19 April 2024

Corporate and International Tax Division
Treasury
Langton Crescent
Parkes ACT 2600

CONFIDENTIAL

Via email: taxtreatiesbranch@treasury.gov.au

To Tax Treaties Branch,

RE: EXPANSION OF AUSTRALIA'S TAX TREATY NETWORK

The Qantas Group (Qantas) welcomes the opportunity for consultation with the Department of Treasury on tax treaty negotiations with Brazil, New Zealand, South Korea, Sweden and Ukraine as part of its expansion of Australia's tax treaty network. Having new treaties with Brazil and Ukraine, and updating the existing treaties mentioned, will ensure their ongoing relevance in our economic environment.

Qantas is particularly pleased that Brazil has been included in the program, having long advocated for a tax treaty with Brazil given Qantas is currently seeking to resolve an existing Brazilian income tax liability first raised in 2012 by the Brazilian tax authority, despite Qantas currently not being an on-line carrier in Brazil.

Qantas currently operates flights to/from New Zealand and South Korea but is not an on-line carrier with flights to/from Brazil (as noted above), Sweden or Ukraine. However, we hope to continue contributing to ongoing dialogue on tax treaties. Accordingly, attached is Qantas' submission focussing on issues specific to Brazil and in respect of the other countries, broader comments consistent with previous submissions Qantas has provided. Ultimately, we are hopeful that our comments will be viewed favourably.

We highlight that this letter and attached submission should remain in confidence, although we give consent for it to be discussed with representatives of the ATO and Government, as required.

If there are any aspects of this submission that Treasury would like to discuss further, please do not hesitate to contact me.

Yours sincerely,

Mark Bradford
Head of Taxation

April 2024
Qantas Submission – Expansion of Australia's tax treaty network

Brazil

Airline profits article ("article 8")

Having this mutual exemption from tax which limits taxing rights on international aircraft operation profits to the carrier's country of residence, would be imperative in providing certainty and reduced compliance costs for the relevant airlines. Qantas is seeking to resolve an existing Brazilian income tax liability first raised in 2012 by the Brazilian tax authority on air tickets sold in Brazil referable to 2009, despite Qantas not being, then and now, an on-line carrier in Brazil (rather Qantas had code-sharing arrangement with LATAM via Chile). This issue has been the subject of protracted litigation in the local judicial system with a recent win where a reciprocity position has been accepted.

Thus, in seeking the inclusion of article 8, we also submit that the following should be considered to provide more certainty:

- Retrospective application of article 8, ideally on or after 1 July 2008, or 5 years. We note there is precedent for this position in Australia's tax treaties:

    - Taipei tax treaty (signed 29 May 1996, entry into force 21 October 1996) includes application of the airline profits article therein on a retrospective basis per its article 25(a)(ii) which states:

      "…This Agreement shall have effect:
      (a) in both territories, in respect of:
      …
      (ii) tax in relation to profits to which Article 8 applies, on or after 1 January 1991;"

    - Italian Airline Profits Agreement (signed 13 April 1972, entry into force 9 April 1976) includes application of this Agreement on a retrospective basis per its article 4(2)(a) which states:

      2. This Agreement shall enter into force on the date of the exchange of the instruments of ratification and its provisions shall have effect-
      (a) in Australia, for the year of income that commenced on the first day of July 1966 and subsequent years of income;
      (b) in Italy, in respect of income assessable for any taxable period commencing on or after the first day of January 1966.

      We note the Italian tax treaty itself (signed 14 December 1982, entry into force 5 November 1985) also has retrospective application per its article 29(2) which states:

      "(2) The Convention shall enter into force on the date of the exchange of instruments of ratification and its provisions shall have effect-
      (a) in Australia-
      (i) in respect of withholding tax on income that is derived by a non-resident, in respect of income derived on or after 1 July 1976;

(ii) in respect of other Australian tax, for any year of income beginning on or after 1 July 1976;
(b) In Italy-
in respect of income assessable for taxable periods beginning on or after 1 January 1976."

We do not believe that the retrospective basis of article 8 in this case would give rise to adverse implications for the rights of any Australian or Brazilian airline or impose tax liabilities on such airlines in relation to any tax period ended prior to the new treaty coming into effect. Rather it would clarify residence-based taxing rights to the respective countries.

- Retrospective application of article 8 will ensure the formal acknowledgement/application of reciprocity principle.

  In the course of Qantas' ongoing litigation, there was some recent success when a Brazilian court stated that Brazil needed to acknowledge a reciprocity position, that is, in a reverse scenario of a Brazilian airline that is not operating in Australia, Australia would not tax this income as it is not Australian sourced – with the Australian Taxation Office confirming this principle in writing. This principle has been similarly recognised in other independent income tax reciprocity proceedings litigated in Brazil, resulting in the Brazilian tax authorities issuing the Executive Declaratory Act and stating that such reciprocity has existed (arguably since 1997).

  As the Brazilian and Australian tax authorities seemingly acknowledge the existence of reciprocity between countries in respect of airlines that operate off-line (that is, with no flights to/from the respective countries), the adoption of an article 8 position in the new tax treaty would allow the respective countries' airlines to have certainty that taxing rights should reside with the airline's home country.

In addition to the above considerations unique to Brazil, the airline profits article usually excludes application to profits confined solely to places in the other country but includes application to profits through participation in pool service, joint operations or international operating agency (this should cover code sharing). Ideally, it should also clarify that the following are also protected:

- wet lease of aircraft;
- bare boat rental (dry lease) of aircraft or other equipment that are incidental/ancillary to operations;
- interest on funds connected with the operations.

We note the existing Airline Profits Agreement with Greece references in the definition of "operation of aircraft in international traffic" the following, which would also be a positive clarification for consideration/inclusion:
"…and, in relation to an enterprise engaged in the operation of aircraft for such carriage, includes the sale of tickets for such carriage and the provision of services in connection with the loading or unloading or aircraft engaged in such carriage, either for the enterprise itself or for any other enterprise engaged in the operation of aircraft for such carriage."

Taxes covered ("article 2")

Brazil has a complex tax system, and we submit that the new tax treaty should cover both the Brazil federal income tax and the social contribution on net profit (understanding that this a form of social security tax which is levied on companies, which in effect is a corporate tax). In this regard, it is noted that the Brazil/Singapore tax treaty (effective 1 January 2022) includes the following in its article 2:

"3. The existing taxes to which the Agreement shall apply are in particular:
a) in the case of Brazil:

(i) the federal income tax; and
(ii) the social contribution on net profit ("Contribuição Social sobre o Lucro Líquido – CSLL", in Portuguese)
(hereinafter referred to as "Brazilian tax");"

Permanent establishment (PE)

A narrowing of the circumstances in which the location of "substantial equipment" in the other country will give rise to a taxable presence or Permanent Establishment (PE) is evident in Australia's recent negotiated tax treaties.

Our preference would be to not include substantial equipment in the definition of PE at all, as per the OECD model treaty. However, we would support adopting a narrower circumstance giving rise to a deemed PE in the following order of preference:

- Operates substantial equipment for a period exceeding 12 months / exceeding 183 days in any 12 months period;
- Maintains equipment for a period exceeding 12 months (should this be adopted, then consideration should also be given to there being no deemed carrying on of a business through the PE);
- Used by, for or under contract.

Interest and royalty withholding taxes

We propose inclusion of:

- interest withholding tax exemption on interest derived by a financial institution or more specifically, loans from foreign financial institutions for the financing of aircraft; and
- royalty withholding tax exemption on cross border equipment leases (or more specifically, aircraft and related equipment, e.g. engine, leases) by excluding from royalty, payments for the use of, or right to use, industrial, commercial or scientific equipment.

Financiers and lessors often require borrowers or equipment lessees to "gross-up" their payments to cover Australian withholding tax, thus passing the burden back to Australian enterprises.

Removal of interest withholding tax and royalty withholding tax as outlined above will increase competitiveness between domestic and foreign investment, assist in raising capital, improve access to foreign investment and increase competitiveness within the global market, as well as supporting the notion of capital export neutrality.

Further, removing interest withholding tax and royalty withholding tax for leasing industrial, commercial or scientific equipment is important as there should be no difference between an enterprise borrowing to finance acquisition of equipment or merely leasing equipment. We understand that this was the intent of Treasury when the US & UK tax treaties were previously renegotiated.

These exemptions should free up access to capital (current rules create a bias to certain treaty favoured jurisdictions over others) and should also remove an administrative compliance burden (such as satisfying the section 128F exemption).

Income from airline crew employment

We propose inclusion of an article to ensure that income from employment by a resident of a country in respect of employment exercised aboard an aircraft operated in international traffic is taxable only in that country. This ensures that such income is only taxed in the country of residence of the individual, rather than country of residence of the airline, and addresses the inequity of potential double taxation for the individual where poor use of language exists e.g. “may”.

FBT article

Where a fringe benefit is taxable in both countries, we need to ensure that the benefit will be taxable only in the country that has the sole or primary taxing right in accordance with the tax treaty in respect of salary/wages from the employment to which the benefit relates.

Source of Income article

Consideration should be given to not including a Source of Income in relation to royalties, particularly if there is a broad PE definition or equipment royalty limb.

Dividend withholding tax rate

Dividend withholding tax rates should be substantially reduced from 15% to 0%, depending on ownership criteria.

New Zealand, South Korea, Sweden and Ukraine

To the extent not already included in the existing tax treaties with New Zealand, South Korea and Sweden, and the new tax treaty with Ukraine, the above comments (other than the article 2 and article 8 considerations unique to Brazil as noted above) should also apply to these other tax treaties.

In passing, we note the existing South Korea and Sweden tax treaties do not have substantial equipment in the definition of PE at all and thus ideal to retain this, but they do have royalty withholding tax on payments for the use of, or right to use, industrial, commercial or scientific equipment and thus ideal to remove this.

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