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EDUCATIONAL MODELS FOR THE INTERNATIONAL CONTRACT FOR THE AVOIDANCE OF DOUBLE TAXATION - with emphasis on the countries of the Western Balkans

Original scientific paper

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ABSTRACT

The purpose of the manuscript is limited exclusively to assessing the role and legal nature of the international contract for the avoidance of double taxation. The subject of the analysis of this paper is the avoidance of the phenomenon of double international taxation through the conclusion and ratification of specific international contracts. These contracts, especially for countries claiming EU membership, should be established through the harmonization of tax legislation and recognized practices of EU member states. Based on the reports of the Western Balkan countries, there is an intensification of energies and strategies for EU membership. Kosovo and other countries in this area have signed a Stabilization and Association Agreement (SAA). This fact has increased the turnover of people and businesses in Western Europe. Challenges in the future are the problems in the field of numerous techniques and methodologies related to the drafting of contracts because countries outside the EU are applying non-unified standards regarding the avoidance of double taxation. Nowadays, this topic has aroused interest in the tax system of Kosovo, having in consideration its commitment to full membership in international integration.

Keywords: *international legal contracts, bilateral, double taxation, evasion, tax evasion*

INTRODUCTION

One of the effects of internationalization is the fact that the borders of the state territory are less and less an obstacle for the movement of people from one area of the state to another (Waldinger, 2021). From this point of view, it is becoming more and more common for citizens residing in one country to be employed in another country, for companies based in one country to open businesses and operate in the territory of other countries, to inherit property abroad. Whilst, the commodity-money transactions as well as consumption are carried out in the state in the area where the participants in these operations do not have their place of residence or headquarters, etc (Polova et al., 2022).

When it comes to a cross-border economic activity or another activity, it usually results in an increase in the economic power of the actors undertaking the activity. This increase in economic power occurs in the form of income, profits, dividends, interest, real estate, movable property or rights and is subject to tax. Therefore, tax regulations (laws and bylaws) of two or more states, as well as international agreements apply. The issues of taxation of certain cross-border activities of natural and legal persons are subjects in the context of global trends. In general, taxes, fees and related phenomena can significantly affect such an activity, most often in terms of their de-stimulation (Bostan, Mihaela Tofan, & AndIonel, 2022).

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Cross-border transactions by definition imply the existence of an international element in doing business, which in turn means that in such cases there will almost always be the operation of at least two tax systems of at least two countries (González, 2021).

Therefore, this work aims to provide the interested professional and scientific national public with an overview of the means, methods, and consequences of such actions, as well as the means and methods of preventing the undesirable consequences of taxation based on the existence of an international element. Most EU countries have double taxation agreements with many other countries to ensure that people do not pay double taxation on the same income. A double taxation contract determines which country is entitled to tax an individual. If both countries have the same right, the contract determines which country has an advantage. Contracts may set different rules for different types of revenue.

The subject of analysis of this topic is exclusively limited to the legal nature and the effects that international contracts have for the avoidance of double taxation as a means of preventing international double taxation or its consequences, which may result in "tax evasion", respectively pertaining to the transfer of capital and assets. This recommends that achievements in this area, urgently, should be undertaken through the process of harmonization of tax legislation in accordance with the legislation and practices of EU member states dedicated to this area. Nowadays, the topic of the tax system of certain states is considered to be important, having considered their commitment to membership and international integration.

BEGINNINGS OF THE IMPLEMENTATION OF INTERNATIONAL CONTRACTS FOR THE AVOIDANCE OF DOUBLE TAXATION

Although the history of the beginnings of international relations and the legislation governing the scope of double taxation dates back to around the 15th century, the aspect of international contracts related to this issue is a recent reality. In Europe, such international contracts appeared only at the end of the XIX century. Initially, such acts were concluded between members of the federal states, e.g. between Prussia and Saxony in 1869 and also between Austria and Hungary in 1869 (Arnold, 2020).

After the First World War, after an exponential increase in income tax revenues in Europe, the importance of the issue of international double taxation increased. One of the first treaties concluded in Europe was the 1925 treaty between Italy and Germany and the 1922 respectively, 1928 treaty between England and Ireland (Torrance, 2020).

The Anglo-Saxon states at the time were still reluctant to enter into treaties of this kind. Furthermore, the Secretary of the Treasury of the United States, expressed his disagreement with the implementation of international treaties in the prevention of double international taxation. According to him, such agreements more often offered concessions to participants in international trade than the application of prudent tax principles. Thus, the United States concluded the first agreement on the avoidance of double international taxation in 1939 with Sweden and France alone (Carroll, 1969).

After the Second World War, due to the emergence of integration processes, there was an increase in interest, theory, and financial practice on the issue of international double taxation, as well as the need to take certain measures, the implementation of which would prevent the emergence of such a tax, hence, would reduce its intensity.

ACTUALITY OF THE INTERNATIONAL CONTRACT FOR THE AVOIDANCE OF DOUBLE TAXATION

Today, more than 1000 international contracts for the avoidance of double taxation are in force in the world, of which over a hundred are concluded only between EU member states (Sztajerowska, 2021).

Most often, these are bilateral agreements. Among the multilateral treaties, which are very rare, are the Vienna Agreement on Diplomatic Relations, concluded in 1961 (VCDR, 1961), and the Vienna Agreement on Consular Relations, 1963 (Arnold, 2020). The two treaties contain provisions regarding the avoidance of double taxation.

Today's international treaties for the avoidance of double taxation are an expression of the mutual will of the signatory states to establish a regulated bilateral system of waiver of tax rights and to differentiate tax relief in a way that excludes double taxation. Recent contracts of this type, in addition to avoiding double taxation, also contain restrictions on the possibility of tax evasion.

International contracts for the avoidance of double taxation are in no way the legal basis on which state parties may introduce a new right on taxation. But, they only through the system of norms of a certain model contract, limit the conflict of the taxation facts.

Through these international treaties the signatory states assume that the taxes which one of the contracting states has the exclusive right to collect will not be levied by the other contracting state or will be levied only to a limited extent. The legal effect of such an obligation can be described in different ways. It can be said that it is about: *"factual tax exemption", "tax relief", "waiver of the state from tax", or "division of the tax source between the contracting states"*.

Each of these descriptions is equally valid and accurate. However, it would be wrong to say that international double taxation treaties share the "right to tax" between the contracting states and that the "right to tax" does not exist in itself. This is because the authority of the state to collect the tax derives from its sovereignty and the treaty cannot revoke the sovereignty: it can only force the state not to use it fully or to limit it (Provencher, Godbout, & St-Cerny, 2021).

When concluding an international contract for the avoidance of double taxation, the signatories taking over a certain obligation. This obligation consists in a full or partial waiver of the tax of a certain contractual fact. How the signatories of the contract will fulfill these obligations is their issue. They have the possibility, for example, to amend domestic regulations in such a way as to cover the facts which are the subject of an agreement on the avoidance of double international taxation or which they may regard as part of domestic law and apply them directly. In that case, the provisions of the contract for tax exemptions or tax benefits will have the effect of special provisions.

The procedure for concluding and enforcing international contracts for the avoidance of double taxation, as well as all other international agreements, are regulated by acts of a special branch of international law. That division is based on some general principles of common law for all agreements between each subject. Most of the norms of this branch of international law have already been codified (Tofan, 2021).

The Vienna Convention on the Law of Treaties, signed on 23 May 1969 and entered into force on 27 January 1980, is considered to be the most important treaty concerning codification of international law (VCLT, 1969). And, this convention is applicable in Kosovo as well as in other countries of the Western Balkans (Qerimi & Istrefi, 2016). The provisions of this Convention have taken on objective significance and almost all have grown into rules of general customary international law, which no one disputes.

The provisions of the Constitution of each signatory state apply to treaties for the avoidance of double international taxation, as well as to all other international treaties. In addition, they are subject to national regulations for the conclusion of international agreements, to the provisions of the Charter of the United Nations relating to international agreements, and to other international regulations.

The purpose of the described international contracts is to avoid or limit double taxation, however. So, what kind of avoidance or restriction of double international tax is intended, it depends from the system of norms of the above-mentioned treaties (Navarro, 2022). It is about the tax, which is a consequence of the conflict of tax principles and refers to the same or similar taxes imposed by the tax authorities of different countries on the income and property of the same tax subject. In no case, these agreements may not serve to ensure the non-taxation (so-called "non-double taxation") of residents or of non-resident states parties (Leduc & Michielse, 2021).

THE ROLE OF INTERNATIONAL CONTRACTS FOR THE AVOIDANCE OF DOUBLE TAXATION

Bilateral contracts concluded between two countries either according to the OECD model or the UN model must respect the specifics of the contracting countries and in the case of EU member states must also respect EU legislation. Their purpose is not only to avoid double taxation but, also to provide substantial tax insurance in one of the contracting states in accordance with the provisions of the contract.

Most Western Balkan countries, including Kosovo, base double tax avoidance contracts on the OECD model, which was established within the OECD in 1963 and amended in 1977 (OECD, 2019). This model has served as the backbone of almost all existing bilateral agreements to avoid double international taxation. But it should be noted that each of the agreements includes solutions that reflect some specifics related to the contracting countries.

The structure of the international double tax avoidance contract, modeled on the OECD agreement, was created to initially define the object of the agreement and the basic principle is that the agreement applies only to persons resident in one or both contracting states. Individuals can use the benefits guaranteed by the contract, then explain the terms of the contract (general definitions, definitions of resident and permanent establishment), and then is enlightened the tax treatment of certain types of income and property (OECD, 2019).

The OECD contract model has 31 articles and an important part of the structure are of course the double tax avoidance methods (method of exemption, method of calculation), followed by special and final provisions (OECD, 2019).

Provisions for the partition of tax rights between the contracting states are given in Articles 6 to 22, with the exception of Article 9, which has to do with companies concerning the issue of price transfer. That is, to avoid double taxation of the same income, profits or property, it is determined which contracting state has the exclusive right to tax or which right is given to both states (OECD, 2019).

THE LEGAL NATURE OF THE INTERNATIONAL CONTRACT FOR THE AVOIDANCE OF DOUBLE TAXATION

As noted above, there are two models on which international contracts for the avoidance of double taxation are drawn up: the OECD Model - Income and Capital Tax Convention and the United Nations Model - Tax Convention. Regardless of their model, international contracts for the avoidance of double taxation in legal terms belong to the set of rules, which according to their name are international legal acts (Larsen & Brøgger, 2021).

The rule applies to international contracts, that *"... if they have political content or change the law with their content, they are applicable in the national territory only with the approval of the national parliament"* (Djanani, 1998.). Since the content of the provisions of the international contract for the avoidance of double taxation often differs from the national tax law which implies the amendment of the national law or at least some of its provisions, it is a condition that for their implementation in a national territory they must pass through their ratification in the national parliament.

In order to categorize international contracts for the avoidance of double taxation as legal rules *"lex specialis"*, it is necessary to fulfil two assumptions (Bröhmer, 2020). First, contracts must contain the same factual elements as national regulations (for example, that the person earning personal income is a taxpayer), and second, they must contain another factual element, on the basis of which national law imposes legal consequences other than those provided for by national law (for example, property consisting of immovable property owned by a resident of a contracting state and situated in the other contracting state may be taxed in that other state (Bröhmer, 2020). Therefore, these contracts contain two sets of factual elements, such are: elements included in national legal regulations and elements specifically defined in the contract.

The interpretation of the international contract for the avoidance of double taxation emphasizes, in addition to the principle of *"lex specialis derogat legi generali"* and the principle *"lex posterior derogat legi priori"*, according to which a subsequently adopted legal rule derogates from an earlier rule (Cheng, 2021). In this regard, the question arises whether the later legalized tax facts, which are also essential elements of the contract, enjoy an advantage over the previously established rules of the contract (abrogation of the contract).

There are different views on the answer to this question, as well as on its implementation. According to one view, if a contract is seen as an agreement of the contracting states, which has reached a compromise between their conflicting interests, then all the provisions of the contract should be interpreted as a whole. Specifically, the contracting states waive some other such rights at the expense of some recognized rights. This is why a contract can only be included in national law in its entirety. Otherwise, each of the contractors may be harmed in the rights guaranteed by the contract. Therefore, the provisions adopted later should not change the provisions of the contract that entered into force earlier. In addition, in accordance with the principle *of "pacta sunt servanda"*, the contracting states have not only the right but also the duty to stand along with the contractual provisions (Arnold, 2020).

However, practice shows that states do not always accept such an attitude and that, when required by certain circumstances, the provisions of a subsequent law recognize the right of precedence over the provisions of the contract, or avoid it. In that case, they invoke a provision of the contract which entitles them to cancel it fully at a later date. Although there are differing views on the validity of the effects of these agreements on national tax law, one has been agreed upon.

Thus, it is generally accepted that an international agreement on the avoidance of double taxation may not be the legal basis for the introduction of a new additional tax liability, which was not enshrined in national tax legislation before its expiry (Freedman & Loutzenhiser, 2022). Independently, calling for an agreement on the avoidance of double international taxation, there is no legal norm that would prohibit, neither at the level of international nor constitutional law.

Under the international double taxation treaty, member states undertake to limit rights of each other's taxation. Therefore, contracts operate in the legal systems of the contracting states by limiting the tax facts set out in their national regulations (Bhattacharya & Stotsky, 2022).

International agreements on the avoidance of double taxation, in principle, improve the position of the taxpayer. However, this does not mean that, in some cases, the implementation of the contract cannot cause deterioration of its condition (Polonskaya, 2022). By implementing the contract, certain incomes that are not subject to taxation under national law, should not remain untaxed. For example, under the national law of a contracting state, certain incomes are taxed only after deducting the expenses necessary for its realization.

However, based on international contracts for the avoidance of double taxation, income is taxable and without prior deduction for expenses. Therefore, with the implementation of the contract, the position of the taxpayer is worse than it would be implementing national legislation (Silvera, Hizazi, Hidayat, & Rahayu, 2022).

Under an international agreement on the avoidance of double taxation, the contracting states undertake that, if one of them waives the collection of a particular tax, the other contracting state shall collect that financial input (Savitskiy, 2021). However, if a contracting state with a right to collect taxes does not exercise that right, that tax may not be levied by the other contracting state because it has waived its collection.

In this case, although this is contrary to the purpose of the international contract for the avoidance of double taxation, the implementation of the respective act may result not only in the elimination of double taxation, but also in the opposite - non-taxation of double.

CONCLUSION

One of the biggest obstacles to the free movement of capital and goods in international transactions is the double taxation, which occurs when a tax is paid more than once on the same taxable income or assets. The only reason double taxation exists today is because there is almost no direct tax harmonization between the tax systems of different countries, even within the European Union (Römgens & Roland, 2022).

Double taxation in a cross-border context, as a result of the unstable interaction of different national tax systems, is a real obstacle and challenge for the internal market. The imposition of comparable taxes in two (or more) member states on the same business activity is a serious obstacle to the need for free movement in the concept of the internal market (European Comission, 2017).

At the country level, the method chosen to avoid double taxation depends mainly on general tax policies and its tax structures. When it comes to developing countries, usually the methods used in developed countries are not very suitable for them.

The importance of the topic of double taxation in certain countries is explained by the fact that the recovery system in all countries is different and this in reality, to a certain extent, promotes the phenomenon of tax evasion. International agreements on the avoidance of double taxation are usually concluded to evade this phenomenon. In cases of international transactions or events in which, each for himself, claims to tax the same profit/income or property, and aims to distribute tax rights including the prevention and elimination of tax evasion in international transactions.

In international tax law, it is common for business transaction invoices to be submitted to one of the contracting states through a system of distribution rules agreed upon by the two contracting states. On the other hand, European Union law does not deal with the balance of tax revenues of the two countries but aims to create a single market guaranteeing fundamental freedoms. Therefore, both the double taxation treaty and the EU treaty have a common goal of reducing barriers to cross-border economic activity. The network of double taxation treaties in the international context is the most important mechanism for eliminating double taxation in the EU, although this is not entirely possible. Therefore, it remains in the competence of the member states to conclude agreements on the avoidance of double taxation, in accordance with the legislation of the European Union.

The rules for concluding a contract are defined by: 1. The law on the conclusion and execution of international agreements, from the initial initiative until the entry into force of the agreement and 2. The Vienna Convention on the Law of Treaties.

The legal nature of these contracts is characterized by the fact that we are dealing with international agreements that countries enter into to avoid double standards by avoiding paying tax twice for the same transaction. The content of these contracts determines the right of the contracting states for full or partial taxation of certain income and sets out rules for resolving the status of their taxpayers, tax sources, and taxable persons. Certain provisions regulate the manner of exchange of data between tax authorities, administration, and conditions for a more favorable exchange of goods, services, labor, and capital between the two countries. After all, their purpose is to prevent evasion and tax avoidance, payment of taxes, if it is a miscalculation of prices on transfers, or another form of tax evasion.

The nature of international contracts for the avoidance of double taxation is also characterized by the fact that they have greater legal force (above the law) than domestic legal acts at the moment when they go through a ratification process. This in almost all Western Balkan countries is regulated by constitutional provisions because they are considered to be part of the domestic legal order. International contracts for the avoidance of double taxation do not preclude the application of domestic legislation but may limit it, for instance, when a double taxation contract reduces tax rates as required by domestic tax laws. Furthermore, they determine the division of tax law between the Contracting States.

The provisions of the contract for the avoidance of double taxation apply only to residents of a contracting state. Residents of third countries cannot use it according to the validity of the contract.

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