

EXPLANATORY MEMORANDUM

Title of instrument

The Double Taxation Relief (Taxes on Income) (Taiwan) Order 2002

Legislative Powers

This Order is made under section 788 Income and Corporation Taxes Act 1988 and section 277 Taxation of Chargeable Gains Act 1992.

Affirmative Resolution

This draft Order is subject to affirmative resolution. Further details of the double taxation agreement scheduled to the draft Order are annexed to this memorandum.

European Convention on Human Rights

The Paymaster General (Dawn Primarolo) has confirmed that, advice provided to her confirms that, the provisions of this draft Order are compatible with the European Convention on Human Rights.

Policy Background to the instrument

Double taxation agreements aim to eliminate the double taxation of income or gains arising in one territory and paid to residents of another territory. They do this by dividing the taxing rights that each treaty partner has under its domestic law over the same income and gains. They provide additional protection for taxpayers by specific measures combating discrimination in tax treatment. More generally, agreements benefit the taxpayer by ensuring certainty of treatment and, as far as possible, by reducing compliance burdens. Double taxation agreements also serve an Exchequer protection role by including provisions to combat avoidance and evasion - not least by measures providing for the exchange of information between Revenue authorities. They also encourage and maintain an international consensus on the appropriate tax treatment of cross border economic activity and thus promote international trade and investment.

Regulatory Impacts

There are no significant regulatory impacts but taxpayers may in some cases have to make a claim to the Inland Revenue or the other territory's fiscal authority in order to benefit from the agreement. However, taxpayers will benefit from reduced compliance burdens and, in many cases, from having to deal with just one fiscal authority.

Financial Effects

The nature of a double tax agreement is that one or both of the territories gives up all or part of their taxing rights so that a given source of income is taxed only once. Measured against a baseline of single taxation only, agreements do not therefore generally have an exchequer cost; rather, by encouraging cross border economic activity, they can lead to an increase in tax revenue. But where double taxation is unrelieved, the economic activity in question, and hence the higher tax revenue attributable to it, will often be only temporary.

Extent

The draft Order applies to the whole of the United Kingdom of Great Britain and Northern Ireland.

STATUS OF THE AGREEMENT

The Double Taxation Agreement (DTA) was signed by the heads of the British Trade and Cultural Office in Taipei and the Taipei Representative Office in the United Kingdom. The DTA is the first agreement to be signed by the heads of unofficial representative offices. It was not possible for it to be signed by a Minister on behalf of the Government, because the Taiwanese government is not one that is recognised by Her Majesty's Government. And because it was not made with a government, it was necessary to amend Section 788 of the Income and Corporation Taxes Act 1988, to enable effect to be given to the DTA. The necessary amendments were made by Section 88 of the Finance Act 2002.

GENERAL

All the United Kingdom's recent Double Taxation Agreements largely follow the approach adopted in the OECD's *Model Tax Convention on Income and on Capital*. This Agreement continues that approach.

NOTES ON DETAILS

ARTICLE 1 – PERSONS COVERED

The Agreement is to apply to persons who are residents of one or both of the territories (the United Kingdom and Taiwan).

ARTICLE 2 – TAXES COVERED

This Article gives a definition of the taxes to which the Agreement is to apply.

The existing Taiwanese taxes to which the Agreement applies are the profit seeking enterprise income tax and the individual consolidated income tax.

The existing United Kingdom taxes to which the Agreement applies are the income tax, the corporation tax and the capital gains tax.

The Agreement is to apply also to any identical or substantially similar taxes subsequently imposed by either territory in addition to or in place of the taxes mentioned above. A provision on these lines is usually included in Double Taxation Agreements.

ARTICLE 3 – GENERAL DEFINITIONS

This Article defines a number of terms used in the Agreement and provides a rule for determining the meaning of terms not defined in the Agreement. Definitions are provided for the two territories.

ARTICLE 4 – RESIDENCE

Paragraph (1) of this Article establishes the meaning of “resident of” a territory.

Paragraph (2) provides that a person is not a resident of a territory for the purposes of the Agreement if that person is liable to tax there only in respect of income or capital gains from sources in that territory. The purpose of this provision is to prevent individuals who enjoy diplomatic or consular exemptions from tax qualifying for additional relief under the Agreement. A foreign diplomat sent to represent his country in the UK is exempt from tax in the UK on income arising outside the UK in accordance with the Vienna Convention on Diplomatic Relations. If he could also claim the benefits of the Double Taxation Agreement as a resident of the UK he might therefore arrange to be exempted from tax (or substantially so) in both territories in respect of income arising in Taiwan. It is not one of the purposes of the Agreement to provide double exemption, and Paragraph (2) is intended to prevent that in the case of a foreign diplomat based in the UK who is in receipt of income from Taiwan. Paragraph (2) does not apply to the staff members of the BTCO and the TRO, because they are not entitled to diplomatic privilege, since the United Kingdom does not recognise the government of Taiwan. Moreover, the final part of this paragraph clarifies that this exclusion does not apply to individuals who are residents of Taiwan, as long as Taiwan continues to tax individuals on a territorial basis. (At present, individuals resident in Taiwan are generally liable to tax only on income arising in Taiwan). If in the future Taiwan changes to a world-wide system of taxation for individuals, Paragraph (2) will however apply to foreign diplomats based in Taiwan in the same way as it applies to foreign diplomats in the United Kingdom. (Some other countries do recognise the government of Taiwan, and their representatives in Taiwan do enjoy diplomatic privileges there.)

Paragraphs (3) and (4) lay down detailed rules for dealing with situations where individuals or other persons may be considered residents of both territories for tax purposes under their respective law.

ARTICLE 5 – PERMANENT ESTABLISHMENT

The definition of a “permanent establishment” (PE) given in this Article departs from the OECD Model in certain areas. For example, it provides that a “building site or construction or installation project” only constitutes a PE if it exists for more than 6 months. It also provides that an enterprise is considered to have a PE if it carries on supervisory activities for more than six months in connection with a building site or construction or installation project;

or if it furnishes services, including consultancy services, through employees in the other territory, for more than six months in any twelve month period.

ARTICLE 6 – INCOME FROM IMMOVABLE PROPERTY

This Article allows the territory in which the property is situated to tax income from immovable property.

ARTICLE 7 – BUSINESS PROFITS

Unless an enterprise of one territory carries on business in the other through a permanent establishment situated there, its profits will be taxable only in its territory of residence.

Where the enterprise has a permanent establishment in the other territory, that territory will be entitled to tax profits attributable to the permanent establishment.

ARTICLE 8 – SHIPPING AND AIR TRANSPORT

This Article provides that profits of an enterprise from the operation of ships or aircraft in international traffic will be taxable only in the territory in which the enterprise is resident. It also provides that profits derived from participation in a pool, joint business or international operating agency and profits which are incidental to the operation of ships or aircraft in international traffic shall likewise be taxable only in the territory in which the operator is resident.

ARTICLE 9 – ASSOCIATED ENTERPRISES

This Article provides that appropriate adjustments may be made in determining the profits of an enterprise of one territory where conditions made or imposed between the enterprise and an associated enterprise of the other territory differ from those that would be made between independent enterprises.

Where such an adjustment is made to the profits of one enterprise by one territory, the other territory will make an appropriate adjustment to the amount of tax charged on those profits, in order to relieve the economic double taxation which might otherwise arise as a result of an adjustment by just one territory. The competent authorities of each territory may consult for this purpose.

ARTICLE 10 – DIVIDENDS

This Article contains the rules for the taxation of dividends paid by a company which is resident of one territory to a resident of the other.

Paragraphs (1) and (2) provide that dividends paid by a company resident in one territory to a resident of the other may be taxed in both territories. The

rate of tax imposed in the territory of source on dividends derived by a resident of the other territory who is the beneficial owner of those dividends is not to exceed 10 per cent. of the gross amount of the dividends.

Paragraph (3) defines the term “dividends”.

Paragraph (4) provides that where a resident of one territory receives dividends from the other territory and carries on business in that other territory through a permanent establishment or fixed base there, with which the holding from which the dividend arises is effectively connected, the provisions of paragraphs (1) and (2) shall not apply. The taxation of the dividends is then governed by Article 7 (Business Profits) or Article 14 (Independent Personal Services).

Paragraph (5) rules out the extra-territorial taxation by one territory of dividends paid by a company which is a resident of the other territory. The first territory will not tax the dividends unless they are connected with a permanent establishment or a fixed base there or are paid to a resident of that territory. There is a similar provision concerning undistributed profits.

Paragraph (6), an anti-abuse provision, ensures that the provisions of the Article will not apply if the shares or other rights in respect of which the dividend is paid were created or assigned mainly to take advantage of the Article.

ARTICLE 11 – INTEREST

This Article contains the rules for the taxation of interest paid by a resident of one territory to a resident of the other.

Paragraphs (1) and (2) provide that interest arising in one territory and paid to a resident of the other may be taxed in both territories. The rate of tax imposed in the territory of source on interest derived by a resident of the other territory who is the beneficial owner of that interest is not to exceed 10 per cent. of the gross amount of the interest.

Paragraph (3) defines the term “interest”.

Paragraph (4) provides that where a resident of one territory receives interest from the other territory and carries on business in that other territory through a permanent establishment or fixed base there, with which the debt claim in respect of which the interest is paid is effectively connected, the provisions of paragraphs (1), (2) and (8) shall not apply. The taxation of interest is then governed by Article 7 (Business Profits) or Article 14 (Independent Personal Services).

Paragraph (5) provides that where, because of a special relationship between the payer and the beneficial owner or between both of them and a third party,

the amount of interest paid is excessive, the relief under the Article will apply only to the interest that would be payable at “arm’s length”.

Paragraph (6) provides rules for determining which is the source territory of the interest for the purposes of applying the Agreement.

Paragraph (7), an anti-abuse provision, stipulates that the terms of this Article will not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the relevant debt claim to take advantage of the provisions of this Article by means of that creation or assignment.

Paragraph (8) provides a complete exemption from taxation in the source territory where the interest is paid to and beneficially owned by the other territory or a local authority thereof, or any agency or instrumentality of that other territory or local authority thereof. The exemption also applies where the interest is paid in respect of certain loans or debt-claims or credit made, guaranteed or insured by an approved agency or instrumentality of that other territory.

Paragraph (9) defines the term “approved agency or instrumentality” referred to in paragraph (8)(b). In the case of the United Kingdom, it means the Export Credits Guarantee Department and such other agencies and instrumentalities of that territory as may be agreed from time to time between the competent authorities. In the case of Taiwan, it means such agencies and instrumentalities of that territory as may be agreed from time to time between the competent authorities.

ARTICLE 12 – ROYALTIES

This Article contains the rules for the taxation of royalties arising in one territory and derived by a resident of the other.

Paragraphs (1) and (2) provide that royalties paid by a resident of one territory to a resident of the other may be taxed in both territories. The rate of tax imposed in the territory of source on royalties derived by a resident of the other territory who is the beneficial owner of those royalties is not to exceed 10 per cent. of the gross amount of the royalties.

Paragraph (3) defines the term “royalties”.

Paragraph (4) provides that where a resident of one territory receives royalties from the other territory and carries on business in that other territory through a permanent establishment or fixed base there, with which the right or property in respect of which the royalties are paid is effectively connected, the provisions of paragraph (1) and (2) shall not apply. The taxation of royalties is then governed by Article 7 (Business Profits) or Article 14 (Independent Personal Services).

Paragraph (5) provides rules for determining which is the source territory of the royalties for the purposes of applying the Agreement.

Paragraph (6) provides that where, because of a special relationship between the payer and the beneficial owner or between both of them and a third party, the amount of royalty paid is excessive the relief under the Article will apply only to the royalty that would be payable at “arm’s length”.

Paragraph (7), an anti-abuse provision, ensures that the terms of this Article will not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the rights in respect of which the royalties are paid to take advantage of the provisions of this Article by means of that creation or assignment.

ARTICLE 13 – CAPITAL GAINS

This Article contains the rules for the taxation of capital gains arising in one territory and paid to a resident of the other.

Paragraph (1) provides that gains derived from the alienation of immovable property in one territory by a resident of the other may be taxed in the territory where the property is situated.

Paragraph (2) provides that gains derived by a resident of a territory from the sale of certain shares (or rights deriving from a partnership or trust) whose value derives mainly from immovable property in the other territory, may be taxed in that other territory.

Paragraph (3) provides that gains arising from the alienation of movable property relating to a fixed base or permanent establishment maintained in the other territory may be taxed in that other territory.

Paragraph (4) provides that gains derived by a resident of a territory from the disposal of ships or aircraft operated in international traffic by an enterprise of that territory shall be taxable only in that territory.

Paragraph (5) provides that gains from the alienation of any other type of property will be taxable only in the alienator’s territory of residence.

Paragraph (6), an anti-abuse provision, ensures that an individual who emigrates may remain liable to capital gains tax in the territory in which he was formerly resident in respect of disposals of property made within six years of his departure.

ARTICLE 14 – INDEPENDENT PERSONAL SERVICES

Paragraph (1) provides that income derived by a resident of one territory in respect of professional services or other independent activities is only taxable in that territory unless he has a fixed base available to him in the other territory. In that case, the other territory may tax so much of the income as is attributable to the fixed base. For this purpose, an individual who is a resident of one territory and is present in the other territory for more than 183 days in the fiscal year concerned shall be deemed to have a fixed base available to him in that other territory for that fiscal year.

Paragraph (2) defines the term "professional services".

ARTICLE 15 – DEPENDENT PERSONAL SERVICES

Paragraph (1) provides that, in general, employment income of a resident of one territory can be taxed in the other territory if the employment is exercised there.

Paragraph (2) provides an exception to the general rule where an employee is present in the other territory for not more than 183 days in any twelve month period beginning or ending in the fiscal year concerned, the remuneration is paid by or on behalf of an employer who is not a resident of the other territory and the remuneration is not borne by a permanent establishment or fixed base which the employer has in the other territory. Where all these conditions are satisfied the remuneration will be taxable only in the employee's territory of residence.

Paragraph (3) provides that the remuneration of someone working on a ship or aircraft operated in international traffic can be taxed in the territory where the operator is resident.

ARTICLE 16 – DIRECTORS' FEES

The Article provides that directors' fees and other similar payments can be taxed in the territory of which the company paying them is a resident.

ARTICLE 17 – ARTISTES AND SPORTSMEN

Paragraphs (1) and (2) provide that income in respect of the personal activities of entertainers and sportsmen can be taxed in the territory in which those activities are exercised, whether it accrues to the entertainer or sportsman or to some other person (e.g. a company controlled by him).

Paragraph (3) provides an exception to these rules where the visit of entertainers or sportsmen is substantially supported by public funds of the other territory.

ARTICLE 18 – PENSIONS AND ANNUITIES

Paragraph (1) provides that an occupational pension (other than a pension in respect of public service) or an annuity will be taxable only in the territory where the pensioner is resident, provided it is subject to tax there.

Paragraph (2) defines the term “annuity”.

Paragraph (3) provides that a lump-sum payment beneficially owned by a resident of a territory from a pension scheme established in the other territory shall be taxable only in that other territory.

ARTICLE 19 – PUBLIC SERVICE

Paragraph (1) provides that in general, remuneration paid to an individual in respect of services rendered to an authority administering a territory or a sub-division thereof, or a local authority of that territory, will be taxable only in that territory. However, if the services are carried out in the other territory by one of that territory’s own nationals or citizens resident there or by a resident who, although not a national, did not become a resident solely to render the services, then that other territory will have the sole taxing right.

Paragraph (2) provides that a pension or annuity paid in respect of services rendered to a territory, or to a political sub-division or local authority of a territory, will generally be taxable only in that territory. But if the recipient is a resident and a citizen or a national of the other territory the pension will be taxable only in the other territory.

Paragraph (3) provides that these provisions do not apply in the case of remuneration or pensions arising in connection with a business.

ARTICLE 20 – STUDENTS

This Article provides that payments for the maintenance or education of visiting students will not be taxed in the territory visited, provided the payments are made from sources outside that territory.

ARTICLE 21 - OTHER INCOME

Paragraphs (1) and (2) provide that any item of income, wherever arising, not specifically covered elsewhere in the Agreement, will be taxed by the territory of which the beneficial owner is a resident, and may also be taxed in the other territory if it is derived from a source in that other territory.

Paragraph (3) provides that the provisions of Paragraph (1) will not apply, other than to income from immovable property, if the right or property in respect of which the income is paid is effectively connected with a permanent establishment or fixed base maintained in the territory of source. In that case, the provisions of Article 7 or Article 14 will apply.

Paragraph (4), an anti-abuse provision, provides that where the amount of a payment to which the Article might apply is excessive because of a special relationship between the payer and the recipient, or both of them and a third person, the terms of the Article will apply only to the income that would be payable at “arm’s length”.

ARTICLE 22 – ELIMINATION OF DOUBLE TAXATION

This Article sets out the methods by which double taxation is to be eliminated.

Paragraph (1) provides the details of how Taiwanese tax shall be allowed as a credit against United Kingdom tax.

Paragraph (2) provides the details of how United Kingdom tax shall be allowed as a credit against Taiwanese tax.

Paragraph (3) provides that profits, income and capital gains owned by a resident of a territory, which may be taxed in the other territory under the Agreement, will be deemed for the purposes of Paragraph (1) to arise from sources in the other territory.

ARTICLE 23 - LIMITATION OF RELIEF

Paragraph (1) provides that where any income or gains are relieved from tax in one territory and tax is determined in the other territory by reference only to the amount remitted to or received in that other territory, the relief allowed in the first mentioned territory will be restricted to the income or gains which is taxed in the other territory.

Paragraph (2), an anti-abuse provision, concerns a resident of a territory who benefits from a lower or zero rate of tax on income or gains under that territory’s incentive legislation. The paragraph provides that such a person shall not receive the benefits of the Agreement from the other territory if the main purpose or one of the main purposes of that resident (or those of a connected person) was to obtain the benefits of the Agreement.

Paragraph (3) ensures that the UK retains its right to tax UK resident members of a Taiwanese resident partnership on their share of partnership income or gains, where the Agreement provides that the partnership itself is entitled to exemption from tax in the United Kingdom on the income or gains.

ARTICLE 24 - NON-DISCRIMINATION

Subject to certain provisos and on lines recommended by OECD, this Article provides that neither territory shall impose discriminatory taxes (or requirements) on the citizens or nationals, on a legal person, partnership or association, permanent establishments and enterprises of the other.

ARTICLE 25 - MUTUAL AGREEMENT PROCEDURE

This Article permits a resident of one territory, who feels that the actions of one or both territories will result for him in taxation that is not in accordance with the terms of the Agreement, to present his case to the competent authority of the territory of which he is resident, or, if the case comes under Article 24, of the territory of which he is a citizen or national. The Article requires the competent authorities of the two territories to consult together to endeavour to resolve such cases, and difficulties in the application or interpretation of the Agreement.

ARTICLE 26 - EXCHANGE OF INFORMATION

This Article provides for the exchange of certain information between the competent authorities of the two territories. No information containing trade etc. secrets or information the disclosure of which would be contrary to public policy will be exchanged.

ARTICLE 27 – ENTRY INTO FORCE

This Article provides that the BTCO and TRO will notify the other of the completion of the procedures required by the laws of each territory to bring the Agreement into force. The Agreement will enter into force on the date of the later of these notifications. It will take effect in the United Kingdom for income tax and capital gains tax from 6th April and for corporation tax from 1st April in the calendar year next following that in which the Agreement enters into force. In Taiwan it will take effect from 1st January in the calendar year following that in which the Agreement enters into force.

ARTICLE 28 – TERMINATION

This Article provides that the Agreement may be terminated by either the BTCO or TRO giving at least six months' notice to the other, following a minimum life of five years.

ANNEX

The Annex in Part II of the Schedule clarifies certain aspects of the Agreement. In particular, it explains that nothing in the Agreement shall affect the imposition of Taiwan's 'Land Value Increment Tax'.

It also clarifies that the authorities referred to in Article 19 (Public Services) include the Taipei Representative Office in the United Kingdom and the British Trade and Cultural Office, Taipei.