

2008-2009

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

INTERNATIONAL TAX AGREEMENTS AMENDMENT BILL (No. 2) 2009

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Treasurer, the Hon Wayne Swan MP)

Table of contents

Glossary	5
General outline and financial impact	7
Chapter 1 Dual listed company arrangement	17
Chapter 2 The Australia-New Zealand Convention	21
Chapter 3 The Second Protocol with Belgium	133
Chapter 4 The Australia-Jersey Agreement	141
Chapter 5 Regulation impact statement for New Zealand and Jersey	151

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
Agreements Act 1953	<i>International Tax Agreements Act 1953</i>
AIL	approved issuer levy
ATO	Australian Taxation Office
CER	Australia New Zealand Closer Economic Relations Trade Agreement
CGT	capital gains tax
Commissioner	Commissioner of Taxation
DLC	dual listed company
existing Belgian Agreement	<i>Agreement between Australia and the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed at Canberra on 13 October 1977 as amended by the Protocol signed at Canberra on 20 March 1984</i>
existing New Zealand Agreement	<i>Agreement between the Government of Australia and the Government of New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income that was signed in Melbourne on 27 January 1995, and the Protocol Amending the Agreement between the Government of Australia and the Government of New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income that was signed in Melbourne on 15 November 2005</i>
FBTAA 1986	<i>Fringe Benefits Tax Assessment Act 1986</i>
GATS	General Agreement on Trade in Services
GST	goods and services tax
ITAA 1936	<i>Income Tax Assessment Act 1936</i>

<i>Abbreviation</i>	<i>Definition</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
MITs	managed investment trusts
OECD	Organisation for Economic Co-operation and Development
OECD Model	<i>OECD Model Tax Convention on Income and on Capital</i>
OECD Model Commentary	OECD Commentary to the OECD Model
Second Protocol	<i>Second Protocol amending the Agreement between Australia and the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed at Canberra on 13 October 1977 as amended by the Protocol signed at Canberra on 20 March 1984</i>
the Convention	<i>Convention between Australia and New Zealand for the Avoidance of Double Taxation with respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion</i>
the Jersey Agreement	<i>Agreement between the Government of Australia and the Government of Jersey for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments</i>
the Jersey Information Exchange Agreement	<i>Agreement between the Government of Australia and the Government of Jersey for the Exchange of Information with Respect to Taxes</i>
UK	United Kingdom of Great Britain and Northern Ireland
US	United States of America

General outline and financial impact

DUAL LISTED COMPANY ARRANGEMENT

This Bill amends the *Income Tax Assessment Act 1997* to align the definition of a dual listed company arrangement with the 2009 Australia-New Zealand Convention.

Date of effect: This amendment applies to capital gains tax events happening on or after this Bill receives Royal Assent.

Proposal announced: This measure was announced in the Assistant Treasurer's Media Release No. 078 of 22 October 2009.

Financial impact: The financial impact of this amendment is unquantifiable, however it is expected to be minimal.

Compliance cost impact: This amendment is expected to have a low overall compliance cost impact, comprised of a low implementation impact and a low decrease in ongoing compliance costs.

THE AUSTRALIA-NEW ZEALAND CONVENTION

What will this Bill do?

This Bill amends the *International Tax Agreements Act 1953* (Agreements Act 1953) to give the force of law in Australia to the *Convention between Australia and New Zealand for the Avoidance of Double Taxation with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion* (the Convention) that was signed in Paris on 26 June 2009.

The Convention is Australia's fourth comprehensive tax treaty with New Zealand. It will modernise the tax relationship between the two countries and will serve to facilitate trade and investment between Australia and New Zealand. The Convention will replace the *Agreement between the Government of Australia and the Government of New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* that was signed in Melbourne on 27 January 1995, and the *Protocol Amending the Agreement between the Government of Australia and the Government of*

New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income that was signed in Melbourne on 15 November 2005 (together referred to as ‘the existing New Zealand Agreement’).

Who will be affected by this Bill?

Persons who are residents of Australia and/or New Zealand and who derive income, profits, gains or fringe benefits from Australia or New Zealand will be affected by this Bill.

How is the legislation structured?

The Agreements Act 1953 gives the force of law in Australia to Australia’s tax treaties which appear as Schedules to that Act. The provisions of the *Income Tax Assessment Act 1936* (ITAA 1936), the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) are incorporated into and read as one with the Agreements Act 1953. The provisions of the Agreements Act 1953 (including the terms of the tax treaties) take precedence over inconsistent provisions of the:

- ITAA 1936 (other than the general anti-avoidance rules under Part IVA);
- ITAA 1997; and
- FBTAA 1986 (other than section 67 which is an anti-avoidance rule).

In what way does this Bill change the *International Tax Agreements Act 1953*?

The Agreements Act 1953 is amended to insert the text of the Convention as a Schedule to that Act. Australia’s tax treaties appear as Schedules to the above Act, which gives them the force of law in Australia.

When will the Convention enter into force, and from what date will the Convention have effect?

The Convention will become law from the date of Royal Assent. Further, the Convention will enter into force after the date of the last notification by diplomatic notes and once the domestic processes to give the Convention the force of law in the respective countries have been completed. In Australia, enactment of this Bill giving the force of law to the Convention, along with tabling the Convention in Parliament, are prerequisites to such notification.

Once it enters into force the Convention will apply as follows

Application in Australia

For withholding taxes, on income derived:

- on or after the first day of the second month next following the date on which the Convention enters into force.

For fringe benefits tax, on fringe benefits provided:

- on or after 1 April next following the date on which the Convention enters into force.

For other Australian taxes, on income, profits or gains:

- of any year of income beginning on or after 1 July next following the date on which the Convention enters into force.

Application in New Zealand

For withholding taxes, on income, profits or gains derived:

- on or after the first day of the second month next following the date on which the Convention enters into force.

For other New Zealand taxes:

- for any income year beginning on or after 1 April next following the date on which the Convention enters into force.

The financial impact of this Bill

The impact of the first round effects on the forward estimates has been estimated as unquantifiable.

Identifiable costs to revenue associated with reductions in the rates of withholding tax and the change in taxing rights for pensions have been estimated as \$142 million over the forward estimates. However, reductions in New Zealand withholding taxes can be expected to result in an increase in the amount of Australian tax revenue through reduced Foreign Income Tax Offsets claimed and increases in Australian taxable income.

Given the bilateral flows between Australia and New Zealand, the current features of the Australian and New Zealand tax systems, and the impact of the changes in the arrangements under the Convention, the revenue costs are expected to be broadly offset by revenue gains.

Compliance costs

No significant compliance costs will result from the entry into force of the Convention.

Summary of regulation impact statement

Regulation impact on business

Impact: Low.

Main points:

- The Convention is expected to have an impact on Australian residents doing business with New Zealand, including Australian investors, banks, suppliers of technology, consultants and exporters; Australian employees working in New Zealand; and Australian residents receiving pensions from New Zealand. The Convention will also impact on the Australian Government and the Australian Taxation Office (ATO).
- While source country tax on interest will generally continue to be limited to 10 per cent, there will be no withholding tax charged on interest derived by a financial institution that is

resident in the other country. However, in the case of interest derived from New Zealand, the zero rate will only apply where the interest is paid by a person who has paid New Zealand's Approved Issuer Levy. The zero rate will also apply to interest derived by governments, their political subdivisions and local authorities (including government investment funds). No tax is payable on dividends in the source country where the dividend recipient is a company that holds directly or indirectly at least 80 per cent of the voting power of the company paying the dividends. The zero dividend withholding tax rate also applies where the beneficial owner of the dividends is a government, political subdivision or local authority (including a government investment fund) and they hold no more than 10 per cent of the voting power of the company paying the dividends. A 5 per cent rate limit applies to other dividends where the dividend recipient is a company that holds directly at least 10 per cent of the voting power of the company paying the dividend. A 15 per cent limitation applies to other dividends. The general limit for royalties will be reduced from 10 per cent to 5 per cent.

- The Convention will assist the bilateral relationship by updating an important treaty in the network of commercial treaties between the countries and provides for greater cooperation between tax authorities to prevent fiscal evasion and tax avoidance.

THE SECOND PROTOCOL WITH BELGIUM

This Bill amends the *International Tax Agreements Act 1953* to give the force of law in Australia to a *Second Protocol amending the Agreement between Australia and the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed at Canberra on 13 October 1977 as amended by the Protocol signed at Canberra on 20 March 1984* (Second Protocol), which was signed in Paris on 24 June 2009.

Date of effect: 1 January 2010.

Proposal announced: This measure was announced in the Assistant Treasurer and Minister for Trade's joint Media Release No. 007 of 25 June 2009.

Financial impact: Treasury has estimated the revenue impact of the Second Protocol which updates the *Exchange of Information* Article in the tax treaty as unquantifiable. As the Article seeks to expand the scope of taxpayer information available to the Commissioner of Taxation, the proposal is expected to improve taxpayer compliance and increase tax revenue.

Compliance cost impact: This proposal is expected to result in a low overall compliance cost impact, comprised of a low implementation impact and no change in ongoing compliance costs relative to the affected group.

THE AUSTRALIA-JERSEY AGREEMENT

What will this Bill do?

This Bill amends the *International Tax Agreements Act 1953* (Agreements Act 1953) to give the force of law in Australia to the *Agreement between the Government of Australia and the Government of Jersey for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments* (the Jersey Agreement), which was signed in London on 10 June 2009.

This Agreement contains Articles that are based on corresponding Articles contained in Australia's bilateral tax treaties.

The Jersey Agreement is the third agreement of its type signed between Australia and a low-tax jurisdiction and was signed in conjunction with the *Agreement between the Government of Australia and the Government of Jersey for the Exchange of Information with Respect to Taxes* (the Jersey Information Exchange Agreement), which was signed in London on 10 June 2009.

Who is affected by this Bill?

The amendments made by this Bill will impact:

- individuals who are residents of Australia and/or Jersey who derive income from pensions or retirement annuities or the provision of government services, or receive payments in their capacity as visiting students or business apprentices; and

- residents of Australia or Jersey that wish to contest a transfer pricing adjustment made by the Australian or Jersey tax authorities.

How the legislation is structured

The Agreements Act 1953 gives the force of law in Australia to Australia's tax treaties which appear as Schedules to that Act. The provisions of the *Income Tax Assessment Act 1936* (ITAA 1936), the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) are incorporated into and read as one with the Agreements Act 1953. The provisions of the Agreements Act 1953 (including the terms of the tax treaties) take precedence over inconsistent provisions of the:

- ITAA 1936 (other than the general anti-avoidance rules under Part IVA);
- ITAA 1997; and
- FBTAA 1986 (other than section 67 which is an anti-avoidance rule).

In what way does this Bill change the *International Tax Agreements Act 1953*?

The Agreements Act 1953 is amended to insert the text of the Jersey Agreement as a Schedule to that Act, which will give it the force of law.

When will these changes take place?

The amendments made by this Bill will take effect from the date of Royal Assent.

When will the Agreement enter into force, and from what date will it have effect?

The Jersey Agreement will enter into force on the date of the last exchange of diplomatic notes notifying that the domestic procedures to give this Agreement the force of law have been completed. In Australia,

enactment of the legislation giving the Agreement the force of law along with tabling this Agreement in Parliament are prerequisites to the exchange of diplomatic notes.

Once it enters into force the Jersey Agreement will apply as follows

Application in Australia

In respect of any income year beginning on or after 1 July in the calendar year next following the date on which the Agreement enters into force.

Application in Jersey

In respect of any income year beginning on or after 1 January in the calendar year next following the date on which the Agreement enters into force.

The financial impact of this Bill

The impact of the Jersey Agreement on the forward estimates is estimated to be negligible.

Compliance costs

No significant compliance costs are expected to result from the entry into force of the Jersey Agreement.

Summary of regulation impact statement

Regulation impact on business

Impact: Minimal.

Main points:

- The Jersey Agreement is likely to have an impact on recipients of Australian source pensions or retirement annuities who reside in Jersey; individuals providing services in Jersey to an Australian government (or political subdivision or local authority); Australian students and business apprentices temporarily residing in Jersey for

education or training purposes; the Australian Government and the ATO.

- The Jersey Agreement will also have an impact on Australian residents (including non-individuals) that wish to contest a transfer pricing taxation adjustment made by the Jersey tax authorities.
- The Jersey Agreement will promote a closer bilateral relationship between Australia and Jersey by eliminating double taxation of certain income derived by individuals, specifically pension recipients, government employees, students and business apprentices.
- In conjunction with the Jersey Information Exchange Agreement, the Jersey Agreement will provide for greater cooperation between tax authorities to prevent tax avoidance and evasion.
- No material costs to taxpayers have been identified as likely to arise from the Jersey Agreement but there is likely to be a small, unquantifiable administration cost.

Chapter 1

Dual listed company arrangement

Outline of chapter

1.1 This Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to align the definition of a dual listed company (DLC) arrangement with the 2009 Australia-New Zealand Convention.

Context of amendments

1.2 The *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* inserted the definition of a ‘DLC arrangement’ into subsection 125-60(4) of the ITAA 1997. The explanatory memorandum to the Bill noted that the definition would be refined following tax treaty discussions with other countries and industry representatives.

1.3 To be defined as a ‘DLC arrangement’ in subsection 125-60(4) of the ITAA 1997, the DLC must have the appointment of common (or almost identical) boards of directors. However, in certain circumstances there is a regulatory restriction (such as an industry regulation) that requires an Australian company to have at least two-thirds of its board of directors to be Australian citizens. If the foreign company also has a similar set of regulatory restrictions in its home country, it becomes impossible to satisfy the requirement of the appointment of common (or almost identical) boards of directors.

1.4 By failing to be defined as a DLC arrangement, the shareholders of the DLC must take into account the DLC voting share when determining whether they meet the requirements for capital gains tax (CGT) demerger relief. Often, it is difficult to ascribe a market value to such shares, as they do not carry rights to financial entitlements (except in certain situations) and it is also difficult to assess how the DLC voting share affects the proportion of interests of all shareholders.

Summary of new law

1.5 The amendment modifies the definition of DLC arrangement in subsection 125-60(4) of the ITAA 1997, ensuring that companies will not be required to have the appointment of common or almost identical boards of directors, where the effect of relevant regulatory requirements prevents this from occurring.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
To be defined as a DLC arrangement, the DLC must have, amongst other things, common (or almost identical) boards of directors, except where the effect of relevant regulatory requirements prevents this.	To be defined as a DLC arrangement, the DLC must have, amongst other things, common (or almost identical) boards of directors.

Detailed explanation of new law

1.6 Subsection 125-60(4) of the ITAA 1997 sets out various, cumulative criteria by which arrangements can be identified as a DLC arrangement. The first criterion that must apply is the appointment of common (or almost identical) boards of directors.

1.7 This criterion is modified and will not be required to be satisfied where the effect of relevant regulatory requirements prevents the appointment of common (or almost identical) boards of directors.

1.8 The relevant regulatory requirements must be imposed by legislation, statutory instrument, mandatory code of a regulatory authority, or similar regulatory requirement. Therefore, the agreement that is entered into to create the DLC will not be a relevant regulatory requirement for the purposes of satisfying the definition.

Example 1.1

Assume provisions regulating an Australian industry require that at least two-thirds of the directors of a company operating in that industry be Australian citizens. Suppose a company covered by those regulations sought to enter into a DLC arrangement with a New Zealand company that under New Zealand corporations law was also required to maintain at least two-thirds of its directors as New Zealand citizens.

As the statutory requirements in each country prevent the appointment of common boards of directors, the DLC would not be required to satisfy this requirement in order to be defined as a DLC arrangement for the purposes of the Australian demerger rules.

Application and transitional provisions

1.9 These amendments apply to CGT events happening on or after this Bill receives Royal Assent.

Chapter 2

The Australia-New Zealand Convention

Outline of chapter

2.1 This Bill amends the *International Tax Agreements Act 1953* (Agreements Act 1953). This chapter explains the rules that apply in the 2009 *Convention between Australia and New Zealand for the Avoidance of Double Taxation with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion* (the Convention).

Context of amendments

2.2 The Convention was signed in Paris on 26 June 2009.

2.3 Once in force, the Convention will replace the *Agreement between the Government of Australia and the Government of New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* that was signed in Melbourne on 27 January 1995, and the *Protocol Amending the Agreement between the Government of Australia and the Government of New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* that was signed in Melbourne on 15 November 2005 (together referred to as ‘the existing New Zealand Agreement’).

Summary of new law

Main features of the Convention

- 2.4 The main features of the Convention are as follows:
- Income from real property (including the profits of an enterprise from agriculture, forestry or fishing) may be taxed by the country in which the property is situated. Income from real property includes natural resource royalties [Article 6].

- Business profits (including income derived from professional services or other activities of an independent nature) are generally to be taxed only in the country of residence of the recipient unless they are derived by a resident of one country through a branch or other prescribed permanent establishment in the other country, in which case that other country may tax the profits. These rules also apply to business trusts *[Article 7]*.
- Profits derived from the operation of ships and aircraft in international traffic are generally to be taxed only in the country of residence of the operator *[Article 8]*.
- Profits of associated enterprises may be adjusted for tax purposes where transactions have been entered into on other than arm's length terms *[Article 9]*.
- Dividends, interest and royalties may generally be taxed in both countries, but there are limits on the tax that the country in which the dividend, interest or royalty is sourced may charge on such income flowing to residents of the other country who are the beneficial owners of the income *[Articles 10 to 12]*.
- In the case of dividends:
 - no source country tax is payable on intercorporate dividends where the beneficial owner of those dividends is a company that holds, directly or indirectly, at least 80 per cent of the voting power, subject to certain conditions *[Article 10, paragraph 3]*;
 - no source country tax is payable on dividends where the beneficial owner of those dividends holds directly no more than 10 per cent of the voting power of the company paying the dividend, and the beneficial owner is a Contracting State, a political subdivision or a local authority thereof *[Article 10, paragraph 4]*;
 - a 5 per cent limitation applies to intercorporate dividends where the beneficial owner of those dividends is a company that holds directly at least 10 per cent of the voting power of the company paying the dividends *[Article 10, subparagraph 2a)]*; and
 - a 15 per cent limitation applies to all other dividends *[Article 10, subparagraph 2b)]*;

- Source country taxation on interest is limited to 10 per cent [*Article 11, paragraph 2*]. However, exemptions from source country taxation have been provided for interest paid to:
 - certain government bodies and banks performing central banking functions [*Article 11, subparagraph 3a*]; and
 - financial institutions that are unrelated and dealing wholly independently with the payer, subject to certain conditions [*Article 11, subparagraph 3b*].
- The rate limit on source country taxation of royalties is 5 per cent [*Article 12, paragraph 2*].
- The definition of ‘royalty’ has been amended to include payments or credits in respect of the use of, or right to use, some or all of the radiofrequency spectrum specified in a spectrum licence and to exclude payments or credits in respect of the use of, or right to use, industrial, commercial or scientific equipment [*Article 12, paragraph 3*].
- Income, profits or gains from the alienation of real property may be taxed by the country in which the property is situated. Subject to that rule and other specific rules in relation to business assets and shares or other interests in land-rich entities (which may be taxed by the country in which the property is situated), all other capital gains will be taxable only in the country of residence [*Article 13*].
- Income from employment (that is, employees’ remuneration) will generally be taxable in the country where the services are performed. However, where the services are performed during certain short visits to one country by a resident of the other country, the income will be exempt in the country visited [*Article 14*].
- Fringe benefits that would otherwise be subject to tax in both countries will be taxable only in the country which would have the primary taxing right in respect of salary or wages to which the benefit relates [*Article 15*].
- Directors’ remuneration may be taxed in the country in which the company of which the person is a director is a resident for tax purposes [*Article 16*].
- Income derived by entertainers and sportspersons may generally be taxed by the country in which the activities are

performed. However, income derived by sportspersons as a member of a recognised team playing in a league competition conducted in both countries shall be taxable under the normal business income or employment income rules *[Article 17]*.

- Pensions (including government pensions) may be taxed only in the country of residence of the recipient. However, pensions arising in the other country will not be subject to tax in the residence country to the extent they would not be subject to tax in the other country if the recipient were a resident of that other country. Certain specified lump sums are only subject to tax in the country in which they arise *[Article 18]*.
- Income from government service will generally be taxed only in the country that pays the remuneration. However, the remuneration will be taxed only in the other country where the services are rendered in that other country by a resident of that other country who is a national of that other country, or did not become a resident of that other country for the purpose of rendering the services *[Article 19]*.
- Payments made from abroad to visiting students or business apprentices for the purposes of their maintenance, education or training will be exempt from tax in the country visited *[Article 20]*.
- Other income (that is, income not dealt with by other Articles) may generally be taxed in both countries, with the country of residence of the recipient providing double tax relief *[Article 21]*.
- Source rules in the Convention prescribe, for domestic law and treaty purposes, that income, profits or gains derived by a resident of one country, which under the provisions of the treaty may be taxed in the other country, will be treated as having a source in that other country *[Article 22]*.
- Double taxation relief for income which, under the Convention, may be taxed by both countries, is required to be provided by the country of which the taxpayer is a resident under the terms of the Convention as follows:
 - in Australia, by allowing a credit for the New Zealand tax against Australian tax payable on income derived by a resident of Australia from sources in New Zealand *[Article 23, paragraph 1]*;

- in New Zealand, by allowing a credit for the Australian tax against New Zealand tax payable on income derived by a resident of New Zealand from sources in Australia [*Article 23, paragraph 2*]; and
- in the case where an item of income is taxed in a country in the hands of an entity that is treated as ‘fiscally transparent’ by the other country, and also taxed in the hands of a resident of that other country as a participant in that entity, by that other country allowing a credit of the tax imposed by the first country [*Article 23, paragraph 3*].
- In the case of Australia, effect will be given to the double tax relief obligations arising under the Convention by application of the general foreign income tax offset provisions of Australia’s domestic law, or the relevant exemption provisions of that law where applicable.
- Rules in the Convention will protect nationals and businesses from tax discrimination in the other country and gives them private rights of appeal. However, Article 24 does not restrict either country from applying provisions designed to prevent avoidance or evasion of taxes (for Australia such measures include thin capitalisation, dividend stripping, transfer pricing and controlled foreign companies measures), rebates or credits for dividends paid by resident companies, research and development concessions, consolidation rules or capital gains deferral rules [*Article 24*].
- The Convention provides for consultation between the two taxation authorities and a mechanism that allows for other forms of dispute resolution, including binding dispute resolution [*Article 25*].
- The Convention provides for exchange of information between the two taxation authorities. It authorises and requires Australia to exchange information where the information relates to federal taxes administered by the Commissioner of Taxation (Commissioner) [*Article 26*].
- The Convention ensures the integrity of the tax system by providing for the mutual assistance in the collection of tax debts. This would allow the Australian Taxation Office (ATO), in certain circumstances, to seek assistance from the New Zealand tax administration to collect Australian taxation debts in respect of all Australian federal taxes administered by the Commissioner, and vice versa [*Article 27*].

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Updates all Articles, having regard to Australian, New Zealand and the Organisation for Economic Co-operation and Development (OECD) tax treaty developments since the existing New Zealand Agreement was entered into.	Not applicable.
Deals specifically with items of income (including profits or gains) derived by or through a fiscally transparent entity under the laws of either Australia or New Zealand. Such items of income will be considered to be derived by a resident of a country to the extent that the item is treated under the taxation laws of that country as income of a resident. Provides for relief of double taxation in respect of such income.	No equivalent.
Provides for mutual agreement procedures to determine residence in respect of persons other than individuals, where place of effective management does not provide an outcome. Includes specific rules for determining treaty residence of dual listed companies. Includes specific rules to provide treaty benefits to income derived through Australian managed investment trusts (MITs).	Resident status in respect of persons other than individuals determined solely by reference to place of effective management. No specific rules for dual listed companies. No specific rules for MITs.
Limits the treaty benefits that Australia is obliged to provide where income, profits or gains of transitional residents are exempted from tax in New Zealand.	No equivalent.

<i>New law</i>	<i>Current law</i>
<p>Updates the meaning of ‘permanent establishment’ in Article 5 (<i>Permanent Establishment</i>). In particular, under the Convention an enterprise is deemed to have a permanent establishment in a country if:</p> <ul style="list-style-type: none"> • it provides services in that country for a period or periods exceeding in the aggregate 183 days in any 12-month period. However, services provided through employees for periods not exceeding five days are generally disregarded for this purpose; • it carries on activities (including the operation of substantial equipment) in the exploration for or exploitation of natural resources for a period or periods exceeding in the aggregate 90 days in any 12-month period; or • it operates substantial equipment (including in natural resource activities) for a period or periods exceeding in the aggregate 183 days in any 12-month period. 	<p>An enterprise is deemed to be a ‘permanent establishment’ if:</p> <ul style="list-style-type: none"> • it carries on activities connected with the exploration for or exploitation of natural resources or standing timber; • it carries on supervisory activities for more than six months in connection with a building site, or construction, installation or assembly project; or • substantial equipment is being used by, for or under contract with the enterprise. <p>Professional services provided by an individual who is present in the other country for a period or periods exceeding in the aggregate 183 days in any 12-month period may be taxed in that country.</p>
<p>Treats certain business profits, such as profits from agriculture, forestry and fishing, as income from real property, and ensures that arms’ length profits are taxed on a net basis.</p> <p>Extends the definition of ‘real property’ to include natural resources (including living resources) and standing timber.</p>	<p>Business profits from agriculture, forestry and fishing are dealt with in Article 7 (<i>Business Profits</i>).</p> <p>The definition of ‘real property’ covers land, and rights relating to exploration for or exploitation of natural resources.</p>
<p>Aligns the treatment of income from independent personal services to that of business profits under Article 7 (<i>Business Profits</i>).</p>	<p>Income from independent personal services is treated under a separate Article — Article 14 (<i>Independent Personal Services</i>) — where a fixed base is regularly available or a person is present for a period or periods exceeding in the aggregate 183 days in any 12-month period.</p>

<i>New law</i>	<i>Current law</i>
No equivalent.	No profits are attributable to a permanent establishment by reason of mere purchase.
No equivalent.	Profits attributed to the permanent establishment should be determined by the same method year by year.
Transfer pricing adjustments are generally limited to seven years.	No equivalent.
Source taxation of shipping and airline profits is limited to income from domestic transport.	Source taxation of profits from all domestic shipping and airline activities (including non-transport activities).
<p>Dividend withholding tax is limited to:</p> <ul style="list-style-type: none"> • zero for intercorporate dividends on non-portfolio holdings of more than 80 per cent, subject to certain conditions; • zero for dividends beneficially owned by a State, political subdivision or local authority where they have direct holdings of no more than 10 per cent; • 5 per cent for intercorporate dividends on other non-portfolio holdings; and • 15 per cent in all other cases. 	Dividend withholding tax is limited to 15 per cent for all dividends.
<p>Reduces the rate of interest withholding tax from a maximum of 10 per cent to zero where interest is paid to:</p> <ul style="list-style-type: none"> • government bodies or central banks; or • financial institutions, provided, in the case of interest paid from New Zealand, that the 2 per cent approved issuer levy (AIL) has been paid. A 'most favoured nation' provision applies if New Zealand subsequently provides better treatment in respect of such interest in another treaty. 	No equivalent exemptions.

<i>New law</i>	<i>Current law</i>
Reduces the rate of royalty withholding tax to a maximum of 5 per cent of the gross royalty payment and extends the meaning of royalty to include spectrum licences. Leasing of industrial, commercial or scientific equipment will no longer constitute a royalty.	The rate of royalty withholding tax is limited to 10 per cent of the gross payment. The definition of 'royalty' includes payments for use of industrial, scientific and commercial equipment.
Allocates taxing rights over residual capital gains to the country of residence of the alienator. However, Australia may continue to tax capital gains of former residents in accordance with domestic law.	Residual capital gains are taxable in accordance with domestic law.
Employment income paid in respect of certain short term visits are taxable only in the country of residence of the employee where the remuneration is borne by a permanent establishment of the employer in the employee's country of residence, or is paid in respect of a secondment.	No equivalent.
Pensions that are exempt in the country of source will also be exempt in the country of residence. Lump sums are taxable only in the country of source.	Pensions are taxable only in the country of residence of the recipient. Lump sums may be taxed in both countries.
Includes a comprehensive article preventing tax discrimination under tax laws.	No equivalent.
Provides for access to arbitration if mutual agreement on issues of fact is not reached within two years.	No equivalent.

Detailed explanation of new law

Article 1 — Persons Covered

Scope

2.5 This Article establishes the scope of the application of the Convention by providing for it to apply to 'persons' (defined to include individuals, trusts, partnerships, companies and any other body of

persons) who are residents of one or both of the countries. It generally precludes extra-territorial application of the Convention. *[Article 1]*

2.6 The Convention also applies to third country residents in relation to Article 24 (*Non-Discrimination*) in its application to nationals of one of the treaty countries, Article 25 (*Mutual Agreement Procedure*) so far as the person is a national of one of the treaty countries, and in relation to the exchange of information under Article 26 (*Exchange of Information*) and the assistance in collection of tax debts under Article 27 (*Assistance in the Collection of Taxes*).

2.7 The application of the Convention to persons who are dual residents (that is, residents of both countries) is dealt with in Article 4 (*Resident*).

Application of the Convention to fiscally transparent entities

2.8 Paragraph 2 addresses special issues arising in relation to income that is derived by or through entities, such as certain partnerships and trusts, that are fiscally transparent with respect to that income; that is, where the participants in the entity are liable to tax on the income, rather than the entity itself. The provision is intended to apply where one or more fiscally transparent entities is interposed between the income and the participant who is ultimately liable to tax on the income.

2.9 As different countries frequently take different views as to when an entity is fiscally transparent, the risk of both double taxation and double non-taxation of income derived by or through such entities is increased. The intention of paragraph 2 is to ensure that treaty benefits are available to residents who are participants in these entities where income derived through such entities is allocated to those members for tax purposes. The provision also prevents the use of such entities to claim treaty benefits in respect of income arising in one country in circumstances where the person investing through such an entity is not a resident of, or is not liable to tax on the income in, the other country.

2.10 While this paragraph covers a broader range of transparent entities than partnerships, its application is intended to be consistent with the OECD conclusions on the application of the OECD *Model Tax Convention on Income and on Capital* (OECD Model) to partnerships. It is also intended to eliminate a number of technical problems which might have prevented participants in such entities from claiming treaty benefits, even though the income derived through such entities is allocated to them under the relevant tax laws such that they are subject to tax on that income. Further, the inclusion of the words 'with respect to that item of income' is included to ensure that this rule will apply appropriately to income derived through entities such as certain trusts, where some items

of income may be allocated to the beneficiary or participant and taxed in that person's hands, while other items of income are taxed at the entity level.

2.11 The provision refers to a 'person' that is fiscally transparent. Partnerships and trusts are specifically included in the definition of 'person' in subparagraph j) of paragraph 1 of Article 3 (*General Definitions*), however other fiscally transparent entities may also be encompassed by the term as the definition is inclusive.

2.12 The paragraph also refers to income derived 'by or through' such a person. This is to take account of the fact that the same income may be regarded as derived by the entity in one country, while the other country considers that, notwithstanding that it is received by the entity, it is derived by the participants.

2.13 Paragraph 2 of Article 1 (*Persons Covered*) applies to all forms of income, including amounts taxable on a net profit basis or, in the case of Australia, as a capital gain.

2.14 In general, paragraph 2 relates to particular items of income of entities that are fiscally transparent under the laws of one or other country. Entities falling under this description in Australia and New Zealand include certain partnerships and trusts. In the case of Australia it includes partnerships subject to Division 5 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) (but not corporate limited partnerships subject to Division 5A of Part III), and trusts which are subject to Division 6 of Part III where the beneficiary of the trust is presently entitled to the income and assessable accordingly (but not a corporate unit trust or public trading trust subject to Division 6B or 6C of Part III). In the case of New Zealand, it includes partnerships, complying trusts and foreign trusts.

2.15 Under paragraph 2, an item of income derived by such entities will be considered to be derived by a resident of a country if a resident is treated under the taxation laws of that country as deriving the item of income. In particular, the paragraph ensures that treaty benefits will apply in three situations:

- where income (including profits or gains) is derived from sources in one country through an entity organised in the other country which is treated as fiscally transparent in that other country (that is, income derived through that entity is taxed in the hands of the beneficiaries, members or participants of the entity);

- where income (including profits or gains) is derived from sources in one country through an entity that is organised in the other country and is treated as a taxable entity under the taxation laws of that country and fiscally transparent under the laws of the source country; and
- where income (including profits or gains) is derived from sources in one country through a third country entity which is treated as fiscally transparent in the other country (that is, income derived through that entity is taxed in that other country in the hands of the beneficiaries, members or participants of the entity).

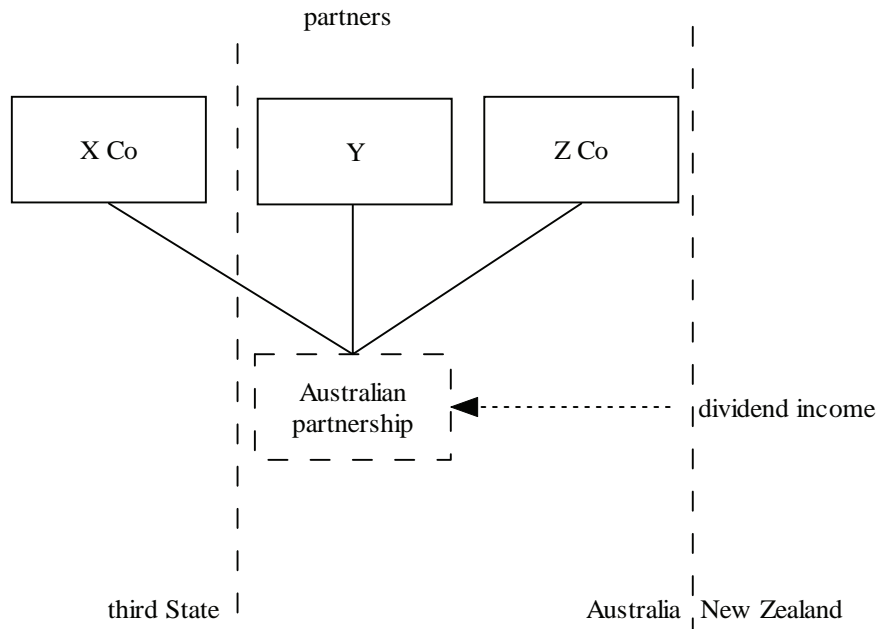
2.16 In the first situation above, treaty residents who participate in the entity will be eligible for treaty benefits in respect of items of income (including profits or gains) derived from the source country through that entity, to the extent that the other country treats the income as ‘flowed-through’ to those participants. Resident participants in the entity will be treated as having derived the income directly and may be entitled to treaty benefits. Treaty benefits in respect of such items of income (including profits or gains) will be granted where:

- the beneficiaries, members or participants are residents of the other country; and
- other conditions in the Convention (such as the specific anti-avoidance measures and limitation of relief) are satisfied.

2.17 Non-resident participants in the entity may not claim a benefit under the Convention in respect of such items of income, because they are not treaty residents for purposes of claiming benefits under this treaty. If, however, the country of which they are a resident for tax purposes has a tax treaty with the source country, they may be entitled to claim a benefit under that treaty.

2.18 It is irrelevant whether the source country sees the income, profits or gains as the income, profits or gains of the entity itself or of the beneficiaries, members or participants under the tax law of that country.

Example 2.1



In the above diagram, dividend income is paid to an Australian partnership from New Zealand. The Australian partnership includes Australian partners (Y and Z Co) who are residents of Australia for the purposes of the treaty. Under Australian law, the income is treated as the income of the partners.

As such, in this example, the dividend income paid to the partnership will be considered, for purposes of the treaty, to be derived by the Australian resident partners as they are assessable under Australian income tax law. Therefore the Australian partners would be eligible for the benefits of the Convention. To the extent that the Australian partners owned only a share of the income, then only the share of the income attributable to the Australian partners' interest would be eligible for the benefits of the Convention.

Treaty relief will not apply to income derived by any partners that are not residents of Australia for purposes of the Convention (in this example, X Co).

Eligibility for the treaty benefits will also be subject to the application of the respective anti-avoidance measures contained in the specific Article (in this example, paragraph 9 of Article 10 (*Dividends*)).

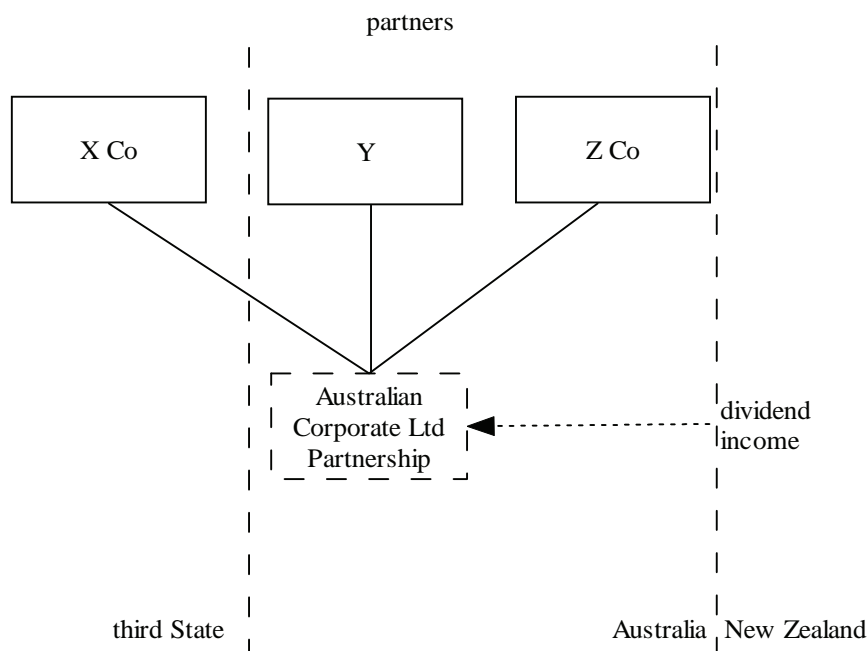
2.19 An example of the second situation would be where dividend income is derived from sources in one country through an entity that is organised in the other country and is treated as a taxable entity under the

tax law of that other country and fiscally transparent under the laws of the source country. In these circumstances, the Convention provides that the income will be treated as derived by the entity for purposes of determining whether treaty benefits apply. Treaty benefits will be granted where:

- the entity is a resident of the other country; and
- other conditions in the Convention (such as the specific anti-avoidance measures and limitation of relief) are satisfied.

2.20 The same outcome arises irrespective of whether the source country sees the income, profits or gains as the income, profits or gains of the entity itself or of the beneficiaries, members or participants under the tax law of that country.

Example 2.2



In the above diagram, dividend income arising in New Zealand is paid to an Australian Corporate Limited Partnership which is subject to Division 5A and is resident in Australia under that Division. The Australian Corporate Limited Partnership includes Australian partners (Y and Z Co) who are residents of Australia for the purposes of the treaty, and a third State resident partner (X Co). The Australian Corporate Limited Partnership is effectively treated as a company that is a resident of Australia for Australian tax purposes.

As such, in this example, the dividend income would be eligible for the benefits of the Convention. This will be the case, notwithstanding that one or more of the participants in the corporate limited partnership is not a resident of Australia and irrespective of whether New Zealand, under its domestic law, would tax the income in the hands of the Australian corporate limited partnership or in the hands of the partners. Even if New Zealand would treat the partnership as fiscally transparent under its domestic law, the income will be considered to be derived by an Australian resident for purposes of the Convention in accordance with paragraph 2 of Article 1 (*Persons Covered*), since the income is treated for purposes of Australian tax law as the income of a resident (that is, the Australian corporate limited partnership).

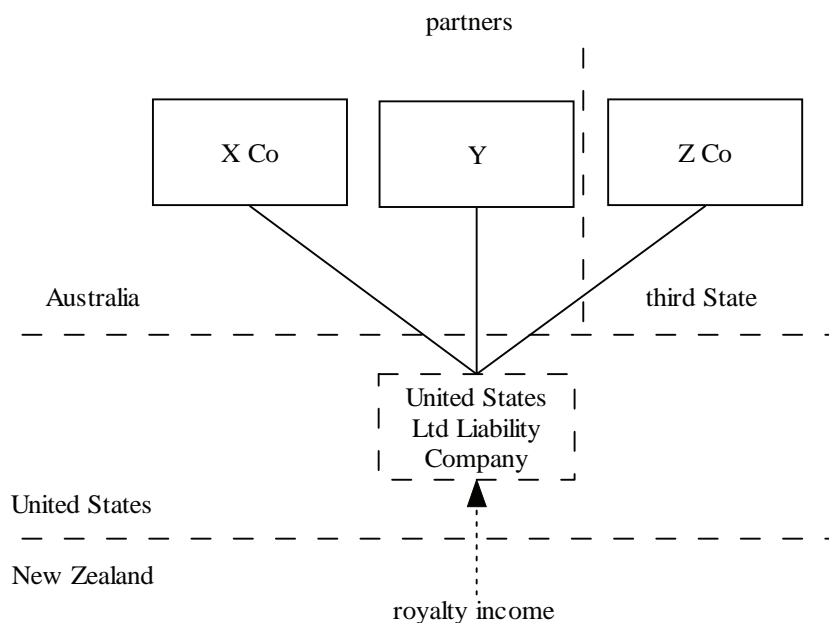
Eligibility for the treaty benefits will also be subject to the application of the respective anti-avoidance measures contained in the specific Article.

2.21 The third situation deals with cases where income is derived from sources in one country through a third country entity which is treated as fiscally transparent in the other country. In these circumstances, the Convention provides that the income will be treated as derived by the participants and eligible for such treaty benefits as would be granted to the beneficiary, member or participant. Treaty benefits in respect of such income will be granted where:

- the beneficiary, member or participant is a resident of the other country; and
- other conditions in the Convention (such as the specific anti-avoidance measures and limitation of relief) are satisfied.

2.22 This outcome will arise irrespective of whether the source country sees the income, profits or gains as the income, profits or gains of the beneficiary, member or participant under the tax law of that country. It is also irrelevant whether the entity is treated as fiscally transparent or not in the third country where it is organised.

Example 2.3



In the above diagram, a New Zealand entity pays royalty income to a United States Limited Liability Company. The United States Limited Liability Company includes Australian partners (X Co and Y) who are residents of Australia for the purposes of the treaty.

As the United States Limited Liability Company is treated as a partnership for US tax law purposes, it is also treated as a partnership for Australian tax law purposes under Australia's foreign hybrid rules.

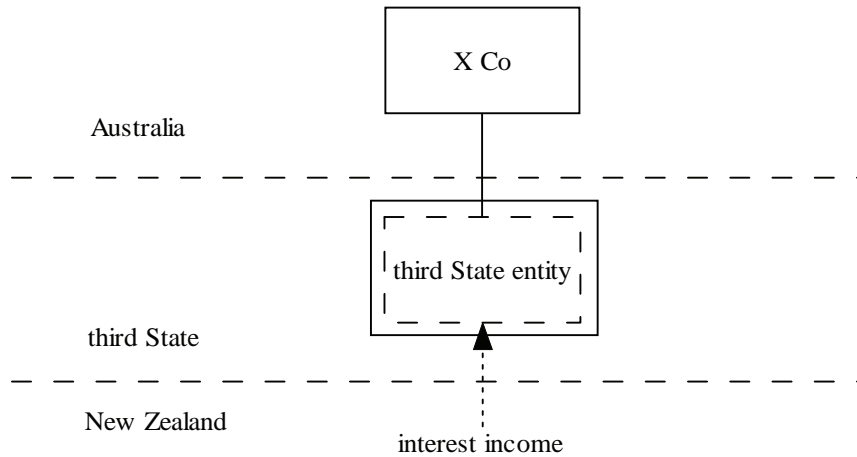
In this example, the royalty income derived through the United States Limited Liability Company on which the Australian resident partners are assessable under Australian income tax law would be eligible for the benefits of the Convention.

Treaty relief under the Convention will not apply to income derived by any partners that are not residents of Australia for purposes of the Convention (in this example, Z Co).

Eligibility for the treaty benefits will also be subject to the application of the respective anti-avoidance measures contained in the specific Article (in this example, paragraph 7 of Article 12 (*Royalties*)).

2.23 On the other hand, if a country regards the income as derived by an entity which it regards as a company, but not a resident, for tax purposes, then income derived from the other country will not be entitled to the benefits of the Convention, even if the shareholders of that company are residents of the first country.

Example 2.4

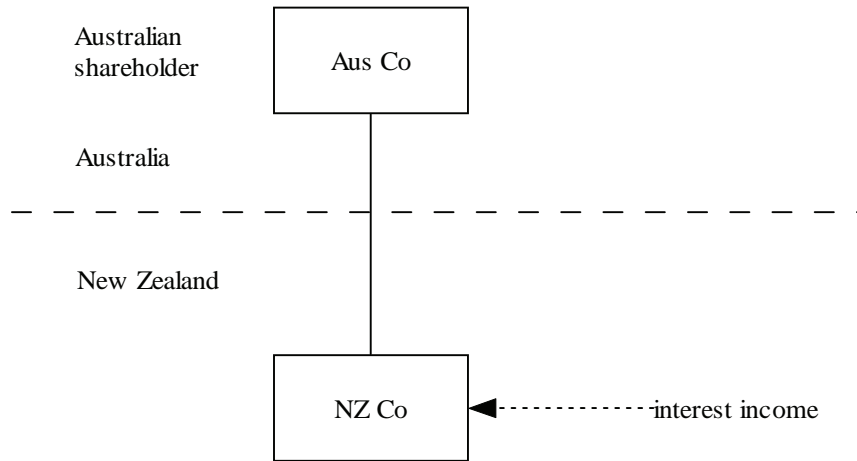


In the above diagram, a New Zealand resident pays interest income to a third State entity that is treated as a company for Australian tax purposes.

In this case, the interest income will not be eligible for the benefits of the Convention. In this example it would not matter if under the tax law of New Zealand, the third State entity were treated as fiscally transparent or as a company. If New Zealand also treats the third State legal entity as a company for its tax purposes, paragraph 2 of Article 1 (*Persons Covered*) would not apply but the outcome would still be the same; that is, no benefits under the Convention.

2.24 Income derived from a country through an entity organised in that country will not be eligible for treaty benefits if the income is treated as derived by that entity under the tax laws of the other country.

Example 2.5



In the above diagram, a New Zealand resident pays interest income to another New Zealand entity, NZ Co. Aus Co, an Australian resident shareholder holds shares in NZ Co. Australia treats NZ Co as a company for tax purposes and as the entity that derives the interest income.

In this example, the interest income would be ineligible for the benefits of the Convention. Australia does not treat the interest income as income of an Australian resident. Accordingly, paragraph 2 of Article 1 (*Persons Covered*) will not apply to treat the income as derived by an Australian resident for purposes of the Convention, even if New Zealand regards NZ Co as a fiscally transparent entity.

2.25 Where the two countries allocate the income to different resident persons (for example, where one country considers that the income is derived by a resident entity, while the other country considers that the same income is derived by a resident who is a participant in that entity), both countries may tax the income in accordance with this provision. Income derived from a country through an entity organised in that country will not be eligible for treaty benefits if the income is treated as derived by a resident entity under the tax laws of that country. In such case, the income would be regarded as domestic source income of a resident which, in accordance with normal treaty principles, would not be limited by the Convention. During negotiations, the two delegations noted that:

‘It is understood that (this) paragraph shall not affect the taxation by a Contracting State of its residents.’

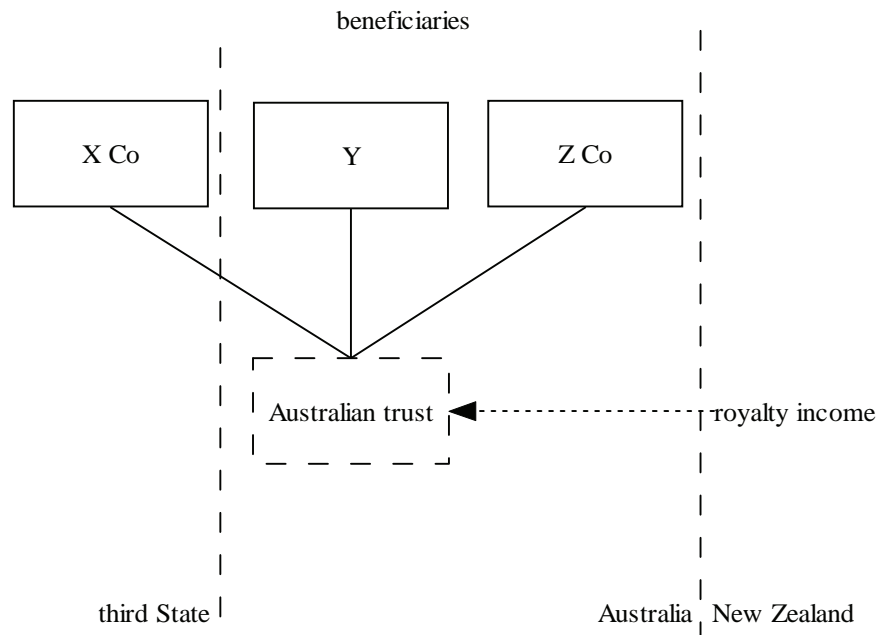
Example 2.6

The facts are the same as Example 2.5 except that New Zealand regards NZ Co as a company and resident there, while Australia regards NZ Co as a fiscally transparent partnership. In this case, New Zealand would not be required to extend source tax reductions on the interest income under Article 11 (*Interest*) of the Convention.

2.26 Where the same income is taxed in the hands of different persons under this provision, paragraph 3 of Article 23 (*Elimination of Double Taxation*) ensures that relief from double taxation is provided.

2.27 The examples above deal with entities that are wholly fiscally transparent or alternatively taxed as a taxable entity such as a company on all their income. As noted above, paragraph 2 of Article 1 applies on an item of income basis. This is illustrated by the following examples which are variations on some of the examples above.

Example 2.7



Royalty income arising in New Zealand is paid to an Australian resident trust. The Australian resident beneficiaries are presently entitled to half of the royalty income and are taxed in Australia under section 97 of the ITAA 1936. A non-resident of Australia is presently entitled to the other half of the royalty income. The trust also derives Australian source income to which no beneficiary is presently entitled and that income is taxed to the trustee under section 99A of that Act.

In this example, the royalty income paid to the trust on which the Australian resident beneficiaries are assessable under Australian income tax law would be eligible for the benefits of the Convention. As the Australian beneficiaries are only entitled to half of the income, only the half of that royalty income attributable to the Australian resident beneficiaries would be eligible for the benefits of the Convention.

Treaty relief will not apply to income derived by any beneficiaries that are not residents of Australia for purposes of the Convention.

Eligibility for the treaty benefits will also be subject to the application of any anti-avoidance measures contained in the specific income Article (in this example, paragraph 7 of Article 12 (*Royalties*)).

The fact that the trustee is taxable in Australia on other items of income of the trust does not affect the fact that the trust is fiscally transparent with respect to the royalty income.

If the trustee is a resident of Australia, it is entitled to treaty benefits in relation to the income in respect of which the trustee is liable to tax under section 99A of the ITAA 1936 as a resident of Australia.

2.28 The same result is obtained even if New Zealand regarded the trust or trustee as taxable on the income rather than the beneficiaries.

2.29 Relief under the Convention will not apply to a beneficiary who is presently entitled to the royalty income but who is not an Australian resident for purposes of the Convention.

2.30 No treaty benefits are available under the Convention where the income is exempt from tax in New Zealand on the basis that it is derived by a transitional resident of New Zealand. [*Article 4, paragraph 4*]

2.31 Where dividends, interest or royalties arising in one country are derived through a trust and are taxed in the other country in the hands of the trustee, paragraph 4 of Article 3 (*General Definitions*) provides that such income will be deemed to be beneficially owned by a resident of the latter country. Accordingly, that income will be treated for the purposes of the Convention as income derived by a resident of that country, even if the source country would treat the trust as fiscally transparent.

Example 2.8

The facts are the same as Example 2.7 except that no beneficiary is presently entitled to the royalty income and the trustee is taxed on that income in Australia under section 99A of the ITAA 1936.

In this example, the royalty income would *prima facie* be eligible for treaty benefits. As the trustee is assessable on the income for Australian tax purposes, the trust is not fiscally transparent in Australia with respect to the royalty income.

Note however to the extent that the Australian tax paid by the trustee is subsequently refunded to a non-resident beneficiary, the income will not be regarded as beneficially owned by an Australian resident (see the explanation on paragraph 4 of Article 3 (*General Definitions*) in paragraphs 2.66 to 2.71).

Eligibility for the treaty benefits will be subject to the application of any anti-avoidance measures contained in the specific income Article (in this example, paragraph 7 of Article 12 (*Royalties*)).

2.32 The same result is obtained even if New Zealand regarded the beneficiaries as taxable on the income rather than the trust or trustee.

2.33 In the case of Australian managed investment trusts, an exception to the discussion here is created by paragraph 7 of Article 4 (*Resident*) (see paragraphs 2.89 to 2.96).

Article 2 — Taxes Covered

2.34 This Article specifies the existing taxes of each country to which the Convention applies. These are, in the case of Australia, the Australian income tax, the petroleum resource rent tax and the fringe benefits tax.

2.35 The term ‘income tax’ includes Australian income tax imposed on capital gains.

2.36 Although Australia considers the petroleum resource rent tax to be encompassed by the term ‘income tax’, a specific reference to this has been included in the Convention to put beyond doubt that it is a tax covered.

2.37 As with the existing New Zealand Agreement, the Convention generally does not cover Australia’s goods and services tax (GST), customs duties, state taxes and duties and estate tax and duties.

2.38 However, paragraph 7 of Article 24 (*Non-Discrimination*) provides that that Article applies to all federal and state taxes (but not local taxes). Similarly, paragraph 1 of Article 26 (*Exchange of Information*) and paragraph 2 of Article 27 (*Assistance in the Collection of Taxes*) provide that all federal taxes administered by the Commissioner are covered by those Articles. [*Article 24, paragraph 7, Article 26, paragraph 1 and Article 27, paragraph 2*]

2.39 For New Zealand, the Convention applies to income tax, including the fringe benefits tax. However, paragraph 7 of Article 24 (*Non-Discrimination*) provides that that Article applies to all New Zealand taxes apart from any taxes that may be imposed by local authorities. Similarly, paragraph 1 of Article 26 (*Exchange of Information*) and paragraph 2 of Article 27 (*Assistance in the Collection of Taxes*) provide that all taxes imposed under New Zealand's tax laws are covered by those Articles. [*Article 24, paragraph 7, Article 26, paragraph 1, and Article 27, paragraph 2*]

Identical or substantially similar taxes

2.40 The application of the Convention (including Articles 26 and 27) will be automatically extended to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of, the existing taxes.

Notification of changes to the tax laws

2.41 The competent authorities (that is, the Commissioner in the case of Australia and the Commissioner of Inland Revenue in the case of New Zealand, or their authorised representatives) are required to notify each other in the event of a significant change in the taxation law of the respective countries, within a reasonable period of time after those changes. [*Article 2, paragraph 2*]

Article 3 — General Definitions

2.42 This Article provides general definitions and rules of interpretation applicable throughout the Convention. In particular, paragraph 1 defines a number of basic terms used in the Convention. The introduction to paragraph 1 makes clear that these definitions apply for all purposes of the Convention, unless the context requires otherwise.

Definition of Australia

2.43 As in Australia's other modern tax treaties, ***Australia*** is defined to include certain external territories and the continental shelf. The Convention also refers specifically to the 'exclusive economic zone'.

Although the exclusive economic zone is considered to be covered by the definition used in Australia's other modern tax treaties, it is specifically included in the Convention for additional clarity. 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 1936, certain sea installations and offshore areas are to be treated as part of Australia). [Article 3, subparagraph 1a)]

Definition of New Zealand

2.44 The definition is similar to that under the existing New Zealand Agreement. ***New Zealand*** covers the territory of New Zealand but does not include Tokelau. Unlike the definition in the existing New Zealand Agreement, no specific mention is made of the Cook Islands and Niue. These jurisdictions are self-governing states and are not covered by the definition of New Zealand. It includes any area beyond the territorial sea under New Zealand legislation and in accordance with international law as an area in which New Zealand may exercise sovereign rights with respect to natural resources. [Article 3, subparagraph 1b)]

Definitions of business and enterprise

2.45 The terms ***enterprise of a Contracting State*** and ***enterprise of the other Contracting State*** are defined as an enterprise carried on by residents of the respective countries. [Article 3, subparagraph 1g)]

2.46 The term ***enterprise*** is stated to apply to the carrying on of any business. The term ***business*** is defined to include the performance of professional services and other activities of an independent character. Both these definitions are identical to the definitions added to the OECD Model concurrently with the deletion of Article 14 (*Independent Personal Services*). The inclusion of the two definitions is intended to clarify that income from the performance of professional services or other activities of an independent character is dealt with under Article 7 (*Business Profits*) and not Article 21 (*Other Income*). [Article 3, subparagraphs 1c) and f)]

Definition of company

2.47 The definition of ***company*** in the Convention accords with the OECD Model, and means any body corporate or any entity which is treated as a body corporate for tax purposes.

2.48 The Australian tax law treats certain trusts (public unit trusts and public trading trusts) and corporate limited partnerships (limited liability partnerships) in the same way as companies for income tax purposes.

These trusts and partnerships are included as companies for the purposes of the Convention. [*Article 3, subparagraph 1d*]

Definition of competent authority

2.49 The ***competent authority*** is the person or institution specifically authorised to perform certain actions under the Convention. For instance, the competent authority is required to give certain notifications (for example, in paragraph 2 of Article 2 (*Taxes Covered*), the competent authorities are required to notify each other of any significant changes to the relevant tax laws of their respective countries) and perform certain tasks (for example, exchange tax information in accordance with Article 26 (*Exchange of Information*)).

2.50 In the case of Australia, the competent authority is the Commissioner or an authorised representative of the Commissioner. In the case of New Zealand, the competent authority is the Commissioner of Inland Revenue or an authorised representative of the Commissioner. [*Article 3, subparagraph 1e*]

Definition of international traffic

2.51 In the Convention, this term is of relevance for taxation of profits from shipping and air transport operations (Article 8 (*Shipping and Air Transport*)), income, profits or gains from the alienation of ships and aircraft (paragraph 3 of Article 13 (*Alienation of Property*)) and wages of crew (paragraph 3 of Article 14 (*Income from Employment*)).

2.52 The definition of ***international traffic*** covers international transport by a ship or aircraft operated by an enterprise of one country, as well as domestic transport within that country. However, it does not include transport where the ship or aircraft is operated solely between places in the other country; that is, where the place of departure and the place of arrival of the ship or aircraft are both in that other country, irrespective of whether any part of the transport occurs in international waters or airspace. For example, a ‘voyage to nowhere’ which begins and ends in Sydney on a ship operated by a New Zealand enterprise would not come within the definition of ‘international traffic’, even if the ship travels through international waters in the course of the cruise. [*Article 3, subparagraph 1h*]

Definition of national

2.53 The Convention defines ***national*** by reference to an individual’s nationality or citizenship. A company, partnership or association will be a national if it is created or organised under the laws of Australia or

New Zealand. For example, a company's nationality is determined by where it is incorporated. [Article 3, subparagraph 1i)]

2.54 The concept of nationality is used in subparagraph c) of paragraph 2 of Article 4 (*Resident*), subparagraph b) of paragraph 1 of Article 19 (*Government Service*) and Article 24 (*Non-Discrimination*).

Definition of person

2.55 The definition of *person* in the Convention generally accords with Australia's normal tax treaty practice and includes individuals, companies and any other body of persons. However, a specific reference to partnerships and trusts is included in the Convention. The intention is for the term 'person' to be given a broad meaning for the purposes of the Convention. During negotiations, the delegations noted that a reference to 'a trust' was included in the definition of the term 'person':

'...to ensure that trusts may be covered by a reference to 'a person that is fiscally transparent' in paragraph 2 of Article 1 (*Persons Covered*) and for purposes of paragraph 7 of Article 4 (*Resident*) which refers to a managed investment trust.'

[Article 3, subparagraph 1j)]

Definition of tax

2.56 For the purposes of the Convention, the term *tax* does not include any amount of penalty or interest imposed under the respective domestic tax law of the two countries. [Article 3, subparagraph 1k)]

2.57 In the case of a resident of Australia, any penalty or interest component of a liability determined under the domestic taxation law of New Zealand with respect to income that New Zealand is entitled to tax under the Convention would not be a creditable New Zealand tax for the purposes of paragraph 1 of Article 23 (*Elimination of Double Taxation*). This is in keeping with the meaning of 'foreign income tax' in subsection 770-15(1) of the *Income Tax Assessment Act 1997* (ITAA 1997). Accordingly, such a penalty or interest liability would be excluded from calculations when determining the Australian resident taxpayer's foreign income tax offset entitlement under paragraph 1 of Article 23 (pursuant to Division 770 of the ITAA 1997 — Foreign Income Tax Offsets).

Definition of recognised stock exchange

2.58 The term is used in relation to withholding tax limits in Article 10 (*Dividends*). No withholding tax will apply to a dividend paid from an Australian resident company to a New Zealand resident company

which holds 80 per cent of the voting power of the paying company where its principal class of shares is listed and regularly traded on a recognised stock exchange.

2.59 The term ***recognised stock exchange*** is defined as:

- the Australian Securities Exchange and any other Australian stock exchange recognised as such under Australian law;
- the securities markets (other than the New Zealand debt market) operated by the New Zealand Exchange Limited; and
- any other stock exchange agreed upon by the competent authorities under the Convention.

[Article 3, subparagraph 11]

Definition of managed investment trust

2.60 The term ***managed investment trust*** is defined as a trust that is a managed investment trust for the purposes of Australian tax. The definition is relevant to paragraph 7 of Article 4 (*Resident*), which in certain circumstances treats, for the purposes of the Convention, a managed investment trust as an individual resident of Australia and as the beneficial owner of the income it receives. *[Article 3, subparagraph 1m]*

2.61 Section 12-400 of Schedule 1 to the *Taxation Administration Act 1953* defines the term ‘managed investment trust’. In general terms, a trust is a managed investment trust in relation to an income year if, at the time of the first fund payment is made:

- the trustee is an Australian resident, or the central management and control of the trust is in Australia;
- the trust satisfies certain requirements under the *Corporations Act 2001* relating to the management of investments; and
- the trust is either listed on an approved stock exchange in Australia, or is widely held.

Definition of natural resources

2.62 The term ***natural resources*** is defined for the purposes of Articles 5 (*Permanent Establishment*) and 6 (*Income from Real Property*) as meaning naturally occurring deposits or sources of materials and substances, such as minerals, oils, gas and water. It also includes forests and fish. During negotiations, the delegations noted that:

‘It is understood that the term ‘naturally-occurring’ in (paragraph 2) refers to both forests and fish.’

[Article 3, paragraph 2]

Terms not specifically defined

2.63 Where a term is not specifically defined within the Convention, 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 taxation law of the country applying the Convention at the time of its application. In that case, the meaning of the term under the taxation law of the country will have precedence over the meaning it may have under other domestic laws.

2.64 The same term may have a differing meaning and a varied scope within different Acts relating to specific taxation measures. For example, GST definitions are sometimes broader than income tax definitions. The definition more specific to the type of tax should be applied in such cases. For example, where the matter subject to interpretation is an income tax matter, but definitions exist in either the ITAA 1936 or the ITAA 1997 and the *A New Tax System (Goods and Services Tax) Act 1999*, the income tax definition would be the relevant definition to be applied.

2.65 If a term is not defined in the Convention, but has an internationally understood meaning in tax treaties and a meaning under the domestic law, the context would normally require that the international meaning be applied. [Article 3, paragraph 3]

Dividends, interest or royalties derived by or through trusts

2.66 For the purposes of Articles 10 (*Dividends*), 11 (*Interest*) and 12 (*Royalties*), dividends, interest or royalties arising in a country and derived by or through a trust are deemed to be beneficially owned by a resident of the other country where such income is subject to tax in that other country in the hands of a trustee of that trust.

2.67 This provision accords with New Zealand treaty practice and has a similar effect to paragraph 2 of Article 3 of the existing New Zealand

Agreement. It ensures that the trustee is treated as the beneficial owner of dividends, interest or royalties for the purposes of obtaining benefits under the respective Articles, but only where those dividends, interest or royalties are subject to tax in the hands of the trustee. *[Article 3, paragraph 4]*

2.68 Where tax paid by a trustee is credited against the tax payable by a beneficiary who is not a resident of Australia in accordance with section 98A of the ITAA 1936, the trustee will not be regarded as subject to tax on that income.

2.69 Furthermore, the trustee will not be regarded as subject to tax on income derived through the trust where the tax is refunded. In the course of negotiations, the two delegations noted that:

‘It is understood that a trustee is not regarded as being subject to tax to the extent that the trustee pays tax that is subsequently refunded to a non-resident beneficiary.’

2.70 For example, where a trust derives foreign income to which no beneficiary is presently entitled, the trustee is assessable on that income if the trust is an Australian resident trust. The later distribution of the income to a beneficiary may allow the beneficiary to claim a refund of the tax paid by the trustee under section 99D of the ITAA 1936 if the income is attributable to a period in which the beneficiary was not an Australian resident. In such cases, the trustee will not be regarded as subject to tax for the purposes of paragraph 4 of Article 3. It follows that, where the income comprises dividends, interest or royalties arising in New Zealand, New Zealand will not be limited by Articles 10, 11 and 12 of the Convention.

2.71 Where dividends, interest or royalties arising in one country are taxed in the hands of a beneficiary who is a resident of the other country, it is intended that the beneficiary would generally be treated as the beneficial owner of the income.

Article 4 — Resident

Residential status

2.72 This Article sets out the basis upon which the residential status of a person is to be determined for the purposes of the Convention. Residential status in one or other country is a necessary condition for the provision of relief under the Convention. For both Australia and New Zealand, ‘resident’ status is determined by reference to the person’s liability to tax as a resident under the laws of the respective country.

2.73 The term ‘liable to tax as a resident’ is intended to capture those persons who are subject to comprehensive taxation under a country’s domestic taxation laws. A person may be regarded as liable to tax as a resident even where the country does not in fact impose tax. For example, under Australian law charitable institutions are exempt from income tax but only if they meet the requirements for exemption. Such institutions are liable to tax for the purposes of the Article and, therefore, are ‘residents’ under the Convention.

2.74 The second sentence of paragraph 1 of the Article deals with a person who may be considered to be a resident of a country according to its domestic laws but is only liable to taxation on income from sources in that country, such as foreign diplomatic and consular staff. In the Australian context, this also means, for example, that Norfolk Island residents, who are generally subject to Australian tax on Australian source income only, are not residents of Australia for the purposes of the Convention. Accordingly, New Zealand will not have to forgo tax in accordance with the Convention on income derived by residents of Norfolk Island from sources in New Zealand (which will not be subject to Australian tax). *[Article 4, paragraph 1]*

Residency of governments

2.75 Article 4 follows the OECD Model in specifically providing that the State, or a political subdivision, or local authority of the State, are residents for the purposes of the Convention. This means that the Australian Government, the state governments and local councils of Australia will be residents for the purpose of the Convention. This does not necessarily mean that income, profits or gains derived by these bodies from sources in New Zealand will be subject to tax in New Zealand as sovereign immunity principles may apply. *[Article 4, paragraph 1]*

Dual residents

2.76 A set of tie-breaker rules is included for determining how residency is to be allocated to one or other of the countries for the purposes of the Convention if a taxpayer, whether an individual, a company or other taxable unit, qualifies as a dual resident; that is, as a resident of both countries in accordance with paragraph 1 of the Article.

2.77 Notwithstanding that the Convention deems certain dual residents to be a resident only of one country for treaty purposes, a dual resident remains a resident for the purposes of Australian domestic tax law. Accordingly, that person remains liable to tax in Australia as a resident, insofar as the Convention allows.

Individuals

2.78 The tie-breaker rules for individuals apply certain tests, in a descending hierarchy, for determining the residential status (for the purposes of the Convention) of an individual who is liable to tax as a resident of both countries under each country's domestic law. These rules, in order of application, are:

- if the individual has a permanent home available to that individual in only one of the countries, the person is deemed to be a resident solely of that country for the purposes of the Convention;
- if the individual has a permanent home available in both countries or in neither, then the person's residential status takes into account the person's personal or economic relations with Australia and New Zealand, and the person is deemed for the purposes of the Convention to be a resident only of the country with which the person has the closer personal and economic relations (centre of vital interests);
- if the individual's centre of vital interests cannot be determined, the individual shall be deemed to be a resident of the country in which that individual has an habitual abode; or
- if the individual has an habitual abode in both Australia and New Zealand or in neither, the individual shall be deemed to be a resident of the country of which they are a national.

[Article 4, paragraph 2]

2.79 In the course of negotiations, the two delegations noted that:

‘It is understood that, although the Convention does not provide for mutual agreement as the final tie-breaker step for individuals, it remains open to the competent authorities to enter into mutual agreement procedure discussions under Article 25 (*Mutual Agreement Procedure*) in dual resident individual cases.’

Other persons

2.80 Where a person that is not an individual (such as a company) is a resident of both countries in accordance with paragraph 1, the person will be deemed to be a resident of the country in which its place of effective management is situated.

2.81 In cases where the country in which the place of effective management is situated cannot be determined, or the place of effective

management is situated neither in Australia or New Zealand, the competent authorities are to endeavour to determine by mutual agreement under Article 25 (*Mutual Agreement Procedure*) the country of which the person shall be deemed to be a resident for the purposes of the Convention.

2.82 In doing so, the competent authorities are to have regard to the person's places of management, the place where it is incorporated or otherwise constituted and any other relevant factors, such as those listed in paragraph 24 of the 2008 OECD Commentary to the OECD Model (OECD Model Commentary) on Article 4. In the absence of agreement between the competent authorities, such a person shall not be entitled to any relief or exemption from tax provided by the Convention.

2.83 Such persons are not denied all of the benefits of the Convention, only relief or exemption from tax. This means that Articles such as Article 24 (*Non-Discrimination*) and 25 (*Mutual Agreement Procedure*) still apply to them. [Article 4, paragraph 3]

Residency of participants in dual listed company arrangements

2.84 Paragraph 5 of the Article provides a specific rule for companies who are participants in 'dual listed company arrangements' and residents of both Australia and New Zealand. Instead of the tie-breaker rule in paragraph 3 of the Article applying, the company will be deemed to be the resident of the country in which it is incorporated provided that it has its primary stock exchange listing in that country. [Article 4, paragraph 5]

2.85 The term ***dual listed company arrangement*** is defined exhaustively to refer to an arrangement consisting of two publicly listed companies which, while retaining their status as separate legal entities, seek to broadly operate as one company. While the companies retain separate shareholdings and stock exchange listings the arrangement provides for alignment of the strategic directions of the two companies involved and the economic interests of their respective shareholders. The treaty sets out various, cumulative criteria by which such an arrangement can be identified.

2.86 The criteria are:

- the appointment of common (or almost identical) boards of directors;
- unified management;
- provision for the payment of equalised distributions as determined by an equalisation ratio (though this ratio may

change over time) and applying to distributions on winding up of either company to this contractual arrangement;

- voting in effect as a single electorate on substantial issues; and
- cross-guarantees or similar financial arrangements to support each company's material ongoing financial obligations under the dual listing arrangement.

2.87 The first criterion does not apply to dual listed company (DLC) arrangements where the effect of relevant regulatory requirements would otherwise prevent this. For example, provisions regulating an Australian industry require that at least two-thirds of the directors of an enterprise operating in that industry be Australian citizens. If a company covered by those provisions sought to enter into a DLC arrangement with a New Zealand company that under New Zealand law was required to maintain a similar number of New Zealand citizens as directors, the two companies could not have common boards of directors. This would prevent them from being able to access this tie-breaker test. The intention is that they not be prohibited from doing so because other regulatory requirements prevent it.

2.88 The final criterion does not apply to DLC arrangements where the companies which are a party to the arrangement are prevented from providing such guarantees or financial support under a regulatory framework applicable to one or both companies; for example, if providing such cross-guarantees would breach the Australian Prudential Regulation Authority's capital adequacy standards for approved deposit institutions. *[Article 4, paragraph 6]*

Managed investment trusts

2.89 The Convention also specifically provides that, notwithstanding any other provisions of the Convention, trusts that are managed investment trusts for Australian tax purposes and that receive income (including profits and gains) arising in New Zealand, shall be treated, for purposes of applying the Convention to that income, as an individual resident of Australia and as the beneficial owner of the income it receives, but only to the extent that residents of Australia are the owners of the beneficial interests in the managed investment trust.

2.90 However, if:

- the managed investment trust has its principle class of units listed on the Australian Securities Exchange, or any other Australian stock exchange recognised as such under

Australian law; and is regularly traded on one or more recognised stock exchanges; or

- at least 80 per cent of the value of beneficial interests in the managed investment trust is owned by Australian residents,

the managed investment trust shall be treated as an individual resident of Australia and as the beneficial owner of all the income it receives.

[Article 4, paragraph 7]

2.91 Paragraph 7 of Article 4 is designed to facilitate the claiming of treaty benefits for New Zealand investments held by MITs. The definition of MIT for this purpose is contained in subparagraph m) of paragraph 1 of Article 3 (*General Definitions*) and is discussed in paragraph 2.60. Generally under that definition a managed investment trust will be directly or indirectly widely held.

2.92 It is often practically difficult for the many investors in widely held MITs to individually claim treaty benefits in the source country. This provision is designed to overcome that practical difficulty.

2.93 The provision achieves this by treating the MIT as an individual resident in Australia and the beneficial owner of the income for purposes of applying the Convention to income received by the MIT, where the MIT meets certain specified conditions. This allows the MIT to claim treaty benefits directly under Articles 6 to 21 of the Convention. As it is almost invariably the investors in the MIT rather than the MIT who are taxed on that income on a fiscally transparent basis, in the absence of this provision it would be those investors who would normally have to claim treaty benefits under paragraph 2 of Article 1 (*Persons Covered*). This provision is thus an exception to this extent to the general operation of paragraph 2 of Article 1 (*Persons Covered*).

2.94 Paragraph 7 of Article 4 (*Resident*) is designed to ensure that the provision does not give rise to treaty shopping by third country investors. The provision achieves this result in two different ways. If the MIT is listed and regularly traded on one or more recognised stock exchanges as defined in sub-subparagraph 1)(i) of paragraph 1 of Article 3 (*General Definitions*) or at least 80 per cent by value of the beneficial interests in the MIT are owned by residents of Australia, it is treated as entitled to treaty benefits with respect to all of its income arising in New Zealand. If neither of these tests is satisfied, the MIT is entitled to treaty benefits only to the extent to which residents of Australia are the owners of the beneficial interests in the MIT.

2.95 For these purposes, unitholders that are residents of Australia for treaty purposes and are liable to tax in Australia on income received by a

MIT would be regarded as residents of Australia that are owners of the beneficial interests in the MIT. Thus, Australian resident individuals and companies that own units in the MIT that are not held on trust will be treated as owners of the beneficial interests in the MIT where the income received by them is allocated to them for tax purposes. This will also be the case for unitholders in the MIT that are life companies or superannuation entities to which the MIT income is allocated for tax purposes, where such entities are liable to tax in Australia on their worldwide income. Where units in one MIT are held by another MIT (investor MIT), the investor MIT will be regarded as an Australian resident that is the owner of the beneficial interests in the first MIT where the investor MIT satisfies the requirements of paragraph 7 to be treated as an individual resident in Australia with respect to all the income it receives.

2.96 Paragraph 7 of Article 4 (*Resident*) is not intended to prevent either country from taxing income derived by its own residents through a MIT. During negotiations, the delegations noted that:

‘It is understood that ... paragraph 7 of Article 4 (*Resident*) shall not affect the taxation by a Contracting State of its residents.’

[Article 4, paragraph 7]

Limitation of relief

2.97 The Convention also provides that where an individual is a transitional resident of New Zealand and is, for that reason, exempt from tax in New Zealand on certain income, profits or gains in New Zealand, then Australia will not be required to provide any relief specified in the Convention in respect of such income, profits or gains.

2.98 ‘Transitional resident’ is a term under New Zealand law, and is intended to equate to temporary residence. *[Article 4, paragraph 4]*

2.99 This provision only applies to transitional residents of New Zealand. It is not intended that similar limitations on treaty benefits apply to temporary residents of Australia.

Article 5 — Permanent Establishment

Role and definition

2.100 The application of various provisions of the Convention (principally Article 7 (*Business Profits*)) is dependent upon whether a person who is a resident of one country carries on business through a permanent establishment in the other country, and if so, whether income

derived by that person is attributable to, or assets of that person are effectively connected with, that permanent establishment.

2.101 The definition of the term ‘permanent establishment’ in this Article corresponds generally with definitions of the term in Australia’s more recent tax treaties, although the definition in the Convention also includes a provision dealing specifically with services. The term also fully encompasses the concept of ‘fixed base’, which is used in the existing New Zealand Agreement in a separate Article dealing with independent personal services. As such services will now be dealt with under Article 7 (*Business Profits*), it is intended that places that constitute a fixed base for purposes of the existing New Zealand Agreement would come within the meaning of permanent establishment for the purposes of the Convention.

Meaning of permanent establishment

2.102 The primary meaning of ***permanent establishment*** is expressed as being a fixed place of business through which the business of an enterprise is wholly or partly carried on. To be a permanent establishment within the primary meaning of that term, the following requirements must be met:

- there must be a place of business;
- the place of business must be fixed (both in terms of physical location and in terms of time); and
- the business of the enterprise must be carried on through this fixed place.

[Article 5, paragraph 1]

2.103 Other paragraphs of this 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 — for example:

- an office;
- a factory;
- a place of extraction of natural resources; or
- an agricultural, pastoral or forestry property.

2.104 As paragraph 2 of this Article is subordinate to paragraph 1, the examples listed will only constitute a permanent establishment if the primary definition in paragraph 1 is satisfied. *[Article 5, paragraph 2]*

Building site or construction or installation project

2.105 A building site or construction or installation project constitutes a permanent establishment only if it lasts more than six months. In the course of negotiations, the two delegations noted:

‘The delegations agreed that a permanent establishment will exist where building sites or projects last for more than six months regardless of whether or not the paragraph 1 test has been satisfied. Sites or projects that last for less than six months can never constitute a permanent establishment.’

2.106 The phrase ‘building site or a construction, installation or assembly project’ includes not only places used for the construction of buildings but also for the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipelines and excavating and dredging. Planning and supervision are considered part of the building site if carried out by the construction contractor. However, planning and supervision carried out by another unassociated enterprise will not be taken into account in determining whether the construction contractor has a permanent establishment in Australia. *[Article 5, paragraph 3]*

Agricultural, pastoral or forestry property

2.107 Most of Australia’s tax treaties include as a permanent establishment an agricultural, pastoral or forestry property. This reflects Australia’s usual practice of providing for taxation of profits from the exploitation of Australian land for the purposes of primary production under Article 7 (*Business Profits*).

2.108 However, under the Convention, profits from agriculture, forestry or fishing are dealt with under Article 6 (*Income from Real Property*). This is reflected in the phrase ‘including profits of an enterprise from agriculture, forestry or fishing’ in paragraph 1 of that Article.

2.109 Nevertheless, a fixed place of business that is used for primary production purposes, such as a farm or forestry property, will constitute a permanent establishment. This has significance for Articles where the concept of permanent establishment is relevant, for example, in determining the right of a country to tax income (that is, income from

employment under Article 14) or the country in which income arises (for example, interest).

Deemed permanent establishment

Performance of services

2.110 Where an enterprise performs services through an individual who is present in a country for a period exceeding 183 days in any 12-month period, and more than 50 per cent of the gross revenues attributable to active business activities of the enterprise during this period are derived from those services, it will be deemed to have in that country a permanent establishment through which those activities are performed (unless the activities are of a type described in paragraph 7 of this Article and are of a preparatory or auxiliary nature). This provision will generally apply in the case of self-employed persons or other small business enterprises where the profits of the business are mainly derived from the activities of one person. *[Article 5, sub-subparagraph 4a)(i)]*

2.111 Services are also deemed to be carried on through a permanent establishment in a country where an enterprise performs services in that country for a period exceeding 183 days in any 12-month period, and those services are performed for the same project or for connected projects through one or more individuals who are present and performing such services in that country (unless the activities are of a type described in paragraph 7 of this Article and are of a preparatory or auxiliary nature). *[Article 5, sub-subparagraph 4a)(ii)]*

2.112 For these purposes, an enterprise performs services mainly through the activities of the entrepreneur or persons who are in a paid employment relationship with the enterprise (personnel). These personnel include employees and other persons receiving instructions from the enterprise (for example, dependent agents).

2.113 Paragraph 5 of the Article provides further rules in respect of services performed for the same project or connected projects (those described in paragraph 2.111). Services performed by an individual on behalf of one enterprise shall not be considered to be performed by another enterprise through that individual unless that other enterprise supervises, directs or controls the manner in which these services are performed by the individual.

Example 2.9

Esky Co, an Australian resident, offers technical support and advice to its clients over the telephone. It has outsourced this function to Chilly Bin Co, a New Zealand resident. Chilly Bin Co operates a call centre which provides similar support for a number of companies as well as

Esky Co. For a period of twelve months, the employees of Chilly Bin Co provide technical support to various clients of Esky Co.

Since the employees of Chilly Bin Co are not under the supervision, direction or control of Esky Co, Esky Co is not considered to be performing services in New Zealand through those employees for the purposes of sub-subparagraph a)(ii) of paragraph 4 of Article 5.

2.114 Further, in calculating whether the 183 day period has been exceeded for the purposes of sub-subparagraph a)(ii) of paragraph 4 of Article 5, paragraph 5 excludes services performed through an individual who is present and performing such services in a country for any period not more than five days. However, they will not be so excluded if those services are performed by that individual on a regular or frequent basis.

Example 2.10

Sushi Co, an Australian resident, provides training services to apprentice sushi chefs. Itto, an employee of Sushi Co, travels to New Zealand and remains there training New Zealand apprentices for 180 days. Due to an unexpected number of apprentices signing up for training, Bruce, another employee of Sushi Co, travels to New Zealand and spends four days assisting Itto. This is the only trip to New Zealand that Bruce makes.

As Bruce is present and performing services for less than five days, his four days in New Zealand are disregarded when determining whether Sushi Co has a permanent establishment in New Zealand.

However, if Bruce were to return to New Zealand for such purposes once a month, the days that he is present and performing the services would be counted in determining whether Sushi Co has a permanent establishment in New Zealand, notwithstanding that each visit may be for less than five days.

[Article 5, paragraph 5]

Natural resource activities

2.115 Where an enterprise carries on activities (including the operation of substantial equipment) in the exploration for, or exploitation of, natural resources or standing timber within a country for a period exceeding 90 days in any 12-month period, it will be deemed to have in that country a permanent establishment through which those activities are performed (unless the activities are of a type described in paragraph 7 of this Article and are of a preparatory or auxiliary nature). Any time during which the substantial equipment was used for such purposes in that country is also counted for the purpose of computing the number of days in this paragraph. *[Article 5, subparagraph 4b)]*

Substantial equipment

2.116 If an enterprise operates substantial equipment in a country for one or more periods which exceed, in the aggregate, 183 days in any 12-month period, the activity will be deemed to be performed through a permanent establishment (unless the activities are of a type described in paragraph 7 of this Article and are of a preparatory or auxiliary nature). Any time during that 12-month period when the substantial equipment is used in the exploitation of or exploration for natural resources or standing timber in that country is also counted for the purpose of computing the number of days in this paragraph. *[Article 5, subparagraph 4c)]*

2.117 Subparagraphs b) and c) of paragraph 4 together reflect Australia's reservation to the OECD Model concerning the use of substantial equipment. Australia's experience is that the permanent establishment provision in the OECD Model may be inadequate to deal with high value mobile activities involving the use of such equipment.

2.118 The words 'operation' and 'operates' have been included to clarify that only active use of substantial equipment assets will be captured by subparagraphs b) and c) of paragraph 4. This means that an enterprise that merely leases substantial equipment to another person for that other person's own use in a country, would not be deemed to have a permanent establishment in that country under these provisions.

2.119 For example, if a New Zealand enterprise itself operates a mobile crane at an Australian port for more than 183 days in a 12-month period, the New Zealand enterprise would be deemed to have a permanent establishment in Australia under subparagraph c) of paragraph 4. If, however, that New Zealand enterprise merely leases the mobile crane to another person and that other person operates the crane at an Australian port for its own purposes, the New Zealand enterprise would not be deemed to have a permanent establishment in Australia under subparagraph c) of paragraph 4. However, if that other person operates the substantial equipment for or on behalf of the enterprise, the enterprise would be considered to operate the equipment in the country.

2.120 The meaning of the term 'substantial' depends on the relevant facts and circumstances of each individual case. Factors such as the size, quantity or value of the equipment, or the role of the equipment in income producing activities, are relevant in determining whether the equipment is substantial. However, some examples of substantial equipment would include:

- industrial earthmoving equipment or construction equipment used in road building, dam building or powerhouse construction;

- manufacturing or processing equipment used in a factory; or
- oil or drilling rigs, platforms and other structures used in the petroleum, gas or mining industry.

Anti-avoidance provision

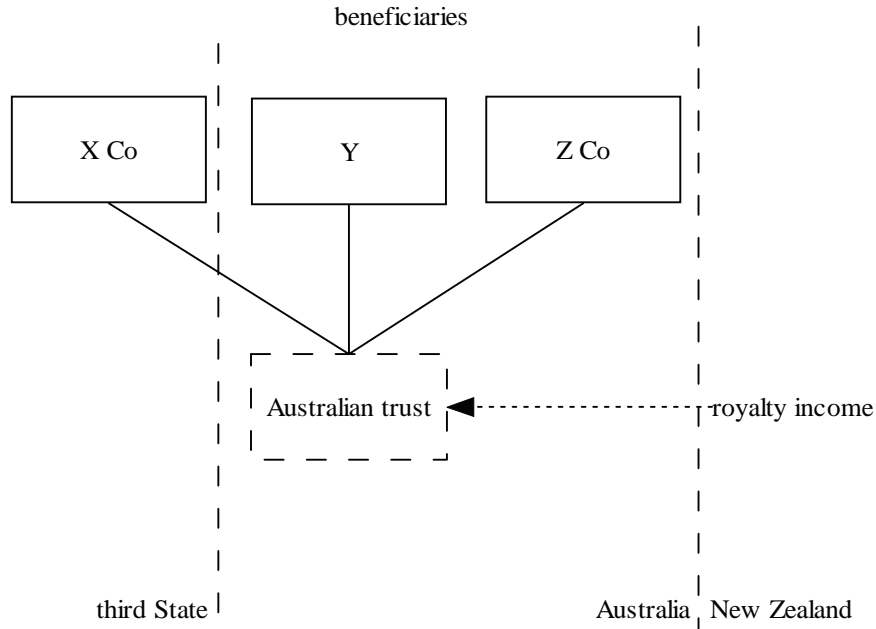
2.121 Given that Article 5 of the Convention contains certain timeframes, an anti-avoidance rule is included to ensure that where associated enterprises carry on connected activities, the periods will be aggregated in determining whether an enterprise has a permanent establishment in the country in which the activities are being carried on. Activities will be regarded as connected where, for example, different stages of a single project are carried out by different subsidiaries within a group of companies or where the nature of the work carried on by the associated enterprises in respect of such project is the same.

2.122 This provision is an anti-avoidance measure aimed at counteracting contract splitting for the purposes of avoiding the application of the permanent establishment rules.

2.123 The OECD Model Commentary recognises that time thresholds in Article 5 may give rise to abuses and notes that countries concerned with this issue may adopt solutions in bilateral negotiations to prevent such abuse.

2.124 The Convention provides that an enterprise shall be deemed to be associated with another enterprise if one enterprise participates directly or indirectly in the management, control or capital of the other enterprise or the same persons participate directly or indirectly in the management, control or capital of the enterprises. It also provides that a period of concurrent activities by such associated enterprises is only counted as one period for aggregation purposes. [*Article 5, paragraph 5*]

Example 2.11



In the above diagram, each of the subsidiaries may conduct similar connected activities, for example, supervisory activities at a single building site. In determining whether the six-month time threshold has been met, the time spent undertaking those activities by each of the enterprises would be aggregated. However, any period during which more than one of the subsidiaries were carrying on activities concurrently would be counted only once. Where the time threshold is met, each of the subsidiaries would be deemed to have a permanent establishment through which its activities with respect to the project are conducted. Only the profits derived by each subsidiary from its own activities would be attributed to each company's permanent establishment.

Preparatory and auxiliary activities

2.125 Certain activities do not generally give rise to a permanent establishment (for example, the use of facilities solely for storage, display or delivery).

2.126 These activities are ordinarily of a preparatory or auxiliary character and are unlikely to give rise to substantial profits. The necessary economic link between the activities of the enterprise and the country in which the activities are carried on does not exist in these circumstances.

2.127 Unlike the OECD Model, which provides that the listed activities are deemed not to constitute a permanent establishment, the Convention provides that the activities will be deemed not to constitute a permanent establishment only if the activities are, in relation to the enterprise, of a preparatory or auxiliary character. This is to prevent the situation where enterprises structure their business so that most of their activities fall within the exceptions with a view to avoiding taxation in that country. It also means that where the listed activities are not preparatory or auxiliary in relation to the enterprise, but instead constitute core business activities of the enterprise, the enterprise will not be excluded from having a permanent establishment if it satisfies the primary meaning in paragraph 1. *[Article 5, paragraph 7]*

Dependent agents

2.128 An enterprise of one country is deemed to have a permanent establishment in the other country if a person acts on its behalf in that other country where that person has and habitually exercises an authority to conclude contracts on behalf of the enterprise. Such people are referred to as dependent agents.

2.129 However, activities of a dependent agent will not give rise to a permanent establishment where that agent's activities are limited to the preparatory and auxiliary activities mentioned in paragraph 7. Agents of independent status (such as brokers or commission agents) to whom paragraph 9 of Article 5 applies are also excluded. *[Article 5, paragraph 8]*

Manufacturing or processing on behalf of others

2.130 Consistent with Australia's reservation to the OECD Model, where a person acts on behalf of another in manufacturing or processing the other's goods, this will give rise to a deemed permanent establishment. An example is the situation where a mineral plant refines minerals for a foreign enterprise at cost, so that the plant operations produce no Australian profits. Title to the refined product remains with the mining consortium and profits on sale are realised mainly outside of Australia.

2.131 The refining activities performed for the enterprise through such a plant are deemed to be carried on through a permanent establishment of the enterprise because the manufacturing or processing activity (which gives the processed minerals much of their value) is conducted in Australia on behalf of the enterprise. Accordingly, Australia should have taxing rights over the business profits attributable to the processing activity carried on in Australia. Subparagraph b) of paragraph 8 prevents an enterprise which carries on substantial manufacturing or processing activities in a country through an intermediary from escaping tax in that country.

2.132 The inclusion of this subparagraph is insisted upon by Australia in its tax treaties and is consistent with Australia's policy of retaining taxing rights over profits from manufacturing or processing on behalf of others including, importantly, in the exploitation of Australia's mineral resources. *[Article 5, subparagraph 8b)]*

Independent agents

2.133 Business carried on through an independent agent will not, of itself, give rise to a permanent establishment, provided that the independent agent is acting in the ordinary course of that agent's business as such an agent. *[Article 5, paragraph 9]*

Subsidiary companies

2.134 Generally, a subsidiary company will not be a permanent establishment of its parent company. A subsidiary, being a separate legal entity, would not usually be carrying on the business of the parent company but rather its own business activities. However, a subsidiary company gives rise to a permanent establishment if the subsidiary permits the parent company to operate from its premises such that the tests in paragraph 1 of Article 5 are met, or the subsidiary acts as an agent such that a dependent agent permanent establishment is constituted. *[Article 5, paragraph 10]*

Other Articles

2.135 The principles set out in this Article are also to be applied in determining whether a permanent establishment exists in a third country or whether an enterprise of a third country has a permanent establishment in Australia (or New Zealand) when applying the source rule contained in:

- paragraph 7 of Article 11 (*Interest*); and
- paragraph 5 of Article 12 (*Royalties*).

[Article 5, paragraph 11]

Article 6 — Income from Real Property

Where income from real property is taxable

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

2.137 Generally, Australia's tax treaties exclude profits of an enterprise from agriculture, forestry or fishing from the operation of this Article. Such profits are generally dealt with under Article 7 (*Business Profits*) of Australian treaties. However, under the Convention, the allocation of taxing rights over such profits is determined by Article 6 (*Income from Real Property*). Accordingly, profits from the relevant activities may be taxed in Australia where the real property is situated in Australia, irrespective of whether the enterprise has a permanent establishment in Australia. [*Article 6, paragraph 1*]

2.138 In the case of agriculture and forestry activities, an enterprise would in any event generally have a permanent establishment in the country in which the property is situated. Inclusion of profits from fishing within the scope of this Article reflects New Zealand's reservation to Article 6 of the OECD Model.

Definition

2.139 ***Real property*** is primarily defined as having the meaning which it has under the domestic law of the country where the property is situated and also extends to:

- any natural resources, property accessory to real property, rights to which the general law respecting real property applies, and rights to standing timber;
- a lease of land and any other interest in or over land (including exploration and exploitations rights over natural resources); and
- royalties and other payments relating to the exploration for or exploitation of natural resources.

Ships, boats and aircraft are excluded from the definition of 'real property', therefore this Article does not cover income from their use. [*Article 6, paragraph 2*]

2.140 The term 'natural resources' used in the definition of 'real property' is defined in paragraph 2 of Article 3 (*General Definitions*). The inclusion of rights to standing timber in the definition reflects New Zealand's strong policy preference. The outcome of including this reference in the definition is broadly consistent with the existing treaty, which deems an enterprise to have a permanent establishment where it performs any operations for the felling, removal or other exploitation of standing timber.

Deemed situs

2.141 Under Australian law the place where an interest in land, natural resources or standing timber, such as a lease, is situated (*situs*) is not necessarily where the underlying property is situated. Paragraph 3 puts the situation of the interest or right beyond doubt by deeming the *situs* to be where the underlying real property over which the lease or right is granted, is situated or where any exploration may take place. [*Article 6, paragraph 3*]

Form of exploitation of real property

2.142 Paragraph 4 makes it clear that the general rule in paragraph 1 applies irrespective of the form of exploitation of the real property. The Article applies to income derived from the direct use, letting or use in any other form of real property. [*Article 6, paragraph 4*]

Real property of an enterprise

2.143 Paragraphs 1, 3 and 4 of Article 6 are extended to income derived from the use or exploitation of real property of an enterprise.

2.144 Accordingly, this Article provides that the country in which the real property is situated may impose tax on the income derived from that property by an enterprise of the other country, irrespective of whether or not that income is attributable to a permanent establishment of such an enterprise situated in the first-mentioned country.

2.145 However, paragraph 5 of this Article specifically provides that the profits of the enterprise shall be determined in accordance with the rules in paragraphs 2 and 3 of Article 7 (*Business Profits*) and taxed as if they were attributable to a permanent establishment. This clarifies that, notwithstanding that the profits are dealt with under Article 6, and not Article 7 as is usually the case under Australian treaties, such profits will be taxed on a net basis. [*Article 6, paragraph 5*]

Article 7 — Business Profits

2.146 This Article is concerned with the taxation by one country of business profits derived by an enterprise that is a resident of the other country.

2.147 The taxing of these profits depends on whether they are attributable to the carrying on of a business through a permanent establishment in that country. If a resident of one country carries on business through a permanent establishment (as defined in Article 5 (*Permanent Establishment*)) in the other country, the country in which the

permanent establishment is situated may tax the profits of the enterprise that are attributable to that permanent establishment. *[Article 7, paragraph 1]*

2.148 If an enterprise which is a resident of one country derives business profits in the other country that are not attributable to a permanent establishment in that other country, the general principle of this Article is that the enterprise will not be liable to tax in the other country on such profits (except where paragraph 7 of this Article applies — see the explanation in paragraphs 2.156 and 2.157).

Determination of business profits

2.149 Profits of a permanent establishment are to be determined for the purposes of this Article on the basis of arm's length dealings. The provisions in the Convention correspond to international practice and comparable provisions in Australia's other tax treaties. *[Article 7, paragraphs 2 and 3]*

2.150 No deductions are allowed in respect of expenses which would not be deductible if the permanent establishment were an independent enterprise which incurred the expense. *[Article 7, paragraph 3]*

Application of domestic law

2.151 The domestic law of the country in which the permanent establishment is situated (for example, Australia's Division 13 of Part III of the ITAA 1936) may be applied to determine the tax liability of a person, consistently with the principles stated in this Article. This is of particular relevance 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. This is especially important where there is no data available or the available data is not of sufficient quality to rely on the traditional transaction methods for the attribution of the arm's length profits.

2.152 Paragraph 4 explicitly recognises the right of each country to apply its domestic law in these circumstances. This is consistent with Australia's reservation to Article 7 (*Business Profits*) of the OECD Model. *[Article 7, paragraph 4]*

Profits dealt with under other Articles

2.153 Where income or gains are specifically dealt with under other Articles of the Convention, the effect of those particular Articles is not overridden by this Article.

2.154 This provision lays down the general rule of interpretation that categories of income or gains which are the subject of other Articles of the Convention (for example, Article 8 (*Shipping and Air Transport*), Article 10 (*Dividends*), Article 11 (*Interest*), Article 12 (*Royalties*) and Article 13 (*Alienation of Property*)) are to be treated in accordance with the terms of those Articles. However, under certain articles, for example paragraph 7 of Article 10 (*Dividends*), where the asset in respect of which the income is paid is effectively connected with a permanent establishment that income will be dealt with under Article 7 (*Business Profits*). [Article 7, paragraph 5]

Insurance with non-residents

2.155 Each country has the right to continue to apply any provisions in its domestic law relating to the taxation of income from insurance with non-resident insurers. An effect of this paragraph is to preserve, in the case of Australia, the application of Division 15 of Part III of the ITAA 1936 (*Insurance with Non-residents*). This is consistent with Australia's reservation to Article 7 (*Business Profits*) of the OECD Model. In the course of negotiations, the two delegations noted:

‘With respect to taxation of income from insurance, it is understood that the term ‘insurance’ includes reinsurance.’

[Article 7, paragraph 6]

Trust beneficiaries

2.156 The principles of this Article will apply to profits which are derived by a resident of one of the countries (directly or through one or more interposed trusts) as a beneficiary of a trust, except where the trust is treated as a company for tax purposes. [Article 7, paragraph 7]

2.157 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 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 New Zealand is beneficially entitled under the trust. Paragraph 7 of this Article ensures that such business profits will be subject to tax in Australia where the trustee of the relevant trust has, or would have if it were a resident of New Zealand, a permanent establishment in Australia in relation to that business. The principles of this paragraph will also apply where relevant to other Articles of the Convention, such as Article 13 (*Alienation of Property*) in its application to income, profits or gains arising from the alienation of the assets of a permanent establishment or the permanent establishment itself.

Time limitation

2.158 The Convention specifies a time limit for the adjustment of profits attributable to a permanent establishment of the enterprise. A country may not make an adjustment to the profits for a year of income where a period of seven years has expired from the date on which the enterprise completed the filing requirements for that year of income in that country. However, the time limit does not apply in the case of fraud, gross negligence, wilful default, or where an audit into the profits of an enterprise was initiated by that country within the seven-year period. *[Article 7, paragraph 8]*

2.159 The Article does not impose a time limit on conclusion of the audit into the profits of the enterprise.

Article 8 — Shipping and Air Transport

Profits from international traffic

2.160 The main effect of this Article is that the right to tax profits from the operation of ships or aircraft in international traffic, including a share of profits attributable to participation in a pool service or other profit sharing arrangement, is generally reserved to the country in which the operator is a resident for tax purposes. *[Article 8, paragraphs 1 and 3]*

2.161 The profits covered consist in the first place of the profits directly obtained by the enterprise from the transportation of passengers or cargo by ships or aircraft (whether owned, leased or otherwise at the disposal of the enterprise) that it operates in international traffic. However, as international transport has evolved, shipping and air transport enterprises invariably carry on a large variety of activities to facilitate or support their international operations. Consistent with the OECD Model Commentary on Article 8 (*Shipping, Inland Waterways Transport and Air Transport*), paragraph 1 also covers profits from activities directly connected with such operations as well as profits from activities which are not directly connected with the operation of the enterprise's ships or aircraft in international traffic but which are ancillary to such operation. An example of such ancillary profits would be profits derived by a ship operator in the business of transport who undertakes a one-off bareboat lease of one of their ships.

2.162 Transport activities will also include profits from the use, maintenance and rental of containers (including trailers and related equipment) used in the transport of goods, where directly connected or ancillary to the operation of ships or aircraft in international traffic. *[Article 8, paragraph 4]*

2.163 The definition of ‘international traffic’ refers only to transport and accordingly limits the scope of paragraph 1 of Article 8 to transport activities. Profits from the operation of ships or aircraft for non-transport activities are treated under Article 7 (*Business Profits*) of the Convention in the same way as profits derived from the use of other types of substantial equipment, such as mining equipment and trucks. [*Article 3, subparagraph 1h*]

Profits from internal traffic

2.164 Under the existing New Zealand Agreement, profits of an enterprise of one country from the operation of ships and aircraft could, to the extent that they related to operations that were confined solely to places in the other country, be taxed in the other country. This included all operations of ships and aircraft, including non-transport activities such as dredging, surveying and crop dusting.

2.165 In contrast, this Article confines the source taxing rights to profits arising from transport activities of ships or aircraft in that country, including where passengers or cargo are transported between places in that country by a ship or aircraft that is engaged in an international voyage or that is leased on a full basis for purposes of providing the domestic transport. In the course of negotiations, the two delegations noted:

‘It is understood that the term ‘leasing on a full basis’ means that the leased ship or aircraft is provided to the lessee on a fully equipped, crewed and supplied basis.’

[*Article 8, paragraph 2*]

2.166 There is no specified limit on the amount of tax that can be charged on profits from the operation of ships and aircraft in internal traffic. However, for Australian tax purposes, Division 12 of Part III of the ITAA 1936, deems 5 per cent of the amount paid in respect of the transport of passengers, livestock, mail or goods shipped in Australia to be the taxable income of a ship operator who has their principal place of business outside of Australia.

Example 2.12

A ship operated by a New Zealand enterprise, in the course of an international voyage from Wellington to Melbourne, makes a stop in Hobart to pick up cargo. Profits derived from the transport of the goods loaded in Hobart and discharged in Melbourne would be profits from the carriage of goods shipped in and discharged at a place in Australia under paragraph 2 of Article 8. Australia would therefore have the right to tax the profits relating to such transport. Five per cent of the amount paid in respect of the transport of those goods would be

deemed to be taxable income of the operator for Australian tax purposes pursuant to Division 12 of Part III of the ITAA 1936.

Example 2.13

A New Zealand enterprise operates sightseeing flights over the Southern Ocean. Passengers board the aircraft in Hobart and disembark at the same airport later on the same day. The profits from the carriage of the passengers shipped in and discharged at a place in Australia would be covered by paragraph 2 of Article 8, notwithstanding that the aircraft passes through international airspace. Australia would therefore have the right to tax the profits relating to the carriage of these passengers.

Article 9 — Associated Enterprises

Reallocation of profits

2.167 This Article deals with associated enterprises (such as parent and subsidiary companies and companies under common control). It authorises the reallocation of profits between related enterprises in Australia and New Zealand 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 unrelated enterprises dealing wholly independently with one another.

2.168 This Article would not generally authorise the rewriting 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. The term 'might be expected to operate' in paragraph 1 is included to conform to Australia's treaty practice and allows adjustments where it is not possible to determine the conditions that 'would have been made or occurred' between the associated enterprises.

2.169 The broad scheme of the Australia's domestic law provisions relating to international profit shifting arrangements under which profits are shifted out of Australia, whether by transfer pricing or other means, is to impose arm's length standards in relation to international dealings. Where the Commissioner cannot ascertain the arm's length consideration, it is deemed to be such an amount as the Commissioner determines.

2.170 Each country has the right to apply its domestic law relating to the determination of the tax liability of a person (for example, Australia's Division 13 of Part III of the ITAA 1936) to enterprises, including in cases where the available information is inadequate, provided that such provisions are applied, so far as it is practicable to do so, consistently with

the principles of the Article. This is of particular relevance where there is no data available or the available data is not of sufficient quality to rely on the traditional transaction methods for the attribution of arm's length profits. This reflects Australia's reservation to Article 9 (*Associated Enterprises*) of the OECD Model. [Article 9, paragraph 2]

Correlative adjustments

2.171 Where a reallocation 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 country are adjusted upwards, economic double taxation (that is, taxation of the same income in the hands of different persons) would arise if the profits so reallocated continued to be subject to tax in the hands of an associated enterprise in the other country. To avoid this result, the other country is required to make an appropriate compensatory adjustment to the amount of tax charged on the profits involved to relieve any such double taxation.

2.172 It would generally be necessary for the affected enterprise to apply to the competent authority of the country not initiating the reallocation of profits for an appropriate compensatory adjustment to reflect the reallocation of profits made by the other treaty partner country. If necessary, the competent authorities of Australia and New Zealand will consult with each other to determine the appropriate adjustment. [Article 9, paragraph 3]

Time limitation

2.173 The treaty specifies a time limit for the adjustment of the profits of the enterprise under paragraph 1 or 2 of this Article. A country may not make an adjustment of the profits for a year of income where a period of seven years has expired from the date on which the enterprise completed the filing requirements for that year of income in that country. However, the time limit does not apply in the case of fraud, gross negligence, wilful default, or where an audit into the profits of an enterprise was initiated by that country within the seven-year period. [Article 9, paragraph 4]

2.174 The Article does not impose a time limit on conclusion of the audit into the profits of the enterprise.

Article 10 — Dividends

2.175 This Article allocates taxing rights in respect of dividends flowing between Australia and New Zealand. The Article provides that:

- certain cross-border intercorporate dividends will be either exempt from source taxation or subject to a maximum 5 per cent rate of tax in that country;
- a maximum 15 per cent rate of source country tax may be applied on all other dividends;
- dividends beneficially owned by a State, or political subdivision or a local authority will be exempt from source taxation where they hold directly no more than 10 per cent of the voting power of the company paying the dividends;
- dividends paid in respect of a holding which is effectively connected with a permanent establishment are to be dealt with under Article 7 (*Business Profits*); and
- the extra-territorial application by either country of taxing rights over dividend income is not permitted.

2.176 However, no such relief is available in cases that have been designed with a main purpose of taking advantage of this Article.

Permissible rate of source country taxation

Exemption for certain cross-border intercorporate dividends

2.177 No tax will be payable in the source country on dividends paid to a company that is the beneficial owner of those dividends and is resident in the other country where:

- the recipient company holds, directly or indirectly, 80 per cent or more of the voting power of the company paying the dividends; and
- satisfies a 12-month holding requirement at the time of the declaration of the dividend in relation to the shares in respect of which the dividend is payable.

[Article 10, paragraph 3]

2.178 To qualify for the exemption, the company that is the beneficial owner of the dividends must either be:

- a company that has its principal class of shares;
 - listed on specified Australian or New Zealand stock exchanges; and
 - regularly traded on one or more recognised stock exchanges (as defined under Article 3 (*General Definitions*) of the Convention);
- a company that is owned either directly or indirectly by one or more such companies;
- a company that is owned either directly or indirectly by one or more third country resident companies that would be entitled to equivalent benefits; or
- granted benefits with respect to those dividends by agreement of the competent authorities under subparagraph c) of paragraph 3 of the Article.

[Article 10, paragraph 3]

2.179 For the purposes of the above tests, a recognised stock exchange includes:

- in Australia's case, the Australian Securities Exchange or any other Australian stock exchange recognised under Australian domestic law; and
- in New Zealand's case, the securities markets (other than the New Zealand Debt Market) operated by the New Zealand Exchange Limited.

2.180 Provision has been made to allow the competent authorities to reach agreement that other stock exchanges constitute a recognised stock exchange for the purpose of the Convention. *[Article 3, sub-subparagraph 11(iii)]*

Equivalent benefits

2.181 Under subparagraph b) of paragraph 3 of this Article, an exemption applies to dividends:

- paid by a company in a country (the paying company) to a company in the other country (the receiving company); and

- where the receiving company is itself wholly-owned by one or more companies (the owning companies) that are either themselves listed on a recognised stock exchange or would be entitled to equivalent benefits under another treaty between country of which the receiving company is a resident and the country of which the paying company is a resident had the owning companies owned the holding in the paying company directly.

2.182 The exemption would apply to dividends paid by an Australian company to a New Zealand company that is itself owned by one or more companies entitled to equivalent benefits under another tax treaty between the country of which that company (or those companies) were a resident and Australia. Similarly, dividends paid by a New Zealand company to an Australian company that is itself owned by one or more companies entitled to equivalent benefits under another tax treaty between the country of which that company (or those companies) were a resident and New Zealand, would also be exempt.

Example 2.14

Milford Co is an unlisted New Zealand company which owns all the shares in Dubbo Co, an Australian company, and has done so for more than 12 months. Assume Milford Co is the beneficial owner of the dividends paid by Dubbo Co.

Kent Co, a company resident in the United Kingdom, is listed on a stock exchange that is a 'recognised stock exchange' within the meaning of Article 3 of the 2003 Australia-United Kingdom Convention, and wholly owns Milford Co.

If Kent Co had owned the shares held by Milford in Dubbo Co directly, then an exemption would apply to the dividends paid on those shares under subparagraph a) of paragraph 3 of Article 10 of the 2003 Australia-United Kingdom Convention. In such case Kent Co is considered to be entitled to equivalent benefits to those provided under paragraph 3. Accordingly, the Australian dividend paid to Milford Co will be exempt under sub-subparagraph b)(ii) of paragraph 3.

Example 2.15

Assume Milford Co is now owned by a second New Zealand resident company, Winton Co, and a Japan resident company, Osaka Co. Winton Co is listed on a stock exchange that is a 'recognised stock exchange' within the meaning of Article 3 of the Convention. Osaka Co is listed on a stock exchange that is a 'recognised stock exchange' within the meaning of Article 23 of the 2008 Australia-Japan Convention. Each company owns 50 per cent of the shares in Milford Co.

Milford Co owns all the shares in Dubbo Co, an Australian company, and has done so for more than 12 months. Assume Milford Co is the beneficial owner of the dividends paid by Dubbo Co.

If Winton Co had owned the shares held by Milford Co directly, then an exemption would apply to the dividends paid on those shares under subparagraph a) of paragraph 3 of Article 10 of the Convention. If Osaka Co had owned the shares held by Milford Co directly, then an exemption would apply to the dividends paid on those shares under subparagraph a) of paragraph 3 of Article 10 of the 2008 Australia-Japan Convention.

In both cases, Winton Co and Osaka Co are considered to be entitled to equivalent benefits to those provided under paragraph 3. Accordingly, the Australian dividend paid to Milford Co will be exempt under sub-subparagraph b)(ii) of paragraph 3.

Example 2.16

Rotorua Co is an unlisted New Zealand company which owns all the shares in Broome Co, an Australian company, and has done so for more than 12 months. Assume Rotorua Co is the beneficial owner of dividends paid by Broome Co.

Rotorua Co is owned by a second New Zealand resident company, Taupo Co, and Oculum Co, a company that is a resident of a treaty partner country. Taupo Co and Oculum Co each own 50 per cent of the shares in Rotorua Co.

Taupo Co is listed on a stock exchange that is a 'recognised stock exchange' within the meaning of Article 3 of the Convention. If Taupo Co had owned the shares held by Rotorua Co directly, then an exemption would apply to the dividends paid on those shares under subparagraph a) of paragraph 3 of Article 10 of the Convention.

Under the tax treaty between Australia and Oculum Co's country of residence, a withholding tax rate of 15 per cent applies for all dividends. If Oculum Co had owned the shares held by Rotorua Co directly, the dividends would have been subject to dividend withholding tax of 15 per cent.

The requirements of sub-subparagraph b)(ii) of paragraph 3 are not met because one of the companies owning Rotorua Co (that is, Oculum Co) is not entitled to equivalent benefits. Accordingly, that provision will not apply to exempt the Australian dividends paid to Rotorua Co from dividend withholding tax.

Competent authority determination

2.183 Dividends which are beneficially owned by a company that does not meet the conditions in subparagraph a) or b) of paragraph 3 of the Article will also be exempt from tax in the source country if the competent authority determines that the receiving company was established, acquired or maintained for reasons other than obtaining benefits under the Convention. Before concluding that the company is not entitled to benefits under this subparagraph (for example, because the arrangements had a principal purpose of obtaining such benefits), the competent authority is required to consult with the competent authority of that company's country of residence. *[Article 10, subparagraph 3c)]*

Exemption for dividends derived by Governments

2.184 Dividends which are beneficially owned by a State, or political subdivision or a local authority (including a government investment fund) will be exempt from tax in the source country if they hold no more than 10 per cent of the voting power in the company paying the dividends. This exemption complements that provided in respect of interest derived by States, their political subdivisions and local authorities (including government investment funds) under Article 11 (*Interest*). In the course of negotiations, the two delegations agreed:

‘...that dividends and interest will be regarded as being derived by a Contracting State, political subdivision, local authority or government investment fund where the investment is made by the Government and the funds are and remain government monies.

The delegations also agreed that this would include dividends and interest paid to, in the case of New Zealand, the New Zealand Superannuation Fund, the Government Superannuation Fund, and in the case of Australia, the Future Fund, the Building Australia Fund, the Education Fund and the Health and Hospital Fund, as well as any similar fund the purpose of which is to pre-fund future government liabilities.’

[Article 10, paragraph 4]

Five per cent rate limit on source country tax of certain cross-border intercorporate dividends

2.185 This Article allows both Australia and New Zealand to tax other dividends flowing between them but limits the rate of tax that the country of source may impose on dividends paid by companies that are resident of that country under its domestic law to companies resident in the other country who are the beneficial owners of the dividends. *[Article 10, paragraphs 1 and 2]*

2.186 A rate limit of 5 per cent will apply for dividends paid in respect of company shareholdings that do not qualify for the intercorporate dividend exemption under paragraph 3 of this Article, but constitute a direct voting interest of at least 10 per cent. [Article 10, subparagraph 2a)]

Fifteen per cent rate limit for all other dividends

2.187 All other cases, the Convention provides that the source country may tax dividends that are beneficially owned by residents of the other country, but will limit its tax to 15 per cent of the gross amount of the dividend. In the case of Australia, this will mean that the rate of withholding tax imposed on unfranked dividends will be retained at the level of the existing New Zealand Agreement; that is, 15 per cent. [Article 10, subparagraph 2b)]

2.188 Although the provisions in Article 10 would allow Australia to impose withholding tax on both franked and unfranked dividends in the specified circumstances, the dividend withholding tax exemption provided by Australia under its domestic law for franked dividends paid to non-residents will continue to apply.

Dividends effectively treated as business profits

2.189 Limitations on the tax of the country in which the dividend is sourced do not apply to dividends derived by a resident of the other country who has a permanent establishment in the source country from which the dividends are derived, if the holding giving rise to the dividends is effectively connected with that permanent establishment.

2.190 Where the holding is so effectively connected, the dividends are to be treated as business profits and therefore subject to the full rate of tax applicable in the country in which the dividend is sourced in accordance with the provisions of Article 7 (*Business Profits*).

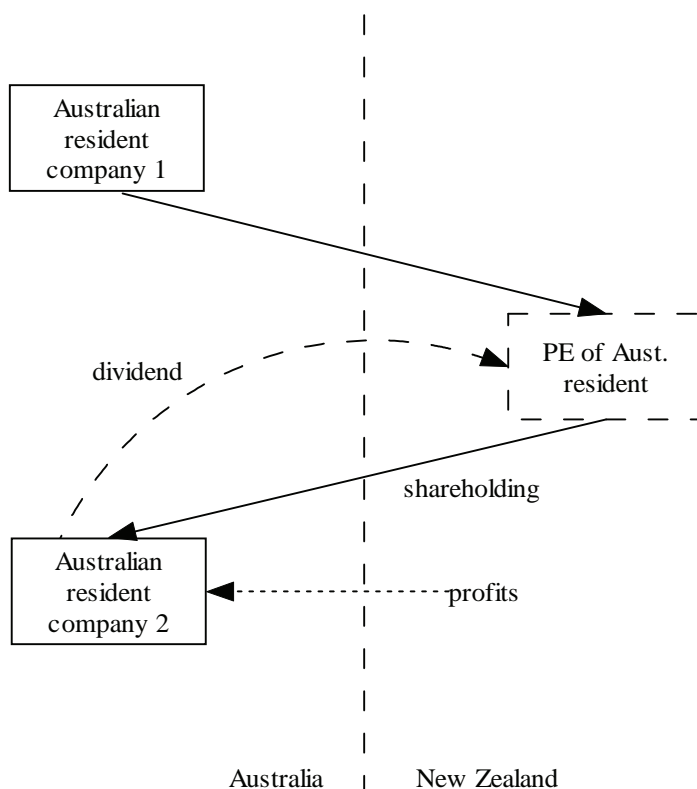
2.191 Franked and unfranked dividends paid by an Australian company will be included in the assessable income of a non-resident company or individual where the dividends are attributable to a permanent establishment of that non-resident situated in Australia. Expenses incurred in deriving the dividend income are allowable as a deduction from that income when calculating the taxable income of the non-resident. Further, a non-resident company or individual may be entitled to tax offsets in respect of any franked dividends under Australia's domestic law. [Article 10, paragraph 6]

Extra-territorial application precluded

2.192 The extra-territorial application by either country of taxing rights over dividend income is precluded. Broadly, one country (the first country) will not tax dividends paid by a company resident solely in the other country, unless:

- the person deriving the dividends is a resident of the first country; or
- the shareholding giving rise to the dividends is effectively connected with a permanent establishment in the first country.

Example 2.17



In the diagram above, paragraph 7 would, but for the exception, preclude New Zealand from taxing the dividend paid by Australian resident company 2 to Australian resident company 1 out of profits derived from New Zealand sources. However, as the dividends relate to the Australian shareholder's permanent establishment in New Zealand with which the holding is effectively connected, New Zealand may tax the dividends.

Dividends paid by dual resident companies

2.193 The restrictions of paragraph 7 do not apply when the company is, for tax purposes, a resident of both Australia and New Zealand under the respective laws of the two countries. In such cases the dividends paid by the dual resident company out of profits arising in one of the countries may be taxed in the country in which those profits arise in accordance with domestic law of that country. However, where the dividends are beneficially owned by a resident of the other country, the limits provided for in paragraphs 2 and 3 apply as if the company were a resident solely of the country in which the profits out of which the dividends are paid arise. *[Article 10, paragraph 8]*

2.194 This provision does not limit taxation in the country of which the dual resident company is deemed to be a resident for treaty purposes in accordance with paragraph 4 of Article 4 (*Resident*) in the case of dividends paid by the company out of profits from sources outside that country. Paragraphs 2 and 3 will apply where those dividends are beneficially owned by a resident of the other country.

Definition of dividends

2.195 The term ***dividends*** in this Article means income from:

- shares or other rights which participate in profits and are not debt-claims; and
- income or other distributions which are subject to the same taxation treatment as income from shares in the country of which the distributing company is resident for the purposes of its tax.

2.196 The phrase ‘for the purposes of its tax’, which appears in paragraph 5 of Article 10, refers to the case where a person is a resident of a country under its domestic tax law, even if the person is deemed to be a resident only of the other country for the purposes of the Convention by virtue of paragraph 2, 3 or 5 of Article 4 (*Resident*). *[Article 10, paragraph 5]*

2.197 In the case of Australia, the definition is consistent with subsection 3(2A) of the Agreements Act 1953 which clarifies that a reference to income from shares, or to income from other rights participating in profits, does not include a reference to a return on a debt interest as defined in Subdivision 974-B of the ITAA 1997. In the course of negotiations, the two delegations noted:

‘It was also agreed that the treaty definition of dividends would not limit Australia’s ability to apply subsection 3(2A) of the *International Tax Agreements Act 1953*, thus ensuring Australia’s debt/equity rules continue to apply as intended.’

Limitation of benefits

2.198 The source country rate limits and exemptions available under this Article will not apply where an assignment of dividends, or a creation or assignment of shares or other rights in respect of which dividends are paid, has been made with the main objective, or one of the main objectives, of accessing the relief otherwise available under this Article. *[Article 10, paragraph 9]*

Article 11 — Interest

2.199 This Article allocates taxing rights in respect of interest flows between Australia and New Zealand. Article 11 provides that:

- an exemption from source country tax applies to certain cross-border interest flows to:
 - government bodies or central banks; and
 - financial institutions in certain circumstances;
- a maximum 10 per cent rate of source country tax may be applied on all other interest income;
- interest paid on a debt-claim which is effectively connected with a permanent establishment shall be subject to Article 7 (*Business Profits*);
- interest payments are deemed to have an Australian source (and may therefore be taxed in Australia) where:
 - the interest is paid by an Australian resident to a New Zealand resident; or

- the interest is paid by a non-resident to a New Zealand resident and it is an expense of the payer in carrying on business in Australia through a permanent establishment; and
- relief will be restricted to the gross amount of interest which would be expected to be paid on an arm's length dealing between independent parties.

2.200 However, no such relief is available in cases that have been designed with the main purpose of taking advantage of this Article.

2.201 The phrase 'for the purposes of its tax', which appears in paragraph 7 of Article 11, refers to the case where a person is a resident of a country under its domestic tax law, even if the person is deemed to be a resident only of the other country for purposes of the Convention by virtue of paragraph 2, 3 or 4 of Article 4 (*Resident*).

Permissible rate of source country taxation

Ten per cent rate limit

2.202 This Article provides for interest income to be taxed by both countries but requires the country in which the interest arises to generally limit its tax to 10 per cent of the gross amount of the interest where a resident of the other country is the beneficial owner of the interest. [*Article 11, paragraphs 1 and 2*]

Exemptions for interest paid to government bodies and central banks

2.203 The exemption for interest paid to the government of a country will apply to interest derived by the Australian or New Zealand governments, or the government of any political subdivision or local authority (including government investment funds) in either Australia or New Zealand. As discussed in relation to dividends in paragraph 2.184, this ensures that interest derived by Australia's Future Fund (and other Funds) from sources in New Zealand is exempt from New Zealand tax.

2.204 The exemption also applies to banks performing central banking functions in Australia and New Zealand. [*Article 11, subparagraph 3a*)]

Exemptions for interest paid to financial institutions

2.205 The exemption for interest paid to financial institutions recognises that the agreed 10 per cent rate on gross interest can be excessive given their cost of funds. The exemption will also broadly align the treatment of interest paid to New Zealand financial institutions with the Australian domestic law exemption for interest paid on widely

distributed arm's length corporate debenture issues (section 128F of the ITAA 1936). [Article 11, subparagraph 3b)]

2.206 The term **financial institution** means a bank or other enterprise substantially deriving its profits by raising debt finance in the financial markets or by taking deposits at interest and using those funds in carrying on the business of providing finance. This does not include a corporate treasury or a member of a group that performs the financing services of the group. [Article 11, subparagraph 3b)]

2.207 In the case of interest arising in New Zealand, the exemption for interest paid to financial institutions will not apply if it is paid to a person who has not paid New Zealand's AIL in respect of the interest. In such cases, the 10 per cent rate limit will apply. [Article 11, subparagraph 4a)]

2.208 Under New Zealand's AIL scheme, eligible borrowers who pay interest to non-resident lenders may elect to pay the AIL instead of having to deduct non-resident withholding tax. The AIL is payable at the rate of 2 per cent of the gross interest. For the purposes of this Article, the term **approved issuer levy** includes any identical or substantially similar charge payable by the payer of the interest arising in New Zealand enacted after the date of the Convention in place of the AIL. However, the exemption will apply if:

- New Zealand no longer has an AIL;
- if the payer of the interest is not eligible to elect to pay the AIL; or
- if the rate of the AIL exceeds 2 per cent of the gross amount of the interest.

2.209 This will ensure that Australian financial institutions will be able to benefit from the exemption in cases where the AIL does not apply to the interest, or where changes are made to remove the AIL scheme or increase its rate. [Article 11, subparagraph 4a)]

2.210 Further, the Convention contains a 'most favoured nation' clause in respect of interest derived by financial institutions. In the event New Zealand agrees under a future tax treaty with any other country to provide more favourable treatment of such interest, New Zealand is required to inform Australia and enter into negotiations with a view to providing the same treatment.

2.211 This ‘most favoured nation’ clause will ensure that Australian financial institutions deriving interest income in New Zealand receive no less favourable treatment than financial institutions benefiting from lower rates of withholding for interest under one of New Zealand’s other tax treaties. Thus for example, if New Zealand agreed in a future treaty with another country to grant an interest withholding tax exemption for financial institutions, without a requirement that AIL be paid, or agreed to a withholding tax rate lower than 10 per cent in the event AIL was not paid, New Zealand would be obliged to negotiate with Australia to provide similar outcomes for Australian financial institutions. *[Article 29, paragraph 2]*

2.212 The exemption is not available for interest paid as part of an arrangement involving back-to-back loans or other arrangement that is economically equivalent and structured to have a similar effect. The denial of the exemption for these back-to-back loan type arrangements is directed at preventing related party and other debt from being structured through financial institutions to gain access to a withholding tax exemption. The exemption will only be denied for interest paid on the component of a loan that is considered to be back-to-back. In such cases, the 10 per cent rate limit will apply. *[Article 11, subparagraph 4b)]*

2.213 An example of a back-to-back arrangement would include, for instance, a transaction or series of transactions structured in such a way that:

- a New Zealand financial institution receives or is credited with an item of interest arising in Australia; and
- the financial institution pays or credits, directly or indirectly, all or substantially all of that interest (at any time or in any form, including commensurate benefits) to another person who, if it received the interest directly from Australia, would not be entitled to similar benefits with respect to that interest.

2.214 However, a back-to-back arrangement would generally not include a loan guarantee provided by a related party to a New Zealand financial institution.

Definition of interest

2.215 The term ***interest*** is defined for the purposes of this Article to include:

- income from debt-claims of every kind;
- interest from government securities;

- interest from bonds and debentures;
- premiums and prizes attaching to such securities, bonds or debentures; and
- income which is subjected to the same taxation treatment as income from money lent by the law of the country in which the income arises.

However, it does not include any income which is treated as a dividend under Article 10 (*Dividends*). [Article 11, paragraph 5]

Interest effectively treated as business profits

2.216 Interest derived by a resident of one country which is paid in respect of a debt-claim which is effectively connected with a permanent establishment of that person in the other country, will form part of the business profits of that permanent establishment and be subject to the provisions of Article 7 (*Business Profits*). Accordingly, the rate limitation of 10 per cent and the exemption for financial institutions (subparagraph b) of paragraph 3 of this Article) do not apply to such interest in the country in which the interest is sourced. [Article 11, paragraph 6]

Deemed source rules

2.217 The source rules which determine where interest arises for the purposes of this Article are set out in paragraph 7. They operate to allow Australia to tax interest paid by a resident of Australia to a resident of New Zealand who is the beneficial owner of that interest. Australia may also tax interest paid by a non-resident, being interest which is beneficially owned by a New Zealand resident, if it is an expense incurred by the payer of the interest in carrying on a business in Australia through a permanent establishment.

2.218 However, consistent with Australia's interest withholding tax provisions, an Australian source is not deemed in respect of interest that is an expense incurred by an Australian resident in carrying on a business through a permanent establishment outside both Australia and New Zealand (that is, the permanent establishment is in a third country). In that case, the interest is deemed to arise in the country in which the permanent establishment is situated. [Article 11, paragraph 7]

2.219 In determining whether a permanent establishment exists in a third country, the principles set out in Article 5 (*Permanent Establishment*) apply. [Article 5, paragraph 11]

Related persons

2.220 This Article includes a general safeguard against payments of excessive interest where a special relationship exists between the persons associated with a loan transaction — by restricting the amount on which the 10 per cent source country tax rate limitation applies to an amount of interest which might have been expected to 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 country but subject to the other Articles of the Convention. *[Article 11, paragraph 8]*

2.221 Examples of cases where a special relationship might exist include payments to a person (either individual or legal):

- who controls the payer (whether directly or indirectly);
- who is controlled by the payer; or
- who is subordinate to a group having common interests with the payer.

A special relationship also covers relationships of blood or marriage and, in general, any community of interests.

Limitation of benefits

2.222 The source country rate limits and exemptions available under this Article will not apply where an assignment of the interest, or a creation or assignment of the debt-claim or other rights in respect of which the interest is paid, has been made with the main objective, or one of the main objectives, of accessing the relief otherwise available under this Article. *[Article 11, paragraph 9]*

Article 12 — Royalties

2.223 This Article allocates taxing rights in respect of royalties paid or credited between Australia and New Zealand. The Article provides that:

- a maximum 5 per cent rate of source country tax may be levied on the gross amount of the royalties;
- royalties paid in respect of a right or property which is effectively connected with a permanent establishment are subject to Article 7 (*Business Profits*);

- equipment royalties are not included within the definition of ‘royalties’ and are subject to either Article 7 (*Business Profits*) or Article 8 (*Shipping and Air Transport*);
- royalties include payments for spectrum licences;
- royalties are deemed to have an Australian source (and may therefore be taxed in Australia) where:
 - the royalties are paid to a New Zealand resident by a person who is a resident of Australia for purposes of Australian tax; or
 - the royalties are paid by a non-resident to a New Zealand resident and are an expense of the payer in carrying on business through a permanent establishment in Australia; and
- relief will be restricted to the gross amount of royalties which would be expected to be paid on an arm’s length dealing between independent parties.

2.224 However, no such relief is available in cases that have been designed with a main purpose of taking advantage of this Article.

2.225 The phrase ‘for the purposes of its tax’, which appears in paragraph 7 of Article 12, refers to the case where a person is a resident of a country under its domestic tax law, even if the person is deemed to be a resident only of the other country for the purposes of the Convention by virtue of paragraph 2, 3 or 5 of Article 4 (*Resident*).

Permissible rate of source country taxation

2.226 This Article in general allows both countries to tax royalty flows but limits the tax of the country of source to 5 per cent of the gross amount of royalties beneficially owned by residents of the other country. *[Article 12, paragraphs 1 and 2]*

2.227 In the absence of a tax treaty, Australia taxes royalties paid to non-residents at 30 per cent of the gross royalty.

2.228 The 5 per cent rate limitation does not apply to natural resource royalties, which, in accordance with Article 6 (*Income from Real Property*), remain taxable in the country of source without limitation of the tax that may be imposed.

Definition of royalties

2.229 The definition of ***royalties*** in this Article reflects most elements of the definition in Australia's domestic income tax law. Royalties include payments for the supply of information concerning technical, industrial, commercial or scientific experience but not payments for services rendered, except as provided for in subparagraph c) of paragraph 3. In the Convention, the definition adopts the OECD Model approach in referring to 'information concerning technical, industrial, commercial or scientific experience', rather than the more usual reference in Australian treaties to 'knowledge or experience'. However, both expressions refer to what is commonly known as 'know-how', and no difference in meaning is intended. In the course of negotiations, the two delegations noted:

'It is understood that the term 'technical, industrial, commercial or scientific experience' includes knowledge or information of such kind.'

[Article 12, paragraph 3]

2.230 The definition also includes payments for the use of intellectual property stored on various media and used in connection with television, radio or other broadcasting (for example, satellite, cable and Internet broadcasting). ***[Article 12, paragraph 3]***

2.231 Payments for the use of, or the right to use industrial, commercial or scientific equipment, do not appear in the definition under the Convention. Such amounts will either be treated as business profits under Article 7 (*Business Profits*) or as profits from transport operations (for certain leases of ships, aircraft and containers) under Article 8 (*Shipping and Air Transport*). The exclusion of payments for the use of equipment from the *Royalties* Article reflects common international tax treaty practice and recognises that source country taxation on a gross basis may be excessive given low profit margins.

Payments for the supply of know-how versus payments for services rendered

2.232 The OECD Model Commentary deals with the need to distinguish these two types of payments in paragraph 11.3 of the Commentary on Article 12 (*Royalties*). The Commentary cites the following criteria as relevant for the purpose of making the distinction:

- Contracts for the supply of know-how concern information of the kind described in paragraph 11 of the Commentary that already exists, or concern the supply of that type of information after its development or creation and include

specific provisions concerning the confidentiality of that information.

- In the case of contracts for the provision of services, the supplier undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise but not the transfer of such special knowledge, skill or expertise to the other party.
- In most cases involving the supply of know-how, there would generally be very little more which needs to be done by the supplier under the contract other than to supply existing information or reproduce existing material. On the other hand, a contract for the performance of services would, in the majority of cases, involve a much greater level of expenditure by the supplier in order to perform their contractual obligations. For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to sub-contractors for the performance of similar services.

2.233 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.

2.234 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 appropriate.

2.235 Payments for services rendered are to be treated under Article 7 (*Business Profits*).

Image or sound reproduction or transmission

2.236 The 'royalties' definition includes payments made for the use of, or the right to use, motion picture films. It also covers payments for the use of, or the right to use, images or sounds, however reproduced or transmitted, for use in connection with broadcasting. Such images or sounds may be reproduced on any form of media, such as film, tape, CD or DVD, or transmitted electronically, such as by satellite, cable or Internet. Where the images or sounds are for use in connection with any

form of broadcasting, such as television, radio or web-casting, the payments will constitute a royalty. [Article 12, subparagraph 3d)]

Spectrum licences

2.237 Under the Convention, payments made for the use of, or right to use, the radiofrequency spectrum specified in a spectrum licence are treated as royalties. This provision preserves Australia's ability to tax payments that arise in Australia for the use in Australia of any part of the radiofrequency spectrum specified in an Australian spectrum licence. In the course of negotiations, the two delegations noted:

'It is understood that 'spectrum licence of a Contracting State' in subparagraph e) of paragraph 3 refers to any licence in respect of the radiofrequency spectrum of that State and is not limited to spectrum licences that are issued by the Government of a Contracting State.'

[Article 12, subparagraph 3e)]

Forbearance

2.238 Consistent with Australian tax treaty practice and international standards (see paragraph 8.5 of the OECD Model Commentary on Article 12), subparagraph f) of paragraph 3 expressly treats as a royalty, amounts paid or credited in respect of forbearance to grant to third persons, rights to use property covered by this Article. This is designed to address arrangements along the lines of those contained in *Aktiebolaget Volvo v Federal Commissioner of Taxation* (1978) 8 ATR 747; 78 ATC 4316, where instead of amounts being payable for the exclusive right to use the property they were made for the undertaking that the right to use the property will not be granted to anyone else. This provision ensures that such payments are subject to tax as a royalty payment under the terms of the Royalties Article. [Article 12, subparagraph 3f)]

Other royalties effectively treated as business profits

2.239 As in the case of dividend or interest income, it is specified that the withholding tax rate limitation does not apply to royalties paid in respect of property or rights which are effectively connected with a permanent establishment in the country in which the income is sourced. Such income is subject to the full rate of tax applicable in the country in which the royalty is sourced in accordance with the provisions of Article 7 (*Business Profits*). [Article 12, paragraph 4]

Deemed source rules

2.240 The source rules which determine where royalties arise for the purposes of this Article effectively correspond, 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 1936 for royalties paid to non-residents of Australia. They broadly mirror the source rule for interest income contained in paragraph 7 of Article 11 (*Interest*) and operate to allow Australia to tax royalties paid by a resident of Australia to a resident of New Zealand who is the beneficial owner of those royalties. Australia may also tax royalties paid by a non-resident, being royalties which are beneficially owned by a New Zealand resident, if the royalties are an expense incurred by the payer in carrying on a business in Australia through a permanent establishment.

2.241 Consistent with Australia's royalty withholding tax provisions, royalty payments that are an expense incurred by an Australian resident in carrying on a business through a permanent establishment outside both Australia and New Zealand (that is, the permanent establishment is in a third State) will not be subject to tax in Australia. Those royalties are deemed to be sourced in the country in which the permanent establishment is situated. [*Article 12, paragraph 5*]

2.242 In determining whether a permanent establishment exists in a third country, the principles set out in Article 5 (*Permanent Establishment*) apply. [*Article 5, paragraph 11*]

Related persons

2.243 Where a special relationship exists between the payer and the beneficial owner of the royalties, the 5 per cent source country tax rate limitation 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 country but subject to the other Articles of the Convention.

2.244 Examples of special relationships have been provided in respect of the corresponding paragraph in Article 11. [*Article 12, paragraph 6*]

Limitation of benefits

2.245 The source country rate limit available under this Article will not apply where the assignment of the royalties, or the creation or assignment of the property or right in respect of which the royalty is paid, has been made or performed with the main objective, or one of the main objectives, of accessing the relief otherwise available under this Article. The competent authority of the source country is required to consult with the other country's competent authority if it intends to deny the benefits of this Article under paragraph 7. [*Article 12, paragraph 7*]

Article 13 — Alienation of Property

Taxing rights

2.246 This Article allocates between the respective countries taxing rights in relation to income, profits or gains arising from the alienation of real property and other items of property.

2.247 The reference to ‘income, profits or gains’ in this Article is designed to put beyond doubt that a gain from the alienation of property, which in Australia may be income or a profit under ordinary concepts, will be taxed in accordance with this Article, rather than Article 7 (*Business Profits*), together with relevant capital gains.

Real property

2.248 Income, profits or gains from the alienation of real property may be taxed by the country in which the property is situated. [*Article 13, paragraph 1*]

2.249 For the purpose of this Article, the term ‘real property’ has the same meaning as it has under paragraph 2 of Article 6. Where the property is situated is clarified under paragraph 3 of Article 6 (*Income from Real Property*).

Permanent establishment

2.250 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. It also applies where the permanent establishment itself (alone or with the whole enterprise) is alienated. Such income, profits or gains may be taxed in the country in which the permanent establishment is situated. This corresponds to the rules for taxation of business profits contained in Article 7 (*Business Profits*). [*Article 13, paragraph 2*]

Disposal of ships or aircraft

2.251 Income, profits or gains derived by a resident of a country from the disposal of ships or aircraft operated by that resident in international traffic, or of associated property (other than real property covered by paragraph 1), are taxable only in that country. This rule corresponds to the operation of Article 8 (*Shipping and Air Transport*) in relation to profits from the international operation of ships or aircraft. [*Article 13, paragraph 3*]

2.252 For the purposes of this Article, the term ‘international traffic’ does not include any transportation which commences at a place in a country and returns to another place in that country, after travelling through international airspace or waters (for example, so-called ‘voyages to nowhere’ by cruise ships). *[Article 3, subparagraph 1h]*

Shares and other interests in land-rich entities

2.253 Paragraph 4 applies to situations involving the alienation of shares or other comparable interests that derive more than 50 per cent of their value directly or indirectly from real property situated in the other country. Income, profits or gains from the alienation of such shares or comparable interests may be taxed in the country in which the real property is situated. Paragraph 4 complements paragraph 1 of this Article and is designed to cover arrangements involving the effective alienation of incorporated real property, or like arrangements.

2.254 This provision ensures that capital gains on a foreign resident’s indirect, as well as direct, interests in certain targeted assets are taxable by Australia. Such treatment applies whether the real property is held directly or indirectly through a chain of interposed entities. *[Article 13, paragraph 4]*

Capital gains

2.255 This Article contains a sweep-up provision which reserves the right to tax any capital gains from the alienation of other types of property to the country of which the person deriving the gains is a resident. These would include, for example, capital gains from the disposal of shares or other interests in an entity (other than a land-rich entity or a company to which paragraph 4 applies). Such gains derived by Australian residents will be taxable only in Australia, regardless of where the property is situated, and will not be taxed in New Zealand. The liability of the Australian resident to taxation on such capital gains will be determined in accordance with Australia’s domestic law. *[Article 13, paragraph 5]*

Departing residents

2.256 The purpose of paragraph 6 is to prevent double taxation of capital gains of departing residents. Under section 104-160 of the ITAA 1997, a person who ceases to be a resident of Australia will generally trigger a tax liability on unrealised gains from assets held, other than taxable Australian property (as defined in section 855-15 of the ITAA 1997). Under subsections 104-165(2) and (3) of the ITAA 1997, the departing Australian resident may elect to either pay the Australian tax at the time of departure or to defer tax on the unrealised gain until the actual disposal of the asset. A former Australian resident who has been

taxed on the unrealised gains upon departure from Australia, and who becomes a New Zealand resident, may elect to be treated for New Zealand taxation purposes as having, immediately before ceasing to be a resident of Australia, alienated and reacquired the property for an amount equal to its fair market value at that time. *[Article 13, paragraph 6]*

Example 2.18

An Australian resident, Kylie, owns a house in Bali which was purchased in the year 2002 for \$200,000 (this is the cost base of the asset as Kylie has not incurred any further expenditure which should be taken into account in determining the cost base of the asset). At the time Kylie ceases to be an Australian resident, the market value of the house is \$300,000. Kylie will therefore have an Australian capital gain of \$100,000. Kylie pays the tax on this unrealised gain rather than electing to defer payment of the tax.

Kylie later sells the house for \$400,000 while a resident of New Zealand. Paragraph 5 will allow Kylie to elect to be treated for New Zealand tax purposes as if she had acquired the property for \$300,000 at the time that she ceased to be an Australian resident. This will mean that New Zealand is precluded from taxing Kylie on the gain that accrued on the house during the period of Kylie's residence in Australia.

[Article 13, paragraph 6]

Australian residents — residence during a six year period prior to alienation of property

2.257 Under Australia's CGT regime, ceasing to be an Australian resident can trigger a CGT event (CGT Event I1). However, an individual can elect to disregard any capital gain or capital loss from CGT assets covered by this event. Where this election is made the relevant assets of the individual are deemed to be taxable Australian property and accordingly are subject to tax in Australia when the individual disposes of the asset or again becomes an Australian resident.

2.258 In the absence of paragraph 7, the Article would not allow Australia to tax the gain that arises from the subsequent disposal of the asset, as the person would no longer be an Australian resident. As New Zealand does not have a comprehensive CGT regime, there may be cases where ceasing to be an Australian resident will result in no tax being payable on gains from CGT Events arising from the disposal of taxable Australian property in either Australia or New Zealand.

2.259 Paragraph 7 protects Australia's taxing rights in respect of income, profits or gains from the alienation of any property of a person who is, or has been, a resident of Australia during the year in which the

property is alienated or during the six years immediately preceding that year. *[Article 13, paragraph 7]*

Double tax relief

2.260 In the event that the operation of this Article should result in an item of income or gain being subjected to tax in both States, the country of which the person deriving the income or gain is a resident (as determined in accordance with Article 4 (*Resident*)) would be obliged by Article 23 (*Elimination of Double Taxation*) to provide double tax relief for the tax imposed by the other country.

Article 14 — Income from Employment

Basis of taxation

2.261 This Article generally provides the basis upon which the remuneration of visiting employees is to be taxed. However, this Article does not apply in respect of income dealt with separately in:

- Article 15 (*Fringe Benefits*);
- Article 16 (*Directors' Fees*);
- Article 17 (*Entertainers and Sportspersons*);
- Article 18 (*Pensions*); and
- Article 19 (*Government Service*).

2.262 Generally, salaries, wages and similar remuneration derived by a resident of one country from an employment exercised in the other country may be taxed in that other country. However, subject to specified conditions, there is a conventional provision for exemption from tax in the country being visited where visits of only a short-term nature are involved. *[Article 14, paragraphs 1 and 2]*

Short-term visit exemption

2.263 The conditions for this exemption are that:

- the period of the visit or visits does not exceed, in the aggregate, 183 days in any 12-month period commencing or ending in the year of income of the visited country;
- the remuneration is paid by, or on behalf of, an employer who is not a resident of the visited country, or is borne by or

deductible in determining the profits attributable to a permanent establishment which the employer has in the 'home' country; and

- the remuneration is not borne by a permanent establishment which the employer has in the country being visited.

2.264 Where all of these conditions are met, the remuneration so derived will be liable to tax only in the country of residence of the recipient. *[Article 14, paragraph 2]*

2.265 This Article differs from those in Australia's recent treaties by extending the short-term visit exemption to cases where the remuneration is borne or deductible in determining the profits attributable to a permanent establishment which the employer has in that country. This will reduce compliance costs for residents of one country who are employed by a local branch of an enterprise of the other country by ensuring that their remuneration derived during short visits to that other country is not taxed in that other country. *[Article 14, subparagraph 2b)]*

Example 2.19

Tasman Bank is an Australian resident company with a branch in Wellington. Jason, a New Zealand resident, is an employee of Tasman Bank who works in the Wellington branch. The branch constitutes a permanent establishment of Tasman Bank situated in New Zealand. Jason's salary is deductible in determining the profits to be attributable to that permanent establishment.

During the year of income, Jason travels to Australia to participate in a two-week training course being held in Tasman Bank's head office and to attend a one-week banking conference in Melbourne. As Jason's salary is borne by Tasman Bank's permanent establishment in Wellington, and the other conditions of paragraph 2 are met, the income will be taxed only in New Zealand.

Secondments

2.266 Paragraph 4 of this Article provides a specific rule in respect of secondments. Where an employee who is a resident of one country derives remuneration in respect of a secondment to the other country, that remuneration will be taxable only in the first country provided that the employee is present in the other country for not more than 90 days in any 12-month period. *[Article 14, paragraph 4]*

2.267 The term *secondment to the other Contracting State* is defined in paragraph 5 of this Article. It means an arrangement under which an

employee of an enterprise in one country temporarily performs employment services in the other country for either:

- a permanent establishment of the enterprise in the other country; or
- an associated enterprise (as determined by subparagraph c) of paragraph 6 of Article 5 (*Permanent Establishment*),

where such employment services are of a similar nature to those ordinarily performed by that employee for their usual employer. However, it does not include arrangements that have as one of their main purposes the obtaining of benefits under this rule. [*Article 14, paragraph 5*]

Example 2.20

Emily and Alicia are Australian residents employed by an Australian company, PR PR Co, in the media relations area situated in Hobart. Emily is seconded to the company's Christchurch branch to assist the branch staff in developing a media strategy with respect to their upcoming product launch, and is present in New Zealand for 45 days. Alicia undertakes a 30-day secondment to provide similar assistance to the company's wholly-owned subsidiary, NZ PR PR Co, in Auckland.

Both Emily and Alicia's activities fall within the definition of 'secondment to another State', and they are both present in New Zealand for less than 90 days. Accordingly, Australia retains taxing rights over both their salaries.

Where the short-term visit exemption doesn't apply

2.268 Where a short-term visit exemption is not applicable, remuneration derived by a resident of Australia from employment in New Zealand may be taxed in New Zealand. However, this Article does not allocate sole taxing rights to New Zealand in that situation.

2.269 Accordingly, Australia would also be entitled to tax that remuneration, in accordance with the general rule of the ITAA 1997 that a resident of Australia remains subject to tax on worldwide income. However, in accordance with Article 23 (*Elimination of Double Taxation*) Australia would be required in this situation to relieve any resulting double taxation.

Employment on a ship or aircraft

2.270 Under the existing New Zealand Agreement, income derived by crew members from employment exercised aboard a ship or aircraft

operated in international traffic may be taxed in the country of which the carrier is a resident.

2.271 In contrast, under paragraph 3 of this Article in the Convention, income derived by crew members from employment exercised aboard a ship or aircraft operated in international traffic will be taxable only in the country of which the crew member is a resident. Thus, for example, an Australian resident pilot employed by a New Zealand airline would be taxable only in Australia on his or her remuneration in respect of services rendered on international flights. This is expected to reduce the compliance costs faced by crew members, as they will only have to file returns and pay tax on this income in their country of residence. [*Article 14, paragraph 3*]

Article 15 — Fringe Benefits

2.272 This Article deals with fringe benefits which, in the absence of the Article, would be taxable in both Australia and New Zealand. Under this Article, the country that would have the primary taxing right if the benefit were ordinary employment income will have the sole taxing right in relation to the fringe benefit. This would generally be determined in accordance with Article 14 (*Income from Employment*) or Article 19 (*Government Service*). [*Article 15, paragraph 1*]

Definition of primary taxing right

2.273 This Article provides that the primary taxing right lies with the country that may, in accordance with the Convention, impose tax on the employment remuneration, being tax in respect of which the other country is required to provide relief under Article 23 (*Elimination of Double Taxation*). [*Article 15, subparagraph 2b*]

Example 2.21

Xavier, a New Zealand resident employee of a New Zealand company is sent to work in Australia. He is present in Australia for more than 183 days, and receives both employment income and fringe benefits. Under paragraph 1 of Article 14 (*Income from Employment*), Australia has the right to tax the employment income. New Zealand may also tax but, under Article 23 (*Elimination of Double Taxation*), would be obliged to give credit for the Australian tax paid on the fringe benefit if it was ordinary employment income. Therefore, Australia has the primary right to tax in these circumstances.

Operation of the provision in respect of fringe benefits tax law

2.274 Both Australia and New Zealand impose taxation on certain ‘fringe’ or employee benefits. In Australia, the relevant law is the

Fringe Benefits Tax Assessment Act 1986 (FBTAA 1986). Under the FBTAA 1986, an employer who provides a fringe benefit to an employee or to an associate of an employee (which includes a family member) may have a fringe benefits tax liability. Such a liability is separate from income tax and is calculated on the grossed-up taxable value of the fringe benefits provided. New Zealand's fringe benefits tax regime operates in a similar fashion, but it is calculated on the grossed-up taxable value at the employee's notional marginal tax rate.

2.275 There may be circumstances in both countries where a resident of one country working in the other country would be liable to tax in both countries on the fringe benefit. Regardless of whether the benefit is taxed under the ordinary income tax law or under a separate enactment (as is currently the case in Australia), or whether the tax is liable to be paid by the employer or the employee, this Article will ensure that the fringe benefit will be taxed in only one of the countries.

Definition of fringe benefit

2.276 The term ***fringe benefit*** is defined as including a benefit provided to an employee or to an associate of an employee by:

- an employer;
- an associate of an employer; or
- a person under an arrangement between that person and the employer, associate of an employer or another person in respect of the employment of that employee.

2.277 They include accommodation allowances or housing benefits but do not include a benefit arising from the acquisition of an option over shares under an employee share scheme. For example, a fringe benefit is provided when an employer allows an employee to use a work motor vehicle for private purposes, gives an employee a subsidised loan, or pays an employee's private health insurance costs. Benefits arising from employee share option schemes are excluded from the treaty definition of fringe benefit. Such option benefits are treated as remuneration from employment for the purposes of Article 14 (*Income from Employment*). [Article 15, subparagraph 2a)]

Article 16 — Directors' Fees

2.278 This Article relates to remuneration received by a resident of one country in the person's capacity as a member of a board of directors of a company which is a resident of the other country. To avoid difficulties in such cases of ascertaining which country a director's

services are performed, and consequently where the remuneration is to be taxed, the Article provides that directors' fees may be taxed in the country of residence of the company.

Article 17 — Entertainers and Sportspersons

Personal activities

2.279 Income derived by visiting entertainers and sportspersons from their personal activities as such may be taxed in the country in which the activities are exercised, irrespective of the duration of the visit. The term 'entertainer' is intended to have a broad meaning and would include, for example, actors and musicians as well as other performers whose activities have an entertainment character, such as comedians, talk show hosts, participants in chess tournaments or racing drivers. The application of this Article extends to income generated from promotional and associated kinds of activities engaged in by the entertainer or sportsperson while present in the visited country. *[Article 17, paragraph 1]*

Safeguard

2.280 Income in respect of personal activities exercised by an entertainer or sportsperson, where derived by another person (for example, a separate enterprise which formally enters into the contractual arrangements relating to the provision of the entertainer's or sportsperson's services), may be taxed in the country in which the entertainer or sportsperson performs, whether or not that other person has a permanent establishment in that country. *[Article 17, paragraph 2]*

Exception for members of teams playing in league competitions

2.281 Income derived in respect of personal activities exercised by sportspersons as members of recognised teams regularly playing in a league competition organised and conducted in both States, but not in respect of performance as a member of a national representative team of either country, is excluded from the operation of paragraphs 1 and 2. In such cases, the provisions of Article 7 (*Business Profits*) or Article 14 (*Income from Employment*) are to apply. Accordingly, New Zealand residents will generally be exempt from Australian tax in respect of income in respect of their activities as members of such teams. However, if the income is attributable to a permanent establishment that the sportsperson has in Australia, or if the conditions of paragraph 2 of Article 14 (*Income from Employment*) are not met in relation to the team member's salary or wages, Australia may tax that income.

2.282 The phrase ‘league competition organised and conducted in both States’ is intended to cover all sports where an association of clubs arranges matches between club teams of approximately similar standard from both countries and the matches are played in both countries. This would include for example, club-level rugby, netball, basketball and soccer competitions which take place in both countries. Unlike the equivalent provision in the existing New Zealand Agreement, paragraph 3 will also apply to league competitions that involve clubs from a third country, such as the Super 14 rugby competition. *[Article 17, paragraph 3]*

Article 18 — Pensions

General scope

2.283 Pensions (including government service pensions) and other similar periodic remuneration are generally taxable only by the country of which the recipient is a resident. In the course of negotiations, the two delegations noted that:

‘The term ‘pensions and other similar periodic remuneration’ is understood to include superannuation annuities, life annuities, periodic workers compensation and periodic accident compensation but would not include financial products in the form of annuities as these are more appropriately covered under the Interest Article.’

2.284 The application of this Article extends to pensions and annuity payments made to dependants, for example, a widow, widower 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 17, paragraph 1]*

Exemption for cross-border pensions

2.285 Paragraph 1 of this Article provides that pensions and other similar remuneration:

- arising in one country and paid to a resident in the other country,

will not be subject to tax by the residence country to the extent that the income:

- would have not been subject to tax in the first country if the recipient was a resident of that country.

2.286 In the course of negotiations, the delegations noted:

‘With respect to the second sentence of paragraph 1 of Article 18 (*Pensions*), it is understood that the term ‘to the extent that such income would not be subject to tax in the other State if the recipient were a resident of that other State’ includes instances where amounts would ordinarily not be included in assessable income under the domestic law of that other State if such amounts are ordinarily payable to residents of that other State and, in the case of payments arising in Australia, includes the deductible amount based on the undeducted purchase price of a pension or annuity, the tax free components of a superannuation benefit and any superannuation benefit amounts to which a nil rate of tax would apply (such as the amount of the taxable component of the element taxed in a superannuation fund which falls below the low rate cap and to which a zero per cent tax rate applies). It does not include instances where no tax is payable on the amount in that other State merely because the individual’s total taxable income falls below the general tax free threshold for resident individuals.’

2.287 The term ‘to the extent that such income would not be subject to tax in the other State if the recipient were a resident of that other State’ would capture pensions and other similar remuneration that are treated under Australian law as:

- not part of assessable income;
- exempt income;
- ‘non-assessable non-exempt income’; or
- assessable income but in respect of which there is a tax offset that results in the rate of income tax applying to that amount equal to 0 per cent.

For example:

- the deductible amount of the undeducted purchase price of a pension annuity or annuity that is subject to section 27H of the ITAA 1936 is not included as part of assessable income;
- the superannuation benefit payable to a member who is over 60 years of age is non-assessable non-exempt income under section 301-10 of the ITAA 1997;
- the tax-free component of an employment termination payment is non-assessable non-exempt income; and
- the taxable component of the superannuation benefit payable to a member who has reached their preservation age but is

below 60 years of age, where a tax offset applies to the element taxed in the fund up to the low rate cap amount such that the tax rate on that element does not exceed 0 per cent under section 301-20 of the ITAA 1997.

2.288 The second sentence in paragraph 1 therefore ensures that the income is not taxed in both countries. This exemption in both countries, however, does not apply to payments of portable New Zealand superannuation, portable veteran's pensions or equivalent portable payments arising in New Zealand.

2.289 Portable New Zealand superannuation is superannuation paid by the New Zealand Government to recipients living overseas. Similarly, portable veteran's pensions are paid by the New Zealand Government to recipients living overseas. 'Equivalent portable payments arising in New Zealand' is intended to cover similar payments made by the New Zealand Government to recipients living overseas.

2.290 Portable New Zealand superannuation or portable veteran's pension are exempt from tax under New Zealand's domestic legislation in order to ensure that the country of residence has sole taxation rights to a person's pension income. The reason why the Article does not apply to payments of portable New Zealand superannuation or portable veteran's pension is to ensure that Australia does not lose the ability to tax such payments. *[Article 18, paragraph 1]*

Example 2.22

Nicholas is a resident of New Zealand in receipt of a pension which is exempt from New Zealand tax under its domestic law. The pension is not of a type specified in the second sentence in paragraph 2 of Article 18. Nicholas decides to permanently relocate to Australia and becomes a resident of Australia for tax purposes. He continues to receive his New Zealand pension.

As the pension would not have been subject to New Zealand tax if Nicholas had remained a New Zealand resident, the pension will also not be subject to Australian tax now that Nicholas is a resident of Australia.

Lump sum payments

2.291 The term 'pension' refers to periodic payments and does not include lump sum payments. Lump sums arising under a 'retirement benefit scheme', or in consequence of retirement, invalidity, disability or death, in one country and payable to a resident of the other country will be taxable only in the country in which they arise.

2.292 In the course of negotiations, the delegations noted:

‘It is understood that the term ‘retirement benefits scheme’ means an arrangement in which the individual participates in order to secure retirement benefits. In the case of payments arising in Australia a retirement benefit scheme includes a superannuation fund and a retirement savings account and in the case of New Zealand includes any superannuation scheme. It was also agreed that in the case of Australia, a payment by the Commissioner under the *Superannuation (Unclaimed Money and Lost Members) Act 1999* shall be treated as a lump sum paid under a retirement benefit scheme.’

[Article 18, paragraph 2]

Pensions and lump sums not subject to tax still counted for certain purposes

2.293 While certain pensions and lump sums are not subject to tax in a country as a result of the Convention, this does not prevent them from being taken into account when determining entitlements to assistance or obligations in that country. In the course of negotiations, the delegations noted:

‘It is understood that pensions and lump sums that are not subject to tax may still be taken into account for the purpose of calculating a person’s income-targeted assistance and obligations such as Working for Families Tax Credits, child support and student loans.’

Where pensions and lump sums arise

2.294 To avoid uncertainty as to where pensions, other similar periodic remuneration and lump sums may be regarded as ‘arising’ for purposes of this Article, the two delegations, in the course of negotiations, reached the following understanding:

‘It is understood that pensions, other similar periodic remuneration and lump sums referred to in Article 18 (*Pensions*) will arise where the fund is established or, in the case of such income paid by the Government of a Contracting State, in that State.’

Alimony payments

2.295 Alimony and other maintenance payments are taxable only in the country of which the payer is a resident. The purpose of this paragraph is to remove any possibility of double taxation of such payments arising by reason of the treatment accorded such payments under the respective domestic law of the two countries. In the case of Australia, those payments will generally remain exempt from Australian

tax in the hands of the recipient and are non-deductible to the payer.
[Article 18, paragraph 3]

Article 19 — Government Service

Salary and wage income

2.296 Salary and wage type income, other than government service pensions, paid to an individual for services rendered to a government (including a political subdivision or local authority) of one of the countries, is to be taxed only in that country. However, such remuneration will be taxable only in the other country if the services are rendered in that other country; and

- the recipient is a resident of, and a national of, that other country; or
- the recipient is a resident of that other country and did not become a resident of that other country solely for the purpose of rendering the services (for example, if the recipient was a permanent resident of that other country prior to rendering the services).

[Article 19, paragraph 1]

Business income

2.297 Remuneration paid in respect of services rendered in connection with a business carried on by any governmental authority referred to in paragraph 1 of this Article is excluded from the scope of the Article. Such remuneration will remain subject to the provisions of Article 14 (*Income from Employment*), Article 16 (*Directors' Fees*) or Article 17 (*Entertainers and Sportspersons*). [Article 19, paragraph 2]

Article 20 — Students

Exemption from tax

2.298 This Article applies to students or business apprentices who are temporarily present in one of the countries solely for the purpose of their education or training if they are, or immediately before the visit were, a resident of the other country. In these circumstances, payments from abroad received by the students or business apprentices solely for their maintenance, education or training will be exempt from tax in the country visited. This will apply even though the student or business apprentice may qualify as a resident of the country visited during the period of their visit.

2.299 The exemption from tax provided by the visited country extends to maintenance payments received by the student or apprentice that are made for maintenance of dependent family members who have accompanied the student or apprentice to the visited country.

Employment income

2.300 Where a New Zealand student visiting Australia solely for educational purposes undertakes any employment in Australia, for example:

- 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 14 (*Income from Employment*), be subject to tax in Australia.

2.301 For business apprentices, this Article only applies where the apprentice's remuneration consists solely of subsistence payments to cover training or maintenance. Remuneration for service, that is, salary equivalents, fall for consideration under Article 14 (*Income from Employment*), as will any income derived from employment with a local employer.

2.302 A payment for maintenance, education or training would not be expected to exceed the level of expenses likely to be incurred to ensure the student or business apprentice's maintenance, education or training (that is, a subsistence payment).

2.303 In these situations, the payments received from abroad for the student or business apprentice's maintenance, education or training will not be taken into account in determining the tax payable on the employment income that is subject to tax in Australia. No Australian tax would be payable on the employment income if the student qualifies as a resident of Australia during the visit and the taxable income of the student does not exceed the tax-free threshold applicable to Australian residents for income tax purposes.

Article 21 — Other Income

Allocation of taxing rights

2.304 This Article provides rules for the allocation between the two countries of taxing rights with respect to items of income not dealt with in

the preceding Articles of the Convention. The scope of the Article is not confined to such items of income arising in one of the countries — it extends also to income from sources in a third country.

2.305 Broadly, such income derived by a resident of one country is to be taxed only in the country of residence unless it is from sources in the other country, in which case the income may also be taxed in the other country. This is consistent with the reservations of both Australia and New Zealand to Article 21 (*Other Income*) of the OECD Model. *[Article 21, paragraphs 1 and 3]*

2.306 Although paragraph 3 refers to income ‘arising’ in a country, rather than the more usual reference to income ‘from sources’ in a country found in Australia’s treaties, no difference in meaning is intended. The wording in this provision in the Convention reflects New Zealand’s treaty practice and the wording used in the United Nations Model *Double Taxation Convention between the Developed and Developing Countries*.

2.307 Where the income may be taxed in both countries in accordance with this provision, the country of residence of the recipient of the income is obliged by Article 23 (*Elimination of Double Taxation*) to provide double taxation relief.

2.308 This Article does not apply to income (other than income from real property as defined in paragraph 2 of Article 6 (*Income from Real Property*)) where the right or property in respect of which the income is paid is effectively connected with a permanent establishment which a resident of one country has in the other country. In such a case, Article 7 (*Business Profits*) will apply. *[Article 21, paragraph 2]*

2.309 This Article does not apply in the situation where business profits are not taxed in the country of source because of the absence of a permanent establishment. That is, in the absence of a permanent establishment, paragraph 1 of Article 7 (*Business Profits*) provides that the profits of an enterprise of a country shall be taxable only in that country.

Example 2.23

Esk Co, an Australia resident company, derives business profits from the sale of merchandise through an independent agent located in New Zealand. As Esk Co does not have a permanent establishment in New Zealand, the business profits will be taxable in Australia pursuant to Article 7 (*Business Profits*) and not under Article 21 (*Other Income*).

Article 22 — Source of Income

Deemed source

2.310 Consistent with Australia's treaty practice, this Article effectively deems income, profits or gains derived by a resident of a country which, in accordance with the Convention, may be taxed in the other country, to have a source in that other country. It therefore avoids any difficulties arising under domestic law source rules in respect of the exercise by Australia of the taxing rights allocated to Australia by the Convention over income derived by residents of New Zealand.

Article 23 — Elimination of Double Taxation

2.311 Double taxation does not arise in respect of income flowing between Australia and New Zealand:

- where the terms of the Convention provide for the income to be taxed only in one country; or
- where the domestic taxation law of one of the States exempts the income from its tax.

2.312 It is necessary, however, to prescribe a method for relieving double taxation for other classes of income, profits or gains which, under the terms of the Convention, remain subject to tax in both countries. In accordance with international practice, Australia's tax treaties provide for double tax relief to be provided by the country of residence of the taxpayer by way of an exemption of the foreign income, or a credit or deduction against its tax for the tax of the country of source. This Article also reflects that approach.

Australian method of relief

2.313 This Article requires Australia to provide Australian residents a credit against their Australian tax liability for New Zealand tax paid under New Zealand laws and in accordance with the Convention, on income which is taxable in Australia. The term 'income' in this context is intended to have a broad meaning and includes items of profit or gains which are dealt with under the income tax law. *[Article 23, paragraph 1]*

2.314 Australia's general foreign income tax offset rules, together with the terms of this Article and of the Convention generally, will form the basis of Australia's arrangements for relieving a resident of Australia from double taxation on income, profits or gains that are also taxed in New Zealand.

2.315 Accordingly, effect is to be given to the tax credit relief obligation imposed on Australia by paragraph 1 of this Article by application of the general foreign income tax offset provisions (Division 770 of the ITAA 1997).

2.316 Dividends and branch profits derived from New Zealand by an Australian resident company that are exempt from Australian tax under the foreign source income measures (for example, sections 23AH or 23AJ of the ITAA 1936) will continue to qualify for exemption from Australian tax under those provisions. As double taxation does not arise in these cases, the credit form of relief will not be relevant.

New Zealand relief

2.317 This Article also requires New Zealand to provide New Zealand residents relief by way of a credit against their New Zealand tax liability for Australian tax paid under Australian laws and in accordance with the Convention, on income which is taxable in New Zealand. However, in the case of dividends derived by a New Zealand resident from an Australian company, no credit will be given in New Zealand for Australian tax paid in respect of profits out of which the dividend is paid. *[Article 23, paragraph 2]*

Fiscally transparent entities

2.318 Paragraph 3 of this Article ensures that double taxation will be relieved in situations where, in accordance with paragraph 2 of Article 1, the same income is taxed in Australia and New Zealand in the hands of different persons. This situation may arise where the two countries allocate the income to different persons for tax purposes; for example, where one country treats the recipient entity as a taxpayer and taxes income received at the entity level, while the other country treats the same income as having been derived by the participants in the entity and taxes that income in the hands of the participants. Assume, for example, that the country of source treats a partnership as a company and the country of residence of a partner treats it as fiscally transparent. In such cases, this paragraph obliges the country of residence of the partners to provide relief from double taxation in respect of taxes imposed by the source country on that income in accordance with the provisions of Article 23. *[Article 23, paragraph 3]*

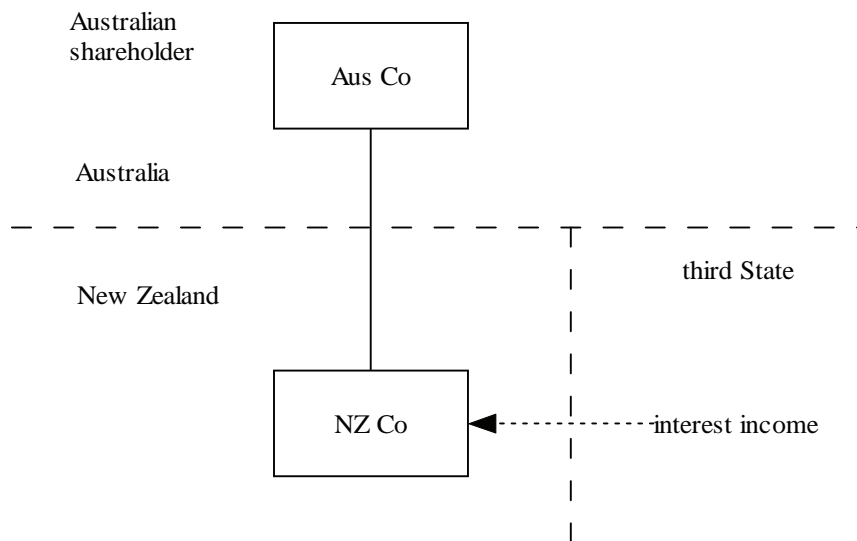
2.319 In the case of Australia a similar outcome is achieved in domestic law by subsection 770-130(2) of the ITAA 1997.

2.320 Paragraph 3 also applies where the country in which the income arises regards the income as derived by a resident entity, while the other country regards the entity as fiscally transparent and allocates the income

to its own residents who are participants in the entity (see Example 2.6). In these circumstances, paragraph 3 provides that the country of residence of the participants will provide relief in respect of taxes imposed in the source country.

2.321 Similarly, where the income arises in a third country, the country of residence of the participant in the entity would provide relief for tax imposed on the income in the hands of the entity in the other country.

Example 2.24



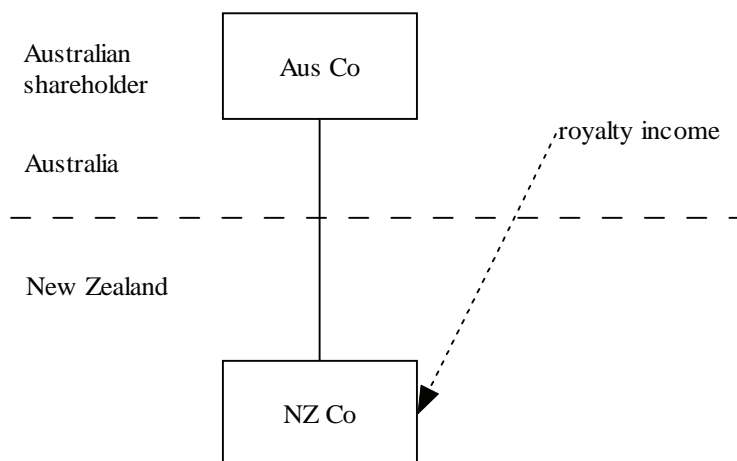
In this case an entity which is treated for tax purposes in New Zealand as a resident company, derives interest income from a third country. The third country taxes the royalty at source at 10 per cent gross. New Zealand taxes that interest income at 30 per cent as foreign income of a New Zealand resident company (assuming that no deductions are available) and gives a foreign tax credit for that foreign tax, so collecting a net 20 per cent tax. Australia regards the entity as fiscally transparent and taxes the Australian resident participant in the entity on the interest income.

Under paragraph 3 of this Article, Australia is required to give a foreign income tax offset for the New Zealand tax actually imposed on the income (that is, the net 20 per cent after a New Zealand foreign tax credit). The offset is subject to the normal limits discussed in paragraph 2.313 on paragraph 1 of Article 23.

Whether Australia would grant an offset for the third country tax on the interest would depend on the operation of the foreign income tax offset rules and any treaty between Australia and the third country. Normally it would be expected that such an offset would be available

subject to the limits arising under Australian domestic law and any treaty with that third country.

Example 2.25

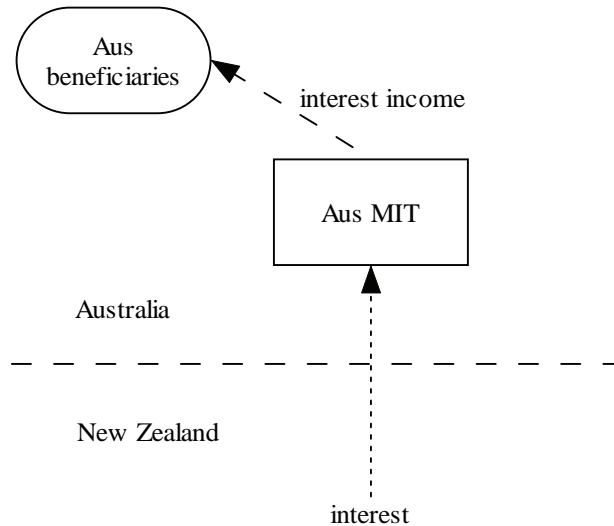


In this case, an entity which is treated for tax purposes in New Zealand as a resident company, derives royalty income from Australia. New Zealand taxes that royalty income at 30 per cent as foreign income of a New Zealand resident company and gives a foreign tax credit for the 5 per cent tax rate set in paragraph 2 of Article 12, so collecting a net 25 per cent tax.

Australia regards the entity as fiscally transparent and taxes the Australian resident participant in the entity on the royalty income. Under paragraph 3 of Article 23, Australia is required to give a foreign income tax offset for the New Zealand tax actually imposed on the income (that is, the net 25 per cent after a New Zealand foreign tax credit). The offset is subject to the normal limits discussed in paragraph 2.313 on paragraph 1 of Article 23.

2.322 As discussed in paragraphs 2.89 to 2.96, in certain circumstances treaty benefits under the Convention apply to income flowing through MITs. Where such income is allocated for Australian tax purposes to an Australian resident unitholder and taxed in their hands (that is, where the unitholder is presently entitled to income of the MIT), the unitholder will be entitled to double tax relief for New Zealand tax imposed on that income.

Example 2.26



In this diagram, interest income arising in New Zealand (not from a financial institution) is paid to a listed Australian MIT with Australian resident individual unitholders who are presently entitled to income of the MIT. The MIT satisfies the conditions in paragraph 7 of Article 4 (*Resident*), with the result that the treaty limits on New Zealand tax on the interest apply. For Australian tax purposes, the interest income is allocated to the unitholders and taxed in their hands.

Australia is required to provide double tax relief for New Zealand tax imposed on the part of the interest income allocated to the Australian resident unitholders.

Article 24 — Non-Discrimination

2.323 The Convention includes rules to prevent tax discrimination. The Australian tax system is generally non-discriminatory. However, for clarity this Article provides that certain features of the Australian tax system should not be seen as coming within the Article’s terms. Similarly, the Article provides that certain features of the New Zealand tax system are not affected by its provisions. The measures identified can be characterised as being an integral part of the administration of the two countries’ economic and tax policy and the collection of their taxes.

Discrimination based on nationality

2.324 This Article prevents discrimination on the grounds of nationality by providing that nationals of one country may not be less favourably treated than nationals of the other country in the same circumstances. [Article 24, paragraph 1]

2.325 The discrimination that this Article precludes applies to both taxation and any requirement connected with such taxation. Accordingly, discrimination in the administration of the tax law is also generally precluded.

2.326 The term ‘national’ is defined in subparagraph i) of paragraph 1 of Article 3 (*General Definitions*) of the Convention and covers both an individual who is a citizen or national of one country or the other, and a company, partnership or association ‘deriving its status as such from the laws in force in that Contracting State’. Accordingly, a company that is incorporated in Australia would be a national of Australia while a company that is incorporated under a law of New Zealand would be a national of New Zealand for the purposes of this paragraph. [*Article 3, subparagraph ii*)]

The meaning of ‘in the same circumstances’ and ‘in particular with respect to residence’

2.327 The expression ‘in the same circumstances’ refers to persons who, from the point of the application of the ordinary taxation laws, are in substantially similar circumstances both in law and in fact.

2.328 Where a person operates in an industry that is subject to government regulation such as prudential oversight, another person operating in the same industry but not subject to the same oversight, would not be in the same circumstances.

2.329 The inclusion of the further clarification ‘in particular with respect to residence’ makes clear that the residence of the taxpayer is one of the factors that are relevant in determining whether taxpayers are placed in similar circumstances. Therefore, different treatment accorded to a New Zealand resident compared to an Australian resident will not constitute discrimination for the purposes of this Article. A potential breach of paragraph 1 of this Article only arises if two persons who are residents of the same country are treated differently solely by reason of one being a national of Australia and the other a national of New Zealand.

The meaning of ‘more burdensome’ taxation

2.330 Unlike paragraph 1 of Article 24 (*Non-Discrimination*) in the OECD Model and equivalent provisions in Australia’s other tax treaties, this provision refers only to ‘more burdensome’ taxation rather than ‘other or more burdensome’. However, it is not intended that the words ‘more burdensome...taxation’ would refer only to the quantum of taxation.

2.331 The phrase is also applicable to more onerous administrative or compliance requirements that a taxpayer may be called upon to meet where those requirements differ based on nationality grounds.

Non-residents of Australia/New Zealand

2.332 Consistent with paragraph 1 of Article 24 (*Non-Discrimination*) of the OECD Model, paragraph 1 of this Article applies to persons who are residents of neither Australia nor New Zealand. Consequently, residents of third countries who are citizens or nationals of either Australia or New Zealand are able to seek the benefits of this provision. Paragraph 1 does not, however, extend to residents of either country who are not ‘nationals’ (as defined in subparagraph i) of paragraph 1 of Article 3 (*General Definitions*)) of either country.

Non-discrimination and permanent establishments

2.333 The tax on permanent establishments of enterprises of the other country shall not be levied less favourably than on the country’s own enterprises carrying on the same activities in similar circumstances. This applies to all residents of a treaty country, irrespective of their nationality, who have a permanent establishment in the other country. [*Article 24, paragraph 2*]

2.334 For this paragraph to apply, the enterprises of both States must be ‘in similar circumstances’. Therefore, the comparison must be made between a permanent establishment and local enterprises which are not only carrying on the same activities but are also carrying on those activities ‘in similar circumstances’. This is to address situations where resident and non-resident enterprises may be carrying on the same activities but the circumstances in which they do so are very different. For example, one may be conducting dealings on a non-arm’s length basis and the other on an arm’s length basis. The provision recognises that appropriate differences in taxation treatment are not precluded because of the differing circumstances.

2.335 Permanent establishments of non-resident enterprises may be treated differently from resident enterprises as long as the treatment does not result in more burdensome taxation for the former than for the latter. That is, a different mode of taxation may be adopted with respect to non-resident enterprises, to take account of the fact that they often operate in different conditions to resident enterprises. The provision would not affect, for example, domestic law provisions that tax a non-resident by withholding, provided that calculation of the tax payable is not greater than that applying to a resident taxpayer.

Non-resident individuals

2.336 Non-resident individuals do not have to be granted the personal allowances, reliefs or reductions available to residents of the tax treaty countries. [*Article 24, paragraph 2*]

2.337 This means that Australia will continue to be able to grant certain tax offsets only to resident individuals, such as the tax offset for dependents contained in Division 13 of the ITAA 1997.

2.338 Unlike paragraph 3 of Article 24 (*Non-Discrimination*) of the OECD Model, the Article is not just limited to those benefits conferred by a country relating to civil status or family responsibilities of the individual. For Australian tax purposes, it also extends, for example, to the tax-free threshold which may be considered not to be based either on civil status or family responsibilities.

Deductions for payments to foreign residents

2.339 The treaty partner countries must allow the same deductions for interest, royalties and other disbursements paid to residents of the other country as it does for payments to its own residents. However, the treaty countries are allowed to reallocate profits between related enterprises on an arm's length basis under Article 9 (*Associated Enterprises*) and to limit deductions in accordance with paragraph 8 of Article 11 (*Interest*), and paragraph 6 of Article 12 (*Royalties*). [*Article 24, paragraph 3*]

Companies owned or controlled abroad

2.340 A country must not give less favourable treatment to an enterprise, the capital of which is owned or controlled, wholly or partly, directly or indirectly, by one or more residents of the other country. That is, Australian companies owned or controlled by New Zealand residents may not be given other or more burdensome treatment than locally owned or controlled Australian companies. [*Article 24, paragraph 4*]

2.341 Differential tax treatment based on residency is not affected by this paragraph. Nor does the paragraph require the same treatment of non-resident shareholders in the company as resident shareholders. Accordingly, there is no obligation under paragraph 4 or any other provision of this Article to allow imputation credits to non-resident shareholders.

Exclusions

2.342 Certain provisions of the law of both countries that are important for purposes of economic regulation and integrity of the tax system are not restricted in their application by this Article. Although most are generally recognised by the international community as not being discriminatory, the specific exclusion of these provisions will ensure that they can continue to operate for their intended purpose. The provisions of the law of Australia and New Zealand which are not restricted in the application by this Article are those that:

- prevent the avoidance or evasion of taxes;
- defer tax where an asset is transferred out of the jurisdiction;
- provide for consolidation of group entities;
- provide for the transfer of losses within company groups;
- do not allow tax rebates, credits or exemptions in relation to dividends paid by a company;
- provide for deductions for research and development expenditure; or
- are agreed in an Exchange of Notes between the two Governments to be unaffected by the Article.

Avoidance or evasion provisions

2.343 The operation of domestic measures to combat avoidance and evasion is not affected by this Article. [*Article 24, subparagraph 5a*)]

2.344 The reference to ‘laws ... designed to prevent avoidance or evasion of taxes’ includes, in the case of Australia, thin capitalisation, dividend stripping, transfer pricing, controlled foreign company, transferor trust and foreign investment fund provisions, and collection measures including conservancy. Although it is commonly accepted by most OECD member countries that such provisions do not contravene *Non-Discrimination* Articles, this outcome is specifically provided for in the Convention by the exclusion of such rules from the operation of this Article. [*Article 24, paragraph 6*]

2.345 The enforcement and operation of the various aspects of the withholding tax provisions relating to non-residents are preserved by this Article. For example, section 26-25 (*Interest or royalty*) of the ITAA 1997 provides that where interest or royalties are paid to a

non-resident and the payer fails to deduct withholding tax, the interest or royalty cannot be claimed as a deduction. No similar measure exists in relation to payments from a resident to another resident. [Article 24, subparagraph 5a) and paragraph 6]

Capital gains roll-over relief

2.346 This Article will not affect the operation of any provision of domestic tax legislation which does not permit the deferral of tax arising on the transfer of an asset where the transfer of the asset by the transferee would take the asset beyond the taxing jurisdiction of the country.

2.347 Under Australia's domestic tax legislation, permanent establishments generally enjoy the same tax treatment as resident enterprises. However, roll-over relief is denied to a permanent establishment where an asset that is taxable Australian property is transferred to a non-resident if the asset is not taxable Australian property in the hands of the transferee. Australia will be able to continue to deny roll-over relief in these circumstances. [Article 24, subparagraph 5b)]

Consolidation

2.348 Domestic law rules which provide for single entity treatment of a group of entities are excluded from the operation of this Article, provided that there is no discrimination regarding access to consolidation treatment between Australian resident companies on the basis of ownership of the company.

2.349 Australia's consolidation measures are restricted to wholly-owned Australian resident entities. This Article will not apply to these measures, with the result that domestic law provisions continue to operate to preclude permanent establishments of non-resident companies from consolidating with resident entities that may be wholly-owned by a non-resident. [Article 24, subparagraph 5c)]

Transfers of losses within company groups

2.350 Under New Zealand's company grouping rules, companies in the same group can group losses either by election or by subvention payment. However, the loss company must either be incorporated in New Zealand or carrying on business through a fixed establishment for the period from the first day of the year in which the net loss was incurred to the last day of the year in which the loss is grouped. The loss company must not be treated under a tax treaty as not being a resident of New Zealand or otherwise be liable to overseas income tax.

2.351 A specific exclusion to this Article was included at the request of New Zealand to ensure these rules ensure they continue to operate for their intended purpose. *[Article 24, subparagraph 5d)]*

Rebates, credits and exemptions paid for dividends by a company

2.352 Domestic law rules of either country which allow an inter-corporate dividend rebate, credit or exemption are excluded from the operation of Article 24. Dividends paid to non-residents are subject to withholding tax and are not assessable income. Where dividends are fully franked they are exempt from withholding tax. As no imputation credits arise for non-residents, there is no possibility of excess imputation credits arising. Accordingly, it is not possible for non-residents to offset excess franking credits against their Australian source income or to seek a refund of any excess imputation credits. This Article preserves this domestic law treatment. *[Article 24, subparagraph 5e)]*

Research and development expenditure

2.353 The domestic law research and development provisions are excluded from the operation of Article 24. It follows that Australia will be able to continue to apply its domestic law rules concerning access to concessions in respect of research and development expenditure. Currently, these concessions are only available to companies that are incorporated in Australia. *[Article 24, subparagraph 5f)]*

Power to carry out an Exchange of Notes

2.354 The two Governments may agree in an Exchange of Notes that other domestic law provisions will not be affected by the requirements of Article 24. Australia and New Zealand can agree in respect of existing laws or laws that are enacted in the future. In the course of negotiations, the delegations noted:

‘It is understood that paragraph g) of paragraph 5 of Article 24 (*Non-Discrimination*) applies to existing and future provisions of the laws of a Contracting State.’

[Article 24, subparagraph 5g)]

Taxes to which this Article applies

2.355 This Article applies to taxes of every kind and description imposed on behalf of the Contracting States, or their political subdivisions. It is intended that the Article extend to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of, these taxes.

2.356 In the case of Australia, the relevant taxes include the income tax (including the petroleum resource rent tax and tax on capital gains), the GST and fringe benefits tax. The provisions of this Article also apply to taxes imposed by the Australian states and territories.

2.357 In the case of New Zealand, the relevant taxes are all taxes imposed by New Zealand except for those imposed by local authorities. *[Article 24, paragraph 7]*

More favourable treatment

2.358 Nothing in this Article prevents either country from treating residents of the other country more favourably than its own residents.

Article 25 — Mutual Agreement Procedure

Consultation on specific cases

2.359 This Article provides for consultation between the competent authorities of the two countries with a view to reaching a solution in cases where a person is able to demonstrate actual or potential imposition of taxation contrary to the provisions of the Convention. *[Article 25, paragraph 2]*

2.360 In the case of Australia, the competent authority is the Commissioner or an authorised representative of the Commissioner. *[Article 3, subparagraph 1e)]*

2.361 A person wishing to use this procedure may present a case to the competent authority of the country of which the person is a resident. If the case comes under paragraph 1 of Article 24 (*Non-Discrimination*) of the Convention, the person may present a case to the competent authority of the country of which the person is a national.

2.362 Presentation of a case by a person to a competent authority must be made within three years of the first notification of the action which the taxpayer considers gives rise to taxation not in accordance with the Convention. Presentation of a case does not deprive the person of access to, or affect their rights in relation to, other legal remedies available under the domestic laws of the countries. *[Article 25, paragraph 1]*

2.363 If the person's claim seems to the competent authority to which the case has been presented to be justified, and that competent authority is not itself able to solve the problem, then the competent authority is required to seek to resolve the case by mutual agreement with the competent authority of the other country, with a view to avoiding taxation not in accordance with the Convention. *[Article 25, paragraph 2]*

2.364 If, after consideration by the competent authorities, a solution is reached, it must be implemented in accordance with the provisions of the Article.

Implementation of a solution

2.365 The solution reached by mutual agreement between the competent authorities of the relevant countries must be implemented notwithstanding any time limits in the domestic laws of the tax treaty countries. This allows the competent authorities the flexibility to reach a satisfactory solution and avoids problems that might arise where each country has a different time limit in their domestic law. [Article 25, paragraph 2]

Consultation on general problems

2.366 This Article also authorises consultation between the competent authorities of the two countries for the purpose of resolving any difficulties that arise regarding the interpretation or application of the Convention. This may allow, for example, the competent authorities to agree to apply an agreed solution to a broader range of taxpayers, notwithstanding that the original uncertainty may have arisen in connection with an individual case that comes under the procedure outlined in paragraphs 1 and 2 of this Article.

2.367 The competent authorities may also consult together with a view to eliminating double taxation in cases where the Convention does not provide a solution. However, in eliminating such double taxation, the competent authorities must act within their statutory powers. In the course of negotiations, the delegations noted:

‘With respect to the provision allowing the competent authorities to consult for the elimination for double taxation in cases not provided for in the Convention, it is understood that this does not provide any additional powers to the competent authorities beyond their usual statutory powers.’

[Article 25, paragraph 3]

Methods of communication between competent authorities

2.368 The competent authorities are permitted to communicate directly with each other without having to go through diplomatic channels. This may be done by electronic means (for example, facsimile transmission, email or web conferencing), letter, telephone, direct meetings or any other convenient means. [Article 25, paragraph 4]

General Agreement on Trade in Services dispute resolution process

2.369 This Article also deals with disputes that may be brought before the World Trade Organisation Council for Trade in Services under the dispute resolution processes of the General Agreement on Trade in Services (GATS).

2.370 Australia and New Zealand are both parties to the GATS. Article XVII (*National Treatment*) of the GATS requires a party to accord the same treatment to services and service suppliers of other parties as it accords to its own like services and service suppliers.

2.371 Articles XXII (*Consultation*) and XXIII (*Dispute Settlement and Enforcement*) of the GATS provide for discussion and resolution of disputes. Where a measure of another party falls within the scope of a tax treaty, paragraph 3 of Article XXII (*Consultation*) provides that the other party to the tax treaty may not invoke Article XVII (*National Treatment*). However, if there is a dispute as to whether a measure actually falls within the scope of a tax treaty, either country may take the matter to the Council on Trade in Services for referral to binding arbitration.

2.372 This provision is based, in all essential respects, on an OECD Model Commentary recommendation, and is common in recent international treaty practice. [*Article 25, paragraph 5*]

Arbitration

2.373 In some instances, the competent authorities will not reach agreement on a solution to a particular case. Paragraph 6 of this Article provides for arbitration to be used to assist in resolving those cases. The provisions contained in this paragraph are broadly consistent with those of paragraph 5 of Article 25 (*Mutual Agreement Procedure*) of the OECD Model.

2.374 Only those cases presented under paragraph 1 of this Article (that is, where a person contends that the actions of either Australia or New Zealand will result in taxation not in accordance with the Convention) are eligible. Cases arising under paragraph 3 of this Article, for example, a case involving a general difficulty in interpreting or applying the Convention raised by a competent authority, are not eligible to be resolved through this arbitration mechanism.

2.375 Cases arising under paragraph 1 can only access the arbitration mechanism if the competent authorities are unable to reach agreement within two years from when the case was first presented by the competent authority in one country to the competent authority of the other country. If the case remains unresolved after that time, the person may request that

the arbitration mechanism be used. Access to arbitration in such cases is automatic; it is not subject to the specific agreement of the competent authorities.

2.376 As discussed in the OECD Model Commentary, it is not intended that the arbitration mechanism be an alternative to the mutual agreement procedure. Where the competent authorities have reached an agreement that does not leave any issues unresolved in the case, that case is not eligible for arbitration even if the taxpayer does not agree with the solution reached. However, if any issue remains outstanding so that taxation contrary to the Convention remains, the competent authorities cannot consider (either singly or together) the case is resolved and refuse the person access to the arbitration mechanism.

2.377 Unlike the mutual agreement procedure, which may be invoked where a taxpayer considers that taxation not in accordance with the treaty will *or may* result, the arbitration mechanism is only available in respect actual taxation contrary to the Convention which has resulted from the actions of either Australia or New Zealand, or both. This would include instances where an assessment or determination of tax has been made, or otherwise where the taxpayer has been officially notified by the ATO or New Zealand Inland Revenue Department that they are going to be taxed on an item of income. *[Article 25, paragraph 6]*

2.378 Not all unresolved issues arising from the case are eligible to be resolved through arbitration. Paragraph 7 of this Article establishes that the issues to which the arbitration mechanism applies are issues of fact and issues to which Australia and New Zealand agree in an Exchange of Notes are to be covered by the arbitration mechanism. Where cases involve both unresolved issues of fact and other unresolved issues (for example, the interpretation to be given to a particular provision in the Convention), only the issues of fact may be resolved through arbitration. The mutual agreement procedure will continue to apply in respect of other issues. *[Article 25, paragraph 7]*

2.379 Further, unresolved issues cannot be submitted for arbitration if a decision on those issues has already been reserved or rendered by a court or administrative tribunal of either Australia or New Zealand. As discussed in the OECD Model Commentary, this means where a court or administrative tribunal of one of the States has already rendered a decision that deals with those issues and that applies to that person. Paragraph 6 of this Article in the Convention also covers those instances where a court or administrative tribunal has reserved its decision. However, it is not intended that a person would be prevented from having unresolved factual issues arising in their case submitted for arbitration merely because another person is pursuing appeals through the domestic courts on similar issues.

2.380 Paragraph 6 provides that unless a person directly affected by the case rejects the arbitration decision on the issues, the decision is binding on both Australia and New Zealand. The competent authorities are required to reflect that decision in the mutual agreement in respect of the case. The outcomes of the mutual agreement are to be implemented notwithstanding any time limits in the domestic laws of both States. *[Article 25, paragraph 6]*

2.381 The arbitration mechanism contained in paragraphs 6 and 7 of this Article shall have effect from the date agreed in a subsequent Exchange of Notes through the diplomatic channel. This Exchange of Notes is expected to occur when Australia and New Zealand have established the underlying procedures governing the arbitration mechanism. Once paragraphs 6 and 7 have effect, cases which have been presented under to the relevant competent authority in accordance with paragraph 1 of the Article in this Convention, whether the case is presented before or after the date agreed in the Exchange of Notes, may be submitted to arbitration if they meet the criteria under paragraphs 6 and 7 of Article 25 (*Mutual Agreement Procedure*). However, arbitration is not available in respect of cases that were brought to the competent authorities under paragraph 1 of the existing New Zealand Agreement. *[Article 30, paragraph 2]*

Article 26 — Exchange of Information

2.382 The Convention allows for the competent authorities to exchange information on a wide range of taxes and irrespective of whether the country of whom the information is requested has a domestic tax interest in the information sought. The information allowed to be exchanged does not have to concern a resident of either Australia or New Zealand.

2.383 The provisions relating to exchange of information in the Convention are identical in effect to those included in the existing New Zealand Agreement by the amending Protocol signed on 15 November 2005.

Foreseeably relevant information

2.384 Article 26 authorises and limits the exchange of information by the two competent authorities to information foreseeably relevant to the administration or enforcement of the relevant taxes. The exchange of information is not restricted by Article 1 (*Persons Covered*) or Article 2 (*Taxes Covered*) of the Convention, and may therefore cover persons who are not residents of Australia or New Zealand.

2.385 The standard of foreseeable relevance is intended to ensure that information may be exchanged to the widest possible extent. However, competent authorities are not entitled to request information from the other country which is unlikely to be relevant to the tax affairs of a taxpayer, or to the administration and enforcement of tax laws. [*Article 26, paragraph 1*]

Taxes to which this Article applies

2.386 Under the Convention, the Australian competent authority can request and obtain information concerning taxes of every kind and description imposed under New Zealand's tax laws. The New Zealand competent authority can request and obtain information concerning taxes of every kind and description under the federal laws administered by the Commissioner. This means, for example, that information concerning Australian indirect taxes (for example, the GST) may be requested and obtained from New Zealand.

2.387 This would also extend to information sought for the prevention of tax evasion, such as for the purposes of both Australia and New Zealand's promoter penalty regimes. In the course of negotiations, the delegations noted:

‘The delegations agreed that the term ‘concerning taxes’ is intended to have a wide operation and an indirect but relevant connection with the information would be a sufficient connection. Accordingly, it was agreed that the competent authorities could exchange information for the purposes of their respective promoter penalty regimes to the extent that the information relates to the promotion of tax avoidance, tax evasion or abuse of administrative guidance.’

2.388 It is intended that the Article extend to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of, these taxes.

Use of exchanged information

2.389 The purposes for which the exchanged information may be used and the persons to whom it may be disclosed are restricted in a manner which is consistent with the approach taken in the OECD Model. However, the final sentence of this paragraph permits the information to be used for other purposes when such use is authorised by the competent authority of the supplying country.

2.390 Any information received by a country must be treated as secret in the same manner as information obtained under the domestic law of that country, and can only be disclosed to the persons identified in paragraph 2 of the Article. [*Article 26, paragraph 2*]

No domestic tax interest required

2.391 When requested, a country is required to obtain information in the same manner as if it were administering its domestic tax system, notwithstanding that the country may not require the information for its own purposes. Australia would recognise this obligation to obtain relevant information for treaty partner countries, even in the absence of an explicit provision to this effect. *[Article 25, paragraph 4]*

Limitations

2.392 The country requested to provide information under this Article is not obliged to do so where:

- it would be required to carry out administrative measures at variance with the law and administrative practice of either Australia or New Zealand; or
- such information is not obtainable under the domestic law or in the normal course of administration of Australia or New Zealand.

[Article 26, subparagraphs 3a) and 3b)]

2.393 Also, in no case is the country receiving the request obliged to supply information under this Article that would:

- disclose any trade, business, industrial, commercial or professional secret or trade process; or
- be contrary to public policy.

[Article 26, subparagraph 3c)]

Information held by institutions such as banks, other financial institutions or nominees

2.394 Paragraph 5 ensures that paragraph 3 of this Article cannot be used to prevent the supply of information solely because the information is held by institutions such as banks, other financial institutions or nominees. This reflects the 2005 changes to Article 26 (*Exchange of Information*) of the OECD Model. *[Article 26, paragraph 5]*

Information that exists prior to the entry into force of this Convention

2.395 Under this Article, the competent authorities can exchange information that relates to transactions or events occurring prior to entry into force of the Convention. This approach conforms with the

international practice contained in paragraph 10.3 of the OECD Commentary on Article 26 (*Exchange of Information*).

Article 27 — Assistance in the Collection of Taxes

2.396 Australia and New Zealand are authorised and required to provide assistance to each other in the collection of revenue claims. This assistance is not to be restricted by the terms of Article 1 (*Persons Covered*) or Article 2 (*Taxes Covered*) of the Convention. Assistance must therefore be provided as regards a revenue claim owed to either country by any person, whether or not a resident of Australia or New Zealand. The form of the assistance is set out in paragraphs 3 and 4 of this Article.

2.397 The provisions relating to assistance in collection in the Convention are identical in effect to those included in the existing New Zealand Agreement by the amending Protocol signed on 15 November 2005. [*Article 27, paragraph 1*]

Definition of revenue claim

2.398 The term *revenue claim* is defined for the purposes of this Article to mean an amount owed in respect of taxes of every kind and description under New Zealand's tax laws, or any Australian federal tax administered by the Commissioner, but only insofar as the imposition of such taxes is not contrary to the Convention or any other instrument in force between Australia and New Zealand. It also applies to interest, administrative penalties and costs of collection or conservancy related to such amount.

2.399 It is intended that the Article extend to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of, these taxes. [*Article 27, paragraph 2*]

Enforceable revenue claims

2.400 Assistance in collection will only be provided by Australia in relation to a revenue claim that is enforceable in New Zealand. Similarly, New Zealand is not required to provide assistance in collection in respect of an Australian revenue claim that is not enforceable in Australia. A revenue claim will be enforceable where the requesting country has the right, under its domestic law, to collect the revenue claim. Further, the revenue claim must be owed by a person who, at that time, under the law of that country, has no administrative or judicial rights to prevent its collection.

2.401 Paragraph 3 of this Article regulates the way in which the revenue claim of the requesting country is to be collected by the requested country. Other than in relation to time limits and priority (see paragraphs 2.405 to 2.408), the requested country is required to collect the revenue claim as though it were its own revenue claim. This obligation applies even if, at that time, the requested country has no need to undertake collection actions related to that taxpayer for its own tax purposes. *[Article 27, paragraph 3]*

2.402 Where New Zealand makes a revenue claim, the Commissioner will apply the provisions of Division 263 in Schedule 1 to the *Taxation Administration Act 1953* for the administration and collection of that claim.

Measures of conservancy

2.403 Australia or New Zealand may request the other country to take measures of conservancy even where it cannot yet ask for assistance in collection, such as where the revenue claim is not yet enforceable or when the debtor still has the right to prevent its collection. An example of a conservancy measure is the seizure or the freezing of assets before final judgment to guarantee that the assets will still be available when collection can subsequently take place.

2.404 If requested to do so by New Zealand, Australia is required to take measures of conservancy in respect of the revenue claim in accordance with the provisions of Australian law as if the revenue claim were an Australian revenue claim. Although Australia does not have specific conservancy measures, the Commissioner may apply for a Mareva injunction, which would prevent the taxpayer and the taxpayer's associates from dealing with certain assets. *[Article 27, paragraph 4]*

Time limits

2.405 The requested country's domestic law time limitations beyond which a revenue claim cannot be enforced or collected do not apply to a revenue claim in respect of which the other country has made a request for assistance in collection. Rather, the time limits of the requesting country apply. *[Article 27, paragraph 5]*

2.406 This paragraph follows the OECD provision but has no practical effect in Australia as there is currently no time limit imposed on the collection of a revenue claim.

Priority of claims

2.407 Any rules of Australia and New Zealand which give priority to tax debts over the claims of other creditors do not apply to a revenue claim of the other country. This restriction applies regardless of the fact that the requested country must generally treat the claim as its own revenue claim.

2.408 The words ‘by reason of its nature as such’ in paragraph 5 indicate that any time limits and priority rules to which the paragraph applies are only those that are specific to unpaid taxes. Consequently, paragraph 5 does not prevent the application of general rules concerning time limits or priority which would apply to all debts, such as rules giving priority to a claim by reason of that claim having arisen or having been registered before another one. *[Article 27, paragraph 5]*

Restriction on judicial and administrative proceedings

2.409 Any legal or administrative objection concerning the existence, validity or the amount of a revenue claim of the requesting country is to be exclusively dealt with in that country. For example, no legal or administrative proceedings, such as a request for judicial review, may be initiated in Australia with respect to the existence, validity or amount of a New Zealand revenue claim. *[Article 27, paragraph 6]*

Change in circumstances

2.410 Where the relevant conditions in paragraph 3 or 4 of this Article are no longer satisfied after a request for assistance has been made, but before the revenue claim has been collected and remitted by the requested country, the competent authority of the requesting country is required to promptly notify the competent authority of the other country of that fact. *[Article 27, paragraph 7]*

2.411 An example of such a situation would be where a request for assistance in collection has been made by New Zealand, but the revenue claim ceases to be enforceable in New Zealand prior to its collection by Australia.

2.412 Following such notification, the requested country has the option to ask the requesting country to either suspend or withdraw its request for assistance. If the request is suspended, the suspension applies until such time as the requesting country informs the other country that the conditions necessary for making a request as regards the revenue claim are again satisfied or that it withdraws its request. *[Article 27, paragraph 7]*

Limitations

2.413 The requested country is permitted to refuse the request for assistance in certain circumstances.

2.414 The first limitation on the obligations of the country receiving the request is that it is not required to exceed the bounds of its own domestic laws and administrative practice or those of the other country in fulfilling its obligations under the Article. *[Article 27, subparagraph 8a)]*

2.415 However, this does not prevent Australia from applying administrative measures to collect a New Zealand revenue claim, even though invoked solely to provide assistance in the collection of New Zealand taxes.

2.416 The second limitation provides that the country is not required to satisfy a request where it would require the carrying out of measures that are contrary to public policy, such as where providing assistance may affect the vital interests of the country itself. *[Article 27, subparagraph 8b)]*

2.417 The third limitation provides that neither country is obliged to satisfy a request for assistance if the other country has not pursued all reasonable measures of collection or conservancy that are available under its own laws or administrative practice. *[Article 27, subparagraph 8c)]*

2.418 Either country may reject a request for assistance on the basis of practical administrative considerations such as when the costs of recovering a revenue claim would exceed the amount of the revenue claim itself. *[Article 27, subparagraph 8d)]*

2.419 The final limitation allows either country to refuse to provide assistance if it considers that the taxes with respect to which assistance is requested are imposed contrary to generally accepted taxation principles. *[Article 27, subparagraph 8e)]*

Article 28 — Members of Diplomatic Missions and Consular Posts

2.420 The purpose of this Article is to ensure that the provisions of the Convention do not result in members of diplomatic missions or consular posts receiving less favourable treatment than that to which they are entitled in accordance with international conventions. Such persons are entitled, for example, to certain fiscal privileges under the *Diplomatic Privileges and Immunities Act 1967* and the *Consular Privileges and Immunities Act 1972* which reflect Australia's international diplomatic and consular obligations.

Article 29 — Miscellaneous

Obligation for Australia and New Zealand to consult every five years

2.421 Paragraph 1 of this Article requires Australia and New Zealand to consult each other every five years regarding the operation of the Convention to ensure that it continues to operate effectively in avoiding double taxation and preventing tax evasion. The first consultation is to occur no later than the end of the fifth year after entry into force of the Convention.

2.422 Regular evaluations of the Convention will ensure it remains consistent with both Australia and New Zealand's objectives. [Article 29, paragraph 1]

Most favoured nation obligation

2.423 The Convention includes a 'most favoured nation' clause which requires New Zealand to notify Australia if it agrees in another tax treaty to provide more favourable treatment of interest derived by financial institutions. New Zealand is further obliged to enter into negotiations with Australia to provide the same treatment under the Convention. [Article 29, paragraph 2]

2.424 This 'most favoured nation' clause will ensure that Australian financial institutions receive no less favourable treatment than financial institutions in New Zealand's other treaty partner countries. Thus for example, if New Zealand agreed in a future treaty to grant an interest withholding tax exemption for financial institutions, without a requirement that AIL be paid, or agreed to a withholding tax rate limit lower than 10 per cent in the event AIL was not paid, New Zealand would be obliged to negotiate with Australia to provide similar outcomes for Australian financial institutions.

Article 30 — Entry into Force

Date of entry into force

2.425 This Article provides for the entry into force of the Convention. The Convention will enter into force on the last date on which diplomatic notes are exchanged notifying that the domestic processes to approve the Convention in the respective countries have been completed. In Australia, enactment of the legislation giving the force of law in Australia to the Convention along with tabling the Convention in Parliament are prerequisites to the exchange of diplomatic notes. [Article 30, paragraph 1]

Date of application for Australian taxes

Withholding taxes

2.426 Once it enters into force, the Convention will apply in Australia in respect of withholding tax on income that is derived by a non-resident in relation to income derived on or after the first day of the second month next following the date on which the Convention enters into force.

[Article 30, sub-subparagraph 1a)(i)]

Fringe benefits tax

2.427 The Convention will apply in Australia in respect of fringe benefits provided on or after 1 April next following the date on which this Convention enters into force. *[Article 30, sub-subparagraph 1a)(ii)]*

Other Australian taxes

2.428 The Convention will first apply to other Australian taxes as regards any year of income beginning on or after 1 July next following the date on which the Convention enters into force.

2.429 Where a taxpayer has adopted an accounting period ending on a date other than 30 June, the accounting period that has been substituted for the year of income beginning on 1 July next following the date on which the Convention enters into force will be the relevant year of income for the purposes of the application of such Australian tax. *[Article 30, sub-subparagraph 1a)(iii)]*

Date of application for New Zealand taxes

Withholding taxes

2.430 In New Zealand, the Convention will apply in respect of withholding tax on income that is derived by a non-resident in relation to income derived on or after the first day of the second month next following the date on which the Convention enters into force. *[Article 30, sub-subparagraph 1b)(i)]*

Other New Zealand taxes

2.431 The Convention will first apply to New Zealand taxes as regards any year of income beginning on or after 1 April next following the date on which the Convention enters into force. *[Article 30, sub-subparagraph 1b)(ii)]*

Arbitration

2.432 Paragraph 2 of this Article establishes that the provisions allowing for arbitration (paragraphs 6 and 7 in Article 25 (*Mutual Agreement Procedure*)) shall have effect from a date agreed in a subsequent Exchange of Notes between Australia and New Zealand. [Article 30, paragraph 2]

Exchange of Information and Assistance in Collection

2.433 Article 26 (*Exchange of Information*) and Article 27 (*Assistance in the Collection of Taxes*) are intended to have effect from the date of entry into force of the Convention, irrespective of the year of income to which the information or the revenue claim relates (subject to any domestic law time limits).

Termination of the existing New Zealand Agreement

2.434 The existing New Zealand Agreement shall cease to have effect from the dates on which the Convention commences to have application for the respective taxes. The existing New Zealand Agreement shall be terminated on the last of those dates. [Article 30, paragraph 3]

Article 31 — Termination

2.435 The Convention is to continue in effect until terminated. Either country may terminate the Convention after the expiration of five years from the date of its entry into force. Termination is by notice in writing of termination through the diplomatic channel, at least six months before the end of any calendar year beginning after the expiration of that five-year period.

Cessation in Australia

2.436 In the event of either country terminating the Convention, the Convention would cease to be effective in Australia for the purposes of:

- withholding tax on income derived by a non-resident, in relation to income derived on or after the first day of the second month next following that in which the notice of termination is given;
- fringe benefits tax, in respect of fringe benefits provided on or after 1 April next following that in which the notice of termination is given; and

- other Australian taxes, as regards any year of income, profits or gains in the Australian year of income commencing on or after 1 July next following that in which the notice of termination is given.

[Article 31, subparagraph a)]

Cessation in New Zealand

2.437 The Convention would correspondingly cease to be effective in New Zealand for the purposes of:

- withholding tax on income derived by a non-resident, in relation to income derived on or after the first day of the second month next following that in which the notice of termination is given; and
- other New Zealand taxes, for income years beginning on or after 1 April next following that in which the notice of termination is given.

[Article 31, subparagraph b)]

Chapter 3

The Second Protocol with Belgium

Outline of chapter

3.1 This Bill amends the *International Tax Agreements Act 1953* (Agreements Act 1953). This chapter explains the rules that apply in the *Second Protocol amending the Agreement between Australia and the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed at Canberra on 13 October 1977 as amended by the Protocol signed at Canberra on 20 March 1984* (Second Protocol), which amends the existing tax treaty with Belgium — the *Agreement between Australia and the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed at Canberra on 13 October 1977 as amended by the Protocol signed at Canberra on 20 March 1984* (existing Belgian Agreement).

Context of amendments

3.2 The Second Protocol was signed in Paris on 24 June 2009.

3.3 The Second Protocol was negotiated in the context of recent international progress in improving tax transparency and exchange of taxpayer information between countries, and the withdrawal by Belgium of its reservation to Article 26 (*Exchange of Information*) of the Organisation for Economic Co-operation and Development (OECD) *Model Tax Convention on Income and on Capital* (OECD Model).

3.4 Once in force, the Second Protocol will replace the *Exchange of Information* Article in the existing Belgian Agreement with a new Article that meets the international standards set by the OECD Model.

Summary of new law

3.5 The main changes to the *Exchange of Information* Article of the existing Belgian Agreement (as revised by the Second Protocol) are as follows:

- neither tax administration can refuse to provide information solely because they do not have a domestic interest in such information, or because the information is held by a bank or similar institution;
- the Article now expands the scope of the *Exchange of Information* Article, as it will now allow tax administrations to request taxpayer information with regard to all federal taxes and not just taxes to which the existing Belgian Agreement applies; and
- the Article also provides that information received by a tax authority may be used for other purposes when the laws of both countries permit this and the tax authority supplying the information authorises such use.

[Article I, paragraph 1 of new Article 26]

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>Closely aligns Article 26 (<i>Exchange of Information</i>) to the current OECD standard. The effect of the change is to expand the range of taxes to which the Article applies and to clarify that neither bank secrecy laws nor any requirement of a domestic tax law interest in the information limits the exchange of information.</p> <p>The new rules also provide that information received may be used for non-tax purposes when the laws of both countries permit this and the supplying tax authority authorises such use.</p>	<p>The existing rules apply to a narrower range of taxes and do not require the exchange of information that is not obtainable by the tax administration under domestic law.</p> <p>The information received can only be used for tax purposes.</p>

Detailed explanation of new law

Article I

Substitutes new Article 26 (Exchange of Information) into the Agreement

3.6 The Second Protocol aligns the information exchange provisions to the current OECD standard by replacing Article 26 (*Exchange of Information*) of the existing Belgian Agreement. The new Article 26 continues to provide for the exchange of tax information by the tax administrations of the two countries, but differs from the previous approach in the following ways:

- the scope is expanded to a wider ranges of taxes;
- the new provision clarifies that the Commissioner of Taxation (Commissioner) is obliged to obtain information for Belgian tax authorities regardless of whether Australia has a domestic tax interest in the information sought or whether the information concerns a resident of either country;
- bank secrecy laws do not limit the exchange of information; and
- information received by a tax authority may be used for other purposes when the laws of both countries permit this and the tax authority supplying the information authorises such use.

Foreseeably relevant information

3.7 Article 26 authorises and limits the exchange of information by the two competent authorities to information foreseeably relevant to the administration or enforcement of the relevant taxes. The exchange of information is not restricted by Article 1 (*Personal Scope*) of the existing Belgian Agreement, and may therefore cover persons who are not residents of Australia or Belgium.

3.8 The standard of foreseeable relevance is intended to ensure that information may be exchanged to the widest possible extent. However, a competent authority is not entitled to request information from the other country which is unlikely to be relevant to the tax affairs of a taxpayer, or to the administration and enforcement of tax laws. [*Article I, paragraph 1 of new Article 26*]

3.9 The change in wording from ‘necessary’ used in the previous version of the Article to a ‘foreseeably relevant’ standard reflects the

wording in Article 26 (*Exchange of Information*) of the OECD Model and no difference in effect is intended.

Taxes to which this Article applies

3.10 Under the corresponding Article in the existing Belgian Agreement, the information that could be requested and obtained between the two countries was limited to information in relation to taxes to which that Agreement applied (generally income taxes).

3.11 Under the new Article 26, the range of taxes for which information may be exchanged has been expanded. The Australian competent authority can now request and obtain information concerning all federal taxes from the Belgian competent authority. This means, for example, that information concerning Australian indirect taxes (for example, the goods and services tax (GST)) may be requested and obtained from Belgium. *[Article I, paragraph 1 of new Article 26]*

3.12 Similarly, in the case of Belgium, the Belgian competent authority can now request and obtain information concerning all federal taxes from the Australian competent authority.

Use of exchanged information

3.13 The purposes for which the exchanged information may be used and the persons to whom it may be disclosed are restricted in a manner which is consistent with the approach taken in the OECD Model. However, the final sentence of this paragraph permits the information to be used for other purposes when the laws of both countries permit this and the tax authority supplying the information authorises such use. *[Article I, paragraph 2 of new Article 26]*

3.14 Any information received by a country must be treated as secret in the same manner as information obtained under the domestic law of that country, and can only be disclosed to the persons identified in paragraph 2 of the Article. *[Article I, paragraph 2 of new Article 26]*

No domestic tax interest required

3.15 When requested, a country is required to obtain information under the new Article in the same manner as if it were administering its domestic tax system, notwithstanding that the country may not require the information for its own purposes. Australia would recognise this obligation to obtain relevant information for treaty partner countries, even in the absence of an explicit provision to this effect. *[Article I, paragraph 4 of new Article 26]*

Limitations

3.16 The country requested to provide information under the new Article 26 is not obliged to do so where:

- it would be required to carry out administrative measures at variance with the law and administrative practice of either Australia or Belgium; or
- such information is not obtainable under the domestic law or in the normal course of administration.

[Article I, subparagraphs 3(a) and (b) of new Article 26]

3.17 Also, in no case is the country receiving the request obliged to supply information under new Article 26 that would:

- disclose any trade, business, industrial, commercial or professional secret or trade process; or
- be contrary to public policy.

[Article I, subparagraph 3(c) of new Article 26]

Information held by institutions such as banks, other financial institutions, trusts, foundations and nominees

3.18 Paragraph 5 ensures that paragraph 3 of the new Article 26 cannot be used to prevent the supply of information solely because the information is held by institutions such as banks, other financial institutions, trusts, foundations and nominees.

3.19 The final sentence in paragraph 5 ensures that, to the extent that it may be necessary in order to obtain information from such persons or institutions for the purposes of exchange of information under the new Article 26, the tax administration of the requested country will have the power to require the disclosure of information and to conduct investigations notwithstanding the country's domestic tax laws. This additional sentence is intended to overcome limitations imposed under Belgian internal law on the ability of the Belgian tax administration to obtain information, especially information from banks and other financial institutions for the purposes of the taxation of their clients. *[Article I, paragraph 5 of new Article 26]*

3.20 The final sentence in paragraph 5 of the new Article 26 will not have any practical application for Australia, since Australian domestic tax law already permits the Commissioner to obtain information from banks and financial institutions in order to meet obligations under *Exchange of*

Information Articles in tax treaties or Tax Information Exchange Agreements.

Information that exists prior to the entry into force of the Second Protocol

3.21 The Article will apply to the exchange of information made after the entry into force of the Second Protocol with respect to tax events occurring on or after the dates specified in Article II, including where the relevant information existed prior to the entry into force of the Second Protocol.

Article II

Date of entry into force of the Second Protocol

3.22 Article II provides for the entry into force of the Second Protocol. The Second Protocol will enter into force on the last date on which diplomatic notes are exchanged notifying that the domestic processes to give the Second Protocol the force of law in the respective countries has been completed. In Australia, enactment of the legislation giving the force of law in Australia to the Second Protocol, along with tabling of the Second Protocol in Parliament, are prerequisites to the exchange of diplomatic notes. *[Article II]*

3.23 New Article 26 will apply to taxes imposed at source on income derived on or after 1 January 2010, and to income tax imposed in respect of taxable periods beginning on or after that date. Thus, for example, the new Article 26 will apply with respect to Australian withholding taxes on income derived from 1 January 2010, and for other Australian income tax, with respect to tax on income derived during the year of income commencing 1 July 2010 and subsequent years. For other taxes, such as Australia's GST and fringe benefits tax, the new Article will apply in respect of taxable events occurring from 1 January 2010. *[Article II, subparagraphs 1a) to c)]*

3.24 The new Article 26 will apply with respect to criminal tax matters from the date of entry into force of the Second Protocol. It applies to requests for exchange of information in respect of federal taxes of both Australia and Belgium received on or after that date. *[Article II, paragraph 2]*

3.25 The information to be exchanged in relation to criminal tax matters may relate to the income tax affairs of a taxpayer in a taxable period (for example, a year of income) that predates the entry into force of the Second Protocol. *[Article II, paragraph 2]*

Article III

Second Protocol part of the existing tax treaty

3.26 Article III provides that the Second Protocol shall form an integral part of the existing Belgian Agreement and will remain in force and apply as long as the existing Belgian Agreement is in force and applicable. *[Article III]*

Chapter 4

The Australia-Jersey Agreement

Outline of chapter

4.1 This Bill amends the *International Tax Agreements Act 1953* (Agreements Act 1953) and inserts Schedule 50 into the Agreements Act 1953 which is the *Agreement between the Government of Australia and the Government of Jersey for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments* (the Jersey Agreement). This chapter explains the rules that apply in the Jersey Agreement. All legislative references are to Schedule 50, unless otherwise stated.

Context of amendments

4.2 The Jersey Agreement was signed in London on 10 June 2009. There is no pre-existing agreement of this type between Australia and Jersey. The Jersey Agreement was signed in conjunction with the *Agreement between the Government of Australia and the Government of Jersey for the Exchange of Information with Respect to Taxes* (the Jersey Information Exchange Agreement), which will establish a legal basis for the exchange of tax information between the two countries. Jointly, the two agreements will promote greater economic and administrative cooperation between the two countries.

Summary of new law

Main features of this Agreement

- 4.3 The main features of the Jersey Agreement are as follows:
- Income from pensions and retirement annuities will generally be taxed only in the country of residence of the recipient, provided the income is subject to tax in that country.
 - Income from government service will generally be taxed only in the country that pays the remuneration. However, the

remuneration shall only be taxed in the other country where the services are rendered in that other country by a resident of that other country who is a national of that other country or did not become a resident of that other country for the purpose of rendering the services.

- Payments made from abroad to visiting students and business apprentices for the purposes of their maintenance, education or training will be exempt from tax in the country visited.
- A non-binding administrative mechanism will be established to assist taxpayers to seek resolution of transfer pricing disputes.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Australian source pensions and retirement annuities derived by residents of Jersey will be exempt from Australian tax, provided they are taxed in Jersey.	Australian source income of foreign residents is generally subject to Australian tax.
Certain income derived by residents of Jersey from government service in Australia will be exempt from Australian tax.	Australian source income of foreign residents is generally subject to Australian tax.
Certain payments received by visiting students and business apprentices from Jersey will be exempt from Australian tax.	Some payments received by foreign students and business apprentices may be taxable in Australia, depending on the circumstances.
The competent authorities of Australia and Jersey will endeavour to resolve taxpayers' transfer pricing disputes arising from transfer pricing adjustments that contravene the arm's length principle.	No equivalent.

Detailed explanation of new law

4.4 This Bill gives effect to the Jersey Agreement, which is inserted as Schedule 50 to the Agreements Act 1953 and deals with the allocation of taxing rights with respect to certain income of individuals.

Article 1 — Persons Covered

4.5 This Article establishes the scope of the application of the Jersey Agreement by providing for it to apply to persons who are residents of one or both of the countries. *[Article 1]*

4.6 The application of the Jersey Agreement to persons who are dual residents (that is, residents of both countries) is dealt with in Article 4 (*Resident*).

Article 2 — Taxes Covered

4.7 This Article specifies the existing taxes of each country to which the Jersey Agreement applies. This is, in the case of Australia, the federal income tax. *[Article 2, subparagraph 1(a)]*

4.8 For Jersey, the Jersey Agreement applies to the income tax (referred to as Jersey tax). *[Article 2, subparagraph 1(b)]*

4.9 The application of the Jersey Agreement will be automatically extended to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of, the existing taxes. The competent authorities for the two countries are required to notify each other in the event of a significant change to the taxation law of the respective countries, within a reasonable period of time after those changes. *[Article 2, paragraph 2]*

Article 3 — Definitions

Definition of Australia

4.10 The definition of **Australia** follows corresponding definitions in Australia's modern tax treaties. 'Australia' is defined to include certain external territories and areas of the continental shelf. *[Article 3, subparagraph 1(a)]*

Definition of Jersey

4.11 **Jersey** is defined to mean the Bailiwick of Jersey, including its territorial sea. *[Article 3, subparagraph 1(b)]*

Definition of competent authority

4.12 The **competent authority** is the person or institution specifically authorised to perform certain actions under the Jersey Agreement. For example, to notify each other of any significant changes to the tax law of

their respective countries, to communicate for the purposes of Article 8 (*Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments*) and to exchange information in accordance with Article 9 (*Exchange of Information*).

4.13 In the case of Australia, the competent authority is the Commissioner of Taxation (Commissioner) or an authorised representative of the Commissioner. In the case of Jersey, the competent authority is the Treasury and Resources Minister or an authorised representative of the Minister. [*Article 3, subparagraph 1(c)*]

Definition of party

4.14 ***Party*** means Australia or Jersey, as the context requires. [*Article 3, subparagraph 1(d)*]

Definition of national

4.15 ***National*** means any individual possessing the nationality or citizenship of Australia or Jersey, as the context requires. [*Article 3, subparagraph 1(e)*]

Definition of person

4.16 ***Person*** includes an individual, a company and any other body of persons. [*Article 3, subparagraph 1(f)*]

Definition of tax

4.17 The term ***tax*** means either Australian tax or Jersey tax, depending on the context. [*Article 3, subparagraph 1(g)*]

Definition of transfer pricing adjustment

4.18 A ***transfer pricing adjustment*** is an adjustment made by the competent authorities of Australia or Jersey to the profits of an enterprise, based on the application of domestic transfer pricing laws. For Australia, such laws are contained in Division 13 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936). [*Article 3, subparagraph 1(h)*]

Terms not specifically defined

4.19 A term that is not specifically defined in the Jersey Agreement shall have (unless the context requires otherwise) the meaning that it has under the domestic taxation law of the country applying the Jersey Agreement at the time of its application. In that case, the term's domestic taxation law meaning will have precedence over the meaning it may have under that country's other domestic laws. [*Article 3, paragraph 2*]

4.20 The same term may have different meaning and a varied scope within different Acts relating to specific taxation measures. For example, goods and services tax definitions are sometimes broader than income tax definitions. The definition more specific to the type of tax should be applied in such cases. For example, where the matter subject to interpretation is an income tax matter, but definitions exist in either the ITAA 1936 or the *Income Tax Assessment Act 1997* (ITAA 1997) and the *A New Tax System (Goods and Services Tax) Act 1999*, the income tax definition would be the relevant definition to be applied.

Article 4 — Resident

4.21 This Article sets out the basis upon which the residence status of a person is to be determined for the purposes of the Jersey Agreement. Residence status is a criterion for determining each country's taxing rights and is a necessary condition for the provision of relief under the Jersey Agreement. In the case of Australia, a person's residence is determined according to Australia's taxation law [*Article 4, subparagraph 1(a)*]. In the case of Jersey, residence is determined according to Jersey's taxation law [*Article 4, subparagraph 1(b)*].

Special residency rules

4.22 A person is not a resident of a country, for the purposes of the Jersey Agreement, if that person is liable to tax in that country in respect only of income from sources in that country. In the Australian context, this would mean, for example, that Norfolk Island residents, who are generally only subject to Australian tax on Australian source income, are not residents of Australia for the purposes of the Jersey Agreement. Accordingly, Jersey will not have to forego tax in accordance with the Jersey Agreement on income derived by Norfolk Island residents (which will not be subject to Australian tax). [*Article 4, paragraph 2*]

Dual residents

4.23 Tie-breaker rules are included for determining residency, for the purposes of the Jersey Agreement, if a taxpayer qualifies as a dual resident, that is, a resident of both countries in accordance with paragraph 1 of Article 4. These rules, in order of application, are:

- if the individual has a permanent home available in only one of the countries, the person is deemed to be a resident solely of that country for the purposes of the Jersey Agreement [*Article 4, subparagraph 3(a)*];

- if the individual has a permanent home available in both countries or in neither, then the person's residential status takes into account their personal or economic relations with Australia and Jersey, and the person is deemed for the purposes of the Jersey Agreement to be a resident only of the country with which they have the closer personal and economic relations [*Article 4, subparagraph 3(a)*];
- residency will be determined on the basis of an individual's nationality where the foregoing tests are not determinative [*Article 4, subparagraph 3(b)*];
- if the individual is a national (as defined in subparagraph 1(e) of Article 3 (*Definitions*) of the Jersey Agreement) of both countries, or of neither, the competent authorities will endeavour to resolve the question of treaty residence by mutual agreement [*Article 4, subparagraph 3(c)*]; or
- where a person that is not an individual is a dual resident, the entity will be deemed, for the purposes of the Jersey Agreement, to be a resident of the country in which its place of effective management is located [*Article 4, paragraph 4*].

4.24 In relation to Australia, a dual resident remains a resident for the purposes of Australian domestic law. Accordingly, that person remains liable to tax in Australia as a resident, insofar as the Jersey Agreement allows.

Article 5 — Pensions and Retirement Annuities

4.25 Pensions and retirement annuities are taxable only by the country of which the recipient is a resident, provided such income is subject to tax in that country. If such income is not subject to tax in that country, the income may be taxed by the country from which the relevant payments were made. [*Article 5, paragraph 1*]

Meaning of retirement annuity

4.26 In the case of Australia, ***retirement annuity*** means a superannuation annuity payment within the meaning of the taxation laws of Australia. That is, a superannuation annuity as defined by Regulation 995-1.01 of the *Income Tax Assessment Regulations 1997*, which took effect from 1 July 2007. [*Article 5, subparagraph 2(a)*]

Article 6 — Government Service

4.27 Salary and wage type income, other than government service pensions or annuities, paid to an individual for services rendered to a government of one of the countries (including a political subdivision or local authority), is to be taxed only in that country [Article 6, subparagraph 1(a)]. However, such remuneration will be taxable only in the other country if the services are rendered in that other country and:

- the recipient is a resident of, and a national of, that other country; or
- the recipient is a resident of that other country and did not become a resident of that country solely for the purpose of rendering the services (for example, if the recipient is a permanent resident of that other country).

[Article 6, subparagraph 1(b)]

Business income

4.28 However, salaries, wages and other similar remuneration in respect of services rendered in connection with a trade or business carried on by any governmental authority referred to in paragraph 1 of Article 6 of the Jersey Agreement is excluded from the scope of the Article. Such remuneration will remain subject to the domestic taxation laws of the two countries. [Article 6, paragraph 2]

Article 7 — Students

Exemption from tax

4.29 Article 7 applies to students or business apprentices who are temporarily present in one of the countries solely for the purpose of their education or training if they are, or immediately before the visit were, resident in the other country. In these circumstances, payments from abroad received by the students or business apprentices solely for their maintenance, education or training will be exempt from tax in the country visited. This will apply even though the student or apprentice may qualify as a resident of the country visited during the period of their visit.

Employment income

4.30 Where, however, a Jersey student visiting Australia solely for educational purposes undertakes employment in Australia, for example, part-time work with a local employer, the income earned by that student as a consequence of that employment may be subject to tax in Australia.

4.31 For business apprentices, this Article only applies where the apprentice's remuneration consists solely of subsistence payments, made from abroad, to cover training or maintenance. Remuneration for service, that is, salary equivalents, falls for consideration under domestic taxation law.

4.32 In the case of a Jersey business apprentice visiting Australia solely for training purposes, it may therefore be necessary to distinguish between remuneration for service and a payment for the apprentice's maintenance or training. The quantum of the payment will be relevant in such cases.

4.33 A payment for maintenance or training would not be expected to exceed the level of expenses likely to be incurred to ensure the apprentice's maintenance and training (that is, a subsistence payment). If the remuneration is similar to the amounts paid to persons who provide similar services who are not business apprentices (that is, salary equivalent), this would generally indicate that the payments constitute income from employment that would fall for consideration under domestic taxation law. Likewise, if that business apprentice undertakes any other employment in Australia, the income earned from that employment may be subject to tax in Australia.

4.34 In these situations, the payments received from abroad for the student or apprentice's maintenance, education or training will not, however, be taken into account in determining the tax payable on the employment income that is subject to tax in Australia. No Australian tax would be payable on the employment income if the student or apprentice qualifies as a resident of Australia during the visit and the taxable income of the student or apprentice does not exceed the tax-free threshold applicable to Australian residents for income tax purposes.

Article 8 — Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments

4.35 Article 8 provides for consultation between the competent authorities of the two countries for the purpose of endeavouring to resolve disputes concerning transfer pricing adjustments purportedly made not in accordance with the arm's length principle. [*Article 8, paragraph 2*]

4.36 The term 'arm's length principle' refers to the requirement that businesses price their related party international dealings according to what truly independent parties acting independently would reasonably be expected to have done in the same situation. The Commissioner would apply the arm's length principle when reviewing business transactions in the context of Division 13 of Part III of the ITAA 1936.

4.37 A person wishing to use this mutual agreement procedure must present their case to the competent authority of their country of residence within three years of the first notification of the transfer pricing adjustment. This procedure operates independently of, and in addition to, domestic legal remedies available to taxpayers. *[Article 8, paragraph 1]*

Article 9 — Exchange of Information

4.38 Article 9 authorises and limits the exchange of information by the competent authorities to information that is foreseeably relevant to the administration of the Jersey Agreement.

4.39 The exchange of information is subject to the provisions of the Jersey Information Exchange Agreement, which was signed by the two countries on 10 June 2009. After that agreement enters into force and takes effect, it will provide for exchange of information that is foreseeably relevant to the administration of the taxation laws of the two countries. It also contains safeguards to protect taxpayers' rights. For example:

- confidentiality rules to ensure that information exchanged is only disclosed to authorised recipients; and
- limitations to ensure that the competent authorities do not exceed domestic laws and normal administrative procedures in the course of obtaining and supplying information.

Article 10 — Entry into Force

Date of entry into force

4.40 The Jersey Agreement will enter into force on the date of the last exchange of diplomatic notes notifying that the domestic procedures to give it the force of law have been completed. In Australia, tabling the Jersey Agreement and enactment of the legislation giving the Jersey Agreement the force of law are prerequisites to the exchange of diplomatic notes. Entry into force is also conditional upon the Jersey Information Exchange Agreement being in force at that time.

Date of application in Australia

4.41 Following entry into force, the Jersey Agreement will take effect in Australia in respect of any income year beginning on or after 1 July in the calendar year next following the date on which it enters into force. *[Article 10, subparagraph (a)]*

4.42 Where a taxpayer has adopted an accounting period ending on a date other than 30 June, the accounting period that has been substituted for the year of income beginning on 1 July in the calendar year next following the date on which this Agreement enters into force will be the relevant year of income for the purposes of the application of such Australian tax. *[Article 10, subparagraph (a)]*

Date of application in Jersey

4.43 Following entry into force, the Jersey Agreement will take effect in Jersey in respect of any income year beginning on or after 1 January in the calendar year next following the date on which it enters into force. *[Article 10, subparagraph (b)]*

Article 11 — Termination

4.44 The Jersey Agreement is to continue in effect indefinitely. However, either country may give written notice of termination of the Jersey Agreement through the appropriate channel. *[Article 11, paragraph 1]*

Cessation in Australia

4.45 In the event of either country terminating the Jersey Agreement, it would cease to be effective in Australia in the year of income beginning on or after 1 July in the calendar year next following that in which the notice of termination is given. *[Article 11, subparagraph 2(a)]*

Cessation for Jersey

4.46 The Jersey Agreement would correspondingly cease to be effective in Jersey for 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. *[Article 11, paragraph 2(b)]*

Cessation in other circumstances

4.47 The Jersey Agreement will also terminate and cease to be effective if the Jersey Information Exchange Agreement is terminated. In that event, the Jersey Agreement would terminate on the first day of the month following the expiration of three months after receipt of notification of termination of that agreement. *[Article 11, paragraph 3]*

Chapter 5

Regulation impact statement for New Zealand and Jersey

THE AUSTRALIA-NEW ZEALAND CONVENTION

Background

How tax treaties operate

5.1 Tax treaties facilitate international investment by removing or reducing tax barriers to cross-border movement of people, capital or technology.

5.2 International taxation is based on concepts of residency and source. Countries generally tax their residents on their world wide income. Countries also seek to tax non-residents on the income that is earned (or sourced) within their borders.

5.3 Double taxation can therefore arise when the country of residence and the country where the income is sourced both seek to tax the same income.

5.4 Tax treaties reduce or eliminate double taxation by treaty partners agreeing in certain situations to limit taxing rights over various types of income. The respective countries also agree on methods of reducing double taxation where both countries exercise their right to tax. In the absence of rules to relieve the resulting double taxation, international commerce would be seriously inhibited.

5.5 In addition, tax treaties provide an agreed basis for determining the allocation of profits within a multinational company and whether the profits on related party dealings by members of a multinational group operating in both countries reflect the pricing that would be adopted by independent parties. Tax treaties are therefore an important tool in dealing with international profit shifting through transfer pricing.

5.6 To prevent fiscal evasion, tax treaties include provision for exchange of information held by the respective revenue authorities. Treaties may also provide for cross-border collection of tax debts and may

preclude certain types of tax discrimination. Taxpayers can also avail themselves of the mutual agreement procedures provided for in treaties which allow the two revenue authorities to consult with a view to developing a common interpretation and to resolving differences arising out of application of the treaty.

5.7 Australia seeks an appropriate balance between source and residence country taxing rights. Generally, the allocation of taxing rights under Australian tax treaties is similar to international practice as set out in the Organisation for Economic Co-operation and Development (OECD) *Model Tax Convention on Income and on Capital* (OECD Model) (Australia being a member of the OECD and involved in the development of that Model). There are however, a few instances where Australian practice favours source country taxing rights rather than the residence approach of the OECD Model.

The existing Australia-New Zealand tax treaty

5.8 The existing Australia-New Zealand tax treaty was signed on 27 January 1995 and has been in effect in Australia since the income year commencing 1 July 1995 in respect of income taxes, and from 1 April 1995 for withholding taxes and fringe benefits tax. The 1995 treaty was amended in 2005 by insertion via a limited Protocol of additional integrity measures. However, the provisions of most interest to business and investors (including the rates of withholding tax applicable to dividends, interest and royalty payments) remained unchanged due to New Zealand undertaking an international tax review. New Zealand completed their internal review in December 2006.

5.9 On 28 January 2008, the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs announced the commencement of negotiations to revise the 1995 New Zealand tax treaty and its 2005 amending Protocol to enhance the mutual conduct of business.

5.10 The detriment to business from not modernising the existing New Zealand tax treaty and Protocol is difficult to assess and quantify. However, international consideration by such forums as the OECD and consultation with business has indicated that a modern tax treaty, including among other things reductions in withholding tax rates on payments to non-residents, provide a clear positive benefit to trade and investment relationships between the countries. Given the extent of Australia and New Zealand's trade and investment relationship it is important that these rate limits remain as up-to-date as possible with current treaty practice.

5.11 Taxpayers would also suffer from greater uncertainty in their tax affairs if other aspects of the tax treaty were not updated. For example, including provisions restricting the time in which transfer pricing adjustments and allowing taxpayers to have issues of fact resolved by arbitration in certain cases will provide greater certainty for taxpayers in their tax affairs. Both provisions would be included in a modernised New Zealand tax treaty.

5.12 Australian taxpayers would also suffer from having no protection from discrimination in the event New Zealand's tax system sought to impose more burdensome taxation on Australians, as the existing New Zealand treaty does not contain a *Non-Discrimination* Article. A modernised treaty which incorporates a *Non-Discrimination* Article would ensure Australian nationals and business are treated no less favourably than nationals and business of New Zealand in similar circumstances, and vice versa.

Australia's trade and investment relationship with New Zealand

Trade

5.13 New Zealand has been a major trading partner for many years. The economic and trade relationship between the two countries is shaped by the Australia New Zealand Closer Economic Relations Trade Agreement (known as CER), which came into effect in 1983. Since the CER came into effect, trade has increased at an average annual rate of 9 per cent over the life of the agreement.

5.14 Based on trade in goods and services, New Zealand is now Australia's fifth largest market taking 5.2 per cent of our exports, and is the eighth largest source of imports for Australia. Australia is New Zealand's principal trading partner, providing 20.8 per cent of its merchandise imports and taking 22 per cent of its merchandise exports.

5.15 Two-way trade reached A\$22.45 billion in 2007-08, with bilateral merchandise trade in 2007-08 accounting for approximately A\$16.47 billion of this, with the balance of trade in Australia's favour. Two-way trade in services was valued at approximately A\$5.98 billion.

5.16 Total exports (goods and services) in 2007-08 were valued at A\$12.9 billion. Key exports include refined petroleum, crude petroleum, passenger motor vehicles, and medicaments.

5.17 Total imports from New Zealand in 2007-08 were valued at A\$9.5 billion. Imports comprised mainly of crude petroleum, gold, paper and paper board, and alcoholic beverages.

Investment

5.18 Two-way investment between Australia and New Zealand currently stands at over A\$110 billion. New Zealand is Australia's sixth largest investor, with a total stock of investment worth A\$32.4 billion at the end of 2006. New Zealand is the third largest market for Australian investment abroad, with Australia the largest investor in New Zealand. The total stock of Australian investment in New Zealand was worth A\$65.3 billion at the end of 2006. Over half of Australia's total investment in New Zealand is foreign direct investment, reflecting the high level of economic integration.

Policy objective

- 5.19 The objective of this measure is to:
- promote closer economic cooperation between Australia and New Zealand by further reducing taxation barriers to trade and investment between the two countries; and
 - update the taxation arrangements between the two countries, including the insertion of provisions to prevent tax discrimination.

Implementation options

- 5.20 The implementation options for meeting the policy objectives specified above are:
- retain the existing Australia-New Zealand tax treaty;
 - conclude a second amending Protocol to amend certain aspects of the existing treaty and Protocol to reflect current policies; or
 - conclude a new bilateral tax treaty.

Option 1: Retain the existing Australia-New Zealand tax treaty

5.21 While the existing tax treaty has provided a good measure of protection against double taxation and prevention of fiscal evasion, it has become outdated in many respects and no longer adequately reflects the current tax treaty policies and practice of Australia or New Zealand.

5.22 In particular, relying on the existing tax treaty means arrangements between Australia and New Zealand would not benefit from the move to lower withholding tax rate limits provided under Australia's most recent tax treaties. The existing treaty also does not contain other recent international developments, such as access to arbitration for taxpayers in certain circumstances where they have been taxed in a way that does not accord with the treaty. Relying on the existing treaty would also mean there would be no protection for Australian nationals or business in the event of tax discrimination. Relying on the existing treaty would also mean that other barriers to conducting cross-border business activities would not be removed.

Option 2: A second limited amending Protocol — rely on the existing tax treaty and Protocol measures

5.23 This option would rely on the existing tax treaty and Protocol measures with an additional amending second Protocol covering both countries' desired changes. In view of the number of changes both partners wanted to make to update the existing treaty and Protocol to reflect the current tax treaty policies and practices of both countries, and the fact that the treaty already contained one amending Protocol, a second amending Protocol did not seem practicable in this instance.

Option 3: Conclude a new tax treaty

5.24 This option would replace the existing treaty and Protocol with a new bilateral tax treaty that reflects the current policies and practices of both countries.

5.25 A new tax treaty would be largely based on the current OECD Model, with some mutually agreed variations reflecting the economic, legal and cultural interests of the two countries.

5.26 Both countries have particular policy objectives to achieve in updating the tax treaty and the end result ultimately represents compromises necessary to achieve a mutually acceptable agreement. The key changes in a new treaty include:

- a reduction of the dividend withholding tax limit from 15 per cent to zero for dividends paid on portfolio investment by government bodies, and for intercorporate dividends on non-portfolio holdings of more than 80 per cent subject to certain conditions; 5 per cent dividend withholding tax limit for other intercorporate non-portfolio holdings and 15 per cent dividend withholding tax limit for all other dividends;

- a reduction in the interest withholding tax limit from 10 per cent to zero where interest is paid to:
 - government bodies and central banks; or
 - financial institutions, provided that in the case of interest paid from New Zealand, the New Zealand 2 per cent Approved Issuer Levy has been paid. A ‘most favoured nation’ provision applies if New Zealand subsequently provides better treatment in respect of such interest in another treaty;
- a reduction in the maximum royalty withholding tax rate limit from 10 per cent to 5 per cent;
- extending the meaning of ‘royalties’ to include spectrum licences. Leasing of industrial, commercial or scientific equipment will no longer constitute a royalty;
- clarifying the residence status of Australian managed investment trusts and entities participating in dual listed company arrangements to ensure these entities can access the treaty’s benefits where appropriate;
- providing for profits from the provision of services performed in a country to be taxed by that country in certain circumstances;
- ensuring that profits derived from the operation of ships and aircraft in international traffic are generally taxed only in the country of residence of the operator;
- updating rules governing the taxation of income, profits or gains from the alienation of real property, and other capital gains;
- ensuring that employees’ remuneration during certain short visits on secondment to one country are not taxed by the country visited;
- providing that pensions will not be subject to tax in the residence country when they are exempt from tax in the country from which they are sourced. Lump sum payments will only be taxed in the country in which they are sourced;

- providing certainty to taxpayers by restricting transfer pricing adjustments to within a seven-year period except where an audit has been initiated or where there is fraud, gross negligence or wilful neglect;
- providing certainty to taxpayers by giving them access to arbitration where issues of fact resulting in taxation not in accordance with the treaty cannot be resolved by the Australian and New Zealand tax authorities within two years; and
- providing new rules to protect nationals and businesses from tax discrimination in the other country.

Assessment of impacts

Difficulties in quantifying the impacts of tax treaties

5.27 Only a partial analysis of costs and benefits can be provided because all of the impacts of tax treaties cannot be quantified. While the direct cost to Australian revenue of withholding tax changes can be quantified relatively easily, other cost impacts such as compliance costs are inherently difficult to quantify. There are also efficiency and growth gains and losses to Australia that provide estimation problems. Analysis has been conducted to establish plausible impacts on Australian economic activity and consequent tax revenue flowing from implementation of the tax treaty. The tax revenue estimates are subject to more uncertainty than the estimates of costs but are best estimates given the technology of estimation, the availability of estimates of behavioural responses, and data.

5.28 Benefits that flow to business are generally equally difficult to quantify. The evidence from international consideration (for example, by the OECD) and from consultation with business strongly indicates, however, that while the quantum of benefits is very difficult to assess, a modern tax treaty provides a clear positive benefit to trade and investment relationships. Tax treaties provide increased certainty and reduce complexity and compliance costs for business.

Impact group identification

5.29 The Convention with New Zealand is likely to have an impact on:

- Australian residents doing business with New Zealand, including principally:
 - Australian residents investing directly in New Zealand (either by way of a subsidiary or a branch);
 - Australian residents investing indirectly in New Zealand;
 - Australian banks and the other specified Australian institutions lending to New Zealand borrowers;
 - Australians borrowing from New Zealand banks;
 - Australian residents using technology and know-how supplied by New Zealand residents;
 - Australian residents supplying services to New Zealand and vice versa; and
 - Australian residents exporting to New Zealand;
- Australian employees working in New Zealand;
- Australian residents receiving pensions from New Zealand;
- Australian residents who receive income that is exempt in New Zealand because they are transitional residents of New Zealand;
- the Australian Government; and
- the Australian Taxation Office (ATO).

Assessment of benefits

Renegotiation provides a better outcome for all stakeholders

5.30 While the existing tax treaty has provided a good measure of protection against double taxation and prevention of fiscal evasion since coming into force, it has become outdated and no longer adequately reflects both partners' desired positions, given Australia and

New Zealand's close economic relationship and the desire of both countries to continue to enhance this relationship.

5.31 The Convention comprehensively modernises and updates the existing treaty and Protocol. As well as revising the allocation of taxing rights between the two countries and the withholding tax rate limits prescribed in the treaty, Australia is able to achieve improved certainty for taxpayers by restricting the time in which transfer pricing adjustments may be made and allowing taxpayers to have issues of fact resolved by arbitration in cases where they cannot be resolved by the Australian and New Zealand tax authorities within two years.

5.32 The Convention provides benefits to Australian business and to the Australian revenue by ensuring certainty of legislative outcomes based on the treaty. It is another step forward in providing Australian business with an internationally competitive tax treaty network and business tax system.

5.33 The Convention provides better outcomes than the existing treaty for a large majority of stakeholders. Given the long-term nature of such arrangements, the Convention is expected to promote greater certainty than the existing tax treaty. It also contributes to the updating of Australia's ageing treaty network.

Economic benefits

Withholding tax reductions

5.34 The Convention will address businesses' desire to improve the competitiveness of Australia's tax treaty network, particularly through the reductions of withholding tax rates.

5.35 Under its domestic tax law, Australia imposes a final withholding tax on interest, royalty and unfranked dividend payments to non-residents at the rates of 10, 30 and 30 per cent of the gross payment, respectively. However, Australia generally agrees to limit these withholding tax rates, on a reciprocal basis, in its bilateral tax treaties. In the existing New Zealand treaty, the withholding tax rates for interest, royalty payments, and dividends are limited to 10, 10 and 15 per cent of the gross payments, respectively.

5.36 Withholding tax reductions below the rates reflected in the existing New Zealand tax treaty were first included in the 2001 Protocol amending the Convention with the United States of America (US). Similar reductions have generally been agreed in Australia's subsequent tax treaties. The similar treatment in the Convention aligns treatment, where possible, with Australia's recent tax treaties, maintains the integrity

of Australia's treaty network and discourages treaty shopping (and the consequent degradation of the tax base of countries where the costs of capital and intellectual property are higher under their treaties as a result of the higher withholding tax rates).

5.37 While a reduction in maximum withholding tax rates will involve a cost to revenue, there are expected to be benefits to the revenue and to the wider economy arising out of increased business and investment activity, with the most direct benefits accruing to business.

Dividends

5.38 Outcomes such as that provided in the US and United Kingdom of Great Britain and Northern Ireland (UK) treaties (that is, no withholding tax on dividends paid to a company with an 80 per cent or greater voting interest in a listed company in the other jurisdiction, and 5 per cent withholding tax where the interest is at least 10 per cent of the voting power) remove distortions in the raising of capital for direct investment that results from the more favourable terms that currently apply bilaterally in the case of the US and the UK. The existing treaty only has a 15 per cent rate for all dividends and therefore would not remove these distortions.

5.39 The Convention also includes an exemption for dividends derived in respect of portfolio holdings by the Governments of either country (including their political subdivisions, local authorities and government investment funds).

Interest

5.40 The zero Australian interest withholding tax rate on interest arising in Australia and paid to unrelated New Zealand financial institutions is consistent with Australia's current treaty practice, recognising that a 10 per cent interest withholding tax rate on gross interest derived by financial institutions may be excessive given their cost of funds. It should accordingly lower the costs of borrowing in those cases where the financial institution can pass the cost represented by the withholding tax on to the Australian borrower. The existing treaty does not provide an exemption for unrelated financial institutions, and therefore in the absence of updating the existing treaty in this respect Australian borrowers often pay the cost of the withholding tax.

5.41 In the case of interest arising in New Zealand and paid to an Australian financial institution, the exemption from withholding tax only applies where the Approved Issuer Levy (if applicable) has been paid. Due to the nature of New Zealand's banking sector it was necessary for New Zealand to maintain payment of this levy in order for a zero

withholding tax rate to apply. New Zealand payers of interest to non-resident lenders can elect (if they meet the required conditions) to pay the Approved Issuer Levy instead of non-resident withholding tax. The Convention provides that if New Zealand repeals their Approved Issuer Levy regime, or increases it beyond the current 2 per cent, then this condition will no longer need to be satisfied for the zero rate to apply.

5.42 A ‘most favoured nation’ provision applies to interest derived by financial institutions so that if New Zealand subsequently provides better treatment in respect of such interest, they must notify Australia and enter into negotiations with Australia with a view to providing the same treatment.

5.43 As is the case in Australia’s other recent tax treaties, the Convention includes an exemption for interest derived by the Governments of either country (including their political subdivisions, local authorities and government investment funds), and the countries’ central banks.

Royalties

5.44 Australian residents required to meet the cost of Australian royalty withholding tax on royalty payments made to New Zealand residents will benefit from the reduced royalty withholding tax rate of 5 per cent. Commercial practice indicates that, as with interest, the cost represented by the royalty withholding tax is commonly passed on to the payer of the royalty. This means that the Australian payer may bear the cost of higher rates of withholding tax if the existing treaty rate of 10 per cent is maintained, which would place them at a competitive disadvantage in competing with businesses from other countries with lower rates. The effect of lowering the withholding tax rate is a lowering of the cost of new technology and intellectual property, which may encourage the development of Australia’s economy through use of the most up-to-date technology and processes. Additionally it may encourage New Zealand residents to use Australian technology and intellectual property.

Managed investments trusts

5.45 The inclusion of provisions to provide treaty benefits in respect of income derived through Australian managed investment trusts (MITs) is of benefit to the managed funds industry and investors. Under the existing treaty, as MITs are considered to be fiscally transparent (where the income flows through the entity and is taxed in the hands of the participants as opposed to taxation at the entity level), Australian investors would need to be able to identify amounts derived by the MIT from New Zealand, and the character of each item of income, in order to be

able to claim treaty benefits in New Zealand (such as reduced withholding tax rates).

5.46 The Convention provides that the MIT will be entitled to treaty benefits if they are listed on an Australian stock exchange, or more than 80 per cent of the interests in the MIT are held by Australian residents. By treating the MIT as an Australian resident for treaty purposes, the MIT is able to claim treaty benefits in respect of items of income flowing from New Zealand to Australia.

5.47 If the MIT does not meet the listing requirement or the 80 per cent resident ownership threshold, the Convention nevertheless allows it to claim treaty benefits to the extent that Australian residents own the income.

5.48 These provisions remove the need for each individual investor in a MIT to claim treaty benefits from New Zealand on their own behalf as is required under the existing treaty, which significantly reduces compliance complexity and costs for Australian investors. This will help promote Australia as a funds management hub in the Asia-Pacific region.

Alienation of Property

5.49 Article 13 (*Alienation of Property*) better aligns with Australia's domestic law treatment and international treaty practice by providing for taxation of certain capital gains only in the alienator's country of residence. The existing treaty maintains the domestic tax law treatment where the taxation treatment of the income, profit or gain from the disposal of property is not subject to specific rules in the treaty. The treatment under the existing treaty is not consistent with recent treaty practice and does not align with OECD practice.

5.50 This is expected to encourage investment in Australia and result in generally lower compliance costs. Australia's source country taxing rights over capital gains on real property, land rich companies and assets which form the business property of a permanent establishment in Australia would be retained.

5.51 The provision permitting Australia to continue to tax capital gains of its former residents for up to six years prevents the creation of double non-taxation, since New Zealand does not have a general capital gains tax regime.

Income from Employment

5.52 The revised provisions in the *Income from Employment* Article will ensure that an employee's remuneration during their short-term visits

on secondment to one country is taxable only in the country of residence of the employee. These provisions will facilitate cross-border secondments within an enterprise or company group and will simplify the taxation affairs of the receiving enterprise and the employee. These provisions will reduce compliance burdens significantly. The existing treaty does not provide special rules for such short-term visits on secondment, resulting in non-residents being burdened with the need to comply with a foreign country's tax system, even though they are only there for a short period.

Pensions

5.53 The Convention provides that pensions are exempt in the country of residence of the recipient to the extent they are not subject to tax if the recipient were resident in the source country. This will encourage the free movement of workers between Australia and New Zealand. In line with the objectives under the CER, encouraging the free movement of people between Australia and New Zealand in this way removes some of the 'behind-the-border' impediments to trade. Australia and New Zealand residents are regularly caught up in both countries' superannuation systems. Each country's domestic law treatment of foreign pension payments means cross-border pension payments are often taxed more heavily than if the payment was received by a resident recipient. This pension provision, unlike the provision in the existing treaty, removes impediments to working and accumulating superannuation benefits in both countries.

Arbitration

5.54 The arbitration provision gives taxpayers access to arbitration where issues of fact in relation to taxation not in accordance with the Convention are not resolved by the Australian and New Zealand tax authorities within two years. This will provide certainty to taxpayers. The arbitration provision also provides businesses with a mechanism for the timely resolution of disputes regarding the application of the tax treaty to issues of fact. The existing treaty does not allow taxpayers to seek arbitration.

Non-Discrimination

5.55 The *Non-Discrimination* Article will prevent tax discrimination against Australian nationals and businesses operating in New Zealand and vice versa. The existing treaty does not provide any such protection.

Other benefits

5.56 Where Australians carry on business activities in New Zealand, the existing treaty prevents New Zealand from taxing the business profits

of an Australian resident unless that Australian resident carries on business through a permanent establishment (such as a branch) in New Zealand. The Convention further refines the concept of when a permanent establishment is taken to exist and the level of activity to constitute a permanent establishment. This principle also applies where a New Zealand enterprise carries on business activities in Australia.

5.57 The refined permanent establishment concept includes a services provision, which allows Australia to tax a New Zealand resident entity on income it derives from the provision of services performed through one or more individuals present in Australia for more than 183 days in a year. It allows New Zealand to tax the Australian resident's income in the reverse situation.

5.58 The 2008 OECD Commentary to the OECD Model (OECD Model Commentary) includes an optional provision providing for source country taxation of services. The provision in the Convention is based on the OECD Model Commentary provision, but incorporates modifications designed to minimise compliance costs for business to the greatest extent possible.

5.59 While the existing New Zealand treaty already has a services provision in that it permits a country to tax professional services in the country where they are performed where the individual is present for a period of 183 days in any twelve months (in the *Independent Personal Services* Article), it does not provide an exemption for short-term stays of five days or less. Further, it only applies to self-employed individuals performing professional services, while the new provision would apply to services provided by individuals or companies.

5.60 Other benefits also include:

- the clarification of the residency rules. Under the existing treaty the residency status of certain entities, for instance entities participating in dual listed company arrangements, is left uncertain;
- clarifying that treaty relief is not available on certain income, profits or gains that are exempt in New Zealand because the recipient is a transitional resident of that country, which the existing treaty does not provide, creating uncertainty for these individuals;
- clarifying the treatment of income derived through trusts, which the existing treaty leaves uncertain;

- ensuring that income from real property, including natural resource royalties, may be taxed in full by the country in which the property is situated;
- providing new time limits for transfer pricing adjustments, giving taxpayers greater certainty;
- ensuring that profits derived from the operation of ships and aircraft in international traffic are generally taxed only in the country of residence of the operator, as opposed to source taxation of profits from all domestic shipping and airline activities, as occurs under the existing treaty. This change will provide closer alignment with the OECD Model and more consistent treatment for similar activities; and
- requiring Australia and New Zealand to consult with each other every five years to ensure the treaty continues to operate effectively. This will ensure the treaty is reviewed at regular intervals, unlike the existing treaty which does not provide for a review period.

Revenue benefits

5.61 The Convention represents another step in facilitating a competitive and modern treaty network for Australian companies and helps to maintain Australia's status as an attractive place for business and investment, helping to better position Australia as a regional headquarters for multinational companies and as a regional financial hub. While a reduction in maximum withholding tax rates and the pensions exemption involve a cost to revenue, there are expected to be benefits to revenue and to the wider economy arising out of increased business and investment activity, with the most direct benefits accruing to business.

Compliance and administrative cost reduction benefits

5.62 Tax exemptions in respect of withholding taxes, and exclusive taxation of income from employment in the employee's resident state in respect of short-term secondments to another country, are likely to reduce compliance and administration costs associated with remitting and claiming credits for such tax.

5.63 The closer alignment with more recent Australian and international treaty practice is generally expected to reduce compliance costs.

5.64 Clarifying other areas of uncertainty, such as tax treaty tests of 'residency' (including for MITs), the time periods for transfer pricing

adjustments, and allowing taxpayers access to arbitration on issues of fact should also decrease compliance costs and uncertainty.

Improved international relationships

5.65 The Convention also assists the bilateral relationship by updating an important treaty in the existing network of commercial treaties between the two countries. It also promotes closer economic relations through the provisions aimed at improving the free movement of employees between the countries and by preventing tax discrimination against Australian nationals and businesses operating in New Zealand and vice versa.

5.66 The Convention takes account of changes to the OECD Model as far as possible (for instance, the inclusion of a limited arbitration provision), and also helps to maintain Australia's status as an active OECD member which in turn maintains Australia's position in the international tax community.

Assessment of costs — types of costs

Revenue costs

5.67 Treasury has estimated the impact of the first round effects on forward estimates as unquantifiable. Identifiable costs to revenue associated with reductions in the rates of withholding tax and the change to taxing rights for pensions have been estimated as A\$142 million over the forward estimates. Estimating the revenue benefits to Australia flowing from reductions in New Zealand withholding taxes is problematic. Reductions in New Zealand withholding taxes can be expected to result in an increase in the amount of Australian tax revenue through reduced Foreign Income Tax Offsets claimed and increases in Australian taxable income. Given the bilateral flows between Australia and New Zealand, the current features of the Australian and New Zealand tax systems, and the impact of the changes in the arrangements under the Convention, the revenue costs are expected to be broadly offset by revenue gains.

Administration costs

5.68 The administrative impacts on the ATO from the changes made by any new treaty arrangements are considered to be minimal. Some formal interpretive advice may be required, for example private binding rulings, concerning the application of the treaty. Staff from the ATO, clients and tax professionals will need to be made aware of the entry into force and changes from the previous treaty. Therefore a number of ATO information products will need to be updated. Further, the insertion of a

new arbitration provision may have some minimal administration impacts in setting up the mode of application of the provision, and once the provision and mode of application are in effect, facilitating arbitration where it is sought.

5.69 The cost of negotiation and enactment of the Convention were minimal and have mostly been borne by Treasury and the ATO. There was also an unquantifiable but small cost in terms of parliamentary time and drafting resources in enacting the Convention.

5.70 There are also ‘maintenance’ costs to the ATO associated with tax treaties and mutual agreement procedures (including advance pricing arrangements). These costs also apply to the existing arrangements. The Convention reduces these costs. However, as treaties are deals struck between the two countries that reflect specific features of the bilateral relationship, some level of differential treatment or wording between treaties, which may require interpretation or explanation by the ATO, is inevitable.

Other costs

5.71 Government policy flexibility in relation to taxation of New Zealand residents has been further constrained by changes to treaty obligations, for example with respect to exemption from taxation of New Zealand pensions where those pensions are exempt in New Zealand. However, such constraints are also placed on New Zealand law makers, providing long-term certainty to taxpayers. As such, the cost of such constraints is outweighed by the benefits. Ultimately, the Convention could be terminated if it became out of step with Government policy. Such terminations are very rare in international tax treaty practice, however, and could be expected to be resisted by the business community and others who benefit from the treaty.

5.72 The impact of new tax treaty arrangements on tax policy flexibility is generally quite minimal as tax treaties are based on broad and generally accepted taxation principles. Australia’s closer economic relations with New Zealand through the CER, has meant that some provisions in the Convention have been negotiated with this particular relationship in mind. Australia can justify these particular provisions within this context, and therefore it is likely that any impact on tax policy flexibility is minimal.

Assessment of costs

Taxpayer costs

5.73 No material additional costs to taxpayers have been identified as likely to arise from the Convention.

5.74 Businesses that collect withholding taxes will need to make small system changes to change the rate at which they withhold to reflect the Convention's withholding tax rate limits. Previous experience and anecdotal evidence suggests that these changes will be straight forward and easily accommodated.

5.75 Businesses with New Zealand resident employees or with employees or professionals performing services in New Zealand may need to make business system changes to calculate days during which services are provided in the other country, as under the Convention very short periods of service (five days or less) are disregarded and other provisions to moderate compliance costs are provided. Under the existing treaty, businesses already have to calculate days of service in the other country for self-employed persons performing independent personal services (under the *Independent Personal Services* Article).

5.76 Most businesses that have dealings with New Zealand would already understand their tax obligations under the existing tax treaty and Protocol, accordingly changes are likely to give only a minor compliance cost as businesses adjust to the Convention.

5.77 No costs for the community or other parties have been identified.

Administration costs

5.78 The costs to the ATO with respect to arbitration are expected to be minor, and only arise when taxpayers seek arbitration.

Consultation

5.79 The then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Press Release No. 004 of 28 January 2008 invited submissions from stakeholders and the wider community on Australia's future tax treaty policy and in particular issues that might arise during negotiations with New Zealand. Treasury has also sought comments from the business community through the Tax Treaties Advisory Panel.

5.80 In general, business and industry groups support the general approaches taken in Australia's recent treaties. They also favour a more residence-based taxation treaty policy, lower withholding taxes, time limits on transfer pricing audits and the inclusion of arbitration clauses.

5.81 The state and territory governments have been consulted through the Commonwealth/State Standing Committee on Treaties. Information on the negotiation of this treaty was included in the Schedules of treaties to state and territory representatives from early March 2009.

5.82 The Convention was considered by the Commonwealth Joint Standing Committee on Treaties, which provides for public consultation in its hearings.

5.83 The Bill and explanatory materials were the subject of confidential consultation with the Tax Treaties Advisory Panel.

Conclusion and recommended option

5.84 While the existing tax treaty and its amending Protocol have provided a good measure of protection against double taxation and prevention of fiscal evasion since coming into force, in the context of the closer economic relationship that Australia and New Zealand share, the treaty has become outdated and no longer adequately reflects current tax treaty policies and practices of either Australia or New Zealand, nor modern international norms.

5.85 The Convention responds to businesses' desire for greater certainty and more competitive withholding tax rate limits in Australia's tax treaty network.

5.86 Developments in both countries' domestic law, commercial practices, and treaty policies and practices supported a full revision of the treaty. This also provided an opportunity to update the text in accordance with modern OECD practice, which a second limited amending Protocol would not permit.

5.87 The Convention is consistent with Australia's recent move towards a more residence-based tax treaty policy. It brings Australia's arrangements with New Zealand more into line with international norms, as set out in the OECD Model and provides outcomes similar to Australia's recent treaties.

5.88 There is a direct cost to revenue, largely due to reduced withholding tax collections and the limited exemption provided for pensions. On balance, the benefits of concluding the Convention outweighed the cost to revenue.

5.89 The Convention was therefore recommended.

Implementation and review

5.90 The Convention is implemented by amending the *International Tax Agreements Act 1953* to include the treaty as a Schedule to that Act, giving the treaty the force of law in Australia. Like all other tax treaties it will be administered by the ATO. Since the ATO already administers the existing New Zealand treaty, implementing and administering the Convention is not expected to require extra resources, and only result in minor costs from updating information products.

5.91 The Convention makes provision for review of the treaty. Review will take place no later than five years after the Convention enters into force, by both countries consulting with each other in regard to the operation and application of the treaty with a view to ensuring that it continues to serve its purposes of avoiding double taxation and preventing fiscal evasion.

THE AUSTRALIA-JERSEY AGREEMENT

Policy objective

5.92 The objective of the *Agreement between the Government of Australia and the Government of Jersey for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments* (the Jersey Agreement) is to promote closer economic and administrative cooperation between Australia and Jersey, by reducing some of the taxation barriers to trade and investment between the two countries.

5.93 The Jersey Agreement was signed in conjunction with the *Agreement between the Government of Australia and the Government of Jersey for the Exchange of Information with Respect to Taxes* (the Jersey Information Exchange Agreement), which will promote greater cooperation between the taxation authorities of the two countries to prevent tax avoidance and evasion.

Implementation options

5.94 The internationally accepted approach to meeting the policy objectives specified above is to conclude a bilateral tax agreement.

Assessment of impacts

Impact group identification

- 5.95 The Jersey Agreement is likely to have an impact on:
- recipients of Australian source pensions or retirement annuities who reside in Jersey;
 - Australian individuals providing services to an Australian government (or political subdivision or local authority) in Jersey;
 - Australian students and business apprentices temporarily residing in Jersey for education or training purposes;
 - the Australian Government; and
 - the ATO.

Analysis of costs/benefits

Assessment of costs

Revenue costs

5.96 The impact of the Jersey Agreement on the forward estimates is estimated to be negligible.

Administration costs

5.97 The administrative impacts on the ATO from the changes made by any new bilateral tax agreements (including tax treaties) are considered to be low. General enquiries may arise and some formal interpretive advice, such as private binding rulings, may be required concerning the application of the Jersey Agreement. ATO staff, taxpayers and tax professionals will need to be made aware of the entry into force of the Jersey Agreement. Therefore a number of ATO information products will

need to be updated. This is normal in the context of any new tax treaty or bilateral agreement.

5.98 The cost of negotiating and enacting the Jersey Agreement was minimal.

Taxpayer costs

5.99 No material additional costs to taxpayers have been identified as likely to arise from the Jersey Agreement. The agreement is expected to simplify the taxation obligations of the entities that fall within their scope.

Other costs

5.100 The Jersey Agreement will constrain Government policy flexibility in relation to the taxation of Jersey individuals. However, as their provisions are consistent with the Government's general tax treaty policy, and are based on broad and generally accepted taxation principles, the impact of such a loss of flexibility would be minimal. Ultimately, the Jersey Agreement could be terminated if it was found to contravene Government policy but such termination is rare in international treaty practice and would likely be resisted by those individuals who will benefit from this Agreement.

Consultation

5.101 The negotiation of the Jersey Agreement was not conducted in the public domain and, consequently, no public consultation was undertaken. It was negotiated in conjunction with the negotiation of the Jersey Information Exchange Agreement, which was also conducted outside the public domain.

5.102 The Jersey Agreement has also been considered by the Commonwealth Joint Standing Committee on Treaties, which provides for public consultation in its hearings.

Conclusion and recommended option

5.103 The Jersey Agreement is consistent with the Government's tax treaty policy and implements the policy objectives stated above.

