpart F, and as a result the principal areas of tax abuse have been closed off. Further legislative restrictions could prove counterproductive by accelerating actual distributions, triggering legislative reactions abroad, reducing the profitability and growth of American firms, adding complexity to the Internal Revenue Code and placing administrative demands on the Internal Revenue Service. Moreover, while the present tax system favors foreign investment in some cases, it favors domestic investment in many other cases.

2. *Broaden subpart F.*

Subpart F could be broadened in several respects, consistent with its objective of reaching foreign income with tax abuse characteristics.

(a) *The substantial reduction test.* Under section 954(b)(4), a CFC that does not have as one of its significant purposes a substantial reduction of taxes is generally excluded from subpart F.[47] This exemption underscores the anti-tax avoidance purpose of the statute, but it has been drafted in a manner that limits the application of subpart F. The test is basically whether the effective tax rate paid by the foreign corporation equals or exceeds 90 percent, or is not less than 5 percentage points lower than, the effective *foreign* tax rate that would have been paid if the income had not passed through a foreign base company (Regulations 1.954-3(b)(4), example (1)). Certain foreign countries impose low rates of tax, while others exclude certain kinds of income from taxation altogether. Therefore, the CFC can meet the 90 percent or the 5 percentage point test, yet still be paying far less than the U.S. corporate tax rate of 48 percent. Moreover, the test poses substantial administrative difficulties, because it requires the Internal Revenue Service agent to have an intimate knowledge of third country tax laws.

This difficulty could be eliminated in the context of subpart F by recasting the "substantial reduction" test to refer not to alternative foreign tax rates, but to the U.S. corporate tax rate. If the present "substantial reduction" test obstructs the revenue gains projected under subpart F as expanded by the Tax Reduction Act of 1975, then very large amounts of revenue could depend on an appropriate modification, perhaps as much as $100 million. However, this amount is not additional to, but rather a part of, the revenue collections already estimated for subpart F.

(b) *50 percent subsidiaries.* The present language of subpart F appears to exclude foreign corporations that are owned exactly 50 percent by U.S. shareholders. However, the Tax Courts have found that 50 percent ownership, combined with actual control, will suffice for subpart F purposes. The statute could be strengthened to include foreign subsidiaries owned 50 percent by U.S. shareholders, with a rebuttable presumption of actual control. The revenue consequences of this change are estimated at less than $5 million.

(c) *Shipping income.* The Tax Reduction Act of 1975 included international shipping income under subpart F, to the extent it is not reinvested in shipping operations. However, the earnings of most shipping companies are likely to come within the reinvestment exclusion. Subpart F could be broadened to include all shipping income, whether or not reinvested. Such a provision should be related to other changes in the taxation of shipping income discussed in the Treasury Paper on the "Tax Treatment of Income from International Shipping," February 1976. The potential revenue gains are estimated at $70 million.

(d) *"Runaway plants" and tax holiday manufacturing.* In 1973, the Treasury proposed that tax haven manufacturing corporations, defined to include "runaway plants" and tax holiday operations, should be taxed currently under provisions similar to subpart F.

A runaway plant would be defined as new

47. Particular items of income may still be taxed under subpart F if the transaction was structured to avoid taxes.

investment in a controlled foreign corporation which realized more than 25 percent of its gross receipts from the manufacture and sale of products to the United States, and paid a foreign effective tax rate of less than 80 percent of the U.S. corporate tax rate. A tax holiday manufacturing corporation would be defined as any controlled foreign corporation which increased its investment in excess of 20 percent during or in anticipation of a foreign tax incentive. Foreign tax incentives would be broadly defined under regulations prescribed by the Secretary of the Treasury. The tax haven manufacturing proposal would increase revenue by about $25 million.

(e) *Simplification.* Although subpart F was based on the earlier foreign personal holding company statute, no effort was made to combine the two pieces of legislation or enact identical statutory tests to define the controlling group or constructive ownership. As a result, there is some overlap between the two statutes, and a foreign personal holding company may also be subject to subpart F. A foreign personal holding company can also be a personal holding company, with a penalty tax imposed both on the company and on the shareholder.

These statutes could be simplified by taxing foreign personal holding companies within the framework of subpart F, and by establishing a mutually exclusive boundary between personal holding companies and foreign personal holding companies. Simplification and rationalization of the law would probably not provoke an adverse foreign reaction. The revenue effect would be minimal.

3. *Partial or complete termination of deferral.*

Some observers contend that the separate entity system of taxing foreign corporations reduces U.S. tax revenue and encourages foreign investment at the expense of domestic investment. These observers argue that the remedy lies in the partial or complete termination of deferral.

Other observers point out that the termination of deferral might produce only short-run revenue gains, and that, as an isolated step, it would move the United States further away from a system of capital-export neutrality. Moreover, adverse foreign reaction could be intense, especially from countries such as Israel, Egypt, and Ireland which promote industrial development through tax relief.

The complete termination of deferral would clearly replace subpart F, but the partial termination of deferral would not serve the same function, since subpart F provides for current taxation of all CFC income in selected situations. Partial termination legislation would need to be carefully coordinated with existing subpart F to avoid overlapping coverage that would cause very severe administrative problems for taxpayers and the Internal Revenue Service. In any event, partial termination would require very complex legislation.

The revenue estimates for the complete termination of deferral under the standard assumption of no behavioral changes range from $365 million to $630 million depending on whether an overall or per-country limitation is used for the foreign tax credit. If allowance is made for behavioral change, the revenue gains would be less, and there might even be a revenue loss of up to $375 million from the termination of deferral. The partial termination of deferral would involve both smaller revenue gains (under the standard assumption) and smaller revenue losses (under the worst case assumption).

The partial or complete termination of deferral involves several choices as to coverage and mechanics. The important choices are outlined in the following paragraphs.

(a) *Required minimum percentage distribution.* The partial termination of deferral would involve a percentage test for the distribution of earnings and profits. To the extent actual distributions do not meet the minimum percentage, earnings would be distributed on a deemed basis. The percentage could be based on after-tax earnings and profits, or on after-tax earnings and profits plus other categories of foreign source income, such as interest, royalties, management fees and branch earnings. The broader the base amount, the easier it is to meet the test, as illustrated by Table 8.

(b) *Allocation of the deemed distribution between CFCs.* The partial termination of deferral would also involve allocation of the deemed distribution between CFCs. This allocation is both to trace the foreign tax credit associated with each deemed distribution and to maintain an inventory of deemed distributions for each CFC. The allocation could be made on a pro rata basis with respect to the undistributed earnings of all CFCs, or the allocation could be made only with respect to the CFCs not meeting the minimum percentage. The allocation rule should be consistent with the consolidation rule.

(c) The extent of consolidation. In the case of partial termination, the question arises whether the minimum percentage applies to each CFC individually, or to a U.S. parent corporation's CFCs grouped on a country, on a worldwide, or on some other basis. In the case of complete termination, the extent of consolidation is also important. The wider the grouping, the smaller the revenue impact of any given percentage test, as shown in Table 8. This relationship reflects two phenomena: first, some CFCs have losses, and these losses increase the apparent distribution rate of profitable CFCs; second, CFCs with high foreign taxes already tend to distribute a larger percentage of earnings than CFCs with low foreign taxes, and if high-tax CFCs are consolidated with low-tax CFCs, the average creditable foreign tax is increased. There are several possible consolidation alternatives.

(i) *Individual foreign corporations approach.* This approach would employ the present subpart F mechanism of computing the income to be deemed distributed separately for each foreign corporation. There would be no consolidation of foreign corporations either with other foreign corporations owned by the same U.S. parent, or with the U.S. parent itself. Losses and blocked currency already create problems under this system, and these problems would become more important if deferral were eliminated. Under the individual foreign corporation approach, there are two methods for computing the amount of income of a lower-tier subsidiary which is included in the income of the U.S. shareholders: the so-called "hopscotch" method; and the so-called "link-by-link" method.

(aa) *Hop-scotch method.* This is the mechanism by which subpart F presently attributes the income of a lower-tier CFC to its shareholders. Under this method, the income is attributed directly to the U.S. shareholders, and cannot be offset by any loss incurred by intermediate foreign corporations. Under this method there are problems concerning the source country of a deemed distribution. In addition, if the intermediate corporation is in a country which restricts the repatriation of earnings, there can be blocked currency problems.

Compulsory adoption of the overall limitation for the foreign tax credit (as proposed in H.R. 10612) would render almost moot the source problem.[48] However, if the per-country limitation is retained, it would be necessary to establish a source rule for the deemed dividend. Under present law, actual dividends are sourced in the country of incorporation of the subsidiary paying the dividend to the U.S. shareholder. Thus, if lower-tier CFC A distributes dividends to higher-tier CFC B, which in turn distributes dividends to the U.S. parent corporation, the dividends are sourced in country B. The rule more in keeping with the intent of the per-country limitation would require that dividends be sourced in the country of incorporation of the lower-tier subsidiary which earns the income.

Blocked currency creates a problem under subpart F, and the problem would continue if the hop-scotch method were used more widely. The problem here is the effect on the lower-tier corporation if the intermediate corporation's country of residence restricts distributions so that the lower-tier corporation cannot distribute up the chain of ownership. Thus, the U.S. shareholder might be taxed on income which he could never realize. One solution is to apply the present blocked currency rules as if the country of incorporation of the lower-tier subsidiary restricts the repatriation.

(bb) *Link-by-link method.* The link-by-link method was considered by the Treasury in 1962. It was rejected partly because its complexity was not justified in light of the limited goals of subpart F as then enacted. The question now is whether the complete or partial termination of deferral, with its impact on all foreign corporations controlled by U.S. persons, would justify reconsideration of the link-by-link approach. Under the link-by-link method, the retained earnings of a lower-tier subsidiary would be constructively distributed up the chain of ownership. The profits of a lower-tier subsidiary would thus offset the losses of a higher-tier subsidiary in the same chain. However, there would be no offset of losses in the lower-tier by profits in the higher-tier, nor would there be offsets as between different chains of CFCs owned by the same U.S. parent.

If the per-country limitation of the foreign tax credit is retained and the present income source rules are not changed, the source of the deemed distribution would be the country of incorporation of the first-tier corporation. Again, this result circumvents the purpose of retaining the per-country limitation, and suggests a reconsideration of the source rules.

If the link-by-link approach is adopted, the computation of earnings and profits must be correspondingly altered. If the constructive distribution is treated as an actual distribution, the earnings and profits of the lower-tier foreign corporation should be reduced by the amount of the constructive distribution, and the earnings and profits of the foreign corporation next in the chain should be correspondingly increased. This process should continue up the chain to the domestic parent. Thus each controlled foreign corporation would keep two sets of accounts: one set would reflect actual distributions while the other set would reflect deemed distributions for U.S. tax purposes. These two sets of books are presently kept for CFCs subject to subpart F.

48. A problem could still arise for a CFC with U.S. source income.

(ii) *Consolidation of foreign operations.* Under this method, all foreign corporations within a controlled group would file a consolidated return in a manner similar to that currently available for domestic corporations. The consolidated return would presumably reflect only the U.S. parent corporation's share of the earnings and profits of its CFCs. If the consolidated return shows an overall profit on foreign operations, the U.S. parent corporation would receive a deemed distribution of the foreign profit. If the consolidated return shows an overall loss, the parent might be allowed to claim the loss as a deduction against domestic income, or at least carry over the loss against future foreign profits. The purpose of a rule limiting the deductibility of overall foreign losses would be to protect the U.S. tax base.

Which foreign corporations would be allowed (or required) to consolidate? Consolidation should probably be limited to foreign corporations which are members of the same affiliated group, as that term is defined in section 1504(a). However, consideration might be given to lowering the required ownership to 50 percent from 80 percent, so that most controlled foreign corporations would be includable in the consolidated return, or even to 10 percent so that all CFCs would be includable.

Consolidation could be required, or it could be provided as an elective alternative to computation of income on an individual foreign corporation basis. If an election is provided, it would seem best to make it binding for future years, revocable only with the consent of the Commissioner. Standards for allowing revocation could be included in the legislative history or in the statute.

Blocked currency would raise problems. If one of the foreign corporations in the affiliated group is prevented by its home country from making a distribution, what is the effect on the group? Should that corporation be excluded from the group, or should it be assumed that the rest of the group will be able to distribute enough to make up the difference? A percentage test might be appropriate so that if the income of the blocked currency corporation is less than a fixed percentage of the income of the group (for example, 10 percent) then that corporation will be consolidated; otherwise it will be excluded.

(iii) *Consolidation of worldwide operations.* Under this approach the controlled group of corporations would file a single U.S. tax return for its worldwide operations rather than separate returns for domestic and foreign activities.

Questions concerning corporations to be included, an elective as opposed to a mandatory system, and blocked currency exist here as with the consolidated foreign operations approach. Additional questions arise. Should an electing corporation still be treated as a foreign corporation for purposes of section 367? Arguably not, because most tax avoidance potential is gone. On the other hand, high overall foreign tax rates might make it advantageous to transfer income producing assets from the United States to tax havens. Worldwide consolidation clearly raises several difficult issues.

(d) *The problem of decontrol.* The partial or complete termination of deferral could encourage firms to decontrol their existing CFCs and to take minority positions in new joint ventures as a means of avoiding U.S. taxation.

If decontrol and minority positions are a matter of concern, the foreign tax credit for deemed paid taxes (Section 902) might be limited to those U.S. shareholders claiming "actual control" of the foreign corporation (alone or acting in concert with other U.S. taxpayers), and thus presumptively subject to current taxation of earnings retained by the foreign corporation. Minority U.S. shareholders in a foreign corporation could thus elect either current taxation coupled with the deemed paid credit, or deferral without the deemed paid credit.[49] Under present law, the deemed paid credit is not available for passive portfolio investments, generally defined as investments where U.S. corporate shareholders have less than 10 percent ownership or investments by individuals. The rationale of the deemed paid credit is to avoid double taxation when a U.S. corporation has an active management stake in the foreign investments. An explicit link between "actual control" and the deemed paid credit would bring the basic purpose of section 902 into sharper focus. The estimated amount of deemed paid foreign tax credit claimed in 1976 for foreign corporations owned less than 50 percent by U.S. shareholders is about $250 million. It is uncertain how much of this amount would be claimed under an "actual control" election, and it is very difficult to predict the potential extent of decontrol following the termination of deferral.

Terminate deferral in the context of repealing domestic tax preferences. As Table 1 indicates, the termination of deferral as an isolated measure would move the U.S. tax system further away from a standard of capital-export neutrality for the non-extractive industries.[50]

The partial or complete termination of deferral, by itself, would favor manufacturing and other non-extractive investment in the United States by comparison with investment abroad. If tax neutrality between domestic and foreign investment is the goal, then deferral should be changed only in the context of a broader program. Specifically, the termination of deferral should be accompanied by collateral tax changes.

Certain of the collateral changes would increase tax revenue, namely, elimination of the Western Hemisphere Trade Corporation (+$20 million), inclusion of less developed country corporations in the gross-up requirements (+$55 million), and provision of a deduction rather than credit for foreign taxes comparable to state taxes (+$450 million).[51]

Other collateral changes would substantially decrease tax revenues, namely, elimination of restrictions on the foreign tax credit (—$180 million), extension of the investment tax credit to foreign non-extractive investment (—$1,000 million), extension of the asset depreciation range to foreign investment (—$300 million), extension of the DISC to export goods produced abroad (—$1,000 million).

The net decrease in tax revenues from non-extractive industries under a system of

49. In both alternatives, a credit for direct foreign taxes, for example, withholding taxes on dividends, would still be available under Section 901.

50. This is true whether capital-export neutrality is defined by reference to present U.S. taxation of corporate income, or by reference to U.S. taxation of corporate income in the absence of domestic tax preferences.

51. The first two changes are proposed in HR 10612.

capital-export neutrality could thus reach \$1,590 million.[52] Extensive tax cooperation and negotiation between the United States and foreign governments would be required to achieve a system of capital-export neutrality. It would not be reasonable for the United States alone to absorb the entire revenue loss. On the other hand, the United States could not increase its own revenues through the termination of deferral and reasonably expect other countries to undertake all the revenue losing changes required to achieve a system of international tax neutrality.

52. This figure is calculated in reference to present U.S. taxation of domestic corporate income. The net figure calculated in reference to U.S. taxation of corporation income with no tax preferences would be \$2,990 million (Table 1). Both figures assume no change in corporate behavior.

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PROF. DR. TIBOR NAGY *:

SYSTEM OF PROFITS TAXES IN HUNGARY

Two periods in the development of socialist tax law

The science of socialist comparative financial law is engaged in the study of, inter alia, the history of taxation, the development of tax law and the significant features of socialist tax systems. Its development after the 2nd World War is divided in two periods. Since amendments in the tax systems have always been major parts of economic reforms, it can be assumed that the present taxation system was formed on the basis of purposes and methods regulating economic control and the system of management.[1]

Each of the two periods started by introducing a comprehensive reform regarding the taxation of State enterprises. In addition, several partial reforms introduced new provisions concerning taxation of the population, taxation of co-operatives and taxation of legal entities in the private sector.

(a) *The first period*

Due to the introduction of planned economies, a new system for raising state revenues in Eastern European countries was worked out in the early fifties. The new provisions simplified the taxation of the population in comparison with former systems. In the new system, profit allotment (or in some countries turnover taxes) on State enterprises became by far the most important ones; wealth taxes lost their importance. Another tax which was introduced was the income tax on co-operatives. Thus, State revenues mainly consisted of the allotment of profits (i.e. the sum of the so-called "planned profits" and the greater part of the profits exceeding the "planned profits") and turnover taxes. Other taxes and dues completed this two-channel system. In this system of centralized control and management, the cost of production was one of the bases for the computation of the turnover tax. The tax, in turn, therefore, played an important role in the regulation of the economic plan.

Other taxes collected from State enterprises were:

1) social insurance premiums at a rate of 10% (4% old age pensions, levied from 1954 onwards, and 6% health insurance, levied from 1956 onwards);
2) a 15% tax on payroll, levied from 1959 onwards;
3) a 5% tax on the average value of business assets (both fixed and current assets).

Concerning the development of other taxes in Hungary in this first period, the following can be said:

1) An individual income tax was introduced in 1949; another income tax on agricultural income was introduced in 1956. Wealth taxes were abrogated in 1953; in their place, some other new taxes were enacted, i.e. the turnover tax due by artisans, the tax on buildings,

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1. See: Tibor Nagy: "Finansovoje pravo i nauka finansovogo prava periode ekonomitseskih reform" (Financial law and its science in the period of economic reforms), in: A szocialista pénzügyi fog aktuális kérdései (Current questions of socialist financial law), ed. T. Nagy, Budapest 1975, Vol. I, p. 209—230.

the land tax and the motor vehicles tax.

2) From 1951 onwards, co-operatives of industry, consumers and agriculture became subject to a separate income tax and to a turnover tax.

3) A company tax due by foreign and Hungarian legal entities in the private sector was introduced in 1950.

(b) *The second period*

In the early sixties, a revision of the former taxation system was planned on the basis of experiences with that system. As a result of this, new principles concerning enterprise taxation were developed and, simultaneously, a new law on economic control and management systems came into force.

In all socialist countries, the purposes of the economic control and management systems are the same, i.e. the improvement of the national economy and an increase of the standard of living. However, the financial means and methods to achieve these purposes are not the same; the tax systems of these countries contain substantial differences.

In all cases, however, the two-channel system was abrogated; instead, several other contributions from the state enterprise to the budget were provided for.[2]

New taxes, e.g. various kinds of turnover taxes and property taxes, were introduced as well.[3]

It should be noted, however, that taxes do not play a role of equal importance in all countries.

The Hungarian taxation system, introduced in 1968 as a part of the new law on economic control and management systems, is different from those of other socialist countries. The National Economic Plan and the plans of state enterprises will remain the two major pillars of the planning system; however, the relationship between them has been changed. As a consequence of the new laws, state enterprises have control over the disposal of their financial means and do their own financial planning. Their activities are influenced and stimulated by the state through various economic regulators, e.g. taxes, distribution of income etc. In this way, the main purposes of the national economic plan can be realized as well.[4]

Thus, the most important feature of this system is that several taxes (in lieu of one or two) are used. In practice, it works well and, in Hungary, it is believed that this method of economic control and management system is a good alternative.

At present, Hungarian law provides for more than 20 kinds of taxes, to be imposed on state enterprises. Certain taxes have a cost-increasing effect, e.g. the turnover tax which is imposed only on the sale of consumer goods by enterprises. Other taxes are levied on the amount of net profits or on the distribution of income by the state enterprise.

In Hungary, legal persons are subject to different kinds of profits taxes, depending on their legal form. Thus, the term "profit

2. For instance, in the Soviet Union profits of enterprises are subject to the following so-called "burdens":
— a charge on business assets;
— a fixed-sum payment;
— interest on bank credits.
From the remainder certain amounts are transferred to profit sharing funds, funds for social and cultural amenities and housing and production development funds. The rest which is considered a "tax" must be remitted to the State.

3. See: D. Butakov: "Nalog s oborota v stranah SEV-a: novie tendencii" (The turnover tax in the Comecon-member states: the new trends), in Finansi SSSR, 1975, No. 1, p. 80—86.

4. See: "A népgazdaság vrányitási rendszene" (The system of economic management), ed. József Bálint, Budapest 1970.

taxation" is a very broad one. However, the most important profits tax is that which is levied on both State enterprises and co-operatives (except agricultural co-operatives) under the same rules. Additionally, special kinds of profits taxes are to be paid by:

1) Hungarian enterprises for their profits from abroad;
2) Hungarian economic associations with foreign participation;
3) Foreign companies;
4) Foreign trade agencies.[5]

Other socialist countries pay close attention to Hungary's experience with this system which is still in force. However, as a consequence of this experience, the National Economic Plan Act No. IV of 1975 introduced a number of changes which will apply during the Vth Five-Year-Plan (1976-1980). Both enterprise taxation and the system of profit taxation have been changed. The rules concerning profit taxation are now co-ordinated with the rules concerning the creation of so-called "company funds" upon which other taxes are imposed. The creation of a company fund has an indirect effect on the levying of the profits tax. It is this system, combined with a new law on the stimulation of investment, which will be discussed below.

Taxation of State enterprises

According to the Finance Act 1976 (Law No. V of 1975), taxes paid by State enterprises and industrial and consumer co-operatives (mainly profits taxes) make up 76.1% of State revenue, i.e. 255,200 Million Forints. The profits tax which was introduced in 1968 is levied on the net profits of the enterprises. Net profits are divided into two parts, one which must be remitted to the State and one which may be retained by the enterprise. The latter part enables the enterprise to create special funds to a certain extent, so that, in fact, the profits tax may be considered an instrument of economic regulation.

(a) *Charges levied on the profits of enterprises*

The following summarizes the most important provisions concerning profits taxes which have been levied as of January 1, 1976:

1. Decree No. 28 of 1975 of the Council of Ministers obliges the enterprises to make a number of contributions, which are computed on the basis of the profits shown on the balance-sheet. These contributions are the following:

a) town and village development fee; the tax is levied at a rate of 6% and collected by the municipalities; [6]
b) repayment of loans granted by the State for the financing of certain so-called "productive investments"; [7]
c) an annual 15% repayment of subsidies allocated for specific development objectives; [8]
d) contributions due from co-operatives, if any, in order to pay the expenses of their federations.

2. Having deducted the above-mentioned charges from the profits, the enterprise is subject to a general profits tax which is levied at a rate of 36% on the remainder.

3. The enterprise must place 15% of the profits remaining after deduction of the

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5. In this article, the taxation of agricultural productive co-operatives (income tax, turnover tax, production tax, motor vehicles tax etc.) and the taxation of the population are not discussed.
6. Decrees of the Minister of Finance No. 31 of 1970 and No. 74 of 1975.
7. See under: "role of the profits tax with respect to the financing of investments", below.
8. Ibid.

charges mentioned under 1 and 2 into a reserve fund.[9]

4. The profits remaining after deduction of the above-mentioned taxes and tax-like obligations will be used for the creation of two special-purpose funds; these are:

a) the development fund; and

b) the employee profit sharing fund.

re a): This fund is accumulated from the so-called development-oriented part of the profits; however, it may also be accumulated from other sources. The fund is subject to the so-called construction tax which is levied at a rate of 10%. The taxable base is the amount of the investment to the extent that it has been paid out of this fund.[10]

re b): The creation of the employee profit sharing fund subjects the enterprise to a progressive profits tax. The rate of this tax may vary from 200% to 800%. The tax rate is determined in accordance with the wage costs of the enterprise expressed as a percentage of its profits. Therefore, high wage costs cause high taxes.

Premiums and other remunerations are also paid out of this fund.[11] If the enterprise increases the wage level compared with the previous year, a special tax, the wage increment levy is paid from the fund as well. Thus, these wage increments are also subject to another progressive tax, the rate of which may vary between 150% and 600% depending on what must be considered to be the taxable base.[12]

Thus, the enterprise pays five different kinds of taxes or tax-like obligations on its profits and on the creation of the above funds.

(b) *Other taxes*

In addition, State enterprises may be subject to a number of other taxes. The most important of these taxes are:

— payroll tax (rate: 13%);
— social insurance premiums (rate: 22%);
— turnover tax;
— production tax (due by enterprises receiving additional profit);
— commercial tax (rates: 0 to 4.1%);
— foreign trade tax (rates: 10 to 60%);
— land tax (only due from agricultural enterprises);
— tax on the value of business assets (rate: 5%);
— centralized part of the depreciation allowance (40%), the remainder is for the benefit of the enterprise;
— contribution to the Central Technical Development Fund;
— duty for the fight against pollution.

All the above taxes and duties must be considered indirect methods of achieving the targets which are set forth by the National Economic Plan.

Role of the profits tax with respect to the financing of investments

The system under which the state finances the investments of the enterprise and under which the latter is obliged to repay such invested amounts was introduced in 1968 and is still in effect in 1976. Thus, gratuitous financing of investments is not possible.

An enterprise may finance its investments from its own development fund (see above) or from the following other sources:

a) Concerning so-called "Individual Gross Investments"; this type of productive

9. Decree of the Minister of Finance No. 37 of 1975.

10. Decree of the Minister of Finance No. 32 of 1975.

11. See note 9, supra.

12. Decree of the Minister of Labour No. 14 of 1975.

investment must be financed with government loans which are repayable and which bear an interest rate of 7%. Such loans are repaid from the annual gross income (before profits tax) as well as from the part of the depreciation fund which remains in the enterprise (60%). The percentage which must be repaid from the annual income and from the depreciation fund is set forth in the provisions of the loan contract.[13]

b) A State-granted investment subsidy may supply the development fund of the enterprise. Such a subsidy must be repaid if the conditions under which it was granted are met. However, under certain exceptional circumstances such a subsidy need not to be repaid. An investment fee of 5% p.a. of the amount granted must be paid as long as the investment is not put into operation.[14]

c) Certain rapidly developing enterprises may qualify for a special kind of State-granted investment subsidy which was introduced in 1976. Such a subsidy must be repaid out of the gross income in the form of an annual special charge of 15% of the amount granted within a maximum period of time of ten years.

d) The enterprise may also get an investment bank credit from the Hungarian National Bank. Such a credit must be repaid out of the development fund at an interest rate of 6—9%.

e) As of the beginning of 1976, a new form of investment financing has been introduced in the form of a tax allowance. If the enterprise uses money from a special credit fund to make an investment, this credit can be repaid by means of a deduction from the general profits tax due. The tax allowance is granted only if the investment was actually made.
It seems clear, that this method of financing investments places a greater responsibility on the enterprise's management.

f) The depreciation allowance which remains in the enterprise (60% — the other 40% is remitted to the State) is placed in the enterprise's development fund. However, certain enterprises need not transfer part of the depreciation allowance to the State, e.g. mining enterprises, those in the food industry etc. These enterprises may place the total depreciation allowance into the development fund.

g) Certain enterprises (e.g. in the consumer's branch) are entitled to put a sum of 45—100% of the general profits tax due directly into the development fund.

Taxes on profits from abroad earned by Hungarian companies

A "gain tax" is levied on domestic entities which establish a business abroad or participate in foreign business entities. The rate of this tax is:

— 10% per annum for activity lasting 1—8 years;
— 30% per annum for the next 4 years of its activity.

After their 12th year of existence such entities are subject to normal taxes levied on Hungarian entities. However, they are exempt from the "charge on assets" (tax on the value of business assets, see above) with respect to their foreign investments.

13. Decree of the Minister of Finance and the President of the National Planning Office No. 52 of 1975.
14. Decree of the Minister of Finance No. 53 of 1975.

Profits tax on economic associations with foreign participation [15]

Under Law Decree No. 18 of 1970, economic associations with foreign participations (joint companies) are permitted in Hungary.

They are not obliged to create any funds other than reserve funds and employee profit sharing funds. Thus, the profits of the association will be divided among the said funds, the taxes and the company's own share.

After deduction of the amounts set aside for the reserve fund and the profit sharing fund — both of which reduce the profits — the remainder is the taxable base for the computation of the profits tax. The rate of the tax on these associations is 40% on profits not exceeding 20% of the paid-in capital and 60% on profits in excess of this amount.

If the association utilizes its taxed profits for increasing its investment capital, a part of the profit taxes paid may be refunded upon application submitted to the Ministry of Finance. Hungarian economic associations with foreign participations are exempt from the following taxes and tax-like obligations (as opposed to State enterprises):

— charge on business assets;
— allotment of the centralized part of the depreciation allowance;
— wage increment levies.

However, they remain subject to the other taxes and tax-like obligations in conformity with the Hungarian statutory rules. The associations may be exempt from Hungarian tax under the rules of international treaties for the avoidance of double taxation, either permanently or temporarily;[16] if not, they are taxed in accordance with the rules which apply to Hungarian entities.

Profits tax on foreign companies [17]

Under Decree of the Council of Ministers No. 38 of 1961, a special profits tax is imposed at progressive rates on foreign companies carrying on business in Hungary. The minimum tax rate is 30%, the next rate is 50% and the next and highest is 70%.

The 70 percent tax is imposed on that part of the taxable profits which exceeds 10% of the working capital. A minimum profits tax at a rate of 1.5% of the working capital is imposed on foreign companies operating at a loss. Companies which are temporarily operating in Hungary pay a profits tax at a uniform rate of 30%.

Foreign companies are also subject to a special company tax which is levied at a special rate of 40% on emoluments allotted, for any reason, to the members of the board of management, the board of supervision or the executive committee. In addition, the recipients are subject to a general income tax on such emoluments. Foreign companies are subject to payroll tax, social insurance premiums and other taxes in the same way as Hungarian enterprises.

Taxation of foreign trade agencies [18]

According to the Decree of the Minister of Finance, No. 18 of 1975, foreign trade agencies which are established in Hungary

15. See also: Tibor Nagy: "Taxation of Economic Association with foreign participation", in Marketing in Hungary, 1973 No. 3.

16. To date, Hungary has concluded tax treaties with Austria, Switzerland, Sweden, Italy and the Netherlands.

17. See also: Tibor Nagy: "The taxation of foreign companies and foreign nationals", in Marketing in Hungary, 1972 No. 4.

18. See also: Tibor Nagy: "The taxation of Foreign Companies, Economic Associations with foreign participations and foreign nationals", Intertax, 1975 No. 7, and "Recent tax changes", Intertax, 1976 No. 4.

by foreign enterprises are subject to a special so-called "agency tax". Agencies of foreign banking institutions are exempt. The rates of this tax are either 3, 5 or 8 percent (depending on the kind of activity) of the agency's turnover in foreign currency less 10 percent of the taxable base for expenses incurred in Hungary. Where an agency performs activities other than those strictly connected with that agency, it is subject to a 3 percent tax on the turnover from those activities.

JOHN F. DUE *:

A COMPARISON OF FOUR MANUFACTURERS SALES TAXES AND TWO RETAIL SALES TAXES — GHANA, KENYA, TANZANIA, ZAMBIA, BARBADOS, ICELAND

The question of the most appropriate form of sales tax has received widespread attention in recent years, in both industrialized and developing countries. This paper seeks to throw additional light on the issue by a comparison of six sales taxes. Four are manufacturers sales taxes used in tropical African countries, Ghana, Kenya, Tanzania, and Zambia, and two are retail sales taxes, in Barbados and Iceland.

Introduction of the Taxes

All of these taxes were introduced between 1960 and 1974 and therefore belong to the "modern" generation of sales taxes. All countries except Iceland are British Commonwealth countries. The first tax to be introduced was in Iceland, influenced by experience in the Scandinavian countries, imposed at a low (3%) rate in 1960 as a revenue measure. The rate was gradually raised, particularly in 1973-74 when customs revenue was lost as a result of Iceland's participation in EFTA. The first of the Commonwealth African countries to impose the tax was Ghana, in 1965, urgently in need of revenue. The Act imposed a multi-stage turnover tax, but this was in fact (but not by law) modified into a manufacturers sales tax before it became operative. In East Africa, the three members of the East African Community were restricted in their ability to adjust income tax and customs-excise duties by agreement on common policy, but were free to impose sales taxes, and Uganda took the lead in 1968, followed by Tanzania in 1969. These two taxes, designed by an adviser from Israel, were unusual in that the tax was imposed separately by BTN (Brussels Tariff Nomenclature) category (as is true in Guyana also). Kenya debated the tax for several years, and finally in 1973, adopted an act greatly simplified compared to those of the two neighboring countries. The tax was sought primarily to gain additional revenue and to increase elasticity of the revenue system. In the same year Zambia introduced its sales tax of limited scope; it was influenced by Kenya's experiences but sought to experiment by taxing only a few commodities initially rather than all. The scope has been progressively broadened. All three countries adopted the manufacturers sales tax for administrative reasons. The last of the six was Barbados, which imposed the tax in 1974 to offset the loss in revenue from elimination of intercountry duties within CARICOM. The retail form was adopted in view of the very limited manufacturing and the desire to include wholesale and retail margins.

Overall Coverage

All of the taxes except Zambia's are general in coverage; Zambia's applies to all dutiable imports and to specified domestically produced goods. In practice, most domestic industries are now covered. The taxes of Barbados and Ghana differ from the others in that imports are not taxed — a source of obvious leakage. Kenya, after changing policy, now requires payment of tax on all

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1. The author is greatly indebted to the officials of the tax departments and Ministries of Finance of the six countries for their assistance.

imports (except of exempt commodities) but allows refund of tax on materials used in manufacturing. The other countries allow importation of materials and parts by registered firms tax free under certificate.

All of these levies are designed to be single stage taxes, but the extent of exclusion of producers goods varies substantially. Materials and parts becoming physical ingredients are universally excluded from tax through import or purchase under certificate (and, in Kenya, refund of tax paid). Zambia limits the exemption to materials in categories specifically designated for each taxed commodity, but in fact excludes most materials. Virtually all farm inputs — seed, feed, fertilizer, machinery, and some other items — are exempted outright in all six countries, partly specifically to aid agriculture, as for example in Zambia and Kenya, partly because of political pressures of farm groups. Iceland exempts virtually everything used in the fishing industry.

The tax treatment of industrial machinery, however, varies, as it does in the rest of the world. Barbados and Ghana seek to exclude all of it; Tanzania exempts some; Zambia, while not taxing when domestically produced, does tax it at importation. Iceland and Kenya apply the tax; Kenya in recent years, like Zambia, has also commenced to apply sales tax to industrial machinery to lessen capital intensivity in production. The common tendency in developing countries to overvalue their currencies may justify taxation of capital equipment, while there is strong objection to such taxation in industrialized countries.

The tax treatment of fuel is complex, but the category it at least partially taxable in all of the countries except Barbados; most is not taxable in Ghana and Zambia. The latter taxes all electricity.

The tax treatment of services is somewhat limited; only the tax in Iceland applies to all services except those excluded — but the exclusion list is lengthy: real property construction on the site; all transport; rentals; hospitals; all professional services; water; computer service. Zambia singles out hotels, restaurants, laundry and drycleaning for taxation; Barbados employs a separate tax on hotels and restaurants, collected in conjunction with the sales tax.

All of the taxes provide some exemptions of food. All food is exempt in Barbados and Kenya (the original plan to exempt only basic foods was abandoned for political reasons). Of necessity unprocessed domestically produced food in the other African countries is exempt since it does not pass through a manufacturing stage. Tanzania, Ghana, and Zambia tax much, but not all, processed food, depending on the importance of the items in the diets of the poor, and Zambia taxes some imported unprocessed food. Medicines are not taxed in Kenya, Tanzania, and Zambia, partly in the other countries, and books, magazines, and newspapers are universally free of tax. Some other exemptions are noted in Table II at the end of this article. But in general, the taxes are relatively broad in coverage, in Zambia much more so on imported than on domestic goods.

Rates

The two retail taxes have single uniform rates — 5% in Barbados, 20% in Iceland, the latter one of the highest in the world. Ghana has un unusual structure, a basic 11.5% rate on non-excise -taxed goods; 7.5% on goods also subject to excises, plus iron reinforcing rods; 10% on liquor and electricity; 5% on cement; and specific rates on tobacco products, diesel oil and fuel oil.

Kenya, which has a basic 10% rate, applies a 20% rate to a wide range of luxury items including consumer durables, jewelry, cosmetics, etc., 15% to wine, and motor vehicles, 30% to tobacco products, and specific rates to beer, motor fuel, oil, grease, and electricity. Tanzania has far more rates and much higher rates, with a basic figure of 12% on many foods and items of widespread household use; 24% on items regarded as luxuries; 25% to 50% on motor vehicles; 50% on most liquor and cigarettes, a number of high rates on textile products not produced in the country (and thus protective, particularly against imports from Kenya, not subject to customs duties), and a large number of other rates, each on a few items. The rate structure has become very complex, as the tax has been used as a protective and sumptuary instrument.

The Zambia rate structure is much simpler, with a basic rate of 10%, 15% on a few items, 20% on footwear, clothing, and several items regarded as luxuries, 30% on perfumery and cosmetics, and rates from 4% to 17% — very low figures — on motor vehicles according to engine capacity. The variation applies only to domestic goods; all dutiable imports are taxed at 10%.

Revenue Importance

The rate levels, coverage, and exemptions influence the revenue importance; the figures range from 38% of tax revenue in Tanzania and 32% in Iceland to 5% and 6% in Ghana and Barbados, neither of which tax imports. In the other two the tax is a significant element in the overall tax structure. The percentage of tax collected on domestic sales as distinguished from imports is lowest in Zambia — 36% (which taxes far more imports than domestic goods). The Tanzania and Kenya figures are surprisingly high — reflecting in part the drastic restriction of imports into Tanzania (for foreign exchange reasons), the extensive growth of Kenya manufacturing.

The Number of Registered Firms

The two countries with retail sales taxes (Barbados and Iceland) have far more registered firms than the others despite their much smaller population, as shown in Table I at the end of this article.

There is one registered vendor for every 42 persons in Barbados and for every 30 persons in Iceland, compared to 1 per 12,000 in Tanzania. The difference reflects in part the difference in commercial economic development in the two sets of countries, but partly the difference between the two forms of tax. But the experiences of Ghana, Kenya, and Zambia suggest that a developing country with an established manufacturing sector can expect to have roughly one registered manufacturer for each 8,000 population.

In all of the countries, registration is required of firms in the categories subject to tax. Thus in Barbados and Iceland all retailers are registered (and in fact wholesalers and manufacturers, since they make some sales at retail), and in the other four countries, all manufacturers except certain small firms. Kenya and Zambia set the exception figure by law, at 100,000 Kenya shillings and 10,000 Kwacha respectively (about $US 12,000 and $15,600 at current official exchange rate). Ghana and Tanzania have no set figure, but do not register firms so small that control is believed to be impossible. Tanzania, like Uganda, also taxes some firms on the sales to them instead of their sales, and does not register them. Firms may apply for this privilege and it will be granted if there is no revenue loss. Some form of exception of small craft producers is imperative for successful operation of a manufacturers sales tax. The two retail sales tax countries provide no similar exemptions, but Barbados does not in fact succeed in registering the itinerant sellers on the beaches.

All countries require firms to fill out a registration form and then issue a registration number.

Administration

The countries fall into two patterns: in Ghana and Zambia, following Commonwealth traditions, sales tax administration was assigned to Customs and Excise. In Ghana, the sales tax is administered by a separate section, under a Deputy Controller, with its own personnel (about 30). In Zambia, there is less separation from customs operation, although one person in headquarters has general jurisdiction over the tax, and in the larger custom houses separate personnel are assigned to sales tax, but they have a customs officer background.

The other four countries assign sales tax to the internal or inland revenue department. In Tanzania and Kenya the tax could not be assigned to Customs and Excise, which was (and at the moment still is) an agency of the East African Community. In Tanzania the sales tax predated the transfer of the income tax from the EAC, and so a separate staff was set up, which in 1973 inherited the income tax as well. In Kenya, a separate sales tax staff, under an Assistant Commissioner, is essentially coordinate with the income tax staff.

Iceland and Barbados deliberately assigned the tax to inland revenue in the belief that operation was more closely related to income tax than to customs — a view that has strong validity.

Thus there are separate sales tax units and staffs in Barbados, Ghana, and Kenya, with some separation of personnel in Zambia, and integration with the income tax staffs in Iceland and Tanzania.

The countries differ in the degrees of centralization. Kenya is completely centralized at the moment, but plans offices in Mombasa and two other cities to reduce travel cost. Barbados assigns inspectors by area but operations are centralized in view of the small size of the island. Iceland's operation is highly decentralized, with 9 district offices and 24 collection offices handling income tax as well, but over two thirds of the tax is paid in the Reykjavik area. Tanzania operations are decentralized, with 21 regional offices and 80 internal revenue offices in total, the records being kept in these offices. Records are also kept in the local offices in Ghana. In Zambia the tax is administered through the ports of entry (there are 10, but 4 handle most of the tax), but duplicate records are kept in headquarters in Livingstone.

All of these countries have computers — in general third generation ones (for example, IBM 360 in Iceland, 370 in Zambia) — but only Iceland uses the computer for sales tax purposes, and then only partially, to provide the listing of registered firms, to make assessments, and to address return forms in larger jurisdictions.

The staffs vary widely in training and adequacy. Of the African countries, Kenya has the most adequate and one of the better trained staffs, under a Deputy Commissioner of Taxes. There are two assistant commissioners, a senior collector and two senior inspectors, 5 inspectors Grade I (8 authorized), 12 inspectors Grade II (15 authorized), 6 collectors Grade I and 4 collectors Grade II. Thus there are 25 authorized inspectors for 1,600 firms, or one to every 64 firms — a figure that compares very well with industrialized countries. The aim is to recruit persons as inspectors who have university degrees in economics or commerce, plus some persons with professional accounting background. The initial trouble to find personnel has been overcome.

In Tanzania, the inspection staffs are located in the regional offices, with a few auditors in Dar es Salaam. The inspectors, except for a few senior ones, are not university graduates and have learned through on-the-job training. The internal revenue officers and the regional finance officers have been promoted on the basis of experience. While some recruiting is now done at the university level, most new employees are recruited at the secondary school graduate level.

The staff in Zambia consists of persons with customs officer training (recruited at the secondary school level) and in general have no accounting or business background. Ghana likewise recruits from secondary school graduates, increasingly, from commercial schools, where bookkeeping training is provided. But they have little training in accounting, and work approaching true audit is impossible.

The two retail sales tax countries, like Kenya, seek to recruit persons with knowledge of accounting. Barbados, with a staff thus far of 5, and 2 vacancies, has recruited persons with training in accounting, gained by articling with public accounting firms or from courses in the United Kingdom. The persons do inspection, information, and enforcement work. Iceland, where the staff handles both sales and income tax work though with some specialization, recruits at the university graduate level, with the BA in Law or Economics, and trains in accounting. Unfortunately Civil Service salaries are not fully competitive, and trained persons are often lost to the private sector. There are at present 18 in the investigation department, located in Reykjavik. The Director of Internal Revenue has a university degree in Accounting, while the head of the collection office is a lawyer.

Operation of the Taxes

All six taxes are collected on the basis of returns, all required on a monthly basis, by the dates noted in Table III at the end of this article. Neither Ghana nor Zambia supply return forms; the firms must buy their own, of a prescribed nature. Only Iceland mails the forms out monthly (addressed by the computer for the larger areas); the others make theirs available in batches. The forms differ widely, from very simple ones in Barbados, Iceland, and Kenya (which does not even require figures of exempt sales), to detailed ones, calling for sales by type of good, invoice numbers, etc., in the other three. Zambia requires both a return form and a sales tax entry form, and details of all sales — necessitating a number of pages from the larger firms. Ghana requires copies of invoices. In Ghana the tax is paid to a bank and the duplicate deposit slip is filed with the return, together with a copy of each invoice. In Zambia, payment is made to the cash office in the custom house, the return filed separately. In the other countries, payment is made by check or cash, in person or by mail, together with the filing of the return. In Iceland, payment is made to the local collection offices, distinct from the district offices.

Kenya, like the states of the United States, requires only one copy of the tax return; Zambia requires 7 copies; the others three.

Delinquency

Different systems are used to ascertain delinquents (nonfilers); none use computers for the purpose as yet, though computers play some role in Iceland.

Barbados: No system is yet developed, though check can be made from ledger cards. Store to store check is being made to insure that firms have registered and have filed returns.

Iceland: Two days after the due date, the returns are checked against the master list in the collection office provided by the computer. The basic delinquency lists, however, are made up at three month intervals in the district offices, by checking the master list against the lists of payments. Late filing penalties are assessed against those that filed late, and assessments of tax against those that have not yet filed.

Ghana: Check is made in the local office to find those firms for which there is no ledger entry.

Kenya: Check is made on the ledger sheets each month to ascertain those firms for which there is no entry for the month.

Tanzania: Check is made monthly in the local offices to find those firms for which there is no return.

Zambia: Check is made by the Custom ports to ascertain which firms have not filed, usually by checking the returns against the master list of firms. Headquarters, which records the payments in a ledger book, also checks to ascertain the nonfilers, but leaves the initiative for action to the local offices.

In these countries the check is made within a few days after the due date.

Most of these countries have not compiled data of nonfilers as a percentage of accounts. Iceland reports a 10% to 12% figure. One custom house in Zambia reports nearly 50%.

The initial action is taken by the local offices, except in Kenya, where the system is completely centralized. Barbados has not yet developed a formal system. In Iceland, Ghana, and Kenya a form letter is sent to the firm requesting filing. In Tanzania, the internal revenue officer contacts the firm by phone, visit or letter, and a similar procedure is followed in Zambia. As is typical, most of the firms file and pay — but there is a hard core that does not — usually smaller firms hard pressed for cash. In Iceland, the collection office threatens to close the business by legal action (and does in a few cases). Ghana ultimately obtains a distress warrant and seizes the property. Tanzania, after assessing the tax, obtains a court order to force collecting; in Zambia legal proceedings are initiated, the Controller lacking power to seize property or close the business. Kenya has not yet taken action but plans to begin criminal prosecution once all firms are familiar with the tax.

There are two difficult problems. First, some of the firms do not pay because they have no funds, and governments are reluctant to force them out of business. Secondly, some of the nonpayers are government-owned firms, and frequently there is no way the revenue department can seize or close down a government-owned and operated hotel, for example, and the management know this.[2] Solution to this very real problem can be obtained only at top levels of government.

Automatic Penalties

Governments long ago discovered that effective enforcement is aided by provision in the Act for automatic (without court action) application of penalties for late

2. The problem is particularly difficult if the government-owned business is out of funds.

filing. Tanzania, with an automatic 20% penalty + 1% a month, is the most drastic; the Iceland rule is 2% a day for 5 days, plus 1.5% a month; Barbados applies a 10% penalty with a $10 minimum + 0.5% a month, Kenya 2% a month, Zambia 2.5% a month. Only Ghana has no automatic penalty and must use criminal prosecution. There are of course, criminal penalties for violation of the Act in all the countries, but these are rarely ever used.

Information

Barbados, Iceland, and Kenya provide relatively detailed information booklets to the registered firms. The other three provide general instructions and answers to questions, but the information is much less detailed.

Inspection and Audit Programs

None of these six countries yet has a systematic overall audit program with substantial coverage and scientific selection of accounts for audit, although there are plans for such systems. As distinguished from true audit, which seeks to ascertain the accuracy of reported figures by utilizing external data, norms, and the like, Ghana and Zambia have frequent inspection, in which officers (who have little knowledge of accounting) check data in the returns against the records from which these returns were prepared. Thus, if the returns show taxable sales of 15,000, do the sales records and invoices show this same figure? Stress is placed on invoices, per se; Ghana requires that they be issued from numbered books purchased from the government.

In Kenya, inspectors have been busy thus far simply checking refunds, giving information, etc. Under present plans, once the audit program is under way, each manufacturer will be subjected to a complete audit every two years, with briefer intermediate checks. In Tanzania, all returns are examined in the district offices, and if there is any doubt, an inspector visits the firm. There are few persons competent to make a true audit. There are plants, however, for improved training and audit programs.

Iceland has the most effective audit program of the group at the moment. Some inspection is done at the district office level, but actual audit is done by the investigation unit in headquarters. There is no broad audit coverage, but a substantial amount is done, some joint of sales with income tax, some separately. Recently selection has been primarily by business category — all car dealers, for example. Invoices are expected in larger firms. Detailed information is required on exempt sales, including information on markup and spoilage.

Taxable Price

With most of the taxes, tax applies to actual selling prices on domestic sales, duty paid value on imports. Ghana requires inclusion of the excises on excisable goods. Only Zambia requires adding markups, designed to apply the tax rate to a figure approximating the retail price. On domestic goods, the taxable price is the factory cost plus 25% or the retail selling price (although the tax is collected from the manufacturer), whichever is higher. Almost always the retail price alternative is higher. On imports, tax applies to value for customs duty purposes plus customs duty plus 20% of the value for customs duty plus 25% of the sum of these three items. In Iceland, on imports for use by the importer, tax applies to duty paid value plus 10%.

In no instance does the taxable price include the amount of the tax itself. Discounts actually given are usually deductible, and bad debts in some instances.

Merits and Criticisms of These Taxes

In general all six of these taxes have become accepted as permanent elements in the tax systems of the respective countries, and basically all are acceptable in structure, given the environment. There is perhaps greatest enthusiasm for the taxes in Kenya and Tanzania, where they yield about one third of the tax revenue. They are regarded as highly productive and the source of few difficulties. The Tanzania levy has higher overall rates and is used in part as a protective and sumptuary device; the Kenya levy is simpler and regarded as more strictly a revenue measure.

The tax in Iceland, the largest revenue source, is also widely accepted in a country in which even the labor unions prefer sales taxes to income taxes. The debate in Iceland is almost solely over the question of whether it should follow the other Nordic countries in shifting to the value added form.[3] The Barbados tax, the newest one, and the only one quoted separately to the consumer, created the greatest public outcry, but this has died down. The only issue now is whether the tax might preferably be imposed at the wholesale level rather than the retail level.

The tax in Ghana is not highly productive of revenues but has not been subjected to great criticism. In Zambia, the tax, still in experimental form, has become a significant revenue producer, and there is some sentiment for converting it into a generalized manufacturers sales tax.

In none of the countries is there criticism of the tax on the grounds of regressiveness, the traditional complaint in many countries. The exemption of basic food, by far the largest item in the budgets of the lowest income groups, and the use in Kenya, Tanzania, and Zambia of higher rates on luxury goods, have minimized complaints on an equity basis. The relative equality of income in Iceland and the widespread support of indirect taxation in the country lessen criticism.

There are, however, certain defects noted in the countries:

1. Lack of trained personnel for inspection. In all of the countries, though to a lesser extent in Barbados and Kenya, the inadequacy of trained personnel for an effective inspection and audit program is recognized. This is true even in Iceland, a country with a well educated population and high civil service standards. It is particularly true in Tanzania and Zambia, with a severe shortage of personnel trained in accounting. In both Zambia and Ghana the location of sales tax administration in Customs and Excise has resulted in failure to recognize the need for personnel trained in accounting. Barbados and Kenya have plans for an effective audit program, but they are not yet implemented.

2. The lack of records on the part of smaller firms, especially family businesses, impairs effective control of the tax. There is greatest concern over this problem in Barbados and Iceland, with retail taxes and no exemption of small firms. In Barbados, there are a number of itinerant firms selling taxable products. Some do not register; others register and buy tax free for their own use without accounting for tax. Small

3. Finland has not shifted to a complete value added tax. In Iceland, a government committee is now considering a proposal to change to the value added form.

rural stores buy from vans without purchase invoices, and the sellers do not issue sales invoices. Iceland likewise expresses concern about evasion by smaller firms, under the pressure of the very high (20%) tax rate. Revenues are substantially protected by the fact that 4% of the firms pay 55% of the tax, 20% pay 80% of the tax. The oil companies, the state liquor monopoly, and the cooperatives are the largest payers. Even with the manufacturers sales tax in Ghana, there is concern with poor records of the smaller firms. Less concern is expressed in the other three countries.

3. Concern is expressed about the demand for more and more exemptions and deductions. In Barbados, for example, there is pressure to allow deduction of trade-in allowances and to exempt coffins. Iceland expresses concern about the vicious cycle of a high rate leading to demand for more exemptions, which reduce yield and complicate control. The Kenya government exempted a much broader range of food than the Ministry sought.

4. While these levies are all basically single stage, some cascading occurs (the least apparently in Barbados), as certain purchases for business use are taxed without subsequent credit. Greatest concern is expressed in Iceland, where an estimated 33% of the tax strikes business sector purchases without credit or refund. The effects on exports are feared, since all EEC and most EFTA countries now minimize the cascade element. This is the primary reason for serious consideration of a value added tax in Iceland (plus the belief that evasion would be lessened through collection of much of the tax at import, the desire to harmonize with other EFTA countries, and the hope that income tax administration would be strengthened). Tanzania also expresses concern over cascade elements in the tax. By contrast in Kenya, taxation of capital equipment is regarded by the government as desirable to increase the relative use of labor.

5. The relationship of the tax on imports and domestic goods is of concern in several countries. The failure to tax imports at all in Barbados invites importing by final consumers and clearly needs correction. The tax in Ghana likewise does not apply to imports, with consequent revenue loss and possible distortions. The tax in Zambia applies to all dutiable imports but to far fewer domestic goods, thus constituting an additional protective mechanism. Rates differ on imports and domestic products for many goods.
Kenya has changed policy on tax treatment of materials. Initially registered firms could import or buy materials tax free under certificate. But there was substantial unreported selling of the materials for taxable purposes, and so imports and purchases of materials were made taxable, with subsequent refund. But this has resulted in so much more work in refunding and excessive tying up of working capital that the government now plans to exempt outright major types of materials not also used for consumption purposes.

6. Some other adverse effects are noted. In Barbados, small shops selling only food and cigarettes have quit handling the latter to avoid the need to file tax returns. The Iceland rule, common with most sales taxes, that on real property contracts fabrication work on the site is not taxable discourages prefabrication.

7. Several countries, but especially Iceland and Zambia, are concerned about the tendency of sales tax increases to lead to

wage increases, destroying the anti-inflationary effectiveness. The problem is most acute in Iceland, with a high rate of inflation and general indexing. But exclusion of the sales tax element from the cost of living index is regarded as politically impossible and is made more difficult by the fact that the tax element is not quoted separately from the price.

8. The tax in Zambia is still in a somewhat experimental, evolving stage, with coverage limited (on domestic products) to specified categories and with imports and domestic goods treated differently.

9. The Tanzania tax, like that of the Republic of Guyana, has far too many different rates, with very fine distinctions that cannot possibly be justified on any scientific basis; there are, for example rates of 10, 12, 15, 17, 18 percent (plus others).

Concluding Observations

These six sales taxes suggest several general conclusions:

1. A sales tax can be a very significant revenue source in developing countries, if imports are included, the base is relatively broad, and higher rates are used on luxury goods. But careful attention to the structure of the taxes is necessary if the desired results are to be attained.

2. Sales taxes at the manufacturing level function extremely well in developing countries if properly structured, without encountering the distortions of distribution channels created by such taxes in highly industrialized countries such as Canada. The manufacturing level facilitates the use of several different rates and minimizes the number of taxpayers. A single rate is almost imperative with a retail tax.

3. Retail sales taxes can be operated successfully when retail sectors are more commercialized and sophisticated, but with more problems with small firms.

4. A general problem is the failure to develop adequate audit programs, with reliance on excessively detailed reporting and routine inspection instead of true audit. Delinquency, in the sense of failure to file on time, is also high, a result in part of inadequate penalties for late filing.

5. The need for simplicity — in tax structure and operation — is very great but often ignored. Kenya offers the model of the manufacturers sales taxes; the retail taxes are relatively good from a simplicity standpoint.

6. There are serious dangers in placing sales tax administration under the jurisdiction of Customs and Excise, unless a separate unit with its own personnel selection is utilized, because the background and training of customs personnel are not suitable for a tax the effective control of which depends on knowledge of accounting.

7. Exemption of basic foods appears to be effective in lessening complaints against the taxes on equity grounds.

TABLE I

Basic Features of Six Sales Taxes

	Retail Sales Taxes		Manufacturers Sales Taxes			
	Barbados	*Iceland*	*Ghana*	*Kenya*	*Tanzania*	*Zambia*
Year Introduced	1974	1960	1965	1973	1969	1973
General or Specified	General	General	General	General	General	Specified Categories
Imports Covered	No	Yes, Except by Registered Firms	No	Yes, All	Yes, Except by Registered Firms	Yes, Except by Registered Firms
Designation of taxed items	General	General	General	General	BTN Category	BTN Category
Designation of exempt items	BTN Category	Specified	Specified	BTN Category	BTN Category	All except those specified as taxable
Basic Rate (%)	5	20	11.5	10 [1]	12 [1]	10 [1]
Other Rates	None	None	5, 7½, 10 some specific	20,[2] 15, 30 some specific	24,[2] 17, 40, plus 13 others plus specific	15, 20, 30 motor vehicles 4, 8, 12, 17 one specific rate
Separate collection of tax at the retail level	Yes [5]	No [3]	—	—	—	—
Sales tax revenue as % of total tax revenue 1975-1976	6	32	5	25	38	14
% of sales tax revenue collected on domestic sales	100 [4]	97	100 [4]	60	84	36
Number of registered firms (approx)	6000	7700	1250	1600	1000	420
Population (approx) 1975	250,000	225,000	9 million	12 million	12 million	5 million
Estimated per capita GNP (US $s)	$1000	$5400	$266	$155	$113	$384

1. Many exceptions; basic rate of limited significance.
2. Many semi-luxury goods.
3. By practice, not by law.
4. Imports not taxable.
5. By law.

TABLE II

Tax Treatment of Major Categories

	Barbados	*Iceland*	*Ghana*	*Kenya*	*Tanzania*	*Zambia*
Food	X (all)	Basic X	Unprocessed X [1]	X (all)	Unprocessed X [1]	Unprocessed X [1]
Beverages	X	T	T	T	T	S
Medicines	T	T	T	X	X (most)	NT
Books, Magazines, Newspapers	X	X	X	X	X	NT
Stationery	X	X	for schools, X	T	T	NT [2]
Building materials	X (most)	T	T	T	T (most)	NT (most) [2]
Fuel	X	T	X (indus., etc.)	T	T (most)	NT [2]
Motor vehicles	X	T	S	T	T	T
Commercial Transport Equipment	X	T	X	T	X	NT
Materials, parts	X	X	X	X	X	X (specified categories)
Farm feed, seed	X	X	X	X	X	NT
Fertilizer	X	X	X	X	X	NT
Pesticides	X	X	X	X	X	NT
Farm machinery	X	X	X	X	X	NT
Fishing equipment	T	X	T	T	T	NT [2]
Sand, stone	X	T	T	T	X	NT
Tractors	X	T	T	X	X	NT
Charcoal, firewood	T	T	X	X	X	NT
Industrial machinery	X	T	X	T	X (some)	NT [2]
Small radios	T	T	X	T	T	T
Exports	X	X	X	X	X	X
Hotels, restaurants	S	X	NT	NT	NT	T
Services generally	NT	T, except specified	NT	NT	NT	NT

1. Some processed items also X.
2. Some items taxed on importation, not domestic production.

T = Taxed S = Special tax X = Exempt NT = Not specified as taxable.

TABLE III

Operational Features of the Six Sales Taxes

	Barbados	*Iceland*	*Ghana*	*Kenya*	*Tanzania*	*Zambia*
Exemption of firms with annual sales under:	No exemption	No exemption	No formal figure	Ks100,000 ($US 12,000)	as proposed by inspector	K10,000 (US$ 15,600)
Jurisdiction over administration	Inland Revenue	Internal Revenue	Customs & Excise	Sales tax unit	Tax department	Customs & Excise
Centralized administration	Centralized, but inspectors in areas	Decentralized	Decentralized	Yes [1]	Decentralized	No; Ports of Entry
Separate staff	Yes	No, integrated with income tax	Yes (with excise)	Yes	Partial integration with income tax	Partial
Integrated sales and income tax audit	No, but plans	Yes	No	No	Yes, but some specialization	No
Trained auditors	Yes	Yes	Limited training	Yes	Limited training	No
Computerization	No, but plan; ledger cards	Listing of firms mailing returns and assessments in larger districts	No, ledger page	No, ledger sheet	No, ledger kept in local offices	No, file in custom house, ledger page in headquarters
Tax return interval	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly
Due date, following month	15th	25th	21st	End of month	15th	21st
Mail return forms to firms	No	Yes	Do not supply forms	Issue batch	No, made available	Do not supply return forms
Type of return form	Simple	Simple	Detailed, and file invoices	Simple	Relatively detailed	Very detailed information
Copies of return required	3	3	3	1	3	7
Delinquency percentage, initial	Not known yet	10—12%	Substantial	No data yet	Not available; apparently low	Est. 50%
Enforcement - initial	Not developed yet	Notice	Letter	Letter	Officer contacts	Call by officer

J. AUTENNE *:

LA T.V.A. ET L'IMPORTATION DE MARCHANDISES EN BELGIQUE

INTRODUCTION

Les modalités d'application de la TVA en matière d'importation sont certainement parmi celles qui posent le plus de difficultés dans les différents pays qui connaissent ce régime de taxe sur le chiffre d'affaires.

Aussi, nous a-t-il paru utile de consacrer une étude au régime applicable à l'importation en Belgique.

La première question qui se pose est évidemment de savoir ce qu'il y a lieu d'entendre par importation. L'article 23 du Code belge de la TVA, ci-après désigné CTVA, définit l'importation comme étant l'introduction d'un bien sur le territoire belge à l'exclusion des parties du territoire sur lesquelles la taxe ne serait pas appliquée en vertu d'un arrêté royal.

L'article 3 du CTVA prévoyant l'imposition des importations de biens faites par toute personne quelconque, il en résulte que la TVA est due par le seul fait matériel du franchisement de la frontière d'un bien meuble sans qu'il faille se préoccuper du point de savoir:

— si la personne est assujettie ou non;
— si les biens ont été ou non acquis à titre onéreux;
— si les biens ont ou non une nature ou une affectation commerciale.

On ne peut toutefois perdre de vue que des franchises ou exonérations sont prévues notamment par les articles 24, 42 et 43 du Code.

Nous devrons donc étudier non seulement les conditions à respecter lors de l'introduction des biens et la destination que ceux-ci peuvent recevoir, mais également le mode de perception de la taxe ou les conditions mises à l'obtention d'une franchise.

Pour ce faire, nous aurons à présenter d'une manière logique mais synthétique les différentes dispositions réglementaires comprises dans l'Arrêté Royal n° 7 et de nombreuses circulaires dont principalement les circulaires 84/1970, 145/1971, 65/1972 et 3/1973.

CHAPITRE II - DESTINATION DES BIENS

II.1. *Principe*

Les biens introduits doivent recevoir une des destinations suivantes: la consommation, le transit, l'entrepôt ou la franchise temporaire. Lorsqu'une destination est déclarée en matière de douane, c'est-à-dire lorsque les biens proviennent d'un pays autre que les Pays-Bas ou le Luxembourg et sont donc soumis à la réglementation douanière, la même destination doit obligatoirement être donnée en matière de T.V.A. lorsque cette destination peut être reçue en vertu de l'A.R. n° 7.

Il peut arriver, en effet, qu'une importation puisse être faite en franchise temporaire de droit de douane alors que l'A.R. n° 7 n'autorise pas cette destination (l'importation par un assujetti en vue de réexportation après main-d'oeuvre peut être faite en franchise temporaire de droit de douane mais doit faire l'objet d'une déclaration en consommation pour la T.V.A. car la franchise temporaire n'est pas prévue dans ce cas).

L'Administration peut toutefois déroger à ce principe (Art. 2, para. 1 de l'A.R. n° 7).

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II.2. *Formalités*

II.2.1. L'importateur doit, en principe désigner la destination qu'il entend donner par le dépôt d'une déclaration.
La déclaration sera écrite lorsque:
- soit les biens sont introduits par une frontière autre que les frontières internes du Benelux;
- soit les biens sont introduits par une frontière interne du Benelux pour une destination autre que la consommation.

La déclaration écrite sera en général un document 136 pour la consommation, un document T ou TIR pour le transit, un document 133 ou ATA pour la franchise temporaire.
La déclaration sera verbale lorsque les biens sont introduits par une frontière interne du Benelux pour la consommation.

II.2.2. Lorsque les biens sont déclarés pour la consommation, l'importateur doit déposer, qu'elle que soit la frontière d'importation, une copie de facture.[1]
Cette obligation est prévue par l'Article 2, paragraphe 2 de l'A.R. n° 7 pour les importations par les frontières internes du Benelux et par la réglementation douanière pour les autres importations.

CHAPITRE III - IMPORTATIONS DE BIENS DECLARES EN CONSOMMATION

III.1. *Importation avec paiement de la TVA*

La déclaration en consommation donne normalement lieu au paiement de la T.V.A. Elle peut toutefois se faire dans des cas déterminés en franchise définitive (il s'agit d'une dispense de payer la taxe dans le cadre d'une déclaration en consommation, à distinguer donc de la franchise temporaire, qui, au même titre que le transit ou l'entrepôt, est une destination différente de la consommation).

III.1.1. *Taux de la taxe:*

Le taux est identique à celui applicable aux livraisons de biens dans le pays. Un taux forfaitaire est prévu dans certains cas pour les petits colis et les biens se trouvant dans les bagages des voyageurs (Article 58 para. 3 CTVA; Article 10 de l'A.R. n° 7 et A.M. n° 4 du 8 décembre 1970).

III.1.2. *Base d'imposition:*

III.1.2.1. *Importation contre paiement d'un prix* (Art. 34 du CTVA)

A. *Principe:*
La base d'imposition est égale au prix plus certaines charges avec minimum de de la valeur sur laquelle est calculée les droits d'entrée augmentée de ces droits pour les biens imposés au droit d'entrée d'après leur valeur.

B. *Prix:*
Il s'agit du prix fait au destinataire (voir notion ci-après).

C. *Charges à ajouter au prix si elles n'y sont pas inclues:*
Doivent être ajoutés s'ils ne sont pas inclus dans le prix:
- les frais d'emballages ordinaires et usuels sauf s'ils ont pu être importés en franchise en vertu de l'Art. 25 Annexe 19 de l'A.R. n° 7;
- les frais de transport et d'assurance depuis le lieu d'expédition jusqu'au lieu de destination. (Il y a lieu de noter que ces frais ne sont pas imposables en tant que prestations de service en raison de l'exonération prévue pour ceux-ci par l'article 41, § 1,2° du CTVA);

1. En cas d'importation par les frontières internes du Benelux, une note d'envoi doit être remise à défaut de facture.

— les frais de commission à l'exclusion des sommes dues aux commissaires ou agents en douane pour la déclaration en douane. (Remarquons que l'inclusion de ces frais dans la base d'imposition est la conséquence de leur non-imposition en tant que prestations de service en vertu de l'article 21 § 3 du CTVA);
— les droits, impôts et taxes à l'exception de la TVA. Ex.: prélèvement agricole, droit de douane, timbres de licence, etc.;
— le coût du travail à façon subi par le bien avant son importation.

D. *Charges à exclure:*
— sommes déductibles au titre d'escompte;
— rabais de prix acquis au destinataire au moment de l'importation;
— intérêts dus pour paiement tardif;
— sommes avancées par le fournisseur pour autant qu'elles ne doivent pas être comprises dans la base d'imposition.

III.1.2.2. *Importation sans paiement d'un prix ou dont la contre-prestation ne consiste pas uniquement en une somme d'argent:*

A. *Principe:*
La base d'imposition est égale à la valeur normale avec le même minimum qu'en cas de paiement d'un prix.

B. *Notion de valeur normale:*
Il s'agit du prix pouvant être obtenu dans le pays au moment où la taxe est due dans des conditions de pleine concurrence entre un fournisseur et un preneur indépendant se trouvant au même stade de commercialisation.
Dans ce cas, les frais cités ci-avant ne doivent plus être ajoutés.

III.1.2.3. *Personne tenue au paiement: Le destinataire*

A. *Principe:*
Le destinataire du bien débiteur de la taxe ne peut être que la personne qui est le dernier acquéreur du bien lors de l'importation. Toutefois un précédent vendeur peut se porter destinataire des biens pour autant qu'il soit établi en Belgique ou y ait un établissement stable ou un représentant responsable.
Dans ce cas, la livraison du destinataire à l'acquéreur subséquent est réputée s'opérer en Belgique et non à l'étranger (Art. 51, para. 4 du CTVA).
A défaut d'acquéreur, le destinataire est le propriétaire de la marchandise.

B. *Exceptions et cas particuliers:*

a) Envoi à des commissionnaires ou personnes y assimilées par l'Art. 13 para. 2 du CTVA.
Ces personnes sont considérées comme des acheteurs.

b) Envoi de biens à vue, à l'essai ou en consignation.
La personne à qui les biens sont expédiés peut être destinataire si elle est un assujetti tenu au dépôt d'une déclaration et à la condition que l'expéditeur n'ait pas d'établissement stable ou de représentant fiscal responsable en Belgique et qu'à défaut d'achat, les biens soient réexpédiés.

c) Envoi à un locataire:
Pas d'exception: le propriétaire doit se porter destinataire.

d) Envoi d'un bien qui doit subir un travail à façon:
Aux mêmes conditions que le b) ci-avant le travailleur à façon belge peut se porter destinataire.

III.1.2.4. *Personne responsable du paiement*

Le destinataire et le déclarant sont en principe solidairement responsables.

III.1.2.5. *Mode de paiement et formalités à accomplir:*

A. *Régime normal:* paiement par timbres adhésifs ou par machine à timbrer:
La TVA s'acquitte par timbrage d'un document 45A blanc pour les assujettis et jaune pour les non assujettis le cas échéant complété par une liste 45Abis si l'espace réservé à la désignation des biens est insuffisant.
Un document distinct doit être créé par destinataire, avec un bordereau récapitulatif en cas d'envoi groupé.
Le document 45 est rédigé en deux exemplaires dont un est retenu par la douane.
En cas d'acquittement par timbres adhésifs, les timbres sont apposés en entier sur l'exemplaire destiné au destinataire. La facture portera référence au document 45A et vice-versa.
En cas d'acquittement par machine à timbrer, l'empreinte de la machine à timbrer est également apposée sur l'exemplaire pour le destinataire. L'exemplaire retenu par la douane ne porte donc pas d'empreinte.

B. *Régime dérogatoire:* Report de paiement:

a) *Notion:*

C'est un mode de paiement en vertu duquel le destinataire assujetti est dispensé d'acquitter la TVA lors de la déclaration en consommation. La TVA est acquittée par inscription dans la case 13 de la prochaine déclaration et déduite dans la mesure où la déduction est permise par inscription à la case 21 de la même déclaration.

b) *Cas d'application:*

1) *Importations par les frontières intérieures du Benelux:*

Le report de paiement est applicable lorsque les conditions suivantes sont remplies:
— Les biens sont importés pour la consommation à destination d'un assujetti tenu au dépôt d'une déclaration.
— Les biens sont importés soit en exécution d'un contrat conclu avec une personne établie en Belgique, au Luxembourg ou aux Pays-Bas, soit à la suite d'un envoi d'un établissement que le destinataire possède dans un de ces deux derniers pays.
— Les biens doivent être en libre pratique du point de vue douanier.

Dans ce cas, le report de paiement peut se faire sans autre formalité. Aucun document ne doit être délivré à la douane.

2) *Importations par d'autres frontières:*

Moyennant autorisation et paiement par l'assujetti d'une provision égale à 1/12e des taxes payées au cours de l'année précédente sur des importations en provenance de pays autres que les Pays-Bas et le Luxembourg ou en provenance de ces pays mais sans droit au report de paiement à l'exclusion des importations temporaires de matériel (voir 3) ci-après), celui-ci peut utiliser, à partir du moment fixé par l'autorisation, la technique du report de paiement.
Dans ce cas, l'assujetti est tenu pour les importations de déposer à la douane un document 45C vert avec la mention: circulaire n° 3/1973 Autorisation du ...... n° ......
Le document 45C portera référence à la facture et vice-versa.
Par ailleurs, l'assujetti joindra à sa déclaration un document ventilant le montant inscrit à la case 13 entre les importations en

provenance des frontières internes du Benelux, celles de matériel importé temporairement et celles des autres importations faites avec report de paiement.
On se référera à la Circulaire n° 3/1973 pour les autres modalités d'application.

3) *Importation temporaire de matériel:*
Le matériel destiné à l'exécution de travaux en Belgique peut à certaines conditions être importé avec report de paiement.
Pour pouvoir bénéficer du régime, il faut:
a) qu'il s'agisse d'une importation faite pour la consommation par un assujetti belge ou étranger tenu au dépôt d'une déclaration;
b) que le destinataire soit le propriétaire du matériel;
c) qu'il s'agisse d'une importation temporaire dont la durée n'excède pas deux ans.

L'assujetti doit déposer à la douane un document 45C avec la mention AR n° 7 art. 7 - Circulaire 145/1971.
La TVA est payée par inscription à la case 13. Elle est déduite totalement à la case 21 si le matériel ne séjournera pas plus d'un an en Belgique et partiellement à concurrence du montant de la taxe moins 2,5% si le matériel séjournera plus d'un an.
La déduction sera revue par:
— reversement de 2,5% au cadre V c 2me tiret de la déclaration mensuelle ou dans la rubrique V de la déclaration trimestrielle si un bien importé pour un an séjourne plus d'un an dans le pays;
— reversement, effectué de la même manière, de la TVA non déductible en vertu de l'Art. 100 du CTVA après imputation des 2,5% éventuellement déjà payés, lorsque les conditions mises à l'octroi du régime ne sont pas respectées (Ex.: non réexportation endéans deux ans).

Un intérêt de retard de 0,6% est en outre exigible.
Aucune régularisation du document 45C ne doit être effectuée.
Les autres modalités d'application du régime sont fixées par les Circulaires 145/1971 et 13/1975.

C. *Régime d'exceptions:*
Des régimes d'exceptions sont prévus pour certaines importations telles les importations de livres et périodiques (Voir au sujet de ces dernières importations la Circulaire 138/1971).

III.2. *Importation sans paiement de la TVA*

III.2.1. *Dispositions communes:*
Certaines importations tout en étant faites pour la consommation avec déclaration écrite 136 ou déclaration verbale (en provenance des Pays-Bas ou du Luxembourg) peuvent être faites sans paiement de la TVA. Le document qui doit en principe être remis à la douane lors de l'introduction des biens est le document 45B pour les assujettis et un document 45A jaune pour les non-assujettis.[2]

III.2.2. *Cas d'application:*

III.2.2.1. *Importation définitive de biens visés aux articles 20 à 24 de l'A.R. n° 7:*
La franchise de TVA prévue pour ses biens est une des franchises prévues par l'Article 24 2° du CTVA.
Elle vise notamment les échantillons de faible valeur, les catalogues et prix-courant

2. En cas d'importation en provenance des Pays-Bas ou du Luxembourg, un document 45B ne doit pas être déposé lorsque les conditions du report de paiement sont remplies.

ou notices commerciales, les objets de déménagement, les trousseaux & cadeaux de mariage, les produits du sol des régions frontalières, les biens contenus dans les bagages des voyageurs, autres que les effets personnels, dont la valeur globale ne dépasse pas 6.250 F ou 1.250 F (selon qu'il s'agit ou non d'un pays de la CEE), petits envois adressés par un particulier à un autre particulier dont la valeur globale ne dépasse pas 2.000 F.

Les importateurs commettent un abus de franchise leur faisant perdre le bénéfice de celle-ci lorsque:

— des renseignements inexacts ou incomplets ont été fournis;
— d'autres biens sont substitués aux biens à importer;
— les conditions mises à la franchise ne sont pas respectées.

III.2.2.2. *Importation définitive des biens dont la livraison dans le pays est exonérée ou qui sont destinés à l'exportation:*

Peuvent être importées en franchise de TVA:

— d'une part, les importations de biens visés à l'Article 42 du CTVA, de monnaie, titres de créance, timbres postes, etc.
— d'autre part, les importations faites par les personnes qui jouissent d'une autorisation prévue par l'Article 43 du CTVA.

III.2.2.3. *Réimportation de biens:*

A. *Réimportation de biens qui n'ont pas subi de travail à l'étranger:*

Peuvent être réimportés en franchise de TVA et le plus souvent aux conditions fixées par la douane les biens visés aux Articles 29, 30, 32, 33 de l'A.R. n° 7, c'est-à-dire notamment les moyens de transport, les emballages, containers, effets personnels dans les bagages de voyageurs établis en Belgique, animaux et autres biens pour l'exploitation de propriétés frontalières.

B. *Réimportation de biens qui ont subi un travail ou une main-d'oeuvre à l'étranger:*

En règle générale, la réimportation de biens qui ont subi un travail ou une main-d'oeuvre à l'étranger ne peut bénéficier d'une franchise partielle que si l'importateur est un non assujetti.

La Circulaire n° 63/1971 prise sur base de l'Article 31 de l'A.R. n° 7 prévoit toutefois la possibilité pour certains assujettis de pratiquer les réimportations en franchise de TVA, tels les égalisés, les assujettis partiels, les travailleurs à façon, les assujettis qui ne bénéficient pas de la franchise prévue par l'Article 43 du CTVA mais qui exportent au moins 50% de leur production, les assujettis qui réimportent un bien d'investissement.

La franchise n'est accordée notamment que si:

— le destinataire a reçu une autorisation de l'Administration;[3]
— l'exportation et la réimportation ont été faites par la même personne;
— la réimportation par des frontières autres que les Pays-Bas ou le Luxembourg a lieu dans l'année, avec déclaration 136 écrite;
— l'exportation par des frontières autres que les Pays-Bas ou le Luxembourg a lieu moyennant une déclaration d'exportation 69 dans laquelle on se réserve le droit de réimporter (une mention ad

3. La circulaire 63/1971 accorde d'office une autorisation générale aux non-assujettis et aux personnes visées à l'alinéa précédent.

hoc justifiant la franchise à la réimportation doit figurer sur le document 69);
- un document 45 B pour les assujettis et 45 A jaune pour les non-assujettis est déposé en même temps que la déclaration d'importation lorsque l'importation est faite par des frontières autres que les frontières intérieures du Benelux;
- un document 45 A jaune est également déposé en cas d'importation par les frontières internes du Benelux.

La franchise est partielle sauf en cas de réparation sous garantie. Elle est équivalente au montant de la taxe calculée sur la valeur normale au jour de l'importation des biens, parties et pièces détachées qui ont été exportés, et au taux applicable aux biens importés. Dans la pratique, la taxe restant due est calculée sur le prix du travail augmenté des accessoires.

CHAPITRE IV - IMPORTATIONS DE BIENS DECLARES POUR LA FRANCHISE TEMPORAIRE

IV.1. *Importation de Biens Autres que du Matériel Destiné à l'Exécution de Travaux*

Peuvent être importés en franchise temporaire, souvent moyennant autorisation et généralement sous le couvert d'un document douanier „acquit à caution 133" les biens visés aux articles 25 et 26 de l'A.R. n° 7, à savoir notamment les effets personnels contenus dans les bagages des voyageurs établis à l'étranger, les films destinés à être examinés, les biens devant être soumis à des épreuves, les objets mobiliers usagés importés pour un séjour temporaire, les biens destinés à être exposés dans des foires, les vêtements et bijoux envoyés à vue à des personnes qui ne font pas le commerce de biens de l'espèce, les pigeons voyageurs, les oeuvres d'art importées par les artistes, les animaux et autres biens importés dans le cadre des propriétés limitrophes.

IV.2. *Importation de Matériel Destiné à l'Exécution de Travaux*

IV.2.1. *Conditions de fond:*

L'importation temporaire de matériel destiné à l'exécution de travaux peut être effectuée en franchise sur base des articles 25, 27 et 28 de l'A.R. n° 7 et aux conditions fixées par la Circulaire n° 145/1971. La franchise ne dépend pas de la qualité de la personne (assujetti ou non assujetti).

Une franchise totale est accordée si le matériel ne séjourne pas plus d'un an dans le pays aux conditions fixées par les circulaires 145/1970 (n° 15 &s.) et 13/1975. Elle est également totale pour le matériel énuméré ci-après qui ne séjourne pas plus de deux ans:
- le matériel qui sert à l'essai, au contrôle ou à la fabrication de biens qui seront totalement exportés;
- le matériel qui a la nature d'emballage;
- les containers;
- le matériel qui a la nature de moyen de transport;
- les films cinématographiques publicitaires et certains échantillons.

Une franchise partielle est accordée soit si le matériel séjourne plus d'un an mais moins de deux ans, soit, dans le cas de matériel qui peut séjourner deux ans, si les conditions mises à l'octroi de la franchise totale ne sont plus remplies.

Lorsqu'une franchise partielle est accordée, une taxe de 2,5% est due; cette taxe n'est pas déductible.

La franchise n'étant que temporaire, le matériel doit être réexporté.

IV.2.2. *Conditions de forme:*

La franchise est subordonnée à l'obtention d'une autorisation délivrée par le fonctionnaire désigné par le Directeur Général des Douanes et Accises.

L'importation en franchise totale donne lieu à la levée soit d'un acquit à caution 133 avec dépôt d'une déclaration A71/2, soit d'un carnet ATA ou E.C.S. ou d'un certificat 133V.

En cas de changement d'affectation du matériel, de nouveaux documents doivent être levés.

Dès que la franchise ne devient plus que partielle, un document 45B pour les assujettis et un document 45A jaune pour les non-assujettis doit être établi pour assurer le paiement de la taxe de 2,5%.

La réexportation du matériel doit être constatée par une déclaration d'exportation n° 68.

IV.2.3. *Renonciation à la franchise:*

Les bénéficiaires de la franchise peuvent demander qu'une destination autre que la réexportation soit donnée au matériel, à savoir la consommation, l'entrepôt ou le transit.

A. *Déclaration pour la consommation:*

L'autorisation donnée par l'Administration des Douanes et Accises avec l'accord de l'Administration de la TVA n'est accordée que lorsque des circonstances spéciales le justifient. En cas de refus et à défaut de réexportation, l'intéressé commet un abus de franchise (voir paragraphe IV.2.4. ci-après).

Lorsque la renonciation pour la consommation est autorisée, la base imposable et le taux seront déterminés à la date de la demande de renonciation.

La manière de déclarer les biens en consommation se fait comme si les biens étaient normalement introduits dans le pays à la date de renonciation (Déclaration 45A ou report de paiement selon le cas, voir supra). Du montant de la taxe ainsi calculée ne peut être déduite la taxe de 2,5% qui, éventuellement, a dû être payée.

B. *Entrepôt ou transit:*

La renonciation à la franchise pour ces destinations se fait aux conditions prévues par la douane.

IV.2.4. *Abus de franchise:*

L'intéressé commet un abus de franchise si:

- les renseignements fournis sont inexacts ou incomplets;
- le matériel est utilisé à d'autres fins que l'exécution de travaux;
- d'autres biens sont substitués au matériel;
- Les conditions mises à la franchise ne sont pas observées. Tel sera le cas de la non-réexportation.

En cas d'abus de franchise, les biens sont considérés comme importés pour la consommation. La base d'imposition sera déterminée à la date de validation du document de franchise et il y a lieu d'appliquer les règles tracées par l'Article 23 al. 2 du CTVA pour le taux.

Sur le montant de la TVA due pourra toutefois être imputée la taxe de 2,5% éventuellement acquittée.

Les amendes prévues par le code seront le cas échéant dues en plus d'un intérêt de retard de 0,6%.

CHAPITRE V - IMPORTATION DE BIENS DECLARES EN TRANSIT

L'importation à destination du transit se fait aux conditions prévues par la douane.

Lorsqu'il est renoncé au transit pour une nouvelle destination, les biens sont censés être importés au moment où ils reçoivent cette nouvelle destination.

CHAPITRE VI - IMPORTATION DE BIENS DECLARES EN ENTREPOT

L'importation à destination d'un entrepôt public, particulier ou fictif, ainsi que le séjour en entrepôt a lieu aux conditions fixées par la douane.
Lorsqu'il est renoncé à l'entrepôt pour une nouvelle destination, les biens sont censés être importés au moment où ils reçoivent cette nouvelle destination.
La cession de biens en entrepôt peut également avoir lieu en franchise de TVA. Toutefois lorsque des biens qui ont été cédés en entrepôt sont enlevés de l'entrepôt pour la consommation, la franchise de TVA n'est maintenue que pour la cession qui a été consentie au destinataire et, le cas échéant, pour les cessions précédentes (Art. 14 para. 2, A.R. n° 7).

CHAPITRE VII - REGULARISATION DES ERREURS COMMISES DANS LES DOCUMENTS 45

Une circulaire n° 65/1972 en fixe les modalités d'application.

* * * DOCUMENTS * * *

UNITED STATES

Permanent establishment *

Advice has been requested whether an Australian corporation that ships goods to the United States on a consignement basis for sale therein is subject to the Federal income tax with respect to such activity under the provisions of the Income Tax Convention between the United States and Australia (the Convention), T. D. 6108, 1954-2 C. B. 614.

P, a foreign corporation organized under the laws of Australia, manufactures products distributed in various countries. *S*, a domestic corporation whose principal place of business is in the United States, is a wholly owned subsidiary of *P*. *P* sells its products at arm's-length prices to *S*, a United States distributor for the products. *S*, on its own behalf, then sells such products (at prices it determines) to independent retailers and wholesalers throughout the United States. In addition, *P* sells its products at arm's-length prices to other unrelated and independent distributors in the United States. These distributors do not constitute permanent establishments of *P* under the Convention.

The agreement between *P* and *S* provides, among other things, that products will be delivered to a carrier at *P's* plant in Australia, to be forwarded by such carrier for and on behalf of, and at the expense and risk of, *S* to such point or points in the United States as *S* may designate. All responsibility for such products is assumed by *S* which may from time to time and without notice to or consent of *P* move such products to such locations as it desires.

The products are held by *S* on consignment. The title to and ownership of such products is in *P* until purchased by *S* in accordance with the provisions of the agreement. The purchase by *S* from *P* takes place immediately prior to the sale of such products by *S*.

The agreement further provides that *S* is responsible to *P* for damage, destruction, theft, or loss of goods prior to purchase by *S*. *S* bears the cost of insurance of the consigned goods with the loss payable to *P*. Upon request, *S* furnishes *P* with an inventory of all products held on consignment, but it is not liable to account to *P* for the proceeds of sales made by *S*. Also, *S* is under no obligation to purchase the consigned products. *P* has the right to recall any consigned products prior to the time of their purchase by *S*.

P has no employees in the United States and conducts no other business in the United States. *S* sells in its own name to its own customers.

Article III(1) of the Convention provides, in part, that an Australian enterprise shall not be subject to United States tax in respect of its industrial or commercial profits unless it is engaged in trade or business in the United States through a permanent establishment therein.

Article II(1)(o) of the Convention defines the term "permanent establishment", in part, as meaning a branch, agency, man-

* Revenue Ruling 76-322 published in Internal Revenue Bulletin 1976-34, 14 (August 23, 1976). This ruling deal with the concept of permanent establishment under the U.S.-Australian tax treaty. It is, however, of broad interest since almost all U.S. tax treaties contain language nearly identical to the U.S.-Australian tax treaty.

agement or fixed place of business. Where an enterprise of one of the Contracting States has a subsidiary corporation that is engaged in trade or business in the other State, whether through a permanent establishment or otherwise, or has an agent in that other State (other than a agent who has and habitually exercises, a general authority to negotiate and conclude contracts on behalf of that enterprise, or regularly fills orders on its behalf from a stock of goods located in that other State), that enterprise shall not, merely by reason thereof, be deemed to have a permanent establishment in that other State.

Under the concepts of the Convention, the absence of a permanent establishment, on the part of an enterprise having business dealings in the country concerned, is based in part upon the premise that such business dealings are handled through a commission agent, broker or other independent agent. A subsidiary corporation will be treated as an independent agent, as distinguished from an agent of the parent, under similar circumstances. The subsidiary corporation's presence in the country concerned, where it is engaged in trade or business, is by itself no basis to hold that the parent corporation has a permanent establishment in such country, unless the subsidiary has and habitually exercises a general authority to contract for its parent, or as an agent of the parent regularly fills orders of goods on behalf of the parent from a stock of the parent's goods located in such country.

Under the agreement in the instant case, neither a limited agency nor a general agency is established. The relationship between *P* and *S* is that of seller and purchaser, since the power that *S* has in determining when title to the consigned goods passes from *P* is exercisable only as a purchaser. *See* Rev. Rul. 63-113, 1963-1 C. B. 410, which holds under substantially similar circumstances, that the relationship between a foreign corporation and an unrelated consignee was that of seller and purchaser. Further, since *S* is not considered *P*'s agent, although *P* has a "stock of goods" in the United States, *P* has no employee or agent in the United States that could fill orders from such stock of goods. Accordingly, *P* does not have a permanent establishment in the United States within the meaning of the Convention. Therefore, the income derived by *P* from transactions with *S*, its subsidiary, in accordance with the terms of the agreement discussed herein, is not subject to Federal income tax.

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Booklet dealing with tax problems of valuation of real property which must be considered part of the business capital. Problems with respect to leasing of such property are discussed as well. (B 9798)

HANDBUCH DER STEUERVERANLAGUNGEN

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Annual guide consisting of information for filing 1975 returns for individual income tax, corporate income tax, trade tax and turnover tax. Texts of relevant statutes are reproduced. (B 9835)

INTERNATIONALE KONZERNPREISE UND KONZERNUMLAGEN IM WANDEL

By H. Becker. Cologne, Otto Schmidt Verlag, 1976. 25 pp.
Separate print of the German tax adviser's yearbook concerning intercompany pricing and levies in international concerns. Special attention is paid to Par. 1 of the Foreign Tax Law. (B 9612)

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Ein Leitfaden für die Praxis. By A. Bordewin. Stuttgart-Wiesbaden, Forkel Verlag, 1976. 112 pp.
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OECD ECONOMIC SURVEYS: GERMANY

Paris, Organisation for Economic Co-operation and Development, 1976. 58 pp. (B 9787)

DIE STEUERBELASTUNG DER UNTERNEHMUNG IN DER BUNDESREPUBLIK DEUTSCHLAND UND IM EUROPÄISCHEN TEIL DES KÖNIGREICHS DER NIEDERLANDE

Ein Vergleich mit Hilfe der Teilsteuerrechnung. By E. Krewani. Düsseldorf, E. Krewani, 1975. 462 pp.
Comparative analysis of the income tax burden on various legal forms of business enterprises in the German Federal Republic and the Netherlands. (B 9816)

VERDECKTE GEWINNAUSSCHÜTTUNGEN UND VERDECKTE EINLAGEN BEI KAPITALGESELLSCHAFTEN

By G. Döllerer. Schriftenreihe "Steuerrecht und Steuerpolitik", Heft 14. Heidelberg, Verlagsgesellschaft Recht und Wirtschaft mbH., 1975. 167 pp., DM 25.—.
Monograph dealing with the conditions and tax consequences of disguised capital investments and disguised profit distributions, including a discussion of several Court decisions in this respect. (B 9834)

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THE DEFINITION OF CAPITAL GAINS IN VARIOUS COUNTRIES

Cahiers de Droit Fiscal International, Vol. LXIb, Jerusalem, I.F.A., 1976. Deventer, Kluwer, 1976. 435 pp.
Congress report for the International Fiscal Association held in Jerusalem in 1976 containing national reports on the above-mentioned subject. A summary of each report in English, French, German and Spanish is appended. The report by the general reporter Yaakov Neemen is fully

reported in the four languages. National reports include the following countries: Federal Republic of Germany, Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Spain, U.S.A., Finland, France, Israel, Italy, Mexico, the Netherlands, the United Kingdom, Sweden and Switzerland. (B 9820)

THE ECONOMIC THEORY OF FISCAL POLICY

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Edited by M. Edwardes-Ker. Dublin, In-Depth Publishing Ltd., 1976.
Loose-leaf publication designed as guide to international tax planning for corporations using the practical opportunities for avoiding taxes. The aim of tax avoidance is to maximize after tax profits. Included are the following subjects: overseas trading activities, anti-avoidance measures, intercompany pricing, fiscal export incentives, interfinancial financing strategy, management services, lease, international mergers, shipping and aircraft operations, administrative head office, tax strategy for individuals, North Sea oil, offshore companies etc. The book is updated monthly. This year we have already received 8 bulletins in which have been discussed such topics and new developments as: the international capital markets in Switzerland, in the United Kingdom, the Netherlands holding companies, offshore funds, the no-tax havens, exchange fluctuations, shipping, headquarters offices, France capital gains tax and banking secrecy, etc. (B 8860)

ITALY

CODICE I.V.A.

Testo coordinato del D.P.R. 26 ottobre 1972, N. 633 con le innovazioni introdotte dal DD.LL. 6 luglio 1974, N. 254 e N. 260 e dal D.P.R. 23 dicembre 1974, N. 687, annotato con la relazione ministeriale agli articoli modificati o sostituiti. By G. Acampora. Secondo volume, aggiornamento al 1975. Rome, Casa Editrice Stamperia Nazionale, 1975. 128 pp.
Text of the Value Added Tax law as of 1975 together with the Ministerial Explanatory Memorandum. (B 9856)

CONTROLLI E SANZIONI IN MATERIA DI I.V.A.

Spunti pratici e critici. By G. Acampora. Rome, Giovanni Acampora, 1975. 18 pp.
Administrative measures against evasion of value added tax. (B 9854)

LA DICHIARAZIONE DEI REDDITI 1976

By G. Acampora, G. Nanula and C. Palmerini. Rome, Casa Editrice Rassegna I.V.A., 1976. 221 pp.
Handbook for the filing of the income tax return for 1975 individual income. (B 9859)

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THE NETHERLANDS

BELASTINGPOLITIEK EN INKOMENSVERDELING

Deventer, Kluwer, 1976. 90 pp.
Text of report containing speeches and discussions on the subject entitled Tax Policy and Income Distribution. The congress was held on December 18, 1975 in honour of professor H. J. Hofstra in Leyden on the occasion of his leaving office at the University of Leyden. (B 9752)

BELASTINGWETTEN

Zevende druk, 1976. Deventer, Kluwer, 1976. 432 pp., Dfl. 19.—.
Seventh updated edition of consolidated text of tax laws levied in the Netherlands pertaining to 1976 tax year. A short introduction by Ch. P. A. Geppaart on taxation is appended. (B 9789)

BRUTO—BTW = NETTO

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Tables for 18 and 4 percent tax on value added beginning with gross price amounts. (B 9810)

FISCALE ASPECTEN VAN DE OVERDRACHT VAN AANDELEN AAN WERKNEMERS

By Ch. P. A. Geppaart. Deventer, FED, 1976. 66 pp., Dfl. 11.50.
Text of lecture and discussions on the subject of fiscal aspects of the transfer of shares to employees on the occasion of the 1976 tax consultants day convened by the Netherlands Federation of Tax Consultants. (B 9826)

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Kluwers BTW tabellen 18%, 4%. Deventer, Kluwer, 1976. 100 pp.
Tables for 18 and 4 percent tax on value added beginning with net price amounts. (B 9809)

DE TELEGRAAF BELASTINGGIDS

Editie 1976. By J. L. van Hedel. Amsterdam, Teleboek, 1976. 544 pp.
Guide containing information for filing individual income tax return and net wealth tax. (B 9801)

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No. 19, July 1976. Paris, Organisation for Economic Co-operation and Development, 1976. 152 pp., Ffrs. 28.—. (B 9805)

PERU

IMPUESTOS A LOS BIENES Y SERVICIOS

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Prepared by Teodoro Nichtawitz and César Talledo with the collaboration of Beatriz Merino. Lima, Editorial Economia y Finanzas, 1976.
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SPAIN

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CAPITAL TRANSFER TAX TABLES 1976

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THE FISCAL IMPLICATIONS OF DEVOLUTION

By D. N. King. A lecture given to the Institute for Fiscal Studies, January 7, 1976. London, Institute for Fiscal Studies, 1976. 14 pp.
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London, Her Majesty's Stationery Office, 1976. 149 pp., £ 1.80. (B 9747)

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By G. MacDonald. A lecture given to the Institute for Fiscal Studies on December 10, 1975. London, Institute for Fiscal Studies, 1976. 12 pp.
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US-UK DOUBLE TAX TREATY

With commentary by Perry A. Lerner. Edited by Robert T. Cole. London, Institute for Interna-

tional Research, 1976. 98 pp., £ 8.95.
Monograph containing text of the double tax treaty between the United Kingdom and the United States of America signed December 31, 1975 and annotation thereto. (B 9808)

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THE POLITICS OF THE PROPERTY TAX

By D. B. Paul. Farnborough (Hants), Lexington Books Teakfield Ltd., 1975. 158 pp., $ 15.95.
Study on the structure of property taxation in big U.S. cities. (B 9821)

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Updated edition containing concise explanation of the federal old age and disability insurance program and federal health insurance. (B 9778)

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Cumulative bulletin 1974-3 supplement. Washington, U.S. Government Printer, 1976. 426 pp.
This supplement contains additional Committee Reports and excerpts from the Congressional Record relating to the Employee Retirement Income Security Act of 1974 and related Committee Reports, which were not published in a weekly Internal Revenue Bulletin. (B 9768)

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Reporters Mary T. Pittman and Ella C. Thomas. Volume 64, April 1, 1975, to September 30, 1975. Washington, U.S. Government Printing Office, 1975. 1191 pp., $ 14.50.
Bound volume containing relevant U.S. Tax Court decisions reported by E. C. Thomas and M. T. Pittman. (B 9780)

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I. ARTICLES

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PROF. DR. VADIM LISOWSKY *:

EINIGE VÖLKERRECHTLICHE FRAGEN DER DOPPELBESTEUERUNG

Das Völkerrecht enthält keine Normen, die die Staaten verpflichten, Ausländer (physische und juristische Personen) und ihr Vermögen von der Besteuerung zu befreien. Die geltende Praxis, soweit sie sich aus den zahlreichen internationalen Konventionen ergibt, beweist, dass Ausländer in der Regel hinsichtlich der Besteuerung den gleichen Regelungen unterliegen, wie die Bürger des betreffenden Staates.

Zwischen den Staaten gibt es selten Streitigkeiten hinsichtlich des Rechts des territorialen Souveräns, ausländische physische und juristische Personen oder ausländisches Eigentum, das sich im Bereich ihrer Jurisdiktion befindet, zu besteuern.

Komplizierter ist die Frage, in welchem Masse die Staaten gegenseitig auf die Ausübung ihres Rechts auf Besteuerung der Ausländer oder ihres Vermögens verzichten sollen. In den meisten Fällen erhebt sich diese Frage dann, wenn der eine und der andere Staat das Recht haben, den betreffenden Ausländer (oder sein Vermögen) getrennt zu besteuern. In diesem Falle handelt es sich um eine Doppelbesteuerung.

Um eine Doppelbesteuerung (ein und desselben Ausländers oder seines Vermögens) zu vermeiden, ist es erforderlich, die Priorität des einen Staates anzuerkennen. Logischerweise sollte in diesen Fällen die Priorität des Staates anerkannt werden, der mit dem Subjekt und Objekt der Besteuerung juristisch stärker verbunden ist.

Um dieses völkerrechtliche Prinzip realisieren zu können ist es erforderlich, dass die beiden interessierten Staaten ein völkerrechtliches Abkommen zur Beseitigung der Doppelbesteuerung abschliessen, da die Doppelbesteuerung die Effektivität normaler Wirtschaftsbeziehungen zwischen den beteiligten Ländern beeinträchtigt.

Bei der Entscheidung der Frage nach Beseitigung der Doppelbesteuerung dürfen nicht die unmittelbaren fiskalischen Interessen irgendeines Staates im Vordergrund stehen, sondern die Interessen der internationalen Zusammenarbeit und deren Entwicklung, wie das in Art. 17 der Charta der ökonomischen Rechte und Pflichten der Staaten vorgesehen ist, die von der XIX. Tagung der UNO-Vollversammlung (im Dezember 1974) angenommen wurde.

Zahlreiche völkerrechtliche Abkommen über die Beseitigung der Doppelbesteuerung sind, ausgehend von den praktischen Interessen, auf dem Gebiete der Handelsschiffahrt abgeschlossen worden.

In einer Reihe von Ländern gibt es Gesetze, aufgrund deren die staatlichen Organe berechtigt sind, von ausländischen Schiffseignern sowie von den Eigentümern von Lufttransportmitteln Steuern auf die Einnahmen und Gewinne zu erheben, die aus dem kommerziellen Betrieb von Seeschiffen und der zivilen Luftfahrt entspringen. Die unterschiedliche Höhe solcher Steuern wird gewöhnlich in Prozen-

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ten zur Frachtsumme erhoben (bei See- und Luftbeförderungen). In verschiedenen Ländern wird ausserdem das Vermögen der ausländischen Schiffs- und Luftfahrtgesellschaften mit Steuer belegt. Der Besteuerung am Arbeitsort unterliegt auch der Arbeitsverdienst der Arbeiter und Angestellten, die bei ausländischen Schiffseignern und Eigentümern von Lufttransportmitteln beschäftigt sind. Auf die gleichen Tatbestände müssen die ausländischen Schiffseigner und Eigentümer von Lufttransportmitteln Steuern auch im eigenen Lande zahlen. Das bezieht sich auch auf den Arbeitslohn ihrer Arbeiter und Angestellten.

Das ergibt eine doppelte Besteuerung, die sich negativ auf die Entwicklung internationaler Beförderungen mit diesen Transportarten auswirkt.

Infolgedessen schliessen die Staaten Abkommen über die gegenseitige Befreiung ausländischer Schiffsgesellschaften und Luftfahrtslinien und deren Angestellten von der Steuerzahlung.

Hier einige Beispiele, die sich auf die Vertragspraxis der Sowjetunion zu Fragen der Beseitigung der Doppelbesteuerung beziehen:

Aufgrund der Gesetze der Sowjetunion sind die Wasser- und Lufttransportunternehmen staatliches Eigentum. Folglich sind die sowjetischen Organisationen, die die Seeschiffahrt bzw. zivile Luftfahrt unmittelbar betreiben, keine Eigentümer des genannten Vermögens. Staat dessen

— verwirklichen sie, vom Staat dazu bevollmächtigt, die wirtschaftliche Verwaltung dieses Vermögens;
— haben sie die Rechte einer juristischen Person.

Kraft dieser Rechtsgrundlagen sind solche Betriebe selbständige Rechtssubjekte.

Das den entsprechende Schiffahrtsgesellschaften und Luftfahrtbetrieben zugeteilte Vermögen ist Eigentum des Sowjetstaates und dieser Umstand bestimmt die Hauptmerkmale ihres Rechtsregimes.

In Anbetracht dessen, dass ein ausländischer Staat steuerliche Immunität geniesst, beanspruchen das sowjetische staatliche Vermögen, die sowjetischen See- und Lufttransportmittel betreibenden staatlichen Betriebe, und ebenso auch deren Angestellte hinsichtlich der Einnahmen, Gewinne, Vermögen und Löhne Besteuerungsfreiheit in einem anderen Staat.

Ungeachtet der steuerlichen Immunität des ausländischen Staates werden deren staatliche See- und Luftfahrtbetriebe sowie die Löhne und Gehälter der Arbeiter und Angestellten in verschiedenen Ländern mit Steuern belegt.

Angesichts dieser Lage der Dinge vereinbart die Sowjetunion bei Abschluss zwischenstaatlicher Abkommen über die Seehandelsschiffahrt die Aufnahme der Bedingung, dass auf eine Doppelbesteuerung gegenseitig verzichtet wird. Dadurch ist gewährleistet, dass die sowjetischen Schiffahrtsgesellschaften von der Zahlung örtlicher Steuern auf die Fracht in ausländischen Häfen befreit sind.

Solche Bedingungen wurden in das mehrseitige Abkommen zwischen der Volksrepublik Bulgarien, der Ungarischen Volksrepublik, der Deutschen Demokratischen Republik, der Sozialistischen Republik Rumänien, der Union der SSR und der Tschechoslowakischen Sozialistischen Republik aufgenommen. Die Bedingung über die Befreiung von der Doppelbesteuerung findet sich auch in den Abkommen der Sowjetunion über die Seehandelsschiffahrt mit England, Algerien, Belgisch-Luxemburgische Union, Brasilien, Dänemark, Italien, Marokko, Norwegen und Frankreich.

Die Abkommen enthalten allgemeine Bestimmungen darüber, dass Schiffahrtsgesellschaften und Betriebe mit einem eigenen Verwaltungs- und Kontrollorgan auf dem Territorium einer vertragschliessenden Partei auf dem Territorium der anderen vertragschliessenden Partei nicht besteuert werden, insbesondere nicht den Gewinn- und Vermögenssteuern unterliegen. Zu bemerken ist, dass diese Abkommen einige unterschiedliche Formulierungen aufweisen, aber in allen ist die Aufhebung der Doppelbesteuerung festgelegt und folglich tragen sie zur Entwicklung des See- und Luftverkehrs zwischen den Vertragsparteien bei.

Die Sowjetunion hat mit Frankreich ein Sonderabkommen „Über die Beseitigung der Doppelbesteuerung auf dem Gebiete des Luft- und Seetransports" abgeschlossen.

Auf Grund dieses Abkommens sind die sowjetischen Luft- und Seetransportbetriebe in Frankreich von allen Steuern auf Einkünfte und Gewinne, die sie durch den Betrieb der Luft- und Seeschiffe haben, befreit; desgleichen von der Handels- und Industriesteuer auf Anlagen, die von diesen Betrieben genutzt werden. Gleichzeitig sind die französischen Luft- und Seetransportbetriebe in der Sowjetunion von allen Steuern auf Einnahmen und Gewinne befreit, die sie vom Betrieb der Luft- und Seeschiffe haben.

Weiter ist vereinbart, dass sowjetische Bürger, die sich für die Arbeit in den sowjetischen Luft- und Seetransportbetrieben in Frankreich aufhalten, von allen französischen Steuern auf Einnahmen, die sie aus dieser ihrer Tätigkeit erhalten, befreit sind. Das gleiche gilt für französische Bürger, die in der Sowjetunion in französischen Betrieben des Luft- und Seetransports beschäftigt sind. Auch sie sind von allen sowjetischen Steuern auf Einkünfte befreit, die sie für ihre Arbeit erhalten.

Unter Berücksichtigung des Umstandes, dass das Abkommen die innerstaatliche Steuergesetzgebung jeder vertragschliessenden Partei berührt, ist vereinbart, dass es am ersten Tag des Monats in Kraft tritt, der auf den Austausch der Benachrichtigungen folgt, dass die erforderliche verfassungsmässige Bestätigung in beiden Staaten erfolgte. Dieses Abkommen ist am 1. Juli 1971 in Kraft getreten. Am 31. März 1956 hat die Sowjetunion ein Abkommen mit Dänemark über den Luftverkehr abgeschlossen. Im Protokoll vom 9. Februar 1971 zu diesem zwischenstaatlichen Abkommen sind ähnliche Bestimmungen über die gegenseitige Befreiung der Luftfahrtbetriebe und ihrer Angestellten von der Besteuerung vorgesehen.

Auf Grund dieses Abkommens werden die sowjetischen Lufttransportbetriebe in Dänemark von allen Steuern auf Einnahmen und Gewinne, die sie aus dem Verkauf von Luftbeförderungen erzielen, sowie von Steuern auf das in Dänemark sich befindende Vermögen befreit. Umgekehrt werden die dänischen Luftfahrtbetriebe in der Sowjetunion ebenfalls von allen Steuern und Einnahmen und Gewinnen, die sie durch den Verkauf der Luftbeförderungen erzielen, befreit, ebenso auch von den Steuern auf das in der Sowjetunion befindliche Vermögen.

Weiter ist vorgesehen, dass die Angestellten und Mitarbeiter der sowjetischen Luftfahrtbetriebe in Dänemark, die Bürger der UdSSR sind, von allen dänischen Steuern auf Einnahmen befreit sind, die sie für ihre Arbeit in dem genannten Luftfahrtbetrieb erhalten. Das gleiche gilt, im Rahmen der Gegenseitigkeit, für die dänischen

Mitarbeiter und Angestellten der Luftfahrtgesellschaften, die sich in der Sowjetunion befinden.

Das Abkommen sieht vor, dass das Protokoll am Tage des Notenaustausches über die Erfüllung der Formalitäten, die die nationale Gesetzgebung der Sowjetunion und die Gesetzgebung Dänemarks vorsieht, in Kraft tritt. Der Notenaustausch erfolgte über diplomatische Kanäle. Dieses Protokoll ist am 12. März 1971 in Kraft getreten.

Ähnliche Protokolle wurden von der Sowjetunion unterzeichnet mit:

— Norwegen am 11. Februar 1971 in Verbindung mit dem Abkommen zwischen der Regierung der Union der SSR und der Regierung Norwegens über den Luftverkehr vom 21. März 1956;
— Schweden am 8. Februar 1971 in Verbindung mit dem Abkommen zwischen der Regierung der Union der SSR und der Regierung Schwedens über den Luftverkehr vom 31. März 1956.

Die Konvention zwischen der Union der Sozialistischen Sowjetischen Republik und den Vereinigten Staaten von Amerika zu Fragen der Besteuerung (vom 20. Juni 1973) sieht die Regelung der Beziehungen auf diesem Gebiet zwischen den vertragschliessenden Parteien vor. In der Konvention sind ausführlich die Arten von Einnahmen festgelegt, die nur auf dem Territorium einer der Vertragsparteien zu besteuern sind, während sie auf dem Territorium der anderen Partei steuerfrei sind.

Die Konvention sieht vor, dass von Einnahmen aus Operationen internationaler Beförderungen auf Seeschiffen und aus Geschäften mit Schiffen, die für internationale Beförderungen genutzt werden, keine Steuern zu zahlen sind. Die Besatzungsmitglieder zahlen Steuern von der Vergütung, die sie für Lohnarbeit erhalten, nur an den Flaggenstaat.

Die Doppelbesteuerung trägt nicht zur Entwicklung der internationalen Wirtschaftsbeziehungen bei, sondern behindert diese sogar in einem gewissen Masse. Daher ist die Entscheidung der Frage nach Beseitigung der Doppelbesteuerung auf breiter völkerrechtlicher Basis, unter Berücksichtigung der entstandenen völkerrechtlichen Praxis und unter Berücksichtigung der in den verschiedenen Staaten geltenden Steuersysteme, von unmittelbarem politischen und wirtschaftlichen Interesse.

DR. AMNON RAFAEL *:

TAX REFORM IN ISRAEL

I. INTRODUCTION

The Israeli income tax system has been criticized as one of the main causes of the shortcomings of Israeli society. Moral decadence, corruption, disregard for truth, the drive towards materialism, the decline of long-established values, acquiescence in injustice and the widening of the gap between the "haves" and the "have nots" — to name but a few — have been ascribed to it. Rarely has a tax system as such, been credited with the ability to contribute so little good. Admittedly, the tax system became an easy scapegoat to blame for the weaknesses of Israeli society. More than the tax system has gone wrong; the very fibre of Israeli society has come under a strain for which Israelis were ill-prepared. It would therefore be more accurate to describe the Israeli tax scene during the past few years as one of the symptoms of the malady, but not as the sickness itself. The cry for "tax reform" is not new and has been heard for almost a decade. The growing awareness of the disgrace involved in a system where all are criminal offenders but hardly any are prosecuted, gave it new momentum. Interestingly, it was the Treasury which tried to conceal the need for reform. Its spokesmen expressly stated that the system was functioning well and that tax evasion was simply the product of the imagination of the average Israeli. Despite these consoling remarks, the public persisted in its demand for tax reform. Finally, on 15 Dec. 1974, a Public Committee, headed by Professor Ben Shahar of Tel Aviv University (and therefore known as the Ben Shahar Committee), was given the task of bringing forth proposals for an overall reform. The Committee was requested to ensure the equitable redistribution of the national income and the elimination of distortions and their negative influence on productivity and the morals of the taxpayer. The Minister of Finance also requested the Committee to consider its recommendations in light of the wage policy and the needs of the Treasury.

The Ben Shahar Committee worked untiringly until, on 12 March, 1975, it presented its recommendations to the Minister of Finance. The Government, afraid of the fury of particular sectors of the taxpaying population, decided to adopt the recommendations in their entirety. The recommendations, coupled with this decision, received widespread public acclaim. On 9 June 1975, the Bill proposing the Reform was published. The Knesset reacted quickly and, with hardly any opposition, passed its first reading. The Finance Committee struggled with the Bill for a number of weeks, attempting to pass it by 1 July. Several changes were inserted in the Bill and several deviations from the Ben Shahar Committee's recommendations were introduced. Finally, on 20 July, 1975, the tax reform was enacted. Since then, tax reform has been a talking point all over the country.

II. BROADENING THE TAX BASE

a) *In General*

The main slogans of those in Israel who demanded the Reform and deemed it

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essential to the restoration of moral integrity were "Broaden the tax base" and "Away with the erosion of the tax base". While these slogans depicted accurately the prevailing weaknesses of the pre-Reform tax system, they were, for the most part, out of place in a purely legal context. For the Ordinance, as such, did not sanction the practices which the layman came to consider to have been prescribed by it. On the contrary. Prior to the Reform, the tax base laid down by the Ordinance was quite wide and comprehensive. The amendments intended to destroy the so-called "contracted tax base", were therefore, more of a psychological than a legal need.

The Israeli tax scene prior to the Reform was chaotic. But, strangely enough, the average Israeli found it quite normal and it is the Reform which he finds somewhat incomprehensible. In effect, the steep progressivity of the rates of tax, coupled with their high percentage, when computed together with the compulsory loans, were a catalyst to using tax terminology designed to describe expenses incurred in the production of income, as unquestionable tax free income in the hands of the "reimbursed" and allowable deductions to the reimburser. The general collapse of the Israeli tax base can, in the main, be attributed to "car expenses". Such "expenses" were paid to employees and excluded from their taxable income, whether or not they used their cars for the production of their employer's income and sometimes, whether or not they owned a car. The game was played merely for the sake of formality by the filing of fictitious meticulous reports, detailing long untravelled journeys. Company cars used almost exclusively for pleasure were quite a common untaxed fringe benefit referred to as "car expenses".

The conversion of allowances for clothing (termed "working clothes"), private telephones, entertainment, trips abroad, representation and similar expenses, and contributions to funds for the maintenance of professional adequacy, among others, into tax free income, all contributed to the narrowing of the tax base. These allowances were allowed as a deduction to the payor and went untaxed at the recipient's level. Moreover, special arrangements such as those won by the airline crews, allowed for the inclusion of foreign currency in gross income at unrealistic and ridiculously low rates of exchange, thus substantially increasing the employee's after-tax salary. In certain cases, employees were given valuable tax-free gifts, price reductions on the purchase of goods or coupons good for purchases at certain stores, non-interest or low interest bearing loans, stock options fixing a purchase price much lower than the fair market value of the stock, and fictitious overtime payments and premiums received as incentives for increased productivity. It should be stressed that only a small fraction of these so-called expenses were sanctioned by law, e.g., professional literature; and that a greater part, were merely extra-legal concessions.

b) *Income*

The Reform introduced several amendments in order to make it quite clear that the pre-Reform situation would no longer be tolerable. These changes were aimed basically at capturing all fringe benefits and other allowances within employment income, and at a widening of the tax base in general.

c) *Expenses*

The Reform brought about a new set of

regulations prohibiting the deduction of certain expenses. Paramount among these are the prohibitions upon the deduction of expenses incurred in travelling and telephone expenses.

III. TAXATION OF THE INDIVIDUAL

A major significant change in the taxation of the individual is the linking of the threshold of taxable income to the cost-of-living index. Prior to the Reform, payments resulting from increases in the cost-of-living index went tax free. These payments are now fully taxable. However, the entire threshold of taxes is increased by its linkage to the cost-of-living index. Hence, the credits, exemptions and tax ceilings, are all linked to the inflationary spiral.

IV. TAXATION OF COMPANIES

The Reform has left intact the fundamental concept on which the taxation of companies is based. The company pays a company tax of 40% and an income tax of 35% on its undistributed profits. For purposes of computing the income tax, the company tax and the dividends distributed to the shareholders are excluded from chargeable income. Thus, the effective rate of both taxes, levied on undistributed profits, is 61%. This rate can be lowered by distributing dividends, which may, in turn, go tax free in the hands of shareholders with carryover losses or small gross income. Prior to the Reform, the Ordinance provided for a maximum tax of 50% on dividends received, by non-corporate taxpayers. This concept, which infers a desire to somewhat mitigate the effects of double income taxation, remains in force after the Reform, except that the rate has been lowered to 45%. Thus, dividends received by an individual will bear a maximum tax of 67%, as opposed to 71% prior to the Reform (without taking into consideration the compulsory loans, which would bring about an effective tax rate of over 95%, if considered in their entirety as a tax). It should be noted that, from a tax point of view, the principle discouraging the use of corporations as a business vehicle now governs. The maximum tax on an individual's chargeable income is 60%, while the rate on undistributed earnings is 61% and that on distributed earnings can reach 67%.

As a result of the Reform, tax planners will have to readjust their thinking Presumably, more taxpayers than before will prefer to conduct their businesses as individuals or in partnerships. Where companies will be used, loan rather than share capital financing will be recommended from a tax vantage point. Dividends will probably be distributed more often than prior to the Reform and companies' resources are liable to suffer.

V. TAXATION OF CAPITAL GAINS

One of the most interesting changes introduced by the Reform concerns the taxation of capital gains. The change is not, as might appear to the uninitiated, of a revolutionary nature. The basic premise, in accordance with which capital gains are not taxed as ordinary income, remains in full force and effect. The amendments introduced are, from a conceptual and philosophical point of view, of a cosmetic rather than of a substantive quality. The cosmetic changes emerge strongly due to the de jure — as opposed to de facto — recognition now given to the inflationary element inherent in the capital gain. Under the Reform, the capital gain is divided into the "real capital gain" and the "inflationary excess". Once a capital gain has been dissected into the real capital gain and the inflationary excess, the tax can be computed. In the case of an individual, the capital gains tax will be levied in accordance with the rates imposed on the vendor's ordinary income, on that part of the gain which comprises the real capital gain. In determining the rate of tax applicable to the individual, the capital gain is regarded as being at the top slice of the vendor's chargeable income. The tax on the inflationary excess, is levied at a flat rate of 10%. In no event, however, may the entire tax imposed on the capital gain exceed 50% of the capital gain. Where the taxpayer is a body of persons e.g., companies, cooperatives, etc., the real capital gain is subject to a flat tax of 61%. The inflationary excess is subject to the same 10% tax applicable in the case of an individual. The tax may not exceed, as in the case of an individual, 50% of the capital gain.

The rates discussed above do not apply to short-term capital gains. Where a capital asset is sold within one year of its acquisition, no adjustment is made for the inflationary excess and the entire capital gain is deemed to be the real capital gain. Where the capital asset is sold during the second year following its acquisition, the inflationary excess is computed by deeming the date of the acquisition of the asset to have moved forward from the date on which it was originally acquired by the number of full months which remain until the closing of the second year from the date of the sale.

Similar provisions have been introduced into the Land Appreciation Tax Law, 1963, although these provisions are not identical with those of the Income Tax Ordinance. It is assumed and hoped, that shortly the Land Appreciation Tax will be meshed into chapter E of the Income Tax Ordinance. Of importance, are the new provisions which deal with the sale of personal residence which allow either for a total exemption or for a carryover basis.

VI. THE "NEW ERA" IN TAXPAYER — TAX AUTHORITIES RELATIONS

The Reform is designated to open a new, hopefully golden, era in the relationship of taxpayer-tax authorities. Many Israeli practitioners are convinced that the real Achilles heel of the Israeli tax system, was the bad relationship between taxpayer and tax collector. Characteristic of the situation were the failure to maintain proper books and records; the assessing of income on the basis of published statistical tables drawn up for the various economic sectors, in consultation or agreement with representatives of the relevant economic sector; bargaining in a style reminiscent of the mid-Eastern markets amidst great mistrust on both sides; the feeling that the burden was divided inequitably, mainly as a result of the fact that taxes were levied on statistical rather than actual income; the lack of regard for the law demonstrated by both the taxpayers and the tax authorities; and, last but not least, the prevalence among many taxpayers of the notion that, no matter what records were kept, the assessing officer would, in the final analysis, base his assessment on his best judgment rather than on the taxpayer's word. To overcome the feelings of hostility and mistrust engendered by this situation, revolutionary changes as opposed to a mere Reform are required. But the law can only provide Reform. Willingness to comply with the Reform will have to emerge from a long and extensive educational process. Taxes change overnight — taxpayers do not.

The Reform sets out from the very basic premise that the collection of taxes depends on the submission of true information to the tax authorities. Therefore, it prescribes that all taxpayers file tax returns once a year and that all taxpayers deriving income from business maintain proper books and records to allow for the proper verification of their true chargeable income. Contrary to the past procedure, the new concept infers that the policy of the tax authorities will be to honour books and records kept in accordance with the prescriptions of the regulations, and termed by a new definition inserted into the Ordinance, "acceptable books".

In most cases, the filing of a timely return substantiated by the appropriate documents, will close the matter. Where the assessing officer finds the books and records acceptable, but believes that tax should be computed differently than in the manner computed by the taxpayer, e.g., denial of deductions, allocation of expenses, he may make his own assessment based on his best judgment. This assessment is subject to an administrative review which the taxpayer is required to initiate within 30 days of the receipt of the assessing officer's final assessment. The new section 150A provides that the review shall not be carried out by the person who assessed the tax — a departure from pre-Reform procedure where assessing officers reviewed their own decisions merely as a formality. As before the Reform, the taxpayer may appeal the ruling of the assessing officer to the District Court and therefrom to the Supreme Court.

VII. EVALUATION OF THE REFORM

The Reform will be evaluated by its results. Israel's problem was not the lack of an orderly statute. Rather, the lack of disciplined taxpayers and disciplining tax authorities created the pre-Reform situation. Indeed, as pointed out repeatedly in this article, the Reform is more of a psychological measure than a change of concept or philosophy.

Much work still remains after the legislating of the Reform. The Ordinance must be codified so as to afford an easier understanding of its provisions. New regulations must take the place of old. These are technical matters, but of paramount importance. An ambiguous law only provides uncertainties.

The Reform has set for itself a number of aims: to prevent tax evasion, to increase the collection of tax through a broadening of the tax base and to introduce a new spirit of voluntary compliance with the law. These are the general aims of every tax system, and it is in their implementation that the system is evaluated. It remains to be seen whether the Reform will achieve its aims. Should the Reform fail, it will leave deep scars on Israeli society. Such a failure would signal a collapse of the rule of law and an unwillingness to attempt self-discipline. Should the Reform succeed, it will prove that a new path has been blazed, and in other fields where norms have been totally distorted, reforms may well follow.

LEE FOOK HONG *:

SOME ASPECTS OF TAX ADMINISTRATION AND COLLECTION IN SINGAPORE

The Inland Revenue Department is the major revenue collector for the Republic of Singapore.[1] According to the latest Annual Report of the Department, it collected in 1974 $1,250 million representing 68% of the Republic's revenue from taxes and 51% of its revenue from all sources.

The Department is headed by the Commissioner of Inland Revenue, who also holds other statutory appointments such as:—

(1) Comptroller of Income Tax,

(2) Comptroller of Property Tax,

(3) Commissioner of Estate Duties, and

(4) Commissioner of Stamps.

The Commissioner is responsible for the implementation and administration of the following Acts:—

	Act	*Chapter*
(1)	Income Tax Act	141
(2)	Economic Expansion Incentives (Relief from Income Tax) Act	135
(3)	Property Tax Act	144
(4)	Rubber Estates Assessment Act	145
(5)	Rubber Estates (Surcharge on Assessment) Act	146
(6)	Auctioneers' Licences Act	214
(7)	Stamp Act	147
(8)	Betting & Sweepstake Duties Act	131
(9)	Finance Act (Payroll Tax)	139
(10)	Estate Duty Act	137
(11)	Private Lotteries Act	143
(12)	Broadcasting and Television Act	83

His duties include the following:—

(1) Administration and enforcement of the various revenue Acts;

(2) Supervision of assessment and collection of all taxes;

(3) Consideration of taxation policy, legislation and administration.

Although the sale of Radio and Television Licences is within the jurisdiction of the Inland Revenue Department, the Postmaster-General is the receiving agent. Similarly, although the collection of payroll tax is the responsibility of the Commissioner of Inland Revenue, the General Manager of the Central Provident Fund is his receiving agent.

The Inland Revenue Department exercises supervision over the following divisions and each Division is responsible for the implementation and administration of the various revenue Acts mentioned below.

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* F.C.I.S., F.A.I.A. This article is part of a paper presented at the Seminar on "Financial Development in Singapore" organised by the Nanyang University on 6 and 7 February 1976.

1. The other large revenue collecting department is the Customs & Excise Department.

Divisions	*Act*	*Chapter*
Income Tax Division	Income Tax Act	141
	Economic Expansion Incentives (Relief from Income Tax) Act	135
Estate Duty Division	Estate Duty Act	137
	Private Lotteries Act	143
Payroll Tax Division	Finance Act (Payroll Tax)	139
Stamp Division	Stamp Act	147
	Betting and Sweepstake Duties Act	131
Property Tax Division	Property Tax Act	144
	Rubber Estates Assessment Act	145
	Rubber Estates (Surcharge on Assessment) Act	146
	Auctioneers' Licences Act	214
Radio and Television Licensing Division	Broadcasting and Television Act	83
Legal Division	All legal matters	
Training Division	Preparation of manuals, instructions and lecture notes; and the conducting of training courses, seminars and examinations.	
Research Division	International Relations; Double Taxation Negotiations; studies on Tax Structures, Tax Planning, Tax Avoidance.	
Administration and Miscellaneous Division	General administration and organisation of the office and of staff matters; preparation of revenue and expenditure estimates, statistics and administration reports; designing of methods and procedures.	

Income Tax Division

The Income Tax Division is responsible for the administration of the Income Tax Act, Chapter 141. It is organised into the following sections, each of which has its specific responsibility or function.

Section	*Responsibility/Function*
Company Section	Assessment of limited liability companies.
Business Section	Assessment of sole-proprietors, partners, partnerships, clubs, associations, and Hindu Joint Families.
Salary Section	Assessment of employees and pensioners.
Trust Section	Assessment of liabilities of trusts.
Anti-Evasion Section	Investigation of tax evasion and fraud, co-ordination of assessing work and technique with field survey and investigation.
Collection	Collection of and accounting for all tax assessed.
Court Section	Prosecution of offences and suit for payment of tax.
Records Section	Maintenance of master registers and indices, collection and dissemination of information, processing of employers' returns in respect of remuneration paid to employees.

The Comptroller of Income Tax

The Comptroller manages the office which actually administers the tax i.e. the day to day work of assessing and collecting tax. The functions of his office are to ensure that all persons who are liable to income tax furnish the information necessary to determine the tax, to assess the amount of tax payable and to collect this amount of tax as assessed.

There are various powers conferred on the Comptroller in relation to the making of assessments on taxpayers. Many of these are subject to appeal to the Board of Review.

Every taxpayer is expected to be aware of his responsibility and obligation to declare honestly and fully his income in the prescribed return form if his income is liable to tax. On receipt of the return form the Department will issue assessment after making necessary enquiries or adjustments. The Department is also empowered to estimate a taxpayer's chargeable income if his return is not furnished or where the declared income is not acceptable to the Comptroller.

Heavy fines and penalties including imprisonment terms are prescribed for failure to furnish a return or furnishing an incorrect return. There is no time limit for the Comptroller to issue assessments in cases where tax evasion has taken place although the time limit in normal cases is 12 years. However there is no provision in the Income Tax Act for the Comptroller to issue any assessments for years prior to 1948 when income tax was first introduced in Singapore.

"Tax Avoidance" and "Tax Evasion"

"Tax Avoidance" and "Tax Evasion" are terms so frequently mentioned in the tax administration and in the business community today that they constitute part of our conversational discussions.
Whatever the distinction may be, the effect of these two terms on the revenue is the same i.e. the result is similar in that the revenue to the Government is reduced. "Tax Evasion" and "Tax Avoidance" are neither new nor peculiar to Singapore.
These problems exist in almost all countries of the world today. They are universal and as old as the taxes themselves. The ever increasing complexity of modern business management makes the problem of tax evasion more serious and universal.

How to improve the tax administration?

The serious problem most governments face today is how to make tax administration convenient to the general public and at the same time how to reduce the practice of tax evasion. It is gratifying to know that generally speaking Singapore income tax system has been well administered. Tax evasion among Government employees and other salaried people is difficult if not impossible. Perhaps the greatest loop-hole in tax collection is among the self-employed small shop proprietors, road-side stall holders or hawkers in the market.
To improve the tax administration it is necessary to find out the causes of tax evasion. One of the most important reasons for tax evasion in a country is that the taxpayers are not conscious of their responsibilities towards society and the country in which they are living. There is no proper or formal training or education made compulsory for people about the obligation to pay proper taxes. Sometimes the tax legislation is so complex that even the tax authorities and the practitioners cannot keep themselves abreast of the changes and latest developments. Some government authorities regard one of the important factors leading to tax evasion is the high tax rates. It is almost impossible to devise ways and means which may totally eliminate tax evasion.
The problem of income tax evasion can be tackled at different levels.

(1) To give wide publicity;

(2) To improve the standard of administration;

(3) To arouse public conscience against tax evasion.

To achieve these, tax administration should be viewed as an important area of public administration in which training, education and research at all levels is needed. Government should give careful consideration to the proposal for a new "Institute for Tax Administration". Such Institute may be formed on the pattern of the Singapore Insurance Training Centre and the Singapore Institute of Banking and Finance or some other similar institutions.
A good tax administration which seeks compliance must protect those who comply and punish those who infringe tax legislation, or else tax compliance would diminish, and tax evasion offences or malpractices would increase.

USHA JAIN *:

TAX INCENTIVES IN INDIA

An essential feature of the Indian Income-tax is that it encompasses various tax incentives to encourage savings, investment, exports etc. in the desired manner. India is perhaps the only country where the tax structure is so oriented that it provides various incentives to achieve the objectives of the state. These incentives are necessary in an under-developed country like India where there is need to increase production, employment and income to match the rapidly increasing population. Per capita income is low in such economies and propensity to consume is high. Provision for tax incentives becomes all the more necessary in view of the low level of savings and investment.[1] Tax incentives have a great advantage in that they facilitate quick recovery of capital and ensure a higher rate of return and encourage thereby domestic and foreign industrialists either to establish "new business that otherwise would not be established"[2] or to expand their activities in already existing enterprises. They also encourage taxpayers to save and invest in the desired directions.

To encourage savings and that too in the desired directions, certain incentives have been provided. An individual taxpayer is allowed deduction in computing his net taxable income if he makes contributions towards life insurance premiums, provident fund, deposits in 10-year or 15-year cumulative time deposit in the Post Office, Public Provident Fund,[3] unit linkel insurance plan of the Unit Trust of India[4] etc. Hindu undivided families and associations of persons are allowed deduction only in respect of life insurance. With the growing need for savings, the limit of deduction towards such contributions has been increased. The amount of deduction in respect of such contributions is, at present, limited to the whole of the first Rs. 4,000 plus 50 percent of the next Rs. 6,000 plus 40 percent of the balance.[5] A monetary limit also exists in this respect. Such contributions are limited to 30 percent of the "gross total income" or Rs. 20,000 whichever is less, in the case of individuals and associations of persons and to 30 percent of the "gross total income" or Rs. 30,000, whichever is less in the case of Hindu undivided families. A higher limit of 33.3 percent or Rs. 25,000,[6] whichever is less,

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1. In 1974-75, total domestic savings constituted 11.8 percent of the net national product (at current prices) and the aggregate investment was 13.8 percent of the national income. See *Report on Currency and Finance* (1974-75), Vol. 1, p. 1.
2. George E. Lent, "Tax Incentives for Investment in Developing Countries", Finance and Development, September, 1967, p. 197.
3. This scheme was instituted by the Government of India in 1968 to encourage savings among all sections of the society particularly self-employed persons. The scheme is for 15 years from the date of opening of an account, after which full withdrawal can be made although partial withdrawals from the fund are permitted after 5 years. A person may subscribe to the fund amounts ranging from a minimum of Rs. 100 to a maximum of Rs. 15,000 in any year.
4. This provision has been introduced by the Finance Act, 1972.
5. For the assessment years 1974-75 and 1975-76, the rates of deduction were 100 percent of the first Rs. 2,000, 50 percent of the next Rs. 3,000 and 40 percent of the balance.
6. The Finance Act, 1976 has raised this limit to Rs. 50,000.

applies in the case of authors, playwrights, artists, musicians and actors.

Complete exemption from income tax is granted if an individual receives interest on deposits in a Post Office Savings Bank including the interest and bonus on Cumulative Time Deposit Accounts and interest on 5-year Fixed Deposits with the Government. Further, interest received on Treasury Savings Deposit certificates, Post Office cash certificates, Post Office National Savings certificates, National Plan certificates, 12-year National Plan Savings certificates, 10-year Defence Deposit certificates, Government of India Defence certificates, Premium Prize Bonds, 1963, 7-year National Savings certificates and 3-year Fixed Deposits with the Government, is also exempt to the extent to which the amount of such certificates or deposits does not exceed in each case the maximum investment or deposit permitted therein.[7]

In order that Government employees may not frequently withdraw and continue to retain their savings in Provident Funds, the Finance Act, 1975 instituted an incentive bonus scheme for the benefit of those Government employees who do not withdraw any amount from their Provident Fund account during the year. The bonus would be 3 percent for employees drawing pay upto Rs. 500 and 1 percent for employees drawing pay above Rs. 500 per month on the contribution made during the year.

From time to time, the Government of India has also instituted compulsory saving schemes. One such scheme (known as Compulsory Deposit Scheme) was introduced in the Budget for 1963-64. The scheme was originally made applicable to all salaried persons earning more than Rs. 1,500 per annum, agriculturists paying land revenue, property owners in urban areas, income-tax payers, shop-keepers etc. However, in view of the administrative difficulties and political opposition, the scheme (as embodied in the Compulsory Deposit Act, 1963) had limited applicability. Even this could not be applied fully. The deposits made under the scheme could not be withdrawn upto 5 years and carried a simple interest of 4 percent per annum. The scheme was estimated to bring about Rs. 70 crores (1 crore = 10 millions) in a year. The actual receipt during 1963-64 amounted to Rs. 15 crores only. In view of the administrative difficulties and strong public opposition the scheme was abandoned next year when it was replaced by the Annuity Deposit scheme in 1964.

The Annuity Deposit scheme was made applicable to all resident assessees (other than registered firms, co-operatives, local authorities and companies) whose total income exceeded Rs. 15,000 per annum. The rates of deposit varied from 5 percent on incomes between Rs. 15,001 to Rs. 20,000 to 12.5 percent on income over Rs. 70,000. The deposits were to be repayable with interest in ten equal instalments. The amount of annuity deposit was to be deducted in computing the taxable income of the assessee but the refunded annuity instalments are treated as earned income. By the Finance Act, 1966, the scheme was made voluntary for incomes upto Rs. 25,000. This scheme was very complicated

7. The limit of deposit in single name is Rs. 25,000 for Post Office Savings Banks, Post Office National Savings certificates, 12-year National Plan Savings certificates, Rs. 54,000 for 5-year, 10-year and 15-year cumulative Time Deposit and Rs. 35,000 for 10-year Defence Deposit-certificates and 12-year National Defence certificates. Deposits in joint names are permissible upto double these amounts.

in its operation and involved lots of administrative work. It necessitated maintenance of accounts for ten years in respect of deposits of each year for every assessee. Moreover, "Under the scheme, people with rising incomes stand to lose, while those with falling incomes benefit because the scheme tends to postpone taxation of that part of income which is represented by the annuity deposit.[8] Therefore, the scheme was abolished by the Finance Act, 1968.

In order to raise resources for financing the plan and to reduce inflationary pressures the Government announced in July 1974, a compulsory deposit scheme for taxpayers whose taxable income exceeds Rs. 15,000 per annum. This scheme covers all Indian individuals, Hindu undivided families and trustees of discretionary trusts. They have to make compulsory deposits for the assessment years 1975-76, and 1976-77 if their "current income" exceeds Rs. 15,000. The deposit has to be made on the whole income. In order to ensure that a part of the tax benefit resulting to the taxpayers from the lowering of tax on personal incomes becomes available for our development efforts, it is proposed to continue the compulsory deposit scheme in the case of income taxpayer for another year 1976-77.

Under the scheme, the compulsory deposit has to be made on the basis of the "total income" which is computed after taking into account the various exemptions and deductions allowed under the Income-tax Act, 1961 (including the deduction allowable with reference to qualifying saving through specified media, e.g., contributions to Provident Fund, Life Insurance premiums). Similarly, net agricultural income is computed after allowing expenses.

The rate of compulsory deposit on the initial slab of Rs. 25,000 of current income is 4 percent; on the slab of Rs. 25,001—70,000 it is 6 percent and on the slab over Rs. 70,000 it is 8 percent. The Finance Act, 1976 has raised the rate on the slab of Rs. 25,001—70,000 from 6 percent to 10 percent and on the slab over Rs. 70,000 from 8 percent to 12 percent. Marginal Provision also exists under the scheme. No deposit is required to be made if the deposit works out to less than Rs. 100. Further, the amount of deposit should not in any case exceed the amount by which the current income exceeds Rs. 15,000.

The amount of the compulsory deposit made under the Act is not allowed as deduction in computing taxable income. However, the deposits made under the Additional Emoluments (Compulsory Deposit) Act 1974 are allowed to be so deducted and also set-off against the deposits required to be made under this Act for that assessment year.

In the case of taxpayers liable for advance tax, the last date for deposit under the Compulsory Deposit Act is the date on which the last instalment of advance tax is payable. In other cases, the deposits are required to be made voluntarily before the end of the financial year immediately preceding the relevant assessment year. The depositor has the choice of making deposit either in one lump-sum or in two or more instalments but not more than one deposit can be made in any quarter.

The amount is repayable in five equal instalments commencing from the expiry of two years from the end of the financial year in which the deposit was made together

8. R. N. Bhargava, *Indian Public Finances,* 1969, p. 72.

with the interest payable thereon. Interest on such deposits will be paid at the maximum bank deposit rate (10 percent at present). The interest will be calculated from the first day of the month immediately following the month in which the deposit is credited to the account of the depositor. Interest received on such deposits will be treated at par with the interest received from banking companies and will be included in the categories of incomes exempt upto Rs. 3,000 under Section 80L of the Income Tax Act, 1961.

If a person fails to make a deposit or makes a short deposit, a penalty is leviable at the rate of 25 percent of the non/short deposit and the Income-tax officer has no discretion whether to levy the penalty or reduce it. So far about Rs. 50 crores have been impounded under the scheme.[9]

To encourage corporate savings, inter-corporate dividends are taxed on a concessional basis. This concessional treatment was first given in 1953-54 when dividends received by companies from certain specified industries were exempt from corporation tax. From the assessment year 1968-69 certain specified percentage of inter-corporate dividends is allowed to be deducted in computing the taxable income of the company. The amount of deduction depends on the type of company. In the case of foreign companies the deduction is 65 percent,[10] and in the case of Indian companies it is 60 percent. To encourage investment of corporate savings in high priority industries, the Finance Act, 1975 has provided complete exemption, from the assessment year 1976-77, to inter-corporate dividends if they are received from companies engaged exclusively in the production of fertilisers, pesticides, paper pulp and newsprint and cement.

To encourage philanthropy, donations [11] to approved charitable institutions are granted rebate at the rate of 50 percent in the case of companies and 55 percent for others. The taxation Laws (Amendment) Act, 1975 has made the deduction uniform at 50 percent. The minimum amount of donation should be Rs. 250. While there is no limit for donations to the National Defence Fund, The Jawaharlal Nehru Memorial Fund, The Prime Minister's Drought Relief Fund and the Prime Minister's National Relief Fund, the aggregate of donations should not exceed 10 percent of the aggregate income or Rs. 2 lakhs (1 lakh = 100,000) whichever is less. Approved sports institutions have been brought in this category by the Finance Act, 1973. Recently the quantum of deduction has been raised from 50 percent to 100 percent if donations are made to the Government or approved local authority, institutions and other agencies for promoting family planning.[12]

A number of incentives have been provided to encourage investment especially by lower and middle income groups, dividend income upto Rs. 1,000 from the Unit Trust of India was exempted in 1963. To encourage investment in equity shares of companies, dividend income upto Rs. 500 was exempted by the Finance (No. 2) Act, 1967. This limit was increased to Rs. 1,000

9. Reported in *the Times of India,* March 17, 1976.

10. The Finance Act, 1976 has amended this provision. In the case of foreign companies no deduction will be allowed from the dividend income and such gross dividends will be taxed at the flat rate of 25 percent.

11. The Finance Act, 1976 has made clear that only the donations made in cash (or by cheque, bank deposit etc.) and not in kind will qualify for this tax concession.

12. Reported in *the Times of India* 196, 1976.

by the Finance Act, 1969. The Finance Act, 1970 replaced these separate exemptions by a broader and more liberal provision. Under the new provision deduction is allowed upto Rs. 3,000 per annum in respect of income derived from one or more of the specified categories [13] of investments. To encourage investment in the units of the Unit Trust of India, the Government of India issued a special ordinance on January 7, 1975 providing for a separate exemption of income upto Rs. 2,000 from units.

A scheme of tax-free tax credit certificate was announced by the Finance Minister in December, 1964 for individuals and Hindu undivided families who invested in newly floated equity shares of public limited companies. The certificates were issued at the rate of 5 percent of the first Rs. 15,000, 3 percent of the next Rs. 10,000 and 10 percent of the next Rs. 10,000. Thus, the maximum amount of certificate was Rs. 1250 on a subscription of Rs. 35,000. This was a very low rate of return in view of the fact that no dividend should be expected from an average undertaking for at least 4 or 5 years. Consequently, the scheme was not very popular and was allowed to lapse after March 31, 1970.

New industrial undertakings established after March 31, 1948 are exempt for 5 years from income tax on their profits upto 6 percent of the capital employed. This period is 7 years in the case of undertakings owned by cooperative societies. This concession was extended to new hotels with effect from April 1, 1961 and to cold-storage plants with effect from April 1, 1962. The Finance (No. 2) Act, 1967 made the tax holiday concession more meaningful by allowing carry forward of the deficiency of the tax-holiday profits upto 8 years from the commencement of the business. Dividends paid by a company out of the tax-holiday profits are also exempt from income-tax in the hands of shareholders. The provision of the exemption of dividends out of the tax-holiday profits has involved a lot of administrative work because "any change in the quantum of income of the company distributing profits requires modification of assessments of all shareholders who may be assessed to tax in different places in different charges".[14] Accordingly, the Finance Act, 1975 has withdrawn exemption in respect of such dividends but has increased the exemption in respect of the tax-holiday profit from 6 percent to 7.5 percent. There is a general feeling that the tax-holiday provision has helped the new industrial undertakings by enabling them to make quick recovery of capital, although the number of companies taking advantage of the provision has not been very large in recent years.[15]

On the recommendation of the Taxation Enquiry Commission (1953-54) development rebate was introduced in 1955 at the rate of 25 percent of the cost of new machinery and plant installed after March 31, 1954. The deduction was allowed in the year in which the machinery or plant was

13. These investments are the securities of the Central Government or any State Government, debentures issued by any cooperative society or any other approved institution or authority, deposits under Post Office (Time Deposits) and Post Office (Recurring Deposits), shares in Indian companies, units in the Unit Trust of India, deposits with banking companies or cooperative banks and deposits with the approved financial corporations.

14. Government of India, *Memorandum Explaining the Provisions in the Finance Bill,* 1975, p. 4.

15. In 1971-72, 1080 assessees took advantage of this provision. The amount of deduction in such cases was Rs. 6.6 crores and the tax relief was Rs. 3.6 crores.

installed. As the development rebate was allowed over and above the normal depreciation allowance, it was in the nature of subsidy from the Government to the enterprise. Development rebate enables quick recovery of capital and reduces the effective rate of tax by lowering the tax base. The general rate of development rebate was reduced to 20 percent in 1961.

From 1965 a higher rate of development rebate of 35 percent was granted to priority industries [16] if the machinery or plant was installed upto March 31, 1970. The rate in such cases was 25 percent if the plant or machinery was installed after March 31, 1970. In other cases, the rate was 20 percent for plant or machinery installed upto March 31, 1970 and 15 percent if it was installed after March 31, 1970. Two important conditions were laid down for granting the development rebate. Firstly, 75 percent of development rebate granted should be credited to a separate reserve account which should not be utilised for 8 years for dividend distribution purposes. Secondly, the asset should not be sold or transferred for 8 years except to the Government, local authority etc. Unabsorbed development rebate could be carried forward upto 8 years. In his budget speech (1971-72) the Finance Minister announced the withdrawal of development rebate after May 31, 1974. However, it was continued for another year in cases where the contracts were finalised before December 1, 1973. In view of the oil shortage and steep increase in petroleum prices, the Finance Act, 1974 granted development rebate in respect of coal fired boilers provided they were installed before June 1, 1975. The Finance Act 1975 extended this benefit only in the case of ships provided the ships are acquired upto December 31, 1976.

There is a general feeling that development rebate has a favourable effect on investment, though no separate data are available for revenue loss through development rebate and its effect on investment in new and old enterprises. Whatever little data are available go to show that between 1958-59 and 1963-64 gross asset formation of large and medium public limited companies amounted to about Rs. 170 crores, 50 percent of this was financed by internal resources. This was made possible through development rebate reserve.[17] Even the Deputy Prime Minister and Minister of Finance, Shri Morarji Desai accepted the utility of the development rebate when he observed that, "I have come to the conclusion that the familiar instrument of development rebate need not be abandoned or replaced by fancier alternatives".[18] It is surprising that only after two years, the Finance Minister, without giving any reason, observed that "the practice of offering a development rebate in respect of new investment has had .... a full play".[19] It would have been better if the development rebate, instead of being abolished was granted on a selective basis.[20] The utility of development rebate is proved by the fact that the initial depreciation allowance

16. There are 33 industries in this list. The important among them are: the business of generation or distribution of electricity or any other form of power or construction, manufacture or production of iron and steel, coal, bauxite, manganese ore, tractors, agricultural implements, fertilizers and pesticides, slips etc. or the business of a hotel approved in this behalf by the Central Government.

17. *Economic Survey* (1965-66), p. 31.

18. *Finance Minister's Budget Speech* (1969-70).

19. *Finance Minister's Budget Speech* (1971-72).

20. Cf. Anil Kumar Jain, *Taxation of Income in India,* 1975 p. 128.

of 20 percent, introduced in 1973, in place of the development rebate has been replaced by an investment allowance. For some time past capital costs had sharply increased. Hence, the Finance Minister rightly felt that, "unless the corporate section is enabled to provide adequately for renewals and renovation, employment and industrial growth will be jeopardised. Fiscal policy should therefore be oriented to provide the necessary stimulus for the growth and modernisation of the corporate sector".[21] This new allowance is broadly on the lines of the development rebate except with the difference that it will be granted at the rate of 25 percent of the cost of acquisition of machinery and plant installed after March 31, 1976 and the "investment allowance reserve" has to be utilised for acquiring new ships, aircraft, machinery or plant within a period of 10 years, failing which the allowance will be withdrawn. No part of it can be used for dividend distribution purposes. The list of industries qualifying for investment allowance has been extended by including eight other priority or export oriented industries, namely, carbon and graphite products; inorganic heavy chemicals; organic heavy chemicals; synthetic rubber and rubber chemicals, including carbon black; industrial explosives; basic drugs; industrial sewing machines and finished leather and leather goods, including footwear made wholly or substantially of leather.

Certain incentives have also been granted for the development of particular industries or areas. For example, from the assessment year 1966-67, all domestic companies engaged in priority industries[22] were allowed a deduction of 8 percent of the profits and gains. This deduction was reduced to 5 percent for the assessment year 1972-73 and abolished with effect from April 1, 1973. From the assessment year 1965-66 incomes from livestock breeding or dairy or poultry farming have been enjoying complete exemption from income tax. As this exemption had become a source of converting black money into white the Finance Act, 1976 has limited such exemption upto a maximum of Rs. 10,000. To provide encouragement to the book publishing industry in India, the Taxation Laws (Amendment) Act, 1970 exempted 20 percent of such profits from Income-tax for 5 years. The Finance Act, 1975 has extended this concession for a further period of 5 years. Development allowance is granted, with effect from April 1, 1976 to a taxpayer who plants tea bushes on his own land[23] in India. The allowance is 50 percent if tea bushes are planted for the first time and 30 percent if they are replanted. Expenditure incurred after March 31, 1970 on prospecting etc. of specified minerals is allowed to be amortised in ten equal instalments and set-off against profits from such business. For the assessment year 1966-67 to 1970-71, tax credit certificates of 20 percent of the excess tax liability were granted to companies which were engaged in the production of articles listed in the First Schedule to the Industries (Development and Regulation) Act, 1951.

The Finance Act, 1965 granted tax credit certificates to a public limited company[24] if it shifts its undertaking from urban areas

21. *Finance Minister's Budget Speech* (1976-77).
22. See footnote 16.
23. The Finance Act, 1975 has clarified that this allowance will be admissible (retrospectively, from April 1, 1965) even where the taxpayer holds any lease or other right of occupancy.
24. Extended to all companies with effect from April, 1971.

to other areas. Capital gains received in this process have been exempted. The Finance Minister announced in his Budget Speech for 1973-74 that industries set up in backward areas will have 20 percent of their profits exempt from tax for 10 years. This concession has no income or investment limit and will help in balancing regional development of the country.

Incentives have also been granted to encourage exports, scientific research and agriculture. The Finance Act, 1962 granted a rebate of 10 percent on profits derived from export. The Finance Act, 1965 introduced the tax credit certificates (Exports) scheme under which tax credit certificates upto 15 percent of the value of exports were granted if the sale proceeds were received in accordance with the Foreign Exchange (Regulation) Act, 1947. The Finance Act, 1968 introduced the Export Markets Development Allowance of $1^1/_3$ times the expenditure incurred for the development of export markets for Indian goods. By the Finance Act, 1973 allowance has been increased to $1^1/_2$ times of such expenditure. The business of hotel has been accorded priority industry treatment and is also eligible for tax-holiday benefit. Upto the assessment year 1974-75, exemption was available in respect of dividends or royalties from export of technical knowhow and deduction of 40 percent was available to resident taxpayers in respect of income from providing technical knowhow. Any expenditure incurred on scientific research after April 1, 1967 is allowed to be deducted in full. By the Finance Act, 1973, the quantum of deduction has been increased to $1^1/_3$ times of such expenditure. From the financial year 1968-69 $1^1/_5$ times the expenditure incurred on the supply of agricultural inputs or promotion of agriculture is allowed in the form of Agricultural Development Allowance. Higher development rebate was granted on new equipment installed in certain agricultural spheres. "Priority industry" treatment was accorded to seed processing industry.

In addition to the above mentioned incentives, some incentives have also been incorporated to achieve certain economic and social objectives. Expenditure incurred for promoting family planning amongst employees is deducted in full. Rehabilitation allowance is granted to facilitate reconstruction and revival of business discontinued by natural calamities. Fifty percent of profits of a new undertaking are deducted for 10 years if it employs displaced persons and repatriates from Burma, Ceylon etc. The Finance Act, 1975 has allowed a deduction of Rs. 500 per child (upto a maximum of two children) in respect of expenditure incurred on the education of dependents, provided the "gross total income" of the taxpayer does not exceed Rs. 12,000 per annum. Such deduction has also been allowed in the past. Indian professors, teachers and research workers who go for short duration to foreign universities or other educational institutions are allowed to deduct 50 percent of such remuneration for the first 36 months of their service in such institutions. The idea behind such deduction is to relieve these persons of higher expenditure in foreign countries. These people also bring foreign exchange when they come back because they are able to save money there.

Certain benefits were allowed to salaried people upto the assessment year 1974-75 in that separate deductions were allowed for the purchase of books, travelling for employment etc. From the assessment year 1975-76, all these deductions have been replaced by a standard deduction at the rate of 20 percent of salary income upto

Rs. 10,000 and 10 percent thereafter, subject to a maximum deduction of Rs. 3,500. Any house rent allowance received by an employee from his employer to meet his actual expenses in respect of residential accommodation is exempt from income tax subject to a maximum of Rs. 400 per month.[25]

It is thus clear that a number of incentives have been granted in the Indian tax structure to achieve various objectives. There is a general feeling that incentives for savings have led to increased aggregate savings, though some diversion of savings might have taken place for persons in high income brackets. Investment has also increased. It should, however, be pointed out that "no data have been collected to indicate as to how far these incentives have served the purpose".[26] In the absence of data, only generalizations are possible.

A review of various incentive provisions also shows that they have been changed very frequently depending upon the whims of the Finance Ministers. These frequent changes have created uncertainty in the minds of the taxpayers. Many taxpayers might not have taken full advantage of these incentives. It is, therefore, desired that incentive provisions should be continued for a longer span, unless the circumstances warrant their earlier withdrawal. It is also desired that "a Tax Research Institute should be set up within the Income-tax Department to evaluate the impact of various exemptions and incentives".[27]

25. Prior to the amendment made by the Finance Act, 1975 this limit was Rs. 300 per month.
26. *Direct Taxes Enquiry Committee,* Final Report, 1971, p. 132.
27. Anil Kumar Jain, *Taxation of Income in India, op. cit.,* p. 141.

* * * DOCUMENTS * * *

UNITED STATES

Excise tax imposed on foreign private foundation *

Advice has been requested whether, under the circumstances described below, a Belgian private foundation is subject to the excise tax imposed by section 4948(a) of the Internal Revenue Code of 1954.

M is a private foundation resident in Belgium that receives substantially all of its support, other than gross investment income, from sources outside the United States. *M* does not have a permanent establishment in the United States and, aside from investment activities, is not engaged in business in the United States. During its 1975 taxable year, *M* derived 20*x* dollars of gross investment income consisting of interest from sources within the United States.

Section 4948(a) of the Code provides, in part, that there is imposed for each taxable year on the gross investment income (within the meaning of section 4940(c)(2)) derived from sources within the United States (within the meaning of section 861) by every foreign organization that is a private foundation for the taxable year a tax equal to 4 percent of such income.

Section 4940(c)(2) of the Code provides, in part, with exceptions not relevant here, that the term "gross investment income" includes the gross amount of income from interest.

Section 53.4948-1(a)(3) of the Foundation Excise Tax Regulations provides that whenever there exists a tax treaty between the United States and a foreign country, and a foreign private foundation subject to section 4948(a) of the Code is a resident of such country or is otherwise entitled to the benefits of such treaty (whether or not such benefits are available to all residents), if the treaty provides that any item or items (or all items with respect to an organization exempt from income taxation) of gross investment income (within the meaning of section 4940(c)(2)) shall be exempt from income tax, such item or items shall not be taken into account by such foundation in computing the tax to be imposed under section 4948(a) for any taxable year for which the treaty is effective.

Section 881(a)(1) of the Code imposes a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as interest to the extent such amount is not effectively connected with the conduct of a trade or business within the United States.

Section 894(a) of the Code provides that income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under subtitle A, Chapter 1 of the Code.

Article 11 of the United States-Belgium Income Tax Convention, 1973-1 C.B. 619, (The Belgian Convention), provides, in part, that interest derived from sources within the United States by a resident of Belgium may be taxed by the United States at a rate not exceeding 15 percent.

Article 9(3) of the Treaty of Friendship, Establishment and Navigation with the Kingdom of Belgium, February 21, 1961, T.I.A.S. No. 5432 (effective October 3,

* Revenue Ruling 76-330 published in Internal Revenue Bulletin 1976-35, 15 (August 30, 1976).

1963) (Belgian F.E.N. Treaty) provides, in part, that companies of Belgium that are not engaged in trade or other gainful pursuit within the territories of the United States, shall not be subject, within the territories of the United States, to the payment of taxes, fees, or charges imposed upon or applied to income, capital, transactions, activities, or any other object, or to requirements with respect to the levy and collection thereof, more burdensome than those borne by companies of any third country.

Article 9(5) of the Belgian F.E.N. Treaty provides, in part, that the provisions of Article 9 shall not obligate the United States to extend to Belgian companies tax advantages accorded to companies of any third country by virtue of agreements for the avoidance of double taxation.

Income tax conventions (agreements for the avoidance of double taxation) with countries *X* and *Y* exempt interest income of corporations resident in *X* and *Y* from income taxation.

The specific question presented in the instant case is whether either (1) the Belgian Convention, or (2) the Belgian F.E.N. Treaty, requires that interest income of a Belgian private foundation be exempt from tax. If so, under section 53.4948-1 (a)(3) of the regulations, these items would not be taken into account by the private foundation in computing the tax imposed by section 4948(a) of the Code.

As described above, the Belgian Convention reduces the tax rate on interest derived by a Belgian corporation from sources in the United States from 30 percent, as specified in section 881(a)(1) of the Code, to 15 percent. This reduction of the applicable rate is not an exemption of such items from tax.

Similarly, the Belgian F.E.N. Treaty does not exempt interest income of a Belgian corporation from tax since the income tax conventions with countries *X* and *Y*, which, exempt such income of corporations resident in *X* and *Y*, are agreements for the avoidance of double taxation.

Accordingly, because neither the Belgian Convention nor the Belgian F.E.N. Treaty exempt *M*'s investment income from income taxation, section 53.4948-1(a)(3) of the regulations does not operate to exempt such income from the tax imposed by section 4948(a) of the Code.

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Study on joint ventures of multinationals interviewed in the German Federal Republic, U.S.A., United Kingdom, France, India, Italy, the Netherlands and Switzerland with emphasis on developing countries practice. (B 9888)

PUBLIC FINANCE IN DEVELOPING COUNTRIES

By A. R. Prest. London, Weidenfeld and Nicolson, 1975. 208 pp., £ 6.50.
Third edition revising the study which examines the final problems of the developing countries. (B 9866)

EASTERN EUROPE

EAST-WEST TRADE

A Source Book on the International Economic Relations of Socialist Countries and their Legal Aspects. Compiled and edited by Dietrich André Loeber. Volume I. New York, Oceana Publications, Inc., 1976. 424 pp., $ 37.50.
First volume of an annotated collection of documents on the international economic relations of socialist countries, e.g. foreign trade systems, intellectual property, financial and credit relations etc. The entire series is projected at 6-7 volumes. (B 9899)

EUROPEAN ECONOMIC COMMUNITY

COMMUNAUTAIRE CONTROLE

Het toezicht in de Europese Gemeenschappen op de naleving van de verdragsverplichtingen door de Lid-Staten. By H. A. H. Audretsch. Deventer, Kluwer, 1975. 229 pp.
Thesis on control in the European Economic Community with respect to observance of agreements by member states. A summary in French is appended. (B 9940)

INTRODUCTION TO THE LAW AND INSTITUTIONS OF THE EUROPEAN COMMUNITIES

2nd Edition. By D. Lasok and J. W. Bridge. London, Butterworths, 1976. 370 pp., £ 9.80.
Revised second edition of introductory textbook primarily intended to deal in some detail with the genesis, nature and general principles of Community Law and with Community institutions. (B 9879)

TECHNICAL AND ADMINISTRATIVE OBSTACLES TO TRADE IN THE EEC

Including a comparison with interstate trade barriers in the USA.
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A SIMPLE GUIDE TO YOUR TAX PROBLEMS

Suva, Commissioner of Inland Revenue, 1976. 34 pp. (B 50.464)

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Traité pratique de la fiscalité française, et plus particulièrement des impôts dus par les entreprises. 8e Edition entièrement revue et mise à jour au 1er septembre 1976. By C. Gambier. Paris, Editions Francis Lefebvre, 1976. 489 pp., Ffrs. 76.—.
Eighth revised and updated edition of introductory textbook on taxation in France. The material is dealt with up to September 1, 1976. (B 9965)

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XXIe Rapport. Conseil de Direction du Fonds de Développement Economique et Social. Paris, Government Printer, 1976. 214 pp.
Report of the Conseil de Direction du Fonds de Développement Economique et Social containing inter alia, information on the development and financing of private and public investment. (B 9964)

GERMANY (FEDERAL REPUBLIC)

ABGABENORDNUNG 1977

By K. H. Mittelsteiner und H. Schaumburg. Cologne, Peter Deubner Verlag, 1976. 476 pp., DM 49.80.
Annotated text of the 1977 Fiscal Code designed as a handbook on the changes in the general tax law in West Germany as of January 1, 1977. Parliamentary documents to each provision are annexed. (B 9869)

GRUNDSÄTZE ORDNUNGSMÄSSIGER BILANZIERUNG FÜR RÜCKSTELLUNGEN

By G. Eifler. Schriften der Schmalenbach-Gesellschaft, Band 5. Düsseldorf, IdW Verlag, 1976. 236 pp., DM 35.—.
Monograph forming part of a series which studies the basic principles of drafting the balance sheet in the proper way; the present work emphasizes reserves and liability provisions. (B 9948)

VERÄUSSERUNGSGEWINNE IM EINKOMMENSTEUERRECHT

5. Auflage. By E. Kobs. Herne/Berlin, Verlag Neue Wirtschafts-Briefe, 1974. 272 pp., DM 54.—.
Monograph on the income tax treatment of capital gains under German law, inclusive a discussion of tax privileges in this report. (B 9829)

GUERNSEY

INCOME TAXES OUTSIDE THE UNITED KINGDOM: GUERNSEY 1973 TO 1975

Compiled by direction of the Board of Inland Revenue. London, Her Majesty's Stationery Office, 1976. Volume I, Group 2, 34 pp.
Booklet on Guernsey from the revised Income Taxes Outside the United Kingdom series describing the taxes on income and capital gains of individuals and companies. In addition net wealth tax, if levied, plus a list of double taxation treaties, if concluded, will be appended. (B 9958)

HONG KONG

INCOME TAXES OUTSIDE THE UNITED KINGDOM: HONG KONG 1972-73 TO 1975-76

Compiled by direction of the Board of Inland Revenue, London, Her Majesty's Stationery Office, 1976. Volume 5, Group 12, 28 pp.
Booklet on Hong Kong from the revised Income Taxes Outside the United Kingdom series describing the taxes on income and capital gains of individuals and companies. In addition net wealth tax, if levied, and a list of double taxation treaties, if concluded, will be appended. (B 50.576)

INDIA

TAXES AND INCENTIVES 1976-77

A guide for investors. New Delhi, Indian Investment Centre, 1976. 173 pp., Rs. 12.—.
Tenth edition of publication which duly incorporates the changes made by the Finance Act, 1976 to provide information in respect of matters pertaining to income tax payable by individuals and corporations in India. Text of relevant statutes and circulars in connection thereto is appended. (B 50.494)

INTERNATIONAL

LAW AND POLICY OF INTERGOVERNMENTAL PRIMARY COMMODITY AGREEMENTS

Volumes I and II. By C. R. Johnston Jr. New York, Oceana Publications, Inc., 1976.
Loose-leaf publication containing text of intergovernmental primary commodity agreements with an introduction thereto. (B 9942)

LES SYNDICATS MULTINATIONAUX

Les structures et les politiques syndicales au niveau européen et international; les stratégies adoptées à l'égard des sociétés multinationales. By R. Miotto. Rome, Istituto per l'Economia Europea, 1976. 174 pp.
Study on the workers' associations in the world with emphasis on the European Economic Community. (B 9842)

STATISTICAL PROBLEMS OF MERGED DATA FILES

By J. B. Kadane. OTA Paper 6, December 12, 1975. Washington, Office of Tax Analysis, U.S. Treasury Department, 1976. 14 pp.
Study by staff members in the Office of Tax Analysis, Department of the Treasury. (B 9813)

STEUERLICHE VERRECHNUNGSPREISE IN INTERNATIONALEN KONZERNEN

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ISRAEL

IMPORT OF SERVICES TAX; FOREIGN TRAVEL TAX

By G. Alon. Haifa, Gabriel Alon Publications, 1976. 20 pp. (B 50.495)

VALUE ADDED TAX LAW 1976

Published in Statute Book No. 791 of 6.1.1976, p. 52. Translated by Gabriel Alon. Haifa, Gabriel Alon Publications, 1976. 92 pp., $ 15.—. (B 50.511)

ITALY

CODICE I.V.A.

Volumes I and II. By G. Acampora. Rome, Casa Editrice Stamperia Nazionale, 1974. 582 + 1322 pp.
Publication in two volumes, containing text of the Value Added Tax Law, parliamentary papers, ministerial decrees, administrative rulings and circulars, case law, etc. with respect to the value added tax. (B 9856)

L'EVASIONE NEL SISTEMA IMPOSITIVO SUL VALORE AGGIUNTO

By G. Acampora. Rome, Giovanni Acampora, 1975. 30 pp.
The evasion of value added tax. (B 9850)

I.V.A.

Milan, Banco Commerciale Italiana, 1976. 1251 pp.
Consolidated text of the value added tax as amended and converted by law of May 10, 1976 No. 249 with annotations of implementing provisions and related by-laws in connection thereto. Appended are the English, German and French translations of the basic consolidated text of the value added tax. (B 9890)

JAPAN

ECONOMIC RELATIONS BETWEEN JAPAN AND THE ARAB COUNTRIES AND IRAN

The Economic Research Institute for the Middle East. BfA-Dokument No. 353/76. (Stand: Dezember 1975). Cologne, Bundesstelle für Aussenhandelsinformation, 1976. 114 pp.
Study consisting of the following chapters: Trade between Japan and the Arab countries; Middle East Imports and Japan's Export to that area, 1970-1974; Japan's economic cooperation, development aid and investment in the Middle and Near East; Recycling of the Petro-dollars into Japan. (B 50.524)

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Compiled by direction of the Board of Inland Revenue. London, Her Majesty's Stationery Office, 1976. Volume 5, Group 12, 35 pp.
Booklet on Japan from the revised Income Taxes Outside the United Kingdom series describing the taxes on income and capital gains of individuals and companies. In addition net wealth tax, if levied, and a list of double taxation treaties, if concluded, will be appended. (B 50.578)

STATISTICAL HANDBOOK OF JAPAN 1976

Tokyo, Bureau of Statistics, Office of the Prime Minister, 1976. 162 pp.
Statistical information on Japan with a short descriptive text and photographs. (B 50.561)

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Compiled by direction of the Board of Inland Revenue. London, Her Majesty's Stationery Office, 1976. Volume 1, Group 2, 23 pp.
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KENYA

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Compiled by direction of the Board of Inland Revenue. London, Her Majesty's Stationery Office, 1976. Volume 3, Group 8, 39 pp.
Booklet on Kenya from the revised Income Taxes Outside the United Kingdom series describing the taxes on income and capital gains of individuals and companies. In addition net wealth tax, if levied, and a list of double taxation treaties, if concluded, will be appended. (B 10.756)

KOREA (SOUTH)

THE KOREAN ECONOMY

Growth, equity and structural change. Seoul, Economic Planning Board, 1976. 36 pp.
Paper designed to review Korea's growth and evolving economic structure and to assess the relationship of this growth and structural change in improving the pattern of employment, sectoral development and rural-urban balance and the rising standard of living of its citizens. (B 50.582)

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Seoul, Economic Planning Board, 1975. 75 pp.
Information guide for doing business in the Republic of Korea. (B 50.551)

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1975-II. Seoul, Economic Planning Board, 1975. 63 pp.
Revised and updated guide describing national and local taxes levied in Korea with emphasis on the taxes on foreign investors. (B 50.562)

LATIN AMERICA

PAPERS AND PROCEEDINGS OF THE THIRD GENERAL ASSEMBLY HELD IN MEXICO FROM MAY 10—16, 1969

Revised English version by María Carolina Bellagamba. Panama, Inter-American Center of Tax Administrators, 1974. 178 pp.
The following main topics are covered: I - Planning in tax administration; II - Budget programming in tax administration; III - Bridging the gap between tax policy planning and planning for tax administration: some aspects of the Philippines experience; IV - Tax audit in Japan: development and present situation of income tax administration; V - Operational planning. (B 15.583)

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Revised English version by María Carolina Bellagamba. Panama, Inter-American Center of Tax Administrators, 1974. 325 pp.
The following main topics are covered: I - Present status of treaties to avoid double taxation; II - Present status of comparative legislation on sales tax; III - Value added tax: administrative problems involved in the transition from a single stage or turnover tax to value added tax; IV - Treatment of small taxpayers; V - Sales tax audit; VI - Taxpayer education; VII - Regulations and rulings: their contribution to improved tax administration in the United States; VIII - Taxpayer assistance. (B 15.584)

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Revised English version by María Carolina Bellagamba. Panama, Inter-American Center of Tax Administrators, 1973. 389 pp.
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LIBYA

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First booklet on Libya from the revised Income Taxes Outside the United Kingdom series describing the taxes on income and capital gains of individuals and companies. In addition net wealth tax, if levied, and a list of double taxation treaties, if concluded, will be appended. (B 10.757)

LIECHTENSTEIN

STEUERN IN LIECHTENSTEIN

By E. L. Hilti and R. H. Melliger. Vaduz, Eduard Hilti Treuhand Aktiengesellschaft, 1976.
Loose-leaf publication containing an explanation survey of the taxes levied in Liechtenstein. Texts of the tax statutes and concluded double taxation treaties are appended. The material will be updated as the need arises. (B 9860)

MALAYSIA

INCOME TAXES OUTSIDE THE UNITED KINGDOM: MALAYSIA 1972 TO 1974

Compiled by direction of the Board of Inland Revenue. London, Her Majesty's Stationery Office, 1976. Volume 5, Group 12, 35 pp.
Booklet on Malaysia from the revised Income Taxes Outside the United Kingdom series describing the taxes on income and capital gains of individuals and companies. In addition net wealth tax, if levied, and a list of double taxation treaties, if concluded, will be appended. (B 50.577)

MAURITIUS

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Compiled by direction of the Board of Inland Revenue. London, Her Majesty's Stationery Office, 1976. Volume 14, Group 11, 31 pp.
Booklet on Mauritius from the revised Income Taxes Outside the United Kingdom series describing the taxes on income and capital gains of individuals and companies. In addition net wealth tax, if levied, and a list of double taxation treaties, if concluded, will be appended. (B 10.758)

MOROCCO

FISCALITE DES ENTREPRISES

Série Maroc, Edition 1976. Paris, Editions EURAFRICAINES, 1976. 38 pp.
Entitled "Taxation of Corporations" this booklet explains all the taxes a corporation may pay in Morocco such as registration duty, stamp duty, income tax, dividend tax, turnover tax.
(B 10.752)

LES CODES MAROCAINS DES INVESTISSEMENTS ET LES GARANTIES AUX INVESTISSEURS ETRANGERS

Série Maroc, Editions 1976. Paris, Editions EURAFRICAINES, 1976. 22 pp.
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NAURU CORPORATION LEGISLATION

Nauru, Government Printer, 1976. 305 pp., A$ 15.—.
Text of the Nauru Corporation Act 1972 as amended with regulations and other statutes in connection thereto. (B 50.558)

NETHERLANDS

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Thesis on income taxation of corporations in the Netherlands in comparison with German Federal Republic tax law. German translation of relevant Dutch tax statute is appended. (B 9845)

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Pamphlet prepared by the Council for Medium- and Small Enterprises in The Hague, No. 2, of a series entitled "Short Advices and Notes III". Subjects considered are such as: social insurance for free professions, introduction of a minimum capital in case of establishing a public company and a private company. (B 9918)

VERMOGENSAANWASDELING (VAD)

Een verkenning in het randgebied van belastingheffing en eigendomsbescherming. By P. den Boer. Geschriften van de Vereniging voor Belastingwetenschap, No. 143. Deventer, Kluwer, 1976. 36 pp.
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O. E. C. D.

OCCASIONAL STUDIES

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Contains the following assessments: Income Distribution in OECD countries by Malcolm Sawyer and Public Sector Balances by Mark Wasserman. (B 9819)

INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES

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Text of the Declaration by the Governments of O.E.C.D. member countries and Decisions of the O.E.C.D. Council on Guidelines for Multinational Enterprises, National Treatment, International Investment Incentives and Disincentives, Consultation Procedures. (B 9843)

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The present Pakistan Economic Survey 1975-76 presents an analysis of the performance of the national economy during the first three quarters of the fiscal year 1975-76. (B 50.553)

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The present 13th edition covers the period upto June 1975. (B 50.552)

PHILIPPINES

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3rd Annual report. Manila, National Tax Research Center, 1975. 39 pp.
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POLAND

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By T. Pusylewitsch. Schriftenreihe zur Rechtsstellung des Ausländers in den sozialistischen Staaten, Band 3. Baden-Baden, Nomos Verlagsgesellschaft, 1976. 282 pp., DM 72.—.
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Summary text and German translation of the Portugese law to regulate foreign investment in Portugal's industry.

ROMANIA

DIE RECHTSSTELLUNG DES AUSLÄNDERS IN RUMÄNIEN

By G. Tontsch. Schriftenreihe zur Rechtsstellung des Ausländers in den sozialistischen Staaten, Band 2. Baden-Baden, Nomos Verlagsgesellschaft, 1975. 242 pp., DM 60.—.
Monograph explaining the legal position of nonresidents in Romania. Civil law, criminal law, procedural law, trade law, tax law, etc. A translation in German of these laws is annexed.
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Investment Services Division, Economic Development Board, Singapore, 1975. 8 pp.
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SOUTH AFRICA

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SUMMARY RECORD OF THE INVESTMENT CONFERENCE OF SEAPCENTRE HELD FROM APRIL 21—22, 1975 IN TOKYO, JAPAN

Tokyo, Southeast Asian Promotion Centre for Trade, Investment and Tourism (SEAPCENTRE), 1975. 71 pp.
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SWEDEN

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SWITZERLAND

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Einführung in das System der Schweizer Mehrwertsteuer mit typischen Buchungsbeispielen. By T. Gimmy. Wiesbaden, Betriebswirtschaftlicher Verlag Th. Gabler, 1975. 52 pp., DM 7.80.
Explanation to the contemplated value added tax system for Switzerland illustrated with examples. (B 9949)

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Prepared by the Eidgenössische Steuerverwaltung/l'Administration fédérale des contributions. Statistische Quellenwerke der Schweiz - Heft 568/Statistiques de la Suisse - 568e fascicule. Bern, Eidgenössisches Statistisches Amt, 1976. 99 pp.
Statistical survey of the taxes levied by the various cantons with respect to taxes on income and capital of individuals and corporations.
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THE REVENUE CODE AS AMENDED UP TO MARCH 1975

Decrees - Regulations - Notifications. Compiled and translated by V.T. Associates. Bangkok, Nai Pinyo Leowrug-o-lan, 1975. 233 pp.
English version of the consolidated text of the Thai Revenue Code as amended up to March, 1975. Decrees, regulations, notifications in connection thereto are appended. (B 50.574)

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Zusammenfassung der gesetzlichen Bestimmungen für Investition und Handel. Frankfurt, Thai Trade and Investment Center, 1976. 70 pp.
Guide for foreign investors on current laws and practices concerning investments, alien business law, taxation, and company law as of February 1, 1976. (B 50.484)

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SOME ECONOMIC PRINCIPLES OF ACCOUNTING

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U. S. S. R.

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Loose-leaf binder dealing in detail with the discussions of the various aspects of doing business with the USSR, such as data on the Soviet economy, foreign trade system, financing, selling licenses (including a chapter on taxes on royalties and fees), cooperation agreements, etc. The binder forms part of a series of 10 binders covering other East-European countries. (B 9913)

U. S. A.

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16th Edition. Chicago, Commerce Clearing House, Inc., 1976. 392 pp., $ 8.50.
Easy reference guide providing detailed information on problematic questions of the complex relationships between the employees and labor unions. (B 9915)

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Convention between the Government of the Republic of Singapore and the Royal Government of Thailand for the avoidance of double taxation and the prevention of fiscal evasion with respect to the taxes on income.

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Convention between the United States of America and the Republic of Korea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and the Encouragement of International Trade and Investment.

ABKOMMEN
Zwischen der Republik Österreich und der Ungarischen Volksrepublik zur Vermeidung der Doppelbesteuerung auf dem Gebiete der Steuern vom Einkommen, Ertrag und vom Vermögen

SUPPLEMENT TO THE BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION
AU BULLETIN DE DOCUMENTATION FISCALE INTERNATIONALE

Vol. XXX, No. 2, February/février 1976

INTERNATIONAL BUREAU
OF FISCAL DOCUMENTATION

Muiderpoort - 124 Sarphatistraat - Amsterdam

A double taxation treaty was signed between Austria and Hungary on February 25, 1975. It is subject to ratification before entering into force. In accordance with Article 27 the treaty shall enter into force sixty days following the date on which the Contracting States have exchanged the instruments of ratification.

TEXT

Die Republik Österreich und die Ungarische Volksrepublik, von dem Wunsche geleitet, die Doppelbesteuerung auf dem Gebiete der Steuern vom Einkommen, Ertrag und vom Vermögen zu vermeiden, sind übereingekommen, das folgende Abkommen abzuschliessen:

Artikel 1
Persönlicher Anwendungsbereich

Dieses Abkommen gilt für Personen, die in einem Vertragstaat oder in beiden Vertragstaaten ansässig sind.

Artikel 2
Unter das Abkommen fallende Steuern

(1) Dieses Abkommen gilt für Steuern, die nach der Gesetzgebung jedes der beiden Vertragstaaten unmittelbar vom Einkommen, Ertrag und vom Vermögen für die Vertragstaaten oder ihre Gebietskörperschaften erhoben werden.

(2) Steuern im Sinne dieses Abkommens sind:
1. in der Ungarischen Volksrepublik:
a) die allgemeine Einkommensteuer;

b) die Einkommensteuer der eine geistige Tätigkeit ausübenden Personen;

c) die Einkommensteuer der landwirtschaftlichen Bevölkerung;

d) die Gewinnsteuer und betriebliche Sondersteuer;

e) die Gewinnsteuer der wirtschaftlichen Assoziationen mit ausländischer Beteiligung;

f) die Haussteuer;

g) die Hauswertsteuer;

h) die Grundsteuer;

i) der Beitrag zur Förderung des Wachstums der Gemeinden;

j) die Gebühr für die Dividenden- und Gewinnauszahlungen der Handelsgesellschaften.

2. in der Republik Österreich:

a) die Einkommensteuer;

b) die Körperschaftsteuer;

c) die Aufsichtsratsabgabe;

d) die Vermögensteuer;

e) die Abgabe von Vermögen, die der Erbschaftssteuer entzogen sind;

f) die Gewerbesteuer einschliesslich der Lohnsummensteuer;

g) die Grundsteuer;

h) die Abgabe von land- und forstwirtschaftlichen Betrieben;

i) die Beiträge von land- und forstwirtschaftlichen Betrieben zum Ausgleichsfonds für Familienbeihilfen;

j) die Abgabe vom Bodenwert bei unbebauten Grundstücken.

(3) Das Abkommen ist auf jede andere ihrem Wesen nach gleiche oder ähnliche Steuer anzuwenden, die nach seiner Unterzeichnung in einem der Vertragstaaten neben den zur Zeit bestehenden Steuern oder an deren Stelle eingeführt wird.

Artikel 3
Allgemeine Definitionen

(1) Im Sinne dieses Abkommens, wenn der Zusammenhang nichts anderes erfordert:

a) umfasst der Ausdruck „Person" natürliche und juristische Personen;

b) bedeuten die Ausdrücke „Unternehmen eines Vertragstaates" und „Unternehmen des anderen Vertragstaates", je nachdem, ein Unternehmen, das von einer in einem Vertragstaat ansässigen Person betrieben wird, oder ein Unternehmen, das von einer in dem anderen Vertragstaat ansässigen Person betrieben wird;

c) bedeutet der Ausdruck „zuständige Behörde"

1. in der Ungarischen Volksrepublik: den Finanzminister,

2. in der Republik Österreich: den Bundesminister für Finanzen.

(2) Bei Anwendung des Abkommens durch einen Vertragstaat hat, wenn der Zusammenhang nichts anderes erfordert, jeder nicht anders definierte Ausdruck die Bedeutung, die ihm nach dem Recht dieses Staates über die Steuern zukommt, welche Gegenstand des Abkommens sind.

Artikel 4
Steuerlicher Wohnsitz

(1) Im Sinne dieses Abkommens bedeutet der Ausdruck „eine in einem Vertragstaat ansässige Person" eine Person, die nach dem Recht dieses Staates dort auf Grund ihres Wohnsitzes, ihres ständigen Aufenthaltes, des Ortes ihrer Geschäftsleitung oder eines anderen ähnlichen Merkmals steuerpflichtig ist.

(2) Ist nach Absatz 1 eine natürliche Person in beiden Vertragstaaten ansässig, so gilt folgendes:

a) die Person gilt als in dem Vertragstaat ansässig, in dem sie über eine ständige Wohnstätte verfügt. Verfügt sie in beiden Vertragstaaten über eine ständige Wohnstätte, so gilt sie als in dem Vertragstaat ansässig, zu dem sie die engeren familiären und wirtschaftlichen Beziehungen hat (Mittelpunkt der Lebensinteressen).

b) Kann nicht bestimmt werden, in welchem Vertragstaat die Person den Mittelpunkt der Lebensinteressen hat, oder verfügt sie in keinem der Vertragstaaten über eine ständige Wohnstätte, so gilt sie als in dem Vertragstaat ansässig, in dem sie ihren gewöhnlichen Aufenthalt hat.

c) Hat die Person ihren gewöhnlichen Aufenthalt in beiden Vertragstaaten oder in keinem der Vertragstaaten, so gilt sie als in dem Vertragstaat ansässig, dessen Staatsangehörigkeit sie besitzt.

d) Besitzt die Person die Staatsangehörigkeit beider Vertragstaaten oder keines Vertragstaates, so werden die Vertragstaaten gemäss Artikel 24 vorgehen.

(3) Ist nach Absatz 1 eine andere als eine natürliche Person in beiden Vertragstaaten ansässig, so gilt sie als in dem Vertragstaat ansässig, in dem sie auf Grund ihres Sitzes steuerpflichtig ist.

Artikel 5

Betriebstätte

(1) Im Sinne dieses Abkommens bedeutet der Ausdruck „Betriebstätte" eine feste Geschäfts- oder Produktionseinrichtung, in der die Tätigkeit des Unternehmens ganz oder teilweise ausgeübt wird.

(2) Der Ausdruck „Betriebstätte" umfasst insbesondere:

a) einen Ort der Leitung,
b) eine Zweigniederlassung,
c) eine Geschäftsstelle,
d) eine Fabrikationsstätte,
e) eine Werkstätte,
f) eine Bergwerk, einen Steinbruch oder eine andere Stätte der Ausbeutung von Bodenschätzen,
g) eine Bauausführung oder Montage, deren Dauer zwei Jahre überschreitet.

(3) Als Betriebstätten gelten nicht:

a) Einrichtungen, die ausschliesslich zur Lagerung, Ausstellung oder Auslieferung von Gütern oder Waren des Unternehmens benutzt werden;

b) Bestände von Gütern oder Waren des Unternehmens, die ausschliesslich zur Lagerung, Ausstellung oder Auslieferung unterhalten werden;

c) Bestände von Gütern oder Waren des Unternehmens, die ausschliesslich zu dem Zweck unterhalten werden, durch ein anderes Unternehmen bearbeitet oder verarbeitet zu werden;

d) eine feste Geschäftseinrichtung, die ausschliesslich zu dem Zweck unterhalten wird, für das Unternehmen Güter oder Waren einzukaufen oder Informationen zu beschaffen;

e) eine feste Geschäftseinrichtung, die ausschliesslich zu dem Zweck unterhalten wird, für das Unternehmen zu werben, Informationen zu erteilen, wissenschaftliche Forschung zu betreiben oder ähnliche Tätigkeiten auszuüben, die vorbereitender Art sind oder eine Hilfstätigkeit darstellen.

(4) Ist eine Person — mit Ausnahme eines unabhängigen Vertreters im Sinne des Absatzes 5 — in einem Vertragstaat für ein Unternehmen des anderen Vertragstaates tätig, so gilt eine in dem erstgenannten Staat gelegene Betriebstätte als gegeben, wenn die Person eine Vollmacht besitzt, im Namen des Unternehmens Verträge abzuschliessen, und die Vollmacht in diesem Staat gewöhnlich ausübt, es sei denn, dass sich ihre Tätigkeit auf den Einkauf von Gütern oder Waren für das Unternehmen beschränkt.

(5) Ein Unternehmen eines Vertragstaates wird nicht schon deshalb so behandelt, als habe es eine Betriebstätte in dem anderen Vertragstaat, weil es dort seine Tätigkeit durch einen Makler, Kommissionär oder einen anderen unabhängigen Vertreter ausübt, sofern diese Personen im Rahmen ihrer ordentlichen Geschäftstätigkeit handeln.

(6) Allein dadurch, dass eine in einem Vertragstaat ansässige juristische Person eine juristische Person beherrscht oder von einer juristischen Person beherrscht wird, die in dem anderen Vertragstaat ansässig ist oder dort (entweder durch eine Betriebstätte oder in anderer Weise) ihre Tätigkeit ausübt, wird eine der beiden juristischen Personen nicht zur Betriebstätte der anderen.

Artikel 6

Einkünfte aus unbeweglichem Vermögen

(1) Einkünfte aus unbeweglichem Vermögen dürfen in dem Vertragstaat besteuert werden, in dem dieses Vermögen liegt.

(2) Der Ausdruck „unbewegliches Vermögen" bestimmt sich nach dem Recht des Vertragstaates, in dem das Vermögen liegt. Der Ausdruck umfasst in jedem Fall das Zubehör zum unbeweglichen Vermögen, das lebende und tote Inventar land- und forstwirtschaftlicher Betriebe, die Rechte, auf die die Vorschriften des Privatrechts über Grundstücke Anwendung finden, die Nutzungsrechte an unbeweglichem Vermögen sowie die Rechte auf veränderliche oder feste Vergütungen für die Ausbeutung oder das Recht auf Ausbeutung von Mineralvorkommen, Quellen und anderen Bodenschätzen; Schiffe und Luftfahrzeuge gelten nicht als unbewegliches Vermögen.

(3) Absatz 1 gilt für Einkünfte aus der unmittelbaren Nutzung, der Vermietung oder Verpachtung sowie jeder anderen Art der Nutzung unbeweglichen Vermögens.

(4) Die Absätze 1 und 3 gelten auch für Einkünfte aus unbeweglichem Vermögen eines Unternehmens und für Einkünfte aus unbeweglichem Vermögen, das der Ausübung eines freien Berufes dient.

Artikel 7

Unternehmensgewinne

(1) Gewinne eines Unternehmens eines Vertragstaates dürfen nur in diesem Staat besteuert werden, es sei denn, dass das Unternehmen seine Tätigkeit im anderen Vertragstaat durch eine dort gelegene Betriebstätte ausübt. Übt das Unternehmen seine Tätigkeit in dieser Weise aus, so dürfen die Gewinne des Unternehmens in dem anderen Staat besteuert werden, jedoch nur insoweit, als sie dieser Betriebstätte zugerechnet werden können.

(2) Übt ein Unternehmen eines Vertragstaates seine Tätigkeit in dem anderen Vertragstaat durch eine dort gelegene Betriebstätte aus, so sind in jedem Vertragstaat

dieser Betriebstätte die Gewinne zuzurechnen, die sie hätte erzielen können, wenn sie eine gleiche oder ähnliche Tätigkeit unter gleichen oder ähnlichen Bedingungen als selbständiges Unternehmen ausgeübt hätte und im Verkehr mit dem Unternehmen, dessen Betriebstätte sie ist, völlig unabhängig gewesen wäre.

(3) Bei der Ermittlung der Gewinne einer Betriebstätte werden die für diese Betriebstätte entstandenen Aufwendungen einschliesslich der Geschäftsführungs- und allgemeinen Verwaltungskosten zum Abzug zugelassen, gleichgültig, ob sie in dem Staat, in dem die Betriebstätte liegt, oder anderswo entstanden sind.

(4) Auf Grund des blossen Einkaufs von Gütern oder Waren für das Unternehmen wird einer Betriebstätte kein Gewinn zugerechnet.

(5) Gehören zu den Gewinnen Einkünfte, die in anderen Artikeln dieses Abkommens behandelt werden, so werden die Bestimmungen jener Artikel durch die Bestimmungen dieses Artikels nicht berührt.

(6) Die Bestimmungen dieses Artikels sind auch auf Gewinnanteile aus einer Beteiligung als stiller Gesellschafter an einem Unternehmen anzuwenden.

Artikel 8
Schiffahrt und Luftfahrt

(1) Eine in einem Vertragstaat ansässige Person darf mit Gewinnen aus dem Betrieb von Seeschiffen oder Luftfahrzeugen im internationalen Verkehr nur in diesem Vertragstaat besteuert werden.

(2) Eine in einem Vertragstaat ansässige Person darf mit Gewinnen aus dem Betrieb von Binnenschiffen im internationalen Verkehr nur in diesem Vertragstaat besteuert werden.

(3) Die Absätze 1 und 2 gelten auch, wenn das Unternehmen im Gebiet des anderes Staates eine Agentur für die Beförderung von Personen oder Waren betreibt. Dies gilt jedoch nur für Tätigkeiten, die unmittelbar mit der Luftfahrt und Schiffahrt, einschliesslich des Zubringerdienstes zusammenhängen.

(4) Die Bestimmungen dieses Artikels gelten auch für Beteiligungen von Unternehmen der Luftfahrt an einer Betriebsgemeinschaft, unabhängig davon, ob der Verkehr mit eigenen oder gecharterten Fahrzeugen durchgeführt wird.

Artikel 9
Verbundene Unternehmen

Wenn

a) ein Unternehmen eines Vertragstaates unmittelbar oder mittelbar an der Geschäftsleitung, der Kontrolle oder am Kapital eines Unternehmens des anderen Vertragstaates beteiligt ist, oder

b) dieselben Personen unmittelbar oder mittelbar an der Geschäftsleitung, der Kontrolle oder am Kapital eines Unternehmens eines Vertragstaates und eines Unternehmens des anderen Vertragstaates beteiligt sind,

und in diesen Fällen zwischen den beiden Unternehmen hinsichtlich ihrer kaufmännischen oder finanziellen Beziehungen Bedingungen vereinbart oder auferlegt werden, die von denen abweichen, die unabhängige Unternehmen miteinander vereinbaren würden, so dürfen die Gewinne, die eines der Unternehmen ohne diese Bedingungen erzielt hätte, wegen dieser Bedingungen aber nicht erzielt hat, den Gewinnen dieses Unternehmens zugerechnet und entsprechend besteuert werden.

Artikel 10

Dividenden

(1) Dividenden, die eine in einem Vertragstaat ansässige juristische Person an eine in dem anderen Vertragstaat ansässige Person zahlt, dürfen in dem anderen Staat besteuert werden.

(2) Diese Dividenden dürfen jedoch in dem Vertragstaat, in dem die die Dividenden zahlende juristische Person ansässig ist, nach dem Recht dieses Staates besteuert werden; die Steuer darf aber 10 vom Hundert des Bruttobetrages der Dividenden nicht übersteigen.
Dieser Absatz berührt nicht die Besteuerung der juristischen Person in bezug auf die Gewinne, aus denen die Dividenden gezahlt werden.

(3) Der in diesem Artikel verwendete Ausdruck „Dividenden" bedeutet Einkünfte aus Aktien, Genussaktien oder Genussscheinen, Kuxen, Gründeranteilen oder anderen Rechten — ausgenommen Forderungen — mit Gewinnbeteiligung sowie aus sonstigen Gesellschaftsanteilen stammende Einkünfte, die nach dem Steuerrecht des Staates, in dem die ausschüttende juristische Person ansässig ist, den Einkünften aus Aktien gleichgestellt sind.

(4) Die Absätze 1 und 2 sind nicht anzuwenden, wenn der in einem Vertragstaat ansässige Empfänger der Dividenden in den anderen Vertragstaat, in dem die die Dividenden zahlende juristische Person ansässig ist, eine Betriebstätte hat und die Beteiligung, für die die Dividenden gezahlt werden, tatsächlich zu dieser Betriebstätte gehört. In diesem Fall ist Artikel 7 anzuwenden.

(5) Bezieht eine in einem Vertragstaat ansässige juristische Person Gewinne oder Einkünfte aus dem anderen Vertragstaat, so darf dieser andere Staat weder die Dividenden besteuern, die die juristische Person an nicht in diesem anderen Staat ansässige Personen zahlt, noch Gewinne der juristischen Person einer Steuer für nichtausgeschüttete Gewinne unterwerfen, selbst wenn die gezahlten Dividenden oder die nichtausgeschütteten Gewinne ganz oder teilweise aus in dem anderen Staat erzielten Gewinnen oder Einkünften bestehen.

Artikel 11

Zinsen

(1) Zinsen, die aus einem Vertragstaat stammen und an eine in dem anderen Vertragstaat ansässige Person gezahlt werden, dürfen nur in dem anderen Staat besteuert werden.

(2) Der in diesem Artikel verwendete Ausdruck „Zinsen" bedeutet Einkünfte aus öffentlichen Anleihen, aus Obligationen, auch wenn sie durch Pfandrechte an Grundstücken gesichert oder mit einer Gewinnbeteiligung ausgestattet sind, und aus Forderungen jeder Art sowie alle anderen Einkünfte, die nach dem Steuerrecht des Staates, aus dem sie stammen, den Einkünften aus Darlehen gleichgestellt sind.

(3) Absatz 1 ist nicht anzuwenden, wenn der in einem Vertragstaat ansässige Empfänger der Zinsen in dem anderen Vertragstaat, aus dem die Zinsen stammen, eine Betriebstätte hat und die Forderung, für

die die Zinsen gezahlt werden, tatsächlich zu dieser Betriebstätte gehört. In diesem Fall ist Artikel 7 anzuwenden.

(4) Bestehen zwischen Schuldner und Gläubiger oder zwischen jedem von ihnen und einem Dritten besondere Beziehungen und übersteigen deshalb die gezahlten Zinsen, gemessen an der zugrundeliegenden Forderung, den Betrag, den Schuldner und Gläubiger ohne diese Beziehungen vereinbart hätten, so wird dieser Artikel nur auf diesen letzten Betrag angewendet. In diesem Fall kann der übersteigende Betrag nach dem Recht jedes Vertragstaates und unter Berücksichtigung der anderen Bestimmungen dieses Abkommens besteuert werden.

Artikel 12

Lizenzgebühren

(1) Lizenzgebühren, die aus einem Vertragstaat stammen und an eine in dem anderen Vertragstaat ansässige Person gezahlt werden, dürfen nur in dem anderen Staat besteuert werden.

(2) Der in diesem Artikel verwendete Ausdruck „Lizenzgebühren" bedeutet Vergütungen jeder Art, die für die Benutzung oder für das Recht auf Benutzung von Urheberrechten an literarischen, künstlerischen oder wissenschaftlichen Werken, einschliesslich kinematographischer Filme und Fernsehfilme, von Patenten, Marken, Mustern oder Modellen, Plänen, geheimen Formeln oder Verfahren oder für die Benutzung oder das Recht auf Benutzung gewerblicher, kaufmännischer oder wissenschaftlicher Ausrüstungen oder für die Mitteilung gewerblicher, kaufmännischer oder wissenschaftlicher Erfahrungen gezahlt werden.

(3) Absatz 1 ist nicht aanzuwenden, wenn der in einem Vertragstaat ansässige Empfänger der Lizenzgebühren in dem anderen Vertragstaat, aus dem die Lizenzgebühren stammen, eine Betriebstätte hat und die Rechte oder Vermögenswerte, für die die Lizenzgebühren gezahlt werden, tatsächlich zu dieser Betriebstätte gehören. In diesem Fall ist Artikel 7 anzuwenden.

(4) Bestehen zwischen Schuldner und Gläubiger oder zwischen jedem von ihnen und einem Dritten besondere Beziehungen und übersteigen deshalb die gezahlten Lizenzgebühren, gemessen an der zugrundeliegenden Leistung, den Betrag, den Schuldner und Gläubiger ohne diese Beziehungen vereinbart hätten, so wird dieser Artikel nur auf diesen letzten Betrag angewendet. In diesem Fall darf der übersteigende Betrag nach dem Recht jedes Vertragstaates und unter Berücksichtigung der anderen Bestimmungen dieses Abkommens besteuert werden.

Artikel 13

Veräusserungsgewinne

(1) Gewinne aus der Veräusserung unbeweglichen Vermögens im Sinne des Artikels 6 Absatz 2 dürfen in dem Vertragstaat besteuert werden, in dem dieses Vermögen liegt.

(2) Gewinne aus der Veräusserung beweglichen Vermögens, das Betriebsvermögen einer Betriebstätte darstellt, die ein Unternehmen eines Vertragstaates in dem anderen Vertragstaat hat, oder das zu einer festen Einrichtung gehört, über die eine in einem Vertragstaat ansässige Person für die Ausübung eines freien Berufes in dem anderen Vertragstaat verfügt, einschliesslich derartiger Gewinne, die bei der Veräusse-

rung einer solchen Betriebstätte (allein oder zusammen mit dem übrigen Unternehmen) oder einer solchen festen Einrichtung erzielt werden, dürfen in dem anderen Staat besteuert werden. Jedoch dürfen Gewinne aus der Veräusserung des in Artikel 21 Absatz 3 genannten beweglichen Vermögens nur in dem Vertragstaat besteuert werden, in dem dieses bewegliche Vermögen nach dem angeführten Artikel besteuert werden darf.

(3) Gewinne aus der Veräusserung des in den Absätzen 1 und 2 nicht genannten Vermögens dürfen nur in dem Vertragstaat besteuert werden, in dem der Veräusserer ansässig ist.

Artikel 14

Freie Berufe

(1) Einkünfte, die eine in einem Vertragstaat ansässige Person aus einem freien Beruf oder aus sonstiger selbständiger Tätigkeit ähnlicher Art bezieht, dürfen nur in diesem Staat besteuert werden, es sei denn, dass die Person für die Ausübung ihrer Tätigkeit in dem anderen Vertragstaat regelmässig über eine feste Einrichtung verfügt. Verfügt sie über eine solche feste Einrichtung, so dürfen die Einkünfte in dem anderen Staat besteuert werden, jedoch nur insoweit, als sie dieser festen Einrichtung zugerechnet werden können.

(2) Der Ausdruck „freier Beruf" umfasst insbesondere die selbständig ausgeübte wissenschaftliche, literarische, künstlerische, erzieherische, unterrichtende oder sportliche Tätigkeit sowie die selbständige Tätigkeit der Ärzte, Rechtsanwälte, Ingenieure, Architekten, Zahnärzte und Steuerberater.

Artikel 15

Nichtselbständige Arbeit

(1) Vorbehaltlich der Artikel 16, 17 und 18 dürfen Gehälter, Löhne und ähnliche Vergütungen, die eine in einem Vertragstaat ansässige Person aus unselbständiger Arbeit bezieht, nur in diesem Staat besteuert werden, es sei denn, dass die Arbeit in dem anderen Vertragstaat ausgeübt wird. Wird die Arbeit dort ausgeübt, so dürfen die dafür bezogenen Vergütungen in dem anderen Staat besteuert werden.

(2) Ungeachtet des Absatzes 1 dürfen Vergütungen, die eine in einem Vertragstaat ansässige Person für eine in dem anderen Vertragstaat ausgeübte unselbständige Arbeit bezieht, nur in dem erstgenannten Staat besteuert werden, wenn

a) die Vergütungen von einem Arbeitgeber oder für einen Arbeitgeber gezahlt werden, der nicht in dem anderen Staat ansässig ist, und
b) die Vergütungen nicht von einer Betriebstätte oder einer festen Einrichtung getragen werden, die der Arbeitgeber in dem anderen Staat hat, und
c) der Empfänger sich in dem anderen Staat insgesamt nicht länger als 183 Tage während des betreffenden Steuerjahres aufhält.

(3) Ungeachtet der vorstehenden Bestimmungen dieses Artikels dürfen Vergütungen für unselbständige Arbeit, die an Bord eines Seeschiffes, Luftfahrzeuges oder eines Schiffes, das der Binnenschiffahrt dient, im internationalen Verkehr ausgeübt wird, in dem Vertragstaat besteuert werden, in dem die Person ansässig ist, die die Gewinne aus dem Betrieb des Schiffes oder Luftfahrzeuges erzielt.

Artikel 16
Aufsichtsrats- oder Verwaltungsratsvergütungen

Aufsichtsrats- oder Verwaltungsratsvergütungen und ähnliche Zahlungen, die eine in einem Vertragstaat ansässige Person in ihrer Eigenschaft als Mitglied des Aufsichts- oder Verwaltungsrates einer juristischen Person bezieht, die in dem anderen Vertragstaat ansässig ist, dürfen in dem anderen Staat besteuert werden.

Artikel 17
Ruhegehälter

Vorbehaltlich des Artikels 18 Absatz 1 dürfen Ruhegehälter und ähnliche Vergütungen, die einer in einem Vertragstaat ansässigen Person für frühere unselbständige Arbeit gezahlt werden, nur in diesem Staat besteuert werden.

Artikel 18
Öffentliche Funktionen

(1) Vergütungen, einschliesslich der Ruhegehälter, die von einem Vertragstaat oder einer seiner Gebietskörperschaften unmittelbar oder aus einem von diesem Staat oder der Gebietskörperschaft errichteten Sondervermögen an eine natürliche Person für die diesem Staat oder der Gebietskörperschaft in Ausübung öffentlicher Funktionen erbrachten Dienste gezahlt werden, dürfen in diesem Staat besteuert werden

(2) Auf Vergütungen oder Ruhegehälter für Dienstleistungen, die im Zusammenhang mit einer kaufmännischen oder gewerblichen Tätigkeit eines der Vertragstaaten oder einer seiner Gebietskörperschaften erbracht werden, finden die Artikel 15, 16 und 17 Anwendung.

Artikel 19
Studenten und Lehrlinge

Zahlungen, die ein Student oder Lehrling, der in einem Vertragstaat ansässig ist oder vorher dort ansässig war und der sich in dem anderen Vertragstaat ausschliesslich zum Studium oder zur Ausbildung aufhält, für seinen Unterhalt, sein Studium oder seine Ausbildung erhält, werden in dem anderen Staat nicht besteuert, sofern ihm diese Zahlungen aus Quellen ausserhalb des anderen Staates zufliessen.

Artikel 20
Nicht ausdrücklich erwähnte Einkünfte

Die in den vorstehenden Artikeln nicht ausdrücklich erwähnten Einkünfte einer in einem Vertragstaat ansässigen Person dürfen nur in diesem Staat besteuert werden.

Artikel 21
Besteuerung des Vermögens

(1) Unbewegliches Vermögen im Sinne des Artikels 6 Absatz 2 darf in dem Vertragstaat besteuert werden, in dem dieses Vermögen liegt.

(2) Bewegliches Vermögen, das Betriebsvermögen einer Betriebstätte eines Unternehmens darstellt oder das zu einer der Ausübung eines freien Berufes dienenden festen Einrichtung gehört, darf in dem Vertragstaat besteuert werden, in dem sich die Betriebstätte oder die feste Einrichtung befindet.

(3) Schiffe und Luftfahrzeuge im internationalen Verkehr sowie bewegliches Vermögen, das dem Betrieb dieser Schiffe und Luftfahrzeuge dient, dürfen nur in dem Vertragstaat besteuert werden, in dem die Person ansässig ist, die die Gewinne aus dem Betrieb des Schiffes oder Luftfahrzeuges erzielt.

(4) Alle anderen Vermögensteile einer in einem Vertragstaat ansässigen Person dürfen nur in diesem Staat besteuert werden.

Artikel 22
Vermeidung der Doppelbesteuerung

(1) Bezieht eine in einem Vertragstaat ansässige Person Einkünfte oder hat sie Vermögen und dürfen diese Einkünfte oder dieses Vermögen nach diesem Abkommen in dem anderen Vertragstaat besteuert werden, so nimmt der erstgenannte Staat, vorbehaltlich des Absatzes 2, diese Einkünfte oder dieses Vermögen von der Besteuerung aus; dieser Staat darf aber bei der Festsetzung der Steuer für das übrige Einkommen oder das übrige Vermögen dieser Person den Steuersatz anwenden, der anzuwenden wäre, wenn die betreffenden Einkünfte oder das betreffende Vermögen nicht von der Besteuerung ausgenommen wären.

(2) Bezieht eine in einem Vertragstaat ansässige Person Einkünfte, die nach Artikel 10 in dem anderen Vertragstaat besteuert werden dürfen, so rechnet der erstgenannte Staat auf die vom Einkommen dieser Person zu erhebende Steuer den Betrag an, der der in dem anderen Vertragstaat gezahlten Steuer entspricht. Der anzurechnende Betrag darf jedoch den Teil der vor der Anrechnung ermittelten Steuer nicht übersteigen, der auf die Einkünfte entfällt, die aus dem anderen Vertragstaat bezogen werden.

Artikel 23
Gleichbehandlung

(1) Die Staatsangehörigen eines Vertragstaates dürfen in dem anderen Vertragstaat weder einer Besteuerung noch einer damit zusammenhängenden Verpflichtung unterworfen werden, die anders oder belastender sind als die Besteuerung und die damit zusammenhängenden Verpflichtungen, denen die Staatsangehörigen des anderen Staates unter gleichen Verhältnissen unterworfen sind oder unterworfen werden können.

(2) Der Ausdruck „Staatsangehörige" bedeutet:

a) alle natürlichen Personen, die die Staatsangehörigkeit eines Vertragstaates besitzen;
b) alle juristischen Personen, Personengesellschaften und anderen Personenvereinigungen, die nach dem in einem Vertragstaat geltenden Recht errichtet worden sind.

(3) Die Besteuerung einer Betriebstätte, die ein Unternehmen eines Vertragstaates in dem anderen Vertragstaat hat, darf in dem anderen Staat nicht ungünstiger sein als die Besteuerung von Unternehmen des anderen Staates, die die gleiche Tätigkeit ausüben.
Diese Bestimmung ist nicht so auszulegen, als verpflichte sie einen Vertragstaat, den in dem anderen Vertragstaat ansässigen Personen Steuerfreibeträge, -vergünstigungen und -ermässigungen auf Grund des Personenstandes oder der Familienlasten zu gewähren, die er den in seinem Gebiet ansässigen Personen gewährt.

(4) Die Unternehmen eines Vertragstaa-

tes, deren Kapital ganz oder teilweise, unmittelbar oder mittelbar, einer in dem anderen Vertragstaat ansässigen Person oder mehreren solchen Personen gehört oder ihrer Kontrolle unterliegt, dürfen in dem erstgenannten Vertragstaat weder einer Besteuerung noch einer damit zusammenhängenden Verpflichtung unterworfen werden, die anders oder belastender sind als die Besteuerung und die damit zusammenhängenden Verpflichtungen, denen andere ähnliche Unternehmen des erstgenannten Staates unterworfen sind oder unterworfen werden können.

(5) In diesem Artikel bedeutet der Ausdruck „Besteuerung" Steuern jeder Art und Bezeichnung.

(6) Es wird festgestellt, dass die abweichende Besteuerung der ungarischen sozialistischen Wirtschaftseinheiten den Bestimmungen dieses Artikels nicht widerspricht.

Artikel 24
Verständigungsverfahren

(1) Ist eine in einem Vertragstaat ansässige Person der Auffassung, dass die Massnahmen eines Vertragstaaten oder beider Vertragstaaten für sie zu einer Besteuerung geführt haben oder führen werden, die diesem Abkommen nicht entspricht, so kann sie unbeschadet der nach innerstaatlichem Recht dieser Staaten vorgesehenen Rechtsmittel ihren Fall der zuständigen Behörde des Vertragstaates unterbreiten, in dem sie ansässig ist.

(2) Hält diese zuständige Behörde die Einwendung für begründet und ist sie selbst nicht in der Lage, eine befriedigende Lösung herbeizuführen, so wird sie sich bemühen, den Fall nach Verständigung mit der zuständigen Behörde des anderen Vertragstaates so zu regeln, dass eine dem Abkommen nicht entsprechende Besteuerung vermieden wird.

(3) Die zuständigen Behörden der Vertragstaaten werden sich bemühen, Schwierigkeiten oder Zweifel, die bei der Auslegung oder Anwendung des Abkommens entstehen, in gegenseitigem Einvernehmen zu beseitigen. Sie können auch gemeinsam darüber beraten, wie eine Doppelbesteuerung in Fällen, die in dem Abkommen nicht behandelt sind, vermieden werden kann.

(4) Die zuständigen Behörden der Vertragstaaten können zur Herbeiführung einer Einigung im Sinne der vorstehenden Absätze unmittelbar miteinander verkehren. Erscheint ein mündlicher Meinungsaustausch für die Herbeiführung der Einigung zweckmässig, so kann ein solcher Meinungsaustausch in einer Kommission durchgeführt werden, die aus Vertretern der zuständigen Behörden der Vertragstaaten besteht.

Artikel 25
Austausch von Informationen

(1) Die zuständigen Behörden der Vertragstaaten werden die zur Durchführung dieses Abkommens erforderlichen Informationen austauschen. Die zuständigen Behörden der Vertragstaaten sind jedoch nicht verpflichtet, Auskünfte zu erteilen, die nicht auf Grund der bei den Finanzbehörden vorhandenen Unterlagen gegeben werden können, sondern gesonderte Ermittlungen erfordern würden. Alle so ausgetauschten Informationen sind geheimzuhalten und dürfen nur solchen Personen

oder Behörden zugänglich gemacht werden, die mit der Veranlagung oder Einhebung der unter das Abkommen fallenden Steuern befasst sind.

(2) Absatz 1 ist auf keinen Fall so auszulegen, als verpflichte er einen der Vertragstaaten:

a) Verwaltungsmassnahmen durchzuführen, die von den Gesetzen oder der Verwaltungspraxis dieses oder des anderen Vertragstaates abweichen;
b) Angaben zu übermitteln, die nach den Gesetzen oder im üblichen Verwaltungsverfahren dieses oder des anderen Vertragstaates nicht beschafft werden können;
c) Informationen zu erteilen, die ein Handels-, Geschäfts-, Gewerbe- oder Berufsgeheimnis oder ein Geschäftsverfahren preisgeben würden oder deren Erteilung dem Ordre public widerspräche.

Artikel 26

Diplomatische und konsularische Beamte

Dieses Abkommen berührt nicht die steuerlichen Vorrechte, die den Mitgliedern diplomatischer oder konsularischer Vertretungen nach den allgemeinen Regeln des Völkerrechts oder auf Grund besonderer Vereinbarungen zustehen.

Artikel 27

Inkrafttreten

(1) Dieses Abkommen ist der Rechtsordnung eines jeden der beiden Vertragstaaten gemäss zu ratifizieren. Die Ratifikationsurkunden sind so bald wie möglich in Budapest auszutauschen.

(2) Das Abkommen tritt 60 Tage nach dem Austausch der Ratifikationsurkunden in Kraft.

Artikel 28

Wirksamkeitsbeginn

Die Bestimmungen dieses Abkommens finden Anwendung auf alle Steuerjahre, die nach dem 31. Dezember des Jahres beginnen, in dem der Austausch der Ratifikationsurkunden erfolgt ist.

Artikel 29

Ausserkrafttreten

Dieses Abkommen bleibt in Kraft, solange es nicht von einem der Vertragstaaten gekündigt worden ist.
Jeder der beiden Vertragstaaten kann das Abkommen schriftlich auf diplomatischem Weg unter Einhaltung einer sechsmonatigen Frist auf das Ende eines Kalenderjahres kündigen. In diesem Fall ist das Abkommen für die Steuerzeiträume nicht mehr anzuwenden, die nach dem Ende des Kalenderjahres beginnen, zu dessen Ende die Kündigung erfolgt ist.

Zu Urkund dessen haben die Bevollmächtigten dieses Abkommen unterzeichnet und mit ihren Siegeln versehen.

Geschehen zu Wien, am 25. Februar 1975 in zweifacher Urschrift, in deutscher und in ungarischer Sprache, wobei beide Texte in gleicher Weise authentisch sind.

Für die Republik Österreich:
Androsch e. h.

Für die Ungarische Volksrepublik:
Faluvégi e. h.

ABKOMMEN zwischen der Republik Österreich und der Sozialistischen Föderativen Republik Jugoslawien zur Vermeidung der Doppelbesteuerung auf dem Gebiete der Steuern vom Einkommen und vom Vermögen

SUPPLEMENT TO THE BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION
AU BULLETIN DE DOCUMENTATION FISCALE INTERNATIONALE

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INTERNATIONAL BUREAU OF FISCAL DOCUMENTATION

Muiderpoort - 124 Sarphatistraat - Amsterdam

A double taxation treaty was signed between Austria and Yugoslavia on May 7, 1975. It is subject to ratification before entering into force. In accordance with Article 28 the treaty shall enter into force sixty days following the date on which the Contracting States have exchanged the instruments of ratification.

TEXT

Die Republik Österreich und die Sozialistische Föderative Republik Jugoslawien, vom Wunsche geleitet, ein Abkommen zur Vermeidung der Doppelbesteuerung auf dem Gebiete der Steuern vom Einkommen und vom Vermögen abzuschliessen, sind übereingekommen wie folgt:

Artikel 1

Dieses Abkommen gilt für Personen, die in einem Vertragstaat oder in beiden Vertragstaaten ansässig sind.

Artikel 2

(1) Dieses Abkommen gilt, ohne Rücksicht auf die Art der Erhebung, für Steuern vom Einkommen und vom Vermögen, die für Rechnung eines der beiden Vertragstaaten oder seiner Gebietskörperschaften erhoben werden; es gilt auch für die in Jugoslawien erhobenen Beiträge mit Ausnahme des Beitrages für Sozialversicherung.

(2) Als Steuern vom Einkommen und vom Vermögen gelten alle Steuern, die vom Gesamteinkommen, vom Gesamtvermögen

oder von Teilen des Einkommens oder des Vermögens erhoben werden, einschliesslich der Steuern vom Gewinn aus der Veräusserung beweglichen oder unbeweglichen Vermögens sowie der Steuern vom Vermögenszuwachs.

(3) Zu den zurzeit bestehenden Steuern, für die das Abkommen gilt, gehören insbesondere

a) in Österreich:
1. die Einkommensteuer;
2. die Körperschaftsteuer;
3. die Aufsichtsratsabgabe;
4. die Vermögensteuer;
5. die Abgabe von Vermögen, die der Erbschaftssteuer entzogen sind;
6. die Gewerbesteuer einschliesslich der Lohnsummensteuer;
7. die Grundsteuer;
8. die Abgabe von land- und forstwirtschaftlichen Betrieben;
9. die Beiträge von land- und forstwirtschaftlichen Betrieben zum Ausgleichsfonds für Familienbeihilfen;
10. die Abgabe vom Bodenwert bei unbebauten Grundstücken.

b) in Jugoslawien:
1. die Steuern und Beiträge vom Einkommen der Grundorganisationen der Vereinten Arbeit (Unternehmen);
2. die Steuern und Beiträge von Einkünften natürlicher Personen aus
   aa) einem Arbeitsverhältnis,
   bb) landwirtschaftlicher Tätigkeit,
   cc) selbständiger Erwerbstätigkeit;
3. die Steuer von Einkünften aus Urheberrechten, Patenten und der Überlassung technischer Verbesserungen;
4. die Steuer von Einkünften aus Vermögenswerten und -rechten;
5. die Steuer von Vermögen;
6. die Steuer von Gesamteinkommen natürlicher Personen;
7. die Steuern von Einkünften Gebietsfremder, nämlich von Einkünften aus
   aa) Investitionen in der jugoslawischen Wirtschaft,
   bb) der Verwirklichung von Investitionsvorhaben und -einrichtungen,
   cc) der Beförderung von Personen, Gütern oder Waren.

(4) Das Abkommen gilt auch für alle Steuern gleicher oder ähnlicher Art, die künftig neben den zurzeit bestehenden Steuern oder an deren Stelle erhoben werden. Die zuständigen Behörden der Vertragstaaten teilen einander die in ihren Steuergesetzen eingetretenen Änderungen mit.

Artikel 3

(1) Im Sinne dieses Abkommens, wenn der Zusammenhang nichts anderes erfordert:

a) bedeutet der Ausdruck „Österreich" die Republik Österreich;
b) bedeutet der Ausdruck „Jugoslawien" die Sozialistische Föderative Republik Jugoslawien einschliesslich aller Gebiete, die an die Hoheitsgewässer Jugoslawiens angrenzen und nach der jugoslawischen Gesetzgebung und dem Völkerrecht als Gebiete gelten oder künftig gelten werden, in denen die Rechte Jugoslawiens hinsichtlich des Seebodens und seiner Unterschicht einschliesslich deren Bodenschätze ausgeübt werden können;
c) umfasst der Ausdruck „Person" natürliche Personen, Gesellschaften und alle anderen Personenvereinigungen;
d) bedeutet der Ausdruck „Gesellschaft" juristische Personen oder Rechtsträger, die für die Besteuerung wie juristische Personen behandelt werden;
e) bedeuten die Ausdrücke „Unternehmen

eines Vertragstaates“ und „Unternehmen des anderen Vertragstaates“, je nachdem, ein Unternehmen, das von einer in einem Vertragstaat ansässigen Person betrieben wird, oder ein Unternehmen, das von einer in dem anderen Vertragstaat ansässigen Person betrieben wird;

f) bedeutet der Ausdruck „zuständige Behörde“
   1. in Österreich: den Bundesminister für Finanzen,
   2. in Jugoslawien: den Bundessekretär für Finanzen.

(2) Bei Anwendung des Abkommens durch einen Vertragstaat hat, wenn der Zusammenhang nichts anderes erfordert, jeder nicht anders definierte Ausdruck die Bedeutung, die ihm nach dem Recht dieses Staates über die Steuern zukommt, welche Gegenstand des Abkommens sind.

Artikel 4

(1) Im Sinne dieses Abkommens bedeutet der Ausdruck „eine in einem Vertragstaat ansässige Person“ eine Person, die nach dem Recht dieses Staates dort auf Grund ihres Wohnsitzes, ihres ständigen Aufenthalts, des Ortes ihrer Geschäftsleitung oder eines anderen ähnlichen Merkmals steuerpflichtig ist.

(2) Ist nach Absatz 1 eine natürliche Person in beiden Vertragstaaten ansässig, so gilt folgendes:

a) Die Person gilt als in dem Vertragstaat ansässig, in dem sie über eine ständige Wohnstätte verfügt. Verfügt sie in beiden Vertragstaaten über eine ständige Wohnstätte, so gilt sie als in dem Vertragstaat ansässig, zu dem sie die engeren persönlichen und wirtschaftlichen Beziehungen hat (Mittelpunkt der Lebensinteressen).

b) Kann nicht bestimmt werden, in welchem Vertragstaat die Person den Mittelpunkt der Lebensinteressen hat, oder verfügt sie in keinem der Vertragstaaten über eine ständige Wohnstätte, so gilt sie als in dem Vertragstaat ansässig, in dem sie ihren gewöhnlichen Aufenthalt hat.

c) Hat die Person ihren gewöhnlichen Aufenthalt in beiden Vertragstaaten oder in keinem der Vertragstaaten, so gilt sie als in dem Vertragstaat ansässig, dessen Staatsangehörigkeit sie besitzt.

d) Besitzt die Person die Staatsangehörigkeit beider Vertragstaaten oder keines Vertragstaates, so werden die zuständigen Behörden der Vertragstaaten gemäss Artikel 25 vorgehen.

(3) Ist nach Absatz 1 eine andere als eine natürliche Person in beiden Vertragstaaten ansässig, so gilt sie als in dem Vertragstaat ansässig, in dem sich der Ort ihrer tatsächlichen Geschäftsleitung befindet.

Artikel 5

(1) Im Sinne dieses Abkommens bedeutet der Ausdruck „Betriebstätte“ eine feste Geschäftseinrichtung, in der die Tätigkeit des Unternehmens ganz oder teilweise ausgeübt wird.

(2) Der Ausdruck „Betriebstätte“ umfasst insbesondere:

a) einen Ort der Leitung,
b) eine Zweigniederlassung,
c) eine Geschäftsstelle,
d) eine Fabrikationsstätte,
e) eine Werkstätte,
f) ein Bergwerk, einen Steinbruch oder eine andere Stätte der Ausbeutung von Bodenschätzen,
g) eine Bauausführung oder Montage, deren Dauer zwölf Monate überschreitet.

(3) Als Betriebstätten gelten nicht:

a) Einrichtungen, die ausschliesslich zur Lagerung, Ausstellung oder Auslieferung von Gütern oder Waren des Unternehmens benutzt werden;
b) Bestände von Gütern oder Waren des Unternehmens, die ausschliesslich zur Lagerung, Ausstellung oder Auslieferung unterhalten werden;
c) Bestände von Gütern oder Waren des Unternehmens, die ausschliesslich zu dem Zweck unterhalten werden, durch ein anderes Unternehmen bearbeitet oder verarbeitet zu werden;
d) eine feste Geschäftseinrichtung, die ausschliesslich zu dem Zweck unterhalten wird, für das Unternehmen Güter oder Waren einzukaufen oder Informationen zu beschaffen;
e) eine feste Geschäftseinrichtung, die ausschliesslich zu dem Zweck unterhalten wird, für das Unternehmen zu werben, Informationen zu erteilen, wissenschaftliche Forschung zu betreiben oder ähnliche Tätigkeiten auszuüben, die vorbereitender Art sind oder eine Hilfstätigkeit darstellen.

(4) Ist eine Person — mit Ausnahme eines unabhängigen Vertreters im Sinne des Absatzes 5 — in einem Vertragstaat für ein Unternehmen des anderen Vertragstaates tätig, so gilt eine in dem erstgenannten Staat gelegene Betriebstätte als gegeben, wenn die Person eine Vollmacht besitzt, im Namen des Unternehmens Verträge abzuschliessen, und die Vollmacht in diesem Staat gewöhnlich ausübt, es sei denn, dass sich ihre Tätigkeit auf den Einkauf von Gütern oder Waren für das Unternehmen beschränkt.

(5) Ein Unternehmen eines Vertragstaates wird nicht schon deshalb so behandelt, als habe es eine Betriebstätte in dem anderen Vertragstaat, weil es dort seine Tätigkeit durch einen Makler, Kommissionär oder einen anderen unabhängigen Vertreter ausübt, sofern diese Personen im Rahmen ihrer ordentlichen Geschäftstätigkeit handeln.

(6) Allein dadurch, dass eine in einem Vertragstaat ansässige Gesellschaft eine Gesellschaft beherrscht oder von einer Gesellschaft beherrscht wird, die in dem anderen Vertragstaat ansässig ist oder dort (entweder durch eine Betriebstätte oder in anderer Weise) ihre Tätigkeit ausübt, wird eine der beiden Gesellschaften nicht zur Betriebstätte der anderen.

Artikel 6

(1) Einkünfte aus unbeweglichem Vermögen dürfen in dem Vertragstaat besteuert werden, in dem dieses Vermögen liegt.

(2) Der Ausdruck „unbewegliches Vermögen" bestimmt sich nach dem Recht des Vertragstaates, in dem das Vermögen liegt. Der Ausdruck umfasst in jedem Fall das Zubehör zum unbeweglichen Vermögen, das lebende und tote Inventar land- und forstwirtschaftlicher Betriebe, die Rechte, auf die die Vorschriften des Privatrechts über Grundstücke Anwendung finden, die Nutzungsrechte an unbeweglichem Vermögen sowie die Rechte auf veränderliche oder feste Vergütungen für die Ausbeutung oder das Recht auf Ausbeutung von Mineralvorkommen, Quellen und anderen Bodenschätzen; Schiffe und Luftfahrzeuge gelten nicht als unbewegliches Vermögen.

(3) Absatz 1 gilt für Einkünfte aus der unmittelbaren Nutzung, der Vermietung oder Verpachtung sowie jeder anderen Art der Nutzung unbeweglichen Vermögens.

(4) Die Absätze 1 und 3 gelten auch für Einkünfte aus unbeweglichem Vermögen eines Unternehmens und für Einkünfte aus unbeweglichem Vermögen, das der Ausübung eines freien Berufes dient.

Artikel 7

(1) Gewinne eines Unternehmens eines Vertragstaates dürfen nur in diesem Staat besteuert werden, es sei denn, dass das Unternehmen seine Tätigkeit im anderen Vertragstaat durch eine dort gelegene Betriebstätte ausübt. Übt das Unternehmen seine Tätigkeit in dieser Weise aus, so dürfen die Gewinne des Unternehmens in dem anderen Staat besteuert werden, jedoch nur insoweit, als sie dieser Betriebstätte zugerechnet werden können.

(2) Wenn ein Unternehmen eines der Vertragstaaten im anderen Vertragstaat durch eine dort gelegene Betriebstätte gewerblich tätig ist, so sind dieser Betriebstätte die gewerblichen Gewinne zuzurechnen, die sie in diesem Staat erzielen könnte, wenn sie sich als selbständiges Unternehmen mit gleichen oder ähnlichen Geschäften unter gleichen oder ähnlichen Bedingungen befasste und mit dem Unternehmen, dessen Betriebstätte sie ist, Geschäfte wie ein unabhängiges Unternehmen tätigte. Diese gewerblichen Gewinne werden in der Regel unter Zugrundelegung der Spezialbilanz der Betriebstätte ermittelt. Bei der Ermittlung des gewerblichen Gewinnes der Betriebstätte werden alle Ausgaben, einschliesslich allgemeiner Verwaltungskosten, zum Abzug zugelassen, die berechtigterweise der Betriebstätte zuzurechnen sind.

(3) Die Steuerbehörden des steuererhebenden Staates dürfen, wenn erforderlich, in Ausführung des Absatzes 2 dieses Artikels die Buchhaltungsergebnisse für steuerliche Zwecke richtigstellen, insbesondere um Fehler und Unterlassungen zu berichtigen oder um die in den Büchern angeführten Preise oder Vergütungen auf die Werte zurückzuführen, die zwischen unabhängigen Personen üblich wären.

(4) Legt die Betriebstätte keine Buchführung vor, die ihre eigenen Geschäfte offenlegt, oder entspricht die vorgelegte Buchführung nicht den Handelsbräuchen des Staates, in dem die Betriebstätte gelegen ist, oder können die Berichtigungen, die nach Absatz 3 dieses Artikels vorgesehen sind, nicht durchgeführt werden, so können die Steuerbehörden des steuererhebenden Staates die gewerblichen Gewinne durch Anwendung solcher Hilfsmethoden auf die Geschäftstätigkeit der Betriebstätte ermitteln, die in Ausführung des Absatzes 2 dieses Artikels gerechtfertigt und angemessen erscheinen.

(5) Auf Grund des blossen Einkaufs von Gütern oder Waren für das Unternehmen wird einer Betriebstätte kein Gewinn zugerechnet.

(6) Die Bestimmungen dieses Artikels sind auch auf Einkünfte anzuwenden,

a) die einer in Jugoslawien ansässigen Person aus ihrer Beteiligung an einer „stillen Gesellschaft" des österreichischen Rechts zufliessen,

b) die einer in Österreich ansässigen Person aus ihrer Beteiligung an einem „Zajednicko poslovanje" des jugoslawischen Rechts zufliessen.

Artikel 8

(1) Gewinne aus dem Betrieb von Seeschiffen oder Luftfahrzeugen im internationalen Verkehr dürfen nur in dem Vertragstaat besteuert werden, in dem sich der Ort der tatsächlichen Geschäftsleitung des Unternehmens befindet.

(2) Gewinne aus dem Betrieb von Schiffen, die der Binnenschiffahrt dienen, dürfen nur in dem Vertragstaat besteuert werden, in dem sich der Ort der tatsächlichen Geschäftsleitung des Unternehmens befindet.

(3) Befindet sich der Ort der tatsächlichen Geschäftsleitung eines Unternehmens der

See- oder Binnenschiffahrt an Bord eines Schiffes, so gilt er als in dem Vertragstaat gelegen, in dem der Heimathafen des Schiffes liegt, oder, wenn kein Heimathafen vorhanden ist, in dem Vertragstaat, in dem die Person, die das Schiff betreibt, ansässig ist.

(4) Absatz 1 gilt auch für eine Beteiligung von Luft- und Schiffahrtunternehmen an einem Pool oder einer Betriebsgemeinschaft.

Artikel 9

Wenn

a) ein Unternehmer eines Vertragstaates unmittelbar oder mittelbar an der Geschäftsleitung, der Kontrolle oder am Kapital eines Unternehmens des anderen Vertragstaates beteiligt ist, oder

b) dieselben Personen unmittelbar oder mittelbar an der Geschäftsleitung, der Kontrolle oder am Kapital eines Unternehmens eines Vertragstaates und eines Unternehmens des anderen Vertragstaates beteiligt sind,

und in diesen Fällen zwischen den beiden Unternehmen hinsichtlich ihrer kaufmännischen oder finanziellen Beziehungen Bedingungen vereinbart oder auferlegt werden, die von denen abweichen, die unabhängige Unternehmen miteinander vereinbaren würden, so dürfen die Gewinne, die eines der Unternehmen ohne diese Bedingungen erzielt hätte, wegen dieser Bedingungen aber nicht erzielt hat, den Gewinnen dieses Unternehmens zugerechnet und entsprechend besteuert werden.

Artikel 10

(1) Dividenden, die eine in einem Vertragstaat ansässige Gesellschaft an eine in dem andern Vertragstaat ansässige Person zahlt, dürfen in dem anderen Staat besteuert werden.

(2) Diese Dividenden dürfen jedoch in dem Vertragstaat, in dem die die Dividenden zahlende Gesellschaft ansässig ist, nach dem Recht dieses Staates besteuert werden; die Steuer darf aber nicht übersteigen:

a) 10 vom Hundert des Bruttobetrages der Dividenden, wenn der Empfänger eine Gesellschaft (ausgenommen eine Personengesellschaft) ist, die unmittelbar über mindestens 25 vom Hundert des Kapitals der die Dividenden zahlenden Gesellschaft verfügt;

b) 15 vom Hundert des Bruttobetrages der Dividenden in allen anderen Fällen.

Dieser Absatz berührt nicht die Besteuerung der Gesellschaft in bezug auf die Gewinne, aus denen die Dividenden gezahlt werden.

(3) Der in diesem Artikel verwendete Ausdruck „Dividenden" bedeutet Einkünfte aus Aktien, Genussaktien oder Genusscheinen, Gründeranteilen oder anderen Rechten — ausgenommen Forderungen — mit Gewinnbeteiligung sowie aus sonstigen Gesellschaftsanteilen stammende Einkünfte, die nach dem Steuerrecht des Staates, in dem die ausschüttende Gesellschaft ansässig ist, den Einkünften aus Aktien gleichgestellt sind.

(4) Die Absätze 1 und 2 sind nicht anzuwenden, wenn der in einem Vertragstaat ansässige Empfänger der Dividenden in dem anderen Vertragstaat, in dem die Dividenden zahlende Gesellschaft ansässig ist, eine Betriebstätte hat und die Beteiligung, für die die Dividenden gezahlt werden, tatsächlich zu dieser Betriebstätte gehört. In diesem Fall ist Artikel 7 anzuwenden.

(5) Bezieht eine in einem Vertragstaat ansässige Gesellschaft Gewinne oder Einkünfte aus dem anderen Vertragstaat, so darf dieser andere Staat weder die Dividenden besteuern, die die Gesellschaft an nicht

diesem anderen Staat ansässige Personen zahlt, noch Gewinne der Gesellschaft einer Steuer für nichtausgeschüttete Gewinne unterwerfen, selbst wenn die gezahlten Dividenden oder die nichtausgeschütteten Gewinne ganz oder teilweise aus in dem anderen Staat erzielten Gewinnen oder Einkünften bestehen.

Artikel 11

(1) Zinsen, die aus einem Vertragstaat stammen und an eine in dem anderen Vertragstaat ansässige Person gezahlt werden, dürfen nur in dem anderen Staat besteuert werden.

(2) Der in diesem Artikel verwendete Ausdruck „Zinsen" bedeutet Einkünfte aus öffentlichen Anleihen, aus Obligationen, auch wenn sie durch Pfandrechte an Grundstücken gesichert oder mit einer Gewinnbeteiligung ausgestattet sind, aus Spareinlagen und laufenden Guthaben bei Kreditunternehmungen und aus Forderungen jeder Art sowie alle andere Einkünfte, die nach dem Steuerrecht des Staates, aus dem sie stammen, den Einkünften aus Darlehen gleichgestellt sind.

(3) Absatz 1 ist nicht anzuwenden, wenn der in einem Vertragstaat ansässige Empfänger der Zinsen in dem anderen Vertragstaat, aus dem die Zinsen stammen, eine Betriebstätte hat und die Forderung, für die die Zinsen gezahlt werden, tatsächlich zu dieser Betriebstätte gehört. In diesem Fall ist Artikel 7 anzuwenden.

(4) Bestehen zwischen Schuldner und Gläubiger oder zwischen jedem von ihnen und einem Dritten besondere Beziehungen und übersteigen deshalb die gezahlten Zinsen, gemessen an der zugrundeliegenden Forderung, den Betrag, den Schuldner und Gläubiger ohne diese Beziehungen vereinbart hätten, so wird dieser Artikel nur auf diesen letzten Betrag angewendet. In diesem Fall kann der übersteigende Betrag nach dem Recht jedes Vertragstaates und unter Berücksichtigung der anderen Bestimmungen dieses Abkommens besteuert werden.

Artikel 12

(1) Lizenzgebühren, die aus einem Vertragstaat stammen und an eine in dem anderen Vertragstaat ansässige Person gezahlt werden, dürfen nur in dem anderen Staat besteuert werden.

(2) Der in diesem Artikel verwendete Ausdruck „Lizenzgebühren" bedeutet Vergütungen jeder Art, die für die Benutzung oder für das Recht auf Benutzung von Urheberrechten an literarischen, künstlerischen oder wissenschaftlichen Werken, einschliesslich kinematographischer Filme sowie von Filmen, Tonaufnahmen und Übertragungen für Rundfunk und Fernsehen, von Patenten, Marken, Mustern oder Modellen, Plänen, geheimen Formeln oder Verfahren oder für die Benutzung oder das Recht auf Benutzung gewerblicher, kaufmännischer oder wissenschaftlicher Ausrüstungen oder für die Mitteilung gewerblicher, kaufmännischer oder wissenschaftlicher Erfahrungen gezahlt werden.

(3) Absatz 1 ist nicht anzuwenden, wenn der in einem Vertragstaat ansässige Empfänger der Lizenzgebühren in dem anderen Vertragstaat, aus dem die Lizenzgebühren stammen, eine Betriebstättet hat und die Rechte oder Vermögenswerte, für die die Lizenzgebühren gezahlt werden, tatsächlich zu dieser Betriebstätte gehören. In diesem Fall ist Artikel 7 anzuwenden.

(4) Bestehen zwischen Schuldner und Gläubiger oder zwischen jedem von ihnen und einem Dritten besondere Beziehungen und übersteigen deshalb die gezahlten Lizenzgebühren, gemessen an der zugrundeliegenden Leistung, den Betrag, den

Schuldner und Gläubiger ohne diese Beziehungen vereinbart hätten, so wird dieser Artikel nur auf diesen letzten Betrag angewendet. In diesem Fall kann der übersteigende Betrag nach dem Recht jedes Vertragstaates und unter Berücksichtigung der anderen Bestimmungen dieses Abkommens besteuert werden.

Artikel 13

(1) Gewinne aus der Veräusserung unbeweglichen Vermögens im Sinne des Artikels 6 Absatz 2 dürfen in dem Vertragstaat besteuert werden, in dem dieses Vermögen liegt.

(2) Gewinne aus der Veräusserung beweglichen Vermögens, das Betriebsvermögen einer Betriebstätte darstellt, die ein Unternehmen eines Vertragstaates in dem anderen Vertragstaat hat oder das zu einer festen Einrichtung gehört, über die eine in einem Vertragstaat ansässige Person für die Ausübung eines freien Berufes in dem anderen Vertragstaat verfügt, einschliesslich derartiger Gewinne, die bei der Veräusserung einer solchen Betriebstätte (allein oder zusammen mit dem übrigen Unternehmen) oder einer solchen festen Einrichtung erzielt werden, dürfen in dem anderen Staat besteuert werden. Jedoch dürfen Gewinne aus der Veräusserung des in Artikel 22 Absatz 3 genannten beweglichen Vermögens nur in dem Vertragstaat besteuert werden, in dem dieses bewegliche Vermögen nach dem angeführten Artikel besteuert werden darf.

(3) Gewinne aus der Veräusserung des in den Absätzen 1 und 2 nicht genannten Vermögens dürfen nur in dem Vertragstaat besteuert werden, in dem der Veräusserer ansässig ist.

Artikel 14

(1) Einkünfte, die eine in einem Vertragstaat ansässige Person aus einem freien Beruf oder aus sonstiger selbständiger Tätigkeit ähnlicher Art bezieht, dürfen nur in diesem Staat besteuert werden, es sei denn, dass die Person für die Ausübung ihrer Tätigkeit in dem anderen Vertragstaat regelmässig über eine feste Einrichtung verfügt. Verfügt sie über eine solche feste Einrichtung, so können die Einkünfte in dem anderen Staat besteuert werden, jedoch nur insoweit, als sie dieser festen Einrichtung zugerechnet werden können.

(2) Der Ausdruck „freier Beruf" umfasst insbesondere die selbständig ausgeübte wissenschaftliche, literarische, künstlerische, erzieherische oder unterrichtende Tätigkeit sowie die selbständige Tätigkeit der Ärzte, Rechtsanwälte, Ingenieure, Architekten, Zahnärzte und Wirtschaftstreuhänder.

Artikel 15

(1) Vorbehaltlich der Artikel 16, 18 und 19 dürfen Gehälter, Löhne und ähnliche Vergütungen, die eine in einem Vertragstaat ansässige Person aus unselbständiger Arbeit bezieht, nur in diesem Staat besteuert werden, es sei denn, dass die Arbeit in dem anderen Vertragstaat ausgeübt wird. Wird die Arbeit dort ausgeübt, so dürfen die dafür bezogenen Vergütungen in dem anderen Staat besteuert werden.

(2) Ungeachtet des Absatzes 1 dürfen Vergütungen, die eine in einem Vertragstaat ansässige Person für eine in dem anderen Vertragstaat ausgeübte unselbständige Arbeit bezieht, nur in dem erstgenannten Staat besteuert werden, wenn

a) der Empfänger sich in dem anderen Staat insgesamt nicht länger als 183 Tage während des betreffenden Steuerjahres aufhält,

b) die Vergütungen von einem Arbeitgeber oder für einen Arbeitgeber gezahlt werden, der nicht in dem anderen Staat ansässig ist, und

c) die Vergütungen nicht von einer Betriebstätte oder einer festen Einrichtung getragen werden, die der Arbeitgeber in dem anderen Staat hat.

(3) Ungeachtet der vorstehenden Bestimmungen dieses Artikels dürfen Vergütungen für unselbständige Arbeit, die an Bord eines Seeschiffes oder Luftfahrzeuges im internationalen Verkehr oder an Bord eines Schiffes, das der Binnenschiffahrt dient, ausgeübt wird, in dem Vertragstaat besteuert werden, in dem sich der Ort der tatsächlichen Geschäftsleitung des Unternehmens befindet.

Artikel 16

Aufsichtsrats- oder Verwaltungsratsvergütungen und ähnliche Zahlungen, die eine in einem Vertragstaat ansässige Person in ihrer Eigenschaft als Mitglied des Aufsichts- oder Verwaltungsrates einer Gesellschaft bezieht, die in dem anderen Vertragstaat ansässig ist, dürfen in dem anderen Staat besteuert werden.

Artikel 17

(1) Ungeachtet der Artikel 14 und 15 dürfen Einkünfte, die berufsmässige Künstler, wie Bühnen-, Film-, Rundfunk- oder Fernsehkünstler und Musiker, sowie Sportler aus ihrer in dieser Eigenschaft persönlich ausgeübten Tätigkeit beziehen, in dem Vertragstaat besteuert werden, in dem sie diese Tätigkeit ausüben.

(2) Fliessen Einkünfte in bezug auf persönlich ausgeübte Tätigkeiten der im Absatz 1 genannten Personen nicht diesen selbst, sondern anderen Personen zu, so dürfen diese Einkünfte ungeachtet der Bestimmungen der Artikel 7, 14 und 15 in dem Vertragstaat besteuert werden, in dem die Tätigkeit dieser Personen ausgeübt wird.

(3) Abweichend von Absatz 1 und 2 können Einkünfte aus Tätigkeiten der in Absatz 1 genannten Art bei Personen, die im Rahmen des vom Entsendestaat gebilligten Kulturaustausches auftreten, nur in dem Staat besteuert werden, in dem sie ansässig sind.

Artikel 18

Vorbehaltlich des Artikels 19 Absatz 1 dürfen Ruhegehälter und ähnliche Vergütungen, die einer in einem Vertragstaat ansässigen Person für frühere unselbständige Arbeit gezahlt werden, nur in diesem Staat besteuert werden.

Artikel 19

(1) Vergütungen, einschiesslich der Ruhegehälter, die von einem Vertragstaat oder einer seiner Gebietskörperschaften unmittelbar oder aus einem von diesem Staat oder der Gebietskörperschaft errichteten Sondervermögen an eine natürliche Person für die diesem Staat oder der Gebietskörperschaft in Ausübung öffentlicher Funktionen erbrachten Dienste gezahlt werden, dürfen in diesem Staat besteuert werden.

(2) Auf Vergütungen oder Ruhegehälter für Dienstleistungen, die im Zusammenhang mit einer kaufmännischen oder gewerblichen Tätigkeit eines der Vertragstaaten oder einer seiner Gebietskörperschaften erbracht werden, finden die Artikel 15, 16 und 18 Anwendung.

Artikel 20

(1) Zahlungen, die ein Student oder Lehrling, der in einem Vertragstaat ansässig ist oder vorher dort ansässig war und der sich in dem anderen Vertragstaat ausschliesslich zum Studium oder zur Ausbildung aufhält, für seinen Unterhalt, sein Studium oder seine Ausbildung erhält, werden in dem anderen Staat nicht besteuert, sofern ihm diese Zahlungen aus Quellen ausserhalb des

anderen Staates zufliessen.

(2) Vergütungen, die die in Absatz 1 genannten Personen für eine unselbständige Tätigkeit beziehen, die in dem anderen Staat ausschliesslich zu dem Zweck ausgeübt wird, praktische Berufserfahrung zu erwerben, und deren Dauer einen Zeitraum von 183 Tagen im Kalenderjahr nicht überschreitet, dürfen in diesem Staat nicht besteuert werden.

Artikel 21

Die in den vorstehenden Artikeln nicht ausdrücklich erwähnten Einkünfte einer in einem Vertragstaat ansässigen Person dürfen nur in diesem Staat besteuert werden.

Artikel 22

(1) Unbewegliches Vermögen im Sinne des Artikels 6 Abs. 2 darf in dem Vertragstaat besteuert werden, in dem dieses Vermögen liegt.

(2) Bewegliches Vermögen, das Betriebsvermögen einer Betriebstätte eines Unternehmens darstellt oder das zu einer der Ausübung eines freien Berufes dienenden festen Einrichtung gehört, darf in dem Vertragstaat besteuert werden, in dem sich die Betriebstätte oder die feste Einrichtung befindet.

(3) Seeschiffe und Luftfahrzeuge im internationalen Verkehr und Schiffe, die der Binnenschiffahrt dienen, sowie bewegliches Vermögen, das dem Betrieb dieser Schiffe und Luftfahrzeuge dient, dürfen nur in dem Vertragstaat besteuert werden, in dem sich der Ort der tatsächlichen Geschäftsleitung des Unternehmens befindet.

(4) Alle anderen Vermögensteile einer in einem Vertragstaat ansässigen Person dürfen nur in diesem Staat besteuert werden.

Artikel 23

(1) Bezieht eine in einem Vertragstaat ansässige Person Einkünfte oder hat sie Vermögen und dürfen diese Einkünfte oder dieses Vermögen nach diesem Abkommen in dem anderen Vertragstaat besteuert werden, so nimmt der erstgenannte Staat, vorbehaltlich des Absatzes 2, diese Einkünfte oder dieses Vermögen von der Besteuerung aus; dieser Staat darf aber bei der Festsetzung der Steuer für das übrige Einkommen oder das übrige Vermögen dieser Person den Steuersatz anwenden, der anzuwenden wäre, wenn die betreffenden Einkünfte oder das betreffende Vermögen nicht von der Besteuerung ausgenommen wären.

(2) Bezieht eine in Österreich ansässige Person Einkünfte, die nach Artikel 10 in Jugoslawien besteuert werden dürfen, so rechnet Österreich auf die vom Einkommen dieser Person zu erhebende Steuer den Betrag an, der der in Jugoslawien gezahlten Steuer entspricht. Der anzurechnende Betrag darf jedoch den Teil der vor der Anrechnung ermittelten Steuer nicht übersteigen, der auf die Einkünfte entfällt, die aus Jugoslawien bezogen werden.

Artikel 24

(1) Die Staatsangehörigen eines Vertragstaates dürfen in dem anderen Vertragstaat weder einer Besteuerung noch einer damit zusammenhängenden Verpflichtung unterworfen werden, die belastender sind als die Besteuerung und die damit zusammenhängenden Verpflichtungen, denen die Staatsangehörigen des anderen Staates unter gleichen Verhältnissen unterworfen sind oder unterworfen werden können.

(2) Der Ausdruck „Staatsangehörige" bedeutet:

a) alle natürlichen Personen, die die Staatsangehörigkeit eines Vertragstaates besitzen;

b) alle juristischen Personen, Personengesellschaften und anderen Personenvereinigungen, die nach dem in einem Vertragstaat geltenden Recht errichtet worden sind.

(3) Die Besteuerung einer Betriebstätte die ein Unternehmen eines Vertragstaates in dem anderen Vertragstaat hat, darf in dem anderen Staat nicht ungünstiger sein als die Besteuerung von Unternehmen des anderen Staates, die die gleiche Tätigkeit ausüben. Diese Bestimmung ist nicht so auszulegen, als verpflichte sie einen Vertragstaat, den in dem anderen Vertragstaat ansässigen Personen Steuerfreibeträge, -vergünstigungen und -ermässigungen auf Grund des Personenstandes oder der Familienlasten zu gewähren, die er den in seinem Gebiet ansässigen Personen gewährt.

(4) Die Unternehmen eines Vertragstaates, deren Kapital ganz oder teilweise, unmittelbar oder mittelbar, einer in dem anderen Vertragstaat ansässigen Person oder mehreren solchen Personen gehört oder ihrer Kontrolle unterliegt, dürfen in dem erstgenannten Vertragstaat weder einer Besteuerung noch einer damit zusammenhängenden Verpflichtung unterworfen werden, die belastender sind als die Besteuerung und die damit zusammenhängenden Verpflichtungen, denen andere ähnliche Unternehmen des erstgenannten Staates unterworfen sind oder unterworfen werden können.

(5) In diesem Artikel bedeutet der Ausdruck „Besteuerung" Steuern jeder Art und Bezeichnung.

Artikel 25

(1) Ist eine in einem Vertragstaat ansässige Person der Auffassung, dass die Massnahmen eines Vertragstaates oder beider Vertragstaaten für sie zu einer Besteuerung geführt haben oder führen werden, die diesem Abkommen nicht entspricht, so kann sie unbeschadet der nach innerstaatlichem Recht dieser Staaten vorgesehenen Rechtsmittel ihrem Fall der zuständigen Behörde des Vertragstaates unterbreiten, in dem sie ansässig ist.

(2) Hält diese zuständige Behörde die Einwendung für begründet und ist sie selbst nicht in der Lage, eine befriedigende Lösung herbeizuführen, so wird sie sich bemühen, den Fall nach Verständigung mit der zuständigen Behörde des anderen Vertragstaates so zu regeln, dass eine dem Abkommen nicht entsprechende Besteuerung vermieden wird.

(3) Die zuständigen Behörden der Vertragstaaten werden sich bemühen, Schwierigkeiten oder Zweifel, die bei der Auslegung oder Anwendung des Abkommens entstehen, in gegenseitigem Einvernehmen zu beseitigen. Sie können auch gemeinsam darüber beraten, wie eine Doppelbesteuerung in Fällen, die in dem Abkommen nicht behandelt sind, vermieden werden kann.

(4) Die zuständigen Behörden der Vertragstaaten können zur Herbeiführung einer Einigung im Sinne der vorstehenden Absätze unmittelbar miteinander verkehren. Erscheint ein mündlicher Meinungsaustausch für die Herbeiführung der Einigung zweckmässig, so kann ein solcher Meinungsaustausch in einer Kommission durchgeführt werden, die aus Vertretern der zuständigen Behörden der Vertragstaaten besteht.

Artikel 26

(1) Die zuständigen Behörden der Vertragstaaten werden die zur Durchführung dieses Abkommens erforderlichen Informationen austauschen. Alle so ausgetauschten Informationen sind geheimzuhalten und dürfen nur solchen Personen oder Behörden zugänglich gemacht werden, die mit der Veranlagung oder Einhebung der unter

das Abkommen fallenden Steuern befasst sind.

(2) Absatz 1 ist auf keinen Fall so auszulegen, als verpflichte er einen der Vertragstaaten:

a) Verwaltungmassnahmen durchzuführen, die von den Gesetzen oder der Verwaltungspraxis dieses oder des anderen Vertragstaates abweichen;

b) Angaben zu übermitteln, die nach den Gesetzen oder im üblichen Verwaltungsverfahren dieses oder des anderen Vertragstaates nicht beschafft werden können;

c) Informationen zu erteilen, die ein Handels-, Geschäfts-, Gewerbe- oder Berufsgeheimnis oder ein Geschäftsverfahren preisgeben würden oder deren Erteilung dem Ordre public widerspräche.

Artikel 27

Dieses Abkommen berührt nicht die steuerlichen Vorrechte, die den diplomatischen und konsularischen Beamten nach den allgemeinen Regeln des Völkerrechts oder auf Grund besonderer Vereinbarungen zustehen.

Artikel 28

(1) Dieses Abkommen soll ratifiziert und die Ratifikationsurkunden sollen so bald wie möglich in Wien ausgetauscht werden.

(2) Dieses Abkommen tritt sechzig Tage nach Austausch der Ratifikationsurkunden in Kraft, und seine Bestimmungen finden Anwendung für die Steuerjahre und Steuerzeiträume, die am oder nach dem 1. Jänner des Jahres beginnen, in dem die Ratifikationsurkunden ausgetauscht werden.

Artikel 29

Dieses Abkommen bleibt in Kraft, solange es nicht von einer der beiden vertragschliessenden Parteien gekündigt worden ist. Jede vertragschliessende Partei kann das Abkommen auf diplomatischem Wege schriftlich unter Einhaltung einer Frist von mindestens sechs Monaten zum Ende eines Kalenderjahres kündigen. In diesem Fall ist das Abkommen für die Steuerjahre und Steuerzeiträume nicht mehr anzuwenden, die nach dem Ende des Kalenderjahres beginnen, zu dessen Ende die Kündigung erfolgt ist.

Zu Urkund dessen haben die Bevollmächtigten der beiden Staaten dieses Abkommen unterzeichnet und mit Siegeln versehen.

Geschehen zu Belgrad, am 7. Mai 1975 in zweifacher Urschrift in deutscher und serbo-kroatischer Sprache, wobei beide Texte authentisch sind.

Für die Republik Österreich:
Dr. ALEXANDER OTTO

Für die Sozialistische Föderative Republik Jugoslawien:
BOZIDAR BRAJOVIC

ABKOMMEN zwischen der Republik Österreich und der Ungarischen Volksrepublik zur Vermeidung der Doppelbesteuerung auf dem Gebiete der Nachlass- und Erbschaftsteuern

SUPPLEMENT TO THE BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION
AU BULLETIN DE DOCUMENTATION FISCALE INTERNATIONALE

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INTERNATIONAL BUREAU OF FISCAL DOCUMENTATION

Muiderpoort - 124 Sarphatistraat - Amsterdam

A treaty for the avoidance of double taxation with respect to death duties was signed between Austria and Hungary on February 25, 1975. In accordance with Article 14 the treaty entered into force on February 9, 1976. The full text of the Austrian Explanatory Memorandum to the treaty has been appended.

TEXT

Die Republik Österreich und die Ungarische Volksrepublik, von dem Wunsche geleitet, die Doppelbesteuerung auf dem Gebiete der Nachlass- und Erbschaftsteuern zu vermeiden, sind übereingekommen, das folgende Abkommen abzuschliessen:

Artikel 1

Unter das Abkommen fallende Nachlässe

Dieses Abkommen gilt für Nachlässe von Erblassern, die im Zeitpunkt ihres Todes einen Wohnsitz in einem Vertragstaat oder in beiden Vertragstaaten hatten.

Artikel 2

Unter das Abkommen fallende Steuern

(1) Dieses Abkommen gilt, ohne Rücksicht auf die Art der Erhebung, für Nachlass- und Erbschaftsteuern, die für Rechnung eines der beiden Vertragstaaten oder seiner Gebietskörperschaften erhoben werden.

(2) Als Nachlass- und Erbschaftsteuern gelten alle Steuern (Gebühren), die von Todes wegen als Nachlassteuern (-gebühren), Erbanfallsteuern (-gebühren), Ab-

gaben (Gebühren) vom Vermögensübergang oder Steuern (Gebühren) von Schenkungen auf den Todesfall erhoben werden.

(3) Die zur Zeit bestehenden Steuern, für die das Abkommen gilt, sind:

a) in der Ungarischen Volksrepublik: die Erbschaftsgebühr,

b) in der Republik Österreich: die Erbschaftsteuer, soweit ihr Erwerb von Todes wegen oder Zweckzuwendungen von Todes wegen unterliegen.

(4) Das Abkommen gilt auch für alle Nachlass- und Erbschaftsteuern, die künftig neben den zur Zeit bestehenden Steuern oder an deren Stelle erhoben werden.

Artikel 3

Allgemeine Definitionen

(1) Im Sinne dieses Abkommens bedeutet der Ausdruck „zuständige Behörde"

1. in der Ungarischen Volksrepublik: den Finanzminister,

2. in der Republik Österreich: den Bundesminister für Finanzen.

(2) Bei Anwendung des Abkommens durch einen Vertragstaat hat, wenn der Zusammenhang nichts anderes erfordert, jeder nicht anders definierte Ausdruck die Bedeutung, die ihm nach dem Recht dieses Staates über die Steuern zukommt, welche Gegenstand des Abkommens sind.

Artikel 4

Steuerlicher Wohnsitz

(1) Ob ein Erblasser im Zeitpunkt seines Todes einen Wohnsitz in einem Vertragstaat hatte, bestimmt sich bei Anwendung dieses Abkommens nach dem Recht dieses Staates.

(2) Hatte nach Absatz I ein Erblasser in beiden Vertragstaaten einen Wohnsitz, so gilt folgendes:

a) Der Wohnsitz des Erblassers gilt als in dem Vertragstaat gelegen, in dem er über eine ständige Wohnstätte verfügte. Verfügte er in beiden Vertragstaaten über eine ständige Wohnstätte, so gilt sein Wohnsitz als in dem Vertragstaat gelegen, zu dem er die engeren familiären und wirtschaftlichen Beziehungen hatte (Mittelpunkt der Lebensinteressen).

b) Kann nicht bestimmt werden, in welchem Vertragstaat der Erblasser den Mittelpunkt der Lebensinteressen hatte, oder verfügte er in keinem der Vertragstaaten über eine ständige Wohnstätte, so gilt sein Wohnsitz als in dem Vertragstaat gelegen, in dem er seinen gewöhnlichen Aufenthalt hatte.

c) Hatte der Erblasser seinen gewöhnlichen Aufenthalt in beiden Vertragstaaten oder in keinem der Vertragstaaten, so gilt sein Wohnsitz als in dem Vertragstaat gelegen, dessen Staatsangehörigkeit er besass.

d) Besass der Erblasser die Staatsangehörigkeit beider Vertragstaaten oder keines Vertragstaates, so werden die Vertragstaaten gemäss Artikel 11 vorgehen.

Artikel 5

Unbewegliches Vermögen

(1) Unbewegliches Vermögen darf in dem Vertragstaat besteuert werden, in dem dieses Vermögen liegt.

(2) Der Ausdruck „unbewegliches Vermögen" bestimmt sich nach dem Recht des Vertragstaates, in dem das Vermögen liegt. Der Ausdruck umfasst in jedem Fall das Zubehör zum unbeweglichen Vermögen,

das lebende und tote Inventar land- und forstwirtschaftlicher Betriebe, die Rechte, auf die die Vorschriften des Privatrechts über Grundstücke Anwendung finden, die Nutzungsrechte an unbeweglichem Vermögen sowie die Rechte auf veränderliche oder feste Vergütungen für die Ausbeutung oder das Recht auf Ausbeutung von Mineralvorkommen, Quellen und anderen Bodenschätzen; Schiffe und Luftfahrzeuge gelten nicht als unbewegliches Vermögen.

(3) Die Absätze 1 und 2 gelten auch für unbewegliches Vermögen eines Unternehmens und für unbewegliches Vermögen, das der Ausübung eines freien Berufes oder einer sonstigen selbständigen Tätigkeit ähnlicher Art dient.

Artikel 6

Vermögen einer Betriebstätte und Vermögen einer der Ausübung eines freien Berufes dienenden festen Einrichtung

(1) Vermögen, das Betriebsvermögen einer Betriebstätte eines Unternehmens darstellt — ausgenommen das nach den Artikeln 5 und 7 zu behandelnde Vermögen —, darf in dem Vertragstaat besteuert werden, in dem sich die Betriebstätte befindet.

(2) Der Ausdruck „Betriebstätte" bedeutet eine feste Geschäfts- oder Produktionseinrichtung, in der die Tätigkeit des Unternehmens ganz oder teilweise ausgeübt wird.

(3) Der Ausdruck „Betriebstätte" umfasst insbesondere:

a) einen Ort der Leitung,
b) eine Zweigniederlassung,
c) eine Geschäftsstelle,
d) eine Fabrikationsstätte,
e) eine Werkstätte,
f) ein Bergwerk, einen Steinbruch oder eine andere Stätte der Ausbeutung von Bodenschätzen,
g) eine Bauausführung oder Montage, deren Dauer zwei Jahre überschreitet.

(4) Als Betriebstätten gelten nicht:

a) Einrichtungen, die ausschliesslich zur Lagerung, Ausstellung oder Auslieferung von Gütern oder Waren des Unternehmens benutzt werden;
b) Bestände von Gütern oder Waren des Unternehmens, die ausschliesslich zur Lagerung, Ausstellung oder Auslieferung unterhalten werden;
c) Bestände von Gütern oder Waren des Unternehmens, die ausschliesslich zu dem Zweck unterhalten werden, durch ein anderes Unternehmen bearbeitet oder verarbeitet zu werden;
d) eine feste Geschäftseinrichtung, die ausschliesslich zu dem Zweck unterhalten wird, für das Unternehmen Güter oder Waren einzukaufen oder Informationen zu beschaffen;
e) eine feste Geschäftseinrichtung, die ausschliesslich zu dem Zweck unterhalten wird, für das Unternehmen zu werben, Informationen zu erteilen, wissenschaftliche Forschung zu betreiben oder ähnliche Tätigkeiten auszuüben, die vorbereitender Art sind oder eine Hilfstätigkeit darstellen.

(5) Ist eine Person — mit Ausnahme eines unabhängigen Vertreters im Sinne des Absatzes 6 — in einem Vertragstaat für ein Unternehmen des anderen Vertragstaates tätig, so gilt eine in dem erstgenannten Staat gelegene Betriebstätte als gegeben, wenn die Person eine Vollmacht besitzt, im Namen des Unternehmens Verträge abzuschliessen, und die Vollmacht in diesem Staat gewöhnlich ausübt, es sei denn, dass sich ihre Tätigkeit auf den Einkauf von Gütern oder Waren für das Unternehmen beschränkt.

(6) Ein Unternehmen eines Vertragstaates wird nicht schon deshalb so behandelt, als habe es eine Betriebstätte in dem anderen Vertragstaat, weil es dort seine Tätigkeit durch einen Makler, Kommissionär oder einen anderen unabhängigen Vertreter ausübt, sofern diese Personen im Rahmen ihrer ordentlichen Geschäftstätigkeit handeln.

(7) Vermögen, das zu einer der Ausübung eines freien Berufes oder einer sonstigen selbständigen Tätigkeit ähnlicher Art dienenden festen Einrichtung gehört — ausgenommen das nach Artikel 5 zu behandelnden Vermögen —, darf in dem Vertragstaat besteuert werden, in dem sich die feste Einrichtung befindet.

Artikel 7

Schiffe und Luftfahrzeuge

Schiffe und Luftfahrzeuge im internationalen Verkehr sowie bewegliches Vermögen, das dem Betrieb dieser Schiffe und Luftfahrzeuge dient, dürfen in dem Vertragstaat besteuert werden, in dem der Erblasser zum Zeitpunkt des Todes seinen Wohnsitz hatte.

Artikel 8

Nicht ausdrücklich erwähntes Vermögen

Das nicht nach den Artikeln 5, 6 und 7 zu behandelnde Vermögen darf nur in dem Vertragstaat besteuert werden, in dem der Erblasser zum Zeitpunkt des Todes seinen Wohnsitz hatte.

Artikel 9

Schuldenabzug

(1) Schulden, die durch das in Artikel 5 genannte Vermögen besonders gesichert sind, werden vom Wert dieses Vermögens abgezogen. Schulden, die zwar nicht durch das in Artikel 5 genannte Vermögen besonders gesichert sind, die aber im Zusammenhang mit dem Erwerb, der Änderung, der Instandsetzung oder Instandhaltung solchen Vermögens entstanden sind, werden vom Wert dieses Vermögens abgezogen.

(2) Vorbehaltlich des Absatzes 1 werden Schulden, die mit einer Betriebstätte eines Unternehmens oder mit einer Ausübung eines freien Berufes oder einer sonstigen selbständigen Tätigkeit ähnlicher Art dienenden festen Einrichtung zusammenhängen, und Schulden, die mit einem Betrieb der Seeschiffahrt, Binnenschiffahrt oder Luftfahrt zusammenhängen, vom Wert des in Artikel 6 bzw. des in Artikel 7 genannten Vermögens abgezogen.

(3) Die anderen Schulden werden vom Wert des Vermögens abgezogen, für das Artikel 8 gilt.

(4) Übersteigt eine Schuld den Wert des Vermögens, von dem sie in einem Vertragstaat nach den Absätzen 1, 2 und 3 abzuziehen ist, so wird der übersteigende Betrag vom Wert des übrigen Vermögens, das in diesem Staat besteuert werden darf, abgezogen.

(5) Verbleibt nach den Abzügen, die auf Grund der vorstehenden Absätze vorzunehmen sind, ein Schuldenrest, so wird dieser vom Wert des Vermögens, das im anderen Vertragstaat besteuert werden darf, abgezogen.

Artikel 10

Vermeidung der Doppelbesteuerung

Der Vertragstaat, in dem der Erblasser zum Zeitpunkt des Todes seinen Wohnsitz hatte, nimmt das Vermögen, das nach diesem Abkommen im anderen Vertragstaat besteuert werden darf, von der Besteuerung aus; dieser Staat darf aber bei der Festsetzung der Steuer für das Vermögen, für das er das Besteuerungsrecht behält, den Steuersatz anwenden, der anzuwenden wäre, wenn das betreffende Vermögen nicht von der Besteuerung ausgenommen wäre.

Artikel 11

Verständigungsverfahren

(1) Ist eine Person der Auffassung, dass die Massnahmen eines Vertragstaates oder beider Vertragstaaten für sie zu einer Besteuerung geführt haben oder führen werden, die diesem Abkommen nicht entspricht, so kann sie unbeschadet der nach innerstaatlichem Recht dieser Staaten vorgesehenen Rechtsmittel ihren Fall der zuständigen Behörde eines der beiden Staaten unterbreiten.

(2) Hält diese zuständige Behörde die Einwendung für begründet und ist sie selbst nicht in der Lage, eine befriedigende Lösung herbeizuführen, so wird sie sich bemühen, den Fall nach Verständigung mit der zuständigen Behörde des anderen Vertragstaates so zu regeln, dass eine dem Abkommen nicht entsprechende Besteuerung vermieden wird.

(3) Die zuständigen Behörden der Vertragstaaten werden sich bemühen, Schwierigkeiten oder Zweifel, die bei der Auslegung oder Anwendung des Abkommens entstehen, in gegenseitigem Einvernehmen zu beseitigen. Sie können auch gemeinsam darüber beraten, wie eine Doppelbesteuerung in Fällen, die in dem Abkommen nicht behandelt sind, vermieden werden kann.

(4) Die zuständigen Behörden der Vertragstaaten können zur Herbeiführung einer Einigung im Sinne der vorstehenden Absätze unmittelbar miteinander verkehren. Erscheint ein mündlicher Meinungsaustausch für die Herbeiführung der Einigung zweckmässig, so kann ein solcher Meinungsaustausch in einer Kommission durchgeführt werden, die aus Vertretern der zuständigen Behörden der Vertragstaaten besteht.

Artikel 12

Austausch von Informationen

(1) Die zuständigen Behörden der Vertragstaaten werden die zur Durchführung dieses Abkommens erforderlichen Informationen austauschen. Die zuständigen Behörden der Vertragstaaten sind jedoch nicht verpflichtet, Auskünfte zu erteilen, die nicht auf Grund der bei den Finanzbehörden vorhandenen Unterlagen gegeben werden können, sondern gesonderte Ermittlungen erfordern würden. Alle so ausgetauschten Informationen sind geheimzuhalten und dürfen nur solchen Personen oder Behörden zugänglich gemacht werden, die mit der Veranlagung oder Einhebung der unter das Abkommen fallenden Steuern befasst sind.

(2) Absatz 1 ist auf keinen Fall so auszulegen, als verpflichte er einen der Vertragstaaten:

a) Verwaltungsmassnahmen durchzuführen, die von den Gesetzen oder der Verwaltungspraxis dieses oder des anderen Vertragstaates abweichen;
b) Angaben zu übermitteln, die nach den Gesetzen oder im üblichen Verwaltungsverfahren dieses oder des anderen Vertragstaates nicht beschafft werden können;
c) Informationen zu erteilen, die ein Handels-, Geschäfts-, Gewerbe- oder Berufsgeheimnis oder ein Geschäftsverfahren preisgeben würden oder deren Erteilung dem Ordre public widerspräche.

Artikel 13

Diplomatische und konsularische Beamte

Dieses Abkommen berührt nicht die steuerlichen Vorrechte, die den Mitgliedern diplomatischer oder konsularischer Vertretungen nach den allgemeinen Regeln des Völkerrechts oder auf Grund besonderer Vereinbarungen zustehen.

Artikel 14

Inkrafttreten

(1) Dieses Abkommen ist der Rechtsordnung eines jeden der beiden Vertragstaaten gemäss zu ratifizieren. Die Ratifikationsurkunden sind so bald wie möglich in Budapest auszutauschen.

(2) Das Abkommen tritt 60 Tage nach dem Austausch der Ratifikationsurkunden in Kraft, und seine Bestimmungen finden auf Nachlässe von Personen Anwendung, die an oder nach diesem Tag sterben.

Artikel 15

Ausserkrafttreten

Dieses Abkommen bleibt in Kraft, solange es nicht von einem der Vertragstaaten gekündigt worden ist.
Jeder der beiden Vertragstaaten kann das Abkommen schriftlich auf diplomatischem Weg unter Einhaltung einer sechsmonatigen Frist auf das Ende eines Kalenderjahres kündigen. In diesem Fall findet das Abkommen nicht mehr auf Nachlässe von Personen Anwendung, die nach Ablauf des Kalenderjahres verstorben sind, zu dessen Ende das Abkommen gekündigt worden ist.

ZU URKUND DESSEN haben die Bevollmächtigten dieses Abkommen unterzeichnet und mit ihren Siegeln versehen.

GESCHEHEN zu Wien, am 25. Februar 1975 in zweifacher Urschrift, in deutscher und in ungarischer Sprache, wobei beide Texte in gleicher Weise authentisch sind.

Für die Republik Österreich:
ANDROSCH e.h.

Für die Ungarische Volksrepublik:
FALUVÉGI e.h.

Erläuterungen

I.

Allgemeiner Teil

Bei dem vorliegenden Abkommen handelt es sich um einen gesetzesändernden Staatsvertrag, der weder verfassungsändernden noch verfassungsergänzenden Charakter hat. Für die Erfüllung des Staatsvertrages ist die Erlassung eines Gesetzes nicht erforderlich.
Im Verhältnis zur Ungarischen Volksrepublik findet auf dem Gebiete der Erbschaftssteuer derzeit die in den Doppelbesteuerungsvereinbarungen zwischen dem Deutschen Reich und dem Königreich Ungarn enthaltenen Bestimmungen Anwendung. Anlässlich der österreichisch-ungarischen Verhandlungen über einen Abschluss eines Doppelbesteuerungsabkommens für den Bereich der Einkommensteuern und Vermögensteuern wurde Einvernehmen darüber erzielt, auch die erbschaftsteuerlichen Bestimmungen der mittlerweile auf dem Gebiet des zwischenstaatlichen Steuerrechts eingetretenen Weiterentwicklung anzupassen und ein gesondertes Abkommen mit einem Anwendungsbereich lediglich für die Erbschaftssteuer zu vereinbaren. Das bei diesen Verhandlungen ausgearbeitete Abkommen ist am 25. Februar 1975 in Wien unterzeichnet worden.
Das vorliegende Abkommen folgt in sei-

nem Aufbau im wesentlichen dem vom Fiskalkomitee der Organisation für wirtschaftliche Zusammenarbeit und Entwicklung (OECD) ausgearbeiteten Musterabkommen zur Vermeidung der Doppelbesteuerung der Nachlässe und Erbschaften. Die Doppelbesteuerung wird in beiden Staaten nach der sogenannten „Befreiungsmethode" beseitigt, d. h. dass die einzelnen Besteuerungsobjekte jeweils einem der beiden Vertragstaaten zur ausschliesslichen Besteuerung zugeteilt werden.

II.

Besonderer Teil

Zu Artikel 1:
Das Abkommen ist auf alle Nachlässe von Erblassern, die im Zeitpunkt ihres Todes einen Wohnsitz in einem der beiden oder in beiden Vertragstaaten hatten, anzuwenden.

Zu Artikel 2:
In sachlicher Hinsicht gilt das Abkommen für alle in beiden Vertragstaaten derzeit in Geltung stehenden oder künftig erhobenen Erbschaftssteuern.

Zu Artikel 3:
Dieser Artikel enthält die in Doppelbesteuerungsabkommen üblichen Begriffsumschreibungen.

Zu Artikel 4:
Diese Bestimmung enthält die Umschreibung des für die Aufteilung der Besteuerungsrechte massgebenden Begriffes des Wohnsitzes. Analog wie bei den Doppelbesteuerungsabkommen auf dem Gebiete der Steuern vom Einkomenm und vom Vermögen gilt in Fällen von Doppelwohnsitz jener Vertragstaat als Wohnsitzstaat, in dem sich der Mittelpunkt der Lebensinteressen des Erblassers befunden hat.

Zu Artikel 5:
Unbewegliches Nachlassvermögen wird ausschliesslich nur in jenem Vertragstaat besteuert, in dem es gelegen ist. Dies gilt auch, wenn es sich um Betriebsvermögen handelt.

Zu Artikel 6:
Das Recht auf Besteuerung des nicht zum unbeweglichen Vermögen gehörenden Vermögens, das Betriebsvermögen einer Betriebstätte eines Unternehmens darstellt, gibt der Artikel dem Vertragstaat, in dem die Betriebstätte liegt.
Der Betriebstättenbegriff entspricht jenem des Doppelbesteuerungsabkommens auf dem Gebiet der Einkommens- und Vermögensbesteuerung.

Zu Artikel 7:
Dieser Artikel gibt dem Staat, in dem der Erblasser zum Zeitpunkt des Todes seinen Wohnsitz hatte, das Recht zur Erhebung der Nachlass- und Erbschaftssteuern für Schiffe und Luftfahrzeuge im internationalen Verkehr.

Zu Artikel 8:
Nach dieser allgemeinen Steuerzuteilungsregel wird Vermögen, das nicht unter die besonderen Zuteilungsregeln der Artikel 5, 6 und 7 fällt, nur in jenem Vertragstaat besteuert, in dem der Erblasser im Zeitpunkt des Todes seinen Wohnsitz im Sinne von Artikel 4 hatte.

Zu Artikel 9:
Hinsichtlich der Aufteilung der Nachlassschulden ist bestimmt, dass der Staat, der nur einzelne Vermögenswerte besteuert, die mit ihnen zusammenhängenden Schulden abzieht und dass alle übrigen Schulden von dem Staat abzuziehen sind, in dem der Erblasser seinen Wohnsitz hatte.
Verbleibt auf diese Art in einem Staat ein ungedeckter Schuldenrest, so ist er vorerst

vom Wert des Nachlassvermögens abzuziehen, der im selben Staat zu besteuern ist; ein darüber hinausgehender Schuldenrest wird vom Wert des Nachlassvermögens abgezogen, das im anderen Staat zu versteuern ist.

Zu Artikel 10:
In diesem Artikel wird die Methode festgelegt, nach der die Doppelbesteuerung vermieden wird: darnach ist vorgesehen, dass jener Vertragstaat, in dem der Erblasser gemäss Artikel 4 im Zeitpunkt seines Todes seinen Wohnsitz hatte (Wohnsitzstaat), alle Nachlassteile, für die nach den Artikeln 5, 6 und 7 das Besteuerungsrecht dem anderen Vertragstaat zugeteilt ist, von seiner Besteuerung auszunehmen hat, dies allerdings unter dem Vorbehalt, dass der Wohnsitzstaat die auszuscheidenden Nachlassteile für die Berechnung des auf die übrigen Nachlassteile entfallenden Steuersatzes ansetzen darf (Befreiungsmethode mit Progressionsvorbehalt).

Zu Artikel 11 und 12:
Die Vorschriften dieser Artikel enthalten die international üblichen Grundsätze über das in Streit- oder in Zweifelsfällen durchzuführende Verständigungsverfahren und über den Informationsaustausch.

Zu Artikel 13:
Dieser Artikel enthält Bestimmungen klarstellender Natur über das Verhältnis des Doppelbesteuerungsabkommens zu völkerrechtlich privilegierten Personen.

Zu Artikel 14 und 15:
Diese Bestimmungen betreffen den zeitlichen Anwendungsbereich.

Convention entre le Gouvernement de la République française et le Gouvernement de la République populaire de Pologne tendant à éviter les doubles impositions en matière d'impôts sur le revenu et sur la fortune

SUPPLEMENT TO THE BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION
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INTERNATIONAL BUREAU
OF FISCAL DOCUMENTATION

Muiderpoort - 124 Sarphatistraat - Amsterdam

A double taxation treaty between France and Poland was signed on June 20, 1975. The treaty, in accordance with Article 29, shall enter into force thirty days following the date on which the Contracting States have exchanged the instruments of ratification.
The full text of the French Explanatory Note to the double taxation treaty has been published in the August 1976 issue of the Bulletin for International Fiscal Documentation under Documents.

TEXTE

Le Gouvernement de la République française et le Gouvernement de la République populaire de Pologne,

Désireux de poursuivre et de faciliter le développement de leurs relations économiques, ont décidé de conclure une Convention en vue d'éviter les doubles impositions en matière d'impôts sur le revenu et sur la fortune et sont convenus des dispositions suivantes:

Article 1er
Personnes visées

La présente Convention s'applique aux personnes qui sont des résidents d'un Etat contractant ou de chacun des deux Etats.

Article 2
Impôts visés

1. La présente Convention s'applique aux impôts sur le revenu et sur la fortune

perçus dans chacun des Etats contractants, quel que soit le système de perception.

2. Sont considérés comme impôts sur le revenu et sur la fortune tous les impôts perçus sur le revenu total, sur la fortune totale ou sur des éléments du revenu ou de la fortune, y compris les impôts sur les gains provenant de l'aliénation de biens mobiliers ou immobiliers, les impôts sur le montant des salaires payés par les entreprises, ainsi que les impôts sur les plus-values.

3. Les impôts actuels auxquels s'applique la Convention sont notamment:
a) En ce qui concerne la République populaire de Pologne:
1° L'impôt sur le revenu (podatek dochodowy);
2° L'impôt sur les salaires (podatek od wynagrodzen);
3° L'impôt complémentaire à l'impôt sur le revenu ou à l'impôt sur les salaires (podatek wyrownawczy do podatku dochodowego albo do podatku od wynagrodzen) (ci-après dénommé «impôt polonais»).
b) En ce qui concerne la République française:
1° L'impôt sur le revenu;
2° L'impôt sur les sociétés;
3° La contribution des patentes;
y compris toutes retenues à la source, tous précomptes et avances décomptés sur les impôts visés ci-dessus (ci-après dénommés «impôt français»).

4. La Convention s'appliquera aussi aux impôts de nature identique ou analogue qui seraient entrés en vigueur après la date de signature de la présente Convention et qui s'ajouteraient aux impôts actuels ou qui les remplaceraient. Les autorités compétentes des Etats contractants se communiqueront les modifications importantes apportées à leurs législations fiscales respectives.

Article 3
Définitions générales

1. Au sens de la présente Convention, à moins que le contexte n'exige une interprétation différente:
a) Les expressions «un Etat contractant» et «l'autre Etat contractant» désignent respectivement la République populaire de Pologne ou la République française;
b) Le terme «personne» comprend les personnes physiques, les sociétés et tous autres groupements de personnes;
c) Le terme «société» désigne toute personne morale ou toute entité qui est considérée comme une personne morale aux fins d'imposition;
d) Les expressions «entreprise d'un Etat contractant» et «entreprise de l'autre Etat contractant» désignent respectivement une entreprise exploitée par un résident d'un Etat contractant et une entreprise exploitée par un résident de l'autre Etat contractant;
e) Le terme «nationaux» désigne:
1° Toutes les personnes physiques qui possèdent la nationalité d'un Etat contractant;
2° Toutes les personnes morales, sociétés de personnes et associations constituées conformément à la législation en vigueur dans un Etat contractant;
f) On entend par «trafic international» tout transport effectué par un navire, un aéronef ou un véhicule ferroviaire ou routier exploité par une entreprise dont le siège de la direction effective est situé dans un Etat contractant, sauf lorsque le navire, l'aéronef ou le véhicule n'est exploité qu'entre des points situés dans l'autre Etat contractant;
g) L'expression «autorité compétente» désigne:
1° Dans le cas de la République populaire de Pologne, le Ministre des Finances ou son représentant autorisé;

2° Dans le cas de la République française, le Ministre de l'Economie et des Finances ou son représentant autorisé.
2. Pour l'application de la Convention par un Etat contractant, toute expression qui n'est pas autrement définie a le sens qui lui est attribué par la législation dudit Etat régissant les impôts faisant l'objet de la Convention, à moins que le contexte n'exige une interprétation différente.

Article 4
Domicile fiscal

1. Au sens de la présente Convention, l'expression «résident d'un Etat contractant» désigne toute personne qui, en vertu de la législation dudit Etat, est assujettie à l'impôt dans cet Etat, en raison de son domicile, de sa résidence, de son siège de direction ou de tout autre critère de nature analogue, mais n'inclut pas les personnes qui ne sont imposables dans cet Etat que pour le revenu qu'elles tirent de sources situées dans ledit Etat ou pour la fortune qu'elles possèdent dans cet Etat.
2. Lorsque, selon la disposition du paragraphe 1, une personne physique est considérée comme résident de chacun des Etats contractants, sa situation est réglée de la manière suivante:
a) Cette personne est considérée comme résident de l'Etat contractant où elle dispose d'un foyer d'habitation permanent. Lorsqu'elle dispose d'un foyer d'habitation permanent dans chacun des Etats contractants, elle est considérée comme résident de l'Etat contractant avec lequel ses liens personnels et économiques sont les plus étroits (centre des intérêts vitaux);
b) Si l'Etat contractant où cette personne a le centre de ses intérêts vitaux ne peut pas être déterminé, ou si elle ne dispose d'un foyer d'habitation permanent dans aucun des Etats contractants, elle est considérée comme résident de l'Etat contractant où elle séjourne de façon habituelle;
c) Si cette personne séjourne de façon habituelle dans chacun des Etats contractants ou si elle ne séjourne de façon habituelle dans aucun d'eux, elle est considérée comme résident de l'Etat contractant dont elle possède la nationalité;
d) Si la situation de cette personne ne peut être réglée conformément aux dispositions des alinéas *a)*, *b)* et *c)* ci-dessus, les autorités compétentes des Etats contractants tranchent la question d'un commun accord.
3. Lorsque, selon la disposition du paragraphe 1, une personne autre qu'une personne physique est considérée comme résident de chacun des Etats contractants, elle est réputée résident de l'Etat contractant où se trouve son siège de direction effective.

Article 5
Etablissement stable

1. Au sens de la présente Convention, l'expression «établissement stable» désigne une installation fixe d'affaires où l'entreprise exerce tout ou partie de son activité.
2. L'expression «établissement stable» comprend notamment:
a) Un siège de direction;
b) Une succursale;
c) Un bureau d'affaires commerciales;
d) Une usine;
e) Un atelier;
f) Une mine, une carrière ou tout autre lieu d'extraction de ressources naturelles;
g) Un chantier de construction ou de montage dont la durée dépasse douze mois.
3. On ne considère pas qu'il y a établissement stable si:
a) Il est fait usage d'installations aux seules fins de stockage, d'exposition ou de livraison de biens ou de marchandises appartenant à l'entreprise;
b) Des biens ou des marchandises apparte-

nant à l'entreprise sont entreposés aux seules fins de stockage, d'exposition ou de livraison;

c) Des biens ou des marchandises appartenant à l'entreprise sont entreposés aux seules fins de traitement ou de transformation par une autre entreprise;

d) Une installation fixe d'affaires est utilisée aux seules fins d'acheter des biens ou des marchandises ou de réunir des informations pour l'entreprise;

e) Une installation fixe d'affaires est utilisée, pour l'entreprise, aux seules fins de publicité, de fourniture d'informations, de recherches scientifiques ou d'activités analogues qui ont un caractère préparatoire ou auxiliaire.

4. Une personne agissant dans un Etat contractant pour le compte d'une entreprise de l'autre Etat contractant — autre qu'un agent jouissant d'un statut indépendant, visé au paragraphe 5 — est considérée comme «établissement stable» dans le premier Etat si elle dispose dans cet Etat de pouvoirs qu'elle y exerce habituellement lui permettant de conclure des contrats au nom de l'entreprise, à moins que l'activité de cette personne ne soit limitée à l'achat de biens ou de marchandises pour l'entreprise.

5. On ne considère pas qu'une entreprise d'un Etat contractant a un établissement stable dans l'autre Etat contractant du seul fait qu'elle y exerce son activité par l'entremise d'une courtier, d'un commissionnaire général ou de tout autre intermédiaire jouissant d'un statut indépendant, à condition que ces personnes agissent dans le cadre de leur activité.

d'un Etat contractant contrôle ou soit cond'n Etat contractant contrôle ou soit contrôlée par une société qui est un résident de l'autre Etat contractant ou qui y exerce son activité (que ce soit par l'intermédiaire d'un établissement stable ou non) ne suffit pas, en lui-même, à faire de l'une quelconque de ces sociétés un établissement stable de l'autre.

Article 6
Revenus immobiliers

1. Les revenus provenant de biens immobiliers, y compris les revenus des exploitations agricoles ou forestières, sont imposables dans l'Etat contractant où ces biens sont situés.

2. L'expression «biens immobiliers» est définie conformément à la législation fiscale de l'Etat contractant où les biens considérés sont situés. L'expression englobe en tout cas les accessoires, le cheptel mort ou vif des exploitations agricoles et forestières, les droits auxquels s'appliquent les dispositions du droit privé concernant la propriété foncière, l'usufruit des biens immobiliers et les droits à des redevances variables ou fixes pour l'exploitation ou la concession de l'exploitation de gisements minéraux, sources et autres richesses du sol; les navires, bateaux et aéronefs ne sont pas considérés comme biens immobiliers.

3. Les dispositions du paragraphe 1 s'appliquent aux revenus provenant de l'exploitation directe, de la location ou de l'affermage, ainsi que de toute autre forme d'exploitation de biens immobiliers.

4. Les dispositions des paragraphes 1 et 3 s'appliquent également aux revenus provenant des biens immobiliers d'une entreprise ainsi qu'aux revenus des biens immobiliers servant à l'exercice d'une profession libérale.

Article 7
Bénéfices des entreprises

1. Les bénéfices d'une entreprise d'un Etat contractant ne sont imposables que dans cet Etat, à moins que l'entreprise n'exerce son activité dans l'autre Etat contractant par

l'intermédiaire d'un établissement stable qui y est situé. Si l'entreprise exerce son activité d'une telle façon, les bénéfices de l'entreprise sont imposables dans l'autre Etat mais uniquement dans la mesure où ils sont imputables audit établissement stable.

2. Sous réserve des dispositions du paragraphe 3, lorsqu'une entreprise d'un Etat contractant exerce son activité dans l'autre Etat contractant par l'intermédiaire d'un établissement stable qui y est situé, il est imputé, dans chaque Etat contractant, à cet établissement stable les bénéfices qu'il aurait pu réaliser s'il avait constitué une entreprise distincte et séparée exerçant des activités identiques ou analogues dans des conditions identiques ou analogues et traitant en toute indépendance avec l'entreprise dont il constitue un établissement stable.

3. Dans le calcul des bénéfices d'un établissement stable, sont admises en déduction les dépenses exposées aux fins poursuivies par cet établissement stable, y compris les dépenses de direction et les frais généraux d'administration ainsi exposés soit dans l'Etat où est situé cet établissement stable, soit ailleurs.

4. S'il est d'usage, dans un Etat contractant, de déterminer les bénéfices imputables à un établissement stable sur la base d'une répartition des bénéfices totaux de l'entreprise entre ses diverses parties, aucune disposition du paragraphe 2 n'empêche cet Etat contractant de déterminer les bénéfices imposables selon la répartition en usage; la méthode de répartition adoptée doit cependant être telle que le résultat obtenu soit conforme aux principes contenus dans le présent article.

5. Aucun bénéfice n'est imputé à un établissement stable du fait que cet établissement stable a simplement acheté des biens ou des marchandises pour l'entreprise.

6. Aux fins des paragraphes précédents, les bénéfices à imputer à l'établissement stable sont calculés chaque année selon la même méthode, à moins qu'il n'existe des motifs valables et suffisants de procéder autrement.

7. Lorsque les bénéfices comprennent des éléments de revenu traités séparément dans d'autres articles de la présente Convention, les dispositions de ces articles ne sont pas affectées par les dispositions du présent article.

8. Les bénéfices d'une entreprise d'assurances ou de réassurances d'un Etat contractant ne sont imposables que dans cet Etat, à moins que l'entreprise n'exerce son activité dans l'autre Etat contractant par l'intermédiaire d'un établissement stable qui y est situé.

Article 8
Transport international

1. Les bénéfices provenant de l'exploitation en trafic international de navires ou d'aéronefs ne sont imposables que dans l'Etat contractant où le siège de la direction effective de l'entreprise est situé.

2. Les bénéfices provenant de l'exploitation de bateaux servant à la navigation intérieure ne sont imposables que dans l'Etat contractant où le siège de la direction effective de l'entreprise est situé.

3. Si le siège de la direction effective d'une entreprise de navigation maritime ou intérieure est à bord d'un navire ou d'un bateau, ce siège est réputé situé dans l'Etat contractant où se trouve le port d'attache de ce navire ou de ce bateau ou, à défaut de port d'attache, dans l'Etat contractant dont l'exploitant du navire ou du bateau est un résident.

4. Les bénéfices provenant de l'exploitation en trafic international de véhicules ferro-

viaires ou routiers ne sont imposables que dans l'Etat contractant où le siège de la direction effective de l'entreprise est situé.

5. Les dispositions des paragraphes 1, 2 et 4 s'appliquent aussi:

a) Aux bénéfices provenant de l'exploitation en trafic international de navires, d'aéronefs ou de véhicules ferroviaires ou routiers loués, ainsi qu'aux bénéfices provenant de l'exploitation de bateaux loués servant à la navigation intérieure;

b) Aux bénéfices provenant de la participation à un groupe, à une exploitation en commun ou à un organisme international d'exploitation.

Article 9
Entreprises associées

Lorsque:

a) Une entreprise d'un Etat contractant participe directement ou indirectement à la direction, au contrôle ou au capital d'une entreprise de l'autre Etat contractant, ou que

b) Les mêmes personnes participent directement ou indirectement à la direction, au contrôle ou au capital d'une entreprise d'un Etat contractant et d'une entreprise de l'autre Etat contractant,

et que, dans l'un et l'autre cas, les deux entreprises sont, dans leurs relations commerciales ou financières, liées par des conditions acceptées ou imposées, qui diffèrent de celles qui seraient conclues entre les entreprises indépendantes, les bénéfices qui, sans ces conditions, auraient été obtenus par l'une des entreprises mais n'ont pu l'être en fait à cause de ces conditions peuvent être inclus dans les bénéfices de cette entreprise et imposés en conséquence.

Article 10
Dividendes

1. Les dividendes payés par une société qui est un résident d'un Etat contractant à un résident de l'autre Etat contractant sont imposables dans cet autre Etat.

2. Toutefois, ces dividendes peuvent être imposés dans l'Etat contractant dont la société qui paie les dividendes est un résident, et selon la législation de cet Etat, mais si la personne qui perçoit les dividendes en est le bénéficiaire effectif, l'impôt ainsi établi ne peut excéder:

a) 5 p. 100 du montant brut des dividendes si le bénéficiaire des dividendes est une société (à l'exclusion des sociétés de personnes) qui dispose directement d'au moins 10 p. 100 du capital de la société qui paie les dividendes;

b) 15 p. 100 du montant brut des dividendes, dans tous les autres cas.

3. Le terme «dividendes» employé dans le présent article désigne les revenus provenant d'actions ou autres parts bénéficiaires à l'exception des créances, ainsi que les revenus d'autres parts sociales assujettis au même régime fiscal que les revenus d'actions par la législation fiscale de l'Etat dont la société distributrice est un résident.

4. Les dispositions des paragraphes 1 et 2 ne s'appliquent pas, lorsque le bénéficiaire des dividendes, résident d'un des Etats contractants, exerce dans l'autre Etat contractant dont la société payant les dividendes est un résident, soit une activité industrielle ou commerciale par l'intermédiaire d'un établissement stable qui y est situé, soit une profession libérale au moyen d'une base fixe qui y est située et lorsque la participation génératrice des dividendes s'y rattache effectivement. Dans ce cas, les dispositions de l'article 7 ou de l'article 14 sont, suivant les cas, applicables.

5. Un résident de Pologne qui reçoit des dividendes distribués par une société qui est un résident de France peut obtenir le remboursement du précompte afférent à ces

dividendes acquitté, le cas échéant, par la société distributrice. Ce précompte sera remboursé sous déduction de l'impôt perçu conformément à la législation interne et aux dispositions du paragraphe 2.
Le montant brut du précompte remboursé sera considéré comme un dividende pour l'application de l'ensemble des dispositions de la présente Convention.

Article 11
Intérêts

1. Les intérêts provenant d'un Etat contractant et payés à un résident de l'autre Etat contractant ne sont imposables que dans cet autre Etat.
2. Le terme «intérêts» employé dans le présent article désigne les revenus des créances de toute nature, assorties ou non de garanties hypothécaires ou d'une clause de participation aux bénéfices du débiteur, et notamment les revenus des fonds publics et des obligations d'emprunt, y compris les primes et lots attachés à ces titres. Les pénalisations pour paiement tardif ne sont pas considérées comme intérêts au sens du présent article.
3. Les dispositions du paragraphe 1 ne s'appliquent pas, lorsque le bénéficiaire des intérêts, résident d'un des Etats contractants, exerce, dans l'autre Etat contractant, d'où proviennent les intérêts, soit une activité industrielle ou commerciale par l'intermédiaire d'un établissement stable qui y est situé, soit une profession libérale au moyen d'une base fixe qui y est située et que la créance génératrice des intérêts s'y rattache effectivement. Dans ce cas, les dispositions de l'article 7 ou de l'article 14 sont, suivant le cas, applicables.
4. Les intérêts sont considérés comme provenant d'un Etat contractant lorsque le débiteur est cet Etat lui-même, une unité d'administration locale autonome, une personne morale de droit public ou un résident de cet Etat. Toutefois, lorsque le débiteur des intérêts, qu'il soit ou non résident d'un Etat contractant, a dans un Etat contractant un établissement stable pour lequel l'emprunt générateur des intérêts a été contracté et qui supporte la charge de ces intérêts, lesdits intérêts sont réputés provenir de l'Etat contractant où l'établissement stable est situé.
5. Si, par suite de relations spéciales existant entre le débiteur et le créancier ou que l'un et l'autre entretiennent avec de tierces personnes, le montant des intérêts payés, compte tenu de la créance pour laquelle ils sont versés, excède celui dont seraient convenus le débiteur et le créancier en l'absence de pareilles relations, les dispositions du présent article ne s'appliquent qu'à ce dernier montant. En ce cas, la partie excédentaire des paiements reste imposable conformément à la législation de chaque Etat contractant et compte tenu des autres dispositions de la présente Convention.

Article 12
Redevances

1. Les redevances provenant d'un Etat contractant et payées à un résident de l'autre Etat contractant sont imposables dans cet autre Etat.
2. Toutefois, ces redevances peuvent être imposées dans l'Etat contractant d'où elles proviennent et selon la législation de cet Etat, mais si la personne qui perçoit les redevances en est le bénéficiaire effectif, l'impôt ainsi établi ne peut excéder 10 p. 100 du montant des redevances.
3. Nonobstant les dispositions du paragraphe 2, les redevances provenant de droits d'auteurs sur des œuvres littéraires, artistiques ou scientifiques ne sont imposables que dans l'Etat contractant dont la personne qui les perçoit est un résident.

4. Le terme «redevances» employé dans le présent article désigne les rémunérations de toute nature payées pour l'usage ou la concession de l'usage d'un droit d'auteur sur une œuvre littéraire, artistique ou scientifique, y compris les films cinématographiques et les œuvres enregistrées pour la radio ou la télévision, d'un brevet, d'une marque de fabrique ou de commerce, d'un dessin ou d'un modèle, d'un plan, d'une formule ou d'un procédé, et pour des informations ayant trait à une expérience, acquise dans le domaine industriel, commercial ou scientifique ou à un savoir-faire.

5. Les dispositions des paragraphes 1, 2 et 3 ne s'appliquent pas, lorsque le bénéficiaire des redevances, résident d'un des Etats contractants, exerce dans l'autre Etat contractant d'où proviennent les redevances soit une activité industrielle ou commerciale par l'intermédiaire d'un établissement stable qui y est situé, soit une profession libérale au moyen d'une base fixe qui y est située et que le droit ou le bien générateur des redevances s'y rattache effectivement. Dans ce cas, les dispositions de l'article 7 ou de l'article 14 sont, suivant les cas, applicables.

6. Les redevances sont considérées comme provenant d'un Etat contractant lorsque le débiteur est cet Etat lui-même, une unité d'administration locale autonome, une personne morale de droit public ou un résident de cet Etat. Toutefois, lorsque le débiteur des redevances, qu'il soit ou non résident d'un Etat contractant, a dans un Etat contractant un établissement stable, lorsque le contrat sur la base duquel les redevances sont payées a été conclu aux fins poursuivies par cet établissement stable et que cet établissement stable supporte la charge de ces redevances, lesdites redevances sont réputées provenir de l'Etat contractant où l'établissement stable est situé.

7. Si, par suite de relations spéciales existant entre le débiteur et le créancier ou que l'un et l'autre entretiennent avec de tierces personnes, le montant des redevances payées, compte tenu de la prestation pour laquelle elles sont versées, excède celui dont seraient convenus le débiteur et le créancier en l'absence de pareilles relations, les dispositions du présent article ne s'appliquent qu'à ce dernier montant. En ce cas, la partie excédentaire des paiements reste imposable conformément à la législation de chaque Etat contractant et compte tenu des autres dispositions de la présente Convention.

Article 13
Gains en capital

1. Les gains provenant de l'aliénation des biens immobiliers, tels qu'ils sont définis au paragraphe 2 de l'article 6, ou de l'aliénation de parts ou de droits analogues dans une société dont l'actif est composé principalement de biens immobiliers, sont imposables dans l'Etat contractant où ces biens sons situés.

2. Les gains provenant de l'aliénation de biens mobiliers faisant partie de l'actif d'un établissement stable qu'une entreprise d'un Etat contractant a dans l'autre Etat contractant ou de biens mobiliers constitutifs d'une base fixe dont dispose un résident d'un Etat contractant dans l'autre Etat contractant pour l'exercice d'une profession libérale, y compris de tels gains provenant de l'aliénation globale de cet établissement stable (seul ou avec l'ensemble de l'entreprise) ou de cette base fixe, sont imposables dans cet autre Etat. Toutefois, les gains provenant de aliénation des biens mobiliers visés au paragraphe 3 de l'article 22 ne sont imposables que dans l'Etat contractant où les biens en question eux-mêmes sont imposables en vertu dudit article.

3. Les gains provenant de l'aliénation de tous biens autres que ceux qui sont men-

tionnés aux paragraphes 1 et 2 ne sont imposables que dans l'Etat contractant dont le cédant est un résident.

Article 14
Professions indépendantes

1. Les revenus qu'un résident d'un Etat contractant tire d'une profession libérale ou d'autres activités indépendantes de caractère analogue ne sont imposables que dans cet Etat, à moins que ce résident ne dispose de façon habituelle dans l'autre Etat contractant d'une base fixe pour l'exercice de ses activités. S'il dispose d'une telle base, les revenus sont imposables dans l'autre Etat mais uniquement dans la mesure où ils sont imputables à ladite base fixe.
2. L'expression «activités indépendantes» désigne toutes les activités — autres que les activités commerciales, industrielles ou agricoles — exercées pour son propre compte, d'une manière indépendante, par une personne qui reçoit les profits ou supporte les pertes provenant de ces activités.

Article 15
Professions dépendantes

1. Sous réserve des dispositions des articles 16, 18 et 19, les salaires, traitements et autres rémunérations similaires qu'un résident d'un Etat contractant reçoit au titre d'un emploi salarié ne sont imposables que dans cet Etat, à moins que l'emploi ne soit exercé dans l'autre Etat contractant. Si l'emploi y est exercé, les rémunérations reçues à ce titre sont imposables dans cet autre Etat.
2. Nonobstant les dispositions du paragraphe 1, les rémunérations qu'un résident d'un Etat contractant reçoit au titre d'un emploi salarié exercé dans l'autre Etat contractant ne sont imposables que dans le premier Etat si:
a) Le bénéficiaire séjourne dans l'autre Etat pendant une période ou des périodes n'excédant pas au total 183 jours au cours de l'année fiscale considérée;
b) Les rémunérations sont payées par un employeur ou au nom d'un employeur qui n'est pas résident de l'autre Etat, et
c) La charge des rémunérations n'est pas supportée par un établissement stable ou une base fixe que l'employeur a dans l'autre Etat.
3. Nonobstant les dispositions précédentes du présent article, les rémunérations au titre d'un emploi salarié exercé à bord d'un navire, d'un aéronef ou d'un véhicule ferroviaire ou routier en trafic international, ou à bord d'un bateau servant à la navigation intérieure, sont imposables dans l'Etat contractant où le siège de la direction effective de l'entreprise est situé.

Article 16
Tantièmes

Les tantièmes, jetons de présence et autres rétributions similaires qu'un résident d'un Etat contractant reçoit en sa qualité de membre du conseil d'administration ou de surveillance d'une société qui est un résident de l'autre Etat contractant sont imposables dans cet autre Etat.

Article 17
Artistes et sportifs

1. Nonobstant les dispositions des articles 14 et 15, les revenus que les artistes du spectacle, tels les artistes de théâtre, de cinéma, de la radio ou de la télévision et les musiciens, ainsi que les sportifs retirent de leurs activités personnelles en cette qualité, sont imposables dans l'Etat contractant où ces activités sont exercées.
2. Lorsque les revenus d'activités exercées personnellement par un artiste du spectacle ou un sportif sont attribués à une autre personne que l'artiste ou le sportif lui-

même, ils peuvent, nonobstant les dispositions des articles 7, 14 et 15, être imposés dans l'Etat contractant où sont exercées les activités de l'artiste ou du sportif.

3. Nonobstant les dispositions des paragraphes 1 et 2, les revenus d'activités définies dans le paragraphe 1 et exercées dans le cadre des échanges culturels approuvés par l'Etat dont les artistes ou les sportifs sont des résidents, ne sont imposables que dans cet Etat.

Article 18

Pensions

Sous réserve des dispositions du paragraphe 2 de l'article 19, les pensions et autres rémunérations similaires versées au titre d'un emploi antérieur à un résident d'un Etat contractant ne sont imposables que dans cet Etat.

Article 19

Fonctions publiques

1. *a)* Les rémunérations, autres que les pensions, versées par un Etat contractant ou l'une de ses collectivités locales ou par l'une de leurs personnes morales de droit public à une personne physique au titre de services à caractère public rendus à cet Etat ou à cette collectivité ou à cette personne morale, ne sont imposables que dans cet Etat.

b) Toutefois, ces rémunérations ne sont imposables que dans l'autre Etat contractant si les services sont rendus dans cet Etat et si le bénéficiaire de la rémunération est un résident de cet Etat qui en possède la nationalité.

2. *a)* Les pensions versées par un Etat contractant ou l'une de ses collectivités locales ou par l'une de leurs personnes morales de droit public, soit directement, soit par prélèvement sur des fonds qu'ils ont constitués, à une personne physique au titre de services à caractère public rendus à cet Etat ou à cette collectivité ou à cette personne morale ne sont imposables que dans cet Etat.

b) Toutefois, ces pensions ne sont imposables que dans l'autre Etat contractant si le bénéficiaire est un résident de cet Etat et s'il en possède la nationalité.

3. Le caractère public des services rendus à un Etat contractant, à l'une de ses collectivités locales ou à l'une de leurs personnes morales de droit public est déterminé conformément à la loi interne de cet Etat contractant.

4. Les dispositions des articles 15, 16 et 18 s'appliquent aux rémunérations ou pensions versées au titre de services rendus dans le cadre d'une activité industrielle ou commerciale exercée par l'un des Etats contractants ou l'une de ses collectivités locales, ou par l'une de leurs personnes morales de droit public.

Article 20

Enseignants, chercheurs et étudiants

1. Un enseignant ou un chercheur qui, résident d'un Etat contractant, se rend dans l'autre Etat contractant pour y enseigner ou s'y livrer à des recherches est exonéré d'impôt dans cet autre Etat pendant une période n'excédant pas deux ans à raison des rémunérations reçues au titre de ces activités.

2. Les dispositions du paragraphe 1 ne s'appliquent pas aux revenus provenant de travaux de recherche, si ces travaux ne sont pas entrepris dans l'intérêt public mais principalement en vue de la réalisation d'un avantage particulier bénéficiant à une ou à des personnes déterminées.

3. Les sommes qu'un étudiant ou un stagiaire qui est, ou qui était auparavant, un résident d'un Etat contractant et qui séjourne dans l'autre Etat contractant à seule fin d'y poursuivre ses études ou sa formation, reçoit pour couvrir ses frais

d'entretien, d'études ou de formation, ne sont pas imposables dans cet autre Etat, à condition qu'elles proviennent de sources situées en dehors de cet autre Etat.

4. Nonobstant les dispositions du paragraphe 3, les rémunérations qu'un étudiant ou un stagiaire qui est, ou qui était auparavant, un résident d'un Etat contractant et qui séjourne dans l'autre Etat contractant à seule fin d'y poursuivre ses études ou sa formation, reçoit au titre de services rendus dans cet autre Etat, ne sont pas imposables dans cet autre Etat à condition que ces services soient en rapport avec ses études ou sa formation ou que la rémunération de ces services soit nécessaire pour compléter les ressources dont il dispose pour son entretien.

Article 21
Revenus non expressément mentionnés

1. Les éléments du revenu d'un résident d'un Etat contractant, d'où qu'ils proviennent, dont il n'est pas traité dans les articles précédents de la présente Convention ne sont imposables que dans cet Etat.

2. Les dispositions du paragraphe 1 ne s'appliquent pas lorsque le bénéficiaire du revenu, résident d'un Etat contractant, exerce dans l'autre Etat contractant, soit une activité industrielle ou commerciale par l'intermédiaire d'un établissement stable qui y est situé, soit une profession libérale au moyen d'un base fixe qui y est située, et lorsque le droit ou le bien générateur du revenu s'y rattache effectivement. Dans ce cas, les dispositions de l'article 7 ou de l'article 14, suivant les cas, sont applicables.

Article 22
Fortune

1. La fortune constituée par des biens immobiliers, tels qu'ils sont définis au paragraphe 2 de l'article 6, est imposable dans l'Etat contractant où ces biens sont situés.

2. La fortune constituée par des biens mobiliers faisant partie de l'actif d'un établissement stable d'une entreprise ou par des biens mobiliers constitutifs d'une base fixe servant à l'exercice d'une profession libérale est imposable dans l'Etat contractant où est situé l'établissement stable ou la base fixe.

3. Les navires, les aéronefs et les véhicules ferroviaires ou routiers exploités en trafic international et les bateaux servant à la navigation intérieure ainsi que les biens mobiliers affectés à leur exploitation ne sont imposables que dans l'Etat contractant où le siège de la direction effective de l'entreprise est situé.

4. Tous les autres éléments de la fortune d'un résident d'un Etat contractant ne sont imposables que dans cet Etat.

Article 23
Dispositions pour éliminer les doubles impositions

La double imposition est évitée de la manière suivante:

1. Dans le cas de la Pologne:

a) Lorsqu'un résident de Pologne reçoit des revenus ou possède de la fortune qui, conformément aux dispositions de la présente Convention, sont imposables en France, la Pologne exonère de l'impôt ces revenus ou cette fortune, sous réserve des dispositions de l'alinéa *b)*, mais peut, pour calculer le montant de l'impôt sur le reste du revenu ou de la fortune de ce résident, appliquer le même taux que si les revenus ou la fortune en question n'avaient pas été exonérés;

b) Lorsqu'un résident de Pologne reçoit des revenus qui, conformément aux dispositions des articles 10, 12, 14, 16 et 17, sont imposables en France, la Pologne accorde sur l'impôt dont elle frappe les revenus de ce résident une déduction d'un montant égal à l'impôt payé en France. La somme ainsi déduite ne peut toutefois excéder la fraction de l'impôt, calculé avant la déduction, correspondant aux revenus reçus de France.

2. Dans le cas de la France:

a) Les revenus autres que ceux visés à l'alinéa *b)* ci-dessous sont exonérés des impôts français mentionnés à l'alinéa *b)* du paragraphe 3 de l'article 2, lorsque ces revenus sont imposables en Pologne en vertu de la présente Convention;

b) Les revenus visés aux articles 10, 12, 14, 16 et 17 provenant de Pologne sont imposables en France. L'impôt polonais perçu sur ces revenus ouvre droit au profit des résidents de France à un crédit d'impôt correspondant au montant de l'impôt polonais perçu mais qui ne peut excéder le montant de l'impôt français perçu sur ces revenus. Ce crédit est imputable sur les impôts visés à l'alinéa *b)* du paragraphe 3 de l'article 2, dans les bases d'imposition desquels les revenus en cause sont compris;

c) Nonobstant les dispositions des alinéas *a)* et *b)*, l'impôt français est calculé, sur les revenus imposables en France en vertu de la présente Convention, au taux correspondant au total des revenus imposables d'après la législation française.

Article 24
Non-discrimination

1. Les nationaux d'un Etat contractant, qu'ils soient ou non résidents de l'un des Etats contractants, ne sont soumis dans l'autre Etat contractant à aucune imposition ou obligation y relative, qui est autre ou plus lourde que celle à laquelle sont ou pourront être assujettis les nationaux de cet autre Etat se trouvant dans la même situation.

2. L'imposition d'un établissement stable qu'une entreprise d'un Etat contractant a dans l'autre Etat contractant n'est pas établie dans cet autre Etat d'une façon moins favorable que l'imposition des entreprises de cet autre Etat qui exercent la même activité.

Cette disposition ne peut être interprétée comme obligeant un Etat contractant à accorder aux résidents de l'autre Etat contractant les déductions personnelles, abattements et réductions d'impôt en fonction de la situation ou des charges de famille qu'il accorde à ses propres résidents.

3. Sauf en cas d'application des dispositions de l'article 9, du paragraphe 5 de l'article 11 et du paragraphe 7 de l'article 12, les intérêts, redevances et autres frais payés par une entreprise d'un Etat contractant à un résident de l'autre Etat contractant sont déductibles pour la détermination des bénéfices imposables de cette entreprise, dans les mêmes conditions que s'ils avaient été payés à un résident du premier Etat.

De même, les dettes d'une entreprise d'un Etat contractant envers les résidents de l'autre Etat contractant sont déductibles, pour la détermination de la fortune imposable de cette entreprise, dans les mêmes conditions que si elles avaient été contractées envers un résident du premier Etat.

4. Les entreprises d'un Etat contractant, dont le capital est en totalité ou en partie, directement ou indirectement, détenu ou contrôlé par un ou plusieurs résidents de l'autre Etat contractant, ne sont soumises dans le premier Etat contractant à aucune imposition ou obligation y relative, qui est autre ou plus lourde que celle à laquelle sont ou pourront être assujetties les autres entreprises de même nature de ce premier Etat.

5. Le terme «imposition» désigne dans le présent article les impôts de toute nature ou dénomination.

6. Les dispositions du présent article ne peuvent être interprétées comme obligeant

un Etat contractant à accorder aux résidents de l'autre Etat contractant les abattements accordés aux résidents d'un Etat tiers, selon des conventions conclues avec cet Etat tiers.

Article 25
Procédure amiable

1. Lorsqu'un résident d'un Etat contractant estime que les mesures prises par un Etat contractant ou par chacun des deux Etats entraînent ou entraîneront pour lui une imposition non conforme à la présente Convention il peut, indépendamment des recours prévus par la législation nationale de ces Etats, soumettre son cas à l'autorité compétente de l'Etat contractant dont il est résident. Le cas devra être soumis dans les trois ans qui suivront la première notification de la mesure qui entraîne une imposition non conforme à la Convention.
2. Cette autorité compétente s'efforcera, si la réclamation lui paraît fondée et si elle n'est pas elle-même en mesure d'apporter une solution satisfaisante, de régler la question par voie d'accord amiable avec l'autorité compétente de l'autre Etat contractant, en vue d'éviter une imposition non conforme à la Convention. L'accord sera appliqué quels que soient les délais prévus par les législations nationales des Etats contractants.
3. Les autorités compétentes des Etats contractants s'efforcent, par voie d'accord amiable, de résoudre les difficultés auxquelles peut donner lieu l'application de la Convention. Elles peuvent aussi se concerter en vue d'éviter la double imposition dans les cas non prévus par la Convention.
4. Les autorités compétentes des Etats contractants peuvent communiquer directement entre elles en vue de parvenir à un accord comme il est indiqué aux paragraphes précédents. Si des échanges de vues oraux semblent devoir faciliter cet accord, ces échanges de vues peuvent avoir lieu au sein d'une commission composé de représentants des autorités compétentes des Etats contractants.
5. Les autorités compétentes règlent d'un commun accord les modalités d'application de la présente Convention, et notamment les formalités que devront accomplir les résidents d'un Etat contractant pour obtenir, dans l'autre Etat contractant, les réductions ou les exonérations d'impôts sur les revenus visés aux articles 10, 11 et 12 provenant de cet autre Etat.

Article 26
Echange de renseignements

1. Les autorités compétentes des Etats contractants échangeront les renseignements nécessaires pour appliquer les dispositions de la présente Convention et celles des lois internes des Etats contractants relatives aux impôts visés par la Convention dans la mesure où l'imposition qu'elles prévoient est conforme à la Convention. Les renseignements ainsi échangés seront tenus secrets et ne seront communiqués qu'aux personnes et autorités (y compris les tribunaux ou organismes administratifs) chargées de l'établissement, de la perception ou du recouvrement des impôts visés par la présente Convention ou des poursuites, réclamations et recours concernant ces impôts.
2. Les dispositions du paragraphe 1 ne peuvent en aucun cas être interprétées comme imposant à l'un des Etats contractants l'obligation:
a) De prendre des dispositions administratives dérogeant à sa propre législation ou à sa pratique administrative ou à celles de l'autre Etat contractant;
b) De fournir des renseignements qui ne pourraient être obtenus sur la base de sa propre législation ou dans le cadre de sa pratique administrative normale ou de celles

de l'autre Etat contractant;

c) De transmettre des renseignements qui révéleraient un secret commercial, industriel, professionnel ou un procédé commercial ou des renseignements dont la communication serait contraire à l'ordre public.

Article 27

Fonctionnaires diplomatiques et consulaires

1. Les dispositions de la présente Convention ne portent pas atteinte aux privilèges fiscaux dont bénéficient les membres des missions diplomatiques et leurs domestiques privés, les membres des postes consulaires, ainsi que les membres des délégations permanentes en vertu soit des règles du droit des gens, soit de dispositions conventionnelles.

2. La Convention ne s'applique pas aux organisations internationales, à leurs organes et fonctionnaires, ni aux personnes qui, membres d'une mission diplomatique, d'un poste consulaire ou d'une délégation permanente d'un Etat tiers, sont présentes dans un Etat contractant et ne sont pas considérées comme résidentes de l'un ou l'autre Etat contractant au regard des impôts sur le revenu et sur la fortune.

Article 28

Champ d'application territorial

La présente Convention s'applique:

a) En ce qui concerne la Pologne, au territoire de la République populaire de Pologne et aux zones situées hors des eaux territoriales de la Pologne sur lesquelles, en conformité avec le droit international, la Pologne peut exercer les droits relatifs au lit de la mer, au sous-sol marin et à leurs ressources naturelles;

b) En ce qui concerne la France, aux départements européens et d'outre-mer de la République française et aux zones situées hors des eaux territoriales adjacentes à ces départements sur lesquelles, en conformité avec le droit international, la France peut exercer les droits relatifs au lit de la mer, au sous-sol marin et à leurs ressources naturelles.

Article 29

Entrée en vigueur

1. La présente Convention sera approuvée. Elle entrera en vigueur trente jours après l'échange des instruments d'approbation.

2. Ses dispositions s'appliqueront pour la première fois:

a) En ce qui concerne les impôts perçus par voie de retenue à la source, aux sommes mises en paiement à compter du 1^er^ janvier 1974;

b) En ce qui concerne les autres impôts sur le revenu, aux revenus réalisés pendant l'année 1974 ou afférents à l'exercice comptable clos au cours de cette année.

Article 30

Dénonciation

1. La présente Convention demeurera en vigueur sans limitation de durée. Toutefois, à partir de la cinquième année suivant celle au cours de laquelle elle est entrée en vigueur, chacun des Etats contractants pourra, moyennant un préavis minimum de six mois notifié par la voie diplomatique, la dénoncer pour la fin d'une année civile.

2. Dans ce cas, ses dispositions s'appliqueront pour la dernière fois:

a) En ce qui concerne les impôts perçus par voie de retenue à la source, aux sommes mises en paiement au plus tard le 31 décembre de l'année civile pour la fin de laquelle la dénonciation aura été notifiée;

b) En ce qui concerne les autres impôts sur le revenu, aux revenus réalisés pendant l'année civile pour la fin de laquelle la dénonciation aura été notifiée ou afférents à l'exercice comptable clos au cours de cette année.

En foi de quoi les soussignés, à ce dûment autorisés par leurs Gouvernements respectifs, ont signé la présente Convention.

Fait à Varsovie, le 20 juin 1975, en double exemplaire, en langues française et polonaise, les deux textes faisant également foi.

Pour le Gouvernement de la République française:
Jean-Pierre Fourcade,
Ministre de l'Economie et des Finances.

Pour le Gouvernement de la République populaire de Pologne:
Henryk Kisiel,
Ministre des Finances.

Protocole

Au moment de procéder, ce jour, à la signature de la Convention tendant à éviter les doubles impositions en matière d'impôts sur le revenu et sur la fortune, les soussignés sont convenus des dispositions suivantes qui font partie intégrante de la Convention:

1. *Addendum* à l'article 3.
Les transports visés à l'article 3, paragraphe 1, alinéa *f*, comprennent également les transports:
a) Par conteneurs, effectués par la voie maritime, terrestre ou aérienne;
b) Par barges embarquées sur des navires;
c) Ou par tout autre équipement lié à l'exploitation de navires, d'aéronefs ou de véhicules ferroviaires ou routiers,
que ces matériels soient la propriété de l'entreprise de transport exploitante ou pris en location par cette entreprise.

2. *Addendum* à l'article 5.
Pour l'application de l'article 5, paragraphe 2, alinéa *g*, il est entendu que pendant la période d'application de l'accord sur le développement de la coopération économique, industrielle, scientifique et technique entre le Gouvernement de la République française et le Gouvernement de la République populaire de Pologne du 5 octobre 1972, un chantier de construction ou de montage ne sera considéré comme un établissement stable que si sa durée dépasse dix-huit mois.

3. *Addendum* à l'article 7.
Pour l'application de l'article 7, paragraphe 2, il est entendu que lorsqu'une entreprise d'un Etat contractant vend des marchandises ou exerce une activité dans l'autre Etat contractant par l'intermédiaire d'un établissement stable qui y est situé, le résultat de cet établissement stable n'est pas déterminé à partir du montant total du chiffre d'affaires ou de la rémunération de l'entreprise, mais est calculé à partir de la rémunération attribuable à l'intervention propre de l'établissement stable dans la vente ou l'activité visées ci-dessus.

4. *Addendum* à l'article 12.
Il est entendu que les dispositions de l'article 7 ou de l'article 14 sont, suivant les cas, seules applicables aux rémunérations de toute nature payées pour l'usage ou la concession de l'usage d'un équipement industriel, commercial ou scientifique, pour des services consistant en études ou en recherches d'ordre scientifique ou technique, ou pour des services de conseil, de contrôle ou de supervision.

5. *Addendum* à l'article 24.
Il est entendu, en ce qui concerne la Pologne:
a) Que, pour l'application de l'article 24, les impôts visés au paragraphe 5 ne comprennent pas la taxe de déclaration (oplaty meldunkowe) et la taxe pour la permission

d'ouverture d'un établissement (oplaty za zezwolenie na otwarcie przedsiębiorstwa);

b) Que les dispositions de l'article 24 ne sont pas affectées par le régime différent d'imposition sur le revenu, le bénéfice ou la fortune prévu en République populaire de Pologne pour les établissements socialisés.

6. *Addendum* à l'article 27.

Aux fins de la Convention, les membres d'une mission diplomatique ou consulaire d'un Etat contractant accréditée dans l'autre Etat contractant ou dans un Etat tiers qui sont ressortissants de l'Etat accréditant sont réputés être résidents de l'Etat accréditant s'ils y sont soumis aux mêmes obligations en matière d'impôts sur le revenu et sur la fortune, que les résidents dudit Etat.

En foi de quoi, les soussignés, à ce dûment autorisés, ont signé le présent Protocole.

Fait à Varsovie, le 20 juin 1975, en double exemplaire, en langues française et polonaise, les deux textes faisant également foi.

Pour le Gouvernement de la République française:
Jean-Pierre Fourcade,
Ministre de l'Economie et des Finances.

Pour le Gouvernement de la République populaire de Pologne:
Henryk Kisiel,
Ministre des Finances.

Convention between the Government of the Republic of Singapore and the Royal Government of Thailand for the avoidance of double taxation and the prevention of fiscal evasion with respect to the Taxes on Income

SUPPLEMENT TO THE BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION
AU BULLETIN DE DOCUMENTATION FISCALE INTERNATIONALE

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INTERNATIONAL BUREAU
OF FISCAL DOCUMENTATION

Muiderpoort - 124 Sarphatistraat - Amsterdam

A double taxation treaty was signed between Singapore and Thailand on September 15, 1975. It enters into force upon the exchange of the instruments of ratification on April 27, 1976 and shall have effect in accordance with Article 28 of the treaty for income of the calendar years or accounting periods beginning on or after January 1, 1976.

TEXT

The Government of the Republic of Singapore and the Royal Government of Thailand,

Desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,

Have agreed as follows:

Article 1

Personal scope

This Convention shall apply to persons who are residents of one or both of the Contracting States.

Article 2

Taxes covered

1. This Convention shall apply to taxes on income imposed on behalf of each Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income all taxes imposed on total income or on elements of income including taxes on gains from the alienation of movable or immovable property, taxes on the total amount of wages or salaries paid by enter-

prises.

3. The existing taxes to which the Convention shall apply are in particular:

(a) In the case of Thailand:
  (i) The income tax;
  (ii) The petroleum income tax;
  (hereinafter referred to as "Thai tax")

(b) In the case of Singapore:
The income tax (hereinafter referred to as "Singapore tax").

4. The Convention shall also apply to any identical or substantially similar taxes which are subsequently imposed in addition to, or in place of, the existing taxes. At the end of each year, the competent authorities of the Contracting States shall notify to each other any significant changes which have been made in their respective taxation laws.

Article 3
General definitions

1. In this Convention, unless the context otherwise requires:

(a) the term "Thailand" means the Kingdom of Thailand and any area adjacent to the territorial waters of the Kingdom of Thailand which by Thai legislation, and in accordance with international law, has been or may hereafter be designated as an area within which the rights of the Kingdom of Thailand with respect to sea-bed and sub-soil and their natural resources may be exercised;

(b) the term "Singapore" means the Republic of Singapore;

(c) the terms "a Contracting State" and "the other Contracting State" mean Thailand or Singapore, as the context requires;

(d) the term "tax" means Thai tax or Singapore tax, as the context requires;

(e) the term "person" comprises an individual, a company and any other body of persons which is treated as an entity for tax purposes;

(f) the term "company" means any entity which is treated as a body corporate for tax purposes under the relevant laws of either Contracting State including any group or body of persons which is taxed substantially in the same manner as a body corporate;

(g) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

(h) the term "competent authority" means
  (i) in the case of Thailand, the Minister of Finance or his authorised representative;
  (ii) in the case of Singapore, the Minister for Finance or his authorised representative.

2. As regards the application of the provisions of the Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of the Convention.

Article 4
Fiscal domicile

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the law of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.

2. Where by reason of the provisions of

paragraph 1 an individual is a resident of both Contracting States, then his case shall be determined in accordance with the following rules:

(a) He shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closest (centre of vital interests);
(b) If the Contracting State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either Contracting State, he shall be deemed to be a resident of the Contracting State in which he has an habitual abode;
(c) If he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national;
(d) If he is a national of both Contracting States or of either of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then the competent authorities of the Contracting States shall resolve the problem by mutual agreement.

Article 5
Permanent establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially:

(a) a place of management;
(b) a branch;
(c) an office;
(d) a factory;
(e) a workshop;
(f) a warehouse;
(g) a farm or plantation;
(h) a mine, quarry or other place of extraction of natural resources;
(i) a building site, construction, installation or assembly project which exists for more than six months.

3. The term "permanent establishment" shall not be deemed to include:

(a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;
(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.

4. A person acting in a Contracting State on behalf of an enterprise of the other

Contracting State — other than a broker, general commission agent or any other agent of an independent status to whom paragraph 5 applies — shall be deemed to be a permanent establishment in the first-mentioned State, but only if

(a) he has and habitually exercises in the first-mentioned State an authority to negotiate and conclude contracts for or on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise; or

(b) he habitually maintains in the first-mentioned State a stock of goods or merchandise belonging to the enterprise from which he regularly delivers goods or merchandise for or on behalf of the enterprise; or

(c) he habitually secures orders in the first-mentioned State wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it transacts business through a broker, general commission agent or any other agent of an independent status in the other Contracting State, where such persons are acting in the ordinary course of their business. For this purpose, an agent shall not be considered to be an agent of an independent status if it acts as an agent exclusively or almost exclusively for the enterprise and carries on any of the activities described in paragraph 4 of this Article.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Article 6
Income from immovable property

1. Income from immovable property may be taxed in the Contracting State in which such property is situated.

2. The term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of professional services.

Article 7
Business profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.

If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

4. Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of a certain reasonable percentage of the gross receipts of the enterprise or on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude such Contracting State from determining the profits to be taxed by any of such methods; the method adopted shall, however, be such that the result shall be in accordance with the principles laid down in this Article.

5. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

6. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

Article 8

Shipping and air transport

1. Income from the operation of aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. Income from the operation of ships in international traffic by an enterprise having a place of effective management in a Contracting State may be taxed in the other Contracting State, but the tax imposed in that other State shall be reduced by an amount equal to 50 per cent thereof.

3. The provisions of paragraphs 1 and 2 shall likewise apply in respect of participations in pools of any kind by enterprises engaged in shipping or air transport.

Article 9

Associated enterprises

Where —

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

Article 10
Dividends

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other Contracting State.

2. However, such dividends may be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the laws of that Contracting State, but the tax so charged shall not exceed 20 per cent of the gross amount of the dividends if the recipient is a company which owns at least 25 per cent of the voting shares of the company paying such dividends.
This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights assimilated to income from shares according to the taxation laws of the Contracting State of which the company making the distribution is a resident.

4. Notwithstanding the provisions of paragraph 2 of this Article, as long as Singapore does not impose a tax on dividends in addition to the tax chargeable on the profits or income of a company, dividends paid by a company which is a resident of Singapore to a resident of Thailand shall be exempt from any tax in Singapore which may be chargeable on dividends in addition to the tax chargeable on the profits or income of the company.

5. The provisions of paragraphs 1 and 2 of this Article shall not apply if the recipient of the dividends, being a resident of a Contracting State, has in the other Contracting State, of which the company paying the dividends is a resident, a permanent establishment with which the holding by virtue of which the dividends are paid is effectively connected. In such a case, the provisions of Article 7 shall apply.

6. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other Contracting State may not impose any tax on the dividends paid by the company to persons who are not residents of that other Contracting State, or subject the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in that other Contracting State.

Article 11
Interest

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such interest may be taxed in the Contracting State in which it arises, and according to the laws of the Contracting State, but the tax so charged shall not exceed:
(a) 10 per cent of the gross amount of the interest if it is received by any financial institution (including an insurance company);
(b) in all other cases, 25 per cent of the gross amount of the interest.

3. Notwithstanding the provisions of

paragraph 2 of this Article, interest arising in a Contracting State and paid to the Government of the other Contracting State shall be exempt from tax of the first-mentioned Contracting State.

4. For the purposes of paragraph 3 of this Article, the term "Government" —

(a) in the case of Thailand means the Royal Government of Thailand and shall include —
  (i) The Bank of Thailand; and
  (ii) such institutions, the capital of which is wholly owned by the Royal Government of Thailand or the local authorities, as may be agreed from time to time between the Governments of the two Contracting States;

(b) in the case of Singapore means the Government of Singapore and shall include —
  (i) the Monetary Authority of Singapore;
  (ii) the Board of Commissioners of Currency; and
  (iii) such institutions, the capital of which is wholly owned by the Government of Singapore, as may be agreed from time to time between the Governments of the two Contracting States.

5. The term "interest" as used in this Article means income from Government securities, bonds or debentures, whether or not secured by mortgage and whether or not carrying a right to participate in profits, and debt-claims of every kind, and any excess of the amount repaid in respect of such debt-claims over the amount lent, as well as all other income assimilated to income from money lent according to the taxation laws of the Contracting State in which the income arises.

6. The provisions of paragraphs 1 and 2 of this Article shall not apply if the recipient of the interest, being a resident of a Contracting State, has in the other Contracting State in which the interest arises a permanent establishment with which the debt-claim from which the interest arises is effectively connected. In such a case, the provisions of Article 7 shall apply.

7. Interest shall be deemed to arise in a Contracting State when the payer is that Contracting State itself, a political subdivision, a local authority or a resident of that Contracting State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred and such interest is borne by such permanent establishment then such interest shall be deemed to arise in the Contracting State in which the permanent establishment is situated.

8. Where, owing to a special relationship between the payer and the recipient or between both of them and some other person, the amount of the interest paid, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the recipient in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 12
Royalties

1. Royalties arising in a Contracting State may be taxed in that State, but the tax

which it imposes may not exceed 15 per cent of the gross amount of the royalties.

2. The term "royalties" as used in this Article means payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use information concerning industrial, commercial or scientific experience.

3. Income derived from the alienation of rights or property mentioned in paragraph 2 may be taxed in the Contracting State in which the income arises, but the tax which it imposes may not exceed 15 per cent of the gross amount of the income.

4. Royalties and the income mentioned in paragraph 3 shall be deemed to arise in a Contracting State if the payer is that State itself, a political subdivision or local authority or a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment by which the royalties are paid, then such royalties shall be deemed to arise in the Contracting State in which the permanent establishment is situated.

5. The provisions of paragraphs 1 and 3 shall not apply if the recipient of the royalties, being a resident of a Contracting State, has in the other Contracting State in which the royalties arise a permanent establishment with which the right or property giving rise to the royalties is effectively connected. In such a case, Article 7 shall apply.

6. Where, owing to a special relationship between the payer and the recipient or between both of them and some other person, the amount of the royalties paid, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the recipient in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

Article 13
Capital gains

1. Gains from the alienation of immovable property, as defined in paragraph 2 of Article 6, may be taxed in the Contracting State in which such property is situated.

2. Gains from the alienation of movable property forming part of the business property employed in a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise), may be taxed in the other State. However, gains from the alienation of ships and aircraft operated in international traffic and assets other than immovable property pertaining to the operation of such ships and aircraft shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

3. Gains from the alienation of any property or assets, other than those mentioned in paragraphs 1 and 2 of this Article and paragraph 2 of Article 12, shall be taxable only in the State of which the alienator is a resident.

Article 14
Personal services

1. Subject to the provisions of Articles 15,

17, 18, 19 and 20, salaries, wages and other similar remuneration or income derived by a resident of a Contracting State in respect of personal (including professional) services shall be taxable only in that State unless the services are rendered in the other Contracting State. If the services are so rendered, such remuneration or income as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration or income derived by a resident of a Contracting State in respect of services rendered in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned, and

(b) the services are rendered for or on behalf of a person who is a resident of the first-mentioned State, and

(c) the remuneration or income is not borne by a permanent establishment which the person paying the remuneration or income has in the other Contracting State.

3. Notwithstanding the preceding provisions of this Article, remuneration in respect of an employment exercised aboard a ship or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

Article 15
Directors' fees

1. Directors' fees and similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other Contracting State.

2. The remuneration which a person to whom paragraph 1 of this Article applies derives from the company in respect of the discharge of day-to-day functions of a managerial or technical nature may be taxed in accordance with the provisions of Article 14.

Article 16
Artistes and athletes

1. Notwithstanding the provisions of Article 14, income derived by public entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by athletes, from their personal activities as such may be taxed in the Contracting State in which these activities are performed.

2. The provisions of paragraph 1 of this Article shall not apply to remuneration or profits, salaries, wages and similar income derived from activities performed in a Contracting State by public entertainers if the visit to that Contracting State is substantially supported by public funds of the other Contracting State, including any political subdivision, local authority or statutory body thereof.

3. Notwithstanding the provisions of Article 7, where the activities mentioned in paragraph 1 of this Article are provided in a Contracting State by an enterprise of the other Contracting State the profits derived from providing these activities by such an enterprise may be taxed in the first-mentioned Contracting State unless the enterprise is substantially supported from the public funds of the other Contracting State, including any political subdivision, local authority or statutory body thereof, in connection with the provision of such activities.

Article 17
Pensions

1. Subject to the provisions of Article 18, pensions or other remuneration for past employment arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in the first-mentioned State.

2. Pensions or other remuneration for past employment shall be deemed to arise in a Contracting State if the payer is that State itself, a political subdivision or local authority or a resident of that State. Where, however, the person paying such income, whether he is a resident of a Contracting State or not has in a Contracting State a permanent establishment, and such income is borne by the permanent establishment, then the income shall be deemed to arise in the Contracting State in which the permanent establishment is situated.

Article 18
Governmental functions

1. Remuneration, including pensions, paid by, or out of funds created by, a Contracting State or a political subdivision or local authority or statutory body thereof to any individual in respect of services rendered to that State or political subdivision or local authority or statutory body thereof, in the discharge of functions of a governmental nature shall be taxable only in that State.

2. The provisions of Articles 14 and 15 shall apply to remuneration, including pensions, in respect of services rendered in connection with any trade or business carried on by a Contracting State or a political subdivision or local authority or statutory body thereof.

Article 19
Students and trainees

1. An individual who is a resident of a Contracting State immediately before making a visit to the other Contracting State and is temporarily present in that other Contracting State solely —

(a) as a student at a recognised university, college or school,

(b) as a recipient of grant, allowance or award for the primary purpose of study or research from a government, religious, charitable, scientific, literary or educational organisation, or

(c) as a business or technical apprentice,

shall be exempt from tax of that other Contracting State in respect of —

(i) remittances from abroad for the purposes of his maintenance, education, study, research or training,

(ii) the grant, allowance or award, and

(iii) remuneration for personal services in that other Contracting State and such services are in connection with his study, research or training or are necessary for the purpose of his maintenance, not exceeding 12,000 Singapore dollars or 96,000 Thai Bahts during any calendar year or such other amounts as the competent authorities of the Contracting States may from time to time agree upon.

2. The provisions of this Article shall not apply to cases in which the study, research or training occupies a secondary character to the personal services rendered that produce any remuneration.

Article 20
Professors, teachers and researchers

An individual who is a resident of a Contracting State immediately before making a visit to the other Contracting State, and who, at the invitation of any university, college, school or other similar educational institution, which is recognised by the competent authority in that other Contracting State, visits that other Contracting State for a period no exceeding two years solely for the purpose of teaching or research or both at such educational institution shall be exempt from tax in that other Contracting State on his remuneration for such teaching or research.

Article 21
Income not expressly mentioned

Items of income of a resident of a Contracting State which are not expressly mentioned in the foregoing Articles of the Convention may be taxed in the State where the income arises.

Article 22
Limitation of relief

Where this Convention provides (with or without other conditions) that income from sources in a Contracting State shall be exempt from tax, or taxed at a reduced rate in that Contracting State and under the laws in force in the other Contracting State the said income is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the exemption or reduction of tax to be allowed under this Convention in the first-mentioned Contracting State shall apply to so much of the income as is remitted to or received in that other Contracting State.

Article 23
Elimination of double taxation

1. The laws in force in either of the Contracting States shall continue to govern the taxation of income in the respective Contracting States except where express provision to the contrary is made in this Convention. Where income is subject to tax in both Contracting States, relief from double taxation shall be given in accordance with the following paragraphs of this Article.

2. In the case of Thailand, Singapore tax payable in respect of income derived from Singapore shall be allowed as a credit against Thai tax payable in respect of that income. The credit shall not, however, exceed that part of the Thai tax, as computed before the credit is given which is appropriate to such item of income. However, where such income is a dividend paid by a company which is a resident of Singapore to a company which is a resident of Thailand and which owns not less than 25 per cent of the voting shares of the company paying the dividend, Thailand shall exempt such income from tax but may in calculating tax on the remaining income of that person, apply the rate of tax which would have been applicable if the exempted income had not been so exempted.

3. In the case of Singapore, subject to the laws of Singapore regarding the allowance as a credit against Singapore tax of tax payable in any country other than Singapore, Thai tax payable in respect of income derived from Thailand shall be allowed as a credit against Singapore tax payable in respect of that income. Where such income is a dividend paid by a company which is a resident of Thailand to a company which is a resident of Singapore and which owns not less than 25 per cent of the voting shares of the company paying the dividend, the credit shall take into account Thai tax payable by that company in respect of its income out of which the dividend is paid. The credit shall not, however, exceed that part of the Singapore tax, as computed be-

fore the credit is given, which is appropriate to such item of income.

4. For the purposes of paragraph 3 of this Article, the term "Thai tax payable" shall be deemed to include the amount of Thai tax which would have been paid if the Thai tax had not been exempted or reduced in accordance with the special incentive laws designed to promote economic development in Thailand, effective on the date of signature of this Convention, or which may be introduced hereafter in modification of, or in addition to the existing laws.

Article 24
Non-discrimination

1. The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.

2. The term "nationals" means:

(a) all individuals possessing the nationality or citizenship of a Contracting State;

(b) all legal persons, partnerships and associations deriving their status as such from the law in force in a Contracting State.

3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State on the same activities.

4. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of that first-mentioned State are or may be subjected.

5. The provisions of this Article shall not be construed as obliging a Contracting State to grant to residents or nationals of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents or nationals.

6. In this Article the term "taxation" means taxes which are the subject of this Convention.

Article 25
Mutual agreement procedure

1. Where a resident of a Contracting State considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of those States, present his case to the competent authority of the Contracting State of which he is a resident.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at an appropriate solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation not in accordance with the Convention.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may

also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a commission consisting of representatives of the competent authorities of the Contracting States.

Article 26
Exchange of information

1. The competent authorities of the Contracting States shall exchange such information as is necessary for the carrying out of this Convention and of the domestic laws of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is in accordance with this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any persons or authorities other than those concerned with the assessment or collection of the taxes which are the subject of the Convention.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on one of the Contracting States the obligation:

(a) to carry out administrative measures at variance with the laws or the administrative practice of that or of the other Contracting State;
(b) to supply particulars which are not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

Article 27
Diplomatic and consular officials

Nothing in this Convention shall affect the fiscal privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements.

Article 28
Entry into force

1. This Convention shall be ratified and the instruments of ratification shall be exchanged at Singapore as soon as possible.

2. This Convention shall enter into force upon the exchange of the instruments of ratification and shall have effect for the income of the calendar years or accounting periods beginning on or after the first day of January of the calendar year in which the instruments of ratification are exchanged.

Article 29
Termination

This Convention shall remain in force indefinitely but either of the Contracting States may terminate the Convention, through diplomatic channels, by giving to the other Contracting State, notice of termination not later than the 30th June of any calendar year from the fifth year from the year in which the Convention entered into force. In such event, the Convention shall cease to have effect for the income of the calendar years or accounting periods beginning on or after the first day of January of the calendar year following that in which the notice is given.

IN WITNESS WHEREOF the undersigned being duly authorised thereto have signed this Convention.

Done in duplicate at Bangkok, this 15th day of September of the year one thousand nine hundred and seventy-five in the English language.

For the Government of the Republic of Singapore:

CHI OWYANG.

For the Royal Government of Thailand:

CHATICHAI CHOONHAVAN.

Convention between the United States of America and the Republic of Korea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and the Encouragement of International Trade and Investment

SUPPLEMENT TO THE BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION
AU BULLETIN DE DOCUMENTATION FISCALE INTERNATIONALE

Vol. XXX, No. 12, December/décembre 1976

INTERNATIONAL BUREAU
OF FISCAL DOCUMENTATION

Muiderpoort - 124 Sarphatistraat - Amsterdam

A treaty for the avoidance of double taxation with respect to taxes on income and the encouragement of international trade and investment was signed between the Republic of Korea and the United States of America on June 4, 1976. In accordance with Article 31 of the treaty it shall enter into force on the thirtieth day following the exchange of instruments of ratification.

TEXT

The Government of the United States of America and the Government of the Republic of Korea, desiring to conclude a convention for the avoidance of double taxation of income and the prevention of fiscal evasion and the encouragement of international trade and investment have appointed for that purpose as their respective Plenipotentiaries:

The Government of the United States of America: His Excellency Richard L. Sneider, Ambassador Extraordinary and Plenipotentiary of the United States of America to the Republic of Korea;

The Government of the Republic of Korea: His Excellency Park Tong-jin, Minister of Foreign Affairs of the Republic of Korea;

Who, having communicated to each other their full powers, found in good and due form, have agreed upon the following articles.

Article 1
Taxes covered

(1) The taxes which are the subject of this Convention are:

(a) In the case of the United States, the Federal income taxes imposed by the Internal Revenue Code (the United States tax), and

(b) In the case of Korea, the income tax and the corporation tax (the Korean tax).

(2) This Convention shall also apply to taxes substantially similar to those covered by paragraph (1) which are imposed in addition to, or in place of, existing taxes after the date of signature of this Convention.

(3) For the purpose of Article 7 (Nondiscrimination), this Convention shall also apply to taxes of every kind imposed at the National, state, or local level. For the purpose of Article 28 (Exchange of Information), this Convention shall also apply to taxes of every kind imposed at the National level.

Article 2
General definitions

(1) In this Convention, unless the context otherwise requires:

(a) (i) The term 'United States' means the United States of America; and
(ii) When used in a geographical sense, the term 'United States' means the states thereof and the District of Columbia. Such term also includes:

(A) The territorial sea thereof, and

(B) The seabed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial sea, over which the United States exercises sovereign rights, in accordance with international law, for the purpose of exploration and exploitation of the natural resources of such areas, but only to the extent that the person, property, or activity to which this Convention is being applied is connected with such exploration or exploitation.

(b) (i) The term 'Korea' means the Republic of Korea; and
(ii) When used in a geographical sense, the term 'Korea' means all the territory in which the laws relating to Korean tax are in force. The term also includes:

(A) The territorial sea thereof, and

(B) The seabed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial sea, over which Korea exercises sovereign right, in accordance with international law, for the purpose of exploration and exploitation of the natural resources of such areas, but only to the extent that the person, property, or activity to which this Convention is being applied is connected with such exploration or exploitation.

(c) The term 'Contracting State' means the United States or Korea, as the context requires.

(d) The term 'person' includes an individual, a partnership, a corporation, an estate, a trust, or any body of persons.

(e) (i) The term 'United States corporation' or 'corporation of the United States' means a corporation which is created or organized under the laws of the United States or any state thereof or the District of Columbia, or any unincorporated entity treated as a United States corporation for United States tax purposes; and
(ii) The term 'Korean corporation' or 'corporation of Korea' means a corporation (other than a United States corporation) which has its head or main office in Korea, or any entity treated as a Korean corporation for Korean tax purposes.

(f) The term 'competent authority' means:
(i) In the case of the United States, the

Secretary of the Treasury or his delegate, and

(ii) In the case of Korea, the Minister of Finance or his delegate.

(g) The term 'State' means any National State, whether or not one of the Contracting States.

(h) The term 'citizen' means:
(i) In the case of the United States, a citizen of the United States, and
(ii) In the case of Korea, a national of Korea.

(2) Any other term used in this Convention and not defined in this Convention shall, unless the context otherwise requires, have the meaning which it has under the laws of the Contracting State whose tax is being determined. Notwithstanding the preceding sentence, if the meaning of such a term under the laws of one Contracting State is different from the meaning of the term under the laws of the other Contracting State, or if the meaning of such a term is not readily determinable under the laws of one of the Contracting States, the competent authorities of the Contracting States may, in order to prevent double taxation or to further any other purpose of this Convention, establish a common meaning of the term for the purposes of this Convention.

Article 3
Fiscal domicile

(1) In this Convention:

(a) The term 'resident of the United States' means:
(i) A United States corporation, and
(ii) Any other person (except a corporation or an entity treated under United States law as a corporation) resident in the United States for purposes of its tax, but in the case of a person acting as a partner or fiduciary only to the extent that the income derived by such person is subject to United States tax as the income of a resident.

(b) The term 'resident of Korea' means:
(i) A Korean corporation, and
(ii) Any other person (except a corporation or any entity treated under Korean law as a corporation) resident in Korea for purposes of its tax, but in the case of a person acting as a partner or fiduciary only to the extent that the income derived by such person is subject to Korean tax as the income of a resident.

(c) In determining the residence of a partnership which makes a payment, a partnership shall be considered a resident of the State under the laws of which it was created or organized.

(2) Where by reason of the provisions of paragraph (1) an individual is a resident of both Contracting States:

(a) He shall be deemed to be a resident of that Contracting State in which he maintains his permanent home;

(b) If he has a permanent home in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of that Contracting State with which his personal and economic relations are closest (center of vital interests);

(c) If his center of vital interests is in neither of the Contracting States or cannot be determined, he shall be deemed to be a resident of that Contracting State in which he has a habitual abode;

(d) If he has a habitual abode in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of the Contracting State of which he is a citizen; and

(e) If he is a citizen of both Contracting States or of neither Contracting State the competent authorities of the Contracting States shall settle the question by mutual agreement.

For the purpose of this paragraph, a permanent home is the place where an individual dwells with his family.

(3) An individual who is deemed to be a resident of one of the Contracting States and not a resident of the other Contracting State by reason of the provisions of paragraph (2) shall be deemed to be a resident only of the first-mentioned Contracting State for all purposes of this Convention, including Article 4 (General Rules of Taxation).

Article 4
General rules of taxation

(1) A resident of one of the Contracting States may be taxed by the other Contracting State on any income from sources within that other Contracting State and only on such income, subject to any limitations set forth in this Convention. For this purpose, the rules set forth in Article 6 (Source of Income) shall be applied to determine the source of income.

(2) The provisions of this Convention shall not be construed to restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded—

(a) By the laws of one of the Contracting States in the determination of the tax imposed by that Contracting State, or

(b) By any other agreement between the Contracting States.

(3) The provisions of this Convention shall not affect Korean law so as to deny benefits accorded residents of the United States under the provisions of the Korean Foreign Capital Inducement Law Number 2598 of March 12, 1973 as amended or any similar law to encourage investment in Korea.

(4) Notwithstanding any provisions of this Convention except paragraph (5) of this Article, a Contracting State may tax a citizen or resident of that Contracting State as if this Convention had not come into effect.

(5) The provisions of paragraph (4) shall not affect:

(a) The benefits conferred by a Contracting State under Articles 5 (Relief from Double Taxation), 7 (Nondiscrimination), 24 (Social Security Payments), and 27 (Mutual Agreement Procedure); and

(b) The benefits conferred by a Contracting State under Articles 20 (Teachers), 21 (Students and Trainees), and 22 (Government Functions), upon individuals who are neither citizens of, nor have immigrant status in, that Contracting State.

(6) The competent authorities of the two Contracting States may prescribe regulations necessary to carry out the provisions of this Convention.

(7) There shall be allowed, for purposes of United States tax, in the case of a resident of Korea who is not a resident of the United States (other than an officer or employee of the Government of Korea or local authority thereof), as long as the United States Internal Revenue Code provides only one personal exemption, a deduction for personal exemptions, subject to the conditions prescribed in sections 151 through 154 of the Internal Revenue Code as in effect on the date of the signature of this Convention, for the spouse of the tax-

payer and for each child of the taxpayer present in the United States and residing with him in the United States at any time during the taxable year, but such additional deduction shall not exceed that proportion thereof which the taxpayer's gross income from sources within the United States which is treated as effectively connected with the conduct of a trade or business within the United States within the meaning of section 864(c) of the Internal Revenue Code for the taxpayer's taxable year bears to his entire income from all sources for such taxable year.

(8) The United States may impose its personal holding company tax and its accumulated earnings tax notwithstanding any provision of this Convention. However, a Korean corporation shall be exempt from the United States personal holding company tax in any taxable year if all of its stock is owned, directly or indirectly, by one or more individuals who are residents of Korea (and not citizens of the United States) for that entire year. A Korean corporation shall be exempt from the United States accumulated earnings tax in any taxable year unless such corporation is engaged in trade or business in the United States through a permanent establishment at any time during such year.

Article 5
Relief from double taxation

Double taxation of income shall be avoided in the following manner:

(1) In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the principles hereof), the United States shall allow to a citizen or resident of the United States as a credit against the United States tax the appropriate amount of Korean tax and, in the case of a United States corporation owning at least 10 percent of the voting power of a Korean corporation from which it receives dividends in any taxable year, shall allow credit for the appropriate amount of taxes paid to Korea by the Korean corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid to Korea but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources within Korea or on income from sources outside the United States) provided by United States law for the taxable year. For the purpose of applying the United States credit in relation to taxes paid to Korea, the rules set forth in Article 6 (Sources of Income) shall be applied to determine the source of income.

(2) In accordance with the provisions and subject to the limitations of the law of Korea (as it may be amended from time to time without changing the principles hereof), Korea shall allow to a citizen or resident of Korea as a credit against Korean tax the appropriate amount of income taxes paid to the United States and, in the case of a Korean corporation owning at least 10 percent of the voting power of a United States corporation from which it receives dividends in any taxable year, shall allow credit for the appropriate amount of taxes paid to the United States by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid to the United States but shall not exceed that portion of Korean tax which such citizen's or resident's net income from

sources within the United States bears to his entire net income for the same taxable year. For the purpose of applying the Korean credit in relation to taxes paid to the United States, the rules set forth in Article 6 (Source of Income) shall be applied to determine the source of income.

Article 6
Source of income

For the purposes of this Convention:

(1) Dividends shall be treated as income from sources within a Contracting State only if paid by a corporation of that Contracting State.

(2) Interest shall be treated as income from sources within one of the Contracting States only if paid by that Contracting State, a political subdivision or a local authority thereof, or by a resident of that Contracting State. Notwithstanding the preceding sentence—

(a) If the person paying the interest (whether or not he is a resident of one of the Contracting States) has a permanent establishment in one of the Contracting States in connection with which the indebtedness on which the interest is paid was incurred and such interest is borne by such permanent establishment, or

(b) If the person paying the interest is a resident of one of the Contracting States and has a permanent establishment in a State other than a Contracting State in connection with which the indebtedness on which the interest is paid was incurred and such interest is paid to a resident of the other Contracting State, and such interest is borne by such permanent establishment, such interest shall be deemed to be from sources within the State in which the permanent establishment is situated.

(3) Royalties described in paragraph (4) of Article 14 (Royalties) for the use of, or the right to use, property (other than as provided in paragraph (5) with respect to ships or aircraft) described in such paragraph shall be treated as income from sources within one of the Contracting States only if paid for the use of, or the right to use, such property within that Contracting State.

(4) Income from real property and royalties from the operation of mines, quarries, or other natural resources (including gains derived from the sale of such property or the right giving rise to such royalties) shall be treated as income from sources within one of the Contracting States only if such property is located in that Contracting State.

(5) Income from the rental of tangible property (movable property) shall be treated as income from sources within one of the Contracting States only if such property is located in that Contracting State. Income from the rental of ships or aircraft derived by a person not engaged in the operation of ships or aircraft in international traffic shall be treated as income from sources within a Contracting State only if the lessee is a resident of that Contracting State.

(6) Income received by an individual for his performance of labor or personal services, whether as an employee or in an independent capacity, or for furnishing the personal services of another person and income received by a corporation for furnishing the personal services of its employees or others, shall be treated as income from sources within one of the Contracting States only to the extent that such services are performed in that Contracting State. Income from personal services performed

aboard ships or aircraft operated by a resident of one of the Contracting States in international traffic shall be treated as income from sources within that Contracting State if rendered by a member of the regular complement of the ship or aircraft. For purposes of this paragraph, income from labor or personal services includes pensions (as defined in paragraph (3) of Article 23 (Private Pensions and Annuities)) paid in respect of such services. Notwithstanding the preceding provisions of this paragraph, remuneration described in Article 22 (Governmental Functions) and payments described in Article 24 (Social Security Payments) shall be treated as income from sources within one of the Contracting States only if paid by or from the public funds of that Contracting State or local authority thereof.

(7) Income from the purchase and sale of intangible or tangible personal (including movable) property (other than gains defined as royalties by paragraph (4)(b) of Article 14 (Royalties)) shall be treated as income from sources within one of the Contracting States only if such property is sold in that Contracting State.

(8) Notwithstanding paragraphs (1) through (7), industrial or commercial profits which are attributable to a permanent establishment which the recipient, a resident of one of the Contracting States, has in the other Contracting State, including income derived from real property and natural resources and dividends, interest, royalties (as defined in paragraph (4) of Article 14 (Royalties)), and capital gains, but only if the rights or property giving rise to such income, dividends, interest, royalties, or capital gains are effectively connected with such permanent establishment, shall be treated as income from sources within that other Contracting State.

(9) The source of any item of income to which paragraphs (1) through (8) of this article are not applicable shall be determined by each of the Contracting States in accordance with its own law. Notwithstanding the preceding sentence, if the source of any item of income under the laws of one Contracting State is different from the source of such item of income under the laws of the other Contracting State or if the source of such income is not readily determinable under the laws of one of the Contracting States, the competent authorities of the Contracting States may, in order to prevent double taxation or further any other purpose of this Convention, establish a common source of the item of income for purposes of this Convention.

Article 7
Nondiscrimination

(1) A citizen of one of the Contracting States who is a resident of the other Contracting State shall not be subjected in that other Contracting State to more burdensome taxes than a citizen of that other Contracting State who is a resident thereof.

(2) A permanent establishment which a resident of one of the Contracting States has in the other Contracting State shall not be subject in that other Contracting State to more burdensome taxes than a resident of that other Contracting State carrying on the same activities. This paragraph shall not be construed as obliging one of the Contracting States to grant to individual residents of the other Contracting State any personal allowances, reliefs, or deductions for taxation purposes on account of civil status or family responsibilities which

the first-mentioned Contracting State grants to its own individual residents.

(3) A corporation of one of the Contracting States, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which a corporation of the first-mentioned Contracting State carrying on the same activities, the capital of which is wholly owned or controlled by one or more residents of the first-mentioned Contracting State, is or may be subjected.

Article 8
Business profits

(1) Industrial or commercial profits of a resident of one of the Contracting States shall be exempt from tax by the other Contracting State unless such resident is engaged in industrial or commercial activity in that other Contracting State through a permanent establishment situated therein. If such resident is so engaged, tax may be imposed by that other Contracting State on the industrial or commercial profits of such resident but only on so much of such profits as are attributable to the permanent establishment.

(2) Where a resident of one of the Contracting States is engaged in industrial or commercial activity in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to the permanent establishment the industrial or commercial profits which would be attributable to such permanent establishment if such permanent establishment were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the resident of which it is a permanent establishment.

(3) In the determination of the industrial or commercial profits of a permanent establishment, there shall be allowed as deductions expenses which are reasonably connected with such profits, including executive and general administrative expenses, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere.

(4) No profits shall be attributed to a permanent establishment of a resident of one of the Contracting States in the other Contracting State merely by reason of the purchase of goods or merchandise by that permanent establishment, or by the resident of which it is a permanent establishment, for the account of that resident.

(5) The term 'industrial or commercial activity' means the active conduct of a trade or business. It includes the conduct of manufacturing, mercantile, insurance, banking, financing, agricultural, fishing, or mining activities, the operation of ships or aircraft, the furnishing of services, and the rental of tangible personal property (including ships or aircraft). Such term does not include the performance of personal services by an individual either as an employee or in an independent capacity.

(6)(a) The term 'industrial or commercial profits' means income derived from industrial or commercial activity, and income derived from real property and natural resources and dividends, interest, royalties (as defined in paragraph (4) of Article 14 (Royalties)), and capital gains but only if the property or rights giving rise to such income, dividends, interest, royalties, or capital gains are effectively connected with a permanent establishment which the recipient, being a resident of one of the Contracting States, has in the other Contracting State, whether or not such income is derived from industrial or commercial activity.

(b) To determine whether property or rights are effectively connected with a permanent establishment, the factors taken into account shall include whether the rights or property are used in or held for use in carrying on industrial or commercial activity through such permanent establishment and whether the activities carried on through such permanent establishment were a material factor in the realization of the income from such property or rights. For this purpose, due regard shall be given to whether or not such property or rights or such income were accounted for through such permanent establishment.

(7) Where industrial or commercial profits include items of income which are dealt with separately in other articles of this Convention, the provisions of those articles shall, except as otherwise provided therein, supersede the provisions of this Article.

Article 9
Permanent establishment

(1) For purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which a resident of one of the Contracting States engages in industrial or commercial activity.

(2) The term 'fixed place of business' includes but is not limited to:

(a) A branch;

(b) An office;

(c) A factory;

(d) A workshop;

(e) A warehouse;

(f) A store or other sales outlet;

(g) A mine, quarry, or other place of extraction of natural resources; and

(h) A building site or construction or installation project which exists for more than 6 months.

(3) Notwithstanding paragraphs (1) and (2), a permanent establishment shall not include a fixed place of business used only for one or more of the following:

(a) The use of facilities for the purpose of storage, display, or delivery of goods or merchandise belonging to the resident;

(b) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display, or delivery;

(c) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person;

(d) The maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the resident;

(e) The maintenance of a fixed place of business for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the resident; or

(f) The maintenance of a building site or construction or installation project which does not exist for more than 6 months.

(4) Even if a resident of one of the Contracting States does not have a permanent

establishment in the other Contracting State under paragraphs (1) through (3) of this Article, nevertheless he shall be deemed to have a permanent establishment in that other Contracting State if he engages in trade or business in that other Contracting State through an agent who—

(a) Has an authority to conclude contracts in the name of that resident and regularly exercises that authority in that other Contracting State, unless the exercise of the authority is limited to the purchase of goods or merchandise for the account of the resident; or

(b) Maintains in that other Contracting State a stock of goods or merchandise belonging to that resident from which he regularly fills orders or makes deliveries.

(5) Notwithstanding subparagraphs (a), (c) and (d) of paragraph (3), if a resident of one of the Contracting States has a fixed place of business in the other Contracting State and goods or merchandise are either:

(a) Subjected to processing in that other Contracting State by another person (whether or not purchased in that other Contracting State); or

(b) Purchased in that other Contracting State (and such goods or merchandise are not subjected to processing outside that other Contracting State)

such resident shall be considered to have a permanent establishment in that other Contracting State, if all or part of such goods or merchandise is sold by or on behalf of such resident for use, consumption, or disposition in that other Contracting State.

(6) Notwithstanding the provisions of paragraphs (4) and (5), a resident of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident engages in industrial or commercial activity in that other Contracting State through a broker, general commission agent or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business.

(7) The fact that a resident of one of the Contracting States is a related person (as defined under Article 11 (Related Persons)) with respect to a resident of the other Contracting State or with respect to a person who engages in industrial or commercial activity in that other Contracting State (whether through a permanent establishment or otherwise) shall not be taken into account in determining whether that resident of the first-mentioned Contracting State has a permanent establishment in that other Contracting State.

(8) The principles set forth in paragraphs (1) through (7) shall be applied in determining for the purpose of this Convention whether there is a permanent establishment in a State other than one of the Contracting States or whether a person other than a resident of one of the Contracting States has a permanent establishment in one of the Contracting States.

Article 10
Shipping and air transport

Notwithstanding Article 8 (Business (Profits), income which a resident of one of the Contracting States derives from the operation in international traffic of ships or aircraft shall be exempt from tax by the other Contracting State. For purposes of this Article, income derived from the operation in international traffic of ships or aircraft includes income incidental to such operation, such as income derived from the use or lease of containers, trailers for the inland transportation of containers and other related equipment, but does not include other income from the inland transportation of containers.

Article 11
Related persons

(1) Where a person subject to the taxing jurisdiction of one of the Contracting States and any other person are related and where such related persons make arrangements or impose conditions between themselves which are different from those which would be made between independent persons, any income, deductions, credits, or allowances which would, but for those arrangements or conditions, have been taken into account in computing the income (or loss) of, or the tax payable by, one of such persons, may be taken into account in computing the amount of the income subject to tax and the taxes payable by such person.

(2) For the purposes of this Convention, a person is related to another person if either person owns or controls directly or indirectly the other, or if any third person or persons owns or controls directly or indirectly both. For this purpose, the term 'control' includes any kind of control, whether or not legally enforceable, and however exercised or exercisable.

Article 12
Dividends

(1) Dividends derived from sources within one of the Contracting States by a resident of the other Contracting State may be taxed by both Contracting States.

(2) The rate of tax imposed by one of the Contracting States on dividends derived from sources within that Contracting State by a resident of the other Contracting State shall not exceed—

(a) 15 percent of the gross amount of the dividend; or

(b) When the recipient is a corporation, 10 percent of the gross amount of the dividend if—
(i) During the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least 10 percent of the outstanding shares of the voting stock of the paying corporation was owned by the recipient corporation, and
(ii) Not more than 25 percent of the gross income of the paying corporation for such prior taxable year (if any) consists of interest or dividends (other than interest derived from the conduct of a banking, insurance, or financing business and dividends or interest received from subsidiary corporations, 50 percent or more of the outstanding shares of the voting stock of which is owned by the paying corporation at the time such dividends or interest is received).

(3) Paragraph (2) shall not apply if the recipient of the dividends, being a resident of one of the Contracting States, has a permanent establishment in the other Contracting State and the shares with respect to which the dividends are paid are effectively connected with such permanent establishment. In such a case, paragraph (6)(a) of Article 8 (Business Profits) shall apply.

Article 13
Interest

(1) Interest derived from sources within one of the Contracting States by a resident

of the other Contracting State may be taxed by both Contracting States.

(2) The rate of tax imposed by one of the Contracting States on interest derived from sources within that Contracting State by a resident of the other Contracting State shall not exceed 12 percent of the gross amount thereof.

(3) Notwithstanding paragraphs (1) and (2), interest derived from sources within one of the Contracting States shall be exempt from tax by that Contracting State if it is beneficially derived by the Government of the other Contracting State, by any local authority thereof, the central bank of that other Contracting State, or any instrumentality wholly owned by that Government or that central bank or both, not subject to tax by that other Contracting State on its income.

(4) Paragraph (2) shall not apply if the recipient of the interest, being a resident of one of the Contracting States, has a permanent establishment in the other Contracting State and the indebtedness giving rise to the interest is effectively connected with such permanent establishment. In such case, paragraph (6)(a) of Article 8 (Business Profits) shall apply.

(5) Where any amount designated as interest paid to any related person exceeds an amount which would have been paid to an unrelated person, the provisions of this article shall apply only to so much of the interest as would have been paid to an unrelated person. In such a case the excess payment may be taxed by each Contracting State according to its own law, including the provisions of this Convention where applicable.

(6) The term 'interest' as used in this Convention means income from bonds, debentures, Government securities, notes, or other evidences of indebtedness, whether or not secured and whether or not carrying a right to participate in profits, and debt-claims of every kind as well as all other income which, under the taxation law of the Contracting State in which the income has its source, is assimilated to income from money lent.

Article 14
Royalties

(1) The tax imposed by one of the Contracting States on royalties derived from sources within that Contracting State by a resident of the other Contracting State shall not exceed 15 percent of the gross amount thereof, except as provided in paragraphs (2) and (3).

(2) Royalties derived from copyrights, or rights to produce or reproduce any literary, dramatic, musical, or artistic work, by a resident of one Contracting State, as well as royalties received as consideration for the use of, or the right to use, motion picture films including films and tapes used for radio or television broadcasting, may not be taxed by the other Contracting State at a rate of tax which exceeds 10 percent of the gross amount of such royalties.

(3) Paragraphs (1) and (2) shall not apply if the recipient of the royalty, being a resident of one of the Contracting States, has in the other Contracting State a permanent establishment and the right or property giving rise to the royalties is effectively connected with such permanent establishment. In such a case, paragraph (6)(a) of Article 8 (Business Profits) shall apply.

(4) The term 'royalties' as used in this article means—

(a) Payment of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, copyrights of motion picture films or films or tapes used for radio or television broadcasting, patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights, or knowledge, experience, or skill (know-how), or ships or aircraft (but only if the lessor is a person not engaged in the operation in international traffic of ships or aircraft), and

(b) Gains derived from the sale, exchange, or other disposition of any such property or rights (other than ships or aircraft) to the extent that the amounts realized on such sale, exchange, or other disposition for consideration are contingent on the productivity, use, or disposition of such property or rights.

The term does not include any royalties, rentals or other amounts paid in respect of the operation of mines, quarries, or other natural resources.

(5) Where an amount is paid to a related person which would be treated as royalty but for the fact that it exceeds an amount which would have been paid to an unrelated person, the provisions of this Article shall apply only to so much of the royalty as would have been paid to an unrelated person. In such a case, the excess payment may be taxed by each Contracting State according to its own law, including the provisions of this Convention where applicable.

Article 15
Income from real property

(1) Income from real property, including royalties and other payments in respect of the exploitation of natural resources and gains derived from the sale, exchange, or other disposition of such property or of the right giving rise to such royalties or other payments, may be taxed by the Contracting State in which such real property or natural resources are situated. For purposes of this Convention, interest on indebtedness secured by real property or secured by a right giving rise to royalties or other payments in respect of the exploitation of natural resources shall not be regarded as income from real property.

(2) Paragraph (1) shall apply to income derived from the usufruct, direct use, letting, or use in any other form of real property.

Article 16
Capital gains

(1) A resident of one of the Contracting States shall be exempt from tax by the other Contracting State on gains from the sale, exchange, or other disposition of capital assets unless—

(a) The gain is derived by a resident of one of the Contracting States from the sale, exchange, or other disposition of property described in Article 15 (Income from Real Property) situated within the other Contracting State,

(b) The recipient of the gain, being a resident of one of the Contracting States, has a permanent establishment in the other Contracting State and the property giving rise to the gain is effectively connected with such permanent establishment, or

(c) The recipient of the gain, being an individual who is a resident of one of the Contracting States—

(i) Maintains a fixed base in the other

Contracting State for a period or periods aggregating 183 days or more during the taxable year and the property giving rise to such gains is effectively connected with such fixed base, or

(ii) Is present in the other Contracting State for a period or periods aggregating 183 days or more during the taxable year.

(2) In the case of gains described in paragraph (1)(a), the provisions of Article 15 (Income from Real Property) shall apply. In the case of gains described in paragraph (1)(b), the provisions of Article 8 (Business Profits) shall apply.

Article 17
Investment or holding companies

A corporation of one of the Contracting States deriving dividends, interest, royalties, or capital gains from sources within the other Contracting State shall not be entitled to the benefits of Article 12 (Dividends), 13 (Interest), 14 (Royalties), or 16 (Capital Gains) if—

(a) By reason of special measures the tax imposed on such corporation by the first-mentioned Contracting State with respect to such dividends, interest, royalties, or capital gains is substantially less than the tax generally imposed by such Contracting State on corporate profits, and

(b) 25 percent or more of the capital of such corporation is held of record or is otherwise determined, after consultation between the competent authorities of the Contracting States, to be owned directly or indirectly, by one or more persons who are not individual residents of the first-mentioned Contracting State (or, in the case of a Korean corporation, who are citizens of the United States).

Article 18
Independent personal services

(1) Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity, may be taxed by that Contracting State. Except as provided in paragraph (2), such income shall be exempt from tax by the other Contracting State.

(2) Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity in the other Contracting State may be taxed by that other Contracting State, if:

(a) The individual is present in that other Contracting State for a period or periods aggregating 183 days or more in the taxable year;

(b) Such income exceeds 3,000 United States dollars or its equivalent in Korean won in a taxable year; or

(c) The individual maintains a fixed base in that other Contracting State for a period or periods aggregating 183 days or more in the taxable year, but only so much of his income as is attributable to such fixed base.

Article 19
Dependent personal services

(1) Wages, salaries, and similar remuneration derived by an individual who is a resident of one of the Contracting States from labor or personal services performed as an employee, including remuneration from services performed by an officer of a corporation, may be taxed by that Contracting State. Except as provided by paragraph (2) such remuneration derived from sources within the other Contracting State

may also be taxed by that other Contracting State.

(2) Remuneration described in paragraph (1) derived by an individual who is a resident of one of the Contracting States shall be exempt from tax by the other Contracting State if—

(a) He is present in that other Contracting State for a period or periods aggregating less than 183 days in the taxable year;

(b) He is an employee of a resident of the first-mentioned Contracting State or of a permanent establishment maintained in the first-mentioned Contracting State;

(c) The remuneration is not borne as such by a permanent establishment which the employer has in that other Contracting State; and

(d) Such income does not exceed 3,000 United States dollars or its equivalent in Korean won.

(3) Notwithstanding paragraph (2), remuneration derived by an individual from the performance of labor or personal services as an employee aboard ships or aircraft operated by a resident of one of the Contracting States in international traffic shall be exempt from tax by the other Contracting State if such individual is a member of the regular complement of the ship or aircraft.

Article 20
Teachers

(1) Where a resident of one of the Contracting States is invited by the Government of the other Contracting State, a political subdivision, or a local authority thereof, or by a university or other recognized educational institution in that other Contracting State to come to that other Contracting State for a period not expected to exceed 2 years for the purpose of teaching or engaging in research, or both, at a university or other recognized educational institution and such resident comes to that other Contracting State primarily for such purpose, his income from personal services for teaching or research at such university or educational institution shall be exempt from tax by that other Contracting State for a period not exceeding 2 years from the date of his arrival in that other Contracting State.

(2) This Article shall not apply to income from research if such research is undertaken not in the public interest but primarily for the private benefit of a specific person or persons.

Article 21
Students and trainees

(1)(a) An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State for the primary purpose of—

(i) Studying at a university or other recognized educational institution in that other Contracting State, or

(ii) Securing training required to qualify him to practice a profession or professional specialty, or

(iii) Studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization,

shall be exempt from tax by that other Contracting State with respect to amounts described in subparagraph (b) for a period not exceeding 5 taxable years from the date of his arrival in that other Contracting State.

(b) The amounts referred to in subparagraph (a) are—

(i) Remittances from abroad for the purpose of his maintenance, education, study research, or training;

(ii) The grant, allowance, or award; and

(iii) Income from personal services performed in that other Contracting State in an amount not in excess of 2,000 United States dollars or its equivalent in Korean won for any taxable year.

(2) An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State as an employee of, or under contract with, a resident of the first-mentioned Contracting State, for the primary purpose of—

(a) Acquiring technical, professional, or business experience from a person other than that resident of the first-mentioned Contracting State or other than a person related to such resident, or

(b) Studying at a university or other recognized educational institution in that other Contracting State,

shall be exempt from tax by that other Contracting State for a period not exceeding 1 year with respect to his income from personal services in an aggregate amount not in excess of 5,000 United States dollars or its equivalent in Korean won.

(3) An individual who is resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State for a period not exceeding 1 year, as a participant in a program sponsored by the Government of that other Contracting State, for the primary purpose of training, research, or study, shall be exempt form tax by that other Contracting State with respect to his income from personal services in respect of such training, research, or study performed in that other Contracting State in an aggregate amount not in excess of 10,000 United States dollars or its equivalent in Korean won.

(4) The benefits provided under Article 20 (Teachers) and paragraph (1) of this Article shall, when taken together, extend only for such period of time, not to exceed 5 taxable years from the date of arrival of the individual claiming such benefits, as may reasonably or customarily be required to effectuate the purpose of the visit.

Article 22
Governmental functions

Wages, salaries, and similar remuneration including pensions, annuities, or similar benefits, paid from public funds of one of the Contracting States to a citizen of that Contracting State for labor or personal services performed as an employee of that Contracting State or an instrumentality thereof in the discharge of governmental functions shall be exempt from tax by the other Contracting State.

Article 23
Private pensions and annuities

(1) Except as provided in Article 22 (Governmental Functions), pensions and other similar remuneration paid to an individual who is a resident of one of the Contracting States in consideration of past employment shall be taxable only in that Contracting State.

(2) Alimony and annuities paid to an individual who is a resident of one of the Contracting States shall be taxable only in that Contracting State.

(3) The term 'pensions and other similar remuneration', as used in this Article,

means periodic payments made (a) by reason of retirement or death in consideration for services rendered, or (b) by way of compensation for injuries received in connection with past employment.

(4) The term 'annuities', as used in this Article, means a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

(5) The term 'alimony', as used in this Article, means periodic payments made pursuant to a decree of divorce, separate maintenance agreement, or support or separation agreement which is taxable to the recipient under the internal laws of the Contracting State of which he is a resident.

Article 24
Social security payments

Social security payments and other public pensions paid by one of the Contracting States to an individual who is a resident of the other Contracting State (or in the case of such payments by Korea, to an individual who is a citizen of the United States) shall be taxable only in the first-mentioned Contracting State. This Article shall not apply to payments described in Article 22 (Governmental Functions).

Article 25
Exemption from social security taxes

(1) The taxes imposed by Chapter 21 of the Internal Revenue Code shall not apply with respect to wages paid for services performed in Guam by a resident of Korea while in Guam on a temporary basis as a nonimmigrant alien admitted to Guam pursuant to section 101(a)(15)(II)(ii) of the United States Immigration and Nationality Act (8 U.S.C. 1101(a)(15)(H)(ii)).

(2) The exemption provided in paragraph (1) shall continue only so long as the similar exemption provided by section 3121 (b)(18) of the Internal Revenue Code.

Article 26
Diplomatic and consular officers

Nothing in this Convention shall affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

Article 27
Mutual agreement procedure

(1) Where a resident of one of the Contracting States considers that the action of one or both of the Contracting States results or will result for him in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of the Contracting States, present his case to the competent authority of the Contracting State of which he is a resident. Should the resident's claim be considered to have merit by the competent authority of the Contracting State to which the claim is made, it shall endeavor to come to an agreement with the competent authority of the other Contracting State with a view to avoiding taxation contrary to the provisions of this Convention.

(2) The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the application of this Convention. In particular, the competent authorities of the Contracting States may agree—

(a) To the same attribution of industrial or commercial profits to a resident of one of the Contracting States and its permanent establishment situated in the other Contracting State;

(b) To the same allocation of income, deductions, credits, or allowances between a person subject to the taxing jurisdiction of one of the Contracting States and any related person;

(c) To the same determination of the source of particular items of income;

(d) To the uniform accounting for income and deductions; or

(e) To the same meaning of any term used in this Convention.

(3) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of this Article. When it seems advisable for the purpose of reaching agreement, the competent authorities may meet together for an oral exchange of opinions.

(4) In the event that the competent authorities reach such an agreement, taxes shall be imposed on such income, and refund or credit of taxes shall be allowed, by the Contracting States in accordance with such agreement.

Article 28
Exchange of information

(1) The competent authorities shall exchange such information as is necessary for carrying out the provisions of this Convention or for the prevention of fraud or for the administration of statutory provisions concerning taxes to which this Convention applies provided the information is of a class that can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

(2) Any information so exchanged shall be treated as secret, except that such information may be—

(a) Disclosed to any person concerned with, or

(b) Made part of a public record with respect to, the assessment, collection, or enforcement of, or litigation with respect to, the taxes to which this Convention applies.

(3) No information shall be exchanged which would be contrary to public policy.

(4) If specifically requested by the competent authority of one of the Contracting States, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and copies of unedited original documents (including books, papers, statements, records, accounts, or writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

(5) The exchange of information shall be either on a routine basis or on request with reference to particular cases. The competent authorities of the Contracting States may agree on the list of information which shall be furnished on a routine basis.

(6) The competent authorities of the Contracting States shall notify each other of any amendments of the tax laws referred to in paragraph (1) of Article 1 (Taxes Covered) and of the adoption of any taxes referred to in paragraph (2) of Article 1 (Taxes Covered) by transmitting the texts of any amendments or new statutes at least once a year.

(7) The competent authorities of the Contracting States shall notify each other of the

publication by their respective Contracting States of any material concerning the application of this Convention, whether in the form of regulations, rulings, or judicial decisions by transmitting the texts of any such materials at least once a year.

Article 29
Extension to territories

(1) Either one of the Contracting States may, at any time while this Convention continues in force, by a written notification given to the other Contracting State through diplomatic channels, declare its desire that the operation of this Convention, either in whole or in part or with such modifications as may be found necessary for special application in a particular case, shall extend to all or any of the areas (to which this Convention is not otherwise applicable) for whose international relations it is responsible and which impose taxes substantially similar in character to those which are the subject of this Convention. When the other Contracting State has, by a written communication through diplomatic channels, signified to the first-mentioned Contracting State that such notification is accepted in respect of such area or areas, and the notification and communication have been ratified and instruments of ratification exchanged, this Convention, in whole or in part, or with such modifications as may be found necessary for special application in a particular case, as specified in the notification, shall apply to the area or areas named in the notification and shall enter into force and effect on and after the date or dates specified therein. None of the provisions of this Convention shall apply to any such area in the absence of such acceptance and exchange of instruments of ratification in respect of that area.

(2) At any time after the date of entry into force of an extension under paragraph (1), either of the Contracting States may, by 6 months' prior notice of termination given to the other Contracting State through diplomatic channels, terminate the application of this Convention to any area to which it has been extended under paragraph (1), and in such event this Convention shall cease to apply and have force and effect, beginning on or after the first day of January next following the expiration of the 6-month period, to the area or areas named therein, but without affecting its continued application to the United States, Korea, or to any other area to which it has been extended under paragraph (1).

(3) In the application of this Convention in relation to any area to which it is extended by notification by the United States or Korea, reference to the 'United States' or 'Korea', as the case may be, shall be construed as referring to that area.

(4) The termination in respect of the United States or Korea of this Convention under Article 32 (Termination) shall, unless otherwise expressly agreed by both Contracting States, terminate the application of this Convention to any area to which the Convention has been extended under this Article by the United States or Korea.

Article 30
Assistance in collection

(1) Each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such taxes imposed by that other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by that other Contracting State shall not be enjoyed by persons not entitled to such benefits.

(2) In no case shall this Article be construed so as to impose upon one of the Contracting States the obligation to carry out measures at variance with the laws, administrative practices, or public policy of either Contracting State with respect to the collection of its own taxes.

Article 31
Entry into force

This Convention shall be ratified and instruments of ratification shall be exchanged at Washington as soon as possible. It shall enter into force on the thirtieth day following the exchange of instruments of ratification and shall then have effect for the first time:

(a) As respects the rate of withholding taxes and Article 25 (Exemption from Social Security Taxes), to amounts paid on or after the first day of the second month following the date on which his Convention enters into force;

(b) As respects other taxes, to taxable years beginning on or after January 1 of the year following the date on which this Convention enters into force.

Article 32
Termination

This Convention shall remain in force until terminated by one of the Contracting States. Either Contracting State may terminate the Convention at any time after 5 years from the date on which this Convention enters into force provided that at least 6 months' prior notice of termination has been given through diplomatic channels. In such event, the Convention shall cease to have force and effect as respects income of taxable years beginning (or, in the case of withholding taxes and social security taxes, payments made) on or after January 1 next following the expiration of the 6-month period.

Done at Seoul in duplicate in the English and Korean languages this 4th day of June 1976.

For the United States of America:
Richard L. Sneider

For the Republic of Korea:
Park Tong-jin

EXCHANGE OF NOTES

Seoul, June 4, 1976

His Excellency
Park Tong-jin,

Minister of Foreign Affairs,
Seoul.

Excellency:

I have the honor to refer to the Income Tax Convention signed between the Governments of Korea and the United States. During the course of the negotiations leading up to the signed Convention, the Korean representatives (A) stressed the need for increased provisions in the Convention that would constitute special incentives to promote the flow of United States capital and technology to Korea and (B) stated that the Convention applies to the Korean Defense Tax imposed in connection with the taxes referred to in Article 1(1) of the Convention.

The United States delegation was unable to agree to provisions for special investment incentives, but I want to assure you that my Government recognizes the importance which your Government places on increased investment in Korea. Accordingly, when circumstances permit, my Government will be prepared to resume discussions with a view to incorporating provisions into this Convention that will minimize the interference of the United States tax system with incentives offered by the Government of the Republic of Korea and that will be consistent with the income tax policies of the United States Government regarding other developing countries.

I should appreciate your confirmation that the Government of the Republic of Korea interprets the words 'Korean Tax' in Article 1(1) as including the Korean Defense Tax assessed on the taxes referred to therein.

Accept, Excellency, the renewed assurances of my highest consideration.

Richard L. Sneider

June 4, 1976

His Excellency
Richard L. Sneider

Ambassador Extraordinary and
Plenipotentiary of
the United States of America to
the Republic of Korea

Excellency:

I have the honor to acknowledge the receipt of your Excellency's Note dated June 4, 1976 with regard to increased investment of the United States in Korea and with regard to the application of the Tax Convention to the Korean Defense Tax imposed in connection with the taxes referred to in Article 1(1) of the Convention.

I have further the honor to note that the United States will be prepared, when circumstances permit, to resume discussions with a view to incorporating provisions into the Convention that will minimize the interference of the U.S. tax system with incentives offered by the Government of Korea and that will be consistent with the income tax policies of the United States Government regarding other developing countries.

I also have the honor to confirm that the definition of Korean tax in Article 1(1) of the Tax Convention includes the Korean Defense Tax assessed on the taxes referred to therein.

Accept, Excellency, the renewed assurances of my highest consideration.

Park Tong-jin
Minister of Foreign Affairs