Certificate in German Taxation Laws

International Taxation

International taxation is a complex and specialized area of tax law that deals with the taxation of cross-border transactions and the taxation of multinational entities. In this explanation, we will cover some of the key terms and vocabulary that are commonly used in international taxation.

1. Permanent Establishment (PE): A PE is a fixed place of business through which a foreign enterprise carries on its business. The concept of PE is important in international taxation because it is used to determine the taxing rights of source and residence countries. If a foreign enterprise has a PE in a particular country, that country has the right to tax the profits attributable to that PE.

Example: A German manufacturing company sets up a sales office in the United States to sell its products in that market. The sales office is a fixed place of business, and if it meets the criteria for a PE under the US-Germany tax treaty, the US has the right to tax the profits attributable to the sales office.

2. Controlled Foreign Corporation (CFC): A CFC is a foreign corporation that is controlled by US shareholders. The concept of CFC is important in international taxation because it is used to prevent US multinationals from shifting profits to low-tax foreign jurisdictions. If a CFC has earnings that are not subject to tax in the foreign jurisdiction, those earnings may be subject to tax in the US under the Subpart F rules.

Example: A US multinational sets up a subsidiary in a low-tax foreign jurisdiction to manufacture products for sale in that market. If the subsidiary is a CFC and has earnings that are not subject to tax in the foreign jurisdiction, those earnings may be subject to tax in the US under the Subpart F rules.

3. Transfer Pricing: Transfer pricing is the pricing of cross-border transactions between related parties. The concept of transfer pricing is important in international taxation because it is used to prevent multinationals from shifting profits to low-tax foreign jurisdictions. The arm's length principle is used to determine the transfer pricing of cross-border transactions.

Example: A German multinational sells products to its subsidiary in a low-tax foreign jurisdiction at a price that is higher than the arm's length price. This may result in the shifting of profits to the low-tax foreign jurisdiction and may be challenged by the tax authorities.

4. Tax Treaties: Tax treaties are agreements between two countries that determine the taxing rights of each country with respect to cross-border transactions. Tax treaties are important in international taxation because they reduce the risk of double taxation and provide certainty for taxpayers.

Example: A German individual receives dividends from a US company. The US-Germany tax treaty provides for a reduced withholding tax rate on dividends paid to German residents.

5. Thin Capitalization: Thin capitalization is the practice of financing a subsidiary with a high level of debt relative to equity. The concept of thin capitalization is important in international taxation because it is used

to prevent multinationals from shifting profits to low-tax foreign jurisdictions. If a subsidiary is thinly capitalized, the interest expense may be disallowed, and the profits may be reallocated to the parent company.

Example: A US multinational finances its subsidiary in a low-tax foreign jurisdiction with a high level of debt. If the subsidiary is thinly capitalized, the interest expense may be disallowed, and the profits may be reallocated to the parent company.

6. Base Erosion and Profit Shifting (BEPS): BEPS is a tax planning strategy used by multinationals to shift profits to low-tax foreign jurisdictions. The OECD has developed a BEPS action plan to address this issue.

Example: A German multinational sets up a subsidiary in a low-tax foreign jurisdiction to shift profits to that jurisdiction. The BEPS action plan includes measures to prevent this type of tax planning.

7. Double Taxation: Double taxation is the taxation of the same income by two or more countries. Double taxation is a common issue in international taxation and is addressed through tax treaties.

Example: A German individual receives dividends from a US company. The US taxes the dividends, and the individual is also subject to tax in Germany. The US-Germany tax treaty provides for a reduced withholding tax rate on dividends paid to German residents.

8. Withholding Tax: Withholding tax is a tax that is levied on payments made to non-residents. Withholding tax is a common issue in international taxation and is addressed through tax treaties.

Example: A US company pays dividends to a German individual. The US is required to withhold tax on the dividends at a rate determined by the US-Germany tax treaty.

9. Tax Havens: Tax havens are countries that have low or zero tax rates and provide secrecy for foreign investors. Tax havens are a common issue in international taxation and are addressed through measures such as the BEPS action plan.

Example: A German multinational sets up a subsidiary in a tax haven to avoid paying taxes on its profits. The BEPS action plan includes measures to prevent this type of tax planning.

10. Tax Information Exchange Agreements (TIEAs): TIEAs are agreements between two countries that provide for the exchange of tax information. TIEAs are important in international taxation because they provide for the exchange of information necessary to enforce tax laws.

Example: A German tax authority requests information from a tax haven about a German taxpayer. The tax haven provides the information under a TIEA.

In conclusion, international taxation is a complex and specialized area of tax law that deals with the taxation of cross-border transactions and the taxation of multinational entities. The key terms and vocabulary covered in this explanation are important in understanding the concepts and issues in international taxation. It is essential for tax professionals working in this field to have a solid understanding of these terms and concepts to provide effective advice to clients. Examples, practical applications, and challenges

have been included in this explanation to enhance understanding and to provide context for the application of these terms and concepts.