ROMANIA AND INTERNATIONAL DOUBLE TAXATION

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Abstract: The phenomenon of double taxation arises not due to the different structures of tax systems, but due to the different conceptions (criteria) which underlie the taxation. Two conceptions apply in the tax practice: territorial conception, which underlies the source criteria (origin) of revenues or the place where the property is located; and the global and world conception, which underlies the residence criteria (of tax residence) or the nationality of the taxpayer, natural person, respectively of the registered office of the taxpayer, legal person. With the purpose of avoiding the double taxation, our country uses both unilateral legislative measures and the negotiation and conclusion of bilateral or multilateral conventions with the partner states, the two measures of tax harmonization being used simultaneously. Our legislation applies the criteria of territoriality and citizenship regarding the settlement of tax rates, taxes, contributions and other public revenues by means of which the double taxation tries to be avoided.

Double taxation consists in the taxation of the same revenue or asset twice or several times, within the same financial year. The tax doctrine differentiates two forms of double taxation and namely, the economic double taxation which consists in submitting a taxable matter to two or more taxes in favour of the same authority or of some different public authorities, in the same financial year and the legal double taxation which consists in the phenomenon of submitting the same person to double taxation for the same object of taxing [Vacarel, 1995].

In a more complete definition and of wide sense in tax doctrine, the double taxation represents the submission to two or more taxes which are similar, upon the same subject of taxing, for the same taxable object and regarding the same period of time [Davis, 1985].

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Two conceptions apply in the tax practice: territorial conception, which underlies the source criteria (origin) of revenues or the place where the property is located; and the global and world conception, which underlies the residence criteria (of tax residence) or the nationality of the taxpayer, natural person, respectively of the registered office of the taxpayer, legal person.

In the country where the territorial conception applies all revenues are taxable, regardlessn their nature (the profit of enterprises, wages, incomes from independent activities, tenures, interests, equities, rents and so on), if the source is located on the territory where the respective state carries on the tax sovereignty, the place where the beneficiary of the respective incomes resides is irrelevant. In exchange, in the country where the world or global conception is applied all incomes (and assets) of natural and legal persons are taxable, persons who have the residence (tax residence) or headquarters, depending on the case, in the respective state, with no importance from where those revenues grow from or where the respective assets are. When a state applies the territorial conception, and the other state applies the global (world) conception arises a conflict of interests between the two states. Also, the conflict of interests may arise if both states apply the same taxation conception. Therefore, in the hypothesis of applying the global conception by both states, the conflict arises if one of the states uses as a taxation criterion the residence of the taxpayer; while the other uses the nationality criterion of the taxation subject. For instance, the U.S.A. apply the nationality criterion of the taxpayer, in exchange other states apply the residence criterion. In such situations, if a taxpayer is an American citizen and has the residence in another state which applies the residence criterion is susceptible to pay taxes in both countries. When applying the territorial conception, may also arise conflicts of capacity if the considered states enacted legislations which define differently the source of revenues.

Such cases arise, for instance, when the states in question define differently the residence notion regarding the main-society and its branches abroad.

In this situation the conflict shall arise concerning the determination of taxable profit of the main-society, respectively of its branches.

One may also assert that, irrespective of its origin, the double taxation has effects which can be only negative, affecting in the last resort the efficiency of exports itself and external competitiveness of goods, as the tax charge is higher if the revenue or property would have been submitted only to the tax legislation from one country.

Therefore one may keep in mind that double taxation, tending to absorb almost integrally the profit, constitutes an obstacle in the optimum geographical distribution of stock investments and productive activities and consequently its elimination represents an essential side of economic and tax policy of governments [Strungaru, 1997].

With the purpose of eliminating or, at least, restrictioning the malefic influence of double taxation, states as well as doctrine, tax practice suggested and enacted the most varied measures, both having internal character and at international level. The general modalities most frequently used to avoid double taxation are the national regulations, bilateral or multilateral conventions, jurisprudence, common law and doctrine. In order to avoid the repeated taxation, there have been adopted unilateral legislative measures which consisted in granting exemptions or tax deductions for certain revenues obtained abroad by natural and legal persons, accomodations which can be applied automatically, sometimes even if for the respective revenue it hasn't actually been paid taxes abroad and in constituting the exemption of custom duties and V.A.T. for the export of goods. Also, some states use the institution of tax credit deducing from the tax due in the residence country the taxes paid by their residents abroad for the revenues made abroad. As by multilateral measures the complex and multiple issues which arose in the field of avoiding the double taxation couldn'y be solved, although progresses had been achieved, the necessity of concluding international bilateral and multilateral conventions arose.

The measures having international character for avoiding the double taxation on revenue and property can be constituted by two categories of conventions: tax conventions which control exclusively measures for avoiding the double taxation on revenue and property and the international agreements having another main object than the tax issues and namely the commercial economic agreements, financial, transportation agreements, and so on, which comprise along with the specific regulations related to the main object also some measures regarding the tax rates and taxes.

In the tax conventional practice, the avoidance of double taxation is ensured either by exemption method (payment exemption) or by lending method. As the Tax Committee of Organization for Economic Cooperation and Development – OECD considers that double taxation may be actually counteracted by both methods, distinct texts have been drawn up, which have been included within the OECD Model Convention.

Within the exemption method, the residence state of the beneficiary of a certain tax does not tax the revenues which, according to the provisions of tax conventions, are taxable in the other state, meaning the source state or the state where the taxable property lies, a permanent headquarters or a determinate basis. In tax conventions, the exemption method is used in two variants: total exemption method or progressive exemption method.

In accordance with the progressive exemption method, the residence state of revenue beneficiary, when determining the taxable revenue of one of its residents does not take in account his taxable revenue in the source state or the revenue afferent to a permanent headquarters or of a determinate basis from the other contracting state. Therefore, it shall take into account only the rest of the taxable revenue. In this way, practically, by not taking into account a certain revenue, an tax exemption is granted. Furthermore, the residence state overlooks the existence of the tax exempted revenues when determining the taxable revenue of the taxpayer residing in that state.

According to the progressive exemption method, the taxable revenue in the other contracting state (which is the source state of the revenue, where the permanent headquarters or determined basis lies) is not taxable in the residence state of the beneficiary of that revenue. In exchange, this last state keeps the right to take into account this revenue, when determining the tax afferent to the residual tax. It is acted in the same manner regarding the property taxation.

Within the lending method, the residence state calculates the due tax of one of its residents according to the total volume of revenues of this taxpayer. This means that in the taxable revenue, the residence state shall include also the taxable revenue from the source state or from the state where the property which brings taxable revenue lies, as well as the taxable revenue in the state where the permanent headquarters or determined basis lies. Naturally, it shall not take into account the revenue and respectively the property which are taxable only in the other contracting state. Of the total tax, established for the total of taxable revenues (or property), the residence state shall deduce the tax paid by the respective taxpayer in the other contracting state. This method has two variants and namely the total lending method (integral) and common lending method (habitual or limited).

According to the total lending method, the residence state deduces from the tax afferent to the taxable revenues (property) of the taxpayer, the total amount of the tax paid by him in the other contracting state.

Concerning the common lending method, the residence state deduces with title of paid tax in the other contracting state an amount which can be equal or lower than the amount actually paid to the source state. Thus, in cases when the tax rates used in the two contracting states are identical and when the rates applied in the residence state are higher than in the source state, the tax loan granted by this last state is equal to the amount of tax paid in the source state. But when the rates applied in the residence state are lower than those used in the source state, differences arise meaning that the residence state cuts down the tax granted to the respective taxpayer, with the title of tax loan, a lower amount than that of the tax actually paid in the source state. Since the tax loan granted by the residence state to its taxpayer is lower than the tax paid by him in the other contracting state, it results that the common lending method leads only to partial avoidance of double taxation [Condor, 1999].

Fighting against the double taxation phenomenon became an imperative necessity for Romania, also, especially after The Romanian Revolution of 1989, being also an important condition in expanding the commercial relations and economic cooperation, technical-scientific and cultural and international cooperation. With the purpose of avoiding the double taxation, our country uses both unilateral legislative measures and the negotiation and conclusion of bilateral or multilateral conventions with the partner states, the two measures of tax harmonization being used simultaneously.

Our legislation applies the criteria of territoriality and citizenship regarding the settlement of tax rates, taxes, contributions and other public revenues by means of which the double taxation tries to be avoided.

In order to apply the territoriality principle, the tax rates and taxes are applied on the owned revenues and assets acquired on the territory of Romanian state, regardless if their beneficiary or acquirer is a Romanian or foreign citizen.

In this respect, we mention, for instance, art. 39 of the Law no. 571 from 22nd of December 2003 concerning the Tax Code, amended by the Law no. 343 from 17th of July 2006, which makes provisions that the Romanian natural person is taxable for the revenues acquired in Romania as well as the foreign natural person for the revenues acquired in Romania or in a period which exceeds in all 183 days in any period of 12 months or ending in the aimed calendar year.

In accordance with the citizenship criterion (the capacity ratione personae), the tax rates and taxes in our country apply for the Romanian citizens and Romanian legal persons for the revenues and assets acquired both in the country and abroad.

For the revenues and the assets acquired abroad, the levy of tax rates and taxes provisioned by the Romanian legislation may be considered legitimate only if for those revenues and assets there weren’t paid tax rates and taxes in the state on which territory they were acquired or attained; for the possible difference between the tax rates and taxes paid abroad and those owed on the territory of Romanian state if these last ones are higher. Regarding such revenues, the Romanian legislation makes provisions about some exemptions, such as the custom duties for some assets acquired abroad by Romanian citizens; the value added tax for some imported goods; the custom duties and the value added tax for the export of goods.

In the last years, the Romanian legislation took into account the tax rates paid by the Romanian residents abroad for some revenues acquired abroad, deducing them from the attained tax rate. In this respect the institution of tax loan has been regulated, which has a special importance in case our country hasn’t concluded a convention of avoiding the double taxation with the source state of the revenue.

Therefore, by the Law no. 571 from 22nd of December 2003 regarding the Tax Code, amended by the Law 343 from 17th of July 2006, related to external relation the tax loan is applied, as an unilateral measure of avoiding the double taxation. In this regard, it is provisioned that the Romanian legal person has the right to be deducted from the profit tax owed in Romania, an amount equivalent with the revenue tax from the external source paid directly or by retention at the source abroad on the grounds of documents which certify the payment, acknowledged by the foreign tax authorities. The amount of the deduction can not exceed the profit tax calculated by applying the profit tax rate provisioned by the Romanian law upon revenues, on each external revenue source, after subtracting their afferent educible expenses.

Another legislative measure designated to avoiding the double taxation is represented by the standard of sending to tax conventions. Therefore, the Law no. 571 from 22nd of December 2003 regarding the Tax Code, art. 1 paragraph (4) shows that "If any provision of the present code contravenes to a provision of a treaty of which Romania makes part, the provision of that treaty is applied". Furthermore, in the art. 118 paragraph 2 it is provisioned that "for applying the provisions of the convention of avoiding the double taxation, the non-resident has the duty to present the revenue payer, in the moment of achieving the revenue, the tax residence certificate issued by the competent body from his resident state. When presenting the tax residence certificate, the provisions of the convention of avoiding the double taxation is applied and the adjustment of the tax is made, within the legal limitation term, under the circumstances when the tax residence certificate mentions that the beneficiary of the revenue had, within the limitation term, the tax residence in the contracting state with which the convention of double taxation is concluded, for the entire period when the revenues were acquired in Romania".

As the unilateral measures above mentioned do not have a reciprocity correspondent in the legislations of all states with which Romania maintains commercial relations and economic cooperation, technical and scientific and of other level, there is the danger that the Romanian legislation to avoid the double taxation, while the legislation of the partner countries shouldn't contain identical or similar legal measures.

Under these circumstances, the necessity of passing to concluding a convention for avoiding the double taxation has arisen for Romania, too. Per se, in the last four decades, Romania accomplished a special performance, succeeding to conclude tax conventions with 80 countries in the world. When concluding the bilateral conventions, Romania used, generally, the rules, solutions and methods of avoiding the double taxation from the OECD Model Convention. Also, Romania concluded two multilateral conventions: the Convention regarding the avoidance of double taxation of the revenues and assets of natural persons concluded in Miskolc (Hungary) on the 27th of May 1977 and the Convention regarding the avoidance of double taxation of the revenues and assets of legal persons, concluded in Ulan-Bator (Mongolia) on the 19th of May 1978. In both conventions the contracting parties were: Bulgaria, Czech Republic, German Democratic Republic, Mongolia, Poland, Romania, Hungary and Union of Soviet Socialist Republics. But after the political mutations from the last 17 years (the breaking of the Union of Soviet Socialist Republics, the unification of Germany) the application scope of the two conventions restricted.

The tax conventions concluded by Romania sanctify the agreement of the signatory states regarding the distribution between them of the right to tax concerning some categories of revenues or property or elements of the property, following either the assignation of exclusive tax right to one of the contracting states or the sharing concretely the tax right between them, the interests of the signatory states being the factor which determine the use of a certain method of avoiding the double taxation. One may notice that Romania didn't have a constant position, meaning it wasn't used the same method or method variant for avoiding the double taxation with all contracting states. In addition, mixed solutions were adopted, using for instance the common lending method for some categories of revenues (royalties, interests, equities and so on), and the progressive exemption method for other revenues. The lean method was more frequently used, with its variants: total lending or common lending.

The conventions concluded by Romania do not comprise the total exemption method as a resolute solution, but only as a solution from which the residence state can derogate, meaning to apply the progressive exemption method.

But one may notice that the solutions used by Romania for the actual avoidance of double taxation are not always simetrical with those taken into account by the other contracting states, regarding either the actual methods of avoiding the double taxation or the approaching manner of some revenue elements.

Therefore, for instance, in the conventions concluded with Denmark, Finland, Norway and Spain, Romania took into consideration the common lending method; in the convention with France, Romania inserted the common lending method, and France – the progressive exemption method; in the conventions with Belgium and Holland, Romania took into account the total lending method, and the partner states – the progressive exemption method. In the conventions concluded with Germany, France, Belgium, Malaysia and so on, there were provisioned distinct solutions for certain revenue elements only for the partner states and not for Romania.

The academician Iulian Văcărel considers that this asymmetry is explained especially by the fact taht until 1990, the state Romanian enterprises participated in forming the budgetary revenues with payments from benefits established by the residual method. Under these circumstances, the method of avoiding the double taxation doesn't present a great practical importance for our country.

The stipulation, in tax conventions, of some asymmetric solutions for avoiding the double taxation might be determined by the interest of the more powerful contracting state to obtain form the other contracting state, weaker from the economic point of view, tax advantages higher than it is willing to offer or the interest of the state with a lower economic potential to obtain, in exchange of a tax grant, some advantages from the other powerful contracting state. Regarding this last hypothesis, we must say that some developing countries, interested in attracting foreign investors and in aquesting modern technique and technologies, agree to make certain tax sacrifices in favour of the stock exporter states, of industrial equipments, licences, brands or trademarks, and so on. In such situations, some states, by concluding the conventions of avoiding the double taxation, offer more than they receive. If the source state of some revenues opted for the lending method, then it should be granted a deduction from the tax of the beneficiary of those revenues at the level of the amounts retained effectively with a tax title from it. In fact, sometimes, the states commit themselves to grant the beneficiaries of revenues tax loans superior to the operated retentions, by establishing the respective loans by a flat-rate manner (with no connection to the retained tax) or by applying the tax criteria of the revenues due to the residents by taxing the expatriated revenues.

But the tax conventions don't have only the purpose of preventing the double taxation but also of preventing the tax evasion. Thus it is shown that "a taxpayer hopes the agreements shall prevent double taxation of his revenue; the tax body hopes the treaty shall prevent tax evasion; the politician just hopes" [Gravelle, 1988].

From the Government's point of view, the explanation given in the OECD Model Convention is probative, where it is shown that the convention between state A and state B for avoiding the double taxation regarding the revenue and stock taxes. Many conventions even contain in their title "the prevention of tax evasion". Therefore, the majority of tax conventions, even if not all of them mention in the title, have also as a purpose the prevention of tax evasion.

The judicial practice in the field emphasizes, also, this aspect. Thus, examining the purpose of conventions of double taxation, the Supreme Court of the USA decided the following: "…the general purpose of a convention wasn't to ensure the complete and rigid treatment equity – in fact an impossible task, taking into account the different tax structures between the two countries – but surely, that, as it arises from the head note of the convention itself, to stimulate the trade exchange by eliminating the double taxation resulted from the taxing of both countries of the same transaction or profit; an additional purpose was the prevention of tax evasion".

This second purpose of tax conventions results from the summary of the conventions concluded by Romania and namely from the head note and its articles, especially from the articles concerning the amiable procedure and information exchange.

In the developed countries, the use of the so called "treaty shopping" strategy grew, in order to reduce the tax charge. This consists of comparing the advantages and inconveniences of the available conventions, further going to be apprehended the convention which facilitates the resort of legal structures able to reduce the tax charge, however without committing illegalities.

The term "treaty shopping" is of English or American origin, but the respective practice is not only characteristic for the companies in these countries. Although this tecnique is not illegal, it rather disclosing a tax strategy (international tax planning) which allows to be obtained the best advantage made the best of the existent tax conventions, is still considered as being an abusive form of tax planning, consisting of creating artificially the conditions of taking benefits from the conventional tax advantage, thus allowing the increase of net profit by decreasing the tax price. The treaty shopping technique consists of interposing some unit (company or establishment) located in a third state in proportion to the state where resides the revenue. Therefore, a trading company established in the third state C interposes between state B, where the revenue is produced and which didn't sign a convention with state A where the revenue beneficiary resides, state which, in exchange, signed a convention regarding the double taxation with state C. As a consequence, teh revenue obtained in state B passes through the company established in state C in order to take advantage of the convention's benefits and it is devolved to state A after being hit by a reduced taxation. Making use of the most profitable conventions, the retention at the source in the state where the revenue comes from is less higher than that which would be operated if the revenue would be devolved directly from the state of revenue source by the state where the beneficiary resides.

Below we give an example of using this technique in case of developing a commercial transaction which implies an international payment of royalties (by the residents).

The royalties, both concerning the Romanian legislation (G.O. no. 83/1998 regarding the taxation of non-resident persons) and of art. 12 from the Model Treaty of Avoiding Double Taxation prepared by OECD signifies "… any kind of payment, inclusivelly in kind, in order to use or lease any right, such as: copyright on a literary, artistic or scientific work, ... as well as pursuing audio or video recordings, any patent, invention, innovation, licence, know-how, trademarks or brands, drawings or models, designs, sketches, secret formulae or manufacturing procedures, any industrial, commercial or scientific equipment, inclusivelly for using and the right to use information and knowledges related to the background in the industrial, commercial or scientific field, as well as any other payments for using other rights...".

Regarding the crossborder payment of royalties, the residence state of the taxpayer has, geenrally, the right to impose a tax by retention at the source, which may vary from state to state, according to the provisions of the Treaties of avoiding the double taxation (if applicable). If between the investing country and the taxpayer country there isn't a treaty or there is an unfavourable one, this tax retained at the source may be burdensome. However, using the treaty shopping strategy, this tax can be lowerer. Thus, the most treaties of avoiding the double taxation concluded by Cyprus stipulate taxes at zero rate or at a very low rate on the royalties received by the companies in Cyprus. The royalties paid by the companies in Cyprus (on shore) are also submmitted to some very low taxes retained at the source. In addition, the royalties paid by the offshore companies in Cyprus are always unrated at the source.

We mention that the treaty of avoiding the double taxation between Romania and Cyprus stipulates a tax on royalties of 5%.

Let's suppose the investor registers a holding (MANCO LTD), who is the owner of an asset susceptible of being leased in exchange of a royalty. The holding is located in Mau Island (tax paradise).

MANCO LTD sells the right to use the asset for 10 years to an offshore company in Cyprus (CYPCO LTD) in exchange of a company in Ireland (IRCO LTD) for a small profit. In the end, IRCO LTD sells the lease to an American client. The American client pays the royalty to IRCO LTD without taxing them at the source, according to the treaty of avoiding the double taxation between the USA and Ireland. IRCO LTD, being an Irish legal person shall pay a profit tax of 29% for the profit margin obtained in Ireland. The royalties paid by IRCO LTD to CYPCO LTD are not submmitted to a taxation by retaining at the source, according to the treaty of avoiding the double taxation between Cyprus and Ireland. The offshore company in Cyprus shall pay a profit tax of 4,25% for the profit margin obtained in Cyprus. The royalties paid by CYPCO LTD are not submmitted to a taxation by retaining at the source.

One may notice that the tax rate cumulated in Cyprus and Ireland is ony of 1,66, thus the election of the countries through which passes the royalties flow is very important, being necessary to chose doublets of successive countries where the tax at the source on royalties doesn't exist or is very low.

As the treaty shopping practice encourages the multiplication of transactions which do not have, generally, economic consistency, running the risk to diminute the trust of taxpayers in their own tax system, some states, in particular the ones from the west enacted many provisions which would obstruct these operations.

The Governments' hostility towards the treaty shoppimg is generated by the fact that the source country loses from tax receipts as it shall apply a lower retaining rate at the source and therefore it is reduced the power of negotiation of the country where the revenue source lies when this tries to obtain for its own residents advantages of taxing nature from the foreign contracting state.

MANCO LTD (Insula Mau)	Received royalties	90,00
CYPCO LTD OFFSHORE COMPANY	Received royalties Paid royalties (90,00) Tax rate (4,25%) Profit	95,00 5,00 (0,21) 4,79
IRCO LTD IRISH COMPANY	Received royalties Paid royalties (95,00) Tax rate (29%)	100,00 5,00 (1,45)
AMERICAN COMPANY **U.S.A.**	Net profit Paid royalties Tax rate at the source	3,95 100,00 (0,00) 100,00

In Romania, many non-resident companies speculate the imperfections and shortcomings of the conventions of avoiding the double taxation obtaining substantial revenues without being submmitted to taxation at the source and namely on the territory of the Romanian state.

Therefore, I may give the example of the biggest foreign invesment in Craiova of the 95's, which, speculating the fact that in the convention between Romania and the country of which it makes part there weren't provisioned expressly as being taxable the revenues from management, sent each month during 1997-1998 billion of dollars in the shape of management expenses to some so called managers of the respective country, who didn't even develop their activity on the territory of our country, without retaining any tax.

The respective company also stood upon the fact that in the convention it was stipulated at the article "Other provisions" that the revenues which weren't found expressly in the convention were taxable in the residence country.

Of course, the local tax bodies (I may say I personally dealt with these checkings) proved that the respective activities producing revenues weren't of management and they situated them in the chapter "Royalties" in the convention (defined as being, among others, payments made for using the background in the industrial field and know-how), situating them with a tax acquired by holding on source of 10%.

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