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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

# INCOME TAX (INTERNATIONAL AGREEMENTS) AMENDMENT BILL 1995

## EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
the Hon. Ralph Willis, M.P.)

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## Table of Contents


| | Page |
|---|---|
| General outline and financial impact | 1 |
| Introduction | 4 |
| Main features of the new DTA | 7 |
| Agreement with New Zealand | 9 |
| Index | 57 |


**Note:** References to paragraph numbers contained in the explanation of the Agreement relate to the relevant paragraph of the Article under discussion.

# General Outline and Financial Impact

## What will the Bill do?

The Bill will amend the *Income Tax (International Agreements) Act 1953* (IT(IA)A) to give the force of law in Australia to a new comprehensive agreement with New Zealand for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (DTA). The DTA covers the various forms of income flows between Australia and New Zealand.

## Who will be affected by the agreement in the Bill?

Any taxpayers who, for the purposes of the DTA, are residents of either Australia or New Zealand and who derive income, profits or gains from the other country.

## In what way does the Bill change the Act

The Bill will make the following changes to the IT(IA)A:

- it will amend the long and short titles of the IT(IA)A to reflect the inclusion of a provision covering fringe benefits in the DTA. The long title of the Act will be the *Income and Fringe Benefits Tax (International Agreements) Act 1953* and the Act will be cited by the short title of the *International Tax Agreements Act 1953*.

- it will amend the definition of 'agreement' in subsection 3(1) by omitting from paragraph (c) the reference to the 'previous' New Zealand agreement and substituting a reference to the '1960' New Zealand agreement. A new paragraph, paragraph (ca), will be inserted into the definition so that the term 'agreement' also refers to 'the 1972 New Zealand agreement'. The inclusion of these references in the definition of agreement facilitate the continued operation of those agreements in income years to which they relate and

the DTA to be given the force of law by this Bill does not operate.

- it will amend the definition of 'Australian tax' to include a reference to tax imposed on fringe benefits by the *Fringe Benefits Tax Act 1986* and to remove references to social services contribution as being no longer relevant. The Bill also provides that this amendment does not affect income tax and social services contribution imposed before the commencement of the amendment.

- it will insert in subsection 3(1) definitions of 'the 1960 New Zealand agreement' and 'the 1972 New Zealand agreement'.

- it will insert after section 4 of the IT(IA)A a new section 4AA. Subsection (1) of this section will incorporate into the IT(IA)A the *Fringe Benefits Tax Assessment Act 1986* (FBTAA). Subsection (2) will provide that provisions of the IT(IA)A will have effect despite anything inconsistent with those provisions in the FBTAA other than the anti-avoidance section of that Act (section 67). This will facilitate the operation of the fringe benefits provision in the DTA.

- it will insert new subsection (1A) into section 6B of the IT(IA)A which will give the force of law in Australia to the DTA.

- it will amend subsections (1), (2) and (3) of section 6B to ensure that the previous New Zealand DTAs, the 1960 New Zealand agreement and the 1972 New Zealand agreement, continue to have the force of law in relation to the years of income to which they respectively relate.

- it will repeal Schedule 4 of the IT(IA)A which contains a copy of the 1972 New Zealand agreement and will add the text of the DTA as Schedule 4.

  it will amend various provisions of the FBTAA, the *Income Tax Assessment Act 1936* (ITAA), the *Petroleum Resource Rent Tax Assessment Act 1987*

and the *Sex Discrimination Act 1984* to alter the references in those provisions to the IT(IA)A to the *International Tax Agreements Act 1953* in line with the change to the short title of the IT(IA)A.

## When will these changes take place?

The DTA will enter into force on the latest date on which diplomatic notes are exchanged between Australia and New Zealand formally advising that all the requirements necessary to give the DTA the force of law in the respective countries have been finalised.

Amendments effected by the Bill will commence on the day on which the Act receives the Royal Assent.

## When the agreement enters into force from what date will it have effect?

The DTA with New Zealand will have effect:

- ***in Australia***, for withholding tax and fringe benefits tax purposes, in respect of income derived and benefits provided on or after 1 April following the entry into force of the DTA; and for other Australian taxes covered by the DTA, in respect of income, profits or gains of any year of income beginning on or after 1 July following the entry into force.
- ***in New Zealand***, for withholding tax and fringe benefits tax purposes, in respect of income derived and benefits provided on or after 1 April following entry into force of the DTA; and for other New Zealand taxes covered by the DTA, in respect of the year of income beginning on or after 1 April following entry into force.

## The Financial Impact of the Bill

The operation of the agreement contained in this Bill is not expected to have a significant effect on revenue.

# Introduction

## What do we mean by double taxation?

Australia's DTAs are primarily concerned with relieving juridical double taxation, which can be described broadly as subjecting the same income derived by a taxpayer during the same period of time to comparable taxes under the taxation laws of two different countries.

## Why are DTAs necessary?

Relief from double taxation is desirable because of the harmful effects double taxation can have on the expansion of trade and the movement of capital and people between countries. A DTA supplements the unilateral double tax relief provisions in the respective treaty partner countries' domestic law and clarifies the taxation position of income flows between them.

## What is the purpose of Australia's DTAs?

Australia's DTAs are designed to:

(a) Prevent double taxation and provide a level of security about the tax rules that will apply to particular international transactions by:-

- allocating taxing rights between the contracting countries over different categories of income;
- specifying rules to resolve dual claims in relation to the residential status of a taxpayer and the source of income; and
- providing, where a taxpayer considers that taxation treatment has not been in accordance with the terms of a DTA, an avenue for the taxpayer to present a case for determination to the relevant taxation authorities.

(b) Prevent avoidance and evasion of taxes on various forms of income flows between the treaty partners by:-

- providing for the allocation of profits between related parties on an 'arm's length' basis;
- generally preserving the application of domestic law rules that are designed to address transfer pricing and other international avoidance practices; and
- providing for exchanges of information between the respective tax authorities.

## How is the legislation structured?

DTAs to which Australia is a partner appear as Schedules to the IT(IA)A. The IT(IA)A gives the force of law in Australia to those DTAs. The provisions of the ITAA are incorporated into and read as one with the IT(IA)A. In any cases of inconsistency, the IT(IA)A provisions (including the terms of the DTAs) generally override the ITAA provisions.

To accommodate the coverage provided in the DTA with New Zealand of the possible double taxation of fringe benefits the IT(IA)A will be amended by the Bill to incorporate the FBTAA and to provide that in cases of inconsistency the International Tax Agreements Act provisions (including the terms of the DTA), generally override the FBTAA provisions.

## Main Features of the New DTA

Under the terms of the DTA with New Zealand:

**Income from real property** may be taxed in full by the country in which the property is situated. Income from real property includes natural resource royalties.

**Business profits** are to be generally taxed only in the country of residence of the recipient unless they are derived by a resident of one country through a branch or other prescribed 'permanent establishment' in the other country, in which case that other country may tax the profits.

**Profits from international operations of ships and aircraft** may be taxed only in the country of residence of the operator.

**Dividends, interest and royalties** may generally be taxed in both countries, but there are limits on the tax that the source country may charge on dividends, interest and royalties flowing to residents of the other country. These limits are, 15 per cent for dividends, 10 per cent for royalties and 10 per cent for interest.

**Income, profits or gains from the alienation of property** may be taxed in full by the country in which the property is situated. Subject to that rule and other specific rules in relation to business assets and some shares, capital gains are to be taxed in accordance with the domestic law of each country.

**Income from professional services and other similar activities** will generally be taxed only in the country of residence of the recipient. However, remuneration derived by a resident of one country in respect of professional services rendered in the other country may, where derived through a fixed base of the person concerned in that country, be taxed in the latter country.

**Income from dependent personal services**, that is, employee's remuneration, will generally be taxable in the

country where the services are performed. However, where the services are performed during certain short visits to one country by a resident of the other country, the income will be exempt in the country visited.

**Fringe benefits provided in relation to dependent personal services** will, where they would otherwise be subject to tax in both countries, be taxable only in the country with the sole or primary taxing right over the employment income to which the benefit relates.

**Government service remuneration** paid by one country will generally be taxed only in that country. However, the remuneration may be taxed in the other country in certain circumstances where the government services are rendered in that other country.

**Directors' fees and similar payments** may be taxed in the country of residence of the paying company.

**Income derived by entertainers and sportspersons** may generally be taxed by the country in which the activities are performed. However, where the sportsperson is a member of, or associated with, a recognised team regularly playing in a league competition the income derived will generally be taxed in the country in which they reside.

**Pensions and annuities** (including government service pensions) may be taxed only in the country of residence of the recipient.

**Income of visiting students** will be exempt from tax in the country visited so far as concerns payments made from abroad for the purposes of their maintenance or education.

**Profits of associated enterprises** may be taxed on the basis of dealings at arm's length.

**Exchange of information and consultation** between the two taxation authorities is authorised by the DTA.

**Dual residents** (i.e., persons, including companies, who are residents of both Australia and New Zealand

according to the domestic law of both countries) are, in accordance with specified criteria, to be treated for the purposes of the DTA as being residents of only one country.

**Source rules** are prescribed in the DTA to the effect that income, profits or gains derived by a resident of one country which, under provisions of the agreement may be taxed in the other country, shall be treated as being sourced in the latter country.

**Double taxation relief for income which under the DTA may be taxed by both countries** is required to be provided by the country of residence under the DTA as follows:-

- ***in Australia***, by allowing a credit for the New Zealand tax against Australian tax payable on income derived by a resident of Australia from sources in New Zealand.
- ***in New Zealand*** by allowing a credit against New Zealand tax for the Australian tax paid on income, profits or gains derived by residents of New Zealand from sources in Australia.

## Agreement With New Zealand

The new comprehensive DTA with New Zealand accords substantially with other recent comprehensive DTAs to which Australia is a party. Like them, the DTA allocates to the country of source, sometimes at limited rates, a taxing right over some income, profits or gains. The country of residence is given the sole right to tax other types of income, profits or gains.

The DTA also provides that where income, profits or gains may be taxed in both countries, the country of residence (if it taxes) is to allow double tax relief against its own tax for the tax imposed by the country of source. In the case of Australia, effect is given to the relief obligations arising under the DTA by application of the general foreign tax credit system provisions of Australia's

domestic law, or relevant exemption provisions of the law where applicable.

In terms of comparison with the existing DTA with New Zealand, the renegotiated DTA:

- **includes provisions to deal with:**

  the taxation of income from real property and from the alienation of property generally;

  the taxation of other income, being a sweep-up article;

  possible double taxation of trans-Tasman fringe benefits;

  a general strengthening of anti-avoidance measures;

- **removes:**

  the 'force of attraction' principle in relation to permanent establishments under which profits of an enterprise from sources in the country in which the enterprise has the permanent establishment were taxable in that country regardless of whether the profits were attributable to the permanent establishment or not;

  the special rule on the taxation of interest payments to associates;

- **reduces:**

  the withholding tax rate on royalties from a maximum of 15% to a maximum of 10% of the gross royalty payment, and

- **reflects:**

  an agreed approach to the taxation of branches of Australian insurers operating in New Zealand.

## Article 1 - Personal Scope

### Scope

This article establishes the scope of application of the DTA, by providing for it to apply to persons (which term includes companies) who are residents of one or both countries. It precludes any extraterritorial application of the DTA.

The application of the DTA to persons who are dual residents (i.e. residents of both countries) is dealt with in Article 4.

## Article 2 - Taxes Covered

### Taxes covered

This article specifies the existing taxes of each country to which the DTA applies. These are, in the case of Australia:

- the Australian income tax;
- the resource rent tax in respect of offshore petroleum projects; and
- the fringe benefits tax.

For New Zealand the DTA applies to:

- the income tax; and
- the fringe benefit tax.

It is specifically stated in both paragraphs of this article that the article applies only to taxes imposed under the federal law of Australia. This is to ensure that the DTA does not bind Australian States and applies only to federal taxes.

In the case of Australia, income tax, capital gains tax, fringe benefits tax and resource rent tax are covered by the DTA. Sales tax, wool tax and levies, customs duties,

State tax and duties, estate tax and duties, and medicare levy are excluded from the scope of the DTA.

### Substantially similar taxes

The application of the DTA will be automatically extended to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of, the existing taxes. A duty is imposed on Australia and New Zealand to notify each other within a reasonable time of any significant changes to their respective laws to which the DTA applies.

## Article 3 - General Definitions

### Definition of 'Australia'

As with Australia's other modern taxation agreements, 'Australia' is defined as including certain external territories and areas of the continental shelf. By reason of this definition, Australia preserves its taxing rights, for example, over mineral exploration and mining activities carried on by non residents on the seabed and subsoil of the relevant continental shelf areas (under section 6AA of the ITAA, certain sea installations and offshore areas are to be treated as part of Australia). The definition is also relevant to the taxation by Australia and New Zealand of shipping profits in accordance with Article 8 of the DTA.

***[Subparagraph 1(a)(ii)]***

### Definition of 'tax'

For the purposes of the DTA, the terms 'Australian tax' and 'New Zealand tax' do not include any amount of penalty or interest imposed under the respective domestic law of the two countries. This is important in determining a taxpayer's entitlement to a credit under the double tax relief provisions of Article 24 of the DTA.

***[Subparagraph 1(k)]***

In the case of a resident of Australia, any penalty or interest component of a liability determined under the domestic taxation law of New Zealand with respect to income that New Zealand is entitled to tax under the DTA, would not be a creditable 'New Zealand tax' for the purposes of Article 24(2) of the DTA. This is in keeping with the meaning of 'foreign tax' in the ITAA (subsection 6AB(2) -Foreign Income and Foreign Tax). Accordingly, such a penalty or interest liability would be excluded from calculations when determining the Australian resident taxpayer's foreign tax credit entitlement under Article 24(2) (pursuant to Division 18 of Part III of the ITAA - Credits in Respect of Foreign Tax).

### Definition of 'international traffic'

The DTA defines the term 'international traffic'. The definition is relevant to the application of Article 13 to the alienation of ships and aircraft and Article 15 to the wages of the crew of a ship or aircraft engaged in international traffic.

The term is defined to mean any transport by a ship or aircraft except where the operation occurs solely from a place in one of the countries or between places in one of the countries.

### Terms not specifically defined

Where a term is not specifically defined within this DTA, that term (unless used in a context that requires otherwise) is to be taken to have the same interpretative meaning as it has under the domestic law of the country applying the DTA.

The expression 'from time to time in force' is included in order to clarify that a term not defined in the DTA is to be given the meaning it has under that country's domestic law at the time of application of the DTA. This ensures that the DTA remains contemporary with developments in the domestic law of the two countries.

In applying this provision the relevant time for drawing upon the domestic meaning of the term used in the DTA will be the time which is relevant for purposes of the claim itself, that is, the law applicable to the claim for the relevant tax year.

If a term is not defined in a DTA, but has an internationally understood meaning and a meaning under the domestic law the context would normally require that the international meaning be applied.

However, the term used would need to be the same term, since there is much uncertainty about whether the interpretation of one phrase can truly be said to throw light on another.

Under Article 3(3) the domestic law meaning is the meaning the law has under the law of that State *relating to the taxes to which this Agreement applies*. The law concerning taxes is comprised of general legal and specifically tax related concepts but if the taxation law uses a term in a different manner to the usage in general law, and that use is more specific, and relevant to the context of the DTA then that special usage is the applicable one and will govern the interpretation.

It should be noted that Article 3(3) does not require that a term be *defined* in Australian law. It is sufficient if the term has a *meaning* under the relevant Australian law.

***[Paragraph 3]***

## Article 4 - Residence

### Residential status

This article sets out the basis by which the residential status of a person is to be determined for the purposes of the DTA. Residential status is one of the criteria for determining each country's taxing rights and is a necessary condition for the provision of relief under the DTA. The concept of resident according to each country's taxation law provides the basic test.

A person is not a resident of a country for the purposes of the DTA if that person is liable to tax in that country in respect only of income from sources in that country. For example, a person may not be domiciled in a country but may be considered to be a resident according to its domestic law and may only be subject to taxation on income from sources in that country, e.g., foreign diplomatic and consular staff serving in some countries. In the Australian context this means that Norfolk Island and Cocos (Keeling) Islands residents who are generally subject to Australian tax on Australian source income only will not be residents of Australia for the purposes of the agreement. Accordingly, New Zealand will not have to forgo tax in accordance with the DTA on income derived by residents of those Islands from sources in New Zealand (which will not be subject to Australian tax).

***[Paragraph 2]***

The article also includes a set of 'tie-breaker' rules for determining how residency is to be allocated to one or other of the countries for the purposes of the DTA if a taxpayer - whether an individual, a company or other entity - qualifies as a dual resident, i.e., as a resident under the domestic law of both countries.

The 'tie-breaker' rules involve considering in a declining hierarchy whether the taxpayer has a permanent home in one country or the other and if in neither or both takes into account factors such as the person's personal or economic relations with Australia and New Zealand, habitual abode and finally citizenship.

***[Paragraph 3]***

**Example**

> A dual resident who is deemed by Article 4 to be a resident solely of New Zealand for purposes of the DTA would be entitled to any exemption from, or reduction in, Australian tax provided by an article of the DTA in respect of income derived from sources in Australia by a resident of New Zealand.

For the categories of income which under the DTA remain taxable in both countries, the obligation placed by Article 24 (Elimination of Double Taxation) on the country of residence of the recipient of the income to provide double tax relief would in that example rest with New Zealand.

Dual residents remain, however, in relation to each country, a resident of that country for the purposes of its domestic law and subject to its tax as such so far as the DTA allows.

**Note**

Article 22 (Other Income) would operate in relation to the dual resident referred to in the example above as if that person were a resident of New Zealand. This would preclude Australia from taxing items of income not dealt with by another article of the DTA, where the income is derived from sources in New Zealand or from sources in a third country unless that income was effectively connected with a permanent establishment or fixed base in Australia of the dual resident.

Paragraph 5 of Article 13 (Alienation of Property) would, however, preserve the application of Australia's rules for taxing capital gains in relation to gains to which the paragraph applies. This is because the paragraph preserves the operation of the law of both countries relating to the taxation of capital gains. The taxing right conferred by the paragraph not being based on where the alienator of the property is resident for the purposes of the DTA, a dual resident would, accordingly, remain a resident of Australia for the purposes of applying Australia's domestic law relating to the taxation of capital gains.

## Article 5 - Permanent Establishment

### Role and definition

Application of various provisions of the agreement (principally Article 7 relating to business profits) is dependent upon whether a person who is a resident of one country has a 'permanent establishment' in the other, and if so, whether income derived by the person in the other country is attributable or effectively connected with that 'permanent establishment'. The definition of the term 'permanent establishment' which this article embodies, corresponds generally with definitions of the term in Australia's more recent DTAs.

### Meaning of 'permanent establishment'

The primary meaning of the term 'permanent establishment' is expressed as being a fixed place of business through which the business of an enterprise is wholly or partly carried on.

***[Paragraph 1]***

Other paragraphs of the article are concerned with elaborating on the meaning of the term by giving examples (by no means intended to be exhaustive) of what may constitute a 'permanent establishment' - for example:

- an office;
- a workshop; or
- a mine.

All of Australia's comprehensive DTAs include as a 'permanent establishment' an agricultural, pastoral or forestry property . This reflects Australia's policy of retaining taxing rights over exploitation of Australian land for the purposes of primary production.

In the OECD Model Double Taxation Convention income from agricultural or forestry pursuits is subject to source

country taxation under Article 6 (Income from Real Property).

Australia's approach is consistent with retention of source country taxing rights in Article 6 but allows for income such as interest, dividends and royalties which may be effectively connected with the agricultural, pastoral or forestry activities to be taxed in Australia as business profits subject to full rates of tax rather than at the limited rates provided for in the Articles of the DTA that cover these income items. Australia's approach also ensures that the arm's length tests provided for in Article 7 (Business Profits) apply to these activities.

*[Subparagraph 2(g)]*

**Building sites**

The DTA provides that a building site, or a construction, installation or assembly project will constitute a permanent establishment if it is in place for more than six months.

The term 'building site, or a construction, installation or assembly project' cover constructional activities such as excavating or dredging. The term 'building site' can only mean such work as is directly connected with the erection of buildings and similar projects (earth work, masonry, painting, roofing, glazing and plumbing). Planning and supervision are certainly part of the building site if carried out by the construction contractor. However, planning and supervision of work does not represent a building site if carried out by another enterprise.

The word construction is used in its normal accepted sense. Income from construction would include: income from construction of buildings, bridges, dams, pipelines, tunnels and other civil engineering projects; income from related activities such as demolition, dredging, heavy earthmoving projects etc; and income from the construction of major plant items including ships and transport vessels.

A definition of 'construction project' is contained in subsection 221YHA(1) of the ITAA for the purpose of the prescribed payments system. The definition is as follows:

"**construction project**" means-

(a) the construction, erection, installation, alteration, modification, repair or improvement of a structure;

(b) the demolition, destruction, dismantling or removal of a structure; or

(c) the undertaking of earthworks or the clearing of land,

and includes-

(d) the installation in, or in connection with, a structure of a system of, or device for, heating, insulation, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply, security or fire protection;

(e) the painting or decorating of a structure;

(f) landscape gardening; and

(g) such other activities in relation to structures or land as may be prescribed for the purposes of this definition.'

The similar provision in the OECD Model Double Taxation Convention dealing with building sites, construction, installation or assembly projects provides that a permanent establishment exists *only* if a building site or construction or installation project lasts for more than 12 months.

This is to be contrasted with the provision in the DTA, which does not confirm the limitation that a permanent establishment will exist *only* if a building site, or a construction, installation or assembly project lasts for more than 6 months. Accordingly, in some instances a building site, construction, installation or assembly

project may constitute a permanent establishment under the paragraph 1 primary definition even though it does not last for more than the 6 months provided for in paragraph 3.

***[Paragraph 3]***

**Supervisory activities**

Supervisory activities carried on for more than 6 months in connection with a building site (or a construction, installation or assembly project) are deemed to constitute a permanent establishment. Australia has a reservation on Article 5 of the OECD model reflecting this position. The rationale for inclusion of this provision is the prevalence of the use in Australia of imported expertise in relation to supervision of such projects.

***[Subparagraph 4(a)]***

**Resource Activities**

The DTA provides that activities associated with the exploration for or exploitation of natural resources will constitute a permanent establishment. This provision extends to services provided in respect of such exploration and exploitation and reflects the importance to both countries of maintaining source country taxing rights over resource activities and associated services.

***[Subparagraph 4(b)]***

**Substantial equipment**

An enterprise shall be deemed to have a permanent establishment in a country if substantial equipment is being used in that country by, for or under contract with, the enterprise. This position is reflected in Australia's reservation to the OECD model and one effect is to further protect Australia's right to tax income from natural resources ( as, for example, oil rigs could otherwise be moved offshore to avoid the operation of the article). The meaning of the term 'substantial' depends on the relevant facts and circumstances of each individual case.

***[Subparagraph 4(c)]***

## Operations in relation to Standing Timber

The DTA provides that operations in respect of the felling, removal or other exploitation of standing timber will be deemed to be a permanent establishment.

***[Subparagraph 4(d)]***

## Anti-avoidance Provision

In relation to the provisions of the DTA dealing with permanent establishments existing where activities are carried on over a certain time frame (eg. building sites and supervisory activities) it is provided that where the activities are split between associated enterprises the periods will be aggregated in determining whether the enterprises have a permanent establishment in the country in which the activities are being carried on.

This provision is an anti-avoidance measure aimed at counteracting contract splitting for the purposes of avoiding the application of the permanent establishment rules.

The DTA provides that an enterprise shall be deemed to be associated with another enterprise if one enterprise is controlled directly or indirectly by the other or if both are controlled directly or indirectly by a third person or persons.

***[Paragraph 5]***

## Cost-toll situations

The inclusion of this subparagraph is insisted upon by Australia and is consistent with Australia's policy of retaining taxing rights over exploitation of its mineral resources. It deals with so-called 'cost-toll' situations. For example, a consortium of mining companies may form a company in Australia to own and operate a mineral refining plant in Australia. The plant refines solely the mineral mined by the consortium, at cost, so that the plant operations produced no taxable income. Title to the refined product remains with the consortium and profits on its sale are realised mainly outside of Australia.

In these circumstances, Australia deems such a plant to be a permanent establishment because the manufacturing or

processing activity is conducted in Australia, and therefore Australia should be able to tax the resulting business profits that would have been earned by the plant on the basis of arm's length dealings with the consortium. This subparagraph makes it less open for an enterprise which carries on very substantial manufacturing or processing activities in one country through an intermediary to claim that it does not have a permanent establishment in that country.

***[Subparagraph 7(b)]***

### Other Provisions of this Article

Other circumstances in which a resident of one country shall, or shall not, be deemed to have a permanent establishment in the other country are also specified. These paragraphs generally correspond with the comparable paragraphs of Australia's existing DTAs.

### Other articles

The principles set down in this article are also to be applied in determining whether a permanent establishment exists in a third country or whether a third country has a permanent establishment in Australia (or in New Zealand) when applying the source rule contained in:

- paragraph 5 of Article 11 (Interest); and
- paragraph 5 of Article 12 (Royalties).

***[Paragraph 10]***

## Article 6 - Income From Real Property

### Where income from real property is taxable

This article provides that the income of a resident of one country from real property situated in the other country may be taxed by the other country. Thus, income from real property in Australia will be subject to Australian tax laws.

***[Paragraph 1]***

### Income from real property

Income from real property is effectively defined as extending to:

- the direct use, letting or use in any other form of any land or interest therein; and
- royalties and other payments relating to the exploration for or exploitation of mines or quarries or other natural resources or rights in relation thereto.

Consistent with the usual rule that whatever is affixed to or attached to land forms part of, or becomes part of, the land, the reference to land is to be read as meaning either improved or unimproved land. For example, the definition of real property will encompass a lease of a building or any other interest in a building.

***[Paragraphs 2 and 3]***

### Real property of an enterprise and of persons performing independent personal services

The operation of this article extends to income derived from the use or exploitation of real property of an enterprise and income derived from real property that is used for the performance of independent personal services.

***[Paragraph 5]***

Accordingly, application of this article (when read with Articles 7 and 14) to such income ensures that the treaty country in which the real property is situated may impose tax on the income derived from that property by:

- an enterprise of the other country; or
- an independent professional person resident in that other country,

irrespective of whether or not that income is attributable to a 'permanent establishment' of such an enterprise, or fixed base of such a person, situated in the firstmentioned country.

## Article 7 - Business Profits

This article is concerned with the taxation of business profits derived by an enterprise carried on by a resident of one country from sources in the other country.

The taxing of these profits depends on whether they are attributable to a 'permanent establishment' in that other country. If a resident of one country carries on business through a 'permanent establishment' (as defined in Article 5) in the other country, the country in which the 'permanent establishment' is situated may tax the profits of the enterprise that are attributable to that permanent establishment.

If a taxpayer who is a resident of one country carries on a business through an enterprise that does not have a 'permanent establishment' in the other country, the taxpayer will not be liable to tax in the other country on the business profits of that enterprise.

*[Paragraph 1]*

**Determination of business profits**

Profits of a 'permanent establishment' are to be determined on the basis of arm's length dealing. The provisions correspond to comparable provisions in Australia's other double taxation agreements.

*[Paragraphs 2 and 3]*

No profits are to be attributed to a permanent establishment merely because it purchases goods or merchandise for the enterprise. Accordingly, profits of a permanent establishment derived from business activities carried on in its own right will not be increased by adding to them any profits attributable to the purchasing activities undertaken for the head office. It follows, of course, that any expenses incurred by the permanent establishment in respect of those purchasing activities will not be deductible in determining the taxable profits of the permanent establishment.

*[Paragraph 4]*

## Inadequate information

This article allows for the application of the source country's domestic law (e.g. Australia's Division 13) where, due to inadequate information, the correct amount of profits attributable to a 'permanent establishment' cannot be determined or can only be ascertained with extreme difficulty. Australia's position is reflected in the Australian observation on the Commentary on Article 7 of the OECD model.

*[Paragraph 5]*

## Trust beneficiaries

The principles of the article will apply to business profits derived by a resident of one of the countries (directly or through one or more interposed trust estates) as a beneficiary of a trust estate. This provision is in accordance with an Australian reservation on Article 7 of the OECD model.

*[Paragraph 7]*

## Example

> In accordance with this article, Australia has the right to tax a share of business profits, originally derived by a trustee of a trust estate (other than a trust estate that is treated as a company for tax purposes) from the carrying on of a business through a permanent establishment in Australia, to which a resident of New Zealand is beneficially entitled under the trust estate. Paragraph 7 ensures that such business profits will be subject to tax in Australia where, in accordance with the principles set out in Article 5, the trustee of the relevant trust estate has a permanent establishment in Australia in relation to that business.

**Income dealt with under other articles**

Where income is otherwise specifically dealt with under other articles of the DTA the effect of those particular articles is not overridden by this article.

*[Paragraph 8]*

This provision lays down the general rule of interpretation that categories of income or gains which are the subject of other articles of the agreement (eg. dividends, interest and royalties) are to be treated in accordance with the terms of those articles and as outside the scope of this article (except where otherwise provided, e.g. by paragraph 4 of Article 10).

**Insurance with non-residents**

Each country has the right to continue to apply any special provisions in its domestic law relating to the taxation of income from insurance. However, if the relevant law in force in either country at the date of signature of this DTA is varied (otherwise than in minor respects so as not to affect its general character), the countries must consult with each other with a view to agreeing to any amendment of this paragraph that may be appropriate. An effect of this paragraph is to preserve, in the case of Australia, the application of Division 15 of Part III of the ITAA (Insurance with Non-residents). This provision is in accordance with an Australian observation on the Commentary on Article 7 of the OECD model.

*[Paragraph 9]*

**Note**

> Australia has also lodged a reservation on Article 7 of the OECD Model Convention which states that Australia reserves the right to tax income derived from the leasing of industrial, commercial or scientific equipment and of containers as royalties under its DTAs, where such income, under Australian law, has a source in Australia.

## Article 8 - Ships And Aircraft

### International traffic

Under this article the right to tax profits from the operation of ships or aircraft in international traffic, including profits derived from:

- participation in a pool service;
- a joint transport operating organisation; or
- an international operating agency,

is generally reserved to the country of residence of the operator.

### Internal traffic

Any profits derived by a resident of one country from internal traffic in the other country (i.e. from operations confined solely to places in the other country) may be taxed in that other country. This position is reflected in Australia's reservation on Article 8 of the OECD model.

By reason of the definition of 'Australia' contained in Article 3 and the terms of paragraph 4 of this article, any shipments by sea or air from a place in Australia (including the continental shelf areas and external territories covered by the definition of 'Australia') for discharge at another place in or for return to that place in Australia, is to be treated as forming part of internal traffic.

***[Paragraph 4]***

### Example

Profits derived from a shipment of goods taken on board (during the course of an international voyage between a place in New Zealand and Sydney) at Cairns for delivery to Brisbane, would be profits from internal traffic and would fall within the scope of section 129 of the ITAA. As such, 5 per cent of the amount paid in respect of internal traffic would be

deemed to be taxable income of the operator for Australian tax purposes pursuant to Division 12 of Part III of the ITAA.

## Article 9 - Associated Enterprises

### Re-allocation of profits

This article authorises the re-allocation of profits between related enterprises in Australia and New Zealand on an arm's length basis where the commercial or financial arrangements between the enterprises differ from those that might be expected to operate between independent enterprises dealing wholly at arm's length with one another.

The article would not generally authorise the re-writing of accounts of associated enterprises where it can be satisfactorily demonstrated that the transactions between such enterprises have taken place on normal, open market commercial terms.

***[Paragraph 1]***

Each country retains the right to apply its domestic law relating to the determination of the tax liability of a person (e.g. Australia's Division 13) to its own enterprises, provided that such provisions are applied, so far as it is practicable to do so, in accordance with the principles of the article. This position is reflected in Australia's observation on the OECD Commentary on this article. Australia also has an observation on the OECD Commentary to include a provision to permit resort to domestic law in relation to the taxation of profits of an insurance enterprise.

***[Paragraph 2]***

Australia's domestic law provisions relating to international profit shifting arrangements were revised in 1981 in order to deal more comprehensively with arrangements under which profits are shifted out of Australia, whether by transfer pricing or other means. The broad scheme of the revised provisions is to impose arm's length standards in relation to

international dealings, but where the Commissioner cannot ascertain the arm's length consideration, it is deemed to be such amount as the Commissioner determines. Paragraph 2 is designed to preserve the application of those domestic law provisions. Australia strongly believes that a tax treaty should not prevent a Contracting State from applying its domestic anti-transfer pricing provisions, particularly in respect of its own residents.

### Correlative adjustments

Where a re-allocation of profits is made (either under this article or, by virtue of paragraph 2, under domestic law) so that the profits of an enterprise of one country are adjusted upwards, a form of double taxation would arise if the profits so re-allocated continued to be subject to tax in the hands of an associated enterprise in the other country. To avoid this result, the other country is required to make an appropriate compensatory adjustment to the amount of tax charged on the profits involved to relieve any such double taxation.

*[Paragraph 3]*

This adjustment has to be made only if the re-allocation was made on the basis of arrangements that might be expected to operate between independent enterprises dealing wholly at arm's length with one another.

It would generally be necessary for the affected enterprise to apply to the competent authority of the country not initiating the re-allocation of profits for an appropriate compensatory adjustment to reflect the re-allocation of profits made by the competent authority of the other treaty partner country. If necessary, the competent authorities of Australia and New Zealand will consult with each other to determine the appropriate adjustment.

## Article 10 - Dividends

This article broadly allows both countries to tax dividends flowing between them but in general limits the tax that the country of source may impose on dividends payable by companies that are residents of that country under its

domestic law to beneficial owners resident in the other country.

### Rate of tax

Under this article, Australia will reduce its rate of withholding tax on unfranked dividends paid by Australian resident companies to residents of New Zealand from 30 per cent to 15 per cent of the gross amount of the dividends. Dividend payments will, of course, remain free of withholding tax under Australia's domestic law to the extent that they are franked. The rate of withholding tax to be imposed by New Zealand on outgoing dividends is generally limited to 15 per cent.

However, in respect of deemed dividends arising in New Zealand as a consequence of an Australian life insurer making an election under section 204M of the *New Zealand Income Tax Act 1976* to be taxed as a New Zealand resident, the rate of tax imposed on that deemed dividend will not exceed 5 per cent of the gross amount of the deemed dividend.

*[Paragraph 2]*

### Exception to limitation

The limitation on the source country's tax does not apply to dividends derived by a resident of the other country who has a 'permanent establishment' or 'fixed base' in the country from which the dividends are derived, if the holding giving rise to the dividends is effectively connected with that 'permanent establishment' or 'fixed base'.

Where the dividends are so effectively connected, they are to be treated as 'business profits' or 'income from independent personal services' and therefore subject to the source country's tax ( in accordance with the provisions of Article 7 or Article 14, as the case may be). In practice, however, under changes made to Australia's domestic law with the introduction from 1 July 1987 of a full imputation system of company taxation, such dividends to the extent that they are franked dividends will remain exempt from Australian tax

while unfranked dividends will be subject to withholding tax at the rate of 15 per cent instead of being taxed by assessment.

*[Paragraph 4]*

### Extra-territorial application precluded

The extra-territorial application by either country of taxing rights over dividend income is precluded by providing, broadly, that one country (the first country) will not tax dividends paid by a company resident solely in the other country, unless:

- the person deriving the dividends is a resident of the first country; or
- the holding giving rise to the dividends is effectively connected with a 'permanent establishment' or 'fixed base' in the first country.

*[Paragraph 5]*

However, the exemption does not apply where the dividend paying company is a dual resident, even though the company is deemed to be a resident of only one country for purposes of the agreement. This proviso ensures that Australia has the right to tax dividends paid to a third country resident by an Australian company which is deemed to be a resident of New Zealand for the purposes of the agreement.

## Article 11 - Interest

### Rate of tax

This article provides for interest income to be taxed by both countries but requires the country of source to generally limit its tax to 10 per cent of the gross amount of the interest where a resident of the other country is the beneficial owner of the interest.

*[Paragraphs 1 and 2]*

The limitation of the source country tax rate to 10 per cent accords with the general rate of interest withholding tax applicable under Australia's domestic law.

### Definition

The term 'interest' is defined for the purposes of the article in a way that, in relation to Australia, encompasses items of income such as discounts on securities and payments under certain hire purchase agreements which are treated for Australian tax purposes as interest or amounts in the nature of interest.

The definition does not, however, include interest that is treated by one of the countries to the DTA as a dividend to which Article 10 would apply.

***[Paragraph 3]***

### Interest effectively treated as business profits

Interest derived by a resident of one country which is effectively connected with a 'permanent establishment' or 'fixed base' of that person in the other country will form part of the business profits of that 'permanent establishment' or 'fixed base' and be subject to the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services). Accordingly, the 10 per cent source country tax rate limitation does not apply to such interest.

***[Paragraph 4]***

### Deemed source rules

Interest 'source' rules which are in accord with the scheme of the interest withholding tax provisions of Australia's domestic law are set out in the article. Those rules operate to allow Australia to tax interest to which a resident of New Zealand is beneficially entitled where the interest is paid by a resident of Australia and is not an expense of a business carried on by the Australian resident through a permanent establishment in a country outside Australia that is deductible by that permanent establishment. Australia may also tax

interest paid by a resident of New Zealand to which another New Zealand resident is beneficially entitled if it is an expense incurred by the payer of the interest in carrying on a business in Australia through a permanent establishment.

***[Paragraph 5]***

### Related persons

The article also contains a general safeguard against payments of excessive interest - in cases where there is a special relationship between the persons associated with a loan transaction - by restricting the 10 per cent source country tax rate limitation in such cases to an amount of interest which might be expected to have been agreed upon by persons dealing at arm's length. Any excess part of the interest remains taxable according to the domestic law of each country but subject to the other articles of this agreement.

***[Paragraph 6]***

## Article 12 - Royalties

### Rate of tax

The article in general allows both countries to tax royalty flows but limits the tax of the country of source to 10 per cent of the gross amount of royalties paid or credited to beneficial owners resident in the other country.

***[Paragraphs 1 and 2]***

The 10 per cent rate limitation is not to apply to natural resource royalties, which, in accordance with Article 6, are to remain taxable in the country of source without limitation of the tax that may be imposed.

In the absence of a DTA, Australia taxes royalties paid to non-residents at 30 per cent of the gross royalty.

**Definition**

The definition of 'royalties' reflects the definition in Australia's domestic income tax law. The definition encompasses payments for the supply of scientific, technical, industrial or commercial 'know how' but not payments for services rendered.

**Payments for the supply of "know how" vs payments for services rendered**

It is considered that a German Supreme Court decision (Bundesfinanzhof (No. IR 44/67) of 16 December 1970) provides a definitive test to distinguish between a know how contract and a contract for services. A know how contract, it was held, involved the supply by a person of his or her know how to the paying entity (e.g., teaching a personal expertise), whereas in a contract for services, although it may involve the use of know how, that know how is applied by the person in the performance of his or her services.

Accordingly, the crucial question to be answered is - is the contract one for the supply, for use by the 'buyer' of a 'product' which is already in existence (or substantially so) or is it one which requires the contractor to apply special skills and knowledge for his own purposes in order to bring the 'product' into existence for the 'buyer'?

Payments for design, engineering or construction of plant or building, feasibility studies, component design and engineering services may generally be regarded as being in respect of a contract for services, unless there is some provision in the contract for imparting techniques and skills to the 'buyer'.

In cases where both know how and services are supplied under the same contract, if the contract does not separately provide for payments in respect of know how and services, an apportionment of the two elements of the contract may be possible.

***[Subparagraph 3(c)]***

Australia has a long standing policy that payments for services rendered are to be treated under the Independent Personal Services Article or the Business Profits Article.

### Other Royalties effectively treated as Business Profits

As in the case of interest income, it is specified that the 10 per cent source country tax rate limitation is not to apply to royalties effectively connected with a 'permanent establishment' or 'fixed base' in that country.

*[Paragraph 4]*

### Deemed source rule

The royalties 'source' rule effectively corresponds in the case of Australia with the deemed source rule contained in section 6C (Source of royalty income derived by a non-resident) of the ITAA for royalties paid to non-residents of Australia. It broadly mirrors the 'source' rule for interest income contained in paragraph 5 of Article 11 (Interest).

*[Paragraph 5]*

### Related persons

If royalties flow between related persons, the 10 per cent source country tax rate limitation will apply only to the extent that the royalties are not excessive. Any excess part of the royalty remains taxable according to the domestic law of each country but subject to the other articles of this agreement.

*[Paragraph 6]*

## Article 13 - Alienation Of Property

### Taxing rights

This article allocates between the respective countries taxing rights in relation to income, profits or gains arising from the

alienation of real property (as defined in Article 6) and other items of property.

Income, profits or gains from the alienation of real property may be taxed by the country in which the property is situated.

*[Paragraph 1]*

**Permanent establishment**

Paragraph 2 deals with income, profits or gains arising from the alienation of property (other than real property covered by paragraph 1) forming part of the business assets of a permanent establishment of an enterprise or pertaining to a fixed base used for performing independent personal services. It also applies where the permanent establishment (alone or with the whole enterprise) or the fixed base is alienated. Such income or gains may be taxed in the country in which the permanent establishment or fixed base is situated. This corresponds to the rules for business profits and for income from independent personal services contained in Articles 7 and 14 respectively.

**Shares**

The treatment of income, profits or gains from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property covered by paragraph 1, is assimilated to the treatment by paragraph 1 of the alienation of that real property. Such income or gains may thus be taxed by the country in which the real property is situated.

*[Paragraph 3]*

**Disposal of ships or aircraft**

Income, profits or gains from the disposal of ships or aircraft operated in international traffic, or associated property (other than real property covered by paragraph 1 are taxable only in the country of residence of the operator of the ships or aircraft. This rule corresponds to the taxing rule contained in

Article 8 in relation to profits from the operation of ships or aircraft in international traffic.

***[Paragraph 4]***

## Capital gains

The article contains a sweep-up provision in relation to capital gains which enables each country to tax, according to its domestic law, any gains of a capital nature derived by its own residents or by a resident of the other country from the alienation of any property not specified in the preceding paragraphs of the article. It thus preserves the application of Australia's domestic law relating to the taxation of capital gains in relation to the alienation of such property.

***[Paragraph 5]***

This paragraph operates independently of Article 22, which contains sweep-up provisions in relation to items of income not dealt with in other articles of the DTA.

### Definition of real property

The term 'real property' is to be defined for the purposes of this Article as it is under Article 6, as is the determination of where the property is situated in accordance with paragraph 4 of Article 6.

***[Paragraphs 6 and 7]***

### Business profits

As indicated earlier, income, profits or gains from the alienation of property that fall within the scope of this article are not affected by the 'business profits' provisions of Article 7. In the event that the operation of this article should result in an item of income or gain being subjected to tax in both countries, the country in which the person deriving the income or gain is a resident (as determined in accordance with Article 4) would be obliged by Article 24 to provide double tax relief for the tax imposed by the other country.

## Article 14 - Independent Personal Services

### Taxing rights

Under this article income derived by an individual in respect of professional services or other independent activities will be subject to tax in the country in which the services or activities are performed if either:

- the individual is present in that country for a period or periods exceeding in the aggregate 183 days in any twelve month period; or
- the recipient has a fixed base regularly available in that country for the purposes of performing his or her activities.

If either of these conditions are met the country in which the services or activities are performed will be able to tax so much of the income as is attributable to the activities performed during such period or periods or that are exercised from that fixed base.

If the above tests are not met, the income will be taxed only in the country of residence of the recipient.

Remuneration derived as an employee and income derived by public entertainers are the subject of other articles of the agreement and are not covered by this article.

## Article 15 - Dependent Personal Services

### Basis of taxation

This article generally provides the basis upon which the remuneration of visiting employees is to be taxed. The provisions of this article do not apply, however, in respect of income that is dealt with separately in:

- Article 16 (Fringe Benefits);

  Article 17 (Directors' Fees);
- Article 19 (Pensions and Annuities); and

Article 20 (Government Service)

of the DTA.

Generally, salaries, wages and similar remuneration derived by a resident of one country from an employment exercised in the other country will be liable to tax in that other country. However, subject to specified conditions, there is a conventional provision for exemption from tax in the country being visited where visits of only a short-term nature are involved.

**Exemption**

The conditions for this exemption are that:

- the visit or visits not exceed, in the aggregate, 183 days in any 12 month period commencing or ending in the year of income concerned;
- the remuneration is paid by, or on behalf of, an employer who is not a resident of the country being visited;
- the remuneration is not deductible in determining taxable profits of a 'permanent establishment' or a 'fixed base' which the employer has in the country being visited; and
- the remuneration is subject to tax in the country of residence of the recipient.

Where all of these conditions are met, the remuneration so derived will be liable to tax only in the country of residence of the recipient.

**Interpretation of the term 'Employer'**

For the purposes of the exemption discussed in the preceding paragraph the competent authorities have agreed that in determining whether the 'employer' is the real employer as opposed to an intermediary between the persons carrying out the work (a hirer) and the persons using the labour (the users) that substance should prevail over form and that cases should be determined on a 'facts and circumstances' approach.

Accordingly, determination of the question should take into account all relevant factors including:

- who has rights on the work produced;
- who bears the responsibility or risk for the results produced by the work of the individual hired out;
- whether the user has authority to instruct the worker;
- whether the work is performed at a place which is under the control and responsibility of the user;
- whether the remuneration to the hirer is calculated on the basis of the individual's time utilised or there is relevant connection between the calculation of the hirer's remuneration and the wages received by the individual hired out;
- whether the user has supplied the necessary tools and materials to the individual for the purposes of performing the tasks for which the individual was hired out; and
- whether the number and qualifications of the individuals hired out are solely determined by the hirer.

**Employment on a ship or aircraft**

Income from an employment exercised aboard a ship or aircraft operated in international traffic may be taxed in the country of residence of the operator.

***[Paragraph 3]***

**Short-term visit**

Where a short-term visit exemption is not applicable, remuneration derived by a resident of Australia from an employment exercised in New Zealand may be subject to tax in New Zealand. However, the article does not allocate sole taxing rights to New Zealand in that situation.

Accordingly, Australia would also be entitled to tax that remuneration in accordance with the general rule of the ITAA that a resident of Australia remains subject to tax on worldwide income. In common, however, with other situations where the DTA allows both countries to tax a category of income, Australia would be required in this situation (pursuant to Article 24(2)), as the country of residence of the income recipient, to relieve the double taxation that would otherwise occur.

Although that paragraph provides for the double tax relief to be provided by Australia to be in the form of the grant of a credit against the Australian tax for the New Zealand tax paid, the 'exemption with progression' method of providing double tax relief in relation to employment income derived in the situation described would normally be applicable in practice pursuant to section 23AG of the ITAA. This method takes into account the foreign earnings when calculating the Australian tax on other assessable income the person has derived.

## Article 16 - Fringe Benefits

Under this article, fringe benefits provided to an employee that are subject to tax in both countries will, upon the application of this article, be taxed only in the country that has the sole or 'primary taxing' right over the remuneration from the employment to which the benefit relates.

The article provides that the 'primary taxing right' lies with the country that does not have to provide relief under Article 24 for tax paid on the employee's remuneration.

### Operation of the Provision in Respect of Fringe Benefits Tax Law

Both Australia and New Zealand operate similar tax systems in relation to the taxation of certain fringe benefits, that is, the employer providing the benefit is required to pay the tax on the value of the benefit. In these cases the liability to tax relies on their being an employer/employee relationship in existence to which the benefit relates.

In the domestic legislation of both countries a person is an employee for the purposes of the fringe benefits tax if the person is liable to have tax instalments deducted from his or her remuneration for the employment. In both countries tax instalments do not have to be deducted from income that is exempt income under the domestic law of the respective countries. Accordingly, where an employee's income is exempt from tax in one country the employer will not be liable for fringe benefits tax in that country on benefits that fall within the domestic fringe benefits law as an employer/employee relationship will not exist in that country.

However, there are circumstances in both countries where a resident of one country working in the other country would be liable to tax on the remuneration from his or her employment in both countries. This position is addressed, so far as concerns the taxing rights of each country in relation to the remuneration, by Article 24 (Elimination of Double Taxation).

In these cases there is a technical liability in both countries for tax instalments to be deducted. Accordingly, there being an employer/employee relationship in both countries fringe benefits falling under the fringe benefits tax law of both countries would, without this provision, be payable by the employer in both countries.

This Article of the DTA will ensure that the employer is only subject to tax under the fringe benefits tax law of only one of the countries.

### Example

A New Zealand resident is seconded by his employer, a New Zealand resident with a permanent establishment in Australia, to Australia for 4 months. During that period he is provided with the use of a company car.

The employee is subject to tax on income derived from the employment in Australia in both Australia and New Zealand. This is because New Zealand tax

their residents on their worldwide income and the exemption from Australian tax in respect of short visits provided for under Article 15(2) is not available as the employee's remuneration is deductible in determining the taxable profits of the permanent establishment for the purposes of Australian income tax.

In these circumstances the employer is technically liable to deduct tax instalments in both countries. Accordingly, there is an employer/employee relationship under the fringe benefits tax law of the two countries. As the car benefit is taxable under the fringe benefits tax law of both countries the employer is liable to pay tax on the benefit in both countries.

The provisions of the DTA will, however, render the benefit taxable to the employer only in Australia because Australia would have the primary taxing right in relation to the remuneration in these circumstances.

**Note**

The possibility of double taxation of the employee on his remuneration from employment in Australia is relieved by the unilateral domestic law foreign tax credit provisions of the New Zealand law and under Article 24 of the DTA, by New Zealand allowing the employee a credit for Australian tax paid on his or her Australian sourced employment income.

The technical liability of the employer to deduct tax instalments in both countries will be relieved by the employer applying to the New Zealand tax authorities to have tax instalment deductions varied or reduced to nil.

## Other Cases

Cases will also arise in the trans-Tasman context where a benefit will be subject to tax under the fringe benefits tax law in one country but will be included in the employee's assessable income under the income tax law of the other

country. In these cases the fringe benefit will be taxed under the relevant tax system applying in the country with the primary taxing right.

**Example**

An Australian employee is seconded to New Zealand to work for the permanent establishment of his Australian resident employer for two months. During that time the employee is provided with a house in New Zealand.

The employee's New Zealand sourced remuneration from his employment is not exempt from Australian tax under section 23AG of the ITAA (because he or she is not employed in New Zealand for a continuous period of 91 days or more). Accordingly, an employer/employee relationship exists for the purposes of the Australian FBTAA and the value of the housing benefit is taxable in Australia to the employer.

The employee's New Zealand sourced remuneration will also be subject to New Zealand tax as the exemption from New Zealand tax in respect of short visits provided for under Article 15(2) is not available because the permanent establishment deducts the employee's remuneration in determining the taxable profits of the permanent establishment for the purposes of New Zealand income tax.

The New Zealand fringe benefit tax law does not extend to housing benefits. Rather, the value of the housing benefit is taxable to the employee under the New Zealand income tax system.

In these circumstances the fringe benefit is taxable under the domestic law of both countries but under the terms of this Article the taxing right over the benefit will be allocated solely to New Zealand as New Zealand has the primary taxing right over the employee's remuneration. Accordingly, no Australian fringe benefits tax will be payable by the employer but

the employee will be subject to tax in respect of the benefit in New Zealand under the New Zealand income tax system.

## Article 17 - Directors' Fees

Under this article, remuneration derived by a resident of one country in the capacity of a director of a company which is a resident of the other country may be taxed in the latter country.

## Article 18 - Entertainers

### Personal activities

By this article, income derived by visiting entertainers (including athletes and other sportspersons) from their personal activities as such may generally be taxed in the country in which the activities are exercised, irrespective of the duration of the visit. The words 'income derived by entertainers.... from their personal activities as such....' extend the application of this article to income generated from promotional and associated kinds of activities engaged in by the entertainer while present in the visited country.

### Safeguard

There is a safeguard provision included in this article which is designed to ensure that income in respect of personal activities exercised by an entertainer, whether received:

- by the entertainer; or
- by another person, e.g., a separate enterprise which formally provides the entertainer's services,

is taxed in the country in which the entertainer performs, whether or not that other person has a 'permanent establishment' or 'fixed base' in that country.

***[Paragraph 2]***

### Non-application to Members of League Competitions

The DTA includes a provision to the effect that this article will not apply to sportspersons resident in one or both countries in respect of income derived as a member or as an associate of a recognised team that is regularly playing in a trans-Tasman league competition.

Where a sportsperson is covered by this provision the income derived by a resident of one country from participating in league competition games played in the other country will be taxed under either Article 14 or Article 15. This will generally mean that the sportsperson will be taxed in the country in which he or she resides unless they are present in the other country for a period exceeding 183 days in any 12 month period for the purpose of deriving the income.

The term 'associate' is defined to cover managers, coaches, trainers, runners, physicians, physiotherapists and other providers of similar support services.

It should be noted that the article continues to apply to sportspersons who are members of a national representative team of either country. However, income derived as a member or associate of such a team is generally exempt from tax in the other country under domestic law provisions.

*[Paragraphs 3 and 4]*]

## Article 19 - Pensions And Annuities

Pensions (including government pensions) and annuities are to be taxed only by the country of residence of the recipient.

*[Paragraph 1]*

### Scope of article

It is intended that the operation of this article extends to pension and annuity payments made to dependants, for example a widow or children, of the person in respect of whom the pension or annuity entitlement accrued where,

upon that person's death, such entitlement has passed to that person's dependants.

### Alimony and maintenance payments

The taxing right in respect of alimony and other maintenance payments is allocated solely to the country of residence of the payer. The purpose of this paragraph is to remove any possibility of double taxation of such payments arising by reason of the treatment accorded such payments under the respective domestic law. In the case of Australia, those payments will generally remain exempt from Australian tax under the ITAA in the hands of the recipient and non-deductible to the payer.

*[Paragraph 3]*

## Article 20 -Government Service

### Salary and wage income

Salary and wage type income, other than a pension or annuity, paid to an individual for services rendered to a government (including a State or local authority) of one of the countries, is to be taxed only in that country. However, such remuneration is to be taxable only in the other country if:

- the services are rendered in that other country; and
- the recipient is a resident of that other country for the purposes of that country's tax but is not a resident of the other country solely for the purpose of rendering the services.

*[Paragraphs 1 and 2]*

### Trade or business income

Remuneration for services rendered in connection with a trade or business carried on by a government is excluded from the scope of this article. This remuneration will remain

subject to the provisions of Article 15 (Dependent Personal Services) or Article 17 (Directors' Fees) as the case may be.

*[Paragraph 3]*

## Article 21 - Students

### Exemption from tax

This article applies to students temporarily present in one of the countries solely for the purpose of their education if the students are, or immediately before the visit were, resident in the other country. In these circumstances, the students will be exempt from tax in the country visited for payments received from abroad for their maintenance or education (even though they may qualify as a resident of the country visited during the period of their visit).

The exemption from tax provided by the visited country is treated as extending to maintenance payments received by the student that are made for maintenance of dependent family members who have accompanied the student to the visited country.

### Employment income

Where however, a student from New Zealand who is visiting Australia solely for educational purposes undertakes:

- some part time work with a local employer; or
- during a semester break undertakes work with a local employer,

the income earned by that student as a consequence of that employment may, as provided in Article 15, be subject to tax in Australia. In this situation the payments received from abroad for the student's maintenance or education will not however be taken into account in determining the tax payable on the employment income that is subject to tax in Australia.

## Article 22 - Other Income

### Allocation of taxing rights

This article provides rules for the allocation between the two countries of taxing rights to items of income not dealt with in the preceding articles of the DTA. The scope of the article is not confined to such items of income arising in one of the countries; it extends also to income from sources in a third country.

Broadly, such income derived by a resident of one country is to be taxed only in his or her country of residence unless it is derived from sources in the other country, in which case the income may also be taxed in the other country. Where this occurs, the country of residence of the recipient of the income would be obliged by Article 24 (Elimination of Double Taxation) to provide double taxation relief.

***[Paragraph 1]***

This article does not apply to income effectively connected with a 'permanent establishment' or 'fixed base' derived by a resident of a country in the other country. In such a case, Article 7 (Business Profits) or 14 (Independent Personal Services), as the case may be, will apply.

However, this article applies to income from real property as defined in paragraph 2 of Article 6 where the income is effectively connected with a 'permanent establishment' or 'fixed base' in the other Contracting State. The reason income from real property continues to be taxed in this situation under this article is that Article 6 does not deal with the situation where income from real property situated in the country of residence of the enterprise or person performing the independent personal services is effectively connected with a 'permanent establishment' or 'fixed base' in the other country. In these circumstances Articles 7 and 14 would allocate a taxing right to the country in which the 'permanent establishment' or 'fixed base' was located when clearly the policy of Article 6 is that income from real property should be taxable by the country in which the property is situated.

This provision ensures that this policy applies in relation to the situation outlined.

*[Paragraph 2]*

**Note**

This article effectively contains 'sweep-up' provisions in relation to items of income not dealt with in other articles of the agreement and paragraph 5 of Article 13 effectively 'sweeps-up' capital gains not dealt with in the other paragraphs of that article.

## Article 23 - Source Of Income

### Deemed source

This article effectively deems income, profits or gains derived by a resident of one country which, under the agreement, may be taxed in the other country to have a source in the latter country for the purposes of Article 24 (Elimination of Double Taxation) and the domestic income tax law of the respective countries. It therefore ensures the jurisdiction of each country to exercise the taxing rights allocated to it by the DTA over residents of the other country.

### Double taxation relief

The article is also designed to ensure that where an item of income, profits or gains is taxable in both countries, double taxation relief will be given by the income recipient's country of residence (pursuant to Article 24) for tax levied by the other country as prescribed under the DTA. In this way, income derived by a resident of Australia, which is taxable by New Zealand under the DTA, will be treated as being foreign income for the purposes of the ITAA, including the foreign tax credit provisions of the ITAA.

## Article 24 - Elimination Of Double Taxation

Double taxation does not arise in respect of income flowing between the two countries where the terms of the agreement provide either:

- for the income to be taxed only in one country; or
- where the domestic taxation law of one of the countries frees the income from its tax.

### Tax credit

It is necessary, however, to prescribe a method for relieving double taxation for other classes of income which, under the DTA, remain subject to tax in both countries. Australia's other DTAs provide for a credit basis for the relief of double taxation to be applied by Australia and, usually, the other country. In these cases, the country of residence is required to give credit against its tax for the tax of the country of source. This article also reflects that approach.

Australia can relieve double taxation by allowing a credit against its own tax for New Zealand tax paid under the law of New Zealand and in accordance with the DTA on income derived by a resident of Australia from sources in New Zealand.

***[Paragraph 2]***

### Australian method of relief

Australia's general foreign tax credit system, together with the terms of this article and of the DTA generally, will form the basis of Australia's arrangements for relieving a resident of Australia from double taxation on income arising from sources in New Zealand. As in the case of Australia's other DTAs, the source of income rules specified by Article 23 for purposes of the DTA will also apply for those purposes.

Accordingly, effect is to be given to the tax credit relief obligation imposed on Australia by paragraph 2 of this article by application of the general foreign tax credit provisions (Division 18 of Part III) of the ITAA. This will include the

allowance of "underlying" tax credit relief in respect of dividends paid by New Zealand resident companies that are related to Australian resident companies, including for unlimited tiers of related companies, in accordance with the relevant provisions of the ITAA.

Notwithstanding the credit form of relief provided for by paragraph 2 of the article, the 'exemption with progression' method of relief will be applicable, as appropriate, in relation to salary and wages and like remuneration derived by a resident of Australia during a continuous period of 'foreign service' (as defined in subsection 23AG(7) of the ITAA) in New Zealand.

### Accruals system

It is also relevant that New Zealand is a listed 'comparable tax' country for purposes of the measures in the ITAA giving effect to the foreign income accruals system.

Accordingly, dividends and branch profits derived from New Zealand by an Australian resident company that are exempt from Australian tax under those measures (e.g., sections 23AH or 23AJ of the ITAA) will continue to qualify for exemption from Australian tax under those provisions. In these cases, the credit form of relief will not be relevant.

## Article 25 - Mutual Agreement Procedure

### Consultation

One of the purposes of this article is to provide for consultation between the competent authorities of the two countries with a view to reaching a satisfactory solution where a person is able to demonstrate actual or potential imposition of taxation contrary to the provisions of the DTA.

### Time limits

A person wishing to use this procedure must present a case to the competent authority of the State of which the person is a resident within three years of the first notification of the

action which the taxpayer considers gives rise to taxation not in accordance with the agreement.

*[Paragraph 1]*

If, on consideration, a solution is reached, it may be implemented irrespective of any time limits imposed by domestic tax law of the relevant country.

*[Paragraph 2]*

### Resolution of difficulties

The article also authorises consultation between the competent authorities of the two countries for the purpose of resolving any difficulties regarding the interpretation or application of the agreement and to give effect to it.

*[Paragraphs 3 and 4]*

## Article 26 - Exchange Of Information

### Limitations on exchange

This article authorises and limits the exchange of information by the two competent authorities to information necessary for the carrying out of the DTA or for the administration of domestic laws concerning the taxes to which the DTA applies.

*[Paragraph 1]*

The limitation placed on the kind of information authorised to be exchanged means that information access requests relating to taxes not within the coverage provided by Article 2, for example sales tax, are not within the scope of the article.

### Purpose

The purposes for which the exchanged information may be used and the persons to whom it may be disclosed are restricted consistently with Australia's other DTAs. Any

information received by a country shall be treated as secret in the same manner as information obtained under the domestic law of that country.

***[Paragraph 1]***

An exchange of information that would disclose any trade, business, industrial, commercial or professional secret or trade process or which would be contrary to public policy is not permitted by the article.

***[Paragraph 2]***

## Article 27-Diplomatic Agents And Consular Officers

The purpose of this article is to ensure that the provisions of the DTA do not result in members of diplomatic and consular posts receiving less favourable treatment than that to which they are entitled in accordance with international conventions. In Australia, such persons are entitled, for example, to certain fiscal privileges under the *Diplomatic (Privileges and Immunities) Act 1967* and the *Consular (Privileges and Immunities) Act 1972.*

## Article 28 - Entry Into Force

### Date of entry into force

This article provides for the entry into force of the DTA. This will be on the last date on which diplomatic notes are exchanged through the diplomatic channel notifying that the last of the processes to give the DTA the force of law in the respective countries has been completed. In Australia, enactment of the legislation giving the force of law in Australia to the DTA is the necessary prerequisite to the exchange of diplomatic notes.

### Withholding tax

Once it enters into force, the DTA will have effect in Australia for purposes of withholding taxes in respect of

income derived on or after 1 April next following the date on which the DTA enters into force.

### Fringe Benefits tax

Once it enters into force, the DTA will have effect in Australia for purposes of fringe benefits tax in respect of fringe benefits provided on or after 1 April next following the date on which the DTA enters into force.

### Other taxes

In respect of other Australian tax, the DTA will first have effect in Australia in relation to profits, income or gains of the Australian year of income beginning on or after 1 July next following the date on which it enters into force.

### Note

> Where a taxpayer has adopted an accounting period ending on a date other than 30 June, profits, income or gains derived on or after the beginning of the accounting period that has been substituted for the year beginning on 1 July next following the date on which the DTA enters into force will be subject to the DTA for purposes of other Australian tax.

### Date of effect in New Zealand

In New Zealand, the DTA will first have effect, in relation to New Zealand tax withheld at source, on or after 1 April next following the date on which the DTA enters into force. For other New Zealand tax, the DTA will first have effect in New Zealand in respect of the year of income beginning on or after 1 April next following the date on which the DTA enters into force.

### Termination of the 1972 DTA

The article provides that the DTA between Australia and New Zealand signed at Melbourne on 8 November 1972

(the 1972 New Zealand agreement) shall terminate and cease to have effect in relation to any tax in respect of which this DTA comes into effect.

## Article 29 - Termination

By this article the DTA is to continue in effect indefinitely. However, either country may give through the diplomatic channel written notice of termination of the DTA on or before 30 June in any calendar year beginning after the expiration of five years from the date of its entry into force.

### Cessation in Australia

In that event, the DTA would cease to be effective in Australia for purposes of withholding tax in respect of income derived on or after 1 April in the calendar year next following that in which the notice of termination is given.

In respect of fringe benefits tax the DTA would cease to be effective in Australia in respect of fringe benefits provided on or after 1 April in the calendar year next following that in which the notice of termination is given.

For other Australian tax, it would cease to be effective in relation to profits, income or gains of any year of income beginning on or after 1 July in the calendar year next following that in which the notice of termination is given.

### Cessation in New Zealand

It would correspondingly cease to be effective in New Zealand in respect of withholding tax on income derived on or after 1 April in the calendar year subsequent to that in which the notice of termination is given, and in relation to other New Zealand tax, the termination would first apply for any income year beginning on or after 1 April in the calendar year next following that in which the notice of termination is given.

## INCOME TAX (INTERNATIONAL AGREEMENTS) AMENDMENT BILL 1995


| | | |
|---|---|---|
| Article 1 | Personal Scope | 11 |
| Article 2 | Taxes Covered | 11 |
| Article 3 | General Definitions | 12 |
| Article 4 | Residence | 14 |
| Article 5 | Permanent Establishment | 17 |
| Article 6 | Income From Real Property | 22 |
| Article 7 | Business Profits | 24 |
| Article 8 | Ships and Aircraft | 27 |
| Article 9 | Associated Enterprises | 28 |
| Article 10 | Dividends | 29 |
| Article 11 | Interest | 31 |
| Article 12 | Royalties | 33 |
| Article 13 | Alienation of Property | 35 |
| Article 14 | Independent Personal Services | 38 |
| Article 15 | Dependent Personal Services | 38 |
| Article 16 | Fringe Benefits | 41 |
| Article 17 | Directors' Fees | 45 |
| Article 18 | Entertainers | 45 |
| Article 19 | Pensions and Annuities | 46 |
| Article 20 | Government Service | 47 |
| Article 21 | Students | 48 |

| | | |
|---|---|---|
| Article 22 | Other Income | 49 |
| Article 23 | Source of Income | 50 |
| Article 24 | Elimination of Double Taxation | 51 |
| Article 25 | Mutual Agreement Procedure | 52 |
| Article 26 | Exchange of Information | 53 |
| Article 27 | Diplomatic Agents and Consular Officers | 54 |
| Article 28 | Entry Into Force | 54 |
| Article 29 | Termination | 56 |


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