

Taxation of non-resident and international taxation (IV)

Prabath Weerasinghe – ACA, MAAT, BB Mgt (HRM) SP,
ACMA, ATII, MBA in Taxation (PIM SJP)

Taxation of non-resident and international taxation

Key learning outcome

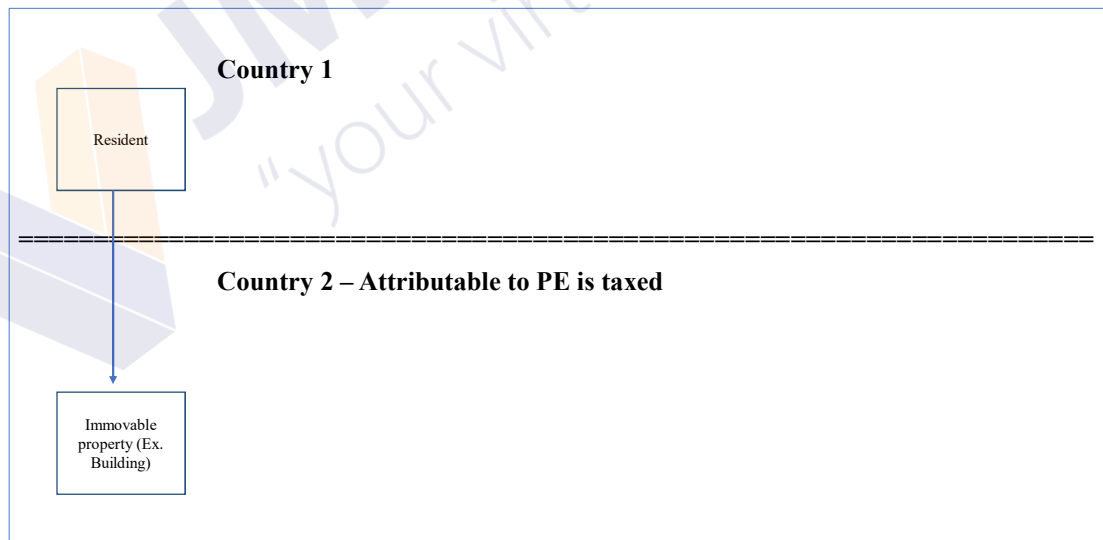
- **Assessing income tax liability of a non-resident person**
 - Resident status of an individual and company
 - Income arising in or derived from a source in Sri Lanka
 - Assessable Income from income sources for a non-resident
 - Taxable income and tax payable by a non-resident
 - Liability of an agent of a non-resident
- **Remittance tax**
 - Liability of a non-resident company for remittance tax
 - Ascertaining the remittance tax liability

Taxation of non-resident and international taxation

Key learning outcome

- **Double tax avoidance agreement** (Tax treaties)
 - Overlapping tax jurisdiction and method of avoiding double taxation
 - OECD Vs UN Model
 - Principles of operation of Double tax avoidance agreement

Article 7 – Business profits



Application of Article 7 Business profits to Article 10 - Dividends

- Article 10 - beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment.
- In such case the provisions of Article 7 shall apply.

Application of Article 14 - Independent Personal Services to Article 10 - Dividends

- Article 14 - beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such fixed base.
- In such case the provisions of Article 14, shall apply.

Article 10 – Dividends

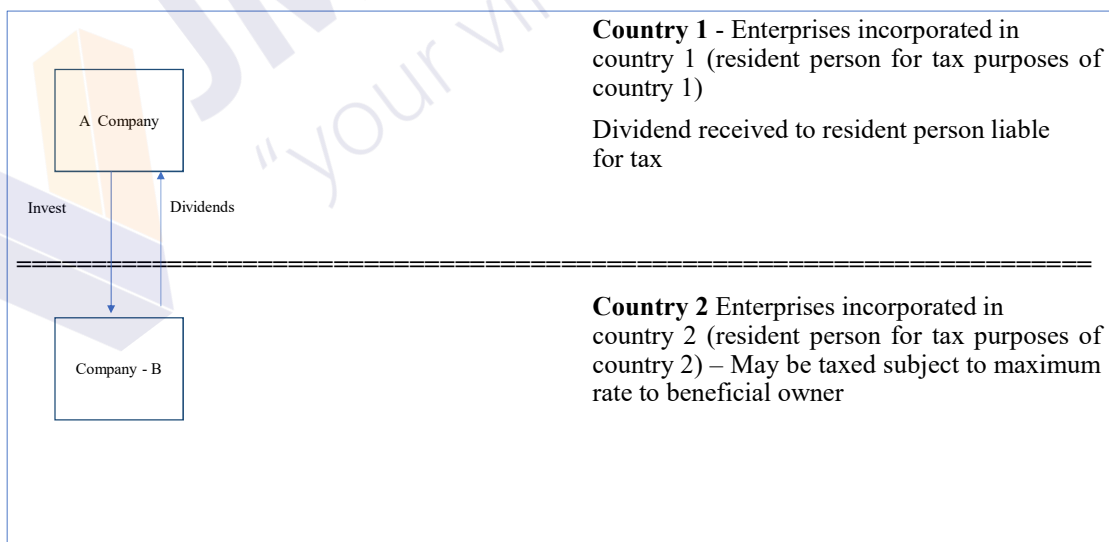
Primary taxing right with country of resident - Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

Source country has a limited taxing right - 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 contacting State – maximum tax rate.

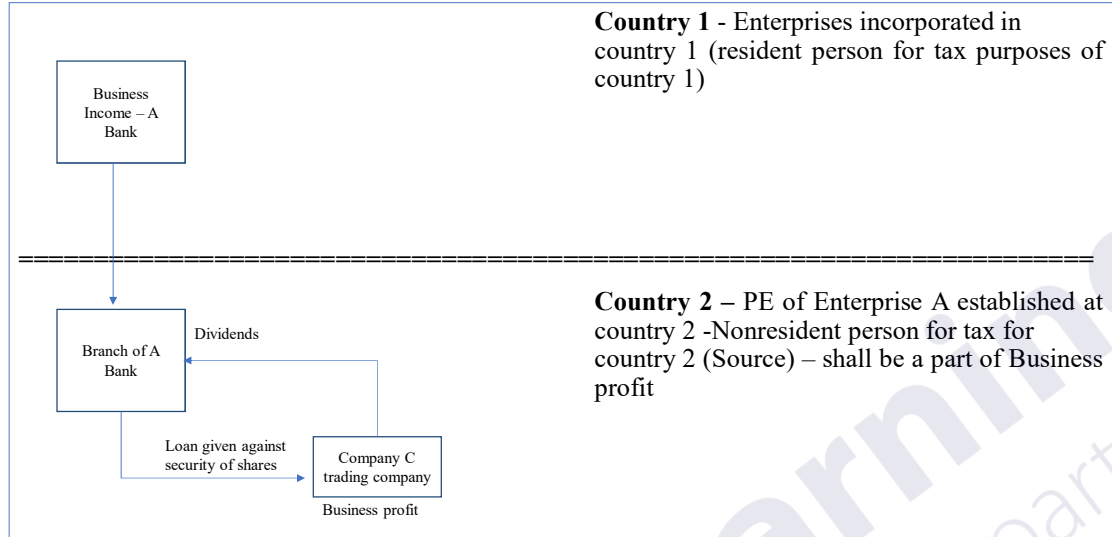
Ex. “dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the **beneficial owner** of the dividends the tax so charged shall not exceed 10 per cent of the gross amount of the dividends”

“dividends” means income from shares, “jouissance” (physical or intellectual pleasure, delight, or ecstasy) shares or “jouissance”, rights, mining shares, founders’ shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

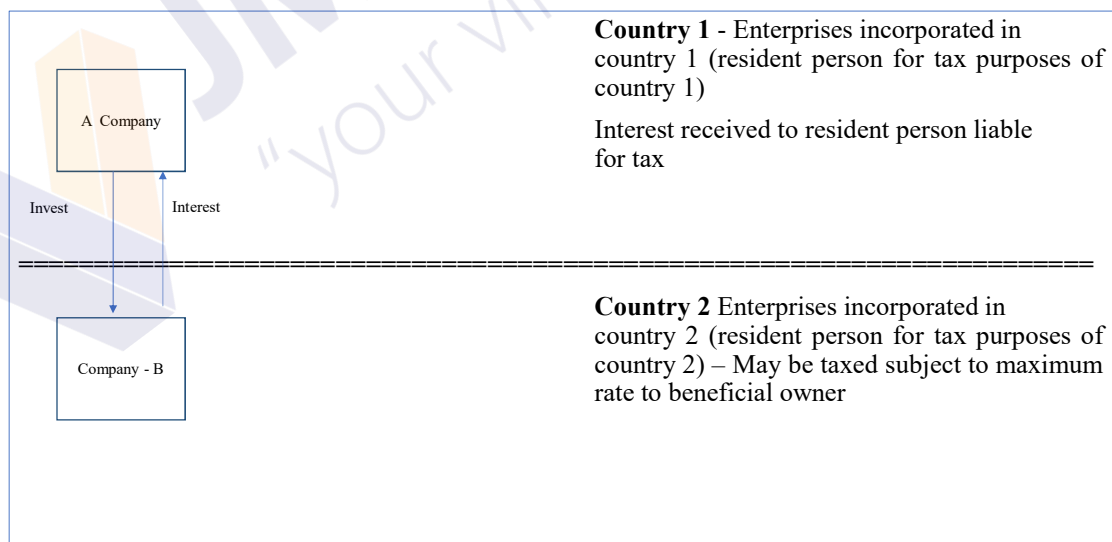
Article 10 – Dividends



Application of Article 7 Business profits to Article 10 - Dividends



Article 11 – Interest



Article 11 – Interest

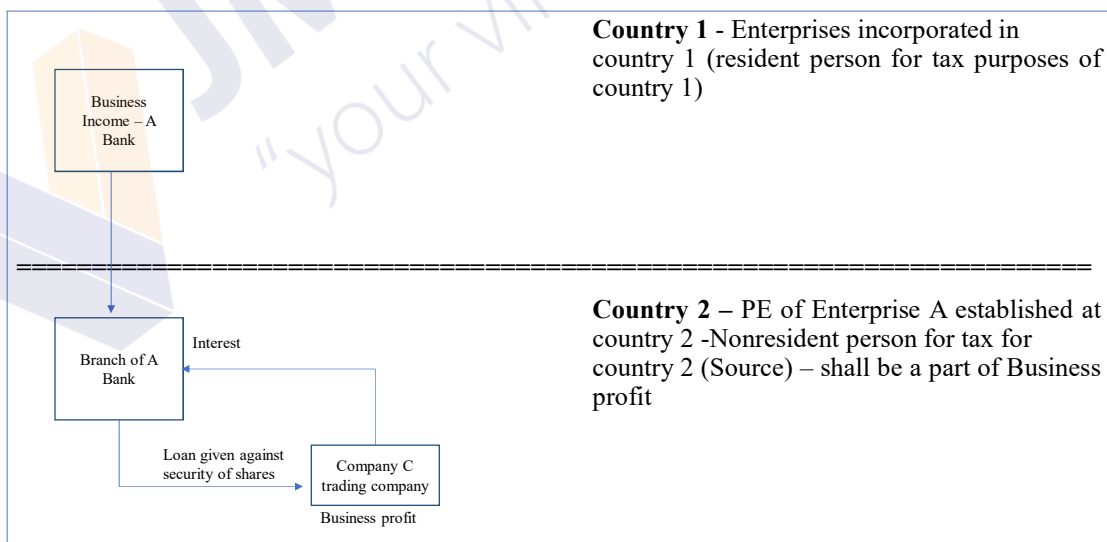
Primary taxing right with country of resident – Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

Source country has a limited taxing right - Interest arising in the Contracting State to a resident of the other Contracting State may be taxed in contacting State – maximum tax rate.

Ex. “However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed 10 per cent of the gross amount of the interest”.

- Interest” means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prize attaching to such securities, bonds or debentures.
- Penalty charges for late payment shall not be regarded as interest for this purpose

Application of Article 7 Business profits to Article 11 – Interest



Application of Article 7 Business profits to Article 11 – Interests

- Article 11 - beneficial owner of the interest , being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment.
- In such case the provisions of Article 7 shall apply.

Application of Article 14 - Independent Personal Services to Article 11 – Interest

- Article 14 - beneficial owner of the interest , being a resident of a Contracting State, performs independent personal services from a fixed base situated therein in the other Contracting State in which the interest arises, and the debt-claim in respect of which the interest is paid is effectively connected with such fixed base.
- In such case the provisions of Article 14, shall apply.
- Interest shall be deemed to arise in a Contracting State when the payer is a resident of that 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 or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment of fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment of fixed base is situated.
- Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, 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 beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such 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 the Agreement.

Article 12 – Royalties

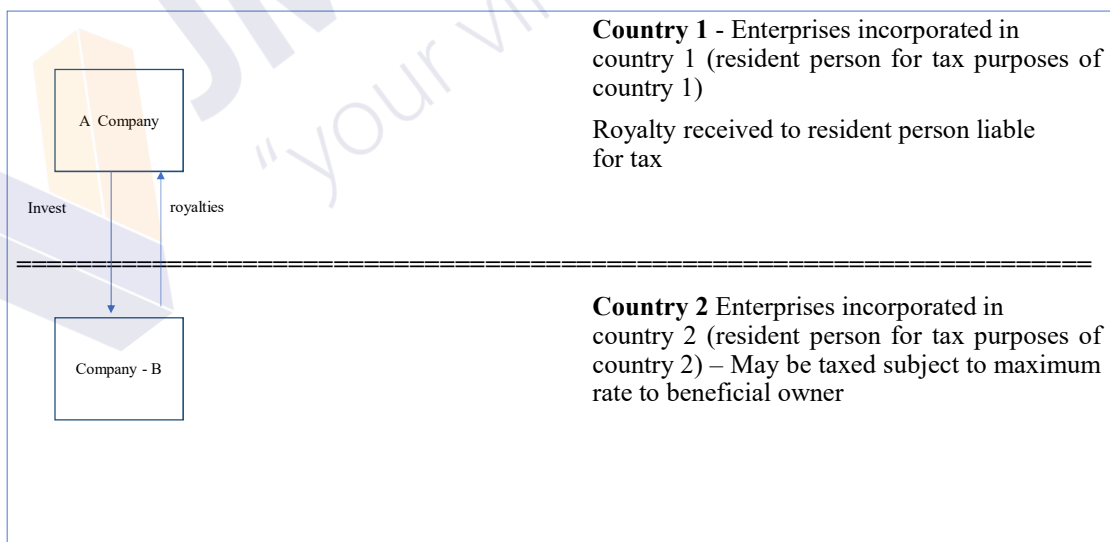
Primary taxing right with country of resident – Royalties arising in a Constructing State and paid to a resident of the other Contracting State may be taxed in that other State.

Source country has a limited taxing right - Royalties arising in the Constructing State to a resident of the other Contracting State may be taxed in contacting State – maximum tax rate.

Ex. *“However, such royalties may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the royalties the tax so charged shall not exceed 10 per cent of the gross amount of the interest”.*

“Royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or films or tapes used for television or radio broadcasting any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience

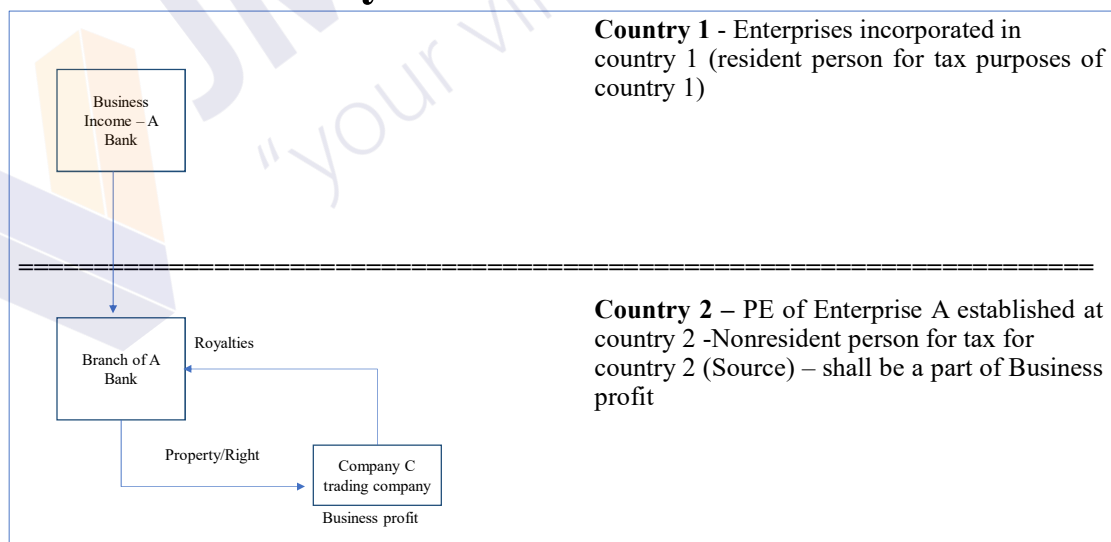
Article 12 – Royalties



Application of Article 7 Business profits to Article 12 – Royalties

- Article 12 - beneficial owner of the royalties , being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arises, through a permanent establishment situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment.
- In such case the provisions of Article 7 shall apply.

Application of Article 7 Business profits to Article 12 – Royalties



Application of Article 14 - Independent Personal Services to Article 12 - Royalties

- Article 14 - beneficial owner of the royalties , being a resident of a Contracting State, performs independent personal services from a fixed base situated therein in the other Contracting State in which the royalties arises, and the right or property in respect of which the royalties are paid is effectively connected with such fixed base.
- In such case the provisions of Article 14, shall apply.
- Royalties shall be deemed to arise in a Contracting State when the payer is 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 or a fixed base in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such royalties shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.
- Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, 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 beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such 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 the Agreement

Article 12 - Royalties

India Tax treaty :- The term "fees for technical services" as used in this Article means payments of any kind, other than those mentioned in Articles 14 and 15 of the Agreement as consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel.

Article 12 A – Fees for Technical Service (UN Model)

Primary taxing right with country of resident – Fee for technical Services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

Source country has a limited taxing right - Fee for technical Services arising in the Contracting State to a resident of the other Contracting State may be taxed in contracting State – maximum tax rate.

Ex. “However, such Fee may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed 10 per cent of the gross amount of the Fees”.

- Fees for technical services" as used in this Article means any payments in consideration for any services of a managerial or technical or consultancy nature, unless the payment is made;
- To an employee of the person making the payment – Article 15
- For teaching in an educational institution or for teaching by an educational institution – Article 7
- By an individual for services for the personal use of an Individual

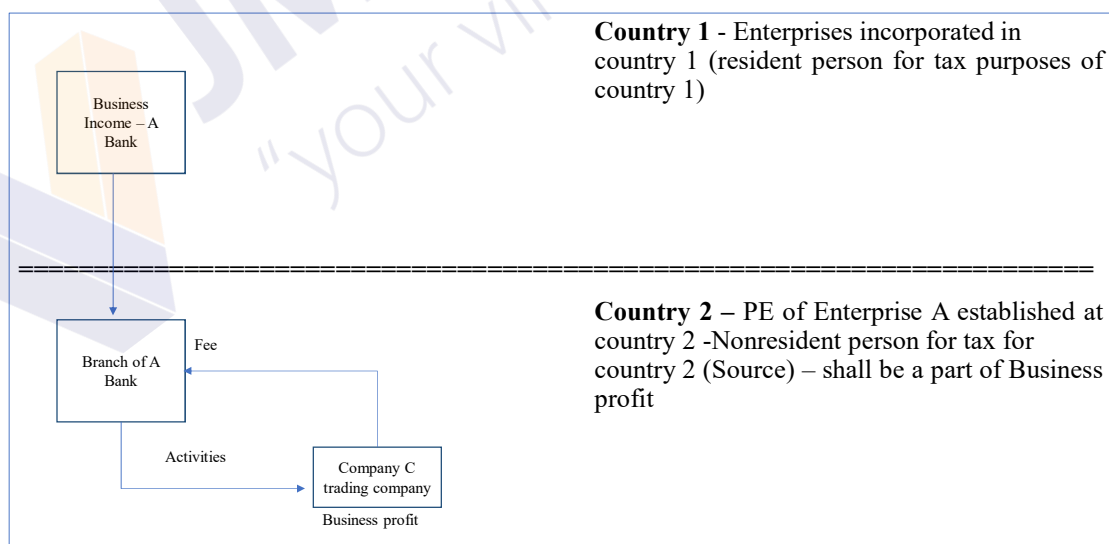
Application of Article 7 Business profits to Article 12 A– Fee for Technical Services

- Article 12 - beneficial owner of the fee , being a resident of a Contracting State, carries on business in the other Contracting State in which the fee arises, through a permanent establishment situated therein, and fee is paid is effectively connected with such permanent establishment.
- In such case the provisions of Article 7 shall apply.

Application of Article 14 - Independent Personal Services to Article 12 A- Fee

- Article 14 - beneficial owner of the fee, being a resident of a Contracting State, performs independent personal services from a fixed base situated therein in the other Contracting State in which the fee arises, and the fee for technical services are effectively connected with such fixed base.
- In such case the provisions of Article 14, shall apply.
- Fee for technical Services shall be deemed to arise in a Contracting State when the payer is a resident of that State.
- Fee for technical Services shall be deemed not to arise in a Contracting State if the payer is a resident of a Contracting State and carries on business in the other contracting state through a permanent establishment or a fixed base, and such fee are borne by such permanent establishment or fixed base.
- Where, by reason of a special relationship between the payer and the beneficial owner of the fee for technical service or between both of them and some other person, the amount of the fee, having regard to the service for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such 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 the Agreement

Application of Article 7 Business profits to Article 12 A – Fee for Technical Services



Article 13 Capital Gain

Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.

Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal service, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

Gains derived by a resident of a Contracting State from the alienation of ships or aircraft operated in international traffic, or movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.

Gains derived by a resident of a Contracting State from the alienation of shares or comparable interest such as interest in a partnership or trust, may be tax in other contracting State if these shares or comparable interest deriving more than 50 per cent of their value directly or indirectly from immovable property situated in that other Contracting State. See China and Singapore Tax treaty

Article 13 Capital Gain

Income earned by dealing "in" assets or property is business income.

Income earned on sale of assets "with" which business is done is capital gain.

This Article is solely discussed with Capital Gains made by alienation of assets.

Alienation of assets covers , gain resulting from the Sale or exchange of property and also from partial alienation, the expropriation, the transfer to a company in exchange of stock, the sale of a right, gift and even the passing the ownership of a property on death.

Movable property forming part of business property including incorporeal (Intangibles) property such as goodwill, licenses, emission permits - gain from such property shall be treated as business profit .

Alienation of ships or aircraft operated in international traffic, or movable property pertaining to the operation of such ships or aircraft, shall be taxable where the effective management is situated.

Article 14 – Independent Personal Services (UN Model)

Income derived by an individual who is a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State.

- if he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities ; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other State ; or
- if his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned ; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

The term “professional services” includes especially independent, scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants

Article 15 – Dependent Personal Services

Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other Contracting State.

Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if ;

- the recipient is present in that other Contracting State for a period or periods not exceeding in the aggregate 183 days in any 12-month period ; and
- the remuneration is paid by, or on behalf of, an employer who is not a resident of that other Contracting State; and
- the remuneration is not borne by a permanent establishment or a fixed base which the employer has in that other Contracting State.

Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic by an enterprise of a Contracting State shall be taxable only in that State.

Article 16 – Directors’ Fees

Directors’ fees and other 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 State.

Article 23 – Method of Elimination of Double taxation

Exemption method

- Full exemption
- Exemption with progression

Credit Method

- Full credit
- Ordinary Credit

Article 23 – Method of Elimination of Double taxation

Exemption method :- Under the exemption method the state of residence does not tax the income which according to the treaty such income may be taxed in other contracting state.

- Full exemption method - State of residence does not tax the income received from Source State
- Ex 01. "A" is a resident of State of "R", received an income of Rs. 80,000/- from "R" where the Tax rate at "R" if the income is less than Rs. 100,000/- it is 30% otherwise it is 35%. And he received an income of Rs. 20,000/- from other State "S" where the applicable tax rate is 20%.
- Under the Full exemption method;

Tax on Income from "R" (80,000 X 30%)	24,000
Tax on Income from "S" (20,000 X 20%)	<u>4,000</u>
Total Tax	<u>28,000</u>

Article 23 – Method of Elimination of Double taxation

If no double tax treaty

Tax on Income from "R" (100,000 X 35%)	35,000
Tax on Income from "S" (20,000 X 20%)	<u>4,000</u>
Total Tax	<u>39,000</u>

Benefit available under double tax avoidance agreement under full exemption method is Rs. 11,000/- (39,000 – 28,000).

Article 23 – Method of Elimination of Double taxation

- Ex 02. “A” is a resident of State of “R”, received an income of Rs. 80,000/- from “R” where the Tax rate at “R” if the income is less than Rs. 100,000/- it is 30% otherwise it is 35%. And he received an income of Rs. 20,000/- from other State “S” where the applicable tax rate is 40%.
- Compute the benefit assuming that full exemption method is available in the double tax avoidance agreement with country “R” and Country “S” ;

Article 23 – Method of Elimination of Double taxation

Article 23 – Method of Elimination of Double taxation

Exemption with progression- Exempt income is taken at the tax computation in the State of residence

- Ex 03. “A” is a resident of State of “R”, received an income of Rs. 80,000/- from “R” where the Tax rate at “R” if the income is less than Rs. 100,000/- it 30% otherwise it is 35%. And he received an income of Rs. 20,000/- from other State “S” where the applicable tax rate is 20%.

- Under the exemption with progression method;

Tax on Income from “R” (80,000 X 35%)	28,000
Tax on Income from “S” (20,000 X 20%)	<u>4,000</u>
Total Tax	<u>32,000</u>

Article 23 – Method of Elimination of Double taxation

If no double tax treaty -

Tax on Income from “R” (100,000 X 35%)	35,000
Tax on Income from “S” (20,000 X 20%)	<u>4,000</u>
Total Tax	<u>39,000</u>

Benefit available under double tax avoidance agreement under above method is Rs. 7,000/- (39,000 – 32,000).

Article 23 – Method of Elimination of Double taxation

- Ex 04. “A” is a resident of State of “R”, received an income of Rs. 80,000/- from “R” where the Tax rate at “R” if the income is less than Rs. 100,000/- it 30% otherwise it is 35%. And he received an income of Rs. 20,000/- from other State “S” where the applicable tax rate is 40%.
- Compute the benefit assuming that exemption with progression method is available in the double tax avoidance agreement with country “R” and Country “S” ;

Article 23 – Method of Elimination of Double taxation

Article 23 – Method of Elimination of Double taxation

Credit method :- Under the credit method the State of residence retains the right to tax the total income but against the tax so imposed, is allowed a deduction.

- Full Credit method - State of residence retain the taxing rights but grant tax credit for tax paid at Source State
- Ex 05. "A" is a resident of State of "R", received an income of Rs. 80,000/- form "R" where the Tax rate at "R" if the income is less than Rs. 100,000/- it 30% otherwise it is 35%. And he received an income of Rs. 20,000/- from other State "S" where the applicable tax rate is 20%.
- Under the Credit method;

Tax on Income from "R" (100,000 X 35%)	35,000
Less: Tax on Income from "S" (20,000 X 20%)	<u>4,000</u>
Tax at "R"	<u>31,000</u>
(Credit given for tax paid at "S")	
Total Tax	35,000

Article 23 – Method of Elimination of Double taxation

If no double tax treaty

Tax on Income from "R" (100,000 X 35%)	35,000
Tax on Income from "S" (20,000 X 20%)	<u>4,000</u>
Total Tax	<u>39,000</u>

Benefit available under double tax avoidance agreement under Credit method is Rs. 4,000/- (39,000 – 35,000).

Article 23 – Method of Elimination of Double taxation

- Ex 06. “A” is a resident of State of “R”, received an income of Rs. 80,000/- from “R” where the Tax rate at “R” if the income is less than Rs. 100,000/- it 30% otherwise it is 35%. And he received an income of Rs. 20,000/- from other State “S” where the applicable tax rate is 40%.
- Compute the benefit assuming that full credit method is available in the double tax avoidance agreement with country “R” and Country “S” ;

Article 23 – Method of Elimination of Double taxation

Article 23 – Method of Elimination of Double taxation

Ordinary Credit method - State of residence retain the taxing rights but grant tax credit for tax paid but under circumstances allow more than the portion of tax in resident State which attributable to the income of the Source State

- Ex 07. "A" is a resident of State of "R", received an income of Rs. 80,000/- from "R" where the Tax rate at "R" if the income is less than Rs. 100,000/- it 30% otherwise it is 35%. And he received an income of Rs. 20,000/- from other State "S" where the applicable tax rate is 20%.
- Under the Ordinary Credit method;

Tax on Income from "R" (100,000 X 35%)	35,000
Less: Tax on Income from "S" (20,000 X 20%)	<u>4,000</u>
(up to the maximum tax of Rs. 7,000/-)	
Tax at "R"	<u>31,000</u>
Total Tax	35,000

Article 23 – Method of Elimination of Double taxation

If no double tax treaty

Tax on Income from "R" (100,000 X 35%)	35,000
Tax on Income from "S" (20,000 X 20%)	<u>4,000</u>
Total Tax	<u>39,000</u>

Benefit available under double tax avoidance agreement under full exemption method is Rs. 4,000/- (39,000 – 35,000).

Article 23 – Method of Elimination of Double taxation

- Ex 08. “A” is a resident of State of “R”, received an income of Rs. 80,000/- from “R” where the Tax rate at “R” if the income is less than Rs. 100,000/- it 30% otherwise it is 35%. And he received an income of Rs. 20,000/- from other State “S” where the applicable tax rate is 40%.
- Compute the benefit assuming that ordinary credit method is available in the double tax avoidance agreement with country “R” and Country “S” ;

Article 23 – Method of Elimination of Double taxation