1996

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT (INTERNATIONAL TAX AGREEMENTS) BILL 1996

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
the Hon. Peter Costello, M.P.)

78220 Cat. No. 96 4797 X ISBN 0644 45069X

9 780644 450690

Table of contents

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 *International Agreements Act 1953* (IntTAA) to give the force of law in Australia to an agreement between the Australian Commerce and Industry Office (ACIO) and the Taipei Economic and Cultural Office (TECO) concerning the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. The agreement covers the various forms of income flows between Australia and Taiwan.

Who will be affected by the agreement in the Bill?

Any taxpayers who, for the purposes of the agreement, are residents of either Australia or Taiwan and who derive income, profits or gains from the other territory.

In what way does the Bill change the Act?

The Bill will make a number of changes to the IntTAA by inserting:

- in subsection 3(1) the definition of 'the Taipei agreement'.
- subsection 11ZF(1) which will give the force of law in Australia to the provisions of the Agreement between ACIO and TECO ('the Taipei agreement') according to their tenor.

subsection 11ZF(2) which effectively provides that particular income, profits or gains which, under the agreement, may be taxed in Australia in the hands of a Taiwan resident, is deemed to have a source in Australia. This provision is designed to ensure that the right given by the agreement for Australia to tax that income is compatible with the domestic law rules with respect to taxation of non-residents and eliminates any possible conflict with the domestic law rules as to the source of income.

- subsection 11ZF(3) which will ensure that for the purposes of allowing a foreign tax credit under the provisions of the *Income Tax Assessment Act 1936* (ITAA) and under Article 22 of the agreement that income, profits or gains that Taiwan may tax under the agreement in the hands of a resident of Australia is deemed to have a source in Taiwan.

- subsection 11ZF(4) which relates to the right given by paragraph 2 of Articles 11 and 12 of the agreement for each territory to tax outgoing interest and royalties, at a limited rate, and the related "source" rules contained in paragraph 5 of Articles 11 and 12. It will ensure that those provisions will not have the unintended effect of subjecting to Australian tax interest or royalties paid by an Australian resident to a Taiwan resident where the interest or royalties are an outgoing wholly incurred by the Australian resident in carrying on business through a permanent establishment outside both territories. Such interest or royalties would not be subject to tax under the provisions of the Australian income tax law (sections 128B and 6C of the ITAA).

- subsections 11ZF(5) and (6) which will allow the Commissioner to amend assessments to give effect respectively to the retrospective operation of Article 8 (Ships and Aircraft) of the agreement and the possible retrospective operation of paragraph 2 of the annex to the agreement.

subsection 11ZF(7) which provides definitions of the terms 'Australian territory' and 'foreign territory' as used in the various subsections of proposed section 11ZF.

The Bill will also make consequential amendments to the ITAA and the *Taxation (Interest on Overpayments and Early Payments) Act 1983*. These amendments reflect the fact that references in those acts to an agreement or to a double tax agreement are currently in terms of the agreement or double tax agreement being between Australia and another country. The agreement between ACIO and TECO does not satisfy this description and, accordingly, the references are being changed to accommodate that agreement.

When will these changes take place?

The agreement will enter into effect on the latest date on which notes are exchanged between ACIO and TECO formally advising of the completion of all the requirements necessary to give the agreement effect in the domestic law of each of the territories to which the agreement applies.

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 agreement will have effect:

- ***in Australia***, for withholding tax, in respect of income, profits or gains derived on or after the first day of the second month next following that in which the agreement enters into effect; and for other Australian taxes covered by the agreement, generally in respect of income, profits or gains of any year of income beginning on or after 1 July in

the calendar year next following that in which the agreement enters into effect.

- ***in Taiwan***, for withholding tax, in respect of income, profits or gains derived on or after the first day of the second month next following that in which the agreement enters into effect; and for other Taiwan taxes covered by the agreement, generally in respect of the year of income beginning on or after 1 January in the calendar year next following that in which the agreement enters into effect.
- ***in both territories***, for tax in relation to profits from shipping and aircraft operations from 1 January 1991; and in respect of income, profits or gains derived by an organisation carrying on activities promoting trade, investment and cultural exchanges between the territories from the dates specified in an exchange of letters by the competent authorities of the territories.

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?

The agreement between ACIO and TECO is primarily concerned with relieving juridical double taxation. This can be described broadly as the situation where the same income derived by a taxpayer during the same period of time is subjected to comparable taxes under the taxation laws of both territories.

Why is the agreement 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. The agreement will, when given effect to by the authorities of both territories, supplement the unilateral double tax relief provisions in each territory's respective domestic law. It will also clarify the taxation position of income flows between Australia and Taiwan.

What is the purpose of the agreement?

The agreement is 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 territories 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 the agreement, 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 Australia and Taiwan 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?

The agreement will appear as a Schedule to the *International Tax Agreements Act 1953* (IntTAA). The IntTAA gives the force of law in Australia to the terms of the agreement. The provisions of the *Income Tax Assessment Act 1936* (ITAA) are incorporated into and read as one with the IntTAA. In any cases of inconsistency, the IntTAA provisions (including the terms of the agreement) generally override the ITAA provisions.

Main features of the agreement

The agreement between ACIO and TECO accords substantially with Australia's recent comprehensive double tax agreements (DTAs).

Under the terms of the agreement:

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

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

Profits from international operations of ships and aircraft may be taxed only in the territory in which the operator is resident for tax purposes.

Dividends, interest and royalties may generally be taxed in both territories, but there are limits on the tax that the territory in which the dividend, interest or royalty is sourced may charge on such income flowing to residents of the other territory who are beneficially entitled to that income. These limits are 12.5 per cent for royalties and 10 per cent for interest. The limit on taxation of dividends flowing from Taiwan is 10 per cent where the dividend recipient is a company that holds directly at least 25 per cent of the capital of the company paying the dividend and 15 per cent in other cases. The limit on taxation of dividends flowing from

Australia is 10 per cent where the dividend is a franked dividend (though, in practice, under existing arrangements no tax will be payable by Taiwan residents on franked dividends) and 15 per cent in respect of unfranked dividends.

Income, profits or gains from the alienation of property may be taxed in full by the territory 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 territory.

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

Income from dependent personal services, that is, employee's remuneration, will generally be taxable in the territory where the services are performed. However, where the services are performed during certain short visits to one territory by a resident of the other territory, the income will generally be exempt in the territory visited.

Public service remuneration paid by an authority administering a territory or part of a territory will generally be taxed only in that territory. However, the remuneration may be taxed in the other territory in certain circumstances where the services are rendered in that other territory.

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

Income derived by entertainers and sportspersons may generally be taxed by the territory in which the activities are performed.

Pensions and annuities (including public service pensions) may be taxed only in the territory of residence of the recipient.

Income of visiting students will be exempt from tax in the territory 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 agreement.

Dual residents (i.e., persons, including companies, who are residents of both Australia and Taiwan according to the domestic law of each territory) are, in accordance with specified criteria, to be treated for the purposes of the agreement as being residents of only one territory.

Double taxation relief for income which under the DTA may be taxed by both territories is required to be provided by the territory in which the taxpayer is resident under the terms of the agreement as follows:-

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

In the case of Australia, effect will be given to the double tax relief obligations arising under the agreement by application of the general foreign tax credit system provisions of Australia's domestic law, or relevant exemption provisions of the law where applicable.

Agreement Between ACIO and TECO

Article 1 - Personal Scope

Scope

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

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

Article 2 - Taxes Covered

Taxes covered

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

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

For Taiwan the agreement applies to:

- the profit seeking enterprise income tax; and
- the individual consolidated income tax.

Substantially similar taxes

The application of the agreement will be automatically extended to any identical or substantially similar taxes which are subsequently imposed by either territory in addition to, or in place of, the existing taxes. The competent authorities will notify each other as soon as is

practicable of any substantial changes which have been made in the taxation laws of their respective territories.

Article 3 - General Definitions

Definition of 'territory'

'Territory' is defined by reference to subparagraphs 1(a) and 1(b) of Article 2 and means, as the case requires, either:

- the territory in which the taxation law administered by the Australian Taxation Office is applied; or
- the territory in which the taxation law administered by the Department of Taxation, Ministry of Finance, Taipei is applied.

Reference to 'the territory in which the taxation law administered by the Australian Taxation Office is applied' means that the agreement will apply geographically to all parts of Australia to which the ITAA and other taxation laws administered by the Australian Taxation Office extend 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 of shipping profits in accordance with Article 8 of the agreement.

Reference to 'the territory in which the taxation law administered by the Department of Taxation, Ministry of Finance, Taipei is applied' should ensure that the agreement applies only to the geographic area in which Taiwan can, as a matter of practicality, enforce its taxation laws.

[Subparagraph 1(a)]

Definition of 'tax'

For the purposes of the agreement, the term 'tax' means tax imposed under the law of a territory to which the agreement applies by virtue of Article 2 of the agreement but does not include any amount of penalty or interest imposed under the respective domestic law of the two territories. This is important in determining a taxpayer's entitlement to a foreign tax credit under the double tax relief provisions of Article 22 of the agreement.

[Subparagraph 1(e)]

In the case of a resident of Australia, any penalty or interest component of a liability determined under the domestic taxation law of Taiwan with respect to income that Taiwan is entitled to tax under the agreement, would not be a creditable 'tax' for the purposes of Article 22 of the agreement. 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 22 (pursuant to Division 18 of Part III of the ITAA - Credits in Respect of Foreign Tax).

Terms not specifically defined

Where a term is not specifically defined within the agreement, 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 territory at the time of applying the agreement, with the meaning it has under the taxation law of the territory having precedence over the meaning it may have under other domestic laws.

The relevant time for drawing upon the domestic meaning of the term used in the agreement will be the time which is relevant for purposes of the claim itself, that is, according to the meaning the term has under the law applicable to the claim for the relevant tax year.

If a term is not defined in the agreement, 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.

It should be noted that Article 3(2) 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 2]

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 agreement. Residential status is one of the criteria for determining each territory's taxing rights and is a necessary condition for the provision of relief under the agreement. The concept of resident according to each territory's taxation law provides the basic test.

A person is not a resident of Australia for the purposes of the agreement if that person is liable to tax in Australia in respect only of income from sources in Australia. The provision means that Norfolk Island 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, Taiwan will not have to forgo tax in accordance with the agreement on income derived by residents of Norfolk Island from sources in Taiwan (which will not be subject to Australian tax).

[Paragraph 2]

Dual Residents

The article also includes a set of 'tie-breaker' rules for determining how residency is to be allocated to one or other of the territories for the purposes of the agreement 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 territories.

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

[Paragraph 3]

Example

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

For the categories of income which under the agreement remain taxable in both territories, the obligation to provide double tax relief placed by Article 22 (Elimination of Double Taxation) on the territory in which the taxpayer is resident for tax purposes would in the example rest with Taiwan.

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

Note

Article 21 (Other Income) would operate in relation to the dual resident referred to in the example above as if that person were a resident of Taiwan. This would preclude Australia from taxing items of income not dealt with by another article of the agreement, where the income is derived from sources in Taiwan or from sources outside both Australia and Taiwan 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 territories 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 agreement, 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.

In circumstances where the dual resident is a company the agreement provides that, for the purposes of the agreement, the company will be deemed to be a resident of the territory in which the company is incorporated.

[Paragraph 4]

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 territory has a 'permanent establishment' in the other, and if so, whether income derived by the person in the other territory is attributable or effectively connected with that 'permanent establishment'. The definition of the term 'permanent establishment' in this article 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 elaborate on the meaning of the term by giving examples (by no means intended to be exhaustive) of what may constitute a 'permanent establishment', such as:

- an office;
- a workshop; or

  a mine.

Agricultural, Pastoral or Forestry Activities

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. This position is also recognised in the agreement between ACIO and TECO.

In the OECD Model Convention on Income and on Capital income from agricultural or forestry pursuits is subject to taxation at source under Article 6 (Income from Real Property).

Australia's approach, and the approach adopted in this agreement, is consistent with the retention of taxing rights at source over income from real property 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 agreement that generally apply in relation to these income items. This approach also ensures that the arm's length tests provided for in Article 7 (Business Profits) apply to the determination of the profits derived from these activities.

[Subparagraph 2(g)]

Building sites

The agreement makes it clear that a building site, or a construction, installation or assembly project will constitute a permanent establishment where it is in place for more than 6 months. Whether such a site or project that is in place for less than 6 months constitutes a permanent establishment within the primary meaning of paragraph 1 remains to be decided on the facts and circumstances of the particular cases.

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 (but refer the note below concerning supervisory activities).

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.'

[Subparagraph 2(h)]

Furnishing of Services

The agreement provides that the furnishing, by an enterprise of one territory, of services including consultancy services, will constitute a permanent establishment in the other territory where those activities continue (for the same or a connected project) within the latter territory for a period or periods aggregating more than 120 days within any 12 month period.

[Subparagraph 2(i)]

Deemed Permanent Establishments

The agreement provides that an enterprise is deemed to have a permanent establishment in a territory and to carry on business through that permanent establishment in certain circumstances. The circumstances in which this is the case are where supervisory activities are being performed in a territory and where substantial equipment is being used in a territory.

(1) Supervisory activities

For supervisory activities to be deemed to be a permanent establishment they must be carried on for more than 6 months in connection with a building site (or a construction,

installation or assembly project) which is being undertaken in a territory.

[Subparagraph 4(a)]

(2) Substantial equipment

A permanent establishment will be deemed to exist in a territory where substantial equipment is being used in that territory by, for or under contract with, the enterprise and the use continues for more than 3 months.

One effect of this provision 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(b)]

Cost-toll situations

'Cost-toll' situations are where, 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 produce 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, the agreement 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 provision makes it more difficult for an enterprise which carries on very substantial manufacturing or processing activities in one territory through an intermediary to claim that it does not have a permanent establishment in that territory.

The inclusion of this subparagraph is insisted upon by Australia in its DTAs and is consistent with Australia's policy of retaining taxing rights over exploitation of its mineral resources.

[Subparagraph 5(b)]

Other Provisions of this Article

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

Application of Permanent Establishment Principles to Other Articles

The principles set down in this article are also to be applied in determining whether a person from outside both territories has a permanent establishment in one of the territories when applying the source rule for interest and royalties income contained in:

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

[Paragraph 8]

Article 6 - Income From Real Property

Where income from real property is taxable

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

[Paragraph 1]

Income from real property

Income from real property is effectively defined as extending, in the case of Australia, to:

- the direct use, letting or use in any other form of real property and any other interest in or over land; 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.

In the case of Taiwan, real property is generally defined as immovable property and includes:

- property accessory to immovable property;
- rights to which the general law in respect of landed property applies; and
- usufruct of immovable property and rights to variable and fixed payments as consideration for the exploitation of or the right to explore for or exploit, or in respect of exploitation of, mineral deposits, sources and other natural resources.

[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 territory in which the real property is situated may impose tax on the income derived from that property by:

an enterprise of the other territory; or

- an independent professional person resident in that other territory,

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 territory.

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 territory from sources in the other territory.

The taxing of these profits depends on whether they are attributable to a 'permanent establishment' in that other territory. If a resident of one territory carries on business through a 'permanent establishment' (as defined in Article 5) in the other territory, the territory 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 territory carries on a business through an enterprise that does not have a 'permanent establishment' in the other territory, the taxpayer will not be liable to tax in the other territory on the business profits of that enterprise.

[Paragraph 1]

Determination of business profits

Profits of a 'permanent establishment' are to be determined for the purposes of the Article on the basis of arm's length dealing. The provisions in the agreement correspond to comparable provisions in Australia's DTAs.

[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 domestic law of the territory in which the profits are sourced (e.g. Division 13 of the ITAA) where, due to inadequate information, the correct amount of profits attributable on the arm's length principle basis to a 'permanent establishment' cannot be determined or can only be ascertained with extreme difficulty.

[Paragraph 5]

Income or gains dealt with under other articles

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

[Paragraph 6]

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 where the income is effectively connected with a permanent establishment or fixed base).

Insurance with non-residents

Each territory 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 territory at the date of signature of the agreement is varied (otherwise than in minor respects so as not to affect its general character), the parties to the agreement shall consult each other with a view to agreeing to any amendment of the 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).

[Paragraph 7]

Trust beneficiaries

The principles of the article will apply to business profits derived by a resident of one of the territories (directly or through one or more interposed trust estates) as a beneficiary of a trust estate.

[Paragraph 8]

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 Taiwan is beneficially entitled under the trust estate. Paragraph 8 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.

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 business; or
- an international operating agency,

is generally reserved to the territory in which the operator is a resident for tax purposes.

The article also extends to profits derived from the lease of ships or aircraft on a full time, voyage or bareboat basis, and of containers and related equipment where the lease of the containers and related equipment is incidental to the international operation of the ships or aircraft. The article only extends to such profits, however, where the lessee operates the ships or aircraft in international traffic or the containers and related equipment are so used.

Internal traffic

Any profits derived by a resident of one territory from internal traffic in the other territory (i.e. from operations confined solely to places in the other territory) may be taxed in that other territory.

By reason of the definition of 'territory' 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) 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 Taiwan and Sydney) at Cairns for delivery to Brisbane, would be profits from internal traffic. As such, 5 per cent of the amount paid in respect of the internal traffic carriage would be deemed to be taxable income of the operator for Australian tax purposes pursuant to Division 12 of Part III of the ITAA.

Retrospective Operation

The allocation of taxing rights that this article provides for will apply in relation to relevant profits derived on or after 1 January 1991 - refer Article 25 (Entry into Effect).

Article 9 - Associated Enterprises

Re-allocation of profits

This article authorises the re-allocation of profits between related enterprises in Australia and Taiwan 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 territory retains the right to apply its domestic law relating to the determination of the tax liability of a person (e.g. Division 13 of the ITAA) to its own enterprises, provided that such provisions are applied, so far as it is practicable to do so, consistently with the principles of the article.

[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.

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 territory 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 territory. To avoid this result, the other territory 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 territory 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 territory. If necessary, the competent authorities of Australia and Taiwan will consult with each other to determine the appropriate adjustment.

Article 10 - Dividends

This article broadly allows both territories to tax dividends flowing between them but in general limits the tax that the territory in which the income is sourced may impose on dividends payable by companies that are residents of that territory under its domestic law to beneficial owners resident in the other territory.

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 Taiwan from 30 per cent to 15 per cent of the gross amount of the dividends.

The agreement provides that the tax in Australia on franked dividends will not exceed 10 per cent of the dividend. However, franked dividend payments will remain free of withholding tax under Australia's current domestic law.

The rate of withholding tax to be imposed by Taiwan on outgoing dividends is limited to 10 per cent of the dividends where the dividends are paid to a company resident in Australia and that company holds directly 25 per cent of the capital of the company paying the dividends. In other cases the agreement provides that Taiwan will generally limit its tax to 15 per cent of the dividend.

[Paragraph 2]

Exception to limitation

The limitation on the tax of the territory in which the dividend is sourced does not apply to dividends derived by a resident of the other territory who has a 'permanent establishment' or 'fixed base' in the territory 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 full rate of tax applicable in the territory in which the dividend is sourced (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 territory of taxing rights over dividend income is precluded by providing, broadly, that one territory (the first territory) will not tax dividends paid by a company resident solely in the other territory, unless:

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

[Paragraph 5]

However, the exemption is specified as not applying where the dividend paying company is a dual resident. This proviso ensures that Australia retains the right to tax dividends paid to a person resident outside of both territories by a company which is a resident of Australia under its domestic law notwithstanding that the company is deemed to be a resident of Taiwan for the purposes of the agreement pursuant to the dual resident "tie-breaker" test for companies contained in Article 4.

Article 11 - Interest

Rate of tax

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

[Paragraphs 1 and 2]

The limitation of the tax rate in the territory in which the interest is sourced 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.

[Paragraph 3]

Interest effectively treated as business profits

Interest derived by a resident of one territory which is effectively connected with a 'permanent establishment' or 'fixed base' of that person in the other territory 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 tax rate limitation does not apply to such interest in the territory in which the interest is sourced.

[Paragraph 4]

Deemed source rules

Interest 'source' rules are set out in the article. Those rules operate to allow Australia to tax interest to which a resident of Taiwan is beneficially entitled where the interest is paid by a resident of Australia. Australia may also tax interest paid by a resident of Taiwan to which another Taiwan 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.

These source rules have to be read in conjunction with the subsection (subsection 11ZF(4)) to be inserted into the IntTAA. Consistent with Australia's domestic interest withholding tax rules, the subsection will have the effect of not subjecting interest to Australian withholding tax where the interest is paid by an Australian resident to a resident of Taiwan and the interest is effectively connected with a business carried on through a permanent establishment or a fixed base of the Australian resident outside Australia.

[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 tax rate limitation applicable in the territory in which the interest is sourced to the amount of the interest which it might be expected would have been agreed upon if the parties to the loan agreement were dealing with one another at arm's length. Any excess part of the interest remains taxable according to the domestic law of each territory but subject to the other articles of the agreement.

[Paragraph 6]

Article 12 - Royalties

Rate of tax

The article in general allows both territories to tax royalty flows but limits the tax of the territory in which the royalty is sourced to 12.5 per cent of the gross amount of royalties paid or credited to beneficial owners resident in the other territory.

[Paragraphs 1 and 2]

The 12.5 per cent rate limitation is not to apply to natural resource royalties, which, in accordance with Article 6, are to remain taxable in the territory in which they are sourced without limitation of the tax that may be imposed.

In the absence of the agreement, Australia's withholding tax on royalties paid to Taiwan residents would apply at the rate of 30 per cent of the gross amount of the royalties.

Definition

The definition of 'royalties' in the agreement 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)]

Payments for services rendered are to be treated under the Independent Personal Services Article (Article 14) or the Business Profits Article (Article 7).

Other Royalties effectively treated as Business Profits

As in the case of interest income, it is specified that the 12.5 per cent tax rate limitation will not apply to royalties effectively connected with a 'permanent establishment' or 'fixed base' in the territory in which the income is sourced.

[Paragraph 4]

Deemed source rule

The royalties 'source' rule provided for in the agreement 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).

These source rules have to be read in conjunction with the subsection (subsection 11ZF(4)) to be inserted into the IntTAA. Consistently with Australia's domestic royalty withholding tax rules, the subsection will have the effect of not subjecting royalties to Australian withholding tax where the interest is paid by an Australian resident to a resident of Taiwan and the royalties are effectively connected with a business carried on through a permanent establishment or fixed base of the Australian resident outside Australia.

[Paragraph 5]

Related persons

If royalties flow between related persons, the 12.5 per cent tax rate limitation in the territory in which the royalty is sourced 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 territory but subject to the other articles of the agreement.

[Paragraph 6]

Article 13 - Alienation Of Property

Taxing rights

This article allocates between the respective territories 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 territory 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 territory 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.

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 territory in which the operator of the ships or aircraft is resident. 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 3]

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 territory in which the real property is situated.

[Paragraph 4]

Capital gains

The article contains a sweep-up provision in relation to capital gains which enables each territory 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 territory 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 21, which contains sweep-up provisions in relation to items of income not dealt with in other articles of the agreement.

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 territories, the territory in which the person deriving the income or gain is a resident (as determined in accordance with Article 4) would be obliged by Article 22 to provide double tax relief for the tax imposed by the other territory.

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 territory in which the services or activities are performed if the recipient has a fixed base regularly available in that territory for the purposes of performing his or her activities.

If this condition is met the territory in which the services or activities are performed will be able to tax so much of the income as is attributable to the activities that are exercised from that fixed base.

If there is no fixed base, the income will be taxed only in the territory in which the recipient is resident.

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 (Directors' Fees);
- Article 18 (Pensions and Annuities); and
- Article 19 (Public Service)

of the agreement.

Generally, salaries, wages and similar remuneration derived by a resident of one territory from an employment exercised in the other territory will be liable to tax in that other territory. However, subject to specified conditions, there is a conventional provision for exemption from tax in the territory 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 territory 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 territory being visited; and
- the remuneration is subject to tax in the territory in which the recipient is resident.

Where all of these conditions are met, the remuneration so derived will be liable to tax only in the territory in which the recipient is resident.

[Paragraphs 1 and 2]

Employment on a ship or aircraft

Income from an employment exercised aboard a ship or aircraft operated in international traffic shall be taxed only in the territory in which the operator of the ship or aircraft is resident.

[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 Taiwan may be subject to tax in Taiwan. However, the article does not allocate sole taxing rights to Taiwan 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 agreement allows both territories to tax a category of income, Australia would be required in this situation (pursuant to Article 22), as the territory in which the income recipient is resident for tax purposes, to relieve the double taxation that would otherwise occur.

Although that article 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 Taiwan 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 the foreign service income provisions of

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 - Directors' Fees

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

Article 17 - Entertainers and Sportspersons

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 territory 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 territory.

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

[Paragraph 2]

Article 18 - Pensions And Annuities

Pensions and annuities are to be taxed only by the territory in which the recipient is resident.

[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.

Article 19 - Public Service

Salary and wage income

Salary and wage type income, other than a pension or annuity, paid to an individual for services rendered to an authority administering a territory or a subdivision of that territory or a local authority of the territory, is to be taxed only in that territory. However, such remuneration is to be taxable only in the other territory if:

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

[Paragraph 1]

Trade or business income

Remuneration for services rendered in connection with a trade or business carried on by any authority referred to in paragraph 1 of the article is excluded from the scope of this article. This remuneration will remain subject to the provisions of Article 15 (Dependent Personal Services) or Article 16 (Directors' Fees) as the case may be.

[Paragraph 2]

Article 20 - Students

Exemption from tax

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

The exemption from tax provided by the visited territory 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 territory.

Employment income

Where however, a student from Taiwan 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 for 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 21 - Other Income

Allocation of taxing rights

This article provides rules for the allocation between the two territories of taxing rights to items of income not dealt with in the preceding articles of the agreement. The scope of the article is not confined to such items of income arising in one of the territories; it extends also to income from sources outside both territories.

Broadly, such income derived by a resident of one territory is to be taxed only in the territory in which the person is resident for tax purposes unless it is derived from sources in the other territory, in which case the income may also be taxed in the other territory. Where this occurs, the territory in which the recipient of the income is resident will be obliged by Article 22 (Elimination of Double Taxation) to provide double taxation relief.

[Paragraphs 1 and 2]

This article does not apply to income effectively connected with a 'permanent establishment' or 'fixed base' derived by a resident of a territory in the other territory. In such a case, Article 7 (Business Profits) or Article 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 territory. 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 territory in which the recipient is resident is effectively connected is effectively connected with a 'permanent establishment' or 'fixed base' in the other territory. In these circumstances Articles 7 and 14 would allocate a taxing right to the territory 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 territory in which the property is situated. This provision ensures that this policy applies in relation to the situation outlined.

[Paragraph 3]

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 22 - Elimination Of Double Taxation

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

- for the income to be taxed only in one territory; or
- where the domestic taxation law of one of the territories 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 terms of the agreement, remain subject to tax in both territories. Australia's DTAs provide for a credit basis for the relief of double taxation to be applied by Australia and, usually, the other DTA partner. In these cases, the DTA partner in which the recipient of the income is resident is required to give credit against its tax for the tax of the DTA

partner in which the income is sourced. The article in this agreement reflects that approach.

Australia's obligation under the Article is to relieve double taxation by allowing a credit against its own tax for Taiwan tax paid under the law of Taiwan and in accordance with the agreement on income derived by a resident of Australia from sources in Taiwan.

Australian method of relief

Australia's general foreign tax credit system, together with the terms of this article and of the agreement generally, will form the basis of Australia's arrangements for relieving a resident of Australia from double taxation on income arising from sources in Taiwan.

Accordingly, effect is to be given to the tax credit relief obligation imposed by this article in Australia by applying 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 Taiwan 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 this 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 Taiwan.

Accruals system

It is also relevant that Taiwan 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 Taiwan 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 23 - Mutual Agreement Procedure

Consultation

One of the purposes of this article is to provide for consultation between the competent authorities of the two territories 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 agreement.

Time limits

A person wishing to use this procedure must present a case to the competent authority of the territory 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 by the competent authority or the competent authorities, a solution is reached, it may be implemented irrespective of any time limits imposed by domestic tax law of the relevant territory.

[Paragraph 2]

Resolution of difficulties

The article also authorises consultation between the competent authorities of the two territories 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 24 - 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 agreement or for the administration of domestic laws concerning the taxes to which the agreement 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 of the agreement as 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 DTAs. Any information received by a territory shall be treated as secret in the same manner as information obtained under the domestic law of that territory.

[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 25 - Entry Into Effect

Date of entry into effect

This article provides for the entry into effect of the agreement. This will be on the last date on which the Australian Commerce and Industry Office or the Taipei Economic and Cultural Office notifies the other in writing that the last of such things has been done is necessary to give the agreement effect in the domestic law of the respective territories. In Australia, enactment of legislation giving the force of law in Australia to the agreement is the necessary prerequisite to the exchange of notices in writing.

Withholding tax

Once it enters into effect, the agreement will have effect in Australia for purposes of withholding taxes in respect of income, profits or gains derived on or after the first day of the second month next following that in which the agreement enters into effect.

Other taxes

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

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 of income beginning on 1 July of the calendar year next following the calendar year in which the

agreement enters into effect will be subject to the agreement for purposes of other Australian tax.

Date of effect in Taiwan

Once it enters into effect, the agreement will have effect in Taiwan for purposes of withholding taxes in respect of income, profits or gains derived on or after the first day of the second month next following that in which the agreement enters into effect.

Other taxes

In respect of other Taiwan tax, the agreement will first have effect in Australia in relation to profits, income or gains of the Taiwan year of income beginning on or after 1 January in the calendar year next following the calendar year in which the agreement enters into effect.

Retrospective Application

Profits which fall to be taxed under Article 8 (Ships and Aircraft) will, in both territories, be taxed in the manner specified in that Article where those profits are derived on or after 1 January 1991.

Article 26 - Termination

By this article the agreement is to continue in effect indefinitely. However, an authority administering either territory may give notice in writing of termination on or before 30 June in any calendar year beginning after the expiration of five years from the date of the entry into effect of the agreement

In that event, the agreement would cease to be effective in both territories for purposes of withholding tax in respect of income, profits or gains derived on or after the first day of the second month next following that in which the notice of termination is given.

Cessation in Australia

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 Taiwan

It would correspondingly cease to be effective in Taiwan in respect of other Taiwan tax for income, profits or gains of any year of income beginning on or after 1 January in the calendar year next following that in which the notice of termination is given.

Annex to the Agreement

The Annex deals with two matters.

Non-Discrimination

The first matter is in relation to the absence from this agreement, consistent with Australia's current tax treaty policy, of a non-discrimination article. The Annex provides that if Australia should negotiate a non-discrimination article in a subsequent agreement which is given effect to under the *International Tax Agreements Act 1953*, then the parties to this agreement will enter into negotiations with a view to providing in this agreement the same treatment as is provided for in the subsequent agreement.

Income of Certain Organisations

The second matter provides for the competent authorities of the two territories, by an exchange of letters, to nominate that an organisation, or its successors, being an organisation that carries on activities promoting, trade, investment and cultural exchanges between the two territories, be only subject to tax in the territory on whose behalf the activities are carried out.

For these purposes the competent authorities can also nominate the date from which such taxation treatment will apply. This includes the possibility of specifying a date prior to the date on which the agreement and the Annex, which forms part of it, enters into effect.

Index

TAXATION LAWS AMENDMENT (INTERNATIONAL TAX AGREEMENTS) BILL 1996

Printed by Authority by the Commonwealth Government Printer