Basic Concepts of International Taxation

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Table of contents

1 Residency Dynamics in Pakistan

2 Fundamentals of International Taxation

3 The Transformative of Roles Tax Agreements

4 Introduction to Multilateral Instrument (MLI)

Objective

The objective of this presentation is to:

- Develop an understanding of some fundamental principles of taxation viz Resident and Non-Resident;
- Have an overview of international tax landscape;
- Discuss the overall framework of Tax Agreements;
- Understand the dynamics of Multilateral Instrument (MLI)

Tax Residency Dynamics in Pakistan

Scenarios cont'd………..

Consider the following situations:

- Mr. "A" is a German citizen and is employed by XYZ (Private) Limited; a company incorporated under the laws of Pakistan. Mr. A has been in Pakistan for the past two (2) years and receives his salary in Pakistan from XYZ (Private) Limited.
  - Mr. A, as in 1 above, has opened a bank account in Pakistan and receives profit on such bank account.
  - Mr. A, as in 1 above, has invested in listed shares of both Pakistani companies and foreign companies
  - Mr. A derives dividend income and capital gains both from Pakistani companies and foreign companies.

Scenarios cont'd..........

- Mr. "B" is a Pakistani citizen but has been living in Dubai, UAE for the past several years. He owns a retail outlet from where he carries on his business in Dubai. He occasionally visits Pakistan to meet his family and friends.

- ABC (Private) Limited is a locally incorporated company. ABC (Private) Limited commercially imports new & used bicycles and sells them in the same form in Pakistan.

- MNO (Private) Limited manufactures textile products and exports them to the USA and EU.

Basis of taxation – A Global perspective

Internationally, countries generally follow either of the following three basis of taxing income in their respective jurisdiction:

- Citizenship-based taxation (Mainly followed in the US);
- Territory-based taxation (Followed in Hong Kong, Singapore, Costa Rica, Panama etc.);
- Residence-based taxation (Followed in most of the EU countries, Canada, Japan, the UK, Pakistan, India etc.);

Persons Liable to Tax

KEY FINDINGS OF THE HIGH COURT

- The Ordinance tends to tax the income derived by a person.
- Following are the main categories of persons:
  - Federal Government.
  - Foreign Government.
  - Political sub division of a foreign government.
  - International organization.
  - Individuals.
  - Association of Persons.
  - Companies.

Extent of Income Liable to Tax

- A resident person for a tax year is:
  - A resident individual
  - A resident company
  - A resident Association of persons
  - The Federal Government

Resident Individual (S:82)

- Residential status of an individual is based on number of days he is physically present in Pakistan during a tax year. Therefore, a foreigner can also be a resident person and a Pakistani national may become non resident for tax purposes.
- An individual shall be a resident individual if:
  - he is present in Pakistan for an aggregate period of 183 days or more in a tax year;
  - An individual who is an employee or official of the Federal Government or a Provincial Government posted abroad in a tax year is always considered as resident irrespective of his physical stay in Pakistan.
  - being a citizen of Pakistan is: i) not present in any other country for more than one hundred and eighty-two days during the tax year; or ii) who is not a resident taxpayer of any other country

Resident Individual (S:83)

- A company shall be a resident company, if:
  - It is incorporated in Pakistan.
  - It is a Provincial Government or a Local Government.
  - A company shall also be a resident company, if the control and management of the affairs of the company is situated wholly in Pakistan at any time in the year, even if it is not incorporated in Pakistan.

Resident Company (S:83)

- A company shall be a resident company, if:
  - It is incorporated in Pakistan or formed under the Pakistan Law.
  - It is a Provincial Government or a Local Government.
  - A company shall also be a resident company, if the control and management of the affairs of the company is situated wholly in Pakistan at any time in the year, even if it is not incorporated in Pakistan.

Resident Association of Person (S:84)

- An association of person shall be resident in Pakistan if the control and management of the affairs of the association is situated wholly or partly in Pakistan at any time in the year.

Geographical source of Income

- It is imperative to note that income may be classified as Pakistan source either as:
  - Absolute – meaning that the income has actual source in Pakistan; or
  - Fictional – meaning that it becomes Pakistan sourced income based on the status of the payer in Pakistan.
- Any income that is not classified as Pakistan source would be treated as foreign source income for the purposes of taxation.

Principles of Taxation in Pakistan

Absolute Income

Section	Character of Income	Comment
101(1)	Salary	From employment exercised in Pakistan; or paid to a Government employee wherever such employment is exercised
101(2)	Business Income of a resident person	When income is derived from business carried on in Pakistan
101(3)	Business Income of a non-resident person	When income is directly or indirectly attributable to a permanent establishment or any other business connection in Pakistan
101(5)	Gains on disposal of business assets	Disposal of business assets in Pakistan
101(6)	Dividend Income	When paid by a resident company; or remittance of after tax profit by a branch of a foreign company operating in Pakistan
101(9)	Rental Income	When it is derived from the lease of immovable property in Pakistan or from any other interest in or over immovable property, including a right to explore for, or exploit, natural resources in Pakistan.
101(10)	Alienation or disposal of immovable property	Referred to in 101(9)
101(13)	Disposal of shares	Gain on disposal of shares of a resident company

Principles of Taxation in Pakistan

Fictional Income

Section	Character of Income	Comment
101(4)	Independent Services rendered by a nonresident person	If paid by a resident person or born by the permanent establishment of a nonresident person
101(7)	Profit on Debt	If paid by a resident person or born by the permanent establishment of a nonresident person
101(8)	Royalty	If paid by a resident person or born by the permanent establishment of a nonresident person
101(11)	Pension or annuity	If paid by a resident person or born by the permanent establishment of a nonresident person
101(12)	technical fee	If paid by a resident person or born by the permanent establishment of a nonresident person
101(12A)	fee for offshore digital services	If paid by a resident person or born by the permanent establishment of a nonresident person
101(13A)	Insurance/reinsurance Premium	Paid by an insurance company to an overseas insurance or re-insurance company.
101(14)	Any other amount	Paid by a resident person or borne by a permanent establishment in Pakistan of a non-resident person
101A	Gain on disposal of assets outside Pakistan	Section 101A deems gain from the disposal or alienation outside Pakistan of an asset located in Pakistan of a non-resident company as Pakistan source.

EY

Fundamentals of International Taxation

Scenario

- Suppose ‘Company A’ is a tax resident of County X where it carries on its business and also sells its goods in ‘Country Y’. The rate of tax in Country X is 30%. The rate of tax in Country Y is 40%. Suppose for the year, Company A makes a total profit of 100 from sale of goods in Country Y. If both Country X & Country Y tax the profits of Company A, the total tax incidence on Company A will be 70. Such a high level of taxation on Company A over its profits leads to the principles of International Taxation.

International Taxation

- What is International Taxation?
  - International taxation refers to the set of rules and principles that govern the taxation of cross-border transactions and the allocation of taxing rights among different jurisdictions.
- Scope and Significance of International Taxation:
  - Encompasses the taxation of income, capital, and transactions that involve entities or individuals operating across multiple countries.
  - Significantly impacts global businesses, influencing investment decisions, profit repatriation, and overall economic activities.

International Taxation

- Legal Framework:
  - Grounded in both domestic tax laws and international agreements, including bilateral tax treaties and multilateral instruments.
  - Involves navigating through a complex web of regulations and ensuring compliance with evolving international tax standards.

The Transformative Roles of Tax Agreements

Power to enter into Agreements

- Pursuant to Section 107 of the Ordinance, The federal government may enter into:
  - a tax treaty;
  - a tax Information Exchange Agreement;
  - a Multilateral Convention;
  - an Intergovernmental Agreement; or
  - similar agreement; or mechanism

  for:
    - the avoidance of double taxation;
    - assistance in the recovery of taxes;

Power to enter into Agreements

- exchange of information for the prevention of fiscal evasion; or
- avoidance of taxes;
- automatic and spontaneous exchange of information

- with respect to taxes under the ordinance or any other law for the time being in force and under the corresponding laws in force in that country

The Transformative Roles of Tax Agreements

What is a Tax Treaty

- A treaty is an international agreement concluded between states and governed by international laws
- These tax treaties confer rights and impose obligations on the contracting states

Framework of a Tax Treaty

Tax treaties follow either of the two Model framework:

- United Nations (UN) Model Convention;
- Organisation for Economic Cooperation & Development (OECD) Model Convention;

The Transformative Roles of Tax Agreements

The basic distinction between the OECD and the UN model Convention is that:

- The UN model is structured to favour developing economies while OECD framework is structured for developed economies;
- Comparatively, the UN Model favors retention of greater taxing rights under a tax treaty for the host country of investment (i.e. the source country) as opposed to those of the investor (i.e. residence country). On the other hand the OECD model favors the rights of the residence country as against the source country.

Comparative Articles under the UN Model vs OECD Model

	UN	OECD
ARTICLE 1	Persons covered	Personal scope
ARTICLE 2	Taxes covered	Taxes covered
ARTICLE 3	Definitions	Definitions
ARTICLE 4	Resident	Resident
ARTICLE 5	Permanent Establishment	Permanent Establishment
ARTICLE 6	Income from Immovable Property	Income from Immovable Property
ARTICLE 7	Business profits	Business profits
ARTICLE 8	International shipping and air transport	Air and shipping transport
ARTICLE 9	Associated enterprises	Associated enterprises
ARTICLE 10	Dividends	Dividends
ARTICLE 11	Interest	Interest

ARTICLE 12	ROYALTIES	ROYALTIES
ARTICLE 12A	Fees for technical services	-
ARICLE 12B	Income from automated digital services	-
ARTICLE 13	Capital gains	Technical fees
ARTICLE 14	Independent personal services	Capital Gain
ARTICLE 15	Dependent personal services	Independent personal services
ARTICLE 16	Directors’ fees and remuneration of top-level managerial officials	Dependent personal services
ARTICLE 17	Artistes and sportspersons	Director’s fee
ARTICLE 18	Pensions and social security payments	Entertainers’ and Athletes
ARTICLE 19	Government service	Government Services
ARTICLE 20	Students	Pensions and Annuities
ARTICLE 21	Other income	Student and Apprentices/Trainees
ARTICLE 22	Capital	Professors and Teachers/Researchers

Comparative Articles under the UN Model vs OECD Model

ARTICLE 23 A	EXEMPTION METHOD	OTHER INCOME
ARTICLE 23 B	Credit method	-
ARTICLE 24	Non-discrimination	Methods for the Elimination of Double Taxation
ARTICLE 25	Mutual agreement procedure (alternatives A and B)	Non-discrimination
ARTICLE 26	Exchange of information	Mutual Agreement Procedure
ARTICLE 27	Assistance in the collection of taxes	Exchange of Information
ARTICLE 28	Members of diplomatic missions and consular posts	Diplomatic and Consular Activities
ARTICLE 29	Entitlement to benefits	Entry into Force
ARTICLE 30	Entry into force	Termination
ARTICLE 31	Termination	-

Need for double taxation Treaty

The objectives of the DTT are to:

- Avoid double taxation; and
- Prevent fiscal evasion

In order to “avoid” double taxation, two rules are devised viz:

- Establishing the Distributive Rule (DR) whereby, taxing rights are allocated between Contracting States (CS) with respect of various kinds of income. Thus under the DR a particular category of income is either taxed in the Contracting State where the income is sourced or in the CS where the tax payer is the tax resident; and
- Establishing the Credit Rule (CR) whereby, if the income is taxed in both the Contracting States, the Resident State (RS) is required to provide credit for taxes paid in the source State or to exempt the income which is taxed in the source State.

Fiscal evasion is prevented through Exchange of Information Protocol as set for in the DTTs

Countries with which Pakistan has Double Taxation Treaties

There are two types of Treaties:

- Full scope Treaties, &
- Limited Scope Treaties

Pakistan has full scope treaties with 66 Countries and limited scope treaties with 4 Countries (other than the multilateral agreement with SAARC Countries)

List of full scope Treaties

Azerbaijan	Germany	Malaysia	Serbia	United Kingdom
Bahrain	Hong Kong	Malta	Singapore	United States of America
Bangladesh	Hungary	Mauritius	South Africa	Uzbekistan
Belgium	Indonesia	Morocco	Spain	Vietnam
Belarus	Iran	Nepal	Sri Lanka	Yemen
Bosnia and Herzegovina	Ireland	Netherlands	Sweden	
Brunei Darussalam	Italy	Nigeria	Switzerland	
Bulgaria	Japan	Norway	Syria	
Canada	Jordan	Oman	Tajikistan	
China	Kazakhstan	Philippines	Thailand	
Czech Republic	Korea	Poland	Tunisia	
Denmark	Kuwait	Portugal	Turkey	
Egypt	Kyrgyz Republic	Qatar	Turkmenistan	
Finland	Libya	Romania	Ukraine	

List of limited scope Treaties

India (Air Transport Agreement)
Jordan (Income from Airlines)
Kenya (Income from Airlines and Shipping)
Saudi Arabia (Income from Airlines)

Treaty Provisions to Prevail

Where Pakistan has signed a tax treaty with another country the provisions of the treaty will prevail over the provisions of the Ordinance (except in certain circumstances) if the treaty provides for at least one of the following:

- Relief from the tax payable under the Ordinance;
- The determination of the Pakistan-source income of non-resident persons;
- Where all the operations of a business are not carried on within Pakistan, the determination of the income attributable to operations carried on within and outside Pakistan, or the income chargeable to tax in Pakistan in the hands of non-resident persons, including their agents, branches, and permanent establishments in Pakistan;
- The determination of the income to be attributed to any resident person having a special relationship with a non-resident person; and
- The exchange of information for the prevention of fiscal evasion or avoidance of taxes on income chargeable under the Ordinance and under the corresponding laws in force in that other country.

Treaty Tax Rates

Subject to fulfilment of specified conditions, the following rates of tax may apply in Pakistan in respect of Pakistan source income derived by a non-resident

Treaty Withholding Tax Rates

Country	Dividend (%)	Interest (%)	Royalties (%)
Austria	10 / 20 (d)	- (b) (g)	20
Azerbaijan	10	10	10
Bahrain	10	10 (b)	10
Bangladesh	15	15 (b)	15
Belarus	10 / 15 (d)	10 (b)	15
Belgium	10 / 15 (d)	15 (b)	20 (m)
Bosnia and Herzegovina	10	20	15
Brunei Darussalam	10	15 (b)	15
Bulgaria	12.5	10 (b)	12.5
Canada	15 / 20 (d)	25	20 (c)
China Mainland	10	10	12.5
Czech Republic	5 / 15 (p)	10 (b)	10
Denmark	15	15 (b) (f)	12
Egypt	15 / 30 (q)	15 (t)	15
Finland	12 / 15 / 20 (s)	15 (i)	10
France	10 / 15 (o)	10 (t)	10
Germany	10 / 15 (v)	20 (b) (i)	10
Hong Kong SAR	10	10 (b)	10
Hungary	15 / 20 (p)	15 (b)	15
Indonesia	10 / 15 (p)	15	15
Iran	5	10	10
Ireland	10 (h)	- (b) (g)	- (e)
Italy	15 / 25 (r)	30 (t)	30
Japan	5 / 7.5 / 10 (a)	10 (b)	10
Jordan	10	10 (b)	10
Kazakhstan	12.5 / 15 (o)	12.5 (t)	15
Korea (South)	10 / 12.5 (d)	12.5 (b)	10
Kuwait	10	10 (t)	10
Kyrgyzstan	10	10	10
Lebanon	10	10 (b)	7.5

Treaty Tax Rates

a	Treaty-determined percentage holding required.
b	Interest paid to the government or, in certain circumstances, to a financial institution owned or controlled by the government is exempt.
c	Fifteen percent for industrial, commercial or scientific know-how.
d	Treaty-determined percentage holding required, and payer must be engaged in an industrial undertaking; otherwise, higher rate or normal rate applies.
e	Royalties are exempt from withholding tax to the extent they represent a fair and reasonable consideration.
f	Certain approved loans are exempt.
g	Normal rates apply.
h	Treaty-determined percentage holding by a public company required and the profits out of which the dividends are paid must be derived from an industrial undertaking; otherwise, normal rates apply.
i	Ten percent if the recipient is a financial institution.

Treaty Tax Rates

j	Lower amount for literary, artistic or scientific royalties.
k	Fifteen percent if payer is an enterprise engaged in preferred activities.
l	Rate reduced to 10% if recipient is a bank or financial institution or if certain types of contracts apply. Rate reduced to 15% if recipient holds 25% of the capital of the paying company.
m	Copyright royalties and other similar payments for literary, dramatic, musical or artistic work are exempt.
n	Fifteen percent if the recipient is a company. Further reduced to 10% if the treaty-determined percentage is held by the recipient and the industrial undertaking is set up in Pakistan after 8 December 1987. Twenty percent in other cases.
o	Lower rate applies if the recipient is a company that controls, directly or indirectly, 10% of the voting power in the company paying the dividend.

Treaty Tax Rates

p	Lower rate applies if recipient is a company that owns directly at least 25% of the capital of the paying company.
q	The 15% rate applies to dividends paid to companies. The 30% rate applies to other dividends.
r	The 15% rate applies if the recipient is a company that owns directly at least 25% of the capital of the payer and is engaged in an industrial undertaking.
s	The 12% rate applies if the recipient is a company that owns directly at least 25% of the capital of the payer; the 15% rate applies to dividends paid to other companies; and the 20% rate applies to other dividends.
t	Interest paid to the government or to an agency of or an instrumentality owned by the government is exempt from tax.
u	The 10% rate applies if the payer is engaged in an industrial undertaking and if the recipient is a company; the 12.5% rate applies if the recipient is a company; the 15% rate applies in all other cases.

Treaty Tax Rates

v	The lower rate applies if the beneficial owner of the dividends is a company that owns at least 20% of the shares of the payer.
w	The 10% rate applies to royalties for cinematographic films and to tapes for television or radio broadcasting. The 15% rate applies to royalties for literary, artistic or scientific works.
x	The treaty rate applies to the extent the amount represents a fair and reasonable consideration.
y	Interest paid to the government or to the central bank is exempt.
z	For details regarding these rates, please see the relevant footnotes in Section A.
Pakistan has also entered into treaties that cover only shipping and air transport. These treaties are not included in the above table.	

Introduction to Multilateral Instrument (MLI)

What is BEPS?

- Base erosion and profit shifting (BEPS) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax.
- Developing countries' higher reliance on corporate income tax means they suffer from BEPS disproportionately.
- BEPS practices cost countries USD 100-240 billion in lost revenue annually. Working together within OECD/G20 Inclusive Framework on BEPS, over 140 countries and jurisdictions have collaborated on the implementation of 15 measures to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.

What is BEPS?

The 15 Action Items under BEPS are:

1. Address the tax challenges of the digital economy
2. Neutralize the effects of hybrid mismatch arrangements
3. Strengthen CFC rules
4. Limit base erosion via interest deductions and other financial payments
5. Counter harmful tax practices more effectively, taking into account transparency and substance
6. Prevent treaty abuse
7. Prevent the artificial avoidance of Permanent Establishment (PE) status
8. Aligning transfer pricing outcomes with value creation: intangibles
9. Aligning transfer pricing outcomes with value creation: risks and capital
10. Aligning transfer pricing outcomes with value creation: other high-risk transactions

What is BEPS?

The 15 Action Items under BEPS are:

11. Measuring and monitoring BEPS
12. Require taxpayers to disclose their aggressive tax planning arrangements
13. Re-examine transfer pricing documentation
14. Make dispute resolution mechanisms more effective
15. Develop a multilateral instrument

Multilateral Instrument

- Action 15 of the BEPS Framework required development of The Multilateral Instrument (MLI)
- The MLI is a multilateral treaty that enables jurisdictions to modify their bilateral tax treaties to implement measures designed to better address multinational tax avoidance
- MLI does not function in the same way as an amending protocol to a single existing treaty would; it is applied alongside existing tax treaties, modifying their appl
- The MLI addresses the following notable topics, among others:
  - Transparent/hybrid entities
  - Dual resident entities
  - Prevention of treaty abuse (limitations on benefits provisions)

Multilateral Instrument

- Capital gains on shareholdings in real estate entities;
- Anti-abuse rules for low-taxed third country permanent establishments;
- Artificial avoidance of permanent establishment status through commissionaire arrangements;
- Artificial avoidance of permanent establishment status through specific activity exemptions;
- Splitting-up of contracts;
- Mutual agreement procedures

- Pakistan signed the same in 07-06-2017 becoming the 104th jurisdiction to join the Convention.
- The instrument of Ratification, was submitted on 18-12-2020 and the entry into force is on 01-04-2021

List of synthesized treaties

- The following is the list of treaties that have been modified by MLI, as available under the FBR website. DTTs of Pakistan as modified by MLI?

Austria	Malaysia
Belgium	Malta
Bosnia and Herzegovina	Mauritius
Canada	Netherlands
China	Oman
Czech Republic	Poland
Denmark	Portugal
Egypt	Qatar
Finland	Saudi Arabia
Hungary	Serbia
Indonesia	Singapore
Ireland	Sweden
Japan	United Arab Emirates
Jordan	United Kingdom
Kazakhstan	

THANK YOU