

Papers on Selected Topics in Protecting the Tax Base of Developing Countries

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## Taxation of Capital Gains

Wei Cui

Associate Professor, Faculty of Law, University of British Columbia

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United Nations  
Department of Economic and Social Affairs  
United Nations Secretariat, DC2-2178  
New York, N.Y. 10017, USA  
Tel: (1-212) 963-8762 • Fax: (1-212) 963-0443  
e-mail: TaxffdCapDev@un.org  
<http://www.un.org/esa/ffd/tax/2014TBP/>  
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## Outline for Chapter on Taxing Capital Gains

This chapter will provide an overview of the policy, administration and compliance issues surrounding the taxation of capital gains realized on the sale of domestic assets and the shares of domestic companies by foreigners. It tries to take a fresh look at some of the fundamental policy questions and implementation options surrounding taxation of capital gains from the perspective of developing countries. For reasons of space, less emphasis will be given to purely legal issues, including tax treaty issues that are not salient in practice.

### Introduction

#### I. Why tax capital gains on the disposition of shares by foreigners?

This section will address policy questions such as the following:

- z What is the relationship of taxing capital gains to taxing dividend distributions from a corporation?
- z How likely is it that capital gains on the shares of a corporation will reflect location specific rent?
- z How important a justification for taxing capital gains is the prospect of tax avoidance?
- z What is the likely revenue benefit from implementing capital gain taxation?
- z Should publicly traded shares be exempt?

#### II. Determining the tax base and tax rate for taxing capital gains

This section will address policy and legal questions and issues such as:

- z Gross v. net income taxation
- z What expenses should be allowed in computing the magnitude of capital gain?
- z The possibility of offsetting capital and other losses
- z Whether to tax foreign exchange gain
- z Should there be exemptions for corporate reorganizations etc.?

#### III. Enforcement issues with respect to privately held shares

This section will address legal and administrative issues such as:

- z The respective advantages and disadvantages of self declaration, third party reporting, and withholding
- z The importance of voluntary compliance
- z Foreign exchange and other practical issues facing compliance
- z Valuation issues in related party transfers

#### IV. Should indirect transfers be taxed?

This section will address policy issues such as:

- z Offshore markets for trading in FDI
- z Recent approaches for taxing indirect transfers in India, China, and other countries
- z The source approach v. the look through approach

V. Tax Treaties

This section will address policy and legal issues such as:

- z The standard OECD/UN position on taxing capital gains
- z Actual treaty practice

VI. Legal Issues

- z Special consideration for taxing capital gain earned by foreign individuals
- z Source rules and treaty sourcing rules