Emerging tax issues

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Agenda

- Value Added Tax
- Emerging Issues in taxation
  - International Tax issues
    - Double taxation relief
    - Impacts of trading blocks
    - Effects of BREXIT
  - Impact of devolution on taxation
Value Added Tax (VAT)
Value added Tax

- Introduction
- General VAT provision
- Summary of penalties and key obligations
VAT is a tax on consumption

- Incidence and impact of VAT is borne by the final consumer of goods and services

Registered business acts as agents for collecting VAT

Generally input tax qualifies for deduction against output tax

- Special consideration required for business with mixed sales

Transactions entered into prior to 02 September 2013 governed under repealed VAT Act

Tax point is the main point of reference for supply

Exempt business not required to register/account for VAT
VAT - Registration

- Threshold for registration is KShs. 5M or more in 12 months (Sec 34) - taxable supplies
- Registration threshold exclude Capital asset and sale of whole/part of a business
- Registration and other formalities are done on-line - itax including VAT Returns/VAT Refunds
- Tax obligations for VAT registered persons
  - Charging VAT on taxable supplies and issuing ETR compliant invoices
  - Paying taxes when output tax is in excess of input tax
  - Filing of monthly VAT 3 return and paying taxes by due date - 20th of the following month
  - Declaration of VAT in relation to exempt supplies upon importation of taxable services
Registered suppliers of taxable supplies required to charge VAT at the rates indicated below:

<table>
<thead>
<tr>
<th>Status</th>
<th>VAT Rate</th>
<th>Example</th>
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</thead>
<tbody>
<tr>
<td>Taxable</td>
<td>16%</td>
<td>Supplies not listed in the 1\textsuperscript{st} Schedule,</td>
</tr>
<tr>
<td>Zero-rated</td>
<td>0%</td>
<td>Supplies listed in the 2\textsuperscript{nd} Schedule of the VAT Act which include exports, sale of business etc.</td>
</tr>
<tr>
<td>Exempt</td>
<td>-</td>
<td>Listed in 1\textsuperscript{st} schedule to the VAT Act. Goods on transition including petroleum products extended</td>
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</table>
VAT – Taxable value

- Taxable value of any supply shall be:
  - The consideration for the supply; or
  - Open market value in case of related parties

- Consideration for supply is the total of:
  - Amount paid or payable for the supply
  - Open market value at the time of the supply
  - Taxes, duties, levies, fees and charges (except VAT) paid or payable for reason of the supply

- The price is to be reduced with discounts or rebates allowed and accounted for at the time of supply

- Consideration for supply shall not include:
  - Financial charges for Hire purchase; and Interest for late payment
VAT is due and payable as follows:

- The date the goods are delivered or services performed;
- The date a certificate is issued by an Architect, surveyor or any person acting as a consultant or in a supervisory capacity in respect of the supply;
- The date an invoice is issued in respect of the supply or
- The date all or part payment is received for the supply.

Due date of payment of VAT is determined by tax point.
VAT – Deduction of input tax

- **Input tax** is tax paid on the supply to a registered person to be used by him for the purpose of his business

- **Input tax** is claimable by a registered provided that:
  - The person is in possession of valid documentations such as a tax invoice
  - The amount thereon has not been previously deducted
  - Not more than 6 months have lapsed after the input tax became due and payable
  - Tax is not restricted under Section 17(4)
  - Tax does not relate to exempt supplies either directly or upon apportionment with taxable supplies
VAT – Deduction of input tax

Restriction - Sec 17(4)

✗ Except where the goods are purchased as stock in trade, deduction of input tax is restricted on the following:

+ Passenger cars and minibuses, as well as their spare parts
+ Entertainment, restaurant and accommodation services unless:
  ✗ Provided in the ordinary course of business
  ✗ Provided while recipient is away from home for purpose of business
A valid Tax Invoice should contain the following:

- Supplier’s name, address, PIN and VAT Reg No. (VAT Reg no longer required w.e.f 12 June 2009)
- Generated through a tax register (ESD) or attached to an ETR generated receipt (w.e.f. 16 June 2006)
- Serially numbered
- Name and address of the supplier
- Description, quantity and price of the supply
- Shows the total value of the supply, VAT rate used and the total amount of VAT charged
VAT – Tax credit (credit notes)

- Should be issued within a period of 6 months (previously 12 months)
- Reversed output tax cannot be netted with output tax after 6 months - requires high efficiency on part of taxpayer
- Period of claiming input tax is 6 months
Sec. 17(6) of the VAT Act provides for apportionment of input VAT claimed where a registered person has both taxable and exempt supplies:

- Full deduction of input tax in relation to taxable supply
- Full exclusion of input tax in relation to exempt supplies
- Apportionment of shared input tax using the following ratio:
  \[
  \text{Deductible VAT} = \frac{\text{Value of taxable supplies} \times \text{Input tax}}{\text{Value of Total Supplies}}
  \]

- No input tax is deductible where exempt supplies are more than 90% of the total supplies
- All input tax is deductible if taxable sales are more than 90%
VAT – Collection of tax

VAT Account (VAT 3)

- Summarizes input and output tax
- Declaration of sales for the business
- Determination of VAT liability/credit
- Reflects the company's VAT account with KRA
- Calls for full disclosure
- VAT is payable monthly by the 20th of the following month
VAT - Imported services

Section 10

- Imported services - means a supply of services that:
  - Is made by a person who is not a registered person
  - Supply would have been taxable
  - Taxable person is not entitled to deduction of input tax

- Supply of imported services deemed as self supply

- VAT payable to the extent it relates to exempt supplies

- VAT on imported taxable services is declared/paid online by generating PRN
VAT – Refunds

- Tax payers allowed to claim for refund of excess input tax where the excess arises from:
  - Making zero-rated supplies; or
  - VAT is refundable on tax paid in error
  - VAT relating to bad debts

- Cumulative VAT credit should be reduced with claims lodged with KRA - effective September 2011
VAT – Withholding

- Under old system appointed agents were required to withhold VAT chargeable on the supply irrespective of whether VAT was charged or not.
- System reintroduced in 2014.
- Appointed agents include government ministries and parastatals or any other person appointed by the Commissioner.
- Only 6% of the taxable value is deducted and remitted to KRA.
Emerging issues in taxation
Globally, taxation has become one of the means of raising sufficient revenue to finance all of a country’s activities, an avenue which Kenya has also adopted.

Taxation must thus be based on binding legal provisions

- National law connotes domestic law enacted by national legislative bodies (may have extra-territorial effect, see FATCA)
- International Law describes bilateral/multilateral treaties which primarily binds sovereign States to each other
- Supranational Law (European Union, EAC)

Sovereign States shift competencies to separate body and accept overriding law

Supranational law prevails over National law
Some important tax developments for boards

- Corporate tax matters are increasingly in the headlines.
  + Boards are facing new challenges due to changes in tax policy, and
  + directors need to be familiar with the risks associated with their company’s tax strategy

- Driven by budget deficits and economic uncertainties, governments are looking for ways to increase revenue, thus many taking a closer look at the taxes companies pay.
  + The Organisation for Economic Co-operation and Development (OECD) member countries and others have instituted, unprecedented information sharing of tax data across countries.
  + Tax authorities are turning to digital methods to improve tax compliance and to identify tax compliance risks
Country by country reporting

- Country-by-country (CbC) reporting requirements of the OECD Base Erosion and Profit Shifting (BEPS) project
  + Multinationals must provide tax authorities with high-level information regarding the global and local distribution of the multinational’s revenue, profits, income taxes paid and employees
  + that information may be shared with other jurisdictions in which the company operates.

- What do boards need to know?
  + Reporting requirements vary by country.
  + Non-compliance could expose a company to civil and even criminal penalties and lead to a loss of stakeholder trust.
  + Companies should consider the potential for corporate reputational risk if the information were to become public.
  + The information to be reported may be difficult to assemble and could be misinterpreted by the public if taken out of context.
    - Consider how their companies will respond to these new disclosure requirements and how they might answer any stakeholder questions.
Country by country reporting

- Questions for the board to consider
  - Is management addressing the **varying timelines and requirements** related to the CbC reporting initiatives?
  - Is the company’s tax function working with the treasury, accounting and IT functions so all key internal stakeholders that will be involved in reporting are aligned?
  - Is there a plan in place to handle potential controversies that may arise as a result of the new reporting requirements and the additional transparency involved, including potential public disclosure?
Tax digitization

- Tax authorities increasingly relying on
  - Digital tax data gathering and analysis to facilitate real-time or near-real-time collection and assessment of taxpayer data, bringing greater scrutiny and new challenges to companies and boards.
  - Data analytics to respond more quickly and in more targeted ways to address perceived compliance risks

- What do boards need to know?
  - Digitization is accelerating the timing and frequency of tax reporting.
  - Legacy systems and processes may not be able to support these requirements, exposing businesses to increased risks, costs and compliance challenges.
  - Digitization is also changing filing obligations: tax authorities are asking companies to disclose information that reaches beyond tax forms and often includes accounting and sales data.

- As tax authorities move toward greater digitization of tax information, businesses need to develop a detailed understanding of digital tax requirements in their markets.
Tax digitization – Questions for the board

- Is the company’s tax function able to meet digital data and filing obligations in its operating jurisdictions?
- Is the company ready to run and review data analytics every time it submits data to ensure accuracy and predict questions for tax authorities?
- Is the company prepared to defend tax audits in real or near-real time?
- What investment may be needed to respond to the increasing demand for digital tax information?
- How will the company address the risks inherent in the expansion of electronic data submission?
The changing global controversy landscape

Tax authorities are expected to act in a more organized manner, which arguably results in increased and more focused scrutiny

- More information available
- Increased number of disputes
- More "false positives"
- Need to align approach globally
- More organized approach globally
- Exchange of information channels improve

Taxpayers in the new environment need to engage extra resources to tackle the increased amounts and quality of scrutiny.
Double taxation regime

Emerging issues in taxation
Double taxation agreement /treaty (DTA)

- Corporate Income Tax (CIT) & Government
  - Revenue 16% of developing country revenue (8% in OECD)
- Effects of double and sometimes multiple taxation
  - Harm to the development of economic relations between countries in the exchange of goods and services as well as movement of capital and persons.
- Some of the means that the international community has sought to alleviate problems of double taxation is through the negotiation of double taxation agreements (DTAs)
Double taxation

- Tax Treaty System Allocates tax rights -
  - includes right not to tax to prevent 'double taxation' & encourage foreign investment,
- Tax conventions reduce juridical double taxation
  - by allocating taxing rights between residence and source states on various categories of income
  - by establishing criteria for determining an exclusive residency status for taxpayers
Objectives of DTA

- In essence, the objectives of DTA include:
  - Elimination of double taxation
  - Prevention of fiscal evasion
  - Enable co-operation between fiscal authorities
  - Allocation of tax revenues between states
  - Provide certainty for investors
  - Eliminate discriminatory taxation
  - Other Political/Business Reasons
Impact on availability of credits in home country of investors

- Tax reliefs provided either under domestic laws or DTA are in the form of:
  - Exemption from tax
  - Credit method and
  - Deduction method

- Tax relief is given to the extent that it does not exceed the tax which would otherwise have been due and payable in the state providing the relief
Credit vs exemption method

- The principle of credit
  - The state of residence calculates its tax basis of the taxpayer’s total income including the income from the other State
  - It then allows a deduction from its own tax for the tax paid in the other State

- The principle of exemption
  - The State of residence does not tax the income which according to the Convention may be taxed by the state of source or situs or of the situation of the permanent establishment or the fixed base
    - full exemption or
    - exemption with progression
Corporate Income Tax (CIT) & Government

- Avoidance by MNEs (BEPS) ~ $300b, 0.6-2% of GDP undermines legitimacy of taxation generally

Tax MNEs 'where economic activities occur & value is created'

- Tax Treaty System Allocates tax rights -
  - currently under the BEPS, also to end 'double non-taxation' & harmful tax practices

Multilateral Convention to Implement Tax Treaty Measures to Prevent BEPS
Recent developments: OECD release BEPS final reports

- Final BEPS reports issued by Organization for Economic Cooperation and Development (OECD) on October 5, 2015:
  - Endorsed by G20 finance ministers on October 8, 2015
  - Approved by G20 leaders on November 15-16, 2015

- Recommendations for domestic law and treaty provisions in variety of forms:
  - There are also analytical reports on the overarching actions.
  - Some measures may have (almost) immediate effect in a number of countries.
Recent developments: OECD release BEPS final reports

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<td>► Action 13 – Transfer pricing documentation and country-by-country (CbC) reporting</td>
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<td>► Action 15 – Multilateral instrument</td>
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<td>► Action 3 – Controlled foreign corporation (CFC) rules</td>
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<td>► Action 5 – Harmful tax practices</td>
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<td>► Action 15 – Multilateral instrument</td>
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Impact of trading blocs

Emerging issues in taxation
Introduction

Trading blocs are groups of nations, within a geographical region, formed with a view to facilitate and promote trade and fluid movement of goods, people, and capital amongst the participants.

Trading blocs – intergovernmental agreement (within the intergovernmental organization) aimed at, inter alia:

- enabling regional trade through reduced or total elimination of barriers to trade for the members of the bloc
- protect themselves from imports from non-members

Trading blocs are said to significantly increase the pace of globalization – through increased integration and interdependence of the national economies
Types of trading blocs

- **Preferential Trade Area (PTAs)**
  - exist when countries within a geographical region agree to reduce or eliminate *tariff* barriers on selected goods imported from other members of the area.

- **Free Trade Area (FTAs)**
  - Created when two or more countries in a region agree to reduce or eliminate barriers to trade on all goods coming from other members.

- **Customs Union**
  - A customs union involves the removal of tariff barriers between members, plus the acceptance of a common (unified) external tariff (CET) against non-members.
  - Members may negotiate as a single bloc with 3rd parties, such as with other trading blocs.
Types of trading blocs...cont’d

- **Common Market / Single market**
  - The first significant step towards **full economic integration**
  - Occurs when member countries trade freely in all economic resources – not just tangible goods.
  - All barriers to trade in goods, services, capital, and labour are removed.
  - In addition, as well as removing tariffs, non-tariff barriers are also reduced and eliminated.
  - A successful common market requires that there must also be:
    - a significant level of harmonization of micro-economic policies,
    - common rules regarding monopoly power and other anti-competitive practices.
    - There may also be common policies affecting key industries.
Examples of world trading blocs

- European Union
- North Atlantic Free Trade Association
- Association of South East Asian Nations (ASEAN)
- Mercado Comun del Cono Sur (MERCOSUR)
- East African Community
- Southern African Development Community
Kenya’s membership

- East African Community (EAC) - a customs union
- The EAC has finalized the negotiations for a region-to-region Economic Partnership Agreement (EPA) with the European Union
- The Common Market for Eastern and Southern Africa (COMESA)
- Trade and Investment Framework Agreements (TIFA) signed by the United States with the EAC in 2008, and with COMESA in 2001
- Kenya is a signatory to the ACP-EU Partnership Agreement (ACP-EU PA) signed between the European Union and more than 70 African, Caribbean and Pacific (ACP) states.
- Kenya is furthermore a beneficiary under the African Growth and Opportunity Act (AGOA).
Advantages for members of trading blocs

- **Free trade within the bloc**
  - Free access to each other's markets, members are encouraged to specialise. This means that, at the regional level, there is a wider application of the principle of comparative advantage.

- **Market access and trade creation**
  - Easier access to each other’s markets means that trade between members is likely to increase.

- **Economies of scale**
  - Producers benefit from the application of economies of scale, leading to lower costs and lower prices for customers.
Advantages for members of trading blocs

- Job creation due to increased trade between member economies
- Protection of entities within the bloc from cheaper imports from outside the bloc
Disadvantages of trading blocs

- **Distortion of trade**
  - **Trade creation** exists when free trade enables high cost domestic producers to be replaced by lower cost, and more efficient imports.
  - Because low cost imports lead to lower priced imports, there is a 'consumption effect', with increased demand resulting from lower prices.

- **Retaliation**
  - The development of one regional trading bloc is likely to stimulate the development of others, leading to trade disputes.
    - There are the so-called beef wars with the US applying £60m tariffs on EU beef in response to the EU’s ban on US beef treated with hormones; and
    - Complaints to the WTO of each other’s generous agricultural support.
Disadvantages of trading blocs

- Inefficiencies and trade diversion
  - Inefficient producers within the bloc can be protected from more efficient ones outside the bloc.
In 2015, the Tripartite Free Trade Area Agreement was signed by the COMESA, the EAC and the Southern African Development Community (SADC).

The tripartite integration process is based on a developmental approach built on three pillars:

- industrial development,
- infrastructure development and
- market integration.
Effects of BREXIT

Emerging issues in taxation
On 23 June 2016, UK voters decided to opt out of the European Union.

The various implications arising from the United Kingdom leaving the European Union, including tax, become clear when the UK invokes article 50 of the Treaty on European Union (TEU).

Even with invoking Article 50, the UK will still be bound by all EU law up to the moment that the terms of the exit have been established.

Article 50 provides for a period of at least 2 years between the moment that article 50 is invoked and the actual exit from the European Union.
# Assessing the potential impact on businesses in UK / EU

## Potential tax and legal implications

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<th>Potential impact</th>
<th>Speed of action</th>
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<td><strong>Forex/treasury</strong></td>
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<tr>
<td>► What are the tax consequences of managing your treasury position?</td>
<td>H M L</td>
<td>H M L</td>
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<tr>
<td><strong>Trading model/operating model</strong></td>
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<tr>
<td>► What are the trade, duties and VAT implications for your supply chain?</td>
<td>H M L</td>
<td>H M L</td>
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<tr>
<td>► How will your people functions be affected?</td>
<td>H M L</td>
<td>H M L</td>
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<tr>
<td>► How will you need to adjust your transfer pricing?</td>
<td>H M L</td>
<td>H M L</td>
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<tr>
<td><strong>Systems</strong></td>
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<tr>
<td>► How will you manage an increased compliance burden, e.g., duties and VAT?</td>
<td>H M L</td>
<td>H M L</td>
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<tr>
<td>► How will it affect entity reporting?</td>
<td>H M L</td>
<td>H M L</td>
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<tr>
<td><strong>People</strong></td>
<td></td>
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<tr>
<td>► What data do you hold on European nationals working for you in the UK and British citizens working in Europe?</td>
<td>H M L</td>
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<tr>
<td>► As the profile of the workforce is set to change, how integrated are your immigration, employment and talent strategies?</td>
<td>H M L</td>
<td>H M L</td>
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<td><strong>Legal structure</strong></td>
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<tr>
<td>► Is your headquarter location fit for purpose?</td>
<td>H M L</td>
<td>H M L</td>
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<tr>
<td>► Could the removal of EU directives impact the tax and legal profile of your existing group structure?</td>
<td>H M L</td>
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<tr>
<td><strong>Regulatory change</strong></td>
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<tr>
<td>► Are you aware to what extent your business relies on EU regulations which might no longer apply in the future?</td>
<td>H M L</td>
<td>H M L</td>
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<tr>
<td><strong>Future of UK Tax</strong></td>
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<tr>
<td>► What do you need the UK tax regime to deliver to help you remain competitive?</td>
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Assessing the tax impact of BREXIT on Kenya and EAC

Some key questions:
+ when the UK will officially start the process of leaving the EU;
+ what types of alternative economic agreements/treaties it may have in place.

EAC businesses that are beneficiaries of the Economic Partnership Agreement (EPA) with the European Union will have to plan ahead, whether in terms of their supply chain or business sourcing decisions.
+ Customs duties: The European Union functions as a customs union, applying common tariffs to imports from non-Member States and no customs duties to transfers of goods between Member States - EAC imports to the UK may attract customs duties
Assessing the tax impact of BREXIT on Kenya and EAC

- Change in preferential trade terms
  - All importing EAC countries like will be affected by the future exclusion of the UK from the umbrella of FTAs that the EU has negotiated, or is still negotiating, with EAC partners
    - In effect, imports from UK could attract higher import duties
    - Ingredients/ raw materials of from UK where the manufacturer is from the EU, imports could may not meet the rules of origin criteria
Impact of devolution on taxation
Principles governing public finance

- Overarching principle in all matters public finance, taxation in particular: Chapter 12 of the Constitution of Kenya 2010
  - openness and accountability, including public participation
  - the public finance system shall promote an equitable society,
    - the burden of taxation shall be shared fairly;
    - revenue raised nationally shall be shared equitably among national and county governments; and
  - expenditure shall promote the equitable development of the country, including by making special provision for marginalised groups and areas;
Equitable share between present and future generations in the burdens and benefits of the use of resources and public borrowing;

Prudent and responsible use of public money; and

Responsible financial management, and clear fiscal reporting
Revenue raising powers

- Only the national government may impose—
  - income tax;
  - value-added tax;
  - customs duties and other duties on import and export goods; and
  - excise tax.

- A county may impose—
  - property rates;
  - entertainment taxes; and
  - any other tax that it is authorised to impose by an Act of Parliament.
Revenue raising powers

The taxation and other revenue-raising powers of a county shall not be prejudicial to:

- national economic policies,
- economic activities across county boundaries or the national mobility of goods, services, capital or labour.
Comparative. The US

- The world’s largest economy, that provides:
  - abundant opportunities in which to operate,
  - an innovative and productive workforce,
  - excellent infrastructure,
  - appropriate legal protections,
  - a predictable regulatory environment, and
  - lucrative consumer and business-to-business markets.
Comparative.. The US

- US tax code, most complex regime in the world, covering more than 17,000 pages, plus common law precedents
  + Federal tax authorities,
  + Plus state and local government agencies within the country's 50 states.
- These tax boards and agencies are responsible for developing and enforcing their own jurisdictional laws in cooperation with federal regulators.
The separate states within the US have specific regulations with their own taxing jurisdictions, with the power:
- to impose taxes on income, rates varying from 0% to 12%.
- Provide tax credits and incentives opportunities for business investment within the jurisdiction (e.g., jobs credits, training credits and negotiated incentives).

Such states with jurisdiction to impose an income based tax must first determine the State’s taxable base:
- the total taxable income under state law — and then determine the State’s share of that income — the state’s apportioned taxable income.
State and local taxes in the US

- State income taxes are generally based upon federal income tax concepts, but the underlying rules may vary from state to state.
- State income tax paid is deductible for federal tax purposes.
- As a general rule, states are not party to tax treaties between the US and foreign nations.
  - A foreign corporation may be subject to state tax even though it is not subject to US federal tax pursuant to a tax treaty.
Questions/ Comments