Submission in response to the expansion of Australia's tax treaty network, March 2024

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Summary

This submission argues that in continuing to expand its tax treaty network, Australia needs transparent and clear guidance on what its overarching tax treaty policy is, and that it should adopt a more consistent and strategic approach to negotiating with new and existing trading partners.

Overview of Australia's tax treaty network

Australia's first tax treaty was entered into with the United Kingdom in 1946, with a continuous expansion of the network since. Specifically, Australia expanded its treaty network to the United States, Canada, New Zealand, Japan, and Singapore from the 1950s through to the 1970s. In 1971, Australia joined the Organization for Economic Cooperation and Development (OECD), with the treaty network subsequently extending to member countries, especially those in Europe. In the 1980s, Australia's treaty network shifted focus to Asian countries, driven by a change in economic policy to a more open economy and a dramatic tariff reduction, the removal of capital controls, and the floating of the currency. At the same time, Australia continued to expand the network by adding more European countries. Following this period, the number of new treaties declined, with agreements entered into when new trading partners emerged in Asia and Europe (for example, the dismantling of the Iron Curtain and the expansion of the European Union). In recent years, Australia has updated its existing network by negotiating new tax treaties with trading partners, replacing existing tax treaties, or signing protocols to amend existing tax treaties. Currently, Australia is a party to 47 double tax agreements,[1] each of which is considered an important part of Australia's international tax regime.

[1] As of March 2024, the treaty with Iceland has not yet been incorporated into Australian law, a step necessary for its operation, and the treaty with Portugal has been signed on 30 November 2023 but has not come into force.

A comprehensive review of Australia's tax treaty policy

A comprehensive review of Australia's overall tax treaty policy is warranted and overdue. Australia has a long history of domestic tax reviews, but none focus specifically on tax treaties and only a few have had any influence on treaty positions.[2] Three reviews since 1999, namely the 1999 *Review of Business Taxation (*the Ralph Review),[3] the 2002-03 *Board of Taxation Review into International Tax Arrangements,*[4] and the 2010 *Australia's Future Tax System Review* (the Henry Review),[5] provided piecemeal recommendations relating to the Australian tax treaty network, predominantly addressing issues surrounding withholding taxes, which were consequently selectively and only partially implemented.

Currently, Australia does not publish its own model tax convention or broad policy approach to its treaty position. Further, it is unclear whether Australia follows the OECD Model Tax Convention or the UN Model Tax Convention, as it often strictly follows neither. In order to have clear and transparent policy guidance, ensuring that Australia has a balanced approach to the taxation principles contained in tax treaties, comprehensive review of Australia's overall treaty policy, is warranted, ideally before negotiating or renegotiating any new tax treaties. The following four (4) specific recommendations on a review approach are made.

1. Determine an appropriate balance between source and residence-based taxing rights

To date, consensus has not been reached as to whether Australia's overall approach to treaty negotiations is one of source-based treaty policy or residence-based treaty policy. This is reflected in current treaties which adopt different approaches. Traditionally, there has been a bias towards source taxation with a number of features in the Australian tax treaties reflecting this. For example, a wide definition of permanent establishment, which increases Australia's taxing rights over non-residents 'business operations in Australia, and relatively high withholding tax rate ceilings for dividends, interest and royalties derived by non-residents from Australia are evident.[6] However, the Australian economic landscape has changed in recent years, particularly from one of traditionally being a net capital importer to an increasingly large amount of capital exports. In 2003, the Board of Taxation suggested a move towards a more

[2] Chris Evans and Richard Krever 'Tax Reviews in Australia: A Short Primer' in *Australian Business Tax Reform in Retrospect and Prospect*, Chris Evans and Richard Krever (eds), Thomson Reuters, Sydney, 2009.
[3] Australia. Review of Business Taxation & Ralph, John Theodore. (1999). A tax system redesigned: more certain, equitable and durable: report / Review of Business Taxation. http://www.rbt.treasury.gov.au/publications/paper4/index.htm
[4] Australia, The Board of Taxation, International Taxation Arrangements: https://taxboard.gov.au/consultation/international-taxation-arrangements
[5] Australian, The Treasury, Australia's Future Tax System Review Final Report: https://treasury.gov.au/review/the-australias-future-tax-system-review/final-report
[6] Board of Taxation, International Taxation: A Report to the Treasurer (2003), https://taxboard.gov.au/consultation/international-taxation-arrangements, Section 3.50.

residence-based treaty policy in substitution for the treaty model based on the source taxation of income.[7]

Australian treaty policy would benefit from clear policy guidelines ensuring an appropriate balance of source and residence-based taxing rights.

2. Identify what taxing rights Australia should not give up

As a resource-rich country, Australia should ensure tax policy facilitates foreign investment while safeguarding taxing rights and the revenue base. A move towards a residence-based approach requires economic interests such as natural resources to be taken into account to ensure tax from the exploitation of natural resources is collected. Currently, this is captured by ensuring taxing rights on income from natural resources in treaty provisions dealing with permanent establishments and treaty provisions dealing with Income from Immovable Property. To date, Australia has made a reservation to Article 5 Paragraph 1 of the OECD Model Tax Convention reserving the right to treat an enterprise as having a permanent establishment in a State if it carries on activities relating to natural resources or operates substantial equipment in that State with a certain degree of continuity, or a person – acting in that State on behalf of the enterprise – manufactures or processes in that State goods or merchandise belonging to the enterprise.

Historically, there have been certain taxing rights that Australia has given up during negotiations or after a treaty has been introduced into Australian law. For example, to facilitate Australia's negotiation with India and its desire to conclude the *Australia-India Economic Cooperation and Trade Agreement* in 2022, the *Treasury Laws Amendment (Australia-India Economic Cooperation and Trade Agreement Implementation) Bill 2022*, introduced the Section 11J into the *International Tax Agreements Act 1953,* which now prevents Australia from taxing the payments and credits made to Indian residents by Australian customers for technical services provided remotely and covered by Article 12(3)(g) of the India-Australia tax treaty. [8]

The non-discrimination article, which is currently in the fourteen of Australia's 47 signed tax treaties should also be considered. These articles can protect Australian residents from tax measures that impose higher taxation than would be imposed on nationals of Australian treaty

[7] Board of Taxation, International Taxation: A Report to the Treasurer (2003), https://taxboard.gov.au/consultation/international-taxation-arrangements, Volume 1, 3.

[8] *The Income Tax (International Agreements) Amendment Act (No. 2) 1991* amended domestic legislation to give force to the India-Australia tax treaty.

partners in the same circumstances. However, the reach of the non-discrimination articles should so be considered.[9]

3. Prioritise treaty negotiations

The current treaty network of Australia of 47 contracting states, is far less than many countries such as the United Kingdom, Germany, China and Singapore. This current initiative indicates Treasury's efforts to expand the Australia's treaty network and it is recognized that political and economic events affect negotiation priorities at times. However, the Treasury should prioritise the negotiation of tax treaties with major trading partners, rather than extend the tax treaty network to countries with which Australia has little trade or investment.

Some aging tax treaties with countries in Asia and Europe have not been renegotiated despite many of these jurisdictions being major trading partners. For example, earlier treaties with the Netherlands (1976), the Philippines (1981), Italy (1982), Korea (1982), Ireland (1983), Austria (1986), China (1988) and Thailand (1989), all fall within this category. To facilitate inbound and outbound investment, it may be necessary to re-negotiate these aging tax treaties, either through new treaties or by signing protocols to amend existing double tax agreements.

4. Improve the transparency of Australia's treaty negotiation process

Transparency of Australia's treaty policy and negotiation practice is desirable in order to provide greater clarity and certainty for all stakeholders, especially cross-border businesses. The Board of Taxation noted in 2003 that it has been extremely rare for government material on Australian tax treaty policy and practice to be made public. Not only did it note the fact that double tax agreements are negotiated largely in secret, but that the treaty negotiation agenda was largely due to earlier inactivity and the practice of giving priority to extending the network to relatively minor investment partners. It also noted that political events may affect negotiation priorities at particular times and stakeholders were invited to comment only after the negotiation process was almost complete and that any subsequent discussion focused on technical wording rather than matters of policy.[10]

The Board of Taxation recommendations should be revisited and implemented. It stated that Australia would benefit from following best practice on consultation in relation to double tax treaties in the same way as other countries do for treaties. Further, it stated that the Tax Treaties

[9] Richard Krever, Kerrie Sadiq, and Na Li, "Australia Treaty Override: Restricting Nondiscrimination Articles" Tax Notes Int'l, Mar. 25, 2024, p. 1839. Na Li, Kerrie Sadiq, and Richard Krever, "Can Australia 's Double Tax Treaties Invalidate State Real Estate Taxes?" Tax Notes Int'l, Jan. 1, 2024, p. 47.

[10] Board of Taxation, International Taxation: A Report to the Treasurer (2003), https://taxboard.gov.au/consultation/international-taxation-arrangements Volume 1, pp.90 to 97.

Advisory Panel should be maintained with an improved approach by having more frequent meetings, input into the formation of basic policy as well as technical details, flexible membership to allow affected taxpayers to be consulted on relevant treaties, and the publishing of an Australia's model tax treaty.[11]

Contributors

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[11] Board of Taxation, International Taxation: A Report to the Treasurer (2003), https://taxboard.gov.au/consultation/international-taxation-arrangements Volume 1, p.96.