OFFSHORE PLANNING CHECKLISTS

TAX TREATIES

DOUBLE TAXATION ISSUES

- International double (or multiple) taxation occurs when the tax authorities of two or more countries concurrently impose taxes having the same bases and incidence, in such a way that a person incurs a heavier tax burden than if he were subject to one tax jurisdiction only.
- Economic double taxation can cause the same profits to be subject to tax at more than one level. The most typical example is the case in which corporate profits are first taxed in the hands of a company and then, upon distribution, are once again taxed in the hands of shareholders.

TAX TREATIES

- Tax treaties are intended to avoid the incidence of double taxation and to prevent certain exercises in tax avoidance.
- Nevertheless tax treaties may inadvertently create opportunities where global tax burdens may be reduced in a manner, which is unintended by the treaty partners.

REDUCTION IN WITHHOLDING RATES

- Treaties normally also reduce the amount of tax a country is allowed to withhold on income being repatriated to another treaty partner country.

BUSINESS PROFITS AND THE PERMANENT ESTABLISHMENT RULE

- Tax treaties lay down which country will be entitled to tax business profits that an enterprise of one country makes in the other country.

- In most cases, this is by reference to whether there is a permanent establishment in such other state.
- In situations in which companies wish to take advantage of the certainty and better provisions of double tax treaties, the possibility of structuring business transactions with or in a high tax country through a third country with which it has a tax treaty should be investigated in the diagnostic.
- It may be possible for an offshore company located in a country that does not have tax treaties to take advantage of the vast network of tax treaties of other countries provided that the structure attracts very little corporate tax in the home country. The company could take advantage of all the treaty advantages since it would be a bona fide company, notwithstanding the fact that there is relatively little tax to be paid and the operations would take place in the IOFC.
- The advantage of using a company incorporated in a country with a useful tax treaty, is the possibility offered by the treaty to reduce taxes on business profits, while structuring the operations so as to attract very little tax in the country of incorporation. This is as a function of the provisions of tax treaties that make it possible to avoid tax on business profits in a foreign treaty country even where such company has profits in the other country. The critical point is to avoid the creation of an office or a branch (permanent establishment) in the country concerned.
- *Note:* The definition of "permanent establishment" as it may vary from treaty to treaty.

POSITIVE DEFINITION OF "PERMANENT ESTABLISHMENT"

The term *permanent establishment* means a fixed place of business in which the business of the enterprise is wholly or partly conducted. Permanent establishment includes especially:

- a place of management;
- a branch;
- a factory;
- a workshop;
- a mine, quarry, or other place of extraction of natural resources; and
- a building site or construction or assembly project that exists for more than twelve months.

NEGATIVE DEFINITION OF "PERMANENT ESTABLISHMENT"

The term *permanent establishment* generally does not include the following:

- the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;

- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or delivery;
- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; or
- the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise.

THE INDEPENDENT AGENT AS A PERMANENT ESTABLISHMENT

A person will not constitute a permanent establishment of the enterprise on whose behalf he acts provided that:

- he is a broker, general commission agent, or any other agent of an independent status in a treaty country;
- he is independent of the enterprise both legally and economically; and
- he acts in the ordinary course of his business when acting on behalf of the foreign enterprise.

THE DEPENDENT AGENT AS A PERMANENT ESTABLISHMENT

Persons whose activities may create a permanent establishment for the enterprise are:

- persons, whether employees or not, who are not independent agents;
- persons having the authority to conclude contracts for the enterprise maintaining them, making use of this authority repeatedly and not merely in isolated cases;
- persons fulfilling orders from a stock of goods.

TREATY SHOPPING

- "Treaty shopping" is the attempt by third parties to benefit artificially from tax treaties intended to benefit the bona fide residents of residents of the two treaty countries.
- In order that a structure purporting to link together entities in different treaty countries may prove efficient, the costs of the structure plus the aggregate tax burden suffered in the third country by the conduit company should not exceed the high tax country's tax burden.
- Both the OECD Model Income Tax Convention on Income and Capital (article 10) and the U.S. Treasury Model Income Tax Treaty (Article 16) contain provisions limiting the use of treaty shopping.
- Additionally provisions are being introduced aimed at denying entities operating under harmful tax regimes access to certain or all of a treaty's benefits.

TAX TREATY CONDUIT HAVENS

- Offshore jurisdictions also include countries that allow foreign corporations to borrow their tax treaties.
- *Note:* Many countries will simply disregard the treaty when the ultimate beneficiary is not a bona fide resident of a treaty country.

MEASURES TO COMBAT HARMFUL TAX PRACTICES

- Countries that allow their treaties to be used for treaty shopping are directly in the firing line of the attack on harmful tax practices by the OECD and the high tax jurisdictions.
- It is always a sound planning measure to refer to the international measures to combat harmful tax practices.