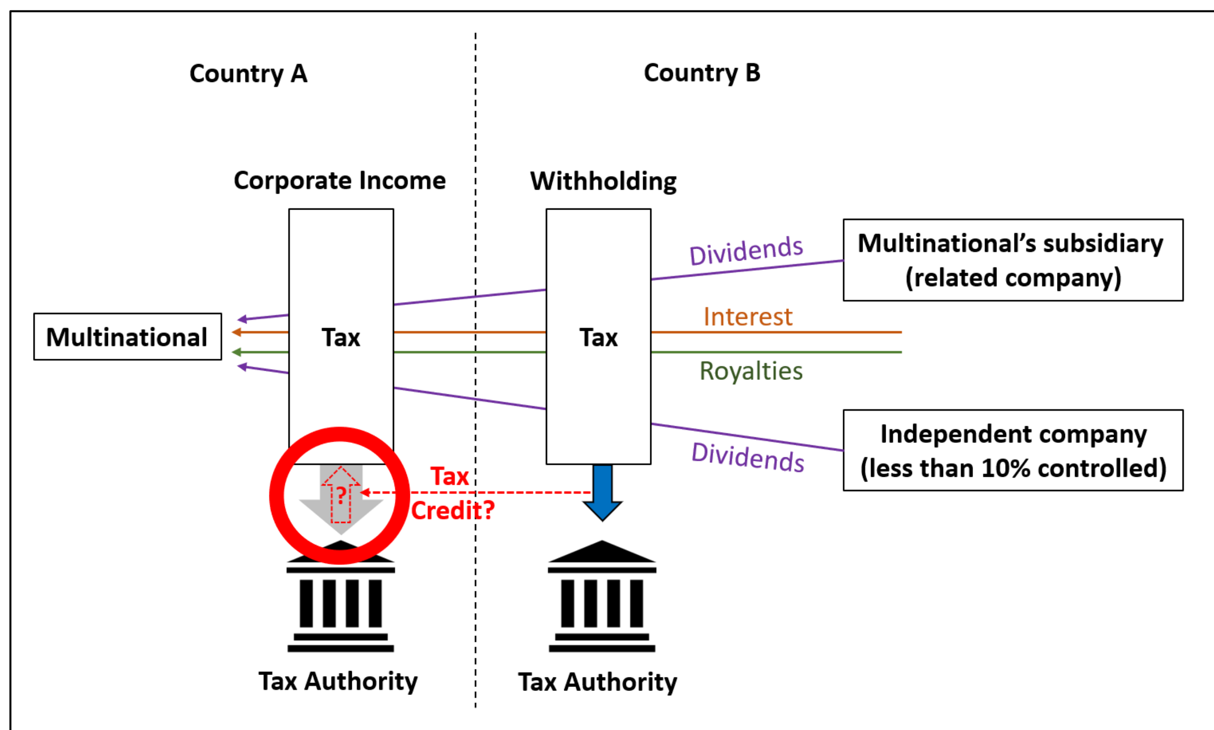
TAX JUSTICE NETWORK

Haven Indicator 2: Foreign investment income treatment

What is measured?

This indicator assesses whether a jurisdiction includes worldwide capital income in its corporate income tax base and if its domestic law grants unilateral tax credits for foreign tax paid on certain foreign capital income. The types of capital income included are interest, royalty and dividend payments. This indicator examines domestic law provisions, and not provisions available in double tax agreements, which are assessed under haven indicator 20.

Figure 2.1: Tax credit for payment of foreign taxes on capital income



In the case of dividends, two different payment scenarios are considered.

(1) Dividends received by a multinational from an independent legal person located abroad (a company owned at less than 10%).[1]

(2) Dividends received by a multinational from a related legal person located abroad.

For interests (3) and royalties[2] (4), no distinction is made between independent and related companies (because no differences were found in regulations for these types of capital income payments).

The scoring matrix for this indicator is shown in Table 2.1, with full details of the assessment logic given in Table 2.4 below.

Table 2.1: Scoring Matrix Haven Indicator 2

Regulation	Haven Score [100 = maximum risk; 0 = minimum risk]
In the assessed jurisdiction, unilateral tax credit is available to domestic companies for foreign (withholding) tax paid on all types of investment income (Dividends, Interest and Royalties) from abroad.	0
Dividends (from an independent company) No (local) unilateral tax credit is available for foreign taxes paid by multinational when receiving dividends from a foreign independent company (less than 10% controlled by the payee). OR Foreign portfolio dividend income is effectively tax-exempt	+25
Dividends (from a related company) No (local) unilateral tax credit is available for foreign taxes paid by multinational when receiving dividends from a foreign related company (+10% controlled by the payee). OR Foreign dividends from substantial holdings are effectively exempt.	+25
Interests (from either related or independent company) No (local) unilateral tax credit is available for foreign taxes paid by multinational when receiving interests from a foreign company (either related or independent). OR Foreign interest income is effectively exempt.	+25
Royalties (from either related or independent company) No (local) unilateral tax credit is available for foreign taxes paid by multinational when receiving royalties from a foreign company (either related or independent). OR Foreign royalty income is effectively exempt.	+25

All underlying data can be accessed in the Corporate Tax Haven Index database[3]. To see the sources we are using for particular jurisdictions please consult the assessment logic in Table 2.4 and search for the corresponding info IDs (IDs 552-555) in the database report of the respective jurisdiction.

The data for this indicator has been collected primarily through the International Bureau for Fiscal Documentation's database (country analyses and country surveys).[4] In some instances, additional websites and reports of the Big 4 accountant firms have also been consulted.

A zero haven score applies to jurisdictions which grant unilateral tax credits for all payment scenarios (independent and related party, if applicable) for all types of capital income payments (dividend, interest or royalty). For each payment scenario and type of capital income payment, a haven score of 25 is added if a unilateral tax credit is not available.

Thus, where no unilateral relief is available at all, or if the jurisdiction only provides for deduction of foreign taxes paid (but not a tax credit), we retain a haven score of 25 for that payment scenario or type of capital income payment.

Also, regardless of the unilateral relief available in a jurisdiction, we retain the maximum haven score (+25) for a payment scenario (e.g. interests) or type of capital income payment (e.g. dividends from independent party) if the jurisdiction effectively exempts foreign income from domestic taxation, be it through:

a) a pure territorial tax system;

b) or through exemptions for

i. specific payments (such as dividends or royalty[5] income) or

ii. specific legal entities (such as International Business Companies);[6]

c) deferral rules which disable taxation unless income is remitted;

or

d) zero or near zero tax rates (e.g. on corporate income).

It is worth noting that in this indicator, we not only score as aggressive instances that may result in double non-taxation (effective exemption of foreign investment income), but we also attribute the maximum risk score to regulations that create double taxation (no unilateral relief, deduction treatment).

Why is this important?

In a world of integrated international economic activity and cross-border financial flows, the question about who taxes what portion of income has become increasingly complex. A conflict exists between the emphasis on taxing the income where it arises (i.e. at source), or taxing it where its recipient resides.[7] A mixture of both principles is implemented in practice.

However, this may lead to instances of so-called double taxation, when both countries claim the right to tax the same income (tax base). While the concept of "double taxation" is theoretically plausible, evidence for real life occurrence is exceptionally rare[8] , especially since many countries have adopted unilateral relief provisions to avoid double taxation. In addition, countries also negotiate bilateral treaties to avoid double taxation, so-called double taxation avoidance agreements.

A potential third option to ensure single taxation would be a multilateral agreement on the definition of the formula for apportioning transnational corporations' global income.[9] Even though the G20 declared that "Profits should be taxed where economic activities deriving the profits are performed and where value is created"[10], which could be interpreted as a mandate to treat the corporate group of multinational enterprise as a single firm and ensure that its tax base is attributed according to its activities in each country[11], the OECD's BEPS[12] project has continued to follow the independent entity principle and refused to consider unitary taxation and formulary apportionment to tax transnational corporations. Only recently has the OECD and United Nations moved to consider this reform option.[13]

Assuming that cross-border trade and investment can be mutually beneficial, the problem of overlapping tax claims (double taxation) needs to be addressed in one or both ways because it hinders cross-border economic activity. Bilateral treaties are expensive to negotiate, and often impose a cost on the weaker negotiating partner which is frequently required to concede lower tax rates in return for the prospect of more investment.[14]

Home countries of investors or transnational companies usually offer unilateral relief from double taxation because they want to support outward investment.

They do this primarily through two different mechanisms:

a) By exempting all foreign income from tax liability at home (exemption);

b) By offering a credit for the taxes paid abroad on the taxes due at home (credit).

As the tables below indicate, in most cases it is a myth that bilateral treaties are necessary to provide relief from double taxation. Countries that are home to investors and transnationals typically offer provisions in their own laws to prevent or reduce double taxation.[15]

There is a third mechanism called "deduction" which is sometimes used to offer relief from double taxation. However, the deduction method does not offer full relief from double taxation. It allows deducting from foreign income (e.g. as a business expense) any taxes paid abroad before including this income in the domestic tax base. Therefore, we consider deduction to be similar to offering no mechanism for double taxation relief, since the incentives to conclude double taxation avoidance agreements remain largely in place.

Where (especially capital exporting) countries refrain from providing unilateral relief, or only provide deduction of foreign taxes from the domestic tax base, they contribute to a problem of double taxation and

thus indirectly exert pressure on capital importing countries to conclude bilateral treaties with the other country. These treaties in turn can expose capital importing countries to risks and disadvantages[16].

In addition, with more than 3000 double tax treaties currently in operation, the system has become overly complex and permissive, encouraging corporations to engage in profit shifting, treaty shopping and other practices at the margins of tax evasion (see here[17] for ways to address these issues and the various reports of the various reports of the BEPS Monitoring Group[18]). This is the context in which we review unilateral mechanisms to avoid double taxation in the first place. However, not all such mechanisms are equally useful.[19]

When using a unilateral exemption mechanism to exempt all foreign income from liability to tax at home, the residence country may be forcing other jurisdictions to compete for inwards investment by lowering their tax rates. Because investors or corporations will not need to pay any tax back home on the profit they declare in the foreign jurisdiction (source), they will look more seriously at the tax rates offered and lobby for tax cuts. This pressures countries to reduce tax rates on capital income paid to non-residents, such as withholding taxes on payments of dividends and interest.

Many countries provide tax exemption on capital income payable to non-residents, especially on interest payments on bank deposits and government debt obligations, or dividends. If a specific income is exempted from tax, there is likely no requirement to report that income, so no authority would have data on it. If we consider that information sharing between states is weak, taxpayers can easily evade the taxes due at home on their foreign income because it may be very difficult for local tax authorities to find out about that income. As a consequence, a country offering no taxes to non-residents promotes tax evasion in the rest of the world.

To summarise the logic:

First, unilateral tax exemption on foreign income puts pressure on source countries to reduce tax rates on investments by non-residents in a process of tax war (or competition). Second, citizens and corporations from other countries make use of the low tax rates by shifting assets into these low-tax countries for the purpose of committing tax evasion. Third, in the medium term, the tax exemption of foreign income acts as an incentive for ruinous tax wars that will eventually lead to the non-taxation of capital income.

In contrast, a unilateral tax credit system does not promote tax evasion and does not incentivise the host countries of investments to lower their tax rates. A tax credit system requires that income earned abroad must be taxed at home as if it was earned at home, unless it has already been

taxed abroad. In the latter case, the effective amount of tax paid abroad on the income will be subtracted from the corresponding amount of tax due at home.

Therefore, for an investor the tax rate in a host country is no longer relevant to her investment decisions. Countries wishing to attract foreign investment will not feel compelled to lower the tax rates in the hope of increasing their stock of foreign investment. As a consequence, the tax evading opportunities of investors are reduced because fewer countries offer zero or very low taxation on capital income. Reuven Avi-Yonah describes how the U.S. adoption of a unilateral tax credit in 1918 has “led to a cooperative outcome that prevents double taxation and maximizes world welfare.”[20]

Results Overview

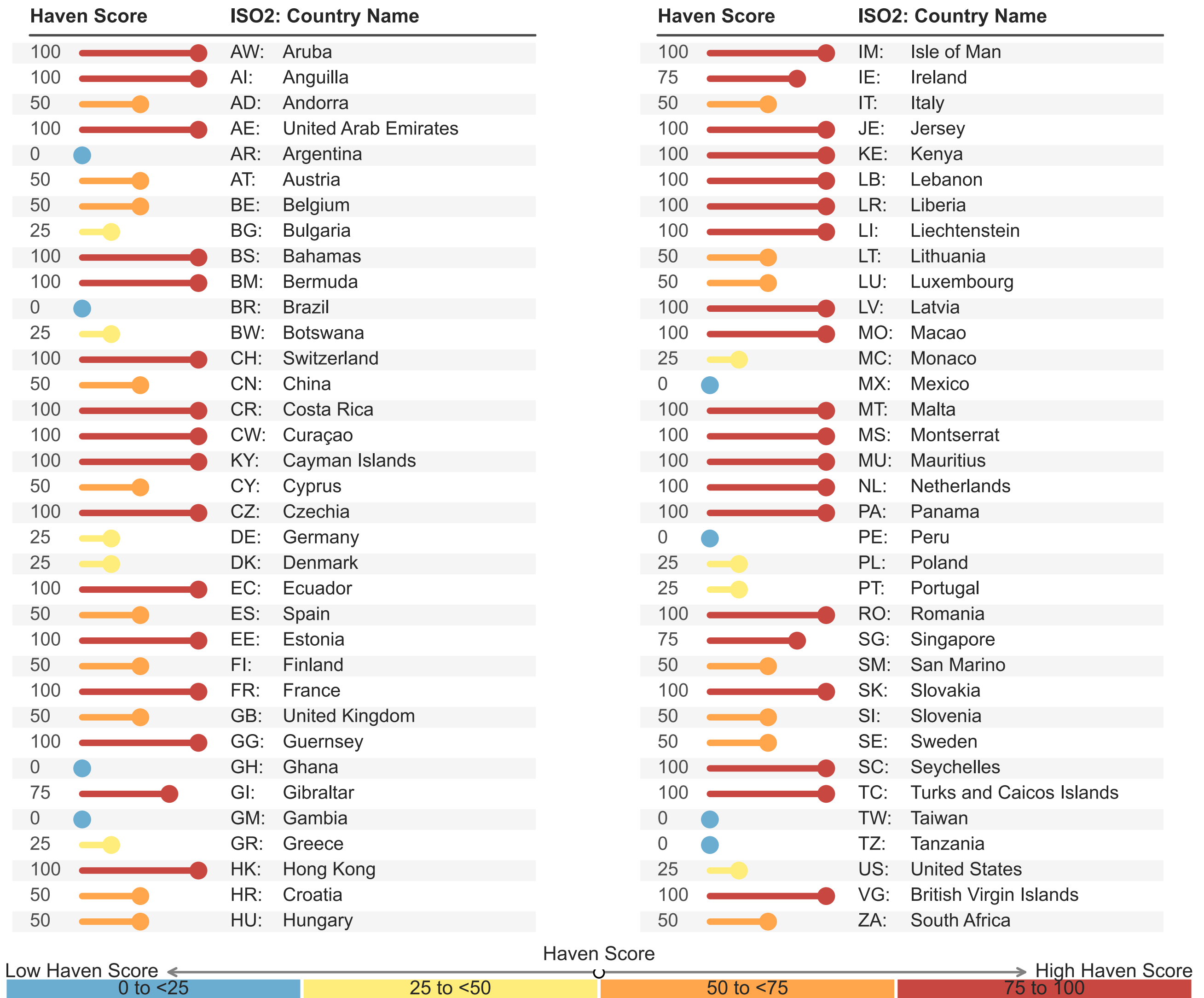
Table 2.2: Foreign Investment Income Overview

Country	Score	Dividends Independent Party	Dividends Related Party	Interests	Royalties
Aruba	100	Exemption	Exemption	Exemption	Exemption
Anguilla	100	Not applicable	Not applicable	Not applicable	Not applicable
Andorra	50	Exemption	Credit	Credit	Exemption
United Arab Emirates	100	Not applicable	Not applicable	Not applicable	Not applicable
Argentina	0	Credit	Credit	Credit	Credit
Austria	50	Exemption	Credit	Credit	Exemption
Belgium	50	None	Credit	Credit	Exemption
Bulgaria	25	Credit	Credit	Credit	Exemption
Bahamas	100	Not applicable	Not applicable	Not applicable	Not applicable
Bermuda	100	Not applicable	Not applicable	Not applicable	Not applicable
Brazil	0	Credit	Credit	Credit	Credit
Botswana	25	Credit	Credit	Credit	Exemption
Switzerland	100	Deduction	Deduction	Deduction	Exemption
China	50	Exemption	Credit	Credit	Exemption
Costa Rica	100	Exemption	Exemption	Exemption	Exemption
Curaçao	100	Deduction	Deduction	Deduction	Exemption
Cayman Islands	100	Not applicable	Not applicable	Not applicable	Not applicable
Cyprus	50	Exemption	Credit	Credit	Exemption
Czechia	100	Deduction	Deduction	Deduction	Exemption
Germany	25	Credit	Credit	Credit	Exemption
Denmark	25	Credit	Credit	Credit	Exemption
Ecuador	100	Exemption	Exemption	Exemption	Exemption
Spain	50	Exemption	Credit	Credit	Exemption
Estonia	100	Exemption	Exemption	Exemption	Exemption
Finland	50	Exemption	Credit	Credit	Exemption
France	100	Exemption	Deduction	Deduction	Exemption
United Kingdom	50	Exemption	Credit	Credit	Exemption
Guernsey	100	Not applicable	Not applicable	Not applicable	Not applicable
Ghana	0	Credit	Credit	Credit	Credit
Gibraltar	75	Exemption	Exemption	Credit	Exemption
Gambia	0	Credit	Credit	Credit	Credit
Greece	25	Credit	Credit	Credit	Exemption
Hong Kong	100	Exemption	Exemption	Exemption	Exemption
Croatia	50	Exemption	Credit	Credit	Exemption
Hungary	50	Exemption	Credit	Credit	Exemption
Isle of Man	100	Not applicable	Not applicable	Not applicable	Not applicable
Ireland	75	Exemption	Deduction	Deduction	Credit
Italy	50	Exemption	Credit	Credit	Exemption
Jersey	100	Not applicable	Not applicable	Not applicable	Not applicable
Kenya	100	Exemption	Deduction	Deduction	Exemption

Haven Indicator 2: Foreign investment income treatment

Country	Score	Dividends Independent Party	Dividends Related Party	Interests	Royalties
Lebanon	100	Exemption	Exemption	Exemption	Exemption
Liberia	100	Exemption	Exemption	Exemption	Exemption
Liechtenstein	100	Exemption	Exemption	Exemption	Exemption
Lithuania	50	Exemption	Credit	Credit	Exemption
Luxembourg	50	Exemption	Credit	Credit	Exemption
Latvia	100	Exemption	Exemption	Exemption	Exemption
Macao	100	Deduction	Deduction	Deduction	Deduction
Monaco	25	Credit	Credit	Credit	Exemption
Mexico	0	Credit	Credit	Credit	Credit
Malta	100	Exemption	Exemption	Exemption	Exemption
Montserrat	100	None	None	None	None
Mauritius	100	Exemption	Exemption	Exemption	Exemption
Netherlands	100	Exemption	Deduction	Deduction	Exemption
Panama	100	Exemption	Exemption	Exemption	Exemption
Peru	0	Credit	Credit	Credit	Credit
Poland	25	Credit	Credit	Credit	Exemption
Portugal	25	Credit	Credit	Credit	Exemption
Romania	100	None	None	None	None
Singapore	75	Exemption	Exemption	Credit	Exemption
San Marino	50	Exemption	Credit	Credit	Exemption
Slovakia	100	None	None	None	None
Slovenia	50	Exemption	Credit	Credit	Exemption
Sweden	50	Exemption	Credit	Credit	Exemption
Seychelles	100	Exemption	Exemption	Exemption	Exemption
Turks and Caicos Islands	100	Not applicable	Not applicable	Not applicable	Not applicable
Taiwan	0	Credit	Credit	Credit	Credit
Tanzania	0	Credit	Credit	Credit	Credit
United States	25	Credit	Credit	Credit	Exemption
British Virgin Islands	100	Not applicable	Not applicable	Not applicable	Not applicable
South Africa	50	Exemption	Credit	Credit	Exemption

Table 2.3: Foreign Investment Income Treatment – Haven Indicator Scores



Haven Score	ISO2: Country Name
100	AW: Aruba
100	AI: Anguilla
50	AD: Andorra
100	AE: United Arab Emirates
0	AR: Argentina
50	AT: Austria
50	BE: Belgium
25	BG: Bulgaria
100	BS: Bahamas
100	BM: Bermuda
0	BR: Brazil
25	BW: Botswana
100	CH: Switzerland
50	CN: China
100	CR: Costa Rica
100	CW: Curaçao
100	KY: Cayman Islands
50	CY: Cyprus
100	CZ: Czechia
25	DE: Germany
25	DK: Denmark
100	EC: Ecuador
50	ES: Spain
100	EE: Estonia
50	FI: Finland
100	FR: France
50	GB: United Kingdom
100	GG: Guernsey
0	GH: Ghana
75	GI: Gibraltar
0	GM: Gambia
25	GR: Greece
100	HK: Hong Kong
50	HR: Croatia
50	HU: Hungary

Haven Score	ISO2: Country Name
100	IM: Isle of Man
75	IE: Ireland
50	IT: Italy
100	JE: Jersey
100	KE: Kenya
100	LB: Lebanon
100	LR: Liberia
100	LI: Liechtenstein
50	LT: Lithuania
50	LU: Luxembourg
100	LV: Latvia
100	MO: Macao
25	MC: Monaco
0	MX: Mexico
100	MT: Malta
100	MS: Montserrat
100	MU: Mauritius
100	NL: Netherlands
100	PA: Panama
0	PE: Peru
25	PL: Poland
25	PT: Portugal
100	RO: Romania
75	SG: Singapore
50	SM: San Marino
100	SK: Slovakia
50	SI: Slovenia
50	SE: Sweden
100	SC: Seychelles
100	TC: Turks and Caicos Islands
0	TW: Taiwan
0	TZ: Tanzania
25	US: United States
100	VG: British Virgin Islands
50	ZA: South Africa

Table 2.4: Assessment Logic

Info_ID	Text_Info_ID	Answers (Codes applicable for all questions: -2: Unknown; -3: Not Applicable)	Valuation Haven Score
552	Dividends (independent party)	0: None. There is no unilateral relief from double taxation; 1: Deduction; 2: Credit; 3: Exemption.	2: 0 All other: 25
553	Interest	0: None. There is no unilateral relief from double taxation; 1: Deduction; 2: Credit; 3: Exemption.	2: 0 All other: 25
554	Royalties	0: None. There is no unilateral relief from double taxation; 1: Deduction; 2: Credit; 3: Exemption.	2: 0 All other: 25
555	Dividends (related party)	0: None. There is no unilateral relief from double taxation; 1: Deduction; 2: Credit; 3: Exemption.	2: 0 All other: 25

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[1] When there is a participation exemption granted to "less than 10%" shareholdings, such as in the Netherlands or Spain, we treat this as a participation exemption for dividends received from an independent party.

[2] Haven indicator 7 (on Patent Boxes) also examines royalties. However, the difference to Indicator 2's treatment of royalty income is mainly that haven indicator 7 (on Patent Boxes) only examines if royalties are taxed preferential in comparison with the general principles of taxation in the relevant jurisdiction, and whether the OECD "nexus" limitation is applicable for this preferential treatment. In contrast, Indicator 2 requires a unilateral credit system for

incoming royalty payments, and a high risk score is given in cases where no unilateral relief or where only application of deduction method is available. Where royalties and/or other payments for the exploitation of intellectual property are exempt without OECD nexus limitation under a Patent Box regime (haven indicator 7), we consider that royalties are generally exempt in HI 2.

[3] Corporate Tax Haven Index database: https://cthi.taxjustice.net/cthi21/data-downloads

[4] IBFD, *Tax Research Platform: Country Surveys, Country Analyses, Country Key Features*, Accessed 2018-2019, 2018 <https://research.ibfd.org/> [accessed 28 April 2019].

[5] Where royalties and/or other payments for the exploitation of IP are excluded from the tax base without OECD nexus limitation under a Patent Box regime (haven indicator 7), we consider that royalties are generally exempt in haven indicator 2. If, however, a jurisdiction has a patent box with an OECD nexus limitation (see ID 515), we disregard such regime from this indicator (for more details, please refer to haven indicator 7 methodology).

[6] The availability of exempt legal entities is only considered in this indicator if a wide range of economic activity can be undertaken tax-free. This is usually the case for International Business Companies (e.g. Mauritius, Montserrat). Where foreign investment income is only exempt because companies exclusively engaged in certain economic activity are tax-exempt (i.e. investment funds, management companies), we consider such broad exemption regimes in haven indicator 5, but not in this indicator.

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[11] BEPS Monitoring Group, *Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project*, 2015 <https://bepsmonitoringgroup.files.wordpress.com/2015/10/general-evaluation.pdf> [accessed 5 March 2021].

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[14] Martin Hearson, *Measuring Tax Treaty Negotiation Outcomes: The ActionAid Tax Treaties Dataset*, ICTD Working Paper 47 (Brighton, 2016) <www.ictd.ac/ju-download/file/88-ictd-wp47-pdf/latest/download?2951319cb2220550f30e41fe8d5e70c7=1&return=aHR0cCUzQSUyRiUyRnd3dy5pY3RkLmFjJTJGanUtZG93bmxvYWQlMkYyLXdvcmtpbmctcGFwZXJzJTJGOTktbWVhc3VyaW5nLXRheC10cmVhdHktbmVnb3RpYXRpb24tb3V0Y29tZXMtdGhlLWFjdGlvbmFpZC10YXgtdHJlYXRpZXMtZGF0YXNldA==> [accessed 28 April 2019]; Katrin McGauran, *Should the Netherlands Sign Tax Treaties with Developing Countries?* (Amsterdam, 2013) <somo.nl/publications-en/Publication_3958/at_download/fullfile> [accessed 28 April 2019]; Markus Meinzer, 'The Creeping Futility of the Global Forum's Peer Reviews', *Tax Justice Briefing*, 2012 <www.taxjustice.net/cms/upload/GlobalForum2012-TJN-Briefing.pdf>; Alliance Sud, 'Schweizer Steuerabkommen Mit Entwicklungsländern: Fragwürdiger Druck Auf Quellensteuern', 2013 <https://www.alliancesud.ch/de/publikationen/downloads/dokument-24-2013.pdf> [accessed 30 January 2020]; Eric Neumayer, 'Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?', *Journal of Development Studies*, 43/8 (2007), 1501–19; Tsilly Dagan, 'The Tax Treaty Myth', *New York University Journal of International Law and Politics*, 32/939 (2000).

[15] It must be conceded, however, that unilateral provisions to avoid double taxation are not as effective at preventing double taxation as double tax treaties. For instance, there may be cases in which the rules determining the residency of taxpayers conflict between countries, leading to both claiming residence and full tax liability of one legal entity or taxpayer. However, for a number of reasons this argument is of limited relevance: a) these cases are the exception rather than the rule; b) pure economic "single taxation" is a theoretical concept derived from economic modelling that is only of limited value in real life. In many countries different types of taxes are levied on the same economic activity, for instance VAT is levied on the turnover of a company, then the profits stemming from the turnover are taxed through federal and state corporate income taxes, and in a third stage the investment income in form of dividends is again taxed in the hands of the shareholders. Nobody would reasonably speak about "triple taxation" in such a case. In a similar way, it is dubious to speak about double taxation in a crossborder context. To paraphrase Professor Sol Picciotto: "But double taxation is a dubious concept. First, it does not mean companies' tax bills doubling: it means that there may (rarely) be some overlap between states' taxing claims (think of this in terms of the overlap in a Venn diagram). Any overlap may result in a modestly higher overall effective tax rate, not a 'double' rate." (See Picciotto, 'Unitary Taxation: Our Responses to the Critics', 3.). This "modestly higher overall effective tax rate" could be higher than the corporate tax rate of one particular country, but it may still be lower than another country's corporate tax rate. If one called this situation double taxation, then this implies speaking about double taxation also in situations in which two unrelated companies operate in two different countries, with one country levying twice as high a corporate tax rate as the other country. This, of course, is non-sense and reveals the dubious and theoretically flawed nature of the concept of double taxation; Martin Hearson, 'Bargaining Away the Tax Base: The North-

South Politics of Tax Treaty Diffusion' (The London School of Economics and Political Science, 2016) <http://etheses.lse.ac.uk/3529/1/Hearson_Bargaining_away_the_tax_base.pdf> [accessed 7 March 2021].

[16] BEPS Monitoring Group, *Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project*.

[17] Sol Picciotto, *Towards Unitary Taxation of Transnational Corporations* (2012) <http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf> [accessed 20 January 2020].

[18] BEPS Monitoring Group, <https://bepsmonitoringgroup.wordpress.com/tag/bmg/> [accessed 5 March 2021].

[19] We are not looking at deduction in more detail because deduction of foreign taxes from domestic tax bases only provides partial relief from double taxation whereas the credit and exemption method both have in principle the capacity to completely avoid double taxation (see endnote 11 above for details). For details about the exemption and credit method, see for instance pages 19-22 in: United Nations Department of Economic & Social Affairs 2003: Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (ST/ESA/PAD/SER.E/37), New York, in: http://unpan1.un.org/intradoc/groups/public/documents/un/unpan008579.pdf; [accessed 28 April 2019].

[20] Reuven S Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State', *Harvard Law Review*, 113/7 (2000), 1608 <https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1049&context=articles> [accessed 28 April 2019].