PARLIAMENTARY ASSEMBLY OF THE BLACK SEA ECONOMIC COOPERATION

PABSEC

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REPORT

LEGAL FRAMEWORK FOR THE AVOIDANCE OF DOUBLE TAXATION

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I. INTRODUCTION

1. The PABSEC Standing Committee at its eleventh meeting in Bucharest on 23 June 1998, decided upon the proposal of the seven national delegations (Albania, Armenia, Bulgaria, Georgia, Romania, Russian Federation and Ukraine) to place on the Agenda of the following meeting of the Committee the issue on Legal Framework for the Avoidance of the Double Taxation.

2. The present Report aims to identify particular problems encountered in regard to double taxation in the BSEC Participating States and to illuminate the importance of bilateral inter-governmental agreements providing for the avoidance of double taxation on international income, such as business profits, dividends, and interests, removing the "tax barrier" to international trade and investment.

3. Among the National Delegations only Armenia, Georgia, Greece and Romania forwarded their contributions for the Report and Recommendation. At the same time, the Azerbaijani delegation presented information at the Committee Meeting in Athens. The BSEC Permanent International Secretariat provided materials on the Meeting of the Working Group on Avoidance of Double Taxation held in Chisinau on 8-9 February 1995. In addition the PABSEC International Secretariat obtained information from various Internet sources to complement the Report.

II. BACKGROUND

4. Tax issues and especially the problem of double taxation becomes more important in view of the globalisation of the world economy and is even more significant in the Black Sea region with its varying levels of economic development of the BSEC member countries. The growing economic integration process within the framework of the Black Sea Economic Cooperation paved the way towards involvement of business communities, workers and private individuals in cross-border activities resulting in the situation when income which arises in one country and is received by a resident of another may therefore be taxed in both countries. Many persons are being subject to taxation on the same income, profits and gains and, on the other hand, many countries charge tax on incomes arising within the country wherever the recipient resides and also tax their residents on income arising abroad. This results legal uncertainty and makes it difficult for taxpayers to determine and evaluate the tax consequences of investing, doing business or working outside their country of residence.

5. Within this situation when in most of the countries there is a danger that the income or returns are taxed twice, both where the money is gained or invested and by businessmen or investors in their own countries, the cross-border business activities and investment are seriously impeded. Complexity of having to deal with various tax jurisdictions and the risk of double taxation is a disincentive for corporate and individual taxpayers to take advantage of the freedoms to engage in activities or to invest outside their country of residence. To this end by providing clear basic rules for taxing income and capital, as well as crystallising the legal

position regarding the tax treatment, business and investment activities in the Black Sea region is to be encouraged.

6. When dealing with the issue of double taxation, it is important to know the tax system of the countries where the cross-border trade or business activities are taking place. The general overview of the tax legislation regulating taxation in cross-border trade world-wide roughly differentiates two principles - taxation in a country where the person is resident and in a country where the income is obtained. The issue is much more complicated within the BSEC countries where there are incompatibilities between tax systems, lack of exchange of information and lack of bilateral double taxation treaties.

III. NATIONAL TAXATION REGIMES IN THE BSEC COUNTRIES

7. Tax systems in general are one of the most dynamically changed branches in the legislative systems of any country. Due to the fact that taxes have substantial role in formation of a state budget it is extremely important that rational tax policies are applied so that budget supplementing goes in harmony with promotion of proper climate for business and investment. It is even more important for the countries in transition who by means of high tax collection try to reduce budget deficit.

8. A brief overview of the tax systems show that there are differences in tax policies and taxation regimes in the BSEC Participating States.

   – *Albania* - Albania is in the process of developing a new legal framework reflecting Albania's programme to integrate the domestic economy in the international one. The new legal framework have the objective of reforming the old system in every sphere in which Albania maintained complex set of standards used to apply in Albania only into a completely new system adapted to the international standards.

   – *Armenia* - *The new Law on Taxes* was adopted on 12 May 1997 establishing six different types of taxes: profit or corporate tax, income tax, value-added tax, excise tax, property tax and land tax. *The Law on Profit Tax* was adopted on 30 September 1997 by which corporate tax is levied on the profits of legal persons, resident or non-resident operating in Armenia, including foreign legal entities. The law provides detailed definition for items and transactions to be considered income or expense. The Law encourages large foreign investment. *The Law on Income Tax* was adopted on 27 December 1997 and applies to individuals with permanent residence in Armenia or with business interests centred in Armenia and those without permanent residence who earn income in Armenia. Income of foreign citizens which are not residents of Armenia not involved in entrepreneurial activities in Armenia is to be taxed at the source of income. *The Law on Value Added Tax* was adopted on 14 May 1997 implying taxation on the supply of goods, labour, and other services by legal persons and individual entrepreneurs. *The Law on Excise Tax* was adopted on 30 May 1997 and is assessed on the production or importation of specified products and is payable on the proceeds of sale of products manufactured in Armenia and on the declared value of products imported to Armenia. *The Law on Property Tax*

was adopted on 27 December 1997 and *the Law on Land Tax* was adopted on 27 April 1997.

– *Azerbaijan* - In the Republic of Azerbaijan there are following taxes: profit tax, income tax, property tax, land tax, value-added tax, excise tax, tax on trade (natural resources), tax to the highway fund, etc. *The Law on Taxes on Profit of Enterprises and Establishments" entered into force on 1 January 1997* determines the following profit taxes of 32%; on profit from retail trade, catering and public service - 3%; on profit from dividends and interests - 15%; on profit from freight - 6%; on profit from author's rights and licences, as well as from rent and other sources of profit within the territory of the Republic of Azerbaijan not connected to the activities conducted in Azerbaijan through the permanent establishments - 20%. The *Individual Income tax* in Azerbaijan is collected from the resident and non-resident natural persons, having or not having permanent residence in Azerbaijan. The permanent residents of Azerbaijan are considered individuals who lives in the Republic of Azerbaijan not less than 183 days in a calendar year. According to the Law the individual income taxes in Azerbaijan is calculated from total income for a calendar year, monthly income or income from the work fulfilled by civil contracts. The individual income taxes in Azerbaijan are collected according to the progressive scheme between 12-40%. *The tax on property* is collected from both legal entities and individuals. The property tax is calculated from the total price of object except the wear out expenses. For the individuals the property tax is calculated from the prise of a building, as well as the air and water transport. *Tax on trade* are collected from the individuals or legal entities exploring the natural resources and is calculated from the wholesale prise of the resource. The taxation legislation envisages *avoidance of double taxation* both for individuals and legal entities and is done according to the method - taxes on the amount of profit of enterprises or individual income received abroad and paid under the laws of foreign countries is taken into account when determining the taxes in the Republic of Azerbaijan. At the same time the tax amount cannot exceed the tax amount in the Republic of Azerbaijan.

– *Georgia* - Georgian and foreign enterprises are payers of *tax on profit*. It is determined as a difference between gross income (resident's gross income consists of incomes obtained by him in and out of Georgia. Non-resident's gross income consists of incomes obtained from the sources existing in Georgia. Gross income includes all incomes obtained from economic activities) of tax payer and the sums deducted according to *the Tax Code*. A foreign enterprise conducting its activities in Georgia through a permanent establishment, is a tax payer according to the gross incomes obtained from the sources existing in Georgia connected with the permanent establishment; these incomes are reduced with the sums deducted according to *the Tax Code*. Enterprise's taxable profit is taxed at 20%. Profit of seafaring (ship owner) companies established by non-residents is exempt from profit tax, if these companies do not conduct entrepreneurial activities on the territory of Georgia and ships (ship) of which navigate under Georgian flag. The gross income of a foreign enterprise, which is not connected with the permanent establishment, is taxable according to the source of issuance determined by *the Tax Code*

without deduction, if a source of income is in Georgia. In this case the rate of taxes is different according to the activity and is 4% and 10%. *Taxing of Dividends at the Source of Payment* - Dividends paid by a Georgian enterprise are taxable at the source of payment at 10% rate. Dividends obtained by a natural entity which was taxed at the source of payment, are not subject to further taxation. If a Georgian enterprise received dividends early taxed at the source of payment in Georgia, then while calculating the tax on profit of this enterprise, the income received from dividends is deducted from gross income. *Taxing of Interests at the Source of Payment* - interests paid by a resident's or non-resident's permanent establishment or on their behalf are taxable at the rate of 10% of the sum to be paid at the source of payment, if the source of income is in Georgia. The interest paid on the credit (loan) for resident banks are not taxable at the source of payment. The interest obtained by a natural entity which were taxed at the source of payment, are not subject to further taxation. If profit of a resident legal entity is subject to taxation and if he/she has received earlier taxed interests at the source of payment, while calculating the tax on profit of this entity, the income received by the interests is excluded from gross income. *Income Tax* - Resident and non-resident natural entities are payers of income taxes (profit received from selling of material assets by a natural entity is exempt from income tax excluding profit received from selling of the assets used for entrepreneurial activities). The tax rate fluctuates between 12% and 20% and is to be paid according to the volume of income.

- *Moldova - The Law on Foundation of the Fiscal System* is the basis for most taxes and provides that all taxpayers are treated the same type of property or form in which they conduct their business. *Corporate tax* is imposed on the profits of all non-agricultural enterprises as legal persons (agricultural enterprises pay *land tax*). A unified tax rate of 32% is applied. Enterprises as legal entities are also subject to an annual company tax of 0,1%. For trading companies a reduced rate of 0,06% applies. *Value-added tax* rate is 20% and a range of products and services exempt from VAT are listed in Article 5 of the *Law on Value-Added Tax*. In trade with CIS countries the principle of country of origin is applied. i.e. exports are subject to Moldovan VAT while no VAT is imposed on Imports from the CIS states. In trade of all other countries the principle of country of destination is applied, i.e. Moldovan VAT is imposed on imports at the border. All individuals who receive income in Moldova are subject to *personal income tax*. No distinction is made between the local and foreign citizens. Personal income is taxable from 180 Lei and taxes rates are from 10% to 50%. These rates apply to all kinds of personal income whether from employment, other economic activities or dividends.
- *Romania* - Romania has at present 59 conventions enforced for the avoidance of double taxation. The negotiations of such conventions are carried on at a time of change of Romanian fiscal legislation, aimed at adapting its provisions to the demands of the market economy and its harmonisation with the EU legislation. The provisions of the Convention on the avoidance of double taxation are prevalent over the provisions of the Romanian legislation on the taxation of incomes derived from Romania by non-resident legal and physical entities in Romania. This is the reason why, generally, taxation quotations

lower than those of the local legislation are negotiated in the fiscal agreements, in order to encourage the flow of capital, labour force and advanced technology. The adopted fiscal solutions vary from one country to another, according to the each country's own legislation provisions and the objectives set for the economic and scientific cooperation, namely a construction site, a development, assembling or installation project, or pertaining supervision activities become a permanent activity and are subject to taxation for the profit achieved, provided its time of activity is no less than 6 to 24 months. In the meantime, the supply of services, including consulting services by an enterprise using its own employees or other persons the respective enterprise has employed for the said purpose becomes a permanent activity provided its time of activity is no less than 6 to 12 months. All income obtained as dividends, interest and dues is provided for as subject to taxation also in the country they are paid from, at the origin, namely, quotations varying from 5 to 15% applied to the gross amount of such income. For all interest derived from a loan granted and guaranteed, either direct or indirectly, by the Government of a contracting state, by its political subdivisions, local authorities, its administrative-territorial units, by the national or central banks of the contracting states, a tax exemption was generally provided for. Profits obtained by transportation enterprises from operating ships or air-crafts in the international traffic are subject to taxation only in the state of the transportation enterprise's actual headquarters or residence. The Conventions on the Avoidance of the Double Taxation also settle the issue of taxation of incomes achieved as salaries derived by a Contracting State's resident from any activity carried on independently as a doctor, a lawyer, an engineer, a dentist and an accountant on the territory of another Contracting State, of those achieved as scholarships granted to students who are residents of a Contracting State and who are currently studying on the territory of the other Contracting State, as well as certain exemptions granted to them provided they are carrying on a remunerated activity in the country they are studying in, of the incomes obtained by teachers and researchers residents of a Contracting State for their activity in the other Contracting State, of the incomes from artistic or sports activities, as well as the way of taxation of the capital and of the earnings derived from the use thereof.

– *Russia - t*he taxation system of the Russian Federation (taxes, duties, levies, and other payments) is governed by legislative acts, primarily the *Law of the Russian Federation No 2118-1 of 27 December 1991 on the Principles of the Taxation System of the Russian Federation*. In the Russian Federation there are the following kinds of taxes: federal taxes, regional taxes and local taxes. Federal taxes are collected over the entire territory of Russia. *Individual Income tax* is regulated by the *Law on Income Tax of Natural Persons* adopted on 7 December 1991. Income tax is collected from the resident and non-resident natural persons. Individual incomes of the Russian federation residents received outside Russia are subject to taxation. Amount of individual income taxes paid by the Russian Federation residents under the laws of foreign countries is taken into account if an individual provides a receipt certified by appropriate tax authorities of a respective foreign country. Pursuant to the *Decree of the President of the Russian Federation No 1004* of *25 May*

1994 on Some Issues of the Taxation Policy draft laws have been submitted to the State Duma to improve the taxation system. Under these draft laws tax benefits enjoyed by small enterprises, which are exempted from the profits tax for the first two years of their operations, will also be granted to enterprises with foreign investments engaged in production activity.

IV. LEGAL FRAMEWORK FOR THE AVOIDANCE OF DOUBLE TAXATION

9. The brief overview of national taxation regimes in the BSEC countries constitutes certain differences in tax laws, non-compliance of applied practices, putting taxpayers in more burdensome condition and implies that domestic policies towards taxation and potential risk of multiple taxation seriously distorts, hampers and even precludes expansion of business and investments in the region.

10. Transparency and harmonisation of tax systems, as well as their adequacy to international standards are among the measures that may contribute to encourage and increase business activities in the BSEC region, which is one of the main goals of the process of the Black Sea Economic Cooperation.

11. One of the essential component of tax legislature avoiding the double taxation is intergovernmental bilateral agreements or conventions regulating the issues of taxation.

Bilateral Agreements

12. Most bilateral intergovernmental tax agreements broadly follow principles and provisions of the OECD Model Treaties providing for relief from double taxation by means of setting on a uniform basis the most common problems which arise in the field of multiple taxation, generally defined as imposition of comparable taxes in two or more states on the same taxpayer in respect of the same income for identical periods.

13. The following is the list of the bilateral Conventions/Agreements on avoidance of double taxation on income and capital between the BSEC Participating States as communicated by the national delegations:

Armenia and Bulgaria	(in force since 1.12.1995)
Armenia and Ukraine	(in force since 25.11.1996)
Armenia and Romania	(in force since 25.08.1997)
Armenia and Russia	(in force since 17.03.1998)
Azerbaijan and Turkey	
Azerbaijan and Russia	
Azerbaijan and Ukraine	
Georgia and Azerbaijan	(in force since 11.11.1997)
Georgia and Romania	(in force since 12.06.1998)
Georgia and Ukraine	(in force since 15.10.1997)
Greece and Romania	(in force since 1.01.1996)

Greece and Bulgaria	(ratified by Greece but not ratified by Bulgaria)
Greece and Albania	(under the process of ratification)
Romania and Albania	(in force since 20.10.1995)
Romania and Bulgaria	(in force since 12.09.1995)
Romania and Turkey	(in force since 15.09.1988)

The agreement between Georgia and Armenia is signed and after intrastate procedures are finished will come into effect.

Treaties between the countries below are still under negotiations:

Greece and Armenia
Greece and Georgia
Greece and Moldova
Greece and Russia
Greece and Ukraine

14. Double taxation treaties contain detailed provisions designed to eliminate or relieve double taxation in respect of income of different types. The aim is either to tax income in one country only or, if both countries tax the income, to ensure that the aggregate amount of tax imposed by the two countries together should not exceed the amount of tax payable in the country with the higher charge to tax. Under double taxation agreements, business profits are taxed only in the country in which the enterprise is situated. Where the enterprise carries on business through a permanent establishment situated in the other contracting country, tax is levied in the other country on so much of the profits as is attributable to or derived by the permanent establishment in the country where the permanent establishment is situated. And finally, under most double taxation agreements, profits from shipping and air transport operations in international traffic are taxed only in the country where the management and control of the enterprise is exercised.

V. ROLE OF INTERNATIONAL ORGANISATIONS AND MULTILATERAL INSTRUMENTS

15. *Organisation of the Black Sea Economic Cooperation (BSEC) - The meeting of the BSEC ad hoc Working Group of Experts on the Avoidance of Double Taxation* was held in Chisinau, 8-9 February 1995. The meeting discussed negative effects of double taxation on economic activity mainly in industrial sector and the importance of stable tax legislation for decisions taken on investments. The experts recommended the participating states to increase their efforts in modifying their domestic legislation in order to avoid double taxation. Referring to the matter that not all the participating states have concluded bilateral agreements on the avoidance of double taxation, enforcing this process and which will encourage economic activities in the region. At the same time while the bilateral approach will continue to play a major role in the future, the consideration of possibility of multilateral framework of the BSEC is pertinent in light of the development of the Black Sea Economic Cooperation.

16. *Organisation for Economic Cooperation and Development (OECD)* - the international organisation which deals with global international trade problems and observes international taxation matters with special focus on double taxation

issues. It has elaborated *Model Double Taxation Convention on Income and Capital* (1992) which serves as a basis for almost all the bilateral treaties and conventions explaining all the components of the agreements including general definitions, income from properties, business profits, shipping and transport, associated enterprises, dividends, interest, royalties, capital gains, independent and dependent personal services, persons and annuities, elimination of double taxation, non-discrimination, mutual agreement procedures, exchange of information, entry into force, termination, etc. At the same time, as a solution, the Convention provides for both the credit method and the exemption method. In the course of bilateral negotiations, the contracting states may opt for either of the two methods. The Convention is widely used in double taxation treaty negotiations.

17. *Council of Europe* - together with the Organisation for Economic Cooperation and Development Council of Europe has elaborated and signed multilateral *Convention on Mutual Administrative Assistance in Tax Matters* entered into force on 1 April 1995. This treaty allows the Parties - the member States of the Council of Europe and the member countries of OECD, to develop, on common foundations and respecting the basic rights of taxpayers, extensive administrative cooperation covering all compulsory taxes, with the exception of customs duty. The types of assistance are varied, covering the exchange of information between Parties, simultaneous tax examinations and participation in tax examinations carried out in other countries, the recovery of taxes due in other Parties and notification of documents issued in other Parties. Moreover, any State wishing to accede to the Convention may tailor the extend of its obligations, by virtue of a detailed system of reservations expressly provided for in the text; it may restrict its participation to certain types of mutual assistance or to assistance in connection with certain taxes. This enhanced mutual assistance is intended to help combat tax evasion, and is accompanied by safeguards to protect tax-payers, whether individual or corporate, and national economies. Thus a Party may refuse to supply information when this would mean divulging trade, industrial or professional secrets, or to provide assistance in connection with a tax which it regards as incompatible with the generally accepted principles of taxation. Moreover, application of the Convention may not restrict the rights and guarantees accorded to individuals by the law of the assisting state. There are strict rules covering the secrecy of information obtained in application of the text. (*It is noteworthy to say that none of the BSEC member countries who are at the same time the members of the Council of Europe or the OECD have signed this Convention).*

18. *The United Nations - The UN Model Double Taxation Convention between Developed and Developing Countries* (1979) and the *Manual for the Negotiations of Bilateral Tax Treaties between Developed and Developing Countries*. The Convention contains articles and provisions different from the OECD Model Convention regarding problems and conditions of developing countries.

VI. CONCLUSIONS

19. The desirability of promoting greater inflows of foreign investment in the Black Sea countries, as well as promotion of activities of business communities and

private sector for consolidation of the Black Sea Economic Cooperation process under conditions that are politically acceptable as well as economically and socially beneficial has been adequately emphasised in the BSEC documents at different levels.[1]

20. The Parliamentary Assembly of the Black Sea Economic Cooperation in its Declaration on the Fifth Anniversary stressed "its full support to the actions undertaken by the BSEC in order to forge closer economic cooperation in the area" by participating "in major multilateral projects such as the harmonisation of legislation of the Member Countries by putting into practice laws and regulations in the fields of foreign trade regimes, banking and finance, investment protection ..... to expand multilateral economic cooperation and gradually establish the BSEC Free Trade Area .... duly observing the obligations vis-à-vis the European Union, World Trade Organisation and other international instruments.

21. The prevention or elimination of double taxation through bilateral double taxation agreements is a significant component for the expansion of free flow of foreign private capital and investment which plays an important complementary role in the economic development process in the region.

22. Bearing in mind the imperatives of the BSEC Summit Declarations to facilitate economic growth, and to further promote process of business and investment, the deep necessity for urgency to conclude (if not yet done so) bilateral double taxation agreements between the BSEC member countries gets priority.

23. Along with the bilateral agreements on the double taxation multilateral mechanism may be considered. This recommendation was initialled by the BSEC WG in 1995 and now is repeated by the national delegation of Romania in their contribution to this Report proposing that it would be necessary to conclude a convention on mutual assistance on taxation and the exchange of information, as well as on the assistance in recovering the sums due to the public budget. It could be presumed that bilateral measures could become no longer sufficient as the Black Sea Cooperation develops in order to meet the needs of the 21st century and to protect taxpayers effectively removing tax barriers which in many ways may prevent development of business and investment in the BSEC countries.

24. The idea to create a multilateral tax treaty is not new in international practice. In some regions, a multilateral tax treaty has acquired significance, for instance in the Nordic region, in the former COMECON region in Eastern Europe and among Caribbean states. Drafts for a multilateral tax treaty were prepared in the past by the League of Nations, EFTA and in 1968 also by the EEC.

25. It appears that certain tax barriers should be addressed not by bilateral but by multilateral agreements. For example, bilateral treaties do not cover triangular

[1] The Istanbul Declaration of 25 June 1992; Statement of the Bucharest High Level Meeting of 30 June 1995; Moscow Declaration of the Heads of state or Government of 25 October 1996; Yalta Summit Declaration of 5 June 1998; Decisions and Resolutions of the BSEC Meetings of the Ministers of Foreign Affairs.

situations, i.e. when a taxpayer becomes potentially subject to tax in more than two countries. For example, there is a risk of double or even triple taxation where a taxpayer resident in one country participates in a partnership in a second country, and this partnership receives dividends or interest from the third country. This situation shall be inevitable as a BSEC process develops and the BSEC Free Trade Area gradually establishes.

26. A multilateral treaty could be an effective step to further the harmonisation of international taxation within the BSEC region as a long-term objective on the long way to the integration of the BSEC region into the European and the world economy.