International

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Key Practical Issues To Eliminate Double Taxation of Business Income

This article summarizes the panel proceedings for Subject 2 at the 65th Congress of the International Fiscal Association held in Paris on 13 September 2011. Subject 2 considered the practical difficulties encountered in both worldwide taxation systems and territorial taxation systems in eliminating double taxation of business income.

1. Introduction[1]

The topic of Subject 2 (the "Subject") at the 2011 International Fiscal Association annual Congress held in Paris, France, from 11 September to 16 September 2011, was "Key practical issues to eliminate double taxation of business income". The panel concentrated on the practical problems raised by the methods of relieving international double taxation and not on the policy aspects of credit versus exemption systems. This summary is, therefore, a practical guide with illustrated examples.[2]

The panel addressed the Subject by applying the following three hypotheses to real world examples: (1) despite conventional wisdom, exemption systems are no better than credit systems at eliminating double taxation; (2) relatively simple practical recommendations could, if implemented, effectively address deficiencies in current rules for eliminating double taxation of business income; and (3) in light of taxpayer calls for less inter-governmental coordination, national governments already do enough to eliminate double taxation.

2. Outline of the Discussion

The panel discussion was divided into five parts. First, the panel described the scope of the topics covered and presented the three hypotheses set out in section 1. Second, the General Reporter summarized the main findings of the General Report (*see* section 3.). Third, the panellists analysed conventional wisdom with regard to certain issues of double taxation: (1) expense allocation; (2) deduction of losses; (3) tax planning activity; and (4) complexity (*see* section 4.). Conventional wisdom as understood by the panel was described and then tested against real world examples involving issues of double taxation. Fourth, the panel focused on three additional significant issues of double taxation: (1) source of income; (2) character of income; and (3) entity classification issues (*see* section 5.). For each issue, the panel presented a list of potential conflicts and then provided real world examples. Finally, the panel concluded its presentation by deriving certain practical implications arising from the discussion and testing its three overriding hypotheses through audience participation (*see* section 6.).

3. Main Findings of the General Report

The Subject's General Report, which was written by Gauthier Blanluet and Philippe Durand, may be summarized as follows:

– Five credit methods exist in worldwide taxation systems: (1) full inclusion regime (taxing foreign source income on a current basis); (2) deferral regime (taxing foreign source income when repatriated); (3) ordinary credit method (foreign tax reduces domestic income tax on foreign income only); (4) full credit method (foreign tax reduces domestic income tax on all income, whether foreign or domestic); and (5) indirect credit method (credit allowed for underlying foreign taxes paid on foreign subsidiary profits out of which a dividend is received).
– Based on the branch reports, countries may be divided into three categories:
  (1) Countries employing a system primarily based on worldwide taxation (the "A Group"). The A Group employs the credit method for active business income from foreign branches and for foreign passive income, including non-portfolio dividends from foreign subsidiaries. The A Group also provides targeted exemptions

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1. The panel members consisted of Carolina del Campo (Spain), Peter van Dijk (Canada), Luciana Rosanova Galhardo (Brazil), Jürgen Lüdicke (Germany) and Larry Magid (Australia). The Subject was chaired by Philip R. West (United States). The General Reporters were Gauthier Blanluet (France) and Philippe J. Durand (France). The panellists gratefully acknowledge the assistance of Anapaula Trindade Marinho (France) as Panel Secretary, Brian R. Symington (United States), who assisted in the preparation of this article, and Dianna K. Muth (United States), who assisted in the preparation of the slides for the panel proceedings.
2. The Subject was limited in scope to taxation of corporate business income. The panel generally did not address indirect taxes or issues of domestic double taxation. The panel also only tangentially addressed issues of individual taxes, double non-taxation, juridical versus economic double taxation and transfer pricing.

in a treaty context. A Group countries include India, the major part of Latin America (including Brazil), Norway and the United States.

(2) Countries employing a truly hybrid system (the "B Group"). Countries in the B Group employ the credit method for active business income from foreign branches and for foreign passive income. The B Group employs the exemption system with regard to non-portfolio dividends from foreign subsidiaries and branch profits in a treaty context. B Group countries include Belgium, Canada, Finland, Germany, Luxembourg, Malta, New Zealand, Poland, Portugal, Russia, South Africa, Sweden and the United Kingdom.

(3) Countries traditionally following the territoriality principle of taxation, which exempt foreign branch income and non-portfolio dividends from foreign subsidiaries and apply the credit method to other foreign passive income (the "C Group"). C Group countries include Australia, Austria, Denmark, Estonia, France, the Netherlands, Spain and Switzerland.

- No country operates under a pure credit system or a pure exemption system. Most countries employ both methods. Pure exemption systems are not found due to the application of the credit method to passive income and the effect of tax treaties. Pure credit systems are not found due to targeted exemptions, for example, non-portfolio dividends, deferral rules and the effect of tax treaties.
- Despite differences and traditional notions regarding the efficacy of the two systems, the credit and exemption systems may yield very similar results and raise similar issues.
- The lack of clear differences between countries' systems is brought about both by the application of the different systems to different types of income and to the same type of income, in addition to departing from domestic principles via tax treaties, which increases the risk of international level conflict and unrelieved international double taxation.
- Further, the lack of clear differences in taxation systems stems from similar risks of double taxation, evidenced by the numerous potential conflicts originating in distortions between source state and residence state treatment with respect to the source or nature of taxable income.
- Territorial taxation systems do not ignore juridical double taxation and both territorial and worldwide taxation systems are equally exposed to economic double taxation.
- Common issues in the credit and exemption systems are more widespread than generally expected:
  - For instance, credit countries do have to allocate deductible expenses between source state and the residence state due to foreign tax credit limitation allocation requirements. Accordingly, unrelieved double taxation from inconsistent allocation of deductions is common to both systems.
  - For instance, the use of foreign losses in credit countries is often restricted or limited, for example, limited to foreign branch losses and subject to recapture, and it is clear that in exemption systems foreign losses are valuable in the residence state. A number of exemption countries provide for derogatory measures that serve as tax incentives for making foreign investments and exemption system taxpayers often avoid the general prohibition against deducting foreign losses by claiming deductions of subsidiaries, debt waivers or capital losses on share dispositions.
  - For instance, despite perceived efficiencies in credit systems circumventing tax avoidance due to the requirement to report and include income in the domestic tax base no matter where it arises and despite the perceived high risk of tax avoidance in exemption systems based on the movement of profits offshore, whether repatriated or not, in practice, the branch reports indicated no substantial difference between the two systems with regard to tax planning and the degree of protection offered against tax avoidance:
    - Indirect credit systems may operate as an exemption system encouraging the transfer of income to low-tax jurisdictions and tax planning in credit systems often includes deferring the repatriation of profits and/or repatriating such profits in a form that does not trigger taxation.
    - Most exemption countries have adopted anti-avoidance provisions offering a degree of protection against profit stripping into low-tax jurisdictions and many implement exemption rules conditioned upon a subject-to-tax test and/or an active income test.
    - Both systems may be equally at risk to certain tax planning tools such as hybrid financial instruments receiving inconsistent treatment in source state and the residence state.
- Fiscally transparent entities generate both tax planning activity and, due to inconsistent treatment, unrelieved double taxation, in both credit and exemption systems.
- The crucial outstanding distinction between the systems is that in the indirect credit method, there is a need for detailed foreign tax credit limitations. These rules create two main drawbacks:

  (1) By restricting or disallowing tax credits, the rules serve as a source of double taxation through inconsistent categorization of the source of income and timing differences with respect to recognition.

  (2) The rules are complex for both taxpayers and governments. Among others, complexities include defining and computing income, look-through treatment for layers of foreign cor-

porations and a high degree of electivity that brings about sophisticated legislative responses, for example, anti-deferral and passive foreign investment rules.

– However, while exemption systems are simpler than an indirect credit system, properly incorporated, they should have complexities such as detailed expense allocation rules and strong anti-avoidance and transfer pricing provisions. Nevertheless, many exemption countries adopt straightforward (relatively speaking) exemption rules subject to anti-avoidance provisions.

4. Conventional Wisdom versus Reality

4.1. Expense allocation

Conventional wisdom with regard to allocating expenses suggests that, as exemption systems allow no deduction for expenses allocated to exempt income and credit systems allow deduction of expenses allocated to foreign income, exemption systems result in double taxation. In reality, certain exemption countries are at times better equipped to relieve double taxation relating to expense allocation. The panel discussed an example of expense allocation between a parent corporation (Parent Co.) and its foreign subsidiary (Foreign Co.), where the state of Foreign Co. allows no deduction of the relevant expenses. In Type A countries, where such expenses are disallowed, as the underlying dividends are tax exempt, double taxation results. However, not all exemption countries follow the path of Type A countries. In Type B countries, while the dividends are exempt, the deduction of related expenses is allowed, although some tax a certain percentage, for example, 5%, of the dividend as a proxy for partial expense disallowance. Accordingly, in Type B exemption countries, expenses are not stranded and double taxation is avoided, at least in substantial part.

Nevertheless, while the allocation of expenses can and often does result in double taxation in exemption systems, the reality is that credit system treatment of expense allocation can also result in double taxation. For instance, in making the complex allocation of expenses for foreign tax credit purposes, there may be an over-allocation to foreign income that inappropriately reduces the foreign tax credit limitation. Some credit countries, in order to incentivize domestic innovation, may also restrict the deduction of foreign expenses, thereby resulting in double taxation. The panel presented the case of Brazil, which, in order to incentivize technological innovation, restricted the ability to take a deduction for technological innovation to those instances where the expense was paid to individuals or legal entities resident and domiciled in Brazil.[3]

The panel also discussed the situation in the United States. There, a domestic corporation that incurs interest expense properly allocable and apportionable to foreign source income may deduct such expense even if the expense exceeds the corporation's gross foreign-source income or even if the corporation earns no foreign-source income.[4] However, the Obama administration has targeted this facet of the expense allocation rules in proposing to defer the deduction of interest expense properly allocated and apportioned to a taxpayer's foreign-source income that is not currently subject to tax. While the final contours of such a proposal, if enacted, are unknown, some view the proposal as a partial, albeit indirect repeal of deferral of foreign subsidiary income, as it may force the repatriation of earnings to secure the related interest deductions.

4.2. Deduction of losses

Conventional wisdom with regard to the deduction of losses suggests that of the two general methods of eliminating double taxation by the resident state, exemption systems more often give rise to double taxation by denying the deduction of foreign losses. In reality, credit systems also limit the deduction of foreign losses in several ways, such as numerous general limits for deductions and losses, for example, related-party loss limits, ordinary and capital loss limits, deduction limits in arbitrage cases, and limits on losses in tax motivated transactions, the inability to deduct foreign losses from domestic income, and the recovery of overall foreign losses and foreign branch losses.

The panel presented the case of Brazil, which has adopted a system of worldwide taxation. In Brazil, although foreign earnings and gains are included in income of the Brazilian corporation, losses from foreign transactions can only be offset against foreign profits. In other words, the result of the foreign transaction is accounted for under Brazilian law if Brazilian taxes are increased and the transaction is not accounted for domestically when Brazilian taxes would otherwise be reduced by the result of the foreign transaction, i.e. a foreign loss is at issue.

On the exemption side, France is somewhat of a counter-example to the conventional wisdom that exemption systems categorically give rise to double taxation by denying foreign losses. The panel explained that French case law provides that a loss of the French head office derived from past subsidies granted to foreign branches may be deducted from French taxable income if the loss arises from a commercial relationship between the branch and head office and if the subsidy allows the company to develop or maintain its French business.

4.3. Tax planning activity

Conventional wisdom suggests that exemption systems offer a high reward for successful tax planning, i.e. exemption from tax in the residence state, and thereby encourage tax planning (or avoidance) to a greater extent than credit systems. While exemption systems do offer high rewards, the reality is that both exemption countries and credit countries reward successful tax planning, for example,

3. Exception was made for payments made to obtain and maintain patents and trademarks abroad.

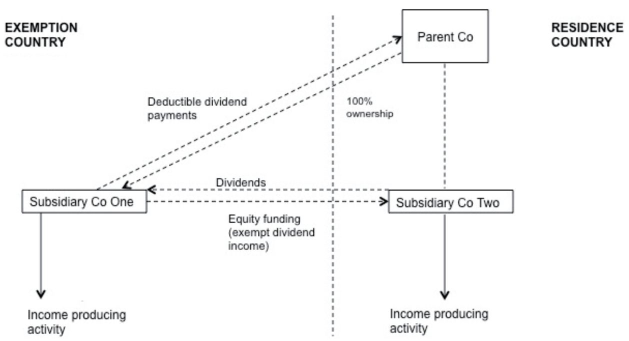
4. While recapture provisions apply, properly allocated and apportioned expenses may not be subject to later recapture if the US taxpayer has sufficient foreign-source income of the same grouping under the applicable regulations.

through allocating (or transferring) income to foreign sources and deductions to domestic income.

While the rewards of successful tax planning may differ in degree, the differences are not as great as they may seem. Under exemption systems, shifted net income may be subject to foreign tax and exemption countries frequently limit exemption to active income rather than passive income, which is more easily shifted. Exemption countries also often impose tax by attribution on the passive income of controlled foreign companies and apply anti-avoidance rules to counter artificial means of shifting income and deductions. Under credit systems, taxpayers may achieve lengthy deferral of residence state taxation.

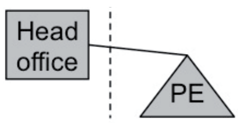
The panel presented the following two examples to reflect the conventional wisdom that tax planning occurs, and is rewarded, in exemption systems. Example 1 is an exemption country example illustrating a taxpayer attempt to achieve double non-taxation.

Example 1: Exemption country tax planning activity



Example 2 illustrates a tax planning opportunity in an exemption system with progressive tax rates based on the ability to influence the timing of permanent establishment (PE) income.

Example 2: Exemption country tax planning opportunity



	Alternative 1		Alternative 2	
	Year 1	Year 2	Year 1	Year 2
Head office	+100	+100	+100	+100
PE	0	0	**–100**	**+100**
Credit tax	30	30	0	**70**
Exemption tax	30	30	0	**35**

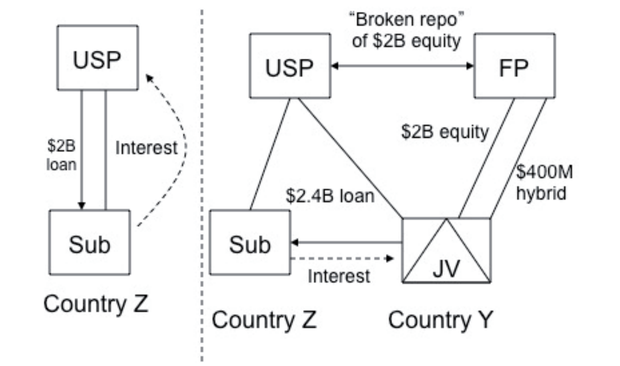
In Alternative 1 in Example 2, where the head office has a profit of 100 in both years and the PE has neither profit nor loss in either year, the resulting tax under the credit and exemption systems is the same. If a 30% progressive tax rate is assumed, the tax will be 30 in each year irrespective of the system of taxation.

In Alternative 2, where the PE suffers a loss in Year 1 and earns a profit in Year 2, the results are markedly different. Assuming a progressive tax rate of 35% in Alternative 2, under the credit method there is a Year 2 tax of 70 in the state of the head office. If it is assumed the state of the PE allows a loss carry forward, there is no PE tax in Year 2 and, therefore, no tax credit in the state of the Head office. The result changes under an exemption system. While, in both Year 1 and Year 2, there is domestic taxable income of 100, for the purposes of determining the applicable tax rate in Year 1, the PE loss is deducted. Accordingly, the "income" for such purposes is 0, the tax rate is 0% and the actual tax 0. In Year 2, however, the "income" for determining the applicable tax rate is 200, to which a tax rate of 35% applies. The actual tax in Year 2 is, however, only 35, as actual taxable income is 100.

Although there is a high reward for successful tax planning in exemption countries, credit countries also provide numerous opportunities. The panel discussed the following foreign tax credit generator transaction example to illustrate the point.

Facts: US parent corporation (USP) finances the formation of its Country Z subsidiary with significant debt. Country Z is about to tighten its earnings stripping rules in a manner that would deny Country Z a deduction for interest on its intercompany debt. USP is presented with an opportunity to refinance debt: (1) through a structure avoiding Country Z's new earnings stripping rules; and (2) at a rate marginally, but not materially, better than the market rate it is currently using. The structure would require USP to invest through a joint venture that is subject to tax in country Y.

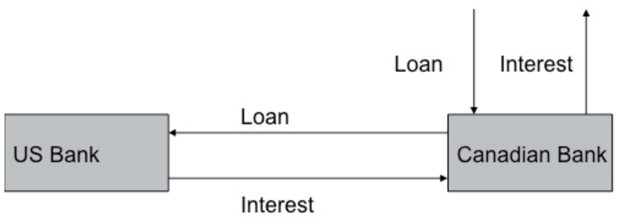
Example 3: Credit country tax planning – foreign tax credit generator

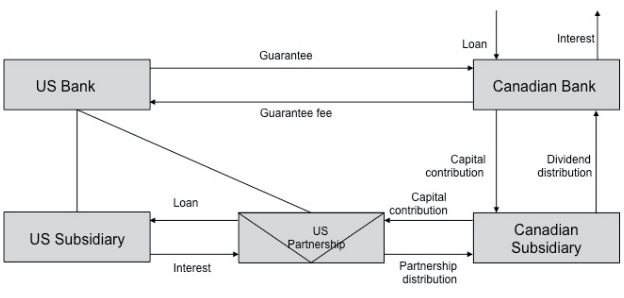


As a result of the transaction: (1) under old Country Z law, the subsidiary is financed with a loan on which the interest is deductible in Country Z and taxable in the United States; (2) under new Country Z law, interest would not be deductible in Country Z, generating taxable income in Country Z that would generate foreign tax credits for USP; and (3) under the proposed structure, the interest would continue to be deductible in Country Z, but would be taxable in Country Y. The question is whether or not the foreign tax credits would be denied in the United States.

The panel also discussed the following foreign tax credit generator transaction in which the partnership distribution to Canadian Bank carries the foreign tax credit and the partnership distribution is effectively tax exempt in Canada. Legislation in Canada now denies the foreign tax credit produced in this example.

Example 4: Credit country tax planning – foreign tax credit generator

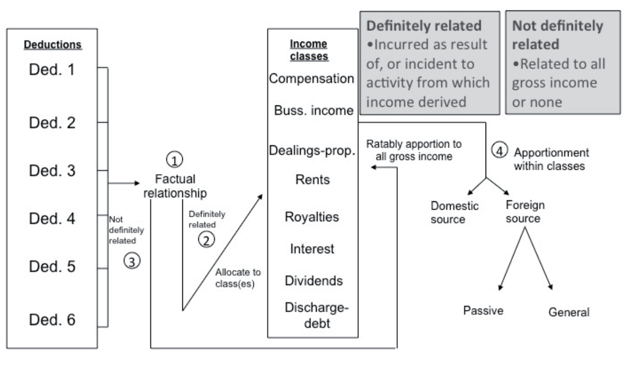




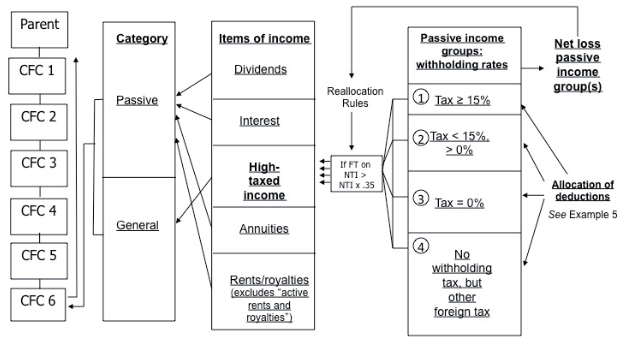
4.4. Complexity

Conventional wisdom suggests that it is credit systems that have a high degree of complexity as income must be defined and characterized for proper basketing, the allocation of deductions are subject to layers of complex rules and very difficult indirect credit factual determinations are necessary that are especially difficult when a corporate taxpayer lacks majority ownership of a lower tier entity, when dividends are paid many years after it is earned or both. The conventional wisdom is illustrated by the following two diagrams relating to US foreign tax credit calculations. Example 5 illustrates rules applicable in properly allocating deductions, while Example 6 illustrates the complexity of foreign tax credit basketing rules. It should be noted that these examples are simplified for the sake of convenience; additional layers of complexity exist.

Example 5: Complexity – allocation of deductions (foreign tax credit)



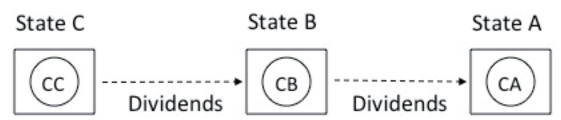
Example 6: Complexity – basketing (foreign tax credit)



The reality, however, is that exemption systems also employ detailed rules with regard to sourcing income and the related expenses, such as anti-avoidance provisions and strong transfer pricing enforcement mechanisms. In addition, exemption is limited to active income and it is at times less than clear what constitutes passive income.

The panel discussed in Example 7 the following exemption country scenario that illustrates the complexities that can arise from two exemption system requirements found in the Spanish system: (1) taxation; and (2) active income. The taxation requirement mandates that the foreign income is subject to a tax that is equivalent to the domestic corporate tax, although a tax treaty may eliminate the requirement for non-domestic taxation. The foreign active income requirement generally is met when at least a threshold percentage of the foreign entity's annual receipts are considered non-passive income.

Example 7: Exemption country complexity



In order for CA's income to meet the requirement of taxation, CB must be taxed. If CB itself is resident in an exemption country, it would not be taxed on the dividend from CC. If CA is taxed by State B through a withholding tax, would this be sufficient to meet the requirement for taxation?

In addition, the foreign income must meet the definition of active income as described previously. Even if the definition of active income can be met, certain limitations may exist. For instance, anti-abuse provisions may apply if the dividends relate to income that was previously deductible or not included in the tax base.

5. Examples of Other Significant Issues Creating Double Taxation

5.1. Introductory remarks

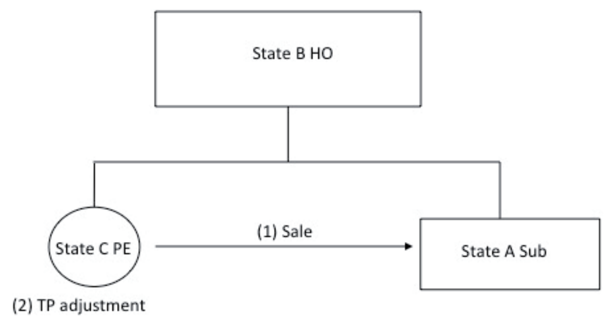
The panel next addressed other significant issues creating double taxation, focusing on source of income (*see* section 5.2.), the character of income (*see* section 5.3.) and entity classification issues (*see* section 5.4.). For each issue, the panel discussed a list of potential conflicts leading to double taxation and then provided real world examples of such conflicts.

5.2. Source of income

The panel first discussed the following five potential source-of-income conflicts: (1) the existence of a PE and attribution of profits to the PE; (2) the allocation of expenses; (3) adjustments made to a PE; (4) conflict of residence; and (5) person subject to tax. Some of the examples discussed by the panel are presented subsequently.

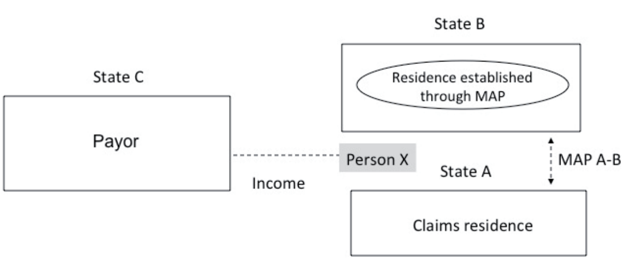
In Example 8, with regard to adjustments made to a PE, the question was what potential tax treaty applies. Initially, one of the State C tax treaties would appear to be relevant, but the PE is not a resident of State C for treaty purposes. Accordingly, a transfer pricing adjustment relating to a sale from State C PE to State A Sub may be governed by the State A-State B Tax Treaty.

Example 8: Source of income



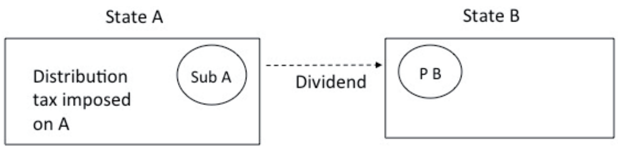
In the conflict-of-residence scenario in Example 9, State C has entered into a tax treaty with both State A and State B. Person X claims residence in State A. However, under the mutual agreement procedures of the State A-State B Tax Treaty, States A and B agree that Person X should be treated as a resident of State B. If the income generated by Person X in State C is subject to higher withholding under the State C-State A Tax Treaty than the State C-State B Tax Treaty, should State C apply the lower State B rate? Should State B act to eliminate the double taxation on the higher withholding that has occurred when the State C payor withholds at the state A rate?

Example 9: Source of income



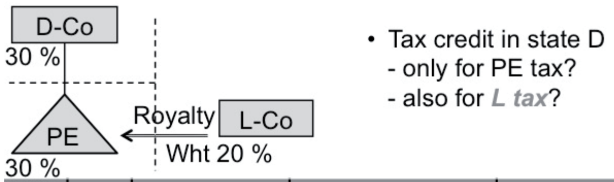
With regard to the person subject to tax, the question in Example 10 is whether PB can credit the tax if a "distribution tax" is imposed on Sub A and whether the applicable tax treaty should address this issue.

Example 10: Source of income



The panel concluded its discussion of source-of-income issues with the following conflict involving a foreign PE earning income in a third state. The conflict can arise in credit countries. In Example 11, corporation D is a resident of State D and has a PE in State PE. The applicable tax rate is 30% in both D and PE. Corporation L is a third party resident of State L that pays a royalty to D. However, the royalty is effectively connected with a business carried on in PE. State L levies a tax of 20% on the royalty payment, which is credited by D in cases A2 and B2. In A1 and A2, no credit is granted by PE for the L tax of 20, while, in B1 and B2, a credit is granted by PE for the L tax. Should state D grant a credit for the PE tax alone, as it does in cases A1 and B1, or also for the L tax, as it does in cases A2 and B2? The table in Example 11 assumes a royalty of 100. While the panellists did not all agree, the example assumes that D tax should be 0, even if the total taxpayer burden varies.[5]

Example 11: Source of income



	L	PE	D	Total
A1	20	30	30-30 = 0 ✓	50
A2	20	30	30-*20*-30 = -20 ?	30
B1	20	30-20 = 10	30-10 = 20 ?	50
B2	20	30-20 = 10	30-*20*-10 = 0 ✓	30

5.3. Character of income

The panel discussed the following two potential character of income conflicts: (1) technical services versus business profits; and (2) dividends/business profits versus interest.

The panel first discussed an advance ruling request submitted to the Brazilian tax authorities by a Brazilian entity ("Renault-BR") established by Renault S.A., a French corporation, for the purpose of manufacturing and selling vehicles in Brazil. Renault-BR, which did not constitute a PE of Renault S.A., hired Renault S.A. to conduct an engineering study for construction of a facility in Brazil and requested the advance ruling to determine whether

5. While A1 and B2 result in a D tax of zero, the taxpayer burden on the royalty is 50 in A1 and 30 in B2. In A2, where D grants a credit for both the PE and L tax, the taxpayer burden is 30, but D is granting an overall credit of 50 on 30 of D tax. On the other hand, in B1, where D grants a credit only for the PE tax, there is a D tax of 20, but a taxpayer burden of 50.

payments for such a service constituted royalties within article 12 of the Brazil–France Income Tax Treaty (1972)[6] or business profits within article 7 of the tax treaty. Despite the previous and subsequent positions of Brazilian tax authorities that payments for services not involving the transfer of technology should nevertheless be subject to withholding taxes based on domestic law concepts of "other income" and "royalties" not incorporated in the treaty, the Brazilian tax authorities determined that withholding taxes were not due on the payments because article 7 (Business profits) was the controlling provision.[7] The decision was one of the first in Brazil to recognize that a withholding tax is not due on payments made to a foreign company that does not have a PE in Brazil, arising from the provision of technical services that are not included in the concept of know-how under a treaty provision.

As a follow-up to the panel's discussion of the Brazilian tax authorities' ruling involving Renault, the panel explored certain national responses, in the form of treaty provisions, to character conflicts. The panel discussed how some tax treaties avoid double taxation by explicitly providing that payments for technical services are treated as royalties,[8] while other tax treaties authorize the assessment of a withholding tax on technical services, as long as the residence state allows a tax credit.[9]

Following its discussion of the technical services versus business profits conflict, the panel discussed the potential for another treaty-driven conflict, i.e. whether to characterize a payment as a dividend, business profits or interest. The result in Example 12 depends on the relevant domestic law and tax treaty, both of which may lead to double taxation.

Example 12: Character of income-business profits and/or dividends versus interest

Facts: Partnership P is established in state P. Partner A and Partner B are residents of State R. Partner A transfers money to Partnership P in an action characterized by R as a loan and by P as a contribution. Does article 7 (Business profits) or article 11 (Interest) apply to the return on the investment by Partner A? Does article 3(2) require that the return be characterized as an equity return?

5.4. Entity classification

Inconsistent entity classification can prevent double tax relief. The panel began this portion of the discussion by noting two general conflicts, i.e. that: (1) companies or partnerships may be transparent in one country and opaque in another; and (2) group status in one country may not be recognized in another country.

The panel then discussed examples of entity classification conflicts, highlighting that if the source state classifies an entity as transparent and imposes a tax on its nonresident owner or member, a residence state classifying the same entity as opaque may: (1) deny the foreign tax credit, as the owner or member did not derive the income "subject to tax"; or (2) defer the foreign tax credit until the income is later distributed to the member or owner. The panel also discussed an example in which the source state classifies an entity located in a third (usually, non-treaty) country as opaque and the residence state classifies the same entity as transparent. The panel discussed how, contrary to Commentaries on the OECD Model (2010)[10] that the source state should accord treaty relief on the basis of the residence state's treatment of the entity and its owners or members in such a situation, certain source states nevertheless deny treaty relief.

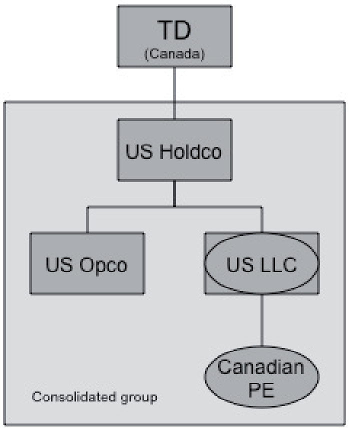
The panel next discussed countries' responses to cases of entity classification leading to double taxation, highlighting that certain countries have: (1) increasingly allowed flexible treatment of hybrid entities so that a foreign tax credit is granted; and (2) increasingly adopted treaty provisions to look through entities disregarded by the residence state.[11]

The panel concluded its discussion of entity classification conflicts with two more real world examples, one of which, depicted in Example 13, is an illustration of the recent Canadian case involving *TD Securities* (2010).[12] In this example, depicted below, US limited liability company (LLC) was disregarded for US tax purposes and is treated as a corporation for Canadian tax purposes. The Canadian PE remittances were subject to a 25% Canadian branch tax, but that tax was reduced to 5% under the Canada–

6. *Convention Between the Federal Republic of Brazil and the Republic of France for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* [unofficial translation] (10 May 1972), Treaties IBFD.
7. BR: Brazil Federal Revenue Office, Supervisory Office of the 9th Tax Region, Taxation Division, Decision No. 9E97F007.
8. For instance, *Convention Between the Government of the Hungarian People's Republic and the Government of the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* (20 June 1986), Treaties IBFD; *Convention Between the Government of the Kingdom of Norway and the Government of the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes On Income And Capital* (21 Aug. 1980), Treaties IBFD; *Convention Between the Portuguese Republic and the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes On Income* (16 May 2000), Treaties IBFD; and *Convention Between the Spanish State and the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* [unofficial translation] (14 Nov. 1974), Treaties IBFD.
9. For instance, *Convention Between the Argentine Republic and the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* [unofficial translation] (17 May 1980), Treaties IBFD and *Convention Between the Kingdom of Belgium and the Federal Republic of Brazil for the Avoidance of Double Taxation and the Settlement of Certain Other Questions with respect to Taxes On Income* [unofficial translation] (23 June 1972) (as amended through 2002), Treaties IBFD.
10. *OECD Model Tax Convention on Income and on Capital: Commentaries* (22 July 2010), Models IBFD.
11. For instance, *Convention Between Japan and Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* (31 Jan. 2008), Treaties IBFD and *Convention Between Australia and New Zealand for the Avoidance of Double Taxation with respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion* (26 June 2009), Treaties IBFD, and numerous tax treaties entered into by the United States.
12. CA: TC, 8 Apr. 2010, *TD Securities (USA) LLC v. Her Majesty the Queen*, 2008-2314(IT)G, Tax Treaty Case Law IBFD.

United States Income and Capital Tax Treaty (1980).[13] At issue was whether or not US LLC was "liable to tax" and thereby qualified as a resident under the tax treaty.[14] If not, the Canadian PE remittances were subject to the full 25% Canadian branch tax.

Example 13: Entity classification



6. Practical Implications and Conclusions

6.1. Introductory remarks

The panel began the final portion of its presentation by discussing possible policy recommendations (*see* section 6.2.). The panel then concluded the presentation by testing its three hypotheses by way of audience feedback (*see* section 6.3.).

13. *Convention Between Canada and the United States of America with respect to Taxes on Income and on Capital* (26 Sept. 1980) (as amended through 2007), Treaties IBFD [hereinafter: *Can.–U.S. Income and Capital Tax Treaty*].
14. The Canada Revenue Agency answered in the negative, on the basis that the fiscally transparent US LLC was not a resident entitled to treaty benefits, as the entity itself was not liable to tax, while the Tax Court of Canada answered affirmatively in *TD Securities* (2010), finding that US LLC was liable to tax and, therefore, a resident under the *Can.–U.S. Income and Capital Tax Treaty*, as US LLC members were taxed on the income in the United States. Effective 15 December 2008, the issue is addressed by art. IV of the *Can.–U.S. Income and Capital Tax Treaty*.

6.2. Basic policy recommendations

The panellists discussed a number of possible policy recommendations. First, with regard to tax treaties alone, the panel offered the following six possible recommendations: (1) follow the tax treaty, i.e. the taxing authorities must respect the principle of *pacta sunt servanda*; (2) provide treaty relief for the double taxation of dividends; (3) expand Mutual Agreement Procedure (MAP) arbitration; (4) permit the application of MAP to PEs; (5) either have a broader inclusion of provisions in respect of fiscally transparent entities or include a treaty clause to resolve discrepancies, such as follow a residence definition; and (6) allow a tax credit for the payee even in situations where the payor is liable, for example, with regard to dividend distribution tax.

Second, the panel provided the following four possible recommendations with regard to credit countries: (1) consider moving to an exemption system; (2) adopt the source states' treatment of the source of income, the character of income and the identity of the taxpayer; (3) extend the foreign tax credit carry forward period; and (4) accept that: (i) income may originate in more than one country; (ii) all taxes, at least income taxes, are eligible for a tax credit; and (iii) all taxes, at least income taxes, are eligible to be reduced by foreign tax credits.

Finally, the panel discussed the recommendation that states generally might reconsider the inability to deduct foreign losses.

6.3. Testing the hypotheses

The panel concluded by again presenting its hypotheses to the audience to ascertain the relative level of audience agreement. The three hypotheses tested were that: (1) despite conventional wisdom, exemption systems are no better than credit systems at eliminating double taxation; (2) relatively simple practical recommendations could, if implemented, effectively address deficiencies in current rules for eliminating double taxation of business income; and (3) in light of taxpayer calls for less inter-governmental coordination, national governments already do enough to eliminate double taxation. In a rare display of relative unanimity in the tax area, the audience resoundingly rejected all of the hypotheses.

