

2022-2023-2024

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL
2022: ADJUSTMENT TO TAX ON CERTAIN PAYMENTS OR CREDITS PAID
TO INDIAN FIRMS

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

This Explanatory Memorandum uses the following abbreviations and acronyms.

Abbreviation	Definition
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
Agreements Act	<i>International Tax Agreements Act 1953</i>
Indian Agreement	<i>Agreement between the Government of Australia and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (signed at Canberra, 25 July 1991) [1991] ATS 49 (entered into force on 30 December 1991), as amended by the Indian protocol (No. 1)</i>

Chapter 1: Adjustment to tax on certain payments or credits paid to Indian Firms

Outline of chapter

- 1.1 Schedule # amends the Agreements Act to stop Australian taxation on income of non-resident Indian firms providing technical services remotely (not through a permanent establishment) to Australian customers that are covered by Article 12(3)(g) of the Indian Agreement, that is a not a royalty within the meaning of the ITAA 1936, and that is only taxable in Australia because of the operation of Article 12(3)(g) and Article 23 of the Indian Agreement, as given effect by the Agreements Act.
- 1.2 Unless otherwise stated, all treaty references in this chapter are to the Indian Agreement. Any references to providing technical services remotely means services not provided through a permanent establishment. In addition, all references to payments or credits in this chapter are to payments and credits that are not royalties within the meaning of the ITAA 1936.

Context of amendments

- 1.3 Currently, Australia is taxing payments or credits paid to non-resident Indian firms by Australian customers for technical services covered by Article 12(3)(g) that are provided remotely. Australia taxes these payments or credits of non-resident Indian firms due to operation of both the royalty definition and the Source Article (Article 23) under the Indian Agreement, which were included when it was first agreed in 1991.
- 1.4 Following extensive negotiations in 2021 and 2022, as part of the AI-ECTA, the Australian Government agreed to stop the taxation of payments or credits paid to non-resident Indian firms by Australian customers for technical services covered by Article 12(3)(g) that are provided remotely. This commitment was reflected through an exchange of side letters on 2 April 2022 between the then Minister for Trade, Tourism and Investment and their Indian counterpart. The Australian Government agreed to implement this legislative change in a similar time frame to the implementation of the AI-ECTA, an interim agreement.

Comparison of key features of new law and current law

Table 1.1 Comparison of new law and current law

New law	Current law
Payments or credits paid to non-resident Indian firms by Australian customers for technical services provided remotely that are covered by Article 12(3)(g) of the Indian Agreement, are not subject to tax in Australia	Payments or credits paid to non-resident Indian firms by Australian customers for technical services provided remotely that are covered by Article 12(3)(g) of the Indian Agreement, are subject to tax in Australia

Detailed explanation of new law

- 1.5 Currently, payments or credits paid to non-resident Indian firms by Australian customers for technical services provided remotely are taxable in Australia through the interaction between the ITAA 1936, the ITAA 1997, the Agreements Act and the Indian Agreement. Specifically, these payments or credits are taxable because:
- they are covered by Article 12(3)(g); and
 - they are considered to be sourced in Australia because of the operation of Articles 12 and 23, as given effect by sections 4 and 5 of the Agreements Acts; and
 - paragraph 6-5(3)(a) of the ITAA 1997 includes the amounts in assessable income.
- 1.6 These payments or credits are taken to have an Australian source by reason of the Source Article (Article 23) which deems an Australian source for royalties in Article 12(3)(g) for the purposes of Australian law relating to its tax and the Agreements Act, which gives effect to the provisions of the Indian Agreement. Consequently, this income is assessable income under section 6-5 of the ITAA 1997 as being Australian sourced income of a non-resident. Without these provisions in the Indian Agreement, Australia would not tax these payments or credits.
- 1.7 New section 11J of the Agreements Act will stop the Australian taxation on payments or credits paid to non-resident Indian firms by Australian customers for technical services covered by Article 12(3)(g) that are provided remotely if three criteria are met.

[Schedule #, item 3, section 11J of the International Tax Agreements Act 1953]

- 1.8 Firstly, the payments or credits have to be paid or credited to a non-resident Indian firm as consideration for a service covered by Article 12(3)(g). Article 12(3)(g) covers services (including those of technical or other personnel) which make available technical knowledge, experience, skill, know-how or processes or consists of the development and transfer of a technical plan or design.
- 1.9 The Income Tax (International Agreements) Amendment Bill (No. 2) 1991 amended domestic legislation to give force to the Indian Agreement. The Explanatory Memorandum to that Bill outlines broadly the types of technical service covered in Article 12(3)(g). ‘Technical service’ is intended to cover services of a technical nature, which is made available to the person acquiring the service through the supply or transfer or transfer of technical knowledge or technology. The typical categories of services intended to be covered by Article 12(3)(g) include:
- engineering services;
 - architectural services; and
 - computer software development.

[Schedule #, item 3, subsection 11J(a) of the International Tax Agreements Act 1953]

- 1.10 Secondly, these payments or credits are not royalties within the meaning of the ITAA 1936. The effect is that an amount that is a royalty under the ITAA 1936 is not affected by the amendments and therefore continues to be subject to taxation in Australia. The definition of “royalties” contained in Article 12(3)(g) is different from the definition in Australia’s domestic income tax law and other tax treaties in that it includes payments or credits for certain technical and consultancy services. If a payment or credit is covered by Article 12(3)(g) and is also considered a ‘royalty’ under the ITAA 1936, then the amendment will not apply and this payment or credit will continue to be subject to Australian tax.

[Schedule #, item 3, subsection 11J(b) of the International Tax Agreements Act 1953]

- 1.11 Thirdly, these payments or credits must only be subject to Australian tax because of the operation of Article 12(3)(g) and Article 23, as given effect by the Agreements Act. If there are amounts that are covered or dealt with by another article of the Indian Agreement, these amounts would continue to be subject to Australian tax. For example, if a technical service is provided in Australia through a permanent establishment of an Indian resident, the amendment does not apply in respect of an amount that Australia has a right to tax under another article, such as the Business Profits Article (Article 7) due to being attributable to that permanent establishment in Australia.
- 1.12 If Australia can tax these payments or credits outside of the operation Article 12(3)(g) and Article 23, then Australia continues to retain and exercise this taxing right.

[Schedule #, item 3, subsection 11J(c) of the International Tax Agreements Act 1953]

Example 1.1 Technical service that will not be subject to Australian tax

An Australian resident for tax purposes owns inventory control software for use in its own chain of retail outlets throughout Australia. It expands its sales operation by employing a team of travelling salespeople to travel around the countryside selling the company's wares. It wants to modify its software to permit salesperson to access its central computers for information on what products are available in inventory and when they can be delivered. It hires a computer programming firm that is a resident of India for tax purposes to modify its software for this purpose.

The payments which the Australian resident pays are royalties within the meaning of Article 12(3)(g). The Indian firm performs a technical service for the Australian company remotely, and it transfers to the Australian company the technical plan (i.e. the computer program) which it has developed for that company.

This payment is not subject to Australian tax because it satisfies the three criteria in section 11J.

Consequential amendments

- 1.13 Consequential amendments are made to the Agreements Acts by amending subsection 5(1) to include "section 11J" in the table item dealing with the Indian Agreement and the table item dealing with the India protocol (No. 1).

[Schedule #, items 1 and 2, subsection 5(1) of the International Tax Agreements Act 1953]

Commencement, application, and transitional provisions

- 1.14 The amendments made by this schedule will commence on the later of the day this Act receives Royal Assent and the day the AI-ECTA signed at Melbourne and New Delhi on 2 April 2022, enters into force for Australia. However, the provisions do not commence at all if the AI-ECTA does not enter into force. The Minister must announce, by notifiable instrument, the day the Agreement enters into force for Australia.
- 1.15 The amendments made by this Schedule apply in relation to assessments for years of income starting on or after the commencement of this Schedule.

[Schedule #, item 4]