

## **“A CRITICAL ANALYSIS ON THE DOUBLE TAXATION AVOIDANCE AGREEMENT OF US AND CHINA”**

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**ABSTRACT:** Double taxation avoidance agreements exist between countries to ensure that the income of citizens is not taxed more than one. As like any other country US and China also have double taxation treaty among each other to protect the interest of their residents who are having international transactions. The treaty was signed namely UNITED STATES-THE PEOPLE'S REPUBLIC OF CHINA INCOME TAX Convention having 28 articles which Entered into Force on January 1, 1987. The Agreement is based on model income tax treaties developed by the Department of the Treasury, the Organization for Economic Cooperation and Development, and the United Nations. The Agreement is meant for contributing to a long-run expansion of economic relations between the countries by providing clear rules as to the tax consequences of investing or working in the other country. It reduces the tax which residents of one country must pay to the other on certain types of income, such as dividends, interest, and royalties. The Agreement also assures nondiscriminatory taxation in the host country, and, provides a mechanism for cooperation between the tax authorities to try to resolve any potential problems of double taxation. Advantages of double taxation treaties for countries participating in trade war involves free flow of international trade and investments, Protection against double taxation, Prevent discrimination between tax payers, Mutual exchange of information etc. Business dimensions of double taxation avoidance agreements is explained in terms of business profits, dividends, interests, royalties, related enterprises. Double taxation avoidance agreements should be continuously maintained to avoid trade war, problems of Capital deficiency, technology deficiency, labor deficiency, building core competencies etc. which can be mitigated only through joint arrangements like associate enterprises, collaboration agreements, joint ventures etc.

**Keywords:** *Business Profits, Dividends, Interests, Royalties, Related Enterprises*

### **INTRODUCTION**

Trade war is a situation in which countries try to damage each other's trade, typically by the imposition of tariffs or quota restrictions. In this current scenario US-China trade war is an influencing point in the global trade. Both of the world's largest economies has imposed tariffs on each other's products. The economic shutdown doesn't look good for the global economy. The taxation systems has changed with more of tariffs and quotas, but does not made any significant change in the double taxation treaty that both these countries are having among each other.

In general the double taxation avoidance agreements exist between countries to ensure that the income of citizens is not taxed more than one. It generally happens when one is resident in a country and has income on other country too. It can be jurisdictional double taxation or economic double taxation. In case of jurisdictional double taxation, income is taxed more than once because

of the residential status of a country and non residential revenue generation in another country. While the economic double taxation arises when the same income is taxed for different assesses, for example: dividends.

The double taxation agreements are generally formed based on the OECD principles with enough modifications for suiting their economies. It may be bilateral (between two countries) or multilateral agreements (between more than two countries)

Since the domestic markets are agreed up for building global markets, the global free order could not be hindered through trade war policies. Trade war also affects the double taxation avoidance agreements of nations. Hence we attempt to study the advantages of having double taxation agreements even for trade war participating countries and the business implications of having double taxation avoidance agreement.

### **AIM OF THE STUDY**

1. To identify advantages of having double taxation avoidance agreements between countries participation in trade war
2. To evaluate the business factors in terms of taxation and double taxation avoidance.

### **PRACTICAL IMPLICATIONS OF THE STUDY**

It's necessary to evaluate the implications of having double taxation avoidance agreements so as to importance to the revenue making of assesses of countries. This study helps businesses to analyze taxation implications and double taxation avoidance agreements benefits. It helps economies to understand the role of such bilateral agreements in enhancing global free trade order

### **REVIEW OF LITERATURE**

1. Aayushi Jain (2015) Journal Of Legal Studies And Research [Vol. 1, Issue 1] page 45-59

In his study he states that nearly all tax treaties provide a specific mechanism for eliminating double taxation which is still potentially present. This mechanism usually requires that each country grant a credit for the taxes of the other country to reduce the taxes of a resident of the country. The treaty may or may not provide mechanisms for limiting this credit, and may or may not limit the application of local law mechanisms to do the same.

2. Sarbapriya Ray (2011), International Affairs and Global Strategy [Vol 2, Issue 2]

According to her study it's known that India had entered into a wide network of tax treaties with various countries all over the world to facilitate free flow of capital into and from the nation. Double Taxation Avoidance Agreements are evidently an interaction of two tax systems each belonging to different country, which aim to mitigate the effect of double taxation.

3. Annapurna Chakra barty, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2404797](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2404797)

As per her study Double Taxation Avoidance Agreement is very much helpful for avoiding double taxation not only that double taxation avoidance agreement can over ride the Income Tax act; if it is beneficial for the assesses. But it should not be used in wrong manners like to promote double non taxation or to unnecessarily or illegally reduce the tax liability or treaty shopping. It is essential that the Double Taxation Avoidance Agreements should have a clear provision which prevent DTAA from misuse.

## **RESEARCH GAP**

Even though many studies are conducted about existence of Double taxation avoidance agreements, study about the business implications of these agreements is needed. And also in this period of trade war it's necessary to evaluate the importance of these agreements for the participants of trade war.

## **DATABASE AND METHODOLOGY**

The study is based on secondary data. The secondary data required for the studies were collected from various websites and journal publications related to the topic under study.

## **US AND CHINA TREATY: CRITICAL CASE ANALYSIS**

### ***Historical background of the Treaty***

The Agreement and Related Protocol was Signed at Beijing on April 30, 1984 .The subsequent and the Second Protocol was Signed at Beijing on May 10,1986;.Ratification on the protocol was Advised by The Senate of The United States of America on July 24, 1986;And Instruments of Ratification was Exchanged on October 22,1986;

The treaty entered into Force on January 1, 1987 aiming at promoting trade relations and economic welfare among the countries. A treaty was further issues for the international transactions relating to aircraft and shipping operations. The present agreement is based on model of Income tax treaties prepared by the Department of the Treasury, the United Nations and the OECD. Like other United States tax treaties, it provides rules for determining the extent to which each country may tax particular types of income. The agreement provides that the country of residence will give a foreign tax credit for income tax paid to the other country. If any potential problems of double taxation should arise, the tax officials of the two countries agree to consult to try each other. The agreement helps know expanding the economic relations between the countries. This bilateral treaty is a comprehensive one where scope applicable to all sources like dividends, interests' and royalties.

### ***Benefits aimed through the treaty***

1. Protocols are set for the avoidance of permanent tax evasion
2. Facilitate a mechanism for cooperation between the income tax authorities of the nations' to try to resolve the potential problems of double taxation
3. Assurance of non discriminatory taxation in the host country important concepts associated with the treaty
4. Along run benefit of economic relations is established through clear cut rules

## **IMPORTANCE OF DOUBLE TAXATION AVOIDANCE**

### **AGREEMENTSBETWEEN NATIONS PARTICIPATING IN TRADE WAR**

“The question of double taxation gains importance both for states and tax-payers.it occurs where states levy taxes not only on domestic assets and domestic economic transactions carried out in other countries in relation to a resident taxpayer's benefits”. The advantages of double taxation treaties for countries participating in trade war involves following;

#### **1. Free flow of international trade and investments**

When the income of an assessee is taxed twice the assessee will not try anymore to go on with the same markets. As far as this liberalized economy is concerned none of the economy can stay solo

without assistance, cooperation and participation of other economies. It is the reason that common beneficial treaties are agreed and signed upon. Similarly the double taxation avoidance agreements between economies will assist the economy to boost their healthy relations for trade. Various kinds of business needs like labor deficit, capital deficiency, technological shifts, etc. can be boosted only when these bilateral agreement are meant for supporting international trade with thought of thinking globally for acting locally.

## **2. Protection against double taxation**

Article 22 clearly states about the protection against double taxation

1. In the case of resident of republic of China When a resident of China derives income from the United States, the amount of the United States income tax payable in respect of that income in accordance with the provisions of this Agreement shall be allowed as a credit against the Chinese tax imposed on that resident. The amount of credit, however, shall not exceed the amount of the Chinese tax computed with respect to that income in accordance with the taxation laws and regulations of China. Where the income derived from the United States is a dividend paid by a company which is a resident of the United States to a company which is a resident of China and which owns not less than 10 percent of the shares of the company paying the dividend, the credit shall take into account the United States income tax payable by the company paying the dividend in respect of the profits out of which the dividends are paid.

**In the United States, double taxation shall be eliminated as follows:**

(a) Where a resident of US derives income from the china, the amount of the Chinese Income tax payable in respect of that income in accordance with the provisions of the agreement shall be allowed as a credit against the US tax imposed on that resident. The amount of credit, however, shall not exceed the amount of the US tax computed with respect to that income in accordance with the taxation laws and regulations of US.

(b) Where the income derived from the China is a dividend paid by a company which is a resident of the china to a company which is a resident of US and which owns not less than 10

Percent of the shares of the company paying the dividend, the credit shall take into account the Chinese income tax payable by the company paying the dividend in respect of the profits out of which the dividends are paid.

## **3. Prevent discrimination between tax payers**

Countries should not show discrimination among their Resident and nonresident tax payers Article 23 clearly states about this.

It's noted that the taxation requirements and procedures connected should not easy as a burdensome than the actual requirements for the non residents of the economies .The permanent establishments partly or wholly controlled from other contracting economy should not be treated less favorably when compared to the regional business establishments. There is no need of granting residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

## **4. Mutual exchange of information**

Article 24 states about the mutual agreement where if the individual or person is of opinion that the actions taken by the departments of contracting or other contracting states are unjust, then he can go for case within 3 years. The case shall be filed to the competent authority where he is a national. The competent authorities shall provide a suitable judgment either independently or jointly or by forming oral opinion

Article 25 states about the exchange of information whereby it's mandatory that the competent authorities should disclose and exchange enough information among each other for prevention of tax evasion and fraud rather than keeping information as secret.

### **5. Legal and fiscal certainty**

The agreement provides certainty with regard to legality where the tax benefit is not hindered to the assessee. In case of royalties only 70 percent is considered for charging for the tax. With this regard it's clearly understood that these agreements are legal bindings which can guarantee the safety of govt revenue through taxes but assuring that there is no overburdensome to the tax payers.

### **6. Acceptable basis of sharing transfer of taxes between states**

The bilateral agreement clearly mentions about the mutual arrangements where the tax is shared between the contracting states. Article 22 states about how double taxation is prevented. The protocol clarifies that the tax income will be shared between contracting states in manner which the income is generated. For instance of a business having permanent establishment in other contracting State the taxable earned by govt will be shared to other contracting State up-to the proportion of the revenue generated by the permanent establishment.

## **BUSINESS DIMENSIONS OF DOUBLE TAXATION AVOIDANCE AGREEMENTS**

Business should be aimed at countries which have lucid taxing treaties. Taxpayers are always interested to invest in countries which they have confidence in the tax system. Business dimensions of double taxation avoidance agreements are given below;

### **1. Business profits and permanent establishment**

Business profits are an important aspect of the economy where the economy knows its level of development. An economic development is made practical only through interaction of economies. Economies make treating to enhance each other in assisting with needs and wants. The essence of business like labor, capital, and technology are made moving across boundaries through these agreements.

In this modern era global business is more important than domestic business. Hence organizations are having a hand in other nations through permanent establishments, associate enterprises, collaborations etc. The business profits are now sourced globally than domestically. A country may not let its income untaxed. Hence the question of double taxation arises. As per the treaty article 7 states about how the business profits are to be taxed by US and China. The resident business having domestic business is taxed only in that country itself unless otherwise it's having a permanent establishment in other contracting states. If the business is having permanent establishment in other contracting State, portion of revenue attributable to such permanent establishment is taxed in that other contracting State.

Permanent establishment may be a branch, place of management, office, workshop etc. Since the company's focus is more on global business rather than domestic business. Each organization is now having globally located production centers, branches, hence there is a question of double taxation. As far as this treaty is concerned the permanent establishment is considered to be a revenue source. The taxation of permanent establishment is made on the basis of deemed profits. Deemed profits are to be computed based on the income that can be pertained to particular permanent establishment after allowing permissible deductions. But the deductions shall not be permissible for the payments to head office in terms of royalties, interests and similar payments. The taxation will be based on the proportion to which it can earn for the complete



business in the other contracting State. The tax paid for permanent establishment's revenue can be claimed as credit for the parent company

## **2. Related enterprises**

“Unity is strength “. When more businesses of different capacity merge together the end result will be the best .Hence companies are having collaborations, merger, acquisitions, cross holdings etc. Taxability regarding related enterprises is mentioned in Article 8 of this double taxation avoidance agreement.

When the business or individuals control or manage other businesses the profits of such businesses can be combined as the income of the controlling or managing firms. But enough adjustment has to be done on combined profits to reduce double taxation. Such adjustments should be in consultation with the provisions of this agreement and competent authorities of the contracting State.

## **3. Dividends**

Dividends are apart of profits. It can be revenue for an individual, while distributive expense for a company. Article9 specifies the double taxation avoidance aspects of dividends. The question of double taxation arises when a residentindividual receives dividend from a resident company for which tax has been already paid to the contracting states .here the dividends of individual will not be taxed again. But when the resident individualreceives dividend from a non resident company for which the contracting Statedoes notcharge tax, is liable to pay tax on dividend income. If the dividend is received by the individual from his permanent establishment orbusiness in other contracting states the provision will switch over to article 7 (business profits).

## **4. Interest**

Article 10 deals with the interest income. Interest includes income from debt funds, income from Government securities, and income from Bonds etc. Interest received by an individual of non contracting State from contracting State us taxable only in non contracting State ,but it can be taxed in contracting State if it arises because of provisions of the Acts of contracting State and such amount shall not exceed 10 percent of the interest amount. If the interest is paid by the government of the contracting authorities then, the income is deemed to accrue in contracting State if which tax is to be paid. When the interest is received by person from his permanent establishment in other contracting state, then the provision of article 7 (business profits) will be considered.

## **5. Royalties**

Royalties are vital in this technological era. Transfer of technical know-how, expertise, equipment has a connection to every business. The payment of such technical assistance we made through royalties. Article 11 of the agreement clearly states about the taxation and double taxation avoidance aspects of royalties. When the royaltyis received by a person of contracting State from other contracting State is taxed only in other contracting states, but this changes when the royalty is arises based on the provisions of laws of contracting states .When Government of the contracting State is the payer of royalties ,tax is to be paid in contracting State itself. When there are related party transactions on royalties having higher consideration or lower payment as

the case may be, then the amount excess than normal consideration of similar transaction is subjected to tax within the contracting State.

### **CONCLUSION**

For every individual or businessman who earns income could not be paid as tax as it may reduce a major portion of his revenue. For business enhancement and economic development they had to enter into economic transactions with another countries enabling capital investment. Economic activities should be done by firms, assesses, individuals, companies. Like minded countries make agreements to avoid the doubling taxation for supporting their assesses to build perfect economy. Even though there's Trade war it's very vital to have such bilateral agreement for benefits of economy so that there will be hindrance of resource flow for Technology importing, business transactions, labour movement. Business opportunities can be enhanced only if the economy tries to have such bilateral agreement to value the efforts of their assesses including businesses and individuals.

In this Liberalized economy no company can exist independently without cooperation, assistances of other countries for getting advantage of core competencies that other economies possess. Double taxation avoidance agreements should be continuously maintained to avoid trade war .problems of Capital deficiency, technology deficiency ,labour deficiency ,Building core competencies etc. which can be mitigated only through joint arrangements like associate enterprises, collaboration agreements, joint ventures etc. For this the double taxation avoidance agreements could not be withheld over a long time .Countries can suspend these agreements for sometime considering their sovereignty but cannot suspend for long as it may harm the global free trade order.

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