

**EXPLANATORY MEMORANDUM TO THE  
DRAFT DOUBLE TAXATION RELIEF (TAXES ON INCOME) (GEORGIA)  
ORDER 2004**

1. This explanatory memorandum has been prepared by Inland Revenue and is laid before House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

To give effect within the domestic legal system of the United Kingdom, so far as necessary, to the provisions of an international agreement on double taxation entered into by Her Majesty's Government and the Government of Georgia.

2. **Description**

This draft Order brings into effect those arrangements specified in the Agreement set out in the attached Schedule.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

- i) **Type of resolution**

This draft Order is subject to the affirmative resolution procedure.

- ii) **Details of the Agreement**

Further details of the Double Taxation Agreement scheduled to the draft Order are annexed to this memorandum.

4. **Legislative Background**

- i) **General**

This Order is made under section 788 of the Income and Corporation Taxes Act 1988 (c.1) which has been amended by section 277 of the Taxation of Chargeable Gains Act 1992 (c.12) and section 198 (1) and (2) of the Finance Act 2003 (c.14),

Section 788 provides the mechanism by which arrangements made with overseas territories for the purpose of affording relief from double taxation in relation to income tax, corporation tax and capital gains tax and taxes of a similar character in the other territory are given effect in the United Kingdom. The relevant Agreement is scheduled to an Order under section 788 and thus given domestic legislative effect

The arrangements contain provisions concerning the exchange of information between the territories and, in particular, provisions to deal

with the prevention of fiscal evasion in relation to the taxes mentioned above and they are also given effect in the United Kingdom by means of an Order under section 788.

**ii) EU legislation**

This instrument does not implement EU Legislation.

**5. Extent**

The draft Order applies to the whole of the United Kingdom.

**6. European Convention on Human Rights**

The Paymaster General (Dawn Primarolo) has confirmed that advice provided to her confirms that the provisions of this draft Order are compatible with the European Convention on Human Rights.

**7. Policy background to the instrument**

Double Taxation Agreements aim to eliminate the double taxation of income or gains arising in one State and paid to residents of another State. They do this by dividing the taxing rights that each treaty partner has under its domestic law over the same income and gains. They provide additional protection for taxpayers by specific measures combating discrimination in tax treatment. More generally, Agreements benefit the taxpayer by ensuring certainty of treatment and, as far as possible, by reducing compliance burdens. Double Taxation Agreements also serve an Exchequer protection role by including provisions to combat avoidance and evasion — not least by measures providing for the exchange of information between Revenue authorities. They also encourage and maintain international consensus on the appropriate tax treatment of cross-border economic activity and thus promote international trade and investment.

**8. Impact**

**i) On business, charities, voluntary bodies or individuals**

There are no significant regulatory impacts but taxpayers may in some cases have to make a claim to the Inland Revenue or the other country's fiscal authority in order to benefit from the Agreement. However, taxpayers will benefit from reduced compliance burdens and, in many cases, from having to deal with just one fiscal authority.

**ii) On the Exchequer**

The nature of a Double Tax Agreement is that one or both of the contracting states gives up all or part of their taxing rights so that a given source of income is taxed only once. Measured against a baseline of single taxation only, Agreements do not therefore generally have an exchequer cost; rather, by encouraging cross-border

economic activity, they can lead to an increase in tax revenue. But where double taxation is unrelieved, the economic activity in question, and hence the higher tax revenue attributable to it, will often be only temporary.

**9. Contact**

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## **GENERAL**

All the United Kingdom's recent Double Taxation Agreements largely follow the approach adopted in the OECD's *Model Tax Convention on Income and on Capital*. This Agreement continues that approach. This is the first comprehensive Double Taxation Agreement between the United Kingdom and Georgia.

## **NOTES ON DETAILS**

### **ARTICLE 1 – PERSONS COVERED**

The Agreement is to apply to persons who are residents of one or both of the Contracting States (the United Kingdom and Georgia).

### **ARTICLE 2 – TAXES COVERED**

This Article lists the taxes to which the Agreement is to apply.

The existing Georgian taxes to which the Agreement applies are the tax on profit (income) of enterprises, the tax on property of enterprises, the tax on income of individuals and the tax on property of individuals.

The existing United Kingdom taxes to which the Agreement applies are the income tax, the corporation tax and the capital gains tax.

The Agreement is to apply also to any identical or substantially similar taxes subsequently imposed by either country in addition to or in place of the taxes mentioned above. A provision on these lines is usually included in our Agreements.

### **ARTICLE 3 – GENERAL DEFINITIONS**

This Article defines a number of terms used in the Agreement and provides a rule for determining the meaning of terms not defined in the Agreement.

### **ARTICLE 4 – RESIDENT**

This Article establishes the meaning of "resident of" the United Kingdom or Georgia and lays down detailed rules for dealing with situations where individuals or other persons may be considered residents of both countries for tax purposes under their respective domestic law.

## **ARTICLE 5 – PERMANENT ESTABLISHMENT**

This Article provides the definition of a “permanent establishment”. It defines when an enterprise will or will not be deemed to have a permanent establishment in the other country. It also provides that a building site, construction, or installation project is considered a permanent establishment if it lasts for more than six months.

Taken with Article 7, this Article prescribes the circumstances and manner in which businesses of one country may be taxed on their profits in the other country.

## **ARTICLE 6 – INCOME FROM IMMOVABLE PROPERTY**

This Article allows the country in which the property is situated to tax income from immovable property.

Paragraphs (2) and (3) provide details of the meaning of “income from immovable property”.

## **ARTICLE 7 – BUSINESS PROFITS**

This Article provides that unless an enterprise of one country carries on business in the other through a permanent establishment situated there, its profits will be taxable only in its country of residence.

Where the enterprise has a permanent establishment in the other country, that country will be entitled to tax profits attributable to the permanent establishment.

## **ARTICLE 8 – INCOME FROM INTERNATIONAL TRAFFIC**

This Article provides that profits of an enterprise from the operation of ships or aircraft in international traffic will be taxable only in the country in which the enterprise has its place of effective management. It includes a rule to determine where profits will be taxed if the place of effective management of a shipping enterprise is aboard a ship.

It also states that profits derived from participation in a pool, joint business or international operating agency shall be taxable only in the country in which the operator is resident.

## **ARTICLE 9 – ASSOCIATED ENTERPRISES**

This Article provides that appropriate adjustments may be made in determining the profits of an enterprise of one country where conditions made or imposed between the enterprise and an associated enterprise of the other country differ from those that would be made between independent enterprises.

Where such an adjustment is made to the profits of an enterprise by one country, the other country will make an appropriate adjustment to the amount of tax charged on those profits, in order to relieve the double taxation which might otherwise arise as a result of an adjustment by just one country.

## **ARTICLE 10 – DIVIDENDS**

This Article contains the rules for the taxation of dividends paid by a company which is resident of one country to a resident of the other.

Paragraph (1) provides that dividends paid by a company resident in one country (the source country) to a resident of the other country may be taxed in that other country.

Paragraph (2)(a) provides that dividends are exempted from tax in the country of source if they are beneficially owned by a company resident in the other country that controls at least 50 per cent of the voting power in, and has invested £2 million (or the equivalent amount in the currency of Georgia) in the share capital of, the company paying the dividends.

Paragraph (2)(b) covers dividends beneficially owned by a company that cannot meet the tests prescribed in paragraph (2)(a). If the beneficial owner is a company resident in the other country that controls at least 10 per cent of the voting power in the company paying the dividends, the tax in the country of source will not exceed 5 per cent of the gross amount of the dividends.

Paragraph (2)(b) also provides that in all other cases the rate of tax in the source country is not to exceed 10 per cent of the gross amount of the dividends, provided the beneficial owner is a resident of the other country.

Paragraph (3) defines the term “dividends”.

Paragraph (4) provides that where a resident of one country receives dividends from the other country and carries on business in that other country through a permanent establishment there, with which the holding from which the dividend arises is effectively connected, the provisions of paragraphs (1) and (2) shall not apply. The taxation of the dividends is then governed by Article 7 (Business Profits).

Paragraph (5) rules out the extra-territorial taxation by one country of dividends paid by a company that is a resident only of the other country. The first country will not tax the dividends unless they are connected with a

permanent establishment or a fixed base there or are paid to a resident of that country. There is a similar provision concerning undistributed profits.

Paragraph (6), an anti-abuse provision, ensures that the provisions of the Article will not apply if the shares or other rights in respect of which the dividend is paid were created or assigned mainly to take advantage of the Article.

## **ARTICLE 11 – INTEREST**

This Article contains the rules for the taxation of interest paid by a resident of one country to a resident of the other.

Paragraph (1) provides that interest arising in one country and paid to a resident of the other shall be taxed only in that other country, if the recipient is the beneficial owner of the interest.

Paragraph (2) defines the term “interest”.

Paragraph (3) provides that where a resident of one country receives interest from the other country and carries on business in that other country through a permanent establishment there, with which the debt claim in respect of which the interest is paid is effectively connected, the provisions of paragraphs (1) shall not apply. The taxation of interest is then governed by Article 7 (Business Profits).

Paragraph (4) provides that where, because of a special relationship between the payer and the recipient, the amount of interest paid is excessive, the relief under the Article will apply only to the interest that would be payable at “arm’s length”.

Paragraph (5), an anti-abuse provision, ensures that the provisions of the Article will not apply if the debt claim on which the interest is paid was created or assigned mainly to take advantage of the Article.

## **ARTICLE 12 – ROYALTIES**

This Article contains the rules for the taxation of royalties arising in one country and derived by a resident of the other.

Paragraph (1) provides that royalties arising in one country and paid to a resident of the other shall be taxed only in that other country, if the recipient is the beneficial owner of the royalties.

Paragraph (2) defines the term “royalties”.

Paragraph (3) provides that where a resident of one country receives royalties from the other country and carries on business in that other country through a

permanent establishment there, with which the right or property in respect of which the royalties are paid is effectively connected, the provisions of paragraph (1) shall not apply. The taxation of royalties is then governed by Article 7 (Business Profits).

Paragraph (4) provides that where, because of a special relationship between the payer and the recipient, the amount of royalty paid is excessive, the relief under the Article will apply only to the royalty that would be payable at “arm’s length”.

Paragraph (5), an anti-abuse provision, ensures that the provisions of the Article will not apply if the rights on which the royalties are paid were created or assigned mainly to take advantage of the Article.

## **ARTICLE 13 – CAPITAL GAINS**

This Article contains the rules for the taxation of income or gains deriving from the alienation of property situated in one country by a resident of the other.

Paragraph (1) provides that income or gains derived from the alienation of immovable property in one country by a resident of the other may be taxed in the country where the property is situated.

Paragraph (2) provides that a resident of one country may be taxable in the other country in respect of certain types of gains.

Paragraph (3) provides that income or gains arising from the alienation of movable property relating to a permanent establishment maintained in the other country may be taxed in that other country.

Paragraph (4) provides that income or gains derived by a resident of one country from the alienation of ships or aircraft operated in international traffic shall be taxable only in the country where the taxpayer is resident.

Paragraph (5) preserves the domestic law right of each country to tax capital gains in cases not covered by paragraphs (1) to (4).

Paragraph (6), an anti-abuse provision, preserves the right of a country to tax income or gains from the alienation of any property by a person (including an individual, company or trustee) who is or was a resident of that country at any time during the fiscal year in which the property is alienated, or at any time during the six preceding fiscal years.

## **ARTICLE 14 – INCOME FROM EMPLOYMENT**

Paragraph (1) provides that, in general, employment income of a resident of one country can be taxed in the other country if the employment is exercised there.

Paragraph (2) provides an exception to the general rule where an employee is present in the other country for not more than 183 days in any twelve-month period beginning or ending in the fiscal year concerned, the remuneration is paid by or on behalf of an employer who is not a resident of the other country and the remuneration is not tax deductible by a permanent establishment which the employer has in the other country. Where all three conditions are satisfied, the remuneration will be taxable only in the employee's country of residence.

Paragraph (3) provides that the remuneration of an individual working on a ship or aircraft operated in international traffic may be taxed in the country where the enterprise has its place of effective management.

## **ARTICLE 15 – DIRECTORS' FEES**

This Article provides that directors' fees (and other similar payments) paid to a resident of one country who is a member of the board of directors of a company may be taxed in the country where the company is resident.

## **ARTICLE 16 – ARTISTES AND SPORTSMEN**

Paragraphs (1) and (2) provide that income in respect of the personal activities of artistes and sportsmen can be taxed in the country in which those activities are exercised, whether it is paid directly to the artiste or sportsman or to some other person.

## **ARTICLE 17 – PENSIONS AND ANNUITIES**

Paragraph (1) provides that pensions (other than government service pensions) and annuities will be taxable only in the country where the recipient is resident.

Paragraph (2) defines the term "annuity".

## **ARTICLE 18 – GOVERNMENT SERVICE**

Paragraph (1) provides that, in general, remuneration paid to an individual in respect of services rendered to a country, or to a political sub-division or local authority of a country, will be taxable only in that country. If, however, the services are carried out in the other country by one of its own nationals resident there, or by a resident who, although not a national, did not become a resident solely to render the services, then that other country will have the sole taxing right.

Paragraph (2) provides that pensions paid to an individual in respect of services rendered to a country, or to a political sub-division or local authority of a country, will be taxable only in that country. If, however, the pension is paid to a resident and national of the other country, then that other country will have the sole taxing right.

Paragraph (3) provides an exception to the rules in paragraphs (1) and (2). In the case of salaries, wages and other similar remuneration or pensions arising in respect of services rendered in connection with a business, the provisions of Articles 14, 15, 16 or 17 are to apply.

## **ARTICLE 19 – STUDENTS**

This Article provides that certain payments for the maintenance, education or training of a visiting student, business apprentice or trainee will not be taxed in the country visited, provided the payments are made from sources outside that country.

## **ARTICLE 20 - PROFESSORS, TEACHERS AND RESEARCHERS**

This Article provides that, subject to certain conditions, the remuneration of a visiting professor, teacher or researcher will not be taxed in the country visited for a period not exceeding two years. It also confirms the type of income from research that is covered by this Article.

## **ARTICLE 21 - OTHER INCOME**

Paragraph (1) provides that any item of income not specifically covered elsewhere in the Agreement, will be taxable only by the country of which the beneficial owner is a resident.

Paragraph (2) provides that the provisions of paragraph (1) will not apply, other than to income from immovable property, if the right or property in respect of which the income is paid is effectively connected with a permanent establishment maintained in the country of source. In that case, the income will be taxable in accordance with Article 7.

Paragraph (3) provides that where, because of a special relationship between the payer and the recipient, the amount of income paid is excessive the relief under the Article will apply only to the income that would be payable at “arm’s length”.

Paragraph (4), an anti-abuse provision, ensures that the provisions of the Article will not apply if the rights on which the income is paid were created or assigned mainly to take advantage of the Article.

## **ARTICLE 22 – CAPITAL**

Paragraph (1) provides that capital, represented by immovable property referred to in Article 6, owned by a resident of one country and situated in the other country may be taxed in that other country.

Paragraph (2) provides that capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of one country has in the other country may be taxed in that other country.

Paragraph (3) provides that capital represented by ships or aircraft in international traffic will be taxable only in the country in which the enterprise has its place of effective management. This also applies to capital represented by movable property pertaining to the operation of such ships and aircraft.

Paragraph (4) provides that all other elements of capital owned by a resident of one country will only be taxable in that country.

## **ARTICLE 23 – ELIMINATION OF DOUBLE TAXATION**

This Article sets out the methods by which double taxation is to be eliminated.

Paragraph (1) provides the details of how United Kingdom tax will be allowed as a deduction against Georgian tax on income or capital. Such a deduction shall not exceed the income tax or capital tax as computed before the deduction was given which may be attributable to the income or capital which may be taxed in Georgia.

Paragraph (2) provides details of how Georgian tax shall be allowed as a credit against United Kingdom tax on profits, income or chargeable gains. In the case of a dividend paid by a company resident in Georgia to a company resident in the United Kingdom and controlling at least 10 per cent of the voting power in the paying company, the credit will take account of the Georgian tax payable by the Georgian company in respect of the profits out of which the dividend is paid.

Paragraph (3) provides that, for the purposes of paragraph (2), profits, income and capital gains owned by a resident of one country which may be taxed in the other country under the terms of the Agreement, will be deemed to arise from sources in that other country.

## **ARTICLE 24 - LIMITATION OF RELIEF**

Paragraph (1) provides that where tax on any income or gains is determined in one country by reference only to the amount actually remitted to or received

in that country, relief given in the other country under the Agreement will be restricted to that part of the income or gains that is taxed in the first-mentioned country.

Paragraph (2) provides that a resident of one country who, as a result of domestic law, is exempted from or qualifies for a reduced rate of tax in respect of income or capital gains will not be given exemption from or qualify for a reduced rate of tax under this Agreement in the other country if the purpose was to obtain the benefits of the Agreement.

## **ARTICLE 25 - NON-DISCRIMINATION**

Subject to certain conditions, this Article provides that neither country shall impose discriminatory taxes (or requirements) on the nationals, permanent establishments and enterprises of the other or on stateless persons resident in the other country. The Article only applies to the taxes that are the subject of the Agreement.

## **ARTICLE 26 - MUTUAL AGREEMENT PROCEDURE**

This Article permits a resident of one country who feels that the actions of one or both countries result, or will result, in taxation that is not in accordance with the terms of the Agreement to present his case to the competent authority of the country of which he is a resident. If the case comes under paragraph (1) of Article 25, he may present his case to the competent authority of the country of which he is a national. It also provides that the competent authorities of the two countries may endeavour to resolve difficulties or doubts arising in the interpretation or application of the Agreement.

## **ARTICLE 27 - EXCHANGE OF INFORMATION**

This Article provides for the exchange of certain information between the competent authorities of the two countries. It confirms who such information may be disclosed to and for what purpose. Neither country is obliged to exchange information that would disclose any trade, business, industrial, commercial or professional secret or trade process or information the disclosure of which would be contrary to public policy.

## **ARTICLE 28 – MEMBERS OF DIPLOMATIC MISSIONS AND CONSULAR POSTS**

This Article confirms that the provisions of the Agreement are not to affect the tax privileges that diplomatic and consular officials are entitled to under international law or under the provisions of special agreements (such as the Vienna Convention on Diplomatic Relations).

## **ARTICLE 29 - ENTRY INTO FORCE**

Paragraph (1) provides that the Agreement shall be ratified and instruments of ratification exchanged as soon as possible.

Paragraph (2) provides that the Agreement will enter into force upon the exchange of instruments of ratification. It will take effect in Georgia in respect of taxes chargeable for any fiscal year beginning on or after 1 January in the calendar year following the date the Agreement enters into force. It will take effect in the United Kingdom in respect of income tax and capital gains tax for any year of assessment beginning on or after on 6 April in the calendar year next following the date of entry into force and in respect of corporation tax for any financial year beginning on or after 1 April next following that date.

## **ARTICLE 30 – TERMINATION**

This Article provides that the Agreement may be terminated by either country giving notice of termination through diplomatic channels at least six months before the end of any calendar year, after 5 years from the date of its entry into force. It details the dates from which the Agreement will be terminated in the United Kingdom and Georgia.