



STUDY GUIDE

DIVISION OF ECONOMIC AND FINANCIAL STUDIES

GRADUATE ACCOUNTING AND COMMERCE CENTRE

Master of Commerce/Master of International Business Programs

UNIT: ACCG 846 - INTERNATIONAL TAXATION

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**SESSION: FIRST TERM, 2008

WORKSHOPS 1 & 2**

MACQUARIE UNIVERSITY

DIVISION OF ECONOMIC AND FINANCIAL STUDIES

GRADUATE ACCOUNTING AND COMMERCE CENTRE

ACCG 846 INTERNATIONAL TAXATION

UNIT OUTLINE - 2008

UNIT DESCRIPTION

This unit examines the impact that taxation considerations have in the international environment. Recent trends in international taxation will also be identified and critiqued. To give the unit a practical focus, case studies of typical investment tax problems will be examined.

UNIT OBJECTIVES

Upon successful completion of this unit, students will have an advanced understanding of policies underlying the rules for taxing international transactions, as well as a detailed knowledge of the basic principles of law applicable to the taxation of inbound and outbound transactions.

TEACHING STAFF

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CLASSES

The unit is divided into six segments which will be conducted over three weekend workshops each of six hours duration. An hour break will be provided half-way through each workshop. Formal lecturing will be reduced to a minimum and workshop sessions will be based on class discussions reviewing and discussing the material identified for reading, as well as discussing issues pertinent to the topic.

Attendance at each session is regarded as an essential part of the course, because of its interactive nature. Unit participants should expect oral questions at each session regarding the material covered for that session. It is essential that adequate preparation be undertaken before

each workshop for the full benefit to be gained. Failure to undertake the necessary readings will significantly diminish the value of the course as well as affect a participant's assessment.

Each workshop will conclude with the discussion of a case study or a series of review questions designed to enable participants to reflect on the issues covered.

The final workshop will be devoted to a discussion of participants' work in progress on their individual research projects.

The timetable for classes can be found on the GACC website at: www.gacc.mq.edu.au/ss/ttable

TEXTS AND REFERENCES

There are no prescribed texts in this unit. Workshop discussions will be based on journal articles and other primary and secondary sources.

Recommended Texts

Hamilton, Deutsch & Raneri, *Guidebook to Australian International Taxation* student edition (8th edn, Prospect, 2003)

2007/08 International Master Tax Guide (CCH).

Rohatgi, R, *Basic International Taxation: vol I – Principles of International Taxation* (BNA International, UK, 2005)

Rohatgi, R, *Basic International Taxation: vol II – Practice of International Taxation* (BNA International, UK, 2005)

Holmes, Kevin *International Tax Policy and Tax Treaties: An Introduction to Principles and Application* (IBFD, Amsterdam 2008)

Finnerty, Marks, Petriccione, and Russo, *Fundamentals of International Tax Planning* (IBFD, Amsterdam, 2007)

Russo, R, *The Attribution of Profits to Permanent Establishments – The Taxation of Intra-Company Dealings* (IBFD, Amsterdam, 2005)

Westin, R (ed.) *International Taxation of Electronic Commerce*, (Kluwer Law International, 2006).

Owens, *International Aspects of US Income Taxation: Cases and Materials*. International Tax Program, Harvard Law School, Cambridge, Mass., 1980.

R. Krever, and Y. Grbich, *Australian International Tax: Recent Developments and Future Directions*. ATAX Research Series No. 1. Law Book Co., Sydney, 1994.

Students are advised that the materials provided for the readings to each workshop are

compulsory, as they represent the minimum that you will need to do to understand the issues covered in the workshops.

Supplementary Readings

There is no single text, which covers all the material dealt with in this unit. The following books however will be useful to you if you would like to read more about the topics.

Bradford D, *Electronic Commerce and International Taxation* (MIT Press, 2000)*

Jeffery R, *The Impact of State Sovereignty on Global Trade and International Taxation* (Kluwer, 1999)*

Chissick M, *Electronic Commerce: Law and Practice* (Sweet & Maxwell, 1999)

Woellner, Barkoczy and Murphy, *Australian Taxation Law* (18th edn. CCH 2008) - cited in this outline as 'Woellner et al'

Coleman, Hart, & McKerchar, *Australian Tax Analysis: Cases, Commentary, Commercial Applications and Questions* (6th ed – Thomson/ATP, 2006).

International Tax Agreements Act, 1953 (Cth)

Lehmann and Coleman *Taxation Law in Australia* (5th edn. Australian Tax Practice, 1998)

Cooper, Krever and Vann, *Income Taxation: Commentary and Materials* (4th. edn. Australian Tax Practice, 2002)

S Barkoczy et al *Australian Tax Casebook* (8th edn CCH, 2007).

REFERENCE MATERIAL

In the course of the program, reference will also be made to current journal articles, reported cases and interpretive rulings issued by the Australian Taxation Office. Some of the referenced items can be accessed from the following sources:

On-Line Services

Both CCH and Thomson Legal & Regulatory provide an on-line service covering a commentary on the Act, Tax Office rulings and reports of all tax cases.

These tax services are also available in loose-leaf format.

These services are all located in the Law Section of the University Library.

Useful Internet sites

- (i) **ATO assist:** The Australian Taxation Office Internet site www.ato.gov.au. This site offers free access to:
- all new and current ATO rulings and determinations
 - current ATO publications
 - draft legislation and discussion papers
 - work being done on ATO projects
 - general information on tax matters
 - useful tools to help calculate tax deductions
 - electronic forms
 - the ATO legal database (This was originally designed and developed for internal use, and is a very useful research tool.)

Addresses to other internet sites which are relevant to tax issues can be found in Barkoczy's **2008 Core Tax Legislation & Study Guide**, at pp 12 – 14.

Professional Reference Texts

2008 Master Tax Guide (CCH)
2008 Australian Tax Handbook (Thomson)
2008 Australian Master GST Guide (CCH)
2007/08 International Master Tax Guide (CCH).

Periodicals

Articles in legal and accounting journals are invaluable aids in keeping up to date with developments in international tax law and practice. These include:

- * **Australian Tax Forum**
- * **Taxation in Australia**
- * **The Tax Specialist**
- * **The Australian Accountant**
- * **The Chartered Accountant in Australia**
- * **The International Tax Journal**
- * **Bulletin for International and Fiscal Documentation**
- * **The Asia Pacific Tax Bulletin**
- * **Tax Notes International**

Research Guides:

Colin Fong, "Researching Comparative Corporate Taxation" (2002) vol 5 no. 3, *The Tax Specialist*, 142.

Obst, Smith & Hanegbi, 2006/07 **Successful Tax Study**, (Thomson/), Chapter 5.

LEARNING OUTCOMES

By the end of this unit, students should be able to:

- apply principles governing connecting factors in determining the incidence of tax in cross-border transactions;
- demonstrate a good working knowledge of how double tax agreements work and how they interact with domestic tax laws and bilateral investment agreements;
- apply the framework of double tax agreements and the international anti-avoidance rules to simulated real life situations for the purposes of giving professional advice;
- develop strategies for solving practical problems involving international tax principles, and the resolution of disputes arising from cross-border tax transactions involving tax authorities;
- work collaboratively to solve legal problems related to cross-border tax issues;
- undertake independent research on cross-border tax issues through using electronic information and retrieval systems.

The Macquarie experience is designed to lead students to a career in the city and a place in the world. It encourages life-long learning and links teaching to cutting-edge research.

Macquarie seeks to develop generic skills for students, building flexible outcomes for life and for the workplace over a life's career. These skills include:

- *foundation skills of literacy, numeracy and information technology;*
- *self-awareness and interpersonal skills, such as the capacity for self-management, collaboration and leadership;*
- *communication skills for effective presentation and cultural understanding;*
- *critical analysis skills to evaluate, synthesise and judge;*
- *problem-solving skills to apply and adapt knowledge to the real world; and*

ASSESSMENT

Assessment in this unit comprises of four major components. Marks will be allocated on the following basis:

<u>Assessment Task</u>	<u>Due Date</u>	<u>Marks</u>
Class Participation*		10%
Group Project (2 per group)	20/04	5%
Presentation of WIP	25/05	10%
Research Project	17/06	75%

*Assessment of class participation will be made on the basis of class attendance, contribution to discussion and to performance of specific tasks assigned by the lecturer. Mere attendance will not be sufficient to gain a passing grade for this component of the course.

Group Project:

Students should pair into groups of 2. The groups will be allocated a journal article on a topic dealing with international tax by the lecturer and will be expected to present a two-page synopsis. The article used for this project must be on a different topic from what is being chosen for the Research Project. This must be handed in to the lecturer at the end of Workshop 4.

Conditions Governing the Submission of this Work:

- Names of group members and their email addresses on the first of the two pages;
- 2-page summary; and
- attach a copy of the article.

Research Project

Students will be required to submit a research paper which should not exceed 5,000 words either on one of the suggested topics which will be provided in the first workshop, or on a topic chosen by the student after consultation with the lecturer.

Students will be expected to present a synopsis of their work in progress at the last workshop in this unit on the 25th of May.

The research project work must be typed and students must keep a copy of all work submitted. Please note that word limits are not optimal. The lecturer will stop reading when the word limit is reached.

The research project work must be properly referenced and conform to standard stylistic conventions. All cases have to be properly cited. Students should consult: E Campbell, R Fox and G Kewley, **Student's Guide to Legal Writing** (Federation Press, Sydney, 1998), and

Australian Guide to Legal Citation (Melbourne University Law Review Association Inc, Melbourne, 1998) for the relevant conventions and rules.

Note:

Where a student changes the topic for the research project after presenting the WIP:

- the student will be expected to re-submit a new abstract; and
- the new abstract will only be awarded 50-60 per cent of the marks originally allocated for the Work in Progress task.

Important Notes:

- You must attach a completed copy of the **Research Project Cover Sheet Declaration Form** on the first page of your Research Paper.
- Where information/article has been retrieved from websites in preparing the research paper, the full URL must be provided, and a copy of the information/article must be included in a separate bound folder

RESEARCH PROJECTS WHICH ARE SUBMITTED AFTER THE DUE DATE MAY NOT BE MARKED

THE DANGERS OF PLAGIARISM AND HOW TO AVOID IT:

The University defines plagiarism in its rules: "Plagiarism involves using the work of another person and presenting it as one's own." Plagiarism is a serious breach of the University's rules and carries significant penalties. You must read the University's practices and procedures on plagiarism. These can be found in the *Handbook of Postgraduate Studies* or on the web at: www.student.mq.edu.au/plagiarism

The policies and procedures explain what plagiarism is, how to avoid it, the procedures that will be taken in cases of suspected plagiarism and the penalties if you are found guilty. Penalties may include a deduction of marks, failure in the unit, and/or referral to the University Discipline Committee.

UNIVERSITY POLICY ON GRADING

Academic Senate has a set of guidelines on the distribution of grades across the range from fail to high distinction. Your final result will include one of these grades plus a standardised numerical grade (SNG).

On occasion your raw mark for a unit (i.e., the total of your marks for each assessment item) may not be the same as the SNG which you receive. Under the Senate guidelines, results may be

scaled to ensure that there is a degree of comparability across the university, so that units with the same past performances of their students should achieve similar results.

It is important that you realise that the policy does not require that a minimum number of students are to be failed in any unit.

The process of scaling does not change the order of marks among students. A student who receives a higher raw mark than another will also receive a higher final scaled mark.

STUDENT SUPPORT SERVICES

Macquarie University provides a range of Academic Student Support Services. Details of these services can be accessed at www.student.mq.edu.au

PROGRAM SCHEDULE

<u>Workshop</u>	<u>Date</u>	<u>Topic(s)</u>
1	15/03	Jurisdiction to Tax (Residency)
2	16/03	Source of Income Taxation of Non-Residents Taxation of Overseas Income of Residents
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3	19/04	Tax treatment of Foreign Investment Income International Mergers and Acquisitions Double Tax Treaties
4	20/04	Combating International Tax Avoidance
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5	24/05	International Taxation and the Challenges of Electronic Commerce
6	25/05	Overview and Class Presentations of Work-in-Progress (research)

WORKSHOP 1: JURISDICTION TO TAX

1.1 RULES FOR DETERMINING RESIDENCE

1.2 OBJECTIVES

At the end of this module, you should be able to understand:

- The meaning and significance of the concept of residence in determining liability to tax

1.3 RESIDENCE OF INDIVIDUALS: Expatriates, Migrants, and Visitors

The residence of a taxpayer is one of the two connecting factors for determining liability to Australian tax.

(a): Principal Sections

- **Income Tax Assessment Act 1936**

Section 6(1): This section contains definitions of a “resident” for both individuals and companies

- **Income Tax Assessment Act 1997**

Section 6-5 sets the practical limit of Australia’s jurisdiction to tax. This section provides as follows:

6-5(1) Your *assessable income* includes income according to ordinary concepts, which is called *ordinary income*

6-5(2) If you are an Australian resident, your assessable income includes the ordinary income you derived directly or indirectly from all sources whether in or out of Australia, during the income year.

6-5(3) If you are *not* an Australian resident, your assessable income includes:

- (a) the ordinary income you derived directly or indirectly from all Australian sources during the income year; and
- (b) other ordinary income that a provision includes in your assessable income for the income year on some basis other than having an Australian source.

See also section **6-10** (Statutory Income)

The meaning of residency for an individual is developed in the following readings:

1.4 CORPORATE RESIDENCE

A company will be a “resident” under the statutory tests if it is:

- (a) incorporated in Australia; or
- (b) not being incorporated in Australia, carries on business in Australia and has either:
 - (i) its central management and control in Australia; or
 - (ii) its voting power is controlled by shareholders who are residents of Australia.

The scope of the terms “incorporation” and “carries on business” have been examined in the following cases:

TASK FOR THE FIRST CLASS:

Students must read the following before turning up to the first class:

"Policy Objectives in International Taxation" Cooper, Kreyer & Vann, *Income Taxation: Commentary and Materials* (2nd edn Law Book Co 1993 pp. 20-4 to 20-14)

READING 1.0

"Policy Objectives in International Taxation" extracted from Cooper, Krever & Vann,
Income Taxation: Commentary and Materials (2nd edn Law Book Co 1993 pp. 20-4 to 20-14)

A. Policy Objectives in International Taxation

Most traditional texts deal with the fundamental concepts of residence and source without elaborating on the possible means of dealing with international taxation and the reasons underlying the current taxation of international income in Australia. Where income is derived overseas, two countries may claim the right to tax the same income - for example, Australia, as the country of residence of the persons deriving the income, and a foreign country, being the country from which the income derives, as the jurisdiction of source. Double taxation of the income can be prevented if either of the countries unilaterally decides to forgo the right to tax such income or if the two jurisdictions together agree by means of a treaty to divide the right to tax the income between them.

Australia did not always tax residents on their foreign source income - from 1915 until 1930 residents were taxed only on their Australian source income. When the base was broadened in 1930 to include income from offshore sources, the problem of double taxation was confronted for the first time. Since that time a variety of approaches have been attempted. The current tax rules pertaining to income derived and taxed overseas continue to follow many models. At one end of the scale are situations in which Australia forgoes all claims to tax the income and completely exempts it from Australian taxation. Along the continuum are cases where Australia recognises the primary right of the source jurisdiction to levy a tax on income derived in that country, but claims a residual right to levy a tax if the foreign tax is not as high as the tax which would otherwise be payable in Australia. Under this model, foreign income is fully assessed in Australia but resident taxpayers are given credit for foreign taxes previously levied overseas on the income. Finally, at the far end of the spectrum are cases in which Australia treats foreign taxes as simply another cost of doing business and fully assesses net after-foreign-tax receipts.

The economic and accounting effects of these different treatments are significant and can be illustrated with an example. There are four parts to this example, each of which involves an Australian resident company subject to tax at a 39 per cent tax rate. In Case One, the corporate taxpayer derives only Australian source income. In each of the remaining three cases the corporate taxpayers derive income in a jurisdiction where the tax rate is 29 per cent, that is, 10 per cent less than in Australia. In Case Two, involving foreign source income, Australia exempts foreign source income so long as it has been subject to a tax overseas. In Case Three involving foreign source income, Australia fully taxes overseas income but provides a credit for any foreign taxes levied on the income. In Case Four involving foreign source income, Australia simply treats the foreign taxes as another cost of doing business and assesses the taxpayer on after-foreign-tax receipts.

Case One

Before tax income	100.00
Foreign taxes	---
After-foreign-taxes receipts	100.00
Amount assessed in Australia	100.00
Australian tax levied	39.00
Credit for foreign taxes	---
Net Australian tax levied	39.00
Total taxes levied	39.00
Net gains to the taxpayer	61.00

Case Two

Before tax income	100.00
Foreign taxes	29.00
After-foreign-taxes receipts	71.00
Amount assessed in Australia	---
Australian tax levied	---
Credit for foreign taxes	---
Net Australian. tax levied	---
Total taxes levied	29.00
Net gains to the taxpayer	71.00

Case Three

Before tax income	100.00
Foreign taxes	29.00
After-foreign-taxes receipts	71.00
Amount assessed in Australia	100.00
Australian tax levied	39.00
Credit for foreign taxes	29.00
Net Australian tax levied	10.00
Total taxes levied	39.00
Net gains to the taxpayer	71.00

Case Four

Before tax income	100.00
Foreign taxes	29.00
After-foreign-taxes receipts	71.00
Amount assessed in Australia	71.00
Australian tax levied	27.69
Credit for foreign taxes	---
Net Australian tax levied	27.69
Total taxes levied	56.69
Net gains to the taxpayer	43.31

The effect of the different types of treatment can be illustrated by comparing the three taxpayers deriving foreign source income with a resident taxpayer deriving only Australian source income.

If foreign income is exempt from Australian tax, taxpayers will always be tempted to invest overseas in preference to in Australia so long as foreign taxes are lower than those in Australia. Given the mobility of capital and the free availability of investment opportunities in low tax jurisdictions, one would expect this system to encourage foreign investment in preference to domestic investment.

If foreign income is taxed in Australia but a credit given for foreign taxes, the tax consequences of deriving income from investments in Australia or from investments outside are the same, unless foreign taxes exceed Australian taxes, of course. A foreign tax credit system is therefore apparently neutral in its impact on investment decisions - the choice to invest onshore or offshore will be based on economic considerations (where the highest rate of return can be realised), not tax considerations (where the highest after-tax rate of return can be realised).

If taxpayers receive no recognition for foreign taxes other than a deduction, so they are taxed on after-foreign-tax income, the total taxes on gains derived overseas are much higher than those derived in Australia. The foreign tax deduction system is thus biased to encourage domestic investment in preference to foreign income--taxpayers will only invest offshore if the total rate of return from a foreign investment is so high that after foreign taxes the gain is still higher than the pre-tax returns available on Australian investments.

Economists are far from unanimous in their opinions as to which system makes most economic sense for Australia. As will be seen in the Musgrave extract below, it is probably fair to say that most tax experts have concluded that there is little justification for the exemption system which encourages taxpayers to invest offshore even when pre-tax higher rates of return are available in Australia. The economic arguments against this system are reinforced by concerns over its equity failings--taxpayers deriving identical economic incomes may face widely disparate tax burdens depending on the source of their incomes. Whatever agreement may exist with regard to the foreign income exemption system (and the preceding description of near consensus on this issue is no doubt an over-exaggeration of the truth), economists are quite divided on the question of whether a foreign tax credit or foreign tax deduction system is the better of the two remaining options.

Supporters of the foreign tax credit system rest their case on the desirability of international tax neutrality. Just as the ideal domestic income tax system is neutral in its impact on alternative investment decisions, foreign tax credit system advocates argue international tax rules should be neutral in their impact on taxpayers' decisions to make domestic or foreign investments. If taxpayers seek the highest pre-tax rate of return available, on the assumption that the final after-tax rate will be the same whatever the source of the income, it is argued that the most efficient international allocation of investment capital will be achieved.

Supporters of the foreign tax deduction system concede the foreign tax credit system best achieves international efficiency in consequence of its neutral impact on the flow of international investments. However, they argue, international efficiency is not synonymous with national benefit. National benefit, they claim, is most likely to be achieved in a tax system that encourages domestic investment in preference to foreign investment. Foreign taxes are a net loss to the nation, they claim, and the ideal income tax system would not permit taxpayers to pay foreign taxes in lieu of Australian taxes. As a nation, they say, we would be better off if Australians invested overseas only where the after-foreign-tax rate of return is superior to the best rate of return available on domestic investments.

The arguments in favour and against each alternative are to be found in P. Musgrave, "**THE TREATMENT OF INTERNATIONAL CAPITAL INCOME**" in J. Head ed., *Taxation Issues of the 1980s* (Sydney, Australian Tax Research Foundation, 1983) (footnotes omitted). The extract also canvasses the position of non-residents where there does seem to be a greater measure of agreement that the country of source has the primary taxing right with respect to income derived by them.

1. GENERAL PRINCIPLES OF INTERNATIONAL TAX RELATIONSHIPS

It is only in recent years that we have seen taxation theory, previously developed within the domain of public finance, brought into the sphere of international economics. As jurisdictions (both national and sub-national) have become increasingly integrated via trade and factor movements and public sectors have grown in relative importance, the role of income, product and wealth taxes has come to rival that of tariffs in these economic relationships. With the involvement of the important broad-based taxes, a wider range of criteria has entered the picture, including such considerations as taxpayer equity, revenue and domestic structural effects, traditionally the concern of the tax literature in the domestic setting.

This paper will address itself largely to the problems of applying the individual and corporate income taxes in open economies with trade and factor movements. We will begin with a consideration of general principles of international tax relationships, then turn to some of the specific problems of implementing these principles in the case of the income taxes...

NATION'S ECONOMIC POSITION IN WORLD ECONOMY

The problem of international tax relationships of any one nation has four aspects, involving its role as country of residence, source, origin and destination respectively. Taking Australia as our example, foreigners will involve themselves in the Australian economy as they supply factor services to and earn income in that economy. Australia, in short., will be the country of source of income to these foreign factors and will tax their income arising in Australia in its capacity as the country of source. Foreigners will also involve themselves in the Australian economy via their use of goods and services produced in that economy. Australia is in this case the country of origin for those products used abroad and it may tax those products in that capacity. Australian residents, in turn, will be involved in the outside economy, as they supply factor services to it and thereby earn income outside Australia, which in this case may tax that income in its role as the country of residence. Australians will also be involved in the world economy as users of goods and services produced abroad, and Australia in its capacity now as the country of destination may tax those goods and services used within its economy. The taxes which Australia applies in this quadripartite role can affect these trade and factor flows as well as the division of the gains from trade and factor movements between it and the rest of the world.

PRINCIPLES

The three major principles with which the taxation of trade and factor flows must be concerned are taxpayer equity, locational neutrality and inter-nation equity. While there may be other objectives in the taxing jurisdiction which enter into the design of tax policy from time to time, the more fundamental objectives which have widespread acceptance are these three. Taxpayer equity is so well known as not to need further explanation. Locational neutrality requires that the tax system not distort decisions of factor owners as to where to put their services to work, at home or abroad, or the decisions of users of goods and services as to the origin of those products, domestic or foreign. Specifically, this requires that the investor be taxed at the same effective rate whether the investment is made at home or abroad, that the worker face the same rates of tax regardless of location of work and that purchasers of goods and services likewise be taxed at the same ad valorem rate on their purchases whether originating at home or abroad. Inter-nation equity is a concept which, while playing an important role implicitly in unilateral tax policy as well as multilateral tax agreements, has been given scant attention in the tax literature. I use this term to suggest "fair tax shares" or a fair division of the gains which are generated by commodity and factor flows between countries.

The three above-mentioned principles each have to be the primary concern of a country according to its role as country of residence, source, destination and origin.

INTER-NATION EQUITY

Consider first inter-nation equity. This involves the country of source since the way in which it taxes the income accruing to non-residents will in itself determine the share of the gains from that non-resident activity between it, as the country in which the activity takes place, and the country of residence to which the individual owes his/her primary tax allegiance. How the country of residence in turn chooses to tax that income earned abroad by its own residents will not affect the basic division between the two countries, but merely the division of the residual (after the source country has taken its share) between taxpayer and treasury of the residence country. Thus the source country's taxation of factor income accruing to non-residents will pertain to inter-nation equity and will determine the share between residence and source jurisdictions. Inter-nation equity also enters qua source-versus-source when the tax base extends over more than one source country and must be divided between them. While this problem is one which has particular significance at the sub-national level in federal systems, it is also acquiring increasing importance at the international level, particularly within common market areas....

It should be noted that implementation of inter-nation equity by the country of source calls for impersonal, in rem and even schedular taxes applied at flat rates to factor incomes....

TAXPAYER EQUITY

Whereas the standard of inter-nation equity is the responsibility of the source-origin jurisdictions, that of taxpayer equity must necessarily be that of the jurisdictions of residence.... Taxpayer equity requires a consideration of global income ... and only the country of residence/citizenship of income recipients ... is in a position to tax those comprehensive measures of economic position. Furthermore, taxpayer equity requires the use of personal taxes and allowances for impersonal, in rem type taxes. Again, such personal taxes can only be adequately imposed by the residence jurisdiction. . . . More fundamentally, different nations may be expected to have different notions regarding the requirements for taxpayer equity and to wish to apply those standards to their own residents. Thus it is appropriate that the country in its role as country of residence be entirely responsible for implementing taxpayer equity.

LOCATIONAL NEUTRALITY

It also seems reasonable, though this is perhaps a more controversial point, that the country of residence be largely responsible for implementation of international locational neutrality. One reason is that neutrality in this context requires that individual decision makers, be they investors, workers or consumers, face effective tax rates which are independent of where they choose to invest and work or of where the products which they consume originate. Only the country of residence can make the necessary adjustments to bring that condition about. In short, all resident investors must be taxed at the same rate whether they invest at home or abroad. The country of source naturally cannot by itself secure that equality.

But there is another more controversial reason why the country of residence should be responsible for locational neutrality. It would seem reasonable that the country of residence and/or citizenship of factor owners and consumers should have some discretion over tax policies as they affect capital and labour outflow and commodity inflow. For the country of residence, there may be a trade off between tax neutrality with respect to capital and labour export on one hand and the national economic advantages of keeping such factors at home. While international economic theory may call for totally unimpeded trade and factor movements, it may be unreasonable to expect this form of laissez-faire in a world of nation states. Just as nations usually have immigration restrictions to control the inflow of labour, so they may wish to exert some control over the outflow of their capital. Furthermore, there may be a real difference in the internal distributional effects of free commodity movements on one hand and free factor movements on the other, even though the pure theory of international trade has traditionally treated them as one and the same. The point is that while locational neutrality is desirable on international efficiency grounds, that neutrality may be secured only at a cost to the residence/destination country, and therefore the latter should retain control over the degree of neutrality which is achieved. This is particularly so since, as discussed in the following section, there may be some conflict between achievement of taxpayer equity and locational neutrality.

2. PROBLEMS OF IMPLEMENTATION

Having sketched out the broad principles to be considered in international tax relationships, let us now turn to some of the very difficult problems of implementation, confining the discussion to the taxation of capital income. Many of the practical problems arise from the interposition of the complexities of business organisation and the role of the corporation income tax in a multi-jurisdictional setting. There are also, of course, the perennial difficulties of identifying the incidence of particular taxes which affects the role of those taxes in relation to the principles under consideration. In a setting of open economies

these incidence issues become even more complex than in a purely domestic framework. To make the problem manageable certain simplifying incidence assumptions are made, such that income taxes fall largely on the sources side of the individual taxpayer's account and product taxes fall on the uses side. We will begin by considering the kinds of tax rules and agreements needed to implement each of the three principles of international equity, taxpayer equity and locational neutrality.

IMPLEMENTATION OF INTERNATIONAL EQUITY

This requires that nations of source take a "fair" tax share of income accruing to non-residents. In its purest form this would mean non-resident individuals, but in a world in which the corporation and corporation income tax are interposed between the income source and the individual shareholder, the concept of "non-resident" must also be applied to the corporation. Different countries in practice have different definitions of what constitutes a resident corporation, with the test of place of incorporation, locus of control and management or of majority ownership being the most common.

International equity requires, if fully implemented, an international agreement (a) to establish a generally acceptable entitlement rule which spells out the source country's right to tax, (b) out of that entitlement rule to establish the base which may be taxed, (c) to lay down common definitional rules to ensure that there are no overlaps or gaps in the tax base which is divided among the countries of source and (d) to set mutually agreed rates of tax which may apply to that base.

ENTITLEMENT RULES

Probably the least controversial rule is that of the benefit charge, that is, that source countries may tax the income of non-resident individuals and corporations in line with the benefits provided by government services in generating that income. If such services are thought of as cost-reducing, and those cost reductions are reflected in higher profits to capital, then a charge on costs incurred by non-resident enterprises would be called for. . . .

But arguments can be made for entitlement rules which go beyond assigning merely a benefit charge to the source country. For instance, it might be argued that the source country has the right to take a tax share of all income earned by non-residents on the grounds that the source country has provided the supporting factors for that activity, and the environment in which it takes place. There is a question, however, whether this would require taxing gross rather than net income. Gross income would encompass the full scope of economic activity, including capital replacement, while net income would include only the net accretion to wealth of non-residents.

Let us assume that the entitlement rule establishes the right of the source country to tax the net income accruing to non-residents. It is clear that international agreement is needed on a common definition of "non-resident". In its absence, there may be an overlapping of base or an incompletely covered tax base. It is also necessary to establish source rules which assign the net income base among competing countries of source. It has traditionally been the rule to divide the corporation income tax base among those countries which share in the base by *separate accounting* which establishes the "water's edge" concept of geographically separable business units. This process has encountered increasing problems at the international level as multinational enterprises extend their interdependent parts across national boundaries. True economic interdependency brought about by shared costs and economies of scale introduces an unresolved difficulty to separate accounting. In practice it is handled by the respective tax authorities imposing rules of thumb or crude margins to sales or mark-ups to costs but again, if there is no international agreement on the precise nature of the constructive accounts, base overlaps or gaps may ensue. Otherwise, separation of the firm's accounts at the water's edge is usually

mandated according to arm's length pricing. However, as experience of the United States Internal Revenue Service in applying its s.482 rules has shown, multinational firms continue to have considerable discretion in this matter. At the sub-national level, separate accounting largely breaks down and formula apportionment then must be used to assign tax base to source, as in the case of the constituent states of the United States. Indeed, the time may come, as economic integration in the world economy proceeds, for such apportionment to be used at the international level. But a much more advanced form of international co-operation in tax administration would be needed to implement it.

It was pointed out earlier that, for purposes of inter-nation equity, impersonal taxes on factor incomes are appropriate. It is interesting, in fact, that whereas in the context of tax neutrality and taxpayer equity the corporation income tax has been the target of much criticism from economists favouring integration of corporate source income with the individual income tax, it can perform an appropriate function in the context of inter-nation equity. It is an impersonal, flatrate tax on an important source of income to non-resident investors. Its objectionable features can be diminished by integration with the residence-based individual income tax, integration which is confined to residents by use of, say, a dividends-received credit. The corporation tax then acts as a withholding tax on all corporate source income. On inter-nation equity grounds the corporation tax is to be preferred to a traditional withholding tax since the latter would apply only to distributed earnings. The spirit of inter-nation equity would suggest the combination of a payroll tax with the corporation income tax to bring non-resident wage income into the source country's tax orbit.

The next question is whether the source country is also entitled to impose withholding taxes on capital income transmitted to non-residents. The withholding tax appears to be imposed as a way of sharing in the individual income tax on the non-resident investor. But there seems little rationale for this in terms of an entitlement rule which specifies a share in net factor income rather than a share in specific taxes on that income. The corporation income tax if applied at the appropriate rate, should be sufficient and no further tax on dividends is not needed. However, if interest is deductible for purposes of the corporation income tax in the source country, then a withholding tax on interest would be justified. The same reasoning might apply to royalties. On the other hand, the rate of corporation income tax may reflect primarily domestic tax policy concerns, in which case an additional withholding tax might be appropriately applied to dividends paid to nonresidents if the former is judged to be inadequate on inter-nation equity grounds.

This brings us to the question of what are appropriate rates of tax to be applied by the source country. In the first place, there is no justification whatsoever for the rate of tax as applied to the net income of non-residents corresponding to the rates as applied via the same taxes to residents. Thus the legal rule of "non-discrimination" as applied to inter-jurisdictional tax relationships hardly seems appropriate. Rather, "reciprocity", requiring agreement on the use of common rates by source countries on income accruing to non-residents, should be the rule. In other words, residents should be taxed according to the country's standards of taxpayer equity and locational neutrality, while non-residents should be subject to the entitlement rule agreed to in the interests of inter-nation equity. Current practice is to reach agreement on reciprocally equal rates with respect to withholding taxes, leaving corporate income taxes to be imposed in line with domestic policy considerations. But surely international tax treaties should consider both in conjunction, establishing reciprocally equal total taxes on capital income accruing to non-residents.

IMPLEMENTATION OF TAXPAYER EQUITY

We have noted the fact that implementation of individual equity is in the hands of the country of residence. Let us assume that this country has both an individual income tax and a corporation income tax

and that each has a comprehensive base, including income from all sources. Then the question is, how can taxpayer equity be implemented where income is of foreign source and may have already been subject to foreign tax? Let us consider first the individual investor resident in Australia and earning income from an investment abroad. Australia has the following choices with respect to the taxation of that income:

- (a) exemption from Australian income tax;
- (b) taxation on a net basis, with foreign income taxes effectively treated as a deduction;
- (c) full double taxation, with net income grossed up by the amount of foreign income tax paid and Australian tax applied to that grossed-up base;
- (d) full taxation, with Australian tax applied to the grossed-up base and a tax credit for the foreign income tax.

Of these alternatives, (a) can confidently be rejected since it is inconsistent with a global income concept. Alternative (c) suggests an equity standard which entirely disregards the foreign tax and could result in confiscatory combined rates of tax, and for that reason is unlikely to be acceptable. Option (b) applies what I have called elsewhere a "national" standard of equity, treating foreign taxes as lower-level taxes are generally treated by the central taxing authority, that is, as deductions. In other words the residence country would tax foreign-source income net of foreign taxes, treating the latter as costs of investing abroad. Alternatively, option (d) might be adopted, which I have called an "international" standard of tax equity. This approach gives full recognition to foreign income taxes, allowing them to be credited against the residence tax and therefore to act as substitutes for that tax. Since this is the more widely used application of equity standards to taxpayers with foreign-source income, it is worth noting some of the more important advantages and disadvantages of the foreign tax credit.

THE FOREIGN TAX CREDIT

There are considerable differences in the administrative convenience of applying the deduction and crediting approaches to treatment of foreign taxes. The foreign tax credit is an enormously complex feature to administer, not least of the difficulties being the rules by which foreign taxes are deemed eligible for the credit and the imputation of the foreign tax for crediting purposes to distributions out of past income or to income from lower-tier subsidiaries. Treatment of foreign taxes as deductions is much simpler since the distinction between taxes on income and taxes on costs does not have to be made and the conversion of foreign-source income into a base as defined under resident-country statutes is simplified.

There is a further conceptual problem regarding the use of the foreign tax credit. Suppose that the foreign effective tax rate exceeds that in the home country. In this case, should full crediting be permitted with a refund for the excess of the foreign over the domestic tax? Typically, in practice this refund of the excess is not permitted. However, in the United States the use of a so called "overall limitation." in the past, by which excess credits in high tax countries could be set off against United States taxes due on income from low-tax jurisdictions or even (in the case of foreign branch operations) against United States tax on domestic income, advanced the United States system substantially in the direction of a full crediting system. But a full, open-ended crediting system, though conceptually correct in terms of the international equity standard, in practice leaves the resident treasury too vulnerable to "raids" by the source country. The high tax rates imposed on income from foreign oil production accruing to United States companies illustrate this point, and are one of the reasons the United States moved back to the so-called "per country" limitation to the credit. However, even without full crediting, the system does afford an incentive to the foreign country of source to impose tax rates up to the full creditable limit, a phenomenon evident in a number of countries where United States foreign investment plays a major role.

We thereby conclude that, using our international standard of equity, the resident corporation must be subject to the same standard. Its foreign-source income is then grossed up by the amount of foreign creditable tax, and the resident corporation tax applied with a credit allowed for the foreign tax up to the limit of the resident tax on that same income. The next question, however, is whether all the foreign income, both distributed to the parent company at home and retained abroad within the foreign operation, should be subject to current residence taxation. Or should the residence tax on undistributed income be deferred until distribution? This, of course, has been a burning issue in the United States tax debate in the past. In that country the practice is to compromise, with the answer depending on the form in which the foreign investment is made. If the investment is made in branch form that branch is considered to be an integral part of the United States resident corporation and all foreign profits are subject to United States tax whatever the disposition of those profits without deferral. If the investment is made in a foreign-incorporated subsidiary, however, that foreign subsidiary is a non-resident corporation and as such its profits are only currently taxable as dividends to the parent while the United States tax is deferred on its undistributed profits. The Sub-part F provisions provide exceptions to that general rule in circumstances which suggest substantial tax avoidance of United States tax with subsidiary profits then imputed to the parent. These provisions are among the most complex in the *Internal Revenue Code* and many tax experts are of the opinion that full, automatic imputation of those undistributed profits to the United States parent company with current taxation would be the preferable course to take and one which would greatly simplify the statutes and regulations. Whilst the present tax treatment of the undistributed profits of foreign subsidiaries introduces a breach of the equity standard by which all income from wheresoever derived should be subject to the same tax treatment, the problem is analogous to that of the tax treatment of undistributed profits of corporations with regard to the shareholder in the domestic setting. The situation is further complicated by the fact that we are dealing here with residence taxation a business unit incorporated (and therefore by many definitions, resident) in a foreign source country. The problem illustrates how the implementation of sound economic principles can be confounded in practice by the artifacts of business organisation.

A further question in applying the international concept of equity to the resident corporation concerns the treatment of the foreign corporation tax on the profits underlying the income accruing to the corporate portfolio investor. Practical considerations have so far dictated that foreign source income earned on portfolio investments by a resident corporation is (a) taxed only when distributed as dividends (as in the direct investment case) and (b) the corporation tax is applied to net dividends without credit for the underlying foreign corporate tax. The result of this differentiation of tax treatment is that corporate investment abroad is subject to a wide range of effective tax rates, particularly if the foreign rate of corporation tax differs significantly from that in the residence country.

IMPLEMENTATION OF TAX NEUTRALITY

To begin with, it is necessary to point out that the "national" concept of taxpayer equity which calls for the deduction of foreign taxes would in most cases result in an overall tax burden on shareholders and corporations alike which is higher if the profits arise abroad than at home. That, at least, is so if the profits are distributed. This contrasts with the "international" equity standard which calls for the foreign tax credit and promotes equality of tax burdens on foreign and domestic investment if the latter is made in subsidiary or branch form. On the other hand, deferral is harmful to tax neutrality if the foreign corporation tax is imposed at a lower rate than that in the residence country. But given that deferral would apply in both cases, the conclusion is that the foreign tax credit does promote capital-export neutrality for investments taken as a whole. Such is not the case, however, for neutrality with respect to the form in which the foreign investment is made. Generalised treatment of foreign taxes as deductions would bring uniformity to the tax treatment of foreign portfolio as against other forms of foreign investment. But this may be of less economic significance than neutrality as between foreign and domestic investment as a whole.

The limitation of the foreign tax credit also leaves a non-neutrality in place if the foreign rate of tax exceeds the residence rate. Again, this is a trade-off which most capital-exporting countries accept to protect their revenue positions.

It is clear that exemption of foreign-source income is neither consistent with equity standards nor is it likely to produce a neutral situation except in those cases where the foreign effective tax rate approximates that of the residence country. While this situation may hold with regard to statutory rates among the more developed industrialised countries, it does not hold for effective rates when all the many tax incentive systems are allowed for. There appears to be a sufficiently wide range of effective rates on corporate source income among countries to suggest that exemption by the residence country is likely to create an (unsystematic) tax preference for investment abroad.

REFERENCING AND FOOTNOTING GUIDE (prepared by Andrew Dahdal, Associate Lecturer, Department of Business Law, Macquarie University)

Footnoting and referencing are essential skills that students need to attain at an early stage in their degrees. Failure to footnote can be considered to be plagiarism. You are required to consistently adopt a clear style guide and provide citations to the sources that you use.

The Department of Business Law uses the footnoting style outlined in the Australian Guide to Legal Citation (AGLC). An electronic PDF copy of the AGLC can be obtained from the University of Melbourne website <http://mulr.law.unimelb.edu.au/aglc.asp>

Apart from supporting an argument with relevant materials, footnotes allow a reader to follow an argument without being distracted with in text references. The general idea of footnoting is to allow a text to be written clearly with supporting materials cited in a concise and non-intrusive manner.

- 1. Types of References**
 - 1.1. Primary Materials**
 - Cases*
 - Legislation*
 - Finding legislation online*
 - 1.2. Secondary Materials**
 - Journals*
 - Books/textbooks*
 - News services (including the internet)*
- 2. References (bibliography)**
- 3. Inserting footnotes using Microsoft Word ®.**
- 4. Tips**
 - 4.1 Citing the Australian Constitution**
 - 4.2 Subsequent citations and using 'Ibid'**
 - 4.3 Chapter in a book**
 - 4.4 Using Headings**

1. Types of References

When you research materials you may need to locate primary and secondary sources. Primary sources include things like cases, statutes and original documents. Secondary sources include textbooks, journals and news services.

1.1 Primary Materials

Cases

Cases are decisions that come from superior courts. Apart from decisions in Australia, there are important decisions that may be referred to from England, America and Canada.

When citing a case, provide the case name (in italics), the year the case was decided, the volume number of the report series where the case was reported, the name of the report series and the paragraph number where the cases begins. (See below for examples). Only one citation is necessary in situations where a case is reported in more than one report.

Example:

Minister for Immigration and Ethnic Affairs v Teoh (1995) 183 CLR 273.

Where the case name appears in the text, the citation can be placed in the footnotes without the case name

Example:

‘In the case of *Minister for Immigration and Ethnic Affairs v Teoh*¹² the court was of the opinion....’

12 (1995) 183 CLR 273.

A specific judgment should state the pinpoint reference (paragraph number) where a statement was made and the name of the judge(s) that made the statement should appear after the citation in (parentheses).

Example:

United Mexican States v Cabal (2001) 183 ALR 645, 656 (Gleeson CJ, McHugh and Gummow JJ).

Legislation

Statutes (or Acts) that have been passed by the Commonwealth or State Parliament take superiority over cases.

When citing an Act or delegated legislation, the citation should have the name of the instrument (i.e. Act or delegated legislation title), the year it was passed, the jurisdiction in which it was passed and the specific section to which reference is being made.

Example:

Crimes Act 1900 (NSW), s 931A (1)(b)(iii).

Finding Legislation Online

Commonwealth legislation can be found online at:
www.scaleplus.law.gov.au; or www.lawsearch.gov.au

NSW legislation can be found online at:
www.legislation.nsw.gov.au

Commonwealth, NSW and other legislation can be found online at: www.austlii.edu.au

1.2 Secondary Materials

Journals

Academic and professional journals contain articles on specific topics which may be relevant to your research or an assignment. Most journals can be found electronically. Some of the older journals will be in hardcopy and catalogued in the library.

When citing an article, the name of the author should appear first followed by the title of the article, the volume number of the journal, the name of the journal, the page number where the article commences in the journal and finally a pinpoint reference to the exact page you are referring to (if applicable).

Example:

Robert Stokes, 'Councillors' Conflicts of Interest in Development Assessment: Lessons from Warringah' (2003) 9 *Local Government Law Journal* 165, 167.

Textbooks

Textbooks are a credible source of information though they are not always up to date.

When citing a textbook (or any book) you include the full name of the author, the title of the book in *italics*, the edition number and year of publication and a pinpoint page reference if required. If there is more than one author you should include the names of all the authors (with the last two names separated by 'and'). If there is more than one editor, the first editor is to be cited followed by 'et al'.

Example:

Authors

Peter Gilles, *Business Law* (9th ed, 1988).

Editors

Patricia Blazey-Ayoub et al, *Concise Evidence* (1996).

Newspapers

Newspapers generally provide useful up to date information and perspectives on a particular topic.

When citing newspapers you should include full name of the author, the title of the article, the name of the newspaper, the place of publication in (parentheses), the full date and a pinpoint reference.

Example:

Julliette Overland, 'Citi case shows need for reform', *The Australian* (Sydney), 7 April 2006, 23.

Internet Websites

Websites are a very popular point of research however as everyone has the ability to put an article on the internet; care should be taken to ensure that the information comes from a credible source. Usually government websites are reliable however they can often be out of date and so caution is needed when citing such information.

Information from the internet should be cited by including the full name of the author, the name of the document in *Italics*, the year of publication, the name of the website, the URL of website (that is, its internet address) and the date of retrieval.

Example:

Shlomo Ben Ami, *How We Got It Wrong* (2002) Ha' Aretz Daily
<<http://www.haaretz.com/articles/2002/05/14/1084289890950.html>> at 31 May 2002.

2. References (bibliography)

References must be included, using the following headings as a guide:-

- A. Books
- B. Articles
- C. Websites
- D. Cases
- E. Legislation
- F. Newspapers and Other Sources e.g. interviews, television reports

It is not enough to merely provide footnotes. Full references must also be provided.

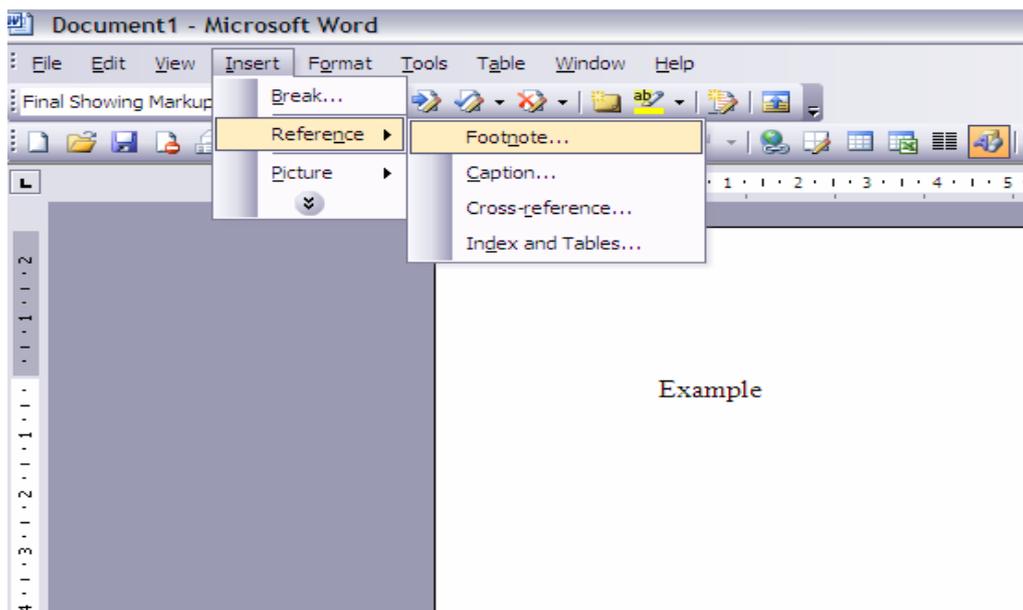
3 Inserting footnotes using Microsoft Word ®

When inserting a footnote for primary materials, the footnote should be inserted immediately after the reference to the material in the text. When referring to an authors work or an idea from a book or journal, the footnote can be inserted at end of the sentence where the reference is made.

Most word processing suites have ‘footnote’ functions. Acknowledging that the most common word processor is Microsoft Word, this section will only provide instructions on inserting footnotes using Microsoft Word.

Steps

1. Position the cursor in the exact place where you desire the footnote to be inserted (i.e. the little superscript number which corresponds with the citation at the bottom of the page)
2. Select ‘Insert’ from the menu at the top of the screen
3. From the dropdown menu beneath ‘Insert’ select ‘Reference’
4. From the menu which opens besides ‘Reference’ select ‘Footnote...’
5. From the pop-up window which appears, press the button ‘Insert’



Example

4. Tips

4.1 Citing the Australian Constitution

The Australian Constitution may be cited as the *Australian Constitution*, the *Commonwealth Constitution*, or simply the *Constitution* if there is no ambiguity to which constitution is being cited.

Example

Australian Constitution s 51 (xiii)

4.2 Subsequent Citations and Using 'Ibid'

Ibid should be used to cite a source (other than legislation) if it appears in the footnote immediately preceding the current footnote, and it is the only source cited in the previous footnote. If you require a pinpoint reference, you may include this directly after 'Ibid'.

Example

12 Dr Niloufer Selvadurai, 'Regulating for the Future - Accommodating the Effects of Convergence' (2005) 13 *Trade Practices Law Journal* 20, 27.

13 Ibid, 31.

4.3 Chapters in a book

When citing the work of a single author in a edited book, the footnote should follow the following style:

Authors Name, 'Chapter Title' in Editors Name (ed), *Title* (Year) starting page, pinpoint reference.

Example

Hope Ashiabor and Patricia Blazey, 'Fiscal Instruments and the Management of the Transition to Sustainable Mobility in Australia - Challenges and Prospects' in EDITORS NAME (ed) *Critical Issues in Environmental Taxation: International and Comparative Perspectives: Volume III* (2006) 143, 161.

4.4 Use of Headings

The use of headings in all assessment tasks including the final exam is useful in introducing new areas or sub areas.

If anything remains uncertain in regards to using and citing sources, you should consult the AUSTRALIAN GUIDE TO LEGAL CITATION (the web address is provided above).