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Master`s Thesis

Methods to Eliminate International Juridical Double Taxation

Tarptautinio teisinio dvigubo apmokestinimo panaikinimo metodai

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ANNOTATION IN ENGLISH

This Master`s thesis provides an investigation and comparison between different methods of elimination of international juridical double taxation with analyses of the most and least effective ones. The question of the double taxation phenomenon as a legal problem is raised in legal and economic regards with its distinguishing characteristics. The elements and principles of taxation are discovered. There is a focus on the conventional methods, mentioned in OECD and UN Models, and its` main ideas.

Keywords: dual taxation, legal taxation, economic taxation, taxation principle, tax relief method, tax treaty, Model convention.

ANNOTATION IN LITHUANIAN

Baigiamajame magistro darbe nagrinėjami ir lyginami skirtingi tarptautinio teisinio dvigubo apmokestinimo panaikinimo būdai, analizuojami efektyviausi ir mažiausiai efektyvūs. Dvigubo apmokestinimo reiškinio, kaip teisinės problemos, klausimas keliamas teisiniu ir ekonominiu požiūriu su jo skiriamaisiais bruožais. Atrandami apmokestinimo elementai ir principai. Daugiausia dėmesio skiriama OECD ir UN Modeliuose minimiems tradiciniams metodams ir pagrindinėms jų idėjoms.

Raktiniai žodžiai: dvigubas apmokestinimas, teisinis apmokestinimas, ekonominis apmokestinimas, apmokestinimo principas, mokesčių lengvatos metodas, mokesčių sutartis, pavyzdinė konvencija.

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INTRODUCTION

This Master`s thesis is dedicated to a very important topic for each state's legal and economic levels. Nowadays, researchers and practitioners are searching for ways to eliminate international double taxation, since it has a negative impact on the general welfare of the economy, affecting individuals` and companies' interests together with states` treasury. As this phenomenon causes a wide range of issues, there is a need to seek any ways to avoid this matter. That's why, I am going to disclose the reasons for the occurrence and the methods for double taxation relief.

It should be pointed out that the issue of international double taxation arises only in relations between states, in cases where more than one country is involved. This is explained by the fact that each state has its unique taxation system. The situation of contradiction of tax systems in international екфву relations generates this problem.

Research problem: The main question to be answered: «Is it possible to eliminate the issue of international juridical double taxation?»

Aim: The purpose of this Master thesis is - to investigate the double taxation relief methods, discover their variety and find the most significant ones in the practical realm.

Structure: I divide my research in several parts, each of it has a detailed division into sub-chapters to structure the paperwork in a clear way. Firstly, I will get acquainted with the basic information concerning the further thorough understanding of the topic. This initial fragment disclose concepts: taxation, international double taxation, taxation principles, elements of taxation, difference between economic and legal taxation. It introduces the elements of taxation, which are dominant for every process of taxation. Furthermore, it discloses the versatility of taxation systems chosen by one another state or as it's customary, used as «principles of taxation». And the demarcation of juridical and economic taxation is closing up the first part.

Then I forward to the most significant part of this work, which reveals all available methods of double tax relief with a certain classification. It is notable, that the exemption tax method splits into —full exemption and exemption with progress, and the credit tax method — in full credit and ordinary ones. Also, I detail explain non-conventional methods of double tax relief: tax-sparing method and deduction method.

After this, the last part of this legal research follows. It concerns the international double tax treaties and conventions, where I will report on bilateral and multilateral tax treaties, differences, complexities and their progress. Also, I will examine all prominent tax model conventions: OECD, UN, and mention about USA and China Model. I focus my attention on the research of the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital, and on United Nations (UN) Model Tax Convention between Developed and Developing Countries.

Novelty: The originality of this Master`s thesis I find in a full research of the previous meaningful learnings, with the emphasis on new corporate reports in the field of audit, and outstanding lawyers' publications on this topic. Due to the detailed research on the double taxation phenomenon, I come up with individual thoughts and ideas regarding overcoming this problem. When determining the conclusion I agree, that it is indeed possible to avoid double taxation under certain conditions. So, this Master`s thesis gives a valuable outlook for lawyers and tax experts handling the double taxation problem.

Objectives: I have a few objectives for every part of my work.

1. To come across the basics of taxation: the meaning of the international double taxation notion, discovering the elements of taxation, taxation principles, the distinction of legal and economic taxation.

2. To discover the reasons for international double taxation.

3. To reveal eliminating double taxation methods and their demarcation.

4. To acquaint with bilateral and multilateral tax treaties.

5. To examine the Model Convention as a way of dual tax relief and define the most essential ones.

6. To identify the main methods of double tax relief, reinforcing with individual thoughts.

Methodology: This research will follow the *analytical method* to disclose the diversity of taxation systems taken into the base for each country. The rest of the findings will be done by using a *comparative method* for differentiating ways of double tax relief, determining their efficiency by giving thematic examples. Also, the sufficiency of *legal analysis and synthesizing method* is needed for discovering the articles of OECD and UN Model Conventions, together with USA Model and China Convention norms. Conclusions will be made through *critical reviewing* of conventional and non-conventional methods of avoidance of double taxation, the use of *logical thinking method* brings down to the final decisions and ideas.

Literature: As the chosen topic is quite complicated, it's appropriate to use the publications of Radu, M. E. (2012). «International Double Taxation», Condor, I. (1999). «International Double Tax Avoidance». Arnold, B. J. (2015). «An Introduction To Tax Treaties», and texts or recent OECD (2019), UN (2021) Tax Model Conventions for deeper research.

Relevance: There are several outstanding research touching on some separate matters of this phenomenon. But, in my master`s thesis, I do a full study on the subject in order to bring the reader closer to the outcome. In my point of view, the double taxation issue is more discovered by economics, and less by lawyers. Thus, the study will draw an attention of legislators and policymakers to examine this problem globally.

DOUBLE TAXATION PHENOMENON

After the lasting World War II, the reason for what was to overthrow the political and military powers, because of the lack of the tools regulating an international economy. According to a 2015 analysis on this subject, it is not possible for any military alliance to achieve stability if the international traders not that developed.

There became a need to raise the world's economy again, because international commercial relations occupied a prominent place. The process of Globalization turned into the only way out and generated many advantageous conditions for the development of interdependence of the world's economies, capital and investment flow, cross-border trade of goods and services. It played a major role, and many states wanted to take part in it, thus establishing strong international ties. As the countries with advanced international trade, less likely to be involved in military aggressions, accordingly, this served as an important impetus in evolution after the World War II, resulting is a decrease in interstate wars. (Jackson, Nei, 2015)

However, at the same time, Globalization brought some problems, especially the double taxation issue, which is not a novelty in modern corporate affairs. Double taxation is not only a trouble for taxpayers, but also for the states, which lose the additional income.

Many governments have already contributed to the evolution of tax matters and in order to attract investors, countries benefit from various attractive investor-friendly methods, such as low-interest loans, tax deductions or incentives, reinforcing with legal tools.

And investors in its turn are searching for countries where their good and services can be delivered cheaply to get a higher competitiveness by establishing lower prices on the market.

The simple situation of double taxation could look like this: if the resident of country A, lives and gets a salary in state B, he will be obliged firstly to pay an income tax in his residency country, and then in the country, this income was obtained.

Double taxation can be both: national and international. Another classification also exists, namely legal double taxation and economic double taxation. Also, it has specific elements used in every taxation process. And double taxation appears due to the divergence of taxation principles, established in each state.

The urgency to eliminate or alleviate international double taxation has grown, given its potential to confer a competitive advantage in today's global economic landscape, marked by advancements in technology, digitization, and increased globalization. (Sarmento, 2023, p. 245)

1.1 Concept of International Double Taxation

«Double taxation» means the simultaneous taxation of the same object twice during the same tax period in different countries.

As every state posses a sovereign right of taxation by its tax authorities, it ma y at its own discretion establish the amount of tax to be charged from a taxpayer. Governments create internal tax systems in compliance with their economic, political and social powers. Thus, every country often imposes tax on the domestic source income of foreign corporations and nonresidents, not to mention on the worldwide income of domestic corporations and residents to keep their income sources on a high level. (Ohno, 2010, p. 288)

Double taxation induces a hardship on taxpayers through an increased tax burden on the investor and can result in the increase of the price of goods and services, discourages cross-border investment through curtailing capital movement, and violates the tax fairness principle.

Double taxation may be in the form of international double taxation encompassing the foreign income in the source state, where it was obtained, and the residency state of the investor. This definition is broader than the simple double taxation.

Thus, international double taxation is considered a kind of double taxation, meaning that the same tax subject and taxpayer are taxed separately under the tax laws of more than one state.

Double taxation will possibly occur in the states with different taxation principles, when the residency taxation system is applied in one state, and source taxation principle in another. The first principle means, that in that country a taxpayer is spotted as a resident, and in the second principle, the taxpayer is a non-resident, but still, the state can tax an object - his income, which is obtained in that territorial measures.

In an international double taxation case, it is essential to pay the same type of tax in two different states: one being that of the origin of the income and the other being the taxpayer's declared residence (Sarmiento, 2023, p. 245).

The situation of international double taxation usually is: a resident of residence-based taxation principle country taxes him, together with the country, where he works and gets a taxation object - income, considered as source-based taxation principle.

"International double taxation is one of the biggest obstacles to cross-border trade and investment relations and the freedom of movement of persons, goods, services, and capital between countries" (Rasmussen, 2011). It is a result of overlapping tax claims of two or more states. The main reason for international double taxation phenomenon is - the differences in the internal tax rules of the states.

International double taxation arises in the states, locating great corporations, which operate their business in a jurisdiction different from their residency country. As it used to happen the situation of taxing the income in the source state and in the country of taxpayers residency. That results in a price increase of goods and services falling in the trap of double taxation and discourages the transnational capital flow and investments.

Double taxation affects the efficiency and competitiveness of exports of goods, external, international elimination of double taxation in order to represent a necessity to ensure an improvement of economic relations at the international level (Radu, 2012 p. 404).

Countries - importers have a great interest on imposing an income tax, gained in the source of income state. Notwithstanding, capital-exporting countries to tax net assets from international investments. The common rule of international double taxation is to tax the income carried out with the territorial ties first and then, to collect the fees in the state of residency or citizenship.

There are some measures to avoid international double taxation by conducting double tax treaties with countries of the same business affairs, using tax relief methods. They help to prevent and decrease the risk of dual tax burden for taxpayers. It is the best course for states with increasing trade relations, to agree and sign bilateral or multilateral tax treaties and decide on how they will deal with the income, received in cross-border transactions and obscure it from double taxation. Thus, they make certain concessions to another partner state.

Generally, double taxation happens if states didn't agree on how the prices should be set up on transfers and transactions between related persons. Thus, the elimination of double taxation is being dealt at both: international and national levels.

Also, there exists a problem of double non-taxation, in a situation, when a resident of state with a territorial taxation principle works in a residency-based country, not being a resident of it, his income is not taxed in either country as it doesn't fall under any tax regulations. It is a common dilemma as well to be resolved, but not in the concept of this research paper.

So, accordingly to the mentioned above, it follows that international double taxation happens when few states have taxation jurisdiction over the same tax object and those tax authorities are disputing on that matter. Likewise, the absence of an official description of double taxation phenomenon leads to some issues in interpretation.

And if both parties agree to adopt either source taxation or residence taxation, the problem of double taxation can be solved (Ohno, 2010, p. 292).

1.2. Variety of Taxation Systems in the World

Discovering the reasons for the double taxation problem, the issue in closely connected with the understanding of principles of taxation. They are also used as taxation systems, as states implement them in the basis of government, and use special steps during taxation based on the chosen principle.

Having absolute taxation powers, countries entering into international relations may face the problem of contradiction of their taxation principles. As often states use different principles of taxation, the clash of sovereignty powers of these states appears. Because they are applied by different means during taxing the taxpayers, and that may lead to international double taxation.

Principles, which lies in the basis of taxation in a particular state - are transformed into taxation systems. That's what, its admitted to separate four taxation systems in the world: residence-based, source-based, domicile-based, and citizen-based.

Thus, they should be examined broadly in order to decide the most spread ones, and which of these principle can cause the issues.

1.2.1. Residence-based Taxation System

I would start this investigation with a residence-based taxation system. It is based on the personal connection of the state with the individual or legal person, residing in it. It worth to be underlined, that this principle is also a personal principle, based on the relationship between state and individual, or state and a legal entity.

Under this principle, it is crucial to decide on how in that jurisdiction, the residency is defined. It is usually established, that to become a resident in a particular country, the person should live there minimum of 183 days per year to get a special residence permission, as a work or study visa with a right to stay there temporarily or permanently. After that, this individual will be a tax resident and fall under the tax jurisdiction, for further income gained there, he will be taxed and t similarly work with companies.

Legitimacy of this taxation system is acquired by the presence of the residents, who have that taxation object in that country. Thus, the physical presence of resident during more than 6 months is key. And the concept of this taxation method lies in the taxation of both: domestic and foreign incomes. But, the challenge in taxation on this principle is in monitoring all business activities, and respectively to determine all gained income.

Consequently, the residence will be taxed all over the world whatever the income comes. For the tax authorities, there is no matter if the resident resides abroad during that taxation period, and the income, assets, and property of the resident, will be taxed, based on his residency, even though he got them in another source state.

Legally it means, that the individual or legal person is in need to tax its residency.

The residence principle is the principle where tax residents of a country are subject to taxation on their worldwide income, a greater portion of taxation rights are allocated to a residence country. (Dauer, Krever, 2012).

This taxation principle is more common in economically advanced countries or called capital-exporting states: Germany, France, Austria, Spain. They are exporters of great capital and have actively involved investors in international trade. And they have absolute rights to tax income generated from these activities, and try not to lose it.

When the countries choose a residence-based system, they charge the tax from external income earned by individuals and entities in their country, including income from exports and investments. Because of its large capital export, this principle is in priority among wealthy countries.

The residence principle aims to prevent capital flight abroad, increase total tax revenue, and ensure equality in the taxation of domestic and foreign income. (Bahar, 2008, p. 24).

1.2.2. Source-based Taxation System

In order to understand the concept, it is a must to underline, that is considered to be a source of income. Thus, it is a place where activities, generating commercial income take place. The scope of the source principle is that the taxpayer can be taxed only for the income earned domestically.
The main element here is object - income, asset, deviants and so on, in contrast with the residence principle, where the individual element prevails.

The source principle is used to call the territorial taxation principle in the legal and economic fields, meaning taxing everything that falls under its tax jurisdiction or goes from the territory of that country to another one as a country of the gained source.

The source principle is the application of territoriality principle within the tax law, the basis for taxation is considered to be the place where income arises or where goods are located.

As a result, the scope of source taxation principle more advantageous when concluding a tax treaty between developing or developed countries. But, the number of countries using a territorial system diminished, because countries have recognized that the failure to tax residents on income derived from foreign activities undermines the fairness of the tax system and provides residents with a tax incentive to invest abroad.

The source principle is a relatively old concept in contrast to the residence principle. There is not any state, that has one pure taxation system, they mostly apply both residence and source principles. Although, in countries with dominating capital imports rather than exports, source taxation principle is prioritized.

Developing states as the capital importers have a lack of influence in international trade and the global economic market, due to a minor number of investors and international companies. Thus, having a limited tax liability, they are trying to get any use from foreign investments by diminishing taxable rate.

Understanding, that collecting an internal income for states with low economy is challenging, there is a need to prioritize the taxation of income generated within its taxation jurisdiction.

1.2.3. Citizen-based Taxation System

This principle, also used as the nationality principle means, that the state has the authority to tax under its jurisdiction any income received by its citizen wherever and whatever income that gets. Citizenship stands out by the political affiliation of individual with the state. And in the case of such taxation, state have a sovereignty to tax its citizen.

Citizen-based taxation system works if the person is taxed even living in another country, but due to its citizenship. It has a determining connection between the state and individuals citizenship, or easier said the presence of passport of the taxable country.

There should be a tie to citizenship, therefore it is spread for individuals as taxpayers and have no tie to legal entities. But regarding the nationality principle, it is observed that there are some issues encountered in practice, with one of the main problems being the determination of the nationality or residence of legal entities. So, its considered that legal domicile of corporations is in the country in which, it has the main business activity.

As a consequence, foreign individuals earning income in a country can be taxed based on unlimited tax liability by the country of which they are citizens.

Currently, it is known that there is only one country using such a taxation system in practice - that is the United States of America. That is the state, where the tax jurisdiction, based on nationality is dominant. In 1861 it was pointed out when trapped the financial demand of the Civil War. US Congress proclaimed, that even Americans residing abroad must fulfill their civic duties to the United States by paying taxes in all times even when receiving the income outside, and establishing the higher tax rate of US-sources income. The USA relies on its taxation system to sponsor government initiatives and programs. This ensured the prosperity of the US economy at all times. The rational taxation approach succeeded in preventing the tax evasion.

Thus, the United States is a great example of achievement in economic prosperity, bringing huge amount of money yearly to the governmental treasury. And in Article 4.2.c of the United Nations Model Double Taxation Convention between Developed and Developing Countries, uses citizenship as a tie-breaker in resolving problems of dual residency.

By this time, other countries, especially Latin American - Mexican, Romania, Bulgaria, Vietnam, the Philippines tried to implement this principle in their taxation system, but there was a huge dissatisfaction by citizens not residing in their home country. That's why people started leaving the countries, giving up their passports and obtaining passports in other states - just to pay less tax. When the authorities realized this problem, in order to detain their citizens, and reduce the outflow of locals, they made up the decision to change the tax system.

Also, after the issue was detected, advanced countries: Monaco, Switzerland, Spain, Israel wanted to make a profit on it, by giving «Golden visas» to newcomers, meaning residency by investment programs allowing individuals to obtain a residency in a foreign state, they invested in (like 500 000 EUR to invest for non-EU residents to get a Golden visa).

1.2.4. Domicile-based Taxation System

The domicile taxation principle is quite not well studied circumstance, and it is not spread among the worlds` economies. This phenomenon is used in the United Kingdom and Australia.The concept of taxation refers to the fiscal domicile where the taxpayers reside, live, or conduct their business during particular time frame. For individuals, it can be a home or workplace, while for legal entities, it can be the legal headquarters, a place of effective management. An individual in usually is domiciled in country considering you long-time permanent home.

Getting a domicile is possible in two ways: either to become a domicile of origin, based on the domicile of parents, or domicile of choice, when changing the countries of residence - domicile also changes.

The UK establishes domicile if the person in its state resides for a long period of time calculating 7 years and more. But, it is not a true resident of that county, although the person is taxed from the income it obtained in UK or his income goes abroad from the UK.

So, if an individual resided in the UK less than the minimum domicile period, let say 7 years, he will be thought as non-domicile resident. Non-domicile persons` income deriving from his citizenship or residence country would not be taxed under the tax jurisdiction of the UK.

Why a domicile is established for goals of taxation? Because to play safe and agree on the solvency of newcomer-domicile. Once, he is detected a a talented and capable individual, which may bring the use of taxes to the governmental funds, and experienced life in that state, then his income, assets, deviants are taxed wherever and whenever he got them.

In some way, this principle is related to the above-mentioned citizen or nationality principle. It is not surprising, that capital-exporting countries with advance economics and international business affairs, may tax their taxpayers: either domicile residents or citizens, income even obtained in foreign county or if the taxpayer lives abroad, but posses a duty to be taxed under that jurisdiction.

Instead, the economic aspect of the principles of the current tax legislation in the world is clearly expressed in their content and is a natural consequence of the economic nature of tax relations the inherent importance of taking into account economic laws, proportions and levers of influence in the formation of legal mechanisms, introduction and administration of taxes and fees.

It is in the unity of legal form and economic content that the principles of tax relations become not only abstract rules, but also directly begin to operate in tax relations, taking into account their dynamics and the rule of economic laws to achieve the goals of taxation with strict observance and implementation of the rule of law and its components. And as a logical result of such interaction, we will get the desired balance of public and private interests in tax relations, which is the key to their effectiveness, both in terms of filling budgets and ensuring economic development.

Concluding everything mentioned in the chapter dedicated to the explanation of taxation systems used in the world, I can confidently say, that neither one county has a pure taxation system. Some taxation principles just prevail over others due to the process of globalization.

1.3. Elements of Taxation

International double taxation is based on the elements of the same taxable subject being taxed within the same period. Elements of each taxation process are those aspects, which initiate a legal basis of tax law. They are impulses or reasons for economic and juridical taxation. Elements are legal frameworks to justify the accuracy of taxation in accordance with legislation.

Elements should define taxpayers, taxable event or object of taxation, and tax base; tax rates; and basic rules for administration. There are many notions, which can be considered as elements of taxation, but I will review the key ones.

There are exist such elements of taxation:

1) Subject
2) Object
3) Tax rate
4) Tax base
5) Tax period
6) Tax calculation procedure
7) Terms and procedure of tax payment
8) Tax holiday.

Regarding the subject - it is an important component of taxation, because it means the taxpayer if the face of an individual or legal entity to be taxed under a certain tax rules. In the context of international double taxation, a crucial requirement is the uniformity of the taxpayer. As in order to be considered as a taxpayer, there is a need to be recognized as subject in tax authority in the state. It may be established by some means: residency, citizenship, domicile or source. In the states with special chosen taxation systems, some of either means will prevail, or the political and economic connections will play a key role. The relationship between the taxable income source and a state takes a crucial place too.

The taxpayer is a person, who has earned a chargeable income during a fiscal year to be taxed. A taxable person may be an individual, company, partnership, trustee. Thus, the taxable individual is a person, having a temporary of permanent residence in the tax jurisdiction state. The legal entity as a taxpayer have its business incorporated, managed or controlled in taxing country. To be a resident trust, it should establish and manage the trust in that territory. And a partnership becomes a resident partnership since one of the partners is a resident person during the year of income. In international juridical double taxation, the same taxpayers are taxed by more than one state on the same tax subjects.

When defining the concept of object of a tax, it must be raised a question: «What is going to be taxed?».

The object of taxation - is an income, asset, or dividends to be taxed. The object varies from the activities performed to obtain it, either it is a passive income or salary. Besides, the which taxation principle has a taxation county in a foundation also make sense. If the income gained in a source state, it must be taxed using legal rules. Once the income originates in residency-based state, i should not be tax for the purpose of avoidance of double taxation. Chargeable income is usually a sum of business income, employment income and property income.

The tax rate is the amount of tax per unit of taxation (per unit of monetary income, land area, product measurement) established either in a firm amount or as a percentage of the value of the object of taxation, or in a combined version. As the amount of the tax is usually related to the scale of economic activity, it is necessary to use rates. Depending on the size of the tax base, the rate may change or remain constant.

Respectively, it is allocated:

- Proportional or flat scale - the rate does not depend on the size of the tax base.
- Progressive scale - the rate increases as the tax base grows.
- Regressive scale - the rate decreases as the tax base grows.

Tax base is recognized as the monetary value of income received from the sale of goods (works, services, property rights) that are the object of taxation. The tax base is regarded as a cost, quantitative, or physical characteristic of the object of taxation, which is determined for each tax separately by types of income for which different tax rates are established. The process of levying taxes will be effective only when the tax base accurately characterizes and determines the object of taxation. It shows the value of the object taxation in units, like an object converted into a number.

And the tax legislation should take into account the formation of accounting indicators when choosing the limitations and norms that determine the method of calculating the tax base.

The taxation period is a period by the end of which the the tax base is determined and the tax must be paid. The uniformity of the taxation period, which is one of the fundamental elements of international double taxation, implies that the occurrence time of the taxable event aligns in both countries. This economic event is a subject of taxation happening in both countries. This may be a calendar month, quarter, calendar year or other period of time and is a mandatory element of taxation.

In the case of international double taxation the occurrence time of the taxable event aligns in both countries. And it should not be confused with concepts such as assessment time, payment time, budget year, which may vary in different tax systems among countries. But, it contradicts main taxation principle to impose similar taxes in different periods.

Tax calculation procedure and terms and procedures of tax payment is usually established in Tax Codes and law in each state, because each Ministry of Economy may establish these procedures differently. It is explained by the economic development - unique in each country, population and its solvency, prices for goods and services, tax tariffs.

Tariffs are charges, levied by the government on goods imported from other countries. When the government applies tariffs on imported goods, the price of those goods in the domestic market increases.

Tariffs are classified into two types: import tariffs and export tariffs. Import tariffs are levied on imported products. Similarly, tariffs levied on exports are called export tariffs. The government uses import or export tariffs to raise revenue through tariff collection.

Tax holiday is a governmental incentive, that temporarily, during some time reduces or do not tax consumers, individuals or businesses.

1.4. The Difference between Economic and Juridical Double Taxation

International double taxation occurs in two ways: international juridical double taxation and international economic double taxation. The literal meaning of international double taxation corresponds to international legal double taxation.

Double taxation is a dual definition, used in Economics and Tax Law. My research study aimed at legal designation of double taxation phenomenon. But, it is a must to understand this difference to specify any of either type in particular cases. This is a key for my further research, baring the complex of methods of particularly international juridical double taxation. In order to understand my topic, it is necessary to reveal these concepts an the current stage and then to move on to the next part. Starting here, I will give examples of taxpayers, residing or obtaining the income, in countries A or B.

The most significant difference between economic and juridical double taxation arises in element of the taxpayer. In economic double taxation, the taxation of the same tax subject in the hands of different taxpayers is underlined whereas in juridical double taxation, having the same taxpayer is particularly crucial.

Starting with the judicial double taxation, it occurs in the situation in which two or even several states enable taxation for the same income or capital; meanwhile, economic double taxation in cases in which two different persons are taxable upon the same income and/or capital. It has the effect of imposing multiple burdens with respect to the same item of income.

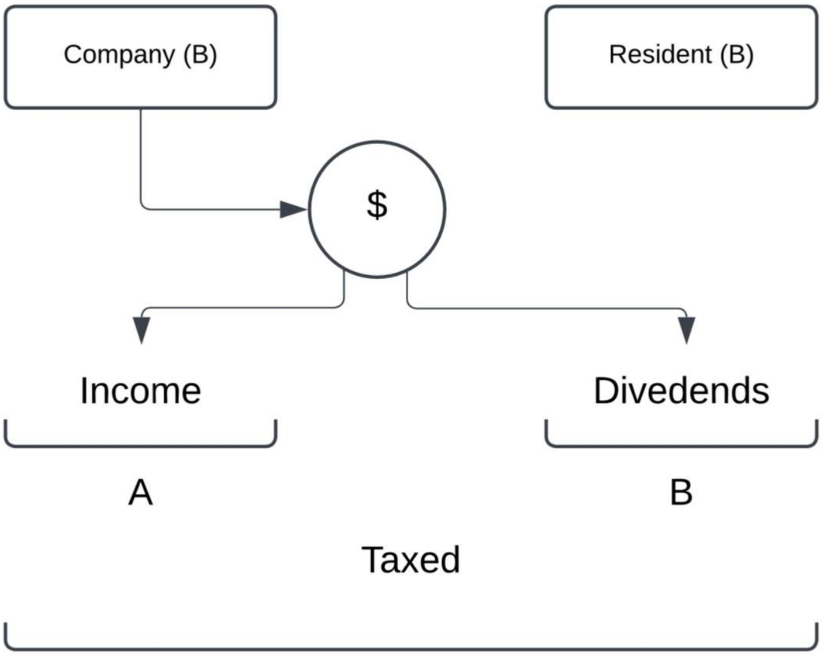
1.4.1. Economic Double Taxation

I would like to start disclosing this question with the economic type of double taxation, because this concept is much broader than legal double taxation. It is explained by the fact, that the notion of economic dual taxation always includes legal one. And the legal double taxation would not always be indicated as economic double taxation.

The economic definition means - the same economic transaction - money is taxed twice, whether the same subject was taxed. It does not matter if objects or subjects were different, thus assets, income or dividends are interpreted as money. It is the taxation of the same income in the hands of different persons (OECD, 2019).

For example, in Economic double taxation the income obtained in a state A and dividends forwarded to state B - are considered as the same operation.

Also, here there may be different subject as individual - resident of state B, who gets dividends from investments there, and his company net income, obtained in state A, and both will be taxed.



Resident B have its company established in state A, the company pays tax from his income in that state A. And Resident of country B, getting dividends from its activity pays tax for it in state of residency - B.

Schematically it would look like:

The economic double taxation means when the tax authorities include exactly the same income in the tax base of different taxpayers. Levying of tax obligations on multiple individuals by more than one state on the same taxable item represents economic double taxation. Thus, international economic double taxation can arise from conflicts in states' taxation powers.

1.4.2. Juridical double Taxation

Legal double taxation arise when the same subject and object are taxed. The same object, taxed in legal taxation means, that it will be either income or evidence, but they are not counted together as the same transaction as in economic taxation. The same subject taxed - is only individual, who gets that money. Juridical double taxation is contrary to tax justice, because it imposes an excessive tax burden on certain taxpayers.

International juridical double taxation can be defined as the “imposition of comparable taxes in two or more States on the same taxpayer in respect of the same subject matter for the same tax period. (OECD, 2019)

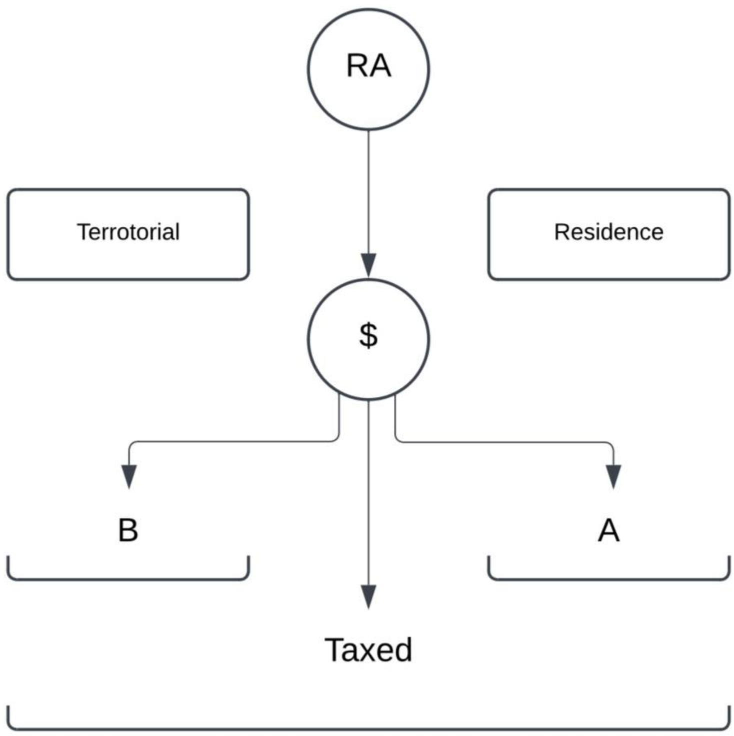
Double Taxation Treaties are generally concerned with international juridical double taxation and, to a lesser extent, with economic double taxation. (Jogarajan 2018, p.7) From the definitions made by the UN and OECD that have prepared Model Conventions on the subject, it is seen that these agreements aim to avoid international juridical double taxation, and it is stated that the avoidance of economic double taxation is not among the objectives of tax agreements.(Van Weeghel, 1998, p. 34)

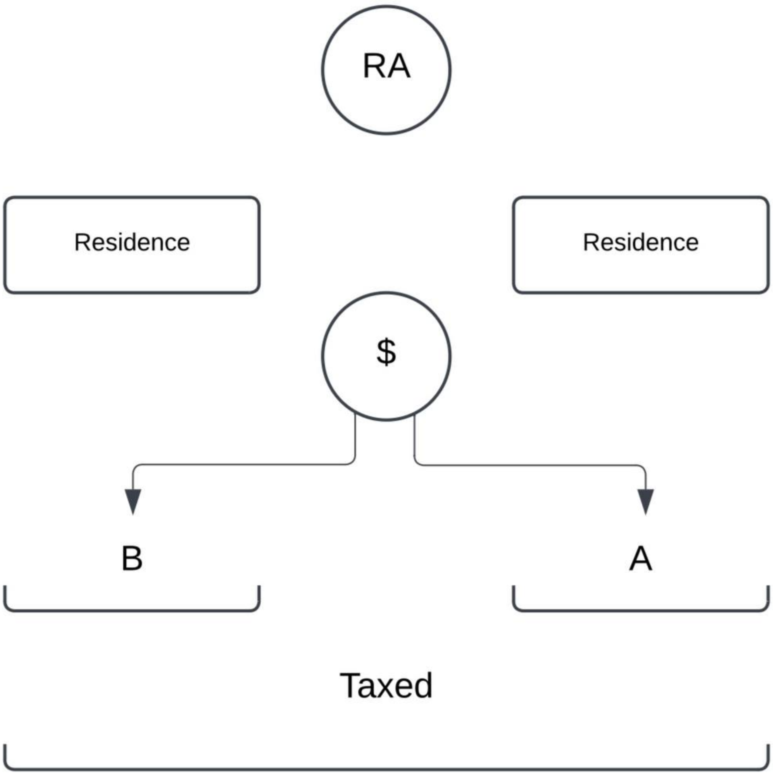
In order to avoid juridical double taxation, states must limit their taxation powers, and in order to avoid economic double taxation, in addition to the other, they must harmonize their tax systems.

To sum up, it is confirmed that double taxation can include both judicial and economical references. Legal double taxation means that it is economic one, and an economic double taxation is not always a legal one.

Juridical double taxation exists on both: national and international levels. The schematic example of international juridical double taxation looks like:

Explanation 1: An individual person is a resident of a residence-based state A. And this resident A works in territorial-based state B, and gets his salary there. Thus, the problem, of international double taxation arises, because he is obliged to be taxed under both counties jurisdictions. Firstly, he tax his income in a source state B, and in another state B his residency is taxed.





Another example of juridical double taxation:

Example 2: An individual is a resident in both states: A and B with established residency-based taxation systems. Let's presume, that this person was a resident of state B since being born or for some extended period and obliged to comply with the laws in his economic activities as paying taxes in accordance with laws and regulations in force. And after a long-term stay in a state A due to the study, work or other conditions - became a resident too, and received temporary residence or permanent residence permit as an official document allowing him to live and work in the residence-based state A. So, tax rules of newly acquired residency country (A) apply to him.

States with same taxation principles in the basis of taxation system - as residency principle here, may tax his residence on either income, which he receives. and again, it is a situation of individuals economic connection with the country - measured by residence means is taxed. Thus, this resident of both countries is obliged to pay taxes on income in states A and B altogether, as a tax resident.

If the person works in residency-based taxation system state A, but does not posses a residency there, he won't pay a tax there, because the residency should be taxed. But, if he is a resident of country B, where he resides, will pay taxes on his income there. That means, if a person is a resident of one country B, goes every day forward and back to the country A for work and gets income there - he is not taxed under this source country jurisdiction, considering that both of these states are oriented on residence principle in their taxation system. Then, here will not be any problem of juridical double taxation.

Intermediate Conclusion: Concluding the first part of this research paper, and before moving on to the extensive topic of methods of elimination of international juridical double taxation, some key elements must be summed up.

The main notions of this theme explained: «Double taxation» means the simultaneous taxation of the same object twice during the same tax period in different countries. “International double taxation is one of the biggest obstacles to cross-border trade and investment relations and the freedom of movement of persons, goods, services, and capital between countries” (Rasmussen, 2011).

The taxation principles were considered, which fall in the base of the taxation system of each state. I have studied all prominent principles of residency, source, citizenship and domicile principles as well. And I ended up with the idea, that the source-based principle is found in use in developing countries. While the residence-based principles is suitable for economically advanced or developed countries. Thus, these taxation principles are more commonly used in ongoing international commercial relations. Likewise, i should be stated, that every state have a mix of some principles in their taxation systems, and there no any pure taxation system with one dominant principle exist.

Considering on elements of taxation, many classifications were reviewed, but the most complete was highlighted in this master's thesis. The tax subject, object, tax rate, tax base, tax period, tax calculation procedure, terms and procedures of tax payment and tax holidays are prominent characteristics used in any taxation process. The subject is a taxpayer - individual or legal entity, and the tax object is an income.

Furthermore, a juridical taxation arises in cases of tax burden on the same subject and object. In economic double taxation, the taxation of the same tax subject in the hands of different taxpayers is underlined whereas in juridical double taxation, having the same taxpayer is particularly crucial.

The reasons for international juridical double taxation is found in differently regulated taxation systems in two states, which under special conditions cause double taxation. Taxation of the same income and the same subject in different states leads to international legal taxation. Thus, it lies in imperfect norms of tax legislation, and a lack of international tax treaties by a state, which subject suffers from this problem.

METHODS TO ELIMINATE INTERNATIONAL DOUBLE TAXATION

Eliminating international double taxation is an urgent matter for states and their place in the international arena. Thus, in order to achieve that, countries must firstly, by unilateral legislative action and secondly, by conclusion of bilateral or multilateral agreements. When doing it by establishing legal rules is more difficult, because every country is interested in how to achieve higher tax revenue.

The adoption of different principles by states alone does not pose a problem. However, when individuals engage in trade relationships with multiple countries, they fall into the tax jurisdictions of these countries, and then problems arise. Even countries that have adopted similar principles and methods may vary in their interpretation of terms and events in their tax laws. This variation can lead to conflicts between the taxation powers of different countries, ultimately resulting in the concept of double taxation.

To eliminate double taxation, it is necessary that the taxations rules of different countries don't contradict each other and are fixed in the provisions of the international treaty, thus regulating the taxation procedure. A major goal of bilateral tax treaties is to remove impediments to international trade and investment by reducing the threat of double taxation that can occur when both Contracting States impose tax on the same income.

Thus, there are four methods, which have an effect in this sphere: exemption tax method, credit tax method, tax-sparing method, deduction tax method. Two main methods are the exemption and the credit method, have commonly been used to mitigate international double taxation.

2.1. Exemption Method

The exemption method involves that the income is to be excluded from the tax base of the State of residence. (Vogel 1997, p. 1179.) Exemption taxation method is an exception for the residence-based country, because this country can not impose tax if the tax on the income was withdrawn in the source-based state. Residence principle state exempt taxation of income, if the same income was taxed in territorial principle state. It order to avoid international double taxation, if in one country the income was taxed, then the same income can not be taxed in another state.

If a domestic manager with established corporation expands abroad in the form of a foreign direct investment and gains income from that. In case of the simultaneous application of the residence and territorial principles - the international double taxation occurs.

As in residence or «worldwide» principle, which is the most widespread, the country taxes its residents on their worldwide income, whether derived from sources in or outside its territory. And in the source or «territorial»-based state, the tax authorities tax all income gained within its territory and jurisdiction.

Countries can adopt an exemption tax method in order to mitigate or fully avoid international double taxation phenomenon.

Exemption methods applied to the tax base of the domestic corporation, and foreign income is explicitly excluded from the tax base of domestic corporation in the resident-based state. So, foreign income is taxed abroad only in the source country.

The question: «How the exemption method influence the overall tax burden of the direct investment?», have to distinguish two situations.

First one, when domestic corporate income tax rate is lower than the foreign one. Thus, an overall tax burden of the investment is determined by the higher foreign tax rate.

Overall Tax Burden = Higher foreign taxes

Second one, the domestic corporate income tax rate is higher that the foreign one. In this case, an overall tax burden is determined by the lower foreign tax rate.

Overall Tax Burden = Lower foreign taxes

This method excludes foreign income from the domestic tax base of the corporation, and the foreign tax rate become definite.

Overall Tax Burden = Foreign taxes

And if the domestic country applies a higher tax rate, a foreign investment is advantageous compared to the domestic investment. But, if a domestic country applies a lower tax rate, foreign investment is a less tax efficient, comparing to the domestic investment. If the foreign country levies are withholding tax, this would become definite and would increase the overall tax burden of the investment.

The aim is to exclude the income generated by resident investors from their activities in foreign countries from the scope of taxation. This is done to ensure that they do not bear an additional tax burden in the source country where they operate. Resident investors are encouraged to invest in countries where the level of taxation is relatively low.

To summarize, under the exemption taxation method, the cross-border investment is the only taxed in a foreign country. And the foreign taxes determine the overall tax burden of the investment. Under this method - double taxation problems is avoided.

The typical effect of the exemption method is that the State where an item of income is generated, that is, the source State, has the exclusive right to tax that item of income. The policy goal of this limitation is to confine the exemption to income that the source State would have jurisdiction to tax, although the source State may choose to exempt the income as an investment incentive. So, state with residence-based system concede to source-based system country to tax their residents.

But, these countries usually do not give a relief for foreign dividends, interest and royalties because those items typically would be deductible expenses in the source State. Thus, priority has a country of active source, where the main business activity is conducted. And the passive source of income in that country has a minor value. So, the country in which the activity is provided always has preference over the country, which only gets tax from it.

If a country adopts the residence principle and applies the exemption method, it grants the authority to tax the taxpayer to the country adopting the source principle according to its own tax laws and rates, and it means that it has accepted the taxing authority of the source country in taxing foreign income and has waived the worldwide taxation feature of the residence principle.

In the exemption method, the residence state excludes elements subject to tax in the source state from the taxation process. The tax paid in the source state will not exceed the tax amount determined according to the tax laws existing in the residence state.

Therefore, the exemption method is most suitable for the taxpayer - if the tax in the source country is lower than the tax in the residence country. And, it is regarded as one of the most successful measures among those used to prevent double taxation and the most suitable for tax technique. (Başak, 2005c, p. 67).

For corporations, this double taxation exemption method is aimed to promote capital export by attracting especially holding companies characterized as regional headquarters of multinational corporations, to the country (Sarı, 2012, p. 49).

There are such kinds of elimination of exemption method: full exemption and exemption with progress.

2.1.1. Full Exemption and Exemption with Progress

Full Exemption:

In the full exemption method, one of the countries abandons all taxing powers and allows taxation based on the tax rates of the other country. (Molenaar, 2006, p. 175)

Meaning, that taxable object taxed in the source-based country is not being taken into account in the residence-based country, and these untaxed income elements are not considered in determining the tax rate to be applied to the tax base.

By granting a full exemption to its residents with respect to their foreign-source income, a residence State may put its foreign investors in a position of tax equality with residents of the source State. Whether this equality of position actually occurs depends on the actions of the source State. If the source State provides tax incentives targeted at foreign investors, as frequently occurs, then the foreign investors may be treated more favorably than residents of the source State. In any event, a source State that is granting tax concessions to foreign investors favors a full exemption system on the part of the residence State because its concessions are not reduced or canceled by the tax of the investor’s country of residence.

In this method, one of the states can exempt income obtained from foreign countries either according to its own legislation or based on bilateral agreements.

Exemption with progression:

In the exemption with progression method, the amount of tax paid in other countries is exempted, and taxation is carried out on the remaining amount. The remaining amount is determined as the amount calculated over the income derived from domestic sources within the country (Molenaar, 2006, p. 175). The exemption with progression method is used in many treaties, including treaties concluded by Austria, Belgium, Germany, Finland, France, Iceland, Luxembourg, The Netherlands, Spain and Switzerland.

Meaning, that the amount of income, taxable in the source-based country is not included in the tax base of the residence country, when determining the tax rate there, although it is being taken into account.

A progressive tax is a tax in which the tax rate increases as the taxable amount increases.

Thus, exemption with progression declares, that a country exempts its residents on certain income arising in another country with zero tax rate, but requires the residents to take that income into account when applying the progressive rate schedule.

Practical example of exemption method: Example 1: The tax resident of the France has income of 500 $ in the France and 100 $ of income in India. So under this method, he supposed to pay taxes in India in amount of 30 $. In case of full exemption - taxable income of source state is not considered at all in the state of residence (Indian income - 0: France income - 500 $).

Exemption with progression - income is being considered when determining a tax rate in order to ascertain an incremental tax, which might be applied. (500 $ of France income + 100 $ of Indian income = 600 $ total). Like once the payable tax is 200 $, the tax for 100 $ of income will be (200-30 =170 $ to be taxed). Considering what tax will be on 100 $ of Indian income and reducing the tax on this.

Example 2: When double taxation treaty has been signed between Country A and B, and an individual residing in Country A earns a total annual income of 100,000, with 80,000 in Country A and 20,000 in Country B. Country A follows the residence principle, Country B follows the source principle of taxation. The tax rates in Country A are progressive, set at 30% for incomes up to 80,000 and 35% for incomes exceeding 80,000. In Country B, the tax rate is fixed at 20%.

When applying both the full exemption and exemption with progression methods in Country A, the calculation of the tax amount the individual would pay in Country A is:

→ Full Exemption Method: When this method is applied, the income earned in Country B (20,000) will be exempted from tax, and tax will be calculated at a rate of 30% on the income exceeding 80,000. In this case, the tax payable in Country A would be: 80,000 * 0.30 = 24,000.

→ Exemption with Progression Method: If this method is applied instead, the income earned in Country B (20,000) will not be included in the tax base, but the tax rate applied to the tax base will be considered when determining the tax rate, which is the tax rate corresponding to 80,000 + 20,000 = 100,000 in the tax tariff. In this case, the tax payable in Country A would be: 80,000 * 0.35 = 28,000.

Intermediate Conclusion: Concluding on an exemption method to eliminate international double taxation: the «full exemption» is applied against the highest marginal tax rate, whereas the "exemption with progression" allows for the exemption against the average tax rate in the country of residence. An «exemption with progression» method lies in the treatment of foreign losses. These losses can be deducted against other positive income items within the domestic territory, effectively reducing the taxable income in the country of residence. This presents a more advantageous scenario compared to the "full exemption" method, where such foreign losses are included in the exemption.

Exemption method provides several advantages as for resident taxpayers and domestic companies. The first benefit of the method is that the taxpayer deals with only one state due to the tax to be paid through this method, especially the income will be taxed preferably in the country of active business. So, the country using a residence principle in taxation system avoids double taxation by its regulations or tax treaties with other states, based on the OECD Model Tax Convention. If a country adopts the source principle and applies the exemption method, it considers only income earned within its territory, but income and wealth gained in foreign countries are entirely excluded from the calculation.

Then, territory-based countries apply tax incentives, creating beneficial and competitive opportunities for foreign investors. And domestic companies can continue their operations in foreign countries under equal conditions. Domestic investors, through this method, channel their investments to foreign countries and are not required to pay taxes in the domestic country for the taxes paid in the foreign country. This situation particularly encourages investing in countries with very low tax rates, but leading to harmful tax competition.

Regarding disadvantages of this exemption method, that is deviating from the principle of taxation, based on residence principle, in favor of those earning income in foreign - source states. This worsens the financial situation in the country of residence, since it does not receive the calculated taxes from foreign income of their residents. But, it suffers losses only in order to protect international economic relations with other countries.

The second disadvantage lies in directing investments towards states with lower tax rates and it hinders the free movement of capital, goods and services.

2.2. Credit Method

As an alternative to an exemption method, a country can apply a credit method, which is also a conventional one. And it is fixed in United Nations Model Convention as a leading to be applied in developing countries.

Zimmer suggests, instead of excluding foreign income from consideration, this method includes foreign source income in the tax base of the State of residence. (Zimmer 2009 p. 137)

Under this method, the country of residence allows to reduce the tax, payable in residence country by amount of taxes actually payed in the country of source. Thus, the taxpayers need to pay the difference of taxes, or if the higher tax has been already paid in another country for passive income, interest, and dividends.

If the tax rate in the foreign country is less than the tax rate in the domestic country, the portion of the tax applied in the domestic country exceeding the tax applied abroad will be paid by the investor in their own country.

This method affects the domestic taxed to be paid and the profits of an investment are subjects to corporate income tax in the foreign country. The cross-border payments to the parent company in corporate relations, may be subject to a withholding tax in the foreign country. Thus, the domestic country of the established corporation may allow to credit the foreign taxes against the domestic tax liability of the corporation, reducing the amount of taxes to be paid for the taxpayer to be taken in a domestic country. Double taxation is eliminated by the State of residence providing the taxpayer a credit for tax paid in the State of source, which entails that tax otherwise payable in the State of residence is reduced by the foreign tax paid (Arnold 2002 p. 37).

And there are two forms of the credit method: Direct (Full) or Indirect (Ordinary). Under the first, only foreign withholding tax can be credited against the domestic tax liability, while the second method considers both foreign withholding tax and foreign income taxes paid.

«What is the implication of the credit method on the overall tax burden?» Also there are two cases: if the domestic tax liability is higher, the foreign taxes paid is fully offset against the domestic corporate income tax liability. And the overall tax burden is equal to the domestic corporate income tax.

Overall Tax Burden = Domestic CIT

Second, if the domestic tax liability is lower, the foreign tax credit exceeds the domestic tax liability. Most countries do not allow the tax refund, thus the overall tax burden equals the foreign taxes.

Overall Tax Burden = Foreign Taxes

Since, tax base can offset the foreign taxes against the domestic tax liability, the higher of the both tax liabilities determines the overall tax burden. And even the domestic paid are higher than foreign tax liability, the foreign investment is not tax advantageous. But, if the domestic tax liabilities are lower, the foreign investment is less efficient as excess, foreign tax credits are not refunded.

Examples:

1. If the resident of country B paid a higher tax in A i, he may not be taxed by his residency country B.

2. But, if the country of residency is B with higher tax, then resident B will be needed to pay difference with lower tax rate in country A (higher tax in B - lower tax in A = Difference) + 25% of tax to pay in country A too.

3. If in the country of source A the tax is higher or same as tax in residence country B, then the result from credit method will be same as in an exemption method.

Summarizing, applying of credit method, the taxpayer can offset foreign taxes paid against the domestic tax liability. The higher of both tax liabilities determines the overall tax burden and the international double taxation problem can be avoided only if the foreign tax paid are fully offset against the domestic income tax liability. When the source country imposes lower taxation compared to the residence country, it is the capital-exporting country rather than foreign investors that benefits from the deductions made by importing countries. Consequently, it becomes apparent that capital-importing countries export their taxes to the capital-exporting countries.

2.2.1. Full Credit and Ordinary Credit Method

As in international tax treaties, the credit method of elimination of double taxation applies two different types: full credit and ordinary credit, then let's disclose their meaning.

The country applying the credit method can deduct an amount equal to the tax collected by the country with source principle — in ordinary credit, but then the full credit is applied in the country with residence principle.

In the full credit method, the tax paid abroad in the source country can be deducted from the total tax calculated on both domestic and foreign income in the residence country.

In the ordinary credit method, the tax paid abroad (in the source country) is only eligible for a reduction equal to the portion attributable to foreign-source income in the total income calculated on both domestic and foreign income in the residence country, so the amount of tax, which is higher in source state than residence state - can not be deducted. Some fragment of the tax liability calculated on all sources of income earned in the country adopting the source principle is deducted from the tax liability planned in the country of residence-based principle.

Practical example of credit method 1:When international double taxation treaty was signed between countries A and B. An individual residing in country A earns a total annual income of 100,000, with 60,000 in country A and 40,000 in country B. The state A applies residence principle in its taxation system, and country B has a source system established. The tax rates are standard, set at 20% in country A and 30% in country B. When applying both full credit and ordinary credit methods in country A, the tax which should be paid will be calculated so:

Tax paid in state A: 100,000 * 0.20 = 20,000. 40,000 * 0.20 = 8,000 tax in B.

Tax paid in state B: 40,000 * 0.30 = 12,000.

— Full credit method is applied, the individual's tax amount in country A will be 8,000 = (20,000 - 12,000).

— Ordinary credit method, the individual's tax amount in country A will be 12,000, because (20,000 - 8,000). The amount, which can be deducted is limited, as the 2,000 portion of the tax paid in country A cannot be taken of beyond the portion related to the income earned in country A (8,000).

Intermediate Conclusion: Concluding this method to avoid international double taxation, the credit method is one of the most commonly used approaches to avoid double taxation. It is disclosed that, the state of residence provide a credit for taxes paid in the source state to the extend of tax in for of such income. The tax paid in a foreign country is deducted from the payable one in domestic country - with residence-based taxation system.

Among the two tax credit methods, the "full credit" results in the most favorable outcome for the taxpayer. After applying the full tax credit, the total tax burden equals the tax amount that would be due if the income were earned solely in the home country." (Molenaar, 2006, p.177)

As an exemption and credit methods are leading in resolving the matter of international double taxation, there are still discussions of the most effective one. The supporters of the credit method consider that it is better in application, justifying it by fact, that it is more constructive in promoting fairness because it causes residents of a state to pay the same amount of income tax without reference to the source of their income. And they also rely on that the credit method encourages coherence and help by granting a equal treatment for from foreign and domestic investments. However, the credit method reduce the impact of tax incentives on investment decisions, it lower a harmful tax competition among developing countries, which is a great advantage for their financial stability.

But, it may be challenge for governments to determine and calculate the tax base of foreign-source income if form of interests, assets, salaries, dividends. The reason is in that, A]a taxpayer who resides in a country that allows a foreign tax credit as a method of relieving double taxation and receives income from another country may seek to reduce tax in the residence country by claiming fictitious or excessive credits for taxes allegedly paid to the other country. And the credit method cannot overcome the unequal treatment of comparably situated taxpayers that results from the imposition of taxes in the source country at effective rates above the rate in the residence country.

2.3. Tax-Sparing Method

Moving forward to tax sparing method of elimination of double taxation, it should be explained as if a country, which has priority to tax certain kind of income refuses to tax that income on purpose, country of residency can not use this refusal as a reason not to apply the exempt method or to apply credit method in a different way, and this method will be applied in case state would not refuse to tax the income. So, it is used next to exempt and credit method to establish the ability of the country to tax the income where it has the priority.

The tax sparing method occurs, when a source country provides tax incentives to foreign investors, leading to a lowered or zero tax liability in the investor's income of the source country compared to what would have been payable in the source country. It uses the lower tax rates instead of the existing tax rate during the calculation of tax on a portion or the entirety of income. It is a process of adjusting by residence state the taxation of its residents to permit them receiving the full benefits of tax concessions provided to them by a source-based state, taking a form of credit for tax.

The concept of tax sparing counteracts the nullification effect induced by this mechanism by fictionally fulfilling the general condition of “tax paid”. Generally, it does so in one or two ways. One method is to stipulate that an item of income, for example interest, always shall be considered as having been “paid” by a fixed percentage, regardless whether it actually has been paid, i.e. matching credit. The other method is to stipulate that a credit shall be granted as if the income was subject to the ordinary level of tax in the host State, regardless that the income is in fact subject to a lower level of tax, or no tax, due to a tax incentive measure, i.e. tax sparing credit.

Tax sparing provisions generally enable tax incentives granted by developing countries to accrue to foreign investors, rather than being consumed under the system of eliminating juridical double taxation. This may make an increase of inbound capital flows to the developing country, which may contribute towards economic development. Tax sparing provisions function as an investment inducement measure, to promote investment behavior that is considered expedient to promote economic development. Thus, very generally, it appears appropriate to deem an arrangement abusive if it is contrary to the investment behavior that the contracting States have intended to stimulate with the inducement of tax sparing.

<u>Practical example of tax sparing method</u>: when company is a resident in a state A and has its revenue of 100,000 $ from its business activity in state B. It has not income generated in a state A although. So, company B will tax company based on source taxation principle, while state A has residence principle established - that is leading to international double taxation.

It is known, that corporate tax rate in state A is 30% and in state B 15%.

The source country B collects - 15,000 $ (100,00 * 0,15%). Thus,

— In the tax sparing methods, when country A is applying a reduced tax rate of 10% for foreign commercial gains instead of 30% as tax incentive, the company is ought to pay only 10,000 $ of taxes in country A. (100,000 *0,1%)

<u>Example 2:</u> when company is a resident in a state A, investing and getting an income in state B, which it has a negotiated tax-sparing tax treaty with. Company earns 100 $ in state B. Usually, these countries impose a taxes at 20 % of tax rate. But, during this period, state B provided company with tax holidays, which reduced tax to 0 $ for comapny`s activity.

Under the tax-sparing agreement, state A may grant to company a credit for the taxes that would have been paid, but for the tax holiday. And company receives the intended benefits of the tax holiday.

Intermediate conclusion: the tax sparing method is not established in either OECD or UN Model Conventions, even though there were discussions to add provisions regarding this. It is not that popular method ti be applied by governments of the states, but it still exists in practice. Developing countries are often willing to provide foreign investors significant fiscal incentives in order to encourage foreign direct investment. There are countries using a tax-sparing credits by double tax treaties as: Canada, France, Germany, Japan and the United Kingdom, but in contrast the USA never ratified such kind of tax treaties. Although, many developed states put this method in the base of their double tax treaties with developing countries.

As some countries with a strong internal economy are opponents of this method, and try to avoid it under any conditions and initiatives. But, other capital-importing states consider its effectiveness, and do not enter into double taxation treaties with developed countries unless the latter offer tax sparing credits and press on their partner to provide relief for double taxation in a way that support. Although, there is not need to apply tax sparing methods in a double taxation if the investors country of residence uses an exemption method.

Considering the existence of varying tax rates for different types of taxes across countries, this method is regarded insufficient in preventing double taxation. This measure can be unilaterally implemented by states or reciprocally applied. Thus, the scope of this method lies in ability to reduce tax rates applied to all or part of the taxpayer's income.

2.4. Deduction Method

Coming up to the last method to eliminate double taxation, let`s dive into the meaning of this process. Applying this taxation method, the residence country is allowed to reduce tax basely reducing the tax paid in another state, which is more likely source-based one.

This method is used in the last turn ultra rational, in order to release a taxpayer from the issue of double taxation only if no exemption or credit method were applied. It appears as a choice between tax-sparing method and itself as methods not recommended by any conventions, but are accepted at the discretion of the states.

This method is regulated only by national laws, and cover the reducing of tax base in the country other than state of residence. In here, the taxes paid in the source country on the same income or wealth elements are deducted from the tax base in the country of residence (Kızılgül, 2019, p. 49).

A tax deduction is an amount that is deducted from taxable income to lower the amount of taxes to be withdrawn. Tax deductions are deducted from taxable income, thereby lowering the amount of tax that taxpayers owe. A tax deduction methods is lowering the taxpayer’s taxable income.

A Standard deduction is a single deduction at a fixed amount. An Itemized deduction, contrary is popular among higher-income taxpayers, who often have significant deductible expenses, such as state and local taxes paid, mortgage interest, charitable contributions, medical expenses. Thus, during tax filing season, all taxpayers must decide whether to claim the standard deduction or itemize their deductions. Once they decide to itemize it, taxpayers claim the mortgage interest deduction, state and local tax deduction, and charitable contributions deduction.

Practical example of deduction method: when company is a resident in residence-based state A and has its revenue of 100,000 EUR from activities in source-based country B. But, the company has not income is its residence state A.

The corporate tax rate in state A is 25%, while tax rate in state B is 20%.

— In the deduction method, the 20,000 EUR (100,000 * 0,2 %) of tax are paid in state B as deducted from the tax base in state A. Thus, the company is obliged to pay tax on 80,000 EUR (1000,000 —20,000 = 80,000 EUR) of tax rate 25% in state of its residence A resulting in (80,000 * 0,25 % = 20,000 EUR).

Intermediate conclusion: In conclusion, countries generally choose to prevent international double taxation through exemption or credit methods. Even in the absence of tax treaties, states refrain from using the deduction method.

Tax deductions are expenses or allowances that reduce a taxpayer's taxable income, thereby lowering the amount of income subject to taxation.

Many federal states set their own tax rates and standard deductions, and they may have additional allowable deductions or different restrictions on deductions based on their national legal rules. And as a legal element governments ma forward tax losses to rearrange earnings for the taxpayers.

To be deducted, the expenses must be incurred in furthering business, and usually only include activities undertaken for profit. Some systems allow a deduction to a company or other entity for expenses or losses of another company or entity if the two companies or entities are commonly controlled. Such deduction may be referred to as "group relief.» Group relief may be available for companies in EU-member states with respect to losses of group companies in other countries.

Businesses applying deduction methods means, that the corporate state and local tax deduction, allows businesses to deduct the taxes already paid to state, which governments from their income.

Net operating losses is, when businesses suffering losses during one year can deduct them from previous or future years' profits, thus reducing their taxable income, or the states may deduct particular amount of capital gains losses from their taxable incomes.

In cases where many countries cannot apply any method, meaning when international double taxation cannot be resolved through bilateral tax agreements, then they decide to apply the deduction method as a last resort. Therefore, resorting to international measures has become inevitable for the resolution of this issue apart from the implementation domestic laws.

Tax deductions are a form of tax incentives, along with exemptions and tax credits.

Conclusions on methods to eliminate international double taxation:

Therefore, exemption and credit methods became an integral parts of international tax law in the avoidance of international double taxation. In theory, an exemption system or a credit system with tax sparing could be designed to support a developing country's tax incentive program. In practice, a developing country is unlikely to have sufficient bargaining power in treaty negotiations to influence the way its prospective treaty partner provides double tax relief. Countries prevails to choose international double taxation elimination method of an exemption or credit. Even in the absence of tax treaties, states refrain from using the deduction method.

At this stage, countries are reluctant to apply the tax credit method, as they refer that they are bound to the exemption or credit norm (Avi-Yonah, 2004, p. 500).

Without doubt, there is no incidence of double taxation as the foreign source income of the investor is either taxed solely in the country of residence or subject to a reduced rate in the country of source, with country of residence offering a corresponding tax credit. As already known from this research, the methods of double taxation relief exist. And I revealed four of them: exemption tax method, credit tax method, tax sparing method, deduction tax method.

Concluding it, an exemption method is the most beneficial for the taxpayer, though the deduction method is the least capable. The credit method eliminates the problem of double taxation with greater success. In the credit method, the tax paid in a foreign country is deducted from the tax payable in the domestic country. Applying the exemption method, international double taxation arising from residence is completely avoidable because only one country fully exercises its taxing authority.

Although its complicated structure can cause particular challenges for taxpayers and the government when enforcing in practice. And regarding tax sparing or deduction methods - they are not recommended by any of the tax model conventions, and are less likely to be used by a states, when exemption or credit methods are prioritized, so it will be put on the back burner. The tax regulations of the residence country play a decisive role in foreign business activities and investments and have a significant impact on investment decisions. (İnce, 2013, p. 9)

INTERNATIONAL DOUBLE TAXATION TREATIES AND MODEL TAX CONVENTIONS

3.1. Tax Treaties Distinguished

Coming up to the last part of my research work, I will talk about double tax treaties and model conventions, which are seeking for ways to eliminate international double taxation. Throughout the history, always the conflicts arising from economic, financial or commercial disputes interfered good international economic relations between states. But, at the current stage of advanced capitalist relations they occupy an important place

Double tax treaties are the dominant treaties in the Global tax law, as they are international treaties of two or more states. These tax agreements are based on international rules of law, allow the prevention of double taxation by mutually limiting the taxing powers of the contracting states and negotiation which state will exercise the taxing authority. These limitations occur through bilateral or through multilateral tax treaties. Tax treaties represent an important aspect of the international tax rules of many countries.

The purpose of the double tax treaties is to balance the interests of contracting states. (Pehlivan , Öz, 2011) Another existing suggestion on it means, that these tax treaties are conducted to prevent tax conflicts arising from the overlapping taxation powers of contracting state, established in their domestic legal norms. The consensus can be made by bilateral or multilateral agreements, in order to enable the international transfer of capital, technology, and services, thereby facilitating the flow of capital from developed to developing countries.

But, come skeptics consider, that the aim of double tax treaties is to shift the burden of tax relief from from one country to another country rather than eliminating the problem of international juridical double taxation.

However, due to comprehensive tax agreements, taxpayers are protected from the unfavorable effects of international double taxation.

3.1.1. Bilateral Tax Treaties

Bilateral tax treaties are defined as agreements between two countries, that regulate the conditions for sharing tax revenues arising from activities within the respective tax jurisdictions of countries, which productivity is facilitated by their trust-building features. (Christians, 2005, p. 10)
Bilateral tax treaties guarantees rights and impose obligations on the two contracting states, but do not have any put on taxpayers. However, tax treaties are obviously intended to benefit taxpayers of the contracting states. Whether treaties do so or not depends on the domestic law of each state. But in some countries, treaties are self-executing: once the treaty is concluded, it confers rights on the residents of the contracting states.

Negotiation procedure on creating bilateral tax treaties: When the country is deciding whether to enter into tax treaty with another country, it will consider many factors - political, economic, social, financial, the most important of which is the level of trade and investment between these potential partner-state. Once the countries examine these matters, they exchange model treaties with each other, and then appoint negotiation of agreement date and place.

Usually, the negotiation of tax treaty goes in two rounds:

1) negotiating teams agree on a particular text based on countries' model treaties or newly prepared ones to use as the basis for the negotiations;
2) presentation of states taxation systems, and conducting negotiations on article-by-article basis. Aspects of the text that cannot be agreed on are usually placed in square brackets, to be dealt with later;
3) after an agreement is reached, arrangements of signing the treaty by an authorized official - an ambassador or government official are made;
4) then states must ratify this tax treaty, usually by exchanging instruments of ratification. The treaty enters into force in accordance with the specific rules in the treaty (Article 29 - Entry into force of UN Model Convention).

The national tax law is in need to amended and interpreted frequently in respect with constantly emerging new circumstances in taxation between the states, as they must correlate.

These agreements regulate which State has the authority to tax when a branch or subsidiary of a multinational company is located in foreign countries. (Erdős, Riczu, 2023, p. 88) It is generally know, that nowadays the number of bilateral income tax treaties is exceeding 3,000 and its number is growing. The majority of these bilateral tax treaties are based in on the United Nations

Model Double Taxation Convention between Developed and Developing Countries and the Organization for Economic Cooperation and Development Model Tax Convention on Income and on Capital.

The application of bilateral tax treaties should be seen from the side of international contract law's basic principle of «Pacta sunt servanda» - as agreements should be kept. So, if the country does not respect its tax treaties, other countries may have no interest in entering into such tax agreements with it.

Bilateral agreements aim to eliminate or minimize international double taxation by imposing limitations on tax obligations of the Contracting States themselves, particularly the state where the income originates. Additionally, they can force the country of residence to either provide an exemption or offer a tax credit for the taxes paid in the source state (Sarmiento, 2023, p. 247).

3.1.2. Multilateral Tax Treaties

Multilateral treaties are - agreements between more than two countries. They are often the result of an international conference or a gathering of nations done under the auspices of an international organization.

A multilateral tax agreement is regarded as an official documents endorsed by multiple states, outlining the limits of tax jurisdiction for the participating states and governing various aspects related to taxation (Kızılgül, 2019, p. 75). These measures were developed as part of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project.

Mainly the states with similar economic situations and taxation systems strive to resolve disputes of international double juridical taxation by being engaged in multilateral tax treaties.

Let's take an example of a multilateral tax agreement signed between Iceland, Finland, Norway, Sweden, Denmark exchange their tax information, and it is easier to be engaged in such an agreement due to the similarity of their tax legislation, administrative procedures, and work cultures. (Valkama, 2013, p. 205).

Thus, multilateral tax treaties is a great economic initiative, but they are more complicated in negotiation and implementation process than bilateral tax treaties. This is explained by that reaching a consensus on the tax conditions easier with only two states than considering preferences on legal and economic interests of many states.

Factors, such as differences in countries' tax legislations, gaps in their levels of development, diverse positions in the world economy and politics make it challenging to establish multilateral tax agreements among more than two countries. Also, making amendments to it is harder than in the treaty, where two governments play the main role. That is why, the practice of using the multilateral tax treaties widely is minor.

3.1.3. Efficiency of Bilateral and Multilateral Double Taxation Treaties

In global tax law, the main sources are exactly bilateral tax treaties and tax conventions. There is a thought in the economic and legal field, that "The number of tax treaties the country has defines how many economic relations the country has with other states». Thus, the more tax treaties: either bilateral or multilateral ones, the state is involved in, show its progress in international economic affairs. Consequently, it follows, that the developed countries are advanced here in comparison to the developing countries.

Most tax treaties are bilateral and there are very few multilateral income tax treaties in the world, as regulating them is a complicated procedure.

Consequently, the resolution of double taxation issues often falls within the scope of domestic or unilateral actions. To address juridical double taxation, numerous countries have incorporated provisions into their domestic laws, specifically designed to unilaterally mitigate the impact of such taxation challenges (Holmes, 2014, p. 103).

However, achieving this goal by means of unilateral legislative measures tends to be more difficult, as every country has the purpose to have a higher tax revenue (Radu, 2012, p. 405).

In practice, while countries may prefer unilateral measures, parallel to the increasing trends of globalization, they generally attempt to address these issues through bilateral or multilateral agreements nowadays (Balcı, 2003b, p. 17).

Bilateral tax treaties aim to prevent the risk of international double taxation issues by establishing the minimum level of economic activity, that the resident of state A must pursue in a state of source B before the last one will charge tax on business profits. Mainly this priority to tax that income belong to the state of source B, and it has the primary jurisdiction over it, in case if the activity has substance and continuity that exceed the established threshold level. This tax treaty may specify which one of both states will have a primary jurisdiction to tax income derived from the performance of an individual or company in one state, whereas they are residents of another state.

The scope of bilateral tax treaties lies not only in commercial activities, they also expand the effect on the elimination of tax impediments to desirable scientific, educational, cultural, artistic and athletic interchanges. So, they have a great influence and profitability for Economics and International Economic relations of both contracting states (country of source and country of taxpayers residence.

The objective of bilateral and multilateral tax treaties is is to strengthen the ability of states to impose taxes fairly and effectively on taxpayers engaged in cross-border activities. As the global economy growth rapidly it puts in a great pressure on all taxation systems, but more the developing countries suffer from that, as they do not improve at such pace. Although, having a common interest with developed countries in promoting measures that prevent multinational corporations from exploiting their market power and their ability to shift investments around the world to avoid a reasonable level of taxation on their profits.

In international treaties agreed by countries, the rights of all sides must be fair and equal, and no discrimination of any party is allowed. The goal is to prevent double taxation arising from the exercise of taxation powers by multiple states and agree to limit the absolute right to impose taxes. These agreements are recognized as a way of distributing jurisdiction between different countries, since they deal with such mechanisms of eliminating double and multiple taxation. Double tax treaties attempt to eliminate most forms of international double taxation, when a failure to do so would have a demonstrably harmful impact on international trade and investment.

The taxation agreements can be bilateral or multilateral, but bilateral agreements are much more commonly used (Öncel et al., 1985, p. 70).

Speaking about the efficiency of applying taxation agreements as methods to eliminate international double taxation, it is commonly employed among developed countries, whereas in developing countries, national unilateral methods and tools have more importance. Regarding the domestic established taxation rules, they are less adequate, and still in preventing this issue states are in need to to enter into international legal agreements. Therefore, to standardize the international double tax agreements and transform them into a standard contract, OECD and the UN Model Conventions have been developed (Karakoç, 2014, p. 144).

3.2. International Double Tax Model Conventions

Double tax conventions are an established way for States to agree at the international level on a method for reducing or eliminating the risk of double taxation. These treaties formally determine which country will tax an item or taxpayer and/or whether exemptions of income or credits for tax paid will be granted in the other jurisdiction (Holmes, 2014. p.103-104).

Model tax treaties have a long history, beginning with early diplomatic treaties of the XIX century. The aim of these first treaties was the establishment of equal treatment of diplomats of one country working in another state. Later on, in early XX century, such agreements were expanded to the sphere of taxation of income.

And after the World War I, the League of Nations took up the development of Model Tax Conventions, including models dealing with issues of taxation of income and capital. And the initial Model Conventions 1943, 1946 were elaborated. Although, they were not accepted, thus the OECD showed the initiative to create an acceptable Tax Model, and later the United Nation joined.

International organizations such as the OECD and UN were motivated to create tax model conventions for the purpose of facilitating easier and faster establishment of such an agreement.

Model conventions can be defined as non-binding international texts that bring states together on specific issues, establishing uniform rules in terms of principles, definitions, methods, and interpretations, which bring overlapping taxation powers of states in accordance with internationally accepted tax norms. (Yaltı Soydan, 1995, p. 43) And they are conducted based on draft agreements prepared for these model conventions.

One of the most significant benefits of Model Conventions is their ability to shorten negotiation periods and facilitate the conclusion of agreements, because countries are guided by already established procedures. They are flexible in implementation and serve as tools that indicate ways to resolve certain issues. Ans Model Conventions ensure legislative and operational consistency between countries as well.

Even though these tax Model Conventions are not legally binding, they have suggestions for the shaping of domestic financial and tax law, the development of bilateral international agreements between countries and cooperation between states on tax avoidance and double taxation. (Erdős, Riczu, 2023, p.90)

But, states are always free to make their amendments ti the taxes of Model Convention considering the domestic tax regulations, laws and policies of this states. So, state may when negotiating the model agreements benefit from it without a need for extensive research. Thus, it will make negotiations much easier than the situation if the states decide and establish each matter.

Tax conventions provide a means of settling on a uniform basis the most common problems that arise in the field of international double taxation.” “Internationally, it is common for states to conclude bilateral double taxation agreements in order to promote both their economic and diplomatic relations.” (Balco, 2017).

Mosts of double taxation treaties have the OECD Model Convention or the United Nations one is the base of negotiable agreement and application of certain method to eliminate double taxation phenomenon in their business relations at their discretion, depending on which model convention they will apply. (Arnold, 2015, p. 1) They differs by principles determined in the allocation of taxation authority.

There are two the most influential Model Tax Conventions in the world — the United Nations Model and OECD Model Convention. In addition, many countries have their own model tax treaties, which are often not published, but they are provided to other countries for the purpose of negotiating tax treaties.

3.2.1. OECD Model Tax Convention on Income and on Capital

There currently exists no single entity with the global legitimacy, resources and expertise to serve as a single coordinating body for international tax cooperation. In the absence of such an entity, organizations active in this area must work together with a view to meeting common tax and development goals in the most efficient, responsive and participatory ways.

In 1923 the Economics Report by the League of Nations was considered the foundation of the international tax regime. This Report laid out the general approaches for avoiding cross-border double taxation and became the commencement for all later studies and reports, including the formation of the first Organization for Economic Co-operation and Development (OECD) Model Tax Treaty 1963.

Firstly in 1961, OECD published its first draft of model for double tax convention on income and capital together with the commentary 1963. Then, it has became one of the foundations to the international tax network.

In a sense, OECD Model 1962 became the first important document after Economics Report. The OECD Model, which was revised and amended in 1977, has served as a working model for the developed European and North American countries.

The idea of this draft - is to regulate the relationships between economically advanced countries, where the both must have the interest to stick to these interests. OECD draft applies, where two countries are residence-based countries, thus priority is for states of residence of taxpayer.

Main features of OECD Model:

OECD Double tax treaty Model - is a source of mosts of Double Tax Treaties world-wide.

1) Prepared for economically developed counties as a base for negotiations. Model gives more taxation right for capital exporting countries.
2) Establish high permanent threshold.
3) Has a binding provision on arbitration to prevent double taxation.
4) Enforce residence-based taxation on its residents and gives more priority on the state of residence.
5) OECD and US Model Tax Conventions are very similar. OECD Model consists of 7 Chapters and 32 Articles.

There are two main matters provided in OECD Model Convention:

First, the country, where the individual or entity is resident will bear the burden of eliminating double taxation by instituting either a foreign tax credit or by merely exempting foreign source income from taxation altogether.

Second, the source country will considerably limit both the extent of its jurisdiction to tax income as it arises at the source and also the rate of tax which is ultimately imposed, where jurisdiction is retained.

OECD Tax Convention applies:

- to persons who are residents of one or both Contracting States (Art. 1);
- to taxes on income or capital... (Art. 2);
- defines certain terms «person», «company», «enterprise», «international traffic»(Art. 3);
- provides with the term of «permanent establishment» - a fixed place of business through which the business of the enterprise is wholly or partly carried on.

When the residence principle is adopted, priority is given to the country where the taxpayer is a resident in taxing the principal amount. So, income is taxed in Residence country. And when this OECD Model is applied in agreement with capital importing state, the source country relinquishes tax revenue subject to international double taxation. Also, OECD Model attempts to have tax treaties concluded between two non-member states.

Issue: When two developed countries sign a tax treaty based on the OECD model, there will be no issue. This is because there is a two-way flow of capital between the two countries. But when, a developing country and a developed country are parties to a treaty based on the OECD model, the developing country will not be able to tax the capital it imports. Therefore, the balance will be tilted in favor of the developed country, what is likely the OECD member (Ildır 1999, p. 73). Fall within the scope of the convention all taxes on income and wealth, regardless of the system in which they are used.

Thus, in developed countries, the residence principle is economically suitable for taxing income derived from capital directed towards foreign investment. In developing countries, economies rely on capital imports, and the source principle is more preferred in terms of subjecting foreign investments to taxation within their own countries.

Key Articles of OECD Model Convention: The convention provides such methods for elimination of double taxation:

Article 23A (Exemption method) —- Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax. (OECD, 2019)

2. Where a resident of a Contracting State derives items of income which may be taxed in the other Contracting State in accordance with the provisions of Articles 10 and 11 (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State), the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.

3. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income. (OECD, 2019)

Article 23B (Credit method) — Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow:

a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;

b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

2. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital. (OECD, 2019)

Conclusion on OECD Mode Tax Convention:

OED Tax Model Convention in its Chapter V proposes methods to eliminate double taxation: Exemption and Credit. (OECD, Art. 23A, 23B) This convention is the most widespread among the world, and it is used by residence-based states, although it is not a rule, but it is more favorable to them. Approximately 9 from 10 countries use the OECD Model for their future tax treaties.

The OECD Model favors the residence taxation principle, where individuals-investors or business owners are residents. (Dauer, Krever, 2012). And the source income state will be fully entirely neglected, and they should refuse from some or all of its taxes earned by residents of the other treaty country resulting in unfavorable taxation for developing countries. In the OECD Model Tax Convention, the main approach accepted is the taxation of foreign income only in the country of residence of the taxpayer (OECD, 2019).

Thus, developing countries did not accept OECD Model Treaty due to the argument, that it leads to treasury losses in the source country where income originates.

In essence, the OECD Model is originally designed to serve as a basis for tax treaties among OECD member countries. However, due to its successful implementation, this framework has become the foundation for tax treaties first among OECD countries with other nations and subsequently for agreements among non-OECD member countries themselves (Nazalı, 2008, p. 84).

In this model, there are two options for elimination: progressive exemption method and the ordinary credit method. Contracting States may agree to apply only one of the methods, as separately regulated in the Model, or they may prefer to implement different methods, opting for exemption for some income elements and credit for others, so they are free in their choice.

As the OECD Model Convention may not be appropriate in use for developing countries, another model convention was created by the organization of United Nations with prevailing taxation authorities of source state in international taxation process to eliminate the dual tax problem.

3.2.2. UN Model Tax Convention between Developed and Developing Countries

Since the flow of capital among these countries is mainly one-way — from developed to developing countries — being a party of a tax treaty based on the OECD Model may not bring significant benefits to developing countries. In 1970 the draft of Model Tax Convention similar to the OECD one was prepared. But, it sets less limitations to the taxing income of the source in territory-based system state. Although, this model is not as spread as the above-discussed one, as it applies where the two countries are territory-based, mainly developing states.

The work of the UN organization on model treaty started in 1968, when there was produced a manual for negotiations on bilateral tax treaties fro developed and developing countries, and that lead to the publication of UN Model Taxation Convention in the year 1980.

During its Eighth Meeting, the Ad Hoc Group of Experts on International Cooperation in

Tax Matters (Group of Experts) established a Focus Group to revise and update the UN Model Convention in view of the significant changes which had taken place in the international economic, financial and fiscal environment. And inspections followed in New York - 1998, Amsterdam - 1999, then after being approved by the members of the Group of Experts, the final version of the United Nations Model Double Taxation Convention between Developed and Developing Countries was published by the United Nations in 2001.

In 2004, the Group of Experts became the Committee of Experts on International Cooperation in Tax Matters. The Committee maintains detailed Commentaries on the United Nations Model Convention; and it is also responsible for the publication of several useful manuals on tax issues important for developing countries, such as transfer pricing and the administration of tax treaties. The members of the Committee are tax officials nominated by their governments and appointed by the Secretary-General of the United Nations, who serve in their individual capacity.

The UN Model Convention followed the pattern set by the OECD Model Convention and provided similar provisions to those mentioned in before the established convention. Thus, we may not say, that it is an entirely separate model provided with favorable taxation initiatives for developing countries, but rather it is a modification of the OECD model.

The United Nations Framework Convention on International Tax Cooperation is a proposed new legal instrument intended to better coordinate international tax policy. Championed by developing countries, a UN framework tax convention aims at making international tax cooperation fully inclusive and more effective.

While each country is responsible for its own tax system, the United Nations universal membership and legitimacy can be a catalyst for increased international cooperation in tax matters to the benefit of developed and developing countries alike. In order to create such an advantage for capital importing or developing c countries, there was created a UN Model Convention.

Since the great majority of United Nations Member States are neither members of OECD nor of the Group of 20, the United Nations Committee of Experts in International Cooperation in Tax Matters ("the Committee") has a key role to play, working with these and other relevant forums, such as the Bretton Woods institutions and regional associations of tax administrations, towards ensuring the active participation of developing countries, especially the least developed ones, in relevant activities. Continued effort in terms of its institutional capacity and resources is needed in order for the Committee to effectively pursue its proper role in international tax cooperation.

The need to eliminate double taxation was addressed by the model developed by the UN, which, unlike the OECD model based on the residence principle, gives priority to the source country. (UN, New York, 2021) The adoption of the source country principle in the UN Model regarding the sharing of taxing rights has led to the fact that it is being preferred by less developed or developing countries that are primarily importers of capital.

The UN Model Convention goals are: the establishment of multilateral tax negotiations, accommodating differences of global approaches, fertile negotiating environment and make procedural transparency.

The latest version of UN Model 2021 has important changes concerning the tax treaty obstacles to the taxation of foreign enterprises on income from automated digital services and on gains on "offshore indirect transfers" — when a transferor of the indirect interest is a resident in another state from other than he send it, or other the country in which the asset in question is located.

<u>Key articles of UN Model Convention:</u>

Article 23A — (Exemption method): Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State, in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

2. Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10, 11, 12, and 12A may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income which may be taxed in that other State.

3. Where in accordance with any provision of this Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this

Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10, 11, 12 or 12A to such income; in the latter case, the 34 Articles 23A and 23B first-mentioned State shall allow the deduction of tax provided for by paragraph 2.

Article 23B — (Credit method): Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State, in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow:

(a) as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State;

(b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State. Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

2. Where, in accordance with any provision of this Convention, income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

Conclusion on OECD and UN Model Conventions:

Comparing both famous taxation conventions, it is a must to underline, that even if the structures of the OECD Model and the UN Model are very similar, their fundamental concept of application taxation powers of any of the state are different. In theory, the UN Model appears more beneficial for developing countries as it imposes fewer restrictions on the taxing rights of the source country, when compared to the OECD Model, which establishes a preference for the country of residence.

The difference between the OECD and UN Models: is that, the OECD Model gives more taxation rights for capital-exporting countries, considered as wealthy states. While UN Model Convention gives more taxation authorities for capital-importing states - for those, that imports the capital form wealthy states - developed ones, and established limitations for capital-exporting states.

The UN model treaty is generally regarded as a better compromise between the costs and benefits for developing countries than the OECD model treaty (Lennard, 2009, p. 4).

Nowadays, the OECD Model has a bigger importance in the taxation field, and its tax treaties number is growing rapidly in recent years. As it is know, there is no EU Model Tax Treaty, as almost all of its countries are members of the OECD. That's why, they usually use this model if some taxation dispute arise in international trade. Thus, there is no need to create its specific EU Mode Convention, as its members are economically advanced and they are capital-exporting counties with residence-based taxation systems.

3.2.3. USA Model Income Tax Convention

It is known that countries also make efforts to create treaty models according to their own approaches, apart from the OECD and UN Models. For instance, the U.S. Treasury, initially in 1976, raised concerns about the inadequate regulation of anti-abuse provisions in the OECD Model (Panayi, 2007, p. 27) And after considering for a while, United Stated decided to create their tax relief convention.

The USA took as an example the OECD Model Convention on Income as a base for its double tax treaties, giving a raise power to the country of residence. As the citizens of US invest a lot of money around the world, the government was in need of controlling incomes coming in or from abroad. And the USA wanted to have a right to tax the incomes of its citizens, not giving an opportunity for other states to do that.

The United States has tax treaties with a number of foreign countries. Under these treaties, residents (not necessarily citizens) of foreign countries are taxed at a reduced rate, or are exempt from U.S. taxes on certain items of income they receive from sources within the United States. These reduced rates and exemptions vary among countries and specific items of income. Tax treaties prevent citizens of the USA from using the provisions to avoid taxation of U.S. source income.

If there is no treaty between your country and the United States, or it doesn't cover some particular kind of income, the taxpayer must pay tax on the income gained in the US or derived to US, whatever as it is established by tax authorities of the USA.

3.2.4. China Model Tax Convention

As China today is considered to be an economically advanced country, exporting goods, services, capital and people all around the world. It has very wide range of economic relations, and stepping at trade with other states, usually double taxation comes here as well.

I would say, that China is a monopolist in international trade, as you can find its influence on the every corner. Thus, it has a great influence on a global economics and it is likely to choose the behavior, that will be beneficial to its economy, taxation power is not an exception. The Chinese economy is now being forced to liquidate its deteriorated balance sheets, which have been weakened by years of excessive debt and over investment. The ineffective investments and the interest payments resulting from "implicit guarantee" by the governments have become a heavy burden on the economy, further distorting the distribution of wealth and leading to a slump in consumption.

The Chinese government permitted some regions to reduce corporate income tax for foreign investors, who set up joint ventures in a bid to gain access to foreign capital, technology, know-how, and earnings. In 1981, the four zones accounted for 59.8 percent of total foreign direct investment (FDI) in China. From 1980–84, Shenzhen grew at an annual rate of 58 percent, Zhuhai at 32 percent, Xiamen at 13 percent, and Shantou at 9 percent; the country overall averaged 10 percent.

So, China adopted Model Tax Convention for their international tax treaties. It took a UN Model Convention, amended in some sense for their economic relations and gave more tax authority to the country of source of income. Even though China is an advanced economy now, in the past it was a developing country with a territorial taxation principle, which it used to apply to all trade affairs.

The 1994 tax reform split taxes into three categories: central government taxes (like customs duties), local government taxes (like business taxes) and shared taxes (like VAT). Thus, the reforms were designed to give the Chinese people the opportunity to "act entrepreneurially and meet market demands" through "pockets of unregulated and lightly taxed activity."

And adopting and publishing their own China Model Convention to eliminate the problem of double taxation took a significant and influential place.

CONCLUSION

In conclusion, I would like to underline the importance of the studied topic. International juridical double taxation is not just a problem for taxpayers, but also for states` economies, which don't receive the proper amount of financial resources. The purpose of optimization of clear international taxation, with avoidance of the double taxation problem - is a great challenge for lawmakers.
The main question of this research was: «Is it possible to eliminate the issue of international juridical double taxation?».

At the current stage, I can confidently mention that «Yes, there are methods to eliminate international juridical double taxation». The prevention of double taxation contributes to Economic growth and the development of international business relations between the states. It brings more desirous foreign investors and companies to realize their business in that particular country. That is crucial for governments of advanced states to keep up with the times, adjust legislation to the new realities, and develop international relations.

According to the previously established objectives, I came up with several conclusions:

1. Discovering the elements of taxation, it was found that subject, object, tax rate, tax base, tax calculation procedure, terms and procedures of tax payment, and tax holidays are prominent characteristics used in any taxation process. As well it was also determined that legal and economic taxation are not identical concepts. Juridical taxation arises in cases of tax burden on the same subject and object - income taxed. Contrary to it, economic taxation may apply whether to the same of different subjects, and it doesn't matter if the object is the same - either income or dividends. Besides, the taxation principles were considered, which fall in the base of the taxation system of each state. I ended up, that the source-based principle is found in use in developing countries. While the residence-based principles is suitable for economically advanced or developed countries. Thus, these both taxation principles are more commonly used in ongoing international commercial relations.

2. The reasons for international juridical double taxation is found in differently regulated taxation systems in two states, which under special conditions cause double taxation. Taxation of the same income and the same subject in different states leads to international legal taxation. Thus, it lies in imperfect norms of tax legislation, and a lack of international tax treaties by a state, which subject suffers from this problem. At present, the issue of overcoming double taxation is one of the most significant conditions in forming an advanced and pure legal taxation culture.

3. As already known from this research, the methods of double taxation relief exist. And I revealed four of them: exemption tax method, credit tax method, tax sparing method, deduction tax method. Concluding it, an exemption method is the most beneficial for the taxpayer, though the deduction method is the least capable. The credit method eliminates the problem of double taxation with greater success. In the credit method, the tax paid in a foreign country is deducted from the tax payable in the domestic country. Applying the exemption method, international double taxation arising from residence is completely avoidable because only one country fully exercises its taxing authority. Although its complicated structure can cause particular challenges for taxpayers and the government when enforced in practice. And regarding tax sparing method - its not recommended by any of the model conventions, and it is less likely to be used by a state when exemption or credit methods can be applied, so it will be put on the back burner.

4. A major goal of bilateral tax treaties is to remove impediments to international trade and investment by reducing the threat of double taxation that can occur when both Contracting States impose tax on the same income. Moreover, a multilateral tax agreement is regarded as official document endorsed by multiple states, outlining the limits of tax jurisdiction for the participating states and governing various aspects related to taxation engaging in a regional-scale multilateral tax agreement (Kızılgül, 2019, p. 75). Although, multilateral tax treaties are more complex than bilateral tax treaties, its harder to make an agreement with all the states in order for them to be satisfied on the same conditions.

5. The previously mentioned bilateral and multilateral tax treaties are based on the most outstanding Model Double Taxation Conventions: OECD and UN, the USA or China. Model Conventions will not directly align with every bilateral agreement signed by each country. But, countries can make some additions to the Model Conventions by means of negotiations, considering their domestic laws. There are two influential model tax conventions — OECD Model Conventions and United Nations Model Convention. OECD Model Convention is more favorable to developed countries, with a dominating residence principle, while UN Model Convention places emphasis on the principle of source taxation in developing states. The USA Model Income Tax Convention and Chinese Economic Model are given in my research more for introductory and explanatory reasons, as they appear not that often when conclusion double tax treaties, and are used locally.

6. After conducting a whole research, comparing double tax relief methods almost in each part of the paperwork, supported with quotes and thoughts of prominent scientists, it has been seen, that some of them are effective, others - not. However, due to my investigation, I refer to the

Exemption and Credit method of elimination of double taxation. It is explained by the fact that the first one is respectable by taxpayers represented by individuals and legal entities. And another one, on my point of view is more fair for both sides, taxpayers and contracting states. It is important to use either of both methods in appropriate situations. Notwithstanding, they still require some improvement, especially in use by governments of contracting states who must adhere to the conducted tax treaties, and in case of disagreement, interpret it in a way that is understandable for both states, and thus reach a consensus. States should arrange their domestic laws in a way that is convenient for international business relations.

At this point, it is possible to say that double taxation has a distorted effect on international capital flows, having a negative impact on globalization.

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SUMMARY IN ENGLISH

Methods to Eliminate International Juridical Double Taxation

Karolina Voinova

This Master`s thesis provides an analysis of methods to eliminate international juridical double taxation. The topic is most revealed through discovering these methods, their classifications, defection of their differences, and practical application. The theme is raised quite thoroughly during the study of conventional methods, introduced by OECD and United Nations Models, naming the notable articles and commentaries. The research gives a comprehensive overview of all possible ways to overcome the international double taxation phenomenon, as the main wrecker of the stable economic development and legal tax culture.

Furthermore, it broadly presents the fundamentals of taxation notions, its elements and principles in the initial part. This master thesis examines the difference between Economic and Juridical Taxations.

The last part discloses the weight of OECD, UN, USA and China Model Conventions. There is a focus on OECD and UN Models as key ones, bringing in order the functioning of normal international business relations between contracting states and avoiding dual taxation problems. Besides this, the research exposes the sense of both bilateral and multilateral tax treaties.

In the end, this Master`s thesis has valuable insight on the researched topic, by offering a comprehensive examination of the ways leading to a solution of double taxation problem. It contributes to scholarly studies, by a complex inquiry of each important element, that causes dual taxation and which get over with this.

This learning serves as an indentation point and precious source for politics, lawmakers, tax advisers, striving to warn and prevent challenging international double taxation in respect to global economics, states` economic well-being and globalization matters.

SUMMARY IN LITHUANIAN

Tarptautinio teisinio dvigubo apmokestinimo panaikinimo metodai

Karolina Voinova

Šiame magistro darbe pateikiama tarptautinio teisinio dvigubo apmokestinimo pašalinimo metodų analizė. Labiausiai tema atsiskleidžia atrandant šiuos metodus, jų klasifikacijas, jų skirtumų trūkumus ir praktinį pritaikymą. Tema gana nuodugniai iškeliama tiriant EBPO ir Jungtinių Tautų modelius įvestus įprastinius metodus, įvardijant žymiausius straipsnius ir komentarus. Tyrimas išsamiai apžvelgia visus įmanomus būdus, kaip įveikti tarptautinį dvigubo apmokestinimo reiškinį, kaip pagrindinį stabilios ekonomikos plėtros ir teisinės mokesčių kultūros griovimą.

Be to, pradinėje dalyje plačiai pristatomi apmokestinimo sampratų pagrindai, jo elementai ir principai. Šiame magistro darbe nagrinėjamas skirtumas tarp ekonominių ir teisinių mokesčių.

Paskutinėje dalyje atskleidžiama EBPO, JT, JAV ir Kinijos pavyzdinių konvencijų svarba. Pagrindinis dėmesys skiriamas EBPO ir JT modeliams, siekiant sutvarkyti įprastų tarptautinių verslo santykių tarp susitariančiųjų valstybių funkcionavimą ir išvengti dvigubo apmokestinimo problemų. Be to, tyrimas atskleidžia tiek dvišalių, tiek daugiašalių mokesčių sutarčių prasmę.

Baigiamajame magistro darbe pateikiama vertinga įžvalga tiriama tema, visapusiškai išnagrinėjus būdus, vedančius į dvigubo apmokestinimo problemos sprendimą. Ji prisideda prie mokslinių tyrimų, kompleksiškai ištyrinėdama kiekvieną svarbų elementą, sukeliantį dvigubą apmokestinimą ir kuris su tuo susitvarko.

Šis mokymasis yra politikos, įstatymų leidėjų, mokesčių konsultantų, siekiančių įspėti ir užkirsti kelią tarptautinio dvigubo apmokestinimo iššūkiams, susijusiems su pasauline ekonomika, valstybių ekonomine gerove ir globalizacija, šaltinis ir vertingas šaltinis.