EXPLANATORY MEMORANDUM TO

THE DOUBLE TAXATION RELIEF (TAXES ON INCOME) (MACEDONIA) ORDER 2007

2007 No.

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

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

2. Description

The 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

3.1 Type of resolution

This draft Order is subject to the affirmative resolution procedure.

3.2 Details of the Agreement

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

4. Legislative Background

4.1 General

This Order is made under section 788 of the Income and Corporation Taxes Act 1988 (c.1) and section 173(7) of the Finance Act 2006 (c.25). Section 788 has been extended by section 277 of the Taxation of Chargeable Gains Act 1992 (c.12), and amended by section 198 (1) and (2) of the Finance Act 2003 (c.14) and section 176 of the Finance Act 2006 (c. 25).

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.

Section 173 of the 2006 Act provides the mechanism by which such arrangements may also include provisions about, among other things, the exchange of information foreseeably relevant to the administration, enforcement or recovery of any tax or duty.

The relevant Agreement is scheduled to an Order made under section 788 ICTA 1988 and section 173 FA 2006. It is thus given domestic legislative effect.

4.2 E U legislation

This instrument does not implement EU legislation.

5. Extent

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

6. European Agreement on Human Rights

The Paymaster General (Dawn Primarolo) has made the following statement regarding Human Rights:

In my view the provisions of the draft Double Taxation Relief (Taxes on Income) (Macedonia) Order 2007 are compatible with the Agreement rights.

7. Policy background

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

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies. However, taxpayers may in some cases have to make a claim to HM Revenue & Customs or the other country's fiscal authority in order to benefit from the Agreement. Taxpayers will benefit from reduced compliance burdens and, in many cases, from having to deal with just one fiscal authority.

8.2 The impact on the public sector is that because of the nature of a Double Taxation Agreement, 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

Steve Reszetniak at HM Revenue & Customs (tel: 020 7147 2674 or e-mail: Steve.Reszetniak@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.

ANNEXE

GENERAL

All the United Kingdom's recent Double Taxation Agreements largely follow the approach adopted in the OECD's *Model Tax Agreement on Income and on Capital*. This Agreement continues that approach. In addition, it reflects changes in policy and legislation in the United Kingdom and Macedonia since the entry into force of the existing Agreement between the two countries, which this new Agreement replaces.

NOTES ON DETAILS

ARTICLE 1 – PERSONS COVERED

This Article sets out the general scope of the Agreement.

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

ARTICLE 2 – TAXES COVERED

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

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

The existing Macedonian taxes to which the Agreement applies are the personal income tax, the profit tax and the property 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 Macedonia 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 twelve 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.

Paragraph (2) defines "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 – INTERNATIONAL TRAFFIC

Paragraph (1) provides that profits of an enterprise of a country from the operation of ships or aircraft in international traffic will be taxable only in that country.

Paragraph (2) provides that profits from the operation of ships or aircraft include profits from the rental of ships, aircraft or the use of containers. In each case the rental or use must be incidental to the operations in international traffic.

Paragraph (3) clarifies that paragraph 1 applies to profits from participation in a pool, a joint business or an international operating agency.

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 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 the rate of tax in the source country is not to exceed 5 per cent of the gross amount of the dividends if they are beneficially owned by a company resident in the other country which owns directly shares representing at least 10 per cent of the capital in the company paying the dividends.

Paragraph (2)(b) provides that in all other cases the rate of tax in the source country is not to exceed 15 per cent of the gross amount of the dividends, provided the beneficial owner is a resident of the other country.

Paragraph (3) gives exceptions to the rules in Paragraph 2 and provides that dividends are exempt from tax in the source country if they are beneficially owned by a company resident in the other country which has held at least 25 per cent of the capital in the company paying the dividends for an uninterrupted 12 month period ending on the date the dividend is paid.

This paragraph also provides that dividends are exempt from tax in the source country if they are beneficially owned by a pension scheme resident in the other country.

Paragraph (4) defines the term “dividends”.

Paragraph (5) 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 (6) 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 may not tax the dividends unless they are paid to a resident of that country or connected with a permanent establishment. There is a similar provision in respect of undistributed profits.

Paragraph (7), an anti-abuse provision, ensures that relief will not be available under the Article 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 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 (the source country) and paid to a resident of the other country may be taxed in that other country (the residence country).

Paragraph (2) provides that interest may also be taxed in the source country, but if the beneficial owner of the interest is a resident of the other country, the tax in the source country will not exceed 10 per cent of the gross amount of the interest.

Paragraph (3) gives exceptions to the rule in paragraph (2), allowing for some categories of interest to be taxable only in the residence country. These include interest on loans granted or credit extended by an enterprise to another enterprise; and interest received by one country or by its political subdivisions or local authorities or by a public entity of that country.

Paragraph (4) defines the term "interest".

Paragraph (5) provides that paragraphs (1) to (2) shall not apply 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. In such circumstances, the taxation of the interest is governed by Article 7 (Business Profits).

Paragraph (6) provides rules for determining the source country of interest.

Paragraph (7) provides that where the amount of interest paid is excessive because of a special relationship between the payer and the recipient, relief under the Article will be given only in respect of the amount that would be payable under "arm's length" conditions.

Paragraph (8), an anti-abuse provision, ensures that relief will not be available under the Article if the debt claim under which the interest is paid was created or assigned mainly to take advantage of the Article.

ARTICLE 12 – ROYALTIES

This Article contains 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 (the source country) and paid to a resident of the other is taxable only in the other country.

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 paragraphs (1) shall not apply. The taxation of royalties is then governed by Article 7 (Business Profits).

Paragraph (4) provides that where the amount of royalties paid is excessive because of a special relationship between the payer and the recipient, relief under the Article will be given only in respect of the amount that would be payable under "arm's length" conditions.

Paragraph (5), an anti-abuse provision, ensures that relief will not be available under the Article if the rights in relation to which the royalties are paid were created or assigned mainly to take advantage of the Article.

ARTICLE 13 – CAPITAL GAINS

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

Paragraph (1) provides that 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 gains by a resident of one country from the alienation of shares or interests in partnerships or trusts that derive their value principally from immovable property situated in the other country may be taxed in that other country. (See below, Protocol paragraph 3.)

Paragraph (3) provides that 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 gains derived by a resident of a country from the alienation of ships or aircraft operated in international traffic by an enterprise resident in that country shall be taxable only in the country where the enterprise is resident.

Paragraph (5) give the residence country the exclusive right to tax gains that are not covered by paragraphs (1) to (4).

Paragraph (6), an anti-abuse provision, confirms the right of a country to tax 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 or a fixed base 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 operating the ship or aircraft is resident.

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 entertainers and sportsmen can be taxed in the country in which those activities are exercised, whether the income is paid directly to the entertainer or sportsman or to some other person.

ARTICLE 17 – PENSIONS

This Article provides that pensions (other than government service pensions), other similar remuneration and pension lump sum payments shall be taxable only in the country of which the pensioner is a resident.

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 one of its political sub-divisions or local authorities, will be taxable only in that country.

However, the other country will have the sole taxing right if the services are carried out in the other country by one of that country's own nationals who is resident there. The other country will also have the sole taxing right if the services are carried out in the other country by one of its residents who did not become a resident solely for the purpose of rendering the services.

Paragraph (2) provides that in general, a pension paid to an individual in respect of services rendered to a country, or to one of its political sub-divisions or local authorities, will be taxable only in that country. If however the individual is 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 paragraph (1). In the case of remuneration or pensions arising in connection with a trade or business, the provisions of Article 14, 15, 16 or 17 will apply, as appropriate.

ARTICLE 19 – STUDENTS

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

ARTICLE 20 – OTHER INCOME

Paragraph (1) provides that any item of income not specifically covered elsewhere in the Convention will be taxable by the country of which the beneficial owner is a resident. There is an exception to this rule in the case of income paid out of trusts or the estates of deceased persons in the course of administration.

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 (Business profits).

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 relief will not be available under the Article if the rights in relation to which the income is paid were created or assigned mainly to take advantage of the Article.

ARTICLE 21 – 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 of an enterprise of one country represented by ships or aircraft in international traffic will be taxable only in that country. 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 22 – ELIMINATION OF DOUBLE TAXATION

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

Paragraph (1) provides details of how Macedonia will relieve double taxation. United Kingdom tax will be allowed as a deduction against Macedonian tax on income or capital. Macedonia will also allow, in the case of dividends, a deduction in respect of underlying tax on the profits out of which the dividends are paid. 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 the United Kingdom.

Paragraph (2) provides details of how the United Kingdom will relieve double taxation. Macedonian 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 Macedonia 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 Macedonian tax payable by the Macedonian 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 the United Kingdom which may be taxed in the Macedonia under the terms of the Agreement, will be deemed to arise from sources in Macedonia.

Paragraph (4) contains a rule to determine which country will relieve double taxation in cases where a tax charge arises only under the special rule in Article 13(6). The country which is entitled to tax under Article 13(6) will relieve any double taxation that would otherwise occur owing to the charge of tax in the other country.

This paragraph also confirms that the normal rules will apply in cases where a tax charge arises under paragraphs (1), (2) and (3) of Article 13

ARTICLE 23 – MISCELLANEOUS PROVISIONS

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 Convention will be restricted to that part of the income or gains that is taxed in the first-mentioned country.

Paragraph (2) provides a rules relating to income, profits and gains derived from a fiscally transparent entity. The income etc will be treated as belonging to a resident of a country to the extent that the taxation law of that country treats it as belonging to him (and not to the entity itself).

ARTICLE 24 – 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. The Article only applies to the taxes that are the subject of the Convention.

ARTICLE 25 – MUTUAL AGREEMENT PROCEDURE

This Article permits a resident of one country who believes that the actions of one or both countries result, or will result, in taxation that is not in accordance with the terms of the Convention 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 24 (prohibiting discrimination on grounds of nationality), 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 Convention.

ARTICLE 26 – EXCHANGE OF INFORMATION

This Article contains rules governing the exchange of information between the competent authorities of the two countries.

Paragraph (1) provides that the competent authorities shall exchange such information as is foreseeably relevant for carrying out the provisions of the Convention or of the two countries' domestic laws concerning taxes of any kind. Information may also be exchanged relating to persons who are not residents of either country.

Paragraph (2) provides that information exchanged in accordance with paragraph (1) shall be treated as secret, although it may be disclosed to certain specified persons or authorities. Such information may be disclosed in public court proceedings or in judicial decisions.

Paragraph (3) imposes certain limitations on the exchange of information. Paragraphs (1) and (2) cannot impose an obligation on a country to carry out administrative measures at variance with the laws and administrative practices of either country or to supply information which is not obtainable under the laws or in the normal course of the administration of either country or to supply information that would disclose any trade secret, or information whose disclosure would be contrary to public policy.

Paragraph (4) provides that the country from which information is requested shall use its information gathering powers to obtain the requested information even though that country may have no domestic tax interest in the information. The obligation is subject to the limitations of paragraph (3) but a country cannot decline to supply information solely because it has no domestic tax interest in it.

Paragraph (5) makes clear that paragraph (3) cannot be applied to permit a country to decline to supply information requested solely because the information is held by certain entities such as banks. However a country may decline to supply information which is covered by professional privilege provisions in domestic law.

ARTICLE 27 – MEMBERS OF DIPLOMATIC OR PERMANENT MISSIONS AND CONSULAR POSTS

This Article confirms that the provisions of the Convention do not disturb 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 28 – ENTRY INTO FORCE

Paragraph (1) provides that both countries will notify each other through diplomatic channels when they have completed their respective legislative procedures. The Convention will enter into force on the date of the later of these notifications. It will take effect in Macedonia on 1 January in the year after entry into force. It will take effect in the United Kingdom on 1 January in the year after entry into force for taxes withheld at source; on 1 April in that year for corporation tax; and on 6 April for income tax and capital gains tax.

Paragraph (2) provides that the United Kingdom/Yugoslavia Double Taxation Convention, signed in 1981, will no longer apply between the United Kingdom and Macedonia as from the date of entry into force of this Agreement.

ARTICLE 29 – TERMINATION

This Article provides that the Convention may be terminated, subject to a minimum life of 5 years, by either country giving notice of termination through diplomatic channels at least six months before the end of a calendar year. The Article also details the dates from which such a termination will be effective.

PROTOCOL

Paragraph (1) confirms that the Convention applies to pension schemes and charitable organisations.

Paragraph (2) provides that the United Kingdom is entitled to tax profits derived by a resident of the United Kingdom from a partnership established in Macedonia.

Paragraph (3) modifies Article 13(2) so that it does not apply to shares that are traded regularly on a Stock Exchange.

The Protocol is an integral part of the Convention and will enter into force on the same date.