PRINCIPLES OF DOUBLE TAXATION
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Double taxation exists when the same source of income is subject to tax in two or more States, known for tax purposes as the Source State and the Resident State. The difference between the Source and Resident State is analysed below:

**Source State** is the State in which the income was generated. Source State claims taxing right because the income was generated in its territory.

**Resident State** is the State in which the taxpayer is tax resident. In the majority of the States, the domestic tax law provides for taxing rights of the Resident State on the income generated by the taxpayer on a worldwide basis.

Conflicts may arise on income generated outside of the Resident State because the Source State may claim taxing rights as well as the Resident State therefore the income is subject to double taxation i.e. to both Source State and Resident State. This is known as Juridical Double Taxation, which is defined as the taxpayer is taxed on the same source of income by two States, the Source and the Resident. The double taxation relief basically resolves this juridical double taxation either with **relief by credit** or **relief by exemption**.

**Relief by credit**

The tax imposed on the source state on the particular source of income is deducted from the tax imposed in the resident state. The relief by credit can be either ordinary credit or full credit. Ordinary credit means that the tax imposed in the source state is restricted to the tax imposed on the resident state that is imposed to the income taxed in the source state. Full credit means that the resident state allows for deduction of the total amount of tax paid in the source state.

The relief by credit mainly applies to withholding tax imposed to the source state. This withholding tax is deducted from the tax imposed on the resident state. The tax authorities of the resident state will request for documents proving the imposition of withholding tax in the source state like tax certificate issued by the tax authorities of the source state or tax receipt.

**Relief by exemption**

Under the principle of relief by exemption, the income generated in the source state and thus subject to tax in the source state exempts from the tax imposed in the Resident state. In substance this income is treated as tax-free income in the tax computation of the taxpayer in the resident state.

The relief by exemption mainly applies to profits generated through a Permanent Establishment in the source state. The source state claims taxing rights on the profits of the permanent establishment and the resident state exempts it from taxation.

**Difference between credit and exemption method**

Fundamentally, the difference between the two methods is that the exemption method looks at the income while the credit method looks at the tax.
Double Taxation Relief

The double taxation relief is granted in two ways:

Bilateral double taxation relief: This depends on the terms of the double taxation treaty concluded between the two States. The majority of the double taxation treaties are based on the OECD Model Tax Treaty, which provides for relief by credit and relief by exemption depending on the particular source of income.

Unilateral double taxation relief: This depends on whether the domestic tax law of the resident state provides for unilateral double taxation relief i.e. irrespective of the existence of double taxation treaty the resident state provides relief on the tax imposed on the source state. Cyprus tax law provides for unilateral tax relief.

Conclusion:

The double taxation is becoming nowadays a very challenging issue for the taxpayers and the tax professionals who should be aware of the methods of its elimination and present to the tax authorities the required documents so as to avoid being taxed twice on the same source of income.

Please do not hesitate to contact our office should you need any additional clarifications.

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