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Our ref Expansion of Australia's tax treaty network- KPMG submission
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Expansion of Australia's tax treaty network

KPMG Australia (**KPMG**) appreciates the opportunity to provide a submission to Treasury in relation to the expansion of Australia's tax treaties network.

Tax treaties play a critical role in facilitating Australian trade and commerce and improving tax system integrity. KPMG is supportive of and commends the Government's endeavours over recent years to expand and enhance Australia's tax treaties.

Given the number of negotiations planned or ongoing under existing tax treaty programs[1], we recommend the Government focus its efforts and resources on countries who are Australia's major trading partners or countries from where there are substantial investment flows.

In this regard, the Government should prioritise negotiations with Luxembourg given its large foreign investment in Australia (noting this investment is largely though Luxembourg funds) and its significance as a financial services centre[2]. We are also pleased that the Government is entering into negotiations with emerging trade partners such as Brazil.

In relation to Australia's existing tax treaties, the Government should prioritise older tax treaties with key countries. The aim should be to ensure these treaties are modernised with contemporary concepts and with consistency across treaties where possible, to ensure Australia's tax treaty network continues to appropriately facilitate trade and commerce with our major trading partners as well as supporting increasing global mobility.

We outline select examples below of potential inadequacies in Australia's tax treaties, which can result in double taxation, unintended consequences and a lack of certainty.

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[1] Expanding Australia's Tax Treaty Network | Treasury.gov.au; Tax treaty network expansion | Treasury.gov.au; Expansion of Australia's tax treaty network | Treasury.gov.au
[2] Luxembourg is Australia's eighth largest investor, valued at $89 billion in 2022, with foreign direct investment in Australia valued at $9 billion: Luxembourg country brief | Australian Government Department of Foreign Affairs and Trade (dfat.gov.au)

These would be addressed by updating the treaties in line with Australia's modern tax treaties.[3]

- Fiscally transparent entities – a transparent entity clause should be included in all tax treaties. Several of Australia's treaties with key trading partners, such as the South Korea tax treaty does not have such a clause, and while not on the tax treaty program, the Indian and Canadian treaties also do not include this clause. We consider the wording in paragraph 2 of Article 1 of Australia's modern tax treaties to work well.
- Superannuation entities and pension funds – several tax treaties (e.g. South Korea) should be updated on a consistent basis to ensure these entities are persons for treaty purposes or can access the treaties (e.g. by way of a 'recognised pension fund' definition). This is important for Australian superannuation entities so that they are not impeded from outbound investment. While not on the tax treaty program, the United States (**US**) tax treaty should also be updated in this regard.
- Pension schemes – there should be clear provision made in all Australian tax treaties for the treatment of individuals' superannuation to enhance workforce mobility. Again, while not on the tax treaty program, the US taxation of Australian superannuation during accumulation is a significant matter and an impediment to workforce mobility between Australia and the US. The Pension Schemes article (Article 8) in the United Kingdom-US tax treaty is a good example of what is needed to address this.
- Financial institution interest withholding tax exemption – the absence of this exemption in many treaties can prevent Australian businesses from accessing foreign capital, and it would be beneficial for a consistent, modern clause to be applied to all new treaties.
- Residency – we consider the New Zealand (**NZ**) tax treaty should revert to a self-assessed determination of residency for dual residents, rather than the competent authority (**CA**) determination which is required following implementation of the Multilateral Instrument (**MLI**). Please refer to the **Appendix** for further discussion on this matter.
- Air Transport – the new Brazil tax treaty should include a Shipping and Air Transport article, consistent with Article 8 of Australia's modern tax treaties. The inclusion of Article 8 will ensure that the profits from the operation of ships or aircraft in international traffic will be taxed in one State alone. Further, given there has been uncertainty regarding taxing rights over airline profits in Brazil for many years, it would be reasonable for Article 8 to have retrospective application.[4]

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[3] Germany, Israel, Iceland.
[4] While retrospectivity in tax treaties is rare, there is precedent for this. In the Australia/Taiwan tax treaty, the airline profit article applied retrospectively from 1991, with the remainder of the treaty applying from

- Following the introduction of the _Treasury Laws Amendment (Foreign Investment) Act 2024_, Australia should confirm whether, on a bilateral basis, relevant countries are in agreement with Australia's new domestic law position in relation to the types of taxes that should or should not be covered by existing non-discrimination articles. The Australian tax treaties that have a non-discrimination article include Finland, South Africa, Japan, New Zealand, Norway, India, Switzerland, and Germany.

Finally, in keeping with the focus on key countries, we urge the Government to prioritise negotiations with Hong Kong given the significant economic relationship and Hong Kong's importance in the Asia Pacific region. It is worth noting that Hong Kong has made significant efforts to comply with international tax standards over recent years and has now been removed from the European Union's list of non-cooperative jurisdictions for tax purposes. Hence, a reassessment of treaty negotiations would be timely.

For completeness, the tax treaties published by Treasury[5] should include the MLI synthesised versions (currently only published by the Australian Taxation Office (**ATO**)).

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Please contact us if you have questions in relation to this submission.

Yours faithfully

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Yours faithfully

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1996. The Australia/ Italy Airline Profit Agreement also includes application of the agreement on a retrospective basis (entry into force in 1976 but has effect from 1966).

[5] [Income Tax Treaties | Treasury.gov.au]

Appendix

NZ Tax Treaty - Article 4 Resident

Background

The NZ Tax Treaty previously provided a self-assessed "tie-breaker" test where a person other than an individual is, prima facie, a resident in both Australia and NZ. Article 4 previously stated the following at paragraph 3:

> "*3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States,* ***then it shall be deemed to be a resident only of the State in which its place of effective management is situated*** [emphasis added]*. If the State in which the place of effective management is situated cannot be determined, or the place of effective management is in neither State, then the competent authorities of the Contracting States shall endeavour to determine by mutual agreement in accordance with Article 25 the Contracting State of which the person shall be deemed to be a resident for the purposes of the Convention, having regard to its places of management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention.*"

Following the implementation of the MLI (which entered into force on 1 January 2019 for Australia and 1 October 2018 for NZ), the NZ Tax Treaty provides a different approach, namely a CA determination to resolve the dual residency of the person. Article 4 now provides the following:

> "*Where by reason of the provisions of [the Convention] a person other than an individual is a resident of both [Contracting States],* ***the competent authorities of the [Contracting States] shall endeavour to determine by mutual agreement*** [emphasis added] *the [Contracting State] of which such person shall be deemed to be a resident for the purposes of [the Convention], having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by [the Convention].*"

KPMG comments

We strongly recommend that the NZ Tax Treaty revert to a self-assessed determination of a person's residency for dual residents under Article 4. The existing process adds an additional administrative process, which results in unnecessary complexity, increased costs for businesses and diversion of revenue authority resources.

We provide the following observations in support of our recommendation:

- The altered work habits in the post COVID-19 environment mean it is more common for people to work abroad. As such, there is a greater risk that activities connected to a company's residency (i.e. management decisions) are not made in the country of a company's incorporation. In the trans-Tasman context, the risk of dual residency is particularly acute. Multinational groups with operations in NZ often have core personnel (e.g. executive and finance functions) based in Australia. It is also very common to have Australian directors on NZ company boards, due to a NZ legal requirement to have at least one director who lives in NZ or Australia (and who is also a director of a company incorporated in Australia).
- Since 2016, there have been multiple Australian developments in relation to company residency, which has created complexity and uncertainty for businesses in Australia and NZ. These include the *Bywater*[6] decision and new ATO guidance (TR 2018/5 and PCG 2018/9). Together, these developments created commercial uncertainty and ambiguity, which led to a Board of Tax review in 2019. The Board of Tax released its report in 2020 and in response to the report, the 2020-21 Federal Budget included an announcement to change the residency test. There has been no further announcement on this measure by the current Government and it is not clear whether the proposed legislative changes will proceed.
  - While the ATO / Inland Revenue joint administrative approach[7] (which allows self-assessment in limited circumstances) provides some welcome relief from the CA determination process, it only applies to small multinational groups (annual accounting income of less than $250M) and has a number of eligibility criteria and on-going conditions that narrow the pool of taxpayers that can access it. Given the limited number of taxpayers that can access the administrative approach, the self-assessment provision in the treaty would further advance the Single Economic Market agenda between Australia and NZ, in a more fulsome way than the administrative approach currently does.
  - As a general comment, we observe that where a foreign incorporated company (i.e. a resident of the foreign jurisdiction under its domestic law) is instead determined to be an Australian tax resident, the ultimate Australian tax outcome remains the same. That is, there is generally no loss to the revenue where the foreign company retains its foreign tax residency.
  - Further, both Australia and NZ have implemented reforms to address integrity issues that can arise in the context of dual residency (in particular, the hybrid mismatch rules, and there are also special rules in Pillar 2 to deal with dual residents). Given there are additional measures in place to address integrity

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[6] *Bywater Investments Limited & Ors v. Commissioner of Taxation; Hua Wang Bank Berhad v. Commissioner of Taxation* [2016] HCA 45.
[7] [MLI Article 4(1) administrative approach | Australian Taxation Office (ato.gov.au)]

concerns, the potential tax issues arising in connection with dual resident entities are low risk.