

The 10 Commandments for SMEs to Avoid Double Taxation



Disclaimer: These commandments are for informational guidance only, not for legal advice.

I. ESTABLISH A SINGLE TAX RESIDENCE (COMPANY LEVEL)

- Thou shalt clearly define the tax residence of the company itself based on the laws of the relevant countries (e.g., place of incorporation or place of effective management).
- This prevents the entire corporate entity from being treated as a resident in two nations and subject to dual corporate tax.
- **Request advise from Simplex Tax.**

II. IDENTIFY AND MANAGE PERMANENT ESTABLISHMENTS (PE)

- Thou shalt rigorously assess the existence of a "Permanent Establishment" (PE) in any foreign country where business is conducted.
- A PE (e.g., an office, factory, or a dependent agent) triggers corporate tax liability in that foreign country.
- Structure sales, storage, and service activities to avoid unintentionally creating a PE.

III. ADHERE TO ARM'S LENGTH PRICING (TRANSFER PRICING)

- Thou shalt use "Arm's Length" pricing for all intra-group transactions (e.g., loans, services, and sales between a parent company and a foreign subsidiary).
- This Transfer Pricing requirement ensures profits are taxed where they are economically generated and prevents tax authorities from re-allocating income to their jurisdiction.

IV. OPTIMIZE SOURCE AND TREATY RULES FOR WITHHOLDING TAX

Thou shalt apply the Double Tax Treaty (DTT) to reduce or eliminate Withholding Tax (WHT) on cross-border payments like dividends, interest, and royalties. Payers must ensure they have the necessary forms (e.g., Certificate of Residence) from the recipient to claim the reduced treaty rate.

V. ALLOCATE INCOME TO THE PE (ATTRIBUTION)

Thou shalt correctly attribute profits to a confirmed Permanent Establishment. If a PE exists, its income must be calculated as if it were a distinct and separate enterprise, adhering to the DTT rules for attributing income to that foreign branch.

VI. UTILIZE THE FOREIGN TAX CREDIT (FTC) OR EXEMPTION

Thou shalt claim relief in the residence state via the credit or exemption method. If the SME is taxed on its worldwide income, it must deduct the foreign corporate tax paid (the FTC method) or seek an exemption for the foreign income (the exemption method) to prevent the same profit from being taxed twice.

VII. DOCUMENT ALL CROSS-BORDER TRANSACTIONS

Thou shalt maintain meticulous documentation for all international activities, including legal contracts, invoices, proof of service delivery, and comprehensive transfer pricing files.

Insufficient documentation is the primary reason tax authorities deny treaty benefits.

VIII. RING-FENCE FOREIGN EXCHANGE GAINS/LOSSES

Thou shalt manage and correctly account for Foreign Exchange (FX) gains and losses on international transactions. Ensure the chosen accounting method for FX is consistent and aligned with the tax treatment in all relevant jurisdictions.

IX. SEEK ADVANCE RULINGS FOR COMPLEX ACTIVITIES

Thou shalt seek an Advance Tax Ruling (ATR) from the tax authorities of the relevant countries for highly complex structures or uncertain treaty interpretations.

An ATR provides legal certainty and protection against future challenges.

X. SEPARATE PERSONNEL AND CORPORATE TAX OBLIGATIONS

Thou shalt maintain a clear separation between the company's tax obligations and the employees' tax obligations. The SME must correctly handle foreign payroll, social security, and expatriate tax issues, as employees can inadvertently create a PE or trigger costly payroll compliance penalties.