Lao PDR tax treaty with Myanmar offers interesting tax planning opportunities

Daodeuane Duangdara & Daniel Harrison

With all the hype surrounding Myanmar at the moment, now is an opportune time to take a look at the pertinent points of the double taxation agreement (DTA) it concluded with its neighbour Laos not so long ago.

Signed in November 2009 and entering into force in September 2010, the DTA came into effect on 1 January 2011. It is one of the eight tax treaties currently in effect between Laos and other countries, including Vietnam, Thailand, China, South Korea, North Korea, Brunei and Malaysia.

Permanent Establishment

Typical of most DTAs in the Southeast Asian region, the treaty follows the United Nations Model Double Taxation Convention (UN Model) with regard to permanent establishment (PE). The common physical presences of a) a place of management; b) a branch; c) an office, etc. are all duly outlined.

However, the countries have opted to specifically include “a farm or plantation”, and extending on the mine, oil or gas well, and quarry clause, they have also explicitly identified drilling rigs, ships, and aircrafts used in exploration or exploitation, in addition to the place of extraction for timber and other forest products.

For example, when an enterprise uses an aircraft to conduct seismological surveys, the fees paid for the mapping may be taxable in the country where the survey is conducted even when such activity is carried out in a very short timeframe.

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ABOUT VDB LOI

VDB Loi is a regional legal and tax services firm with more than 60 outstanding local and international lawyers and tax advisers. We provide the highest quality integrated solutions for structuring investment and business transactions in Cambodia, Indonesia, Laos, Myanmar, Singapore and Vietnam.

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Projects

A building site, construction, assembly or installation project – and even the supervisory activities connected to such – will be deemed a PE if the site, project or activities last more than six months.

This is true of supervisory activities even if the enterprise carrying out such work acts only as a consultant of the building contractor and is not itself participating in the physical construction.

In other words, if a Myanmar design and project management firm supervises the construction of a bank in Laos that is entirely carried out by Lao contractors, and the project lasts for nine months – the Myanmar entity will be deemed to have a PE in Laos.

Services

Under the furnishing of services provision of the PE article (Article 5), an enterprise can be deemed to have a PE in a country where it provides services through employees or other personnel engaged in a similar manner if the service activity continues for more than six months in any 12-month period.

The six-month period is cumulative in nature, meaning the six months need not be continuous to satisfy the rule. Also noteworthy, it is not necessary for the six months to relate to a single project; time amassed on connected projects will form part of the cumulative time period.

For example, if a Lao mining company outsourced the services of its geology experts to an exploration project in Myanmar for the five months of December 2012 to April 2013, and then again a month later for another four months (June to September) to a different exploration project by the same Myanmar enterprise – the Lao mining company will be considered to have a PE in Myanmar.

Stock of Goods and Merchandise

One area of PE where the DTA moves away from the UN Model is in regard to maintaining a stock of goods or merchandise, or the facilities for such purpose. Here the DTA follows the OECD Model – a common practice in Southeast Asian tax treaties.

The key difference between the two models here is delivery of goods or merchandise. The Lao PDR-Myanmar DTA stipulates that “the use of facilities solely for the purpose of storage or display or delivery of goods or merchandise belonging to the enterprise” and “the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery” shall not be deemed a PE.

In practice, this means that, say for instance, if a Lao coffee producer maintains a warehouse in Myanmar solely for the purpose of storing and delivering coffee that it had sold in Laos, the warehouse would not constitute a PE in Myanmar.

Business Profits

In relation to determining taxable business profits – and thus taxation rights of a PE in the source country – the DTA follows the UN Model’s limited force of attraction rule, deviating from the trend of treaties which otherwise follow the UN Model but opt to omit this rule. It is usually omitted because it tends to create uncertainty for taxpayers, and therefore acts as a disincentive for investment between countries – as taxation rights are not ‘black and white’.

Essentially, the limited force of attraction methodology has a potentially much wider scope than ‘normal’ profit attribution. In simple terms, it takes the general principles of profit attribution and adds to this two more criteria:

- Sales of goods or merchandise of the same or similar kind as those sold through the PE
- Other business activities of the same or similar kind as those effected through the PE

Dividends, Interest and Royalties

Under Lao and Myanmar tax law, when a non-resident is paid dividends, interest or royalties, withholding tax will be deducted at the source before making payment – with dividend payments from Myanmar being the exception to the rule.
However, residents of either country can seek to rely on the DTA to effectively cap the tax which may be charged (withheld). Under the Lao PDR-Myanmar DTA, the maximum tax rates which can be applied to dividend, interest and royalty payments – going in either direction – is 5%, 10% and 10%, respectively (Articles 10, 11 and 12). The table below summarizes the withholding rates:

<table>
<thead>
<tr>
<th></th>
<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lao PDR domestic</td>
<td>10%</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>withholding tax rates</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Myanmar domestic</td>
<td>0%</td>
<td>15%</td>
<td>20%</td>
</tr>
<tr>
<td>withholding tax rates</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DTA rates</td>
<td>5%</td>
<td>10%</td>
<td>10%</td>
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</tbody>
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The DTA clearly provides a benefit for dividend payments sourced from Laos, effectively limiting source taxation to 5% of the gross amount where 10% would otherwise apply. It is neutral with regard to Myanmar-sourced dividends, however, which are already afforded a pleasing tax-free treatment (at the source anyway).

With regard to interest, only Myanmar-sourced payments will benefit, as the Lao withholding tax rate is already equal to the DTA cap – thus providing no relief.

The DTA provides a significant windfall for Myanmar-sourced royalty payments, with a massive 10 percentage point reduction available – while the Lao withholding tax rate is again within the cap.

### Capital Gains

Under the DTA, gains from the sale of shares in a company whose assets consist principally of immovable property may be taxed in the country in which the immovable property is located.

Gains from the sale of shares in a company whose assets do not consist principally of immovable property, and in which the shares in question represent at least 25% of the company, may be taxed in the country in which the company is a resident.

For example, a Myanmar resident individual holds 49% of the shares of a heavy machinery leasing company in Laos and decides to sell those shares to another Myanmar resident individual. Despite the sale of shares being by a tax resident of Myanmar to another tax resident of Myanmar – the gain on the sale may be taxed in Laos.

### Independent Personal Services

Individuals providing professional services or other independent activities of a similar nature shall be taxed only in their resident country, unless:

- a) A fixed base is regularly available to the individual; or
- b) The individual stays in the source country for 183 days or more within any 12-month period (cumulative in nature); or
- c) Payment for the activities is by a resident, or at least borne by a PE, of the source country and total payment for the fiscal year exceeds US$6,000.

In the case of a) and b) above, only so much of the income that is attributable to the fixed base or derived from the activities in the source country shall be taxable in the source country.

‘Professional services’ in this context encompasses independent scientific, literary, artistic, educational or teaching activities and also the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

### Dependent Personal Services

An individual’s employment income shall be taxable only in their resident country, unless the employment is exercised in the other country (source country) – in which case, the income derived from that employment may be taxed in the source country.

However, such income shall still only be taxable in the individual’s resident country where the individual:

- a) Is present in the other country (source country) for less than a total of 183 days in any 12-month period (cumulative in nature); and
b) Is paid by, or on behalf of, a non-resident of the source country; and

c) Payment is not borne by a resident of the source country, or a PE or fixed base the employer has in the source country.

**Other Income**

As is common in other treaties, Article 22 of the DTA provides a ‘catch all’ provision. Income of a resident which is not explicitly mentioned in any other part of the DTA will be caught by this article. In practice, this class of income does not occur often. Some examples arising under “other income” are income derived in third countries, alimony and certain income generated from derivatives. This income will only be taxable in the resident’s country, unless it is derived in the other country, in which case it may also be taxed there. So, unlike the OECD Model, the DTA foresees that the source country may indeed tax “other income”.

However, where the resident receiving the income has a PE or fixed base for carrying on a business or providing independent personal services, and the income is connected to that PE or fixed base, Article 22 will not apply. In such a case, the provisions contained in Articles 7 and, presumably, 14 regarding business profits and independent personal services (respectively) shall apply.

**Elimination of Double Taxation**

Both Laos and Myanmar follow the ‘credit method’ for eliminating double taxation. This means that the source-country tax paid shall be allowed as a credit against the resident-country tax calculated on the same income, although the credit allowed shall not exceed the resident-country tax calculated on such income.

Notably, however, the DTA allows for ‘tax sparing’. Tax sparing is the practice of allowing a credit for source-country tax that would have been payable on income against resident-country tax on the same income but for a source-country tax exemption or reduction on that income as part of special incentive laws designed to promote economic development. In other words, although a company pays no source-country tax for certain income (because of a special exemption or reduction), a notional tax credit is still allowed against the resident-country tax calculated.

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