EXPLANATORY MEMORANDUM TO THE DRAFT DOUBLE TAXATION RELIEF AND INTERNATIONAL TAX ENFORCEMENT (TAXES ON INCOME AND CAPITAL) (MOLDOVA) ORDER 2008

2008 No. [XXXX]

1. This explanatory memorandum has been prepared by HM Revenue & Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

The draft Order brings into effect those arrangements specified in the Double Taxation Convention set out in the Schedule to the draft Order.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 Type of resolution

The draft Order is subject to the affirmative resolution procedure.

3.2 Details of the Convention

Further details of the Convention scheduled to the draft Order are annexed to this memorandum.

4. Legislative Background

4.1 General

The Order is made under section 788(1) of the Income and Corporation Taxes Act 1988 (c. 1) and section 173(1) of the Finance Act 2006 (c. 25). Section 788 was amended by section 88(1) of the Finance Act 2002 and extended by section 277 of the Taxation of Chargeable Gains Act 1992 (c. 12).

Section 788 provides the mechanism by which arrangements made with overseas territories for the purpose of affording relief from double taxation in relation to income tax, corporation tax and capital gains tax and taxes of a similar character in the other territory are given effect in the United Kingdom.

Section 173 of FA 2006 provides the mechanism by which such arrangements may also include provisions about, among other things, the exchange of information foreseeably relevant to the administration, enforcement or recovery of any tax or duty.

The relevant Convention is scheduled to the Order. It is thus given domestic legislative effect.

In accordance with section 788(10) of the Income and Corporation Taxes Act 1988 and section 173(7) of the Finance Act 2006, a draft of this Order is required to be laid before and approved by a resolution of the House of Commons prior to submission to Her Majesty in Council. Section 788(10) was substituted by section 176 of the Finance Act 2006 (c. 25).

4.2 EU Legislation

This instrument does not implement EU legislation.

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary (Jane Kennedy) has made the following statement regarding Human Rights:

In my view the provisions of the draft Double Taxation Relief and International Tax Enforcement (Taxes on Income and Capital) (Moldova) Order 2008 are compatible with the Convention rights.

7. Policy background

Double Taxation Conventions aim to eliminate the double taxation of income or gains arising in one country and paid to residents of another country. 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, Conventions benefit the taxpayer by ensuring certainty of treatment and, as far as possible, by reducing compliance burdens. Conventions 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 international consensus on the appropriate tax treatment of cross-border economic activity and thus promote international trade and investment.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no regulatory impact on business, charities or voluntary bodies. Taxpayers may have to make a claim to HM Revenue & Customs or the other country's fiscal authority in order to benefit from the Convention. However,

taxpayers will benefit from reduced compliance burdens and, in many cases, from having to deal with just one fiscal authority.

8.2 Under a Double Taxation Convention, one or both of the countries 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, Conventions 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.

9. Contact

Steve Reszetniak at HM Revenue & Customs (Tel: 020 7147 2674 / Email: Steve.Reszetniak@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.

ANNEXE

GENERAL

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

NOTES ON DETAILS

ARTICLE 1 – PERSONS COVERED

This Article sets out the general scope of the Convention.

It provides that the Convention is to apply to persons who are residents of one or both of the Contracting States (the United Kingdom and Moldova).

ARTICLE 2 – TAXES COVERED

This Article lists the taxes to which the Convention is to apply.

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

The existing Moldovan taxes to which the Convention applies are the income tax and the tax on immovable property.

The Convention will also apply to any identical or substantially similar taxes subsequently imposed by either country in addition to or in place of the taxes mentioned above, and it obliges each country to notify the other of significant changes in their taxation laws.

ARTICLE 3 – GENERAL DEFINITIONS

This Article defines a number of terms used in the Convention and provides a rule for determining the meaning of terms not defined in the Convention.

ARTICLE 4 - RESIDENT

This Article establishes the meaning of “resident of” the United Kingdom or Moldova and lays down detailed rules for resolving cases where individuals or other persons may be considered residents of both countries for tax purposes under their domestic laws.

ARTICLE 5 – PERMANENT ESTABLISHMENT

This Article defines the term “permanent establishment” for the purposes of the Convention.

It gives examples of permanent establishments. It also provides that a building site, construction, assembly or installation project, or supervisory activities connected therewith, is considered a permanent establishment if it lasts for more than nine months. In addition, the furnishing of services, including consultancy services, constitutes a permanent establishment, but only where the activities continue (for the same or a connected project) for a period or periods aggregating more than six months within any 12-month period.

The Article identifies a number of activities which do not constitute a permanent establishment even though they are carried on through a fixed place of business. These include the usual activities set out in the OECD Model.

Taken with Article 7, this Article prescribes in general terms the circumstances and manner in which businesses of one country may be taxed on their profits arising in the other.

ARTICLE 6 – INCOME FROM IMMOVABLE PROPERTY

This Article allows the country in which the property is situated to tax income from immovable property. It also defines immovable property.

ARTICLE 7 – BUSINESS PROFITS

This Article provides that unless an enterprise of one country carries on business in the other through a permanent establishment situated there, its profits will be taxable only in its country of residence. Where the enterprise has a permanent establishment in the other country, that country will be entitled to tax profits attributable to the permanent establishment.

The expenses of a permanent establishment are deductible in computing its profits, however the Article includes some restrictions on the deductibility of payments made to the Head Office or other offices of the enterprise where these exceed the amount paid directly by the permanent establishment. These restrictions apply to payments of interest, royalties and fees for management and other services. The restrictions on interest payments do not apply to banks.

ARTICLE 8 – SHIPPING AND AIR TRANSPORT

This Article governs the taxation of shipping and air transport operated in international traffic.

Paragraph 1 provides that profits of an enterprise from the operation of ships or aircraft in international traffic shall be taxable only in the country where the enterprise is resident.

Paragraph 2 provides that profits from the operation of ships or aircraft include profits from the rental of ships, aircraft or the use, maintenance or rental of containers. In each case the rental or use, maintenance or rental must be incidental to the operations in international traffic.

Paragraph 3 clarifies that paragraph 1 also applies to profits from participation in a pool, a joint business or an international operating agency.

ARTICLE 9 – ASSOCIATED ENTERPRISES

This Article governs the evaluation for tax purposes of transfers of goods, services, finance and intangible property between associated enterprises. It requires such transfers to be evaluated as if they had taken place between independent enterprises.

Where such an adjustment is made to the profits of an enterprise by one country, the other country will make an appropriate adjustment to the amount of tax charged on those profits, in order to relieve the double taxation which might otherwise arise as a result of an adjustment by just one country.

ARTICLE 10 – DIVIDENDS

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

Paragraph 1 provides that dividends paid by a company resident in one country to a resident of the other country may be taxed in that other country.

Paragraph 2 a) provides that dividends are exempt from tax in the source country if they are beneficially owned by a company resident in the other country which holds, directly or indirectly, at least 50 per cent of the capital of the company paying the dividends and has invested at least £1 million (or the equivalent amount in any other currency) in the capital of the company paying the dividends at the date of payment of the dividends. This paragraph also provides that dividends are exempt from tax in the source country if they are beneficially owned by a pension scheme resident in the other country.

Paragraph 2 b) provides that the rate of tax in the source country is not to exceed 5 percent of the gross amount of the dividends if they are beneficially owned by a company

resident in the other country which holds, directly or indirectly, at least 20 per cent of the capital of the company paying the dividends. In all other cases the rate of tax is limited to 10 per cent of the gross amount of the dividends.

Paragraph 3 defines the term "dividends".

Paragraph 4 provides that paragraphs 1 and 2 shall not apply where a resident of one country receives dividends from the other country and carries on business in that other country through a permanent establishment there, with which the holding from the dividend arises is effectively connected. In such circumstances, the taxation of the dividends is governed by Article 7 (Business profits).

Paragraph 5 prevents the extra-territorial taxation by one country of dividends paid by a company that is a resident only of the other country. The first country may not tax the dividends unless they are paid to a resident of that country or connected with a permanent establishment or a fixed base in that country. There is a similar provision in respect of undistributed profits.

Paragraph 6 an anti-abuse provision, ensures that relief will not be available under the Article 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 rules for the taxation of interest paid by a resident of one country to a resident of the other.

Paragraph 1 provides that interest arising in one country (the source country) and paid to a resident of the other country may be taxed in that other country (the residence country).

Paragraph 2 provides that interest may also be taxed in the source country, but if the beneficial owner of the interest is a resident of the other country, the tax in the source country will not exceed 5 per cent of the gross amount of interest.

Paragraph 3 gives exceptions to the rule in paragraph 2, allowing for some categories of interest to be taxable only in the residence country if the interest is beneficially owned by a resident of that country. These include interest received by the State or the Central Bank of a country; interest on loans paid or guaranteed by the State or an export financing agency; interest received by a financial institution; and interest paid in connection with the sale on credit of industrial, commercial or scientific equipment.

Paragraph 4 defines the term "interest".

Paragraph 5 provides that paragraphs 1 to 3 shall not apply where a resident of one country who receives interest from the other country carries on business in that other country through a permanent establishment there, with which the debt claim in respect of

which the interest is paid is effectively connected. In such circumstances, the taxation of the interest is governed by Article 7 (Business profits).

Paragraph 6 provides rules for determining the source country of interest.

Paragraph 7 provides that where the amount of interest paid is excessive because of a special relationship between the payer and the recipient, relief under the Article will be given only in respect of the amount that would be payable under "arm's length" conditions.

Paragraph 8, an anti-abuse provision, ensures that relief will not be available under the Article if the debt-claim under which the interest is paid was created or assigned mainly to take advantage of the Article.

ARTICLE 12 – ROYALTIES

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

Paragraph 1 provides that royalties arising in one country (the source country) and paid to a resident of the other may be taxed in that other country.

Paragraph 2 provides that royalties may also be taxed in the source country, but if the recipient is the beneficial owner the tax in the source country will not exceed 5 per cent of the gross amount of the royalties.

Paragraph 3 defines the term "royalties".

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

Paragraph 5 provides rules for determining the source country of royalties.

Paragraph 6 provides that where the amount of royalties paid is excessive because of a special relationship between the payer and the recipient, relief under the Article will be given only in respect of the amount that would be payable under "arm's length" conditions.

Paragraph 7, an anti-abuse provision, ensures that the provisions of the Article will not apply if the rights in relation to which the royalties are paid were created or assigned mainly to take advantage of the Article.

ARTICLE 13 – CAPITAL GAINS

This Article contains rules for the taxation of gains deriving from the disposal (alienation) of property situated in one country by a resident of the other.

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

Paragraph 2 provides that gains derived by a resident of one country from the alienation of certain types of shares or interests in partnerships or trusts may be taxed in the other country if they derive their value principally from immovable property situated in that other country.

Paragraph 3 provides that gains arising from the alienation of movable property relating to a permanent establishment maintained in the other country may be taxed in that other country.

Paragraph 4 provides that gains derived by a resident of one country from the alienation of ships or aircraft operated in international traffic shall be taxable only in the country where the taxpayer is resident.

Paragraph 5 preserves the domestic law right of each country to tax gains in cases not covered by paragraphs 1 to 4.

Paragraph 6, an anti-abuse provision, confirms the right of a country to tax gains from the alienation of any property by a person (including an individual, company or trustee) who is or was a resident of that country at any time during the fiscal year in which the property is alienated or at any time during the six preceding fiscal years.

ARTICLE 14– INCOME FROM EMPLOYMENT

This Article contains the rules for the taxation of employment income.

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

Paragraph 2 provides an exception to the general rule where an employee is present in the other country 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 country and the remuneration is not tax-deductible by a permanent establishment or a fixed base which the employer has in the other country. Where all three conditions are satisfied, the remuneration will be taxable only in the employee’s country of residence.

Paragraph 3 provides that the remuneration of an individual working on a ship or aircraft operated in international traffic may be taxed in the country where the enterprise operating the ship or aircraft is resident.

ARTICLE 15 – DIRECTORS' FEES

This Article provides that directors' fees (and other similar payments) paid to a resident of one country who is a member of the board of directors of a company may be taxed in the country where the company is resident.

ARTICLE 16 – ARTISTES AND SPORTSPERSONS

This Article provides that income in respect of the personal activities of entertainers and sportsmen can be taxed in the country in which those activities are exercised, whether the income is paid directly to the entertainer or sportsman or to some other person.

ARTICLE 17 – PENSIONS

This Article provides that pensions (other than government service pensions) and other similar remuneration shall be taxable only in the country of which the pensioner is a resident.

Paragraph 2 provides that lump sum pension payments shall be taxable only in the country where the pension scheme is established.

Paragraphs 3 and 4 provide, with certain conditions, that contributions made by or on behalf of an internationally mobile worker to a pension scheme that is recognised for tax purposes in his/her "home" country will qualify for tax relief in the country where he/she is working.

Paragraph 5 clarifies the meaning of the words "recognised for tax purposes".

ARTICLE 18 – GOVERNMENT SERVICE

This Article contains rules for the taxation of remuneration and pensions paid in respect of Government Service.

Paragraph 1 provides that in general, remuneration paid to an individual in respect of services rendered to a country, or to one of its political sub-divisions or local authorities, will be taxable only in that country.

However, the other country will have the sole taxing right if the services are carried out in the other country by one of that country's own nationals who is resident there. The other country will also have the sole taxing right if the services are carried out in the

other country by one of its residents who did not become a resident solely for the purpose of rendering the services.

Paragraph 2 provides that in general, a pension paid to an individual in respect of services rendered to a country, or to one of its political sub-divisions or local authorities, will be taxable only in that country. If however the individual is a resident and national of the other country then that other country will have the sole taxing right.

Paragraph 3 provides an exception to the rules in paragraph 1. In the case of remuneration or pensions arising in connection with a trade or business, the provisions of Article 14, 15, 16, , or 17 will apply, as appropriate.

ARTICLE 19 – STUDENTS

This Article provides that certain payments for the maintenance, education or training of a visiting student or business apprentice will not be taxed in the country visited, provided the payments are made from sources outside that country.

ARTICLE 20 – OTHER INCOME

This Article contains the rules for the taxation of income not dealt with elsewhere in the Convention.

Paragraph 1 provides that any item of income not specifically covered elsewhere in the Convention will be taxable by the country of which the beneficial owner is a resident.

Paragraph 2 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 maintained in the country of source. In that case, the income will be taxable in accordance with Article 7 (Business profits).

Paragraph 3 provides that where the amount of income paid is excessive because of a special relationship between the payer and the recipient, relief under the Article will only be available for the amount of income that would be payable at “arm’s length”.

Paragraph 4, an anti-abuse provision, ensures that relief will not be available under the Article if the rights in relation to which the income is paid were created or assigned mainly to take advantage of the Article.

ARTICLE 21– CAPITAL

This Article contains the rules governing the taxation of capital.

Paragraph 1 provides that capital represented by immovable property owned by a resident of one country and situated in the other country may be taxed in that other country.

Paragraph 2 provides that capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of one country has in the other country may be taxed in that other country.

Paragraph 3 provides that capital of an enterprise of one country represented by ships or aircraft in international traffic will be taxable only in that country. This also applies to capital represented by movable property pertaining to the operation of such ships and aircraft.

Paragraph 4 provides that capital represented by shares which derive their value from immovable property may be taxed in the country where the property is situated.

Paragraph 5 provides that all other elements of capital owned by a resident of one country will only be taxable in that country.

ARTICLE 22– ELIMINATION OF DOUBLE TAXATION

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

Paragraph 1 provides details of how Moldova will relieve double taxation. United Kingdom tax will be allowed as a deduction against Moldovan tax on income or capital. Moldova may however take account of the tax relieved under this paragraph in calculating the overall amount of tax chargeable on one of its residents.

Paragraph 2 provides details of how the United Kingdom will relieve double taxation. Moldovan tax shall be allowed as a credit against United Kingdom tax on the same profits, income or chargeable gains. In the case of a dividend paid by a company resident in Moldova to a company resident in the United Kingdom which controls at least 10 per cent of the voting power in the paying company, the credit will take account of the underlying tax paid in Moldova on the profits out of which the dividend is paid.

Paragraph 3 provides that, for the purposes of paragraphs 1 and 2, profits, income and capital gains owned by a resident of one of the countries which may be taxed in the other country under the terms of the Agreement, will be deemed to arise from that other country.

Paragraph 4 contains a rule to determine which country will relieve double taxation in cases where a tax charge arises only under the special rule in Article 13(6). The country

which is entitled to tax under Article 13(6) will relieve any double taxation that would otherwise occur owing to the charge of tax in the other country.

This paragraph also confirms that the normal rules will apply in cases where a tax charge arises under paragraphs 1, 2 and 3 of Article 13 (Capital gains).

ARTICLE 23 – MISCELLANEOUS PROVISIONS

Paragraph 1 applies to income or gains that are not fully taxable in one country, but are only taxable on the amount remitted to that country or received there. Any relief given in the other country on such income or gains will be restricted to the amount that is taxed in the first country.
Paragraph 2 provides rules relating to income, profits and gains derived from a fiscally transparent entity. The income etc will be treated as belonging to a resident of a country to the extent that the taxation law of that country treats it as belonging to him (and not to the entity itself).

ARTICLE 24 – NON DISCRIMINATION

Subject to certain conditions this Article provides that neither country shall impose discriminatory taxes or other requirements on the nationals, permanent establishments and enterprises of the other. The Article only applies to the taxes that are the subject of the Convention.

ARTICLE 25 – MUTUAL AGREEMENT PROCEDURE

This Article permits a resident of one country who believes that the actions of one or both countries result, or will result, in taxation that is not in accordance with the terms of the Convention, to present his case to the competent authority of the country of which he is a resident. If the case comes under paragraph 1 of Article 24 (prohibiting discrimination on grounds of nationality), he may present his case to the competent authority of the country of which he is a national. It also provides that the competent authorities of the two countries may communicate directly with one another in order to resolve difficulties or doubts arising in the interpretation or application of the Convention

ARTICLE 26 – EXCHANGE OF INFORMATION

This Article contains rules governing the exchange of information between the competent authorities of the two countries.

Paragraph 1 provides that the competent authorities shall exchange such information as is foreseeably relevant for carrying out the provisions of the Convention or of the two countries' domestic laws concerning taxes of any kind. Information may also be exchanged relating to persons who are not residents of either country.

Paragraph 2 provides that information exchanged in accordance with paragraph 1 shall be treated as secret, although it may be disclosed to certain specified persons or authorities. Such information may be disclosed in public court proceedings or in judicial decisions.

Paragraph 3 imposes certain limitations on the exchange of information. Paragraphs 1 and 2 cannot impose an obligation to carry out administrative measures at variance with the laws and administrative practices of either country or to supply information which is not obtainable under the laws or in the normal course of the administration of either country or to supply information that would disclose any trade secret, or information whose disclosure would be contrary to public policy.

Paragraph 4 provides that the country from which information is requested shall use its information gathering powers to obtain the requested information even though that country may have no domestic tax interest in the information. The obligation is subject to the limitations of paragraph 3 but a country cannot decline to supply information solely because it has no domestic tax interest in it.

Paragraph 5 makes clear that paragraph 3 cannot be applied to permit a country to decline to supply information requested solely because the information is held by certain entities such as banks. However a country may decline to supply information which is covered by professional privilege provisions in domestic law.

ARTICLE 27 – MEMBERS OF DIPLOMATIC OR PERMANENT MISSIONSAND CONSULAR POSTS

This Article confirms that diplomats etc shall not receive less favourable treatment under the Convention than they are entitled to under international law (such as the Vienna Convention on Diplomatic Relations)or under the provisions of special agreements.

ARTICLE 28 – ENTRY INTO FORCE

This Article contains the provisions governing how and when the Convention will enter into force and take effect.

This Article provides that both countries will notify each other through diplomatic channels when they have completed their respective legislative procedures. The Convention will enter into force on the date of the later of these notifications. It will take effect in Moldova on 1 January in the year after entry into force. In the United Kingdom it will take effect in respect of income tax and capital gains tax on 6 April in the year after entry into force and in respect of corporation tax on 1 April in the year after entry into force.

ARTICLE29 – TERMINATION

This Article contains provisions for the termination of the Convention.

This Article provides that the Convention may be terminated by either country giving notice of termination through diplomatic channels. Notice must be given at least six months before the end of any calendar year beginning after a period of five years from the date the Convention enters into force.

In the event of termination, the Convention shall cease to have effect in the year after the notice is given. As in Article 28, the date when the Convention ceases to have effect will be different in the two countries.

PROTOCOL

The Protocol contains clarificatory material relating to the Articles above and which forms an integral part of the Convention.

Paragraph 1: clarifies that in the case of Moldova the term "capital" may be understood to mean "property", as this is the term used in Moldovan tax legislation. The exceptions are Article 9, paragraph 1; Article 10, paragraph 2; and Article 24, paragraph 4.

Paragraph 2: confirms that a country is entitled to tax the profits of one of its residents which derive from a partnership established in the other country.

Paragraph 3: obliges the governments of the two countries to consult each other, within five years of the entry into force of the Convention, to ensure that it is not being misused and that it continues to serve its declared purpose.