DOUBLE TAXATION

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Glossary*
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Double taxation occurs when tax is paid more than once on the same taxable income or asset, and it can be legal or economic. Double taxation is *legal* if the same person is taxed twice on the same income in at least two states (or in two entities of the same federal state). *Economic* double taxation arises when firstly corporate income tax is levied, and then the shareholders of the enterprise are required to pay tax on the dividends distributed out of the profit after taxes have been paid.

Legal double taxation arises when two or more tax jurisdictions prescribe comparable taxes for the same taxable entity, with respect to the same taxable earnings or asset. Such double taxation can arise intra-state or internationally. Intra-state double taxation occurs if same-level sovereign tax jurisdictions impose comparable taxes. International double taxation arises when the comparable taxes are imposed in two or more states with respect to the same taxpayer and in connection with the same taxable earnings or asset, for instance, if income is taxable in the country in which it is earned and also in the country of residence of the recipient of the earnings.

Intra-state and international double taxation can be avoided or mitigated by relief applied unilaterally, while international double taxation is avoided or mitigated with bilateral or multilateral double taxation avoidance treaties.

According to double taxation avoidance treaties, the right to tax a given income will belong to one country, either the country in which the earnings originate, or the country of residence of the recipient of the earnings. Sometimes, however, both countries are authorised to tax a given taxable entity, the right of a given country being restricted to a precisely determined percentage of the tax. The country of residence usually avoids double taxation by excluding income on which tax is paid abroad from the taxable income or by allowing a tax deduction for tax that has been paid in another state. Well-known models for the avoidance of international double taxation are those of the OECD and the UN.

Economic double taxation arises when the same income is taxed at corporate and at stockholder level. In this classical system of taxation, profit is really being taxed twice, because no relief is given for profits distributed at either enterprise or at share-

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holder level. But economic double taxation can be avoided or mitigated in various ways of reducing or obviating the double taxation, such as a system for deducting dividends, an imputation system or a system of separate tax rates.

The Dividend Deduction System is a system of corporate income tax in which relief is allowed at company level by the permission for deductions of dividends from the taxable base of the company.

In the Imputation System, at least part of the tax that the corporation pays on its earnings is deductible from the tax liability of the shareholders as they receive their dividend. In this system, the entire profit, whether it is issued in dividends or not, is taxed at the company level in statutorily defined rates. After the corporate income tax is issued in dividends, the shareholder must report the dividend received as taxable income augmented by the appropriate corporate income tax.[1] The corporate income tax can then by deducted from the tax liability of the actual shareholder. If the amount of this imputed deduction is greater than the tax liability of the actual shareholder, the taxpayer can require the refund of the amount that exceeds the tax liability. If on the other hand the stockholder's tax liability exceeds the deduction, then the difference has to be paid. Many states have accepted the imputation system, in various different forms. There can be a full imputation system, when the total profits are imputed to the shareholders, and then they are taxed with individual income tax, or the system can be one of partial imputation, in which the shareholder can deduct the profit tax paid only in part.

The Split Rate System is also one of the ways of reducing the double taxation of dividends. This is a system of taxing corporate profits according to which various tax rates are applied to the distributed and to the retained profit, without the application of the imputation system. Lower rates of taxation on corporate income tax are applied to the distributed profit, because it is assumed that it will be attract additional taxation when in the hands of the shareholder.

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[1] The dividend is imputed tax on the earnings of the firm, hence the name of the system:imputation.