1983-84

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

INCOME TAX (INTERNATIONAL AGREEMENTS) AMENDMENT BILL 1984

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
the Hon. P.J. Keating, M.P.)

14881/84 Cat. No. 84 7791 3—Recommended retail price $2.00

General Outline

This Bill will amend the Income Tax (International Agreements) Act 1953 to :

- make clear Australia's right to tax distributions of income derived from business operations carried on in Australia by a trustee of a trust estate where the beneficiary (or unit holder in the case of a unit trust) is a resident of a country with which Australia has concluded a comprehensive taxation agreement. This measure was announced on 19 August 1984, and will guard against revenue losses that could be substantial if a court were to hold that Australia does not have the right to tax the distributions in question; and

- give the force of law in Australia to

  - a comprehensive taxation agreement between Australia and Malta which was signed in Malta on 9 May 1984; and

  - a protocol amending the existing taxation agreement between Australia and the Kingdom of Belgium which was signed in Canberra on 20 March 1984.

Neither the Maltese agreement nor the Belgian protocol is expected to have any significant effect on revenue.

Main features

The main features of the Income Tax (International Agreements) Amendment Bill 1984 are as follows:

Taxation of foreign beneficiaries of Australian business trusts

(Clause 3)

The Bill will amend Australia's domestic taxation law to clarify the operation of Australia's comprehensive taxation agreements in relation to certain distributions to a trust beneficiary (or unit holder in the case of a unit trust) who is a resident of an agreement partner country. The distributions dealt with by the amendment are those that consist of business profits derived in Australia by a trustee of a trust or a unit trust. It has been argued in some quarters, but not accepted by the Commissioner of Taxation, that Australia would be unable to tax such distributions, since the trust does not represent a permanent establishment of the beneficiary in Australia.

Under the proposed amendment, a resident of a taxation agreement partner country who is entitled to a share of Australian source business profits derived by a trustee of a trust estate or unit trust from the carrying on of a business in Australia, is expressly to be taken as carrying on the business of the trustee. The effect of this will be that, in accordance with the "business profits" article of Australia's comprehensive taxation agreements, business income derived in Australia by a trust and distributed to a resident of an agreement partner country will be subject to tax in Australia. That result is in keeping with domestic tax policy and with what was clearly intended when Australia's comprehensive taxation agreements were negotiated.

The proposed amendment also includes a safeguarding measure to ensure the intended effect cannot be circumvented by the interposing of one or more trust estates between the business trust and the ultimate beneficiary.

This measure will apply to income entitlements arising after 19 August 1984.

Maltese agreement and Belgian protocol
(Clauses 3 to 6 and 8)

Amendments proposed by this Bill will give the force of law in Australia to the comprehensive taxation agreement with Malta that was signed in Malta on 9 May 1984, and to the protocol that was signed in Canberra on 20 March 1984 to amend the existing comprehensive agreement with Belgium.

Comprehensive taxation agreements have two main purposes - the avoidance of double taxation of income by the country in which the income arises and by the country in which the person beneficially entitled to the income resides, and assistance in preventing tax evasion.

The protocol to the comprehensive taxation agreement with Belgium will amend the existing agreement - which was signed in 1977 - to fully preserve Australia's right to apply its revised transfer pricing provisions to Australian enterprises, and to specifically recognise the "branch profits tax" provided for in Australia's domestic law. The protocol will also amend the definition of the term "royalty" contained in the agreement to ensure that it includes amounts credited, as well as amounts paid. The term is also to expressly include consideration paid or credited for a forbearance by the owner of industrial property from granting rights to use that property.

The agreement between Australia and Malta covers all forms of income flowing between the two countries, and its provisions correspond in substantial practical effect with those in other modern taxation agreements which Australia has concluded. Under the agreement, certain types of income may be taxed in full in the country of source while other types of income may be taxed only by the country of residence of the recipient. A third category of income comprising dividends, interest and royalties may be taxed by both countries, with the country of source limiting its tax and the country of residence allowing credit against its tax on the income for the limited source country tax.

The main features of the agreement with Malta are as follows:

- Business profits are 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 "permanent establishment" in the other country, in which case, that other country may tax the profits.

- Dividends, interest and royalties may be taxed in the country of source, but there are general limits on the tax that that country may charge on such income flowing to residents of the other country. These limits are 15 per cent for interest and 10 per cent for royalties. In the case of dividends, the Australian tax is limited to 15 per cent and, to reflect the Maltese system of taxing company profits and dividend distributions, the Maltese tax on dividends is normally not to exceed the company tax chargeable on the profits from which the dividends are paid.

- Income from real property is taxable in full in the country in which the property is situated.

- Profits from international operations of ships and aircraft will generally be taxed only in the country of residence of the operator.

- Income from independent personal services will generally be taxed only in the country of residence of the recipient.

However, the other country may also tax the income where it is attributable to activities performed from a fixed base of the recipient in the other country, where the recipient is present in that other country for a period or periods exceeding 183 days in aggregate in a year of income, or where the recipient derives, in a year of income, gross remuneration exceeding $A12,500, or its Maltese equivalent, from residents of that other country.

- <u>Income from dependent personal services</u>, that is, employees' remuneration, will generally be taxable in the country where the services are performed.

  However, where the services are performed during a short visit to one country by a resident of the other country, and the remuneration is not an expense borne by a resident of, or a permanent establishment in, the country visited, the income will be exempt in the country visited provided it is subject to tax in the country of residence of the recipient.

- <u>Government officials</u> will generally be taxed only in their home country.

- <u>Directors' fees</u> are to be taxed in the country of residence of the paying company.

- <u>Income derived by public entertainers</u> from their activities as such is to be taxed by the country in which the activities are performed.

- <u>Pensions and annuities</u> will generally be taxed only in the country of residence of the recipient.

- <u>Students</u> resident in one country who are temporarily present in the other country solely for the purpose of their education will be exempt from tax in the country visited in respect of payments made from abroad for the purposes of their maintenance or education.

- Dual residents (i.e. residents of both Australia and Malta according to the domestic taxation laws of each country) are, in accordance with specified criteria, to be treated for the purpose of the agreement as being residents of only one country.

- Associated enterprises may be taxed on the basis of dealings at arm's length.

- Exchange of information and consultation between the taxation authorities of each country is authorised.

- Double taxation relief to be allowed by the country of residence where it taxes income taxed in the other country will be:

  - in Australia, by allowance of a credit against Australian tax for Maltese tax on interest and royalties, where that tax is subject to a limit expressed in the agreement, and on dividends received by individuals. Dividends received by Australian companies from Malta are effectively freed from Australian tax by the inter-corporate dividend rebate, and all other categories of income received by Australian residents from, and taxed in, Malta are exempt from Australian tax by the operation of provisions in Australian tax law.

    Australia will also grant, in respect of Maltese source dividends, interest or royalties, a "tax sparing" credit for Maltese tax forgone under agreed incentive legislation of that country.

  - in Malta, generally by the allowance of a credit against Maltese tax for the Australian tax paid on income derived by residents of Malta from sources in Australia.

Notes on the clauses of the Bill are given below and these are followed by explanations of the articles of the protocol to the agreement with Belgium and the agreement with Malta.

Clause 1 : Short title, etc.

This clause formally provides for the short title of the amending Act and refers to the Income Tax (International Agreements) Act 1953 as the Principal Act.

Clause 2 : Commencement

Under section 5(1A) of the Acts Interpretation Act 1901, unless the contrary intention appears, every Act is to come into operation on the twenty-eighth day after the day on which it receives the Royal Assent. By this clause the amending Act will come into operation on the day on which it receives the Royal Assent, thus enabling early implementation of the agreement with Malta and the protocol with Belgium.

Clause 3 : Interpretation

This clause will amend section 3 of the Principal Act which contains a number of definitions for the more convenient interpretation of the Act.

Paragraph (a) of sub-clause (1) will substitute a new definition of the term "the Belgian agreement", and add a definition of the term "the Belgian protocol". As the Belgian protocol will amend the existing Belgian agreement, the term the "Belgian agreement" is being re-defined to mean the agreement (a copy of which is set out in Schedule 13 to the Principal Act) as amended by the Belgian protocol. The Belgian protocol is, by clause 8 of the Bill, being incorporated as Schedule 13A to the Principal Act.

Paragraph (b) of sub-clause (1) will insert in sub-section 3(1) of the Principal Act a definition of the term "the Maltese agreement". This agreement is, by clause 8 of the Bill, to be incorporated as Schedule 24 to the Principal Act.

Paragraph (c) of sub-clause (1) proposes the insertion in section 3 of the Principal Act of two new sub-sections - sub-sections (11) and (12) - which will clarify Australia's right to tax a share of business income, originally derived by a trustee of a trust estate (including a unit trust) from the carrying on in Australia of a business, which is distributed to a beneficiary (or unit holder) resident in an agreement partner country. In other words the amendment will ensure that such distributions of business income will be subject to tax in

Australia in accordance with the principles contained in the articles of Australia's comprehensive taxation agreements that relate to the taxing of income that may generally be described as "business profits".

The effect of these business profits articles, which are basically in accordance with the OECD model double taxation convention, is that, on a reciprocal basis, Australia can only tax business profit income derived by a resident of an agreement partner country if the profit is attributable to a permanent establishment (that is, broadly, a substantial business presence) of the overseas resident in Australia. Proposed new sub-section 3(11) will deem an overseas benficiary to have the necessary permanent establishment in Australia so as to ensure Australia's taxing right under the business profits article.

The primary conditions for the operation of proposed sub-section 3(11) are contained in paragraph (a). The conditions are that -

- the beneficiary is a resident of a country with which Australia, at the date of commencement of sub-section (11), has signed a comprehensive taxation agreement;
- the beneficiary is presently entitled to a share of trust income;
- the trust is not a corporate unit trust (a term which is defined in proposed sub-section (12)); and
- the trust income concerned is derived from the carrying on of a business in Australia by the trustee through a permanent establishment (a term which is also defined in proposed sub-section (12) in Australia.)

A safeguarding measure is also contained in paragraph (a) to prevent the intended effect of the proposed amendment being circumvented by the interposing of one or more trusts between the business trust and the ultimate beneficiary.

Paragraph (b) of new sub-section (11) identifies the particular article of a comprehensive taxation agreement under which the taxing of income of an enterprise that carries on business in an agreement country is dealt with. The relevant article of each agreement is referred to as the "business profits article".

So that the beneficiary's share of business profits income may be taxed in accordance with the principles contained in the business profits article of each of Australia's agreements, paragraph (c) deems the beneficiary to carry on in Australia, through a permanent establishment in Australia, the Australian business carried on by the trustee of the trust estate. Paragraph (d) attributes to the Australian permanent establishment of the overseas beneficiary, as established by paragraph (c), the beneficiary's share of trust income derived from business operations carried on in Australia.

Proposed new sub-section (12) contains definitions of certain expressions used in sub-section (11). These are -

"Contracting State" is a drafting measure to facilitate identification, under new paragraph 11(b) discussed above, of the business profits article in each of Australia's concluded comprehensive taxation agreements;

"corporate unit trust" is defined to mean a corporate unit trust for the purposes of Division 6B of Part III of the Income Tax Assessment Act;

"income" is defined to specifically include profit. The effect of this is to equate the income derived by a trust estate with the profit referred to in the business profits article of the various taxation agreements; and

"permanent establishment" is to have the same meaning as that term has in a comprehensive taxation agreement.

By sub-clause (2), which will not amend the Principal Act, the amendments made by paragraph (c) of sub-clause (1) will apply to any distributions of trust income to which a beneficiary became presently entitled on and after 20 August 1984.

Clause 4 : Protocol with the Kingdom of Belgium

This clause will insert a new section - section 11CA - in the Principal Act which will give the force of law in Australia to the protocol with Belgium with effect from the dates set out in the protocol - see later notes on Article V of the Belgium protocol.

By sub-section (1) of proposed section 11CA, the Belgian protocol, when it enters into force, will have effect in Australia, in relation to income of any year of income commencing on or after 1 July in the calendar year immediately following that in which the protocol enters into force.

Sub-section (2) provides for the date on which the protocol enters into force to be notified in the Gazette as soon as practicable thereafter. This will provide a readily available and authoritative source from which persons may ascertain the fact and date of entry into force of the protocol. Because, under the terms of the protocol, it will enter into force after an exchange of notes, it is not possible to indicate in this Bill the date of entry into force.

Clause 5 : Agreement with Malta

This clause proposes the insertion in the Principal Act of a new section - section 11N - which will give the force of law in Australia to the comprehensive taxation agreement with Malta with effect from the dates set out in Article 27 of the Maltese agreement - see later notes on that Article.

By sub-section (1) of proposed section 11N, the Maltese agreement will, when it enters into force, have effect as regards Australian tax -

(a) in respect of dividends or interest subject to withholding tax that are derived on or after 1 January in the calendar year next following that in which the agreement enters into force; and

(b) in respect of other income, for any year of income beginning on or after 1 July in the calendar year next following that in which the agreement enters into force.

Sub-section (2), which provides for the dates on which the agreement enters into force to be notified in the Gazette as soon as practicable thereafter, corresponds to sub-section (2) of proposed section 11CA to be inserted by clause 4. (See notes on that section).

Sub-section (3) provides for the publication in the Gazette of details of any variation which is agreed in an exchange of letters between the Treasurer of Australia and the Minister responsible for finance in Malta in accordance with paragraph (2) of Article 14 of the agreement. That paragraph provides that the amount specified in sub-paragraph (1)(c) of Article 14 may be varied in accordance with the particulars contained in the exchange of letters described above. Sub-paragraph (1)(c) of Article 14 relates to one of the conditions which operate whereby income from independent personal services may be taxed in the country where those services are performed rather than in the country of residence of the person performing those services. (See notes on Article 14 of the agreement).

By sub-section (4) provision is made for publication in the Gazette of a notice specifying particulars of those provisions that are agreed in an exchange of letters through the diplomatic channel between Australia and Malta to be of a substantially similar character to the provisions of the Maltese Aids to Industries Ordinance 1959 referred to in sub-paragraph (3)(a) of Article 23 of the agreement. Paragraphs (3) and (4) of that Article provide details of the "tax sparing" provisions contained in the Maltese agreement. (See also the notes on Article 23 of the agreement).

Sub-section (5) provides for publication in the Gazette of a notice specifying any date agreed to by Australia and Malta in letters exchanged in accordance with the provisions of paragraph (4) of Article 23 of the agreement. That paragraph provides that the "tax sparing" provisions referred to in paragraph (3) of Article 23 shall not apply after 30 June 1989 unless the two countries agree on a later date. It is this later date which is referred to in sub-section (5).

Clause 6 : Provisions relating to certain income derived from sources in certain countries

The primary purpose of this clause is to apply the credit method of relief of double taxation to interest and royalties that are derived by residents of Australia from Malta and in respect of which, under the agreement, the source country's rate of tax is limited. Section 12 of the Principal Act, which is to be amended by this clause, already achieves a corresponding result for interest and royalties derived by residents of Australia from other countries with which Australia has concluded comprehensive double taxation agreements and in which the rate of foreign tax on such income is limited.

Section 23(q) of the Income Tax Assessment Act 1936 (the "Assessment Act") confers relief from double taxation in the form of an exemption from Australian tax in respect of foreign source income (other than dividends) of Australian residents that is not exempt from income tax in the country where it is derived. Section 12 of the Principal Act gives effect to a policy that this exemption method of relief is not to apply to interest or royalties derived, either directly or as a beneficiary in a trust estate, from another country where the double taxation agreement with that country limits the tax it may charge. Once the exempting provision is, by section 12, made inapplicable, interest and royalties that are taxed in the country of source become assessable income for the general purposes of the Assessment Act, but in each case the agreement requires Australia to credit against its tax the limited tax of the other country. Sections 14 and 15 of the Principal Act govern the allowance of the credit.

By clause 6, this policy will apply, as was indicated when signature of the agreement was announced, to interest and royalties derived by Australian residents from Malta after the dates identified in the provisions being inserted by the clause. Article 23 is the relevant credit article in the agreement.

Paragraph (a) of clause 6 will affect a formal drafting amendment consequent upon the addition to section 12(1) of the Principal Act of new paragraph (at).

Paragraph (b) will insert the new paragraph in section 12(1) of the Principal Act. This section formally sets out classes of income to which the exemption under section 23(q) of the Assessment Act is not to apply.

The new paragraph (at) will ensure that interest and royalties derived by a resident of Australia from Malta, the Maltese tax on which is expressly limited to 15 per cent of the gross amount of the interest and 10 per cent of the gross amount of the royalties, will not be exempt from Australian tax. Paragraph (at) will apply to such income derived in income years which commence on 1 July in the calendar year next following that in which the agreement enters into force.

Clause 7 : Source of dividends

This clause proposes a technical amendment to section 18 of the Principal Act to reflect the fact that the Maltese agreement and the Belgian protocol which are to be given force of law in Australia by this Bill are "country-to-country" agreements as distinct from "government-to-government" agreements. However, the amendment in no way affects the substantive operation of section 18 which will continue to ensure that a dividend paid by a company resident in a country with which an agreement has been made, but not resident in Australia, shall, for the purposes of the particular agreement, be deemed to be from a source in that country.

Clause 8 : Schedules 13A and 24

This clause will add the protocol with Belgium and the agreement with Malta as Schedules 13A and 24 respectively to the Principal Act.

PROTOCOL TO THE AGREEMENT WITH THE KINGDOM OF BELGIUM

Australia's existing double taxation agreement with Belgium was signed in 1977, and given the force of law in Australia in 1979. Since that time, three significant developments have taken place in Australia in areas relevant to the operation of the provisions of the 1977 agreement ("the agreement"). The first two developments were the enactment of legislation for a branch profits tax and to introduce the revised Division 13 of the Income Tax Assessment Act dealing with transfer pricing. The third development was the exposure of technical deficiencies in the definition of the term "royalties" in the existing agreement. The protocol will amend the agreement to take account of these three matters and, in so doing, will bring the Belgian agreement into line with Australia's more recently concluded agreements.

Article I - Amendment of Article 7

The amendment proposed by this article - the deletion of paragraphs (8) and (9) of Article 7 of the agreement arises as a result of the introduction in Australia in 1978 of the branch profits tax. Under Belgium's domestic law, the rate of tax applicable to Belgian source profits of non-resident companies is in excess of the rate applicable to profits derived by Belgian resident companies. Paragraph (8) of Article 7 of the agreement ensures that the profits of a permanent establishment in Belgium of an Australian company will not be subject to Belgian tax at a rate that is in excess of the highest rate applicable to the profits of a Belgian company. Paragraph (9) of Article 7 is a related provision which provides that, if Australia imposes any tax on the profits attributable to a permanent establishment in Australia of a Belgian company that is in addition to the Australian tax that would be chargeable on those profits if they were derived by an Australian resident company, the two countries shall endeavour to agree to appropriate amendments to paragraph (8) of that article.

The amendments agreed are the deletion of paragraphs (8) and (9) of Article 7, and the addition of paragraph (6) to Article 10 of the agreement which has the effect of allowing both countries to impose the branch profits tax provided for in their respective domestic laws. (See notes on Article 3).

Article II - Amendment of Article 9

This article will amend Article 9 of the agreement by adding to it a new paragraph - paragraph (4). This amendment, which will bring the agreement into line with

Australia's more recently negotiated agreements, will ensure that each country retains the right to apply its domestic law transfer pricing provisions - in the case of Australia, the provisions of the revised Division 13 of the Assessment Act - to its own enterprises, provided that such provisions are applied, so far as it is practicable to do so, in accordance with the principles of paragraph (1) of Article 9.

Article III - Amendment to Article 10

The amendment proposed by this article is related to that proposed by Article I of the protocol and arises as a result of the introduction in Australia of the branch profits tax. As indicated in the notes on Article I, this article will add paragraph (6) to Article 10 of the agreement to preserve the right of each country to impose the branch profits tax provided for in its domestic law. The paragraph also provides for consultation between the two countries with a view to possible amendments to Article 10 where the branch profits tax provisions in either country's domestic law are substantially varied.

Article IV - Amendment of Article 12

By this article, the definition of the term "royalties", which is contained in paragraph (3) of Article 12 of the agreement, is to be omitted and replaced by a revised definition of the term that will take account of two technical deficiencies revealed by a Victorian Supreme Court decision in the case of Aktiebolaget Volvo v Federal Commissioner of Taxation. Firstly, in the revised definition, the term "royalties" is to be expressed to apply to amounts which are credited, in the same way that it applies to those which are actually paid. Secondly, the revised definition will include amounts paid or credited by a person in return for a forbearance to grant to third persons rights to use property covered by the royalty definition. This change is designed to prevent Australian tax being escaped by arrangements under which, instead of amounts being payable for the exclusive right to use property, it is agreed that payments will be made for an undertaking that rights to use the property will not be granted to anyone else.

Article V - Entry into Force

By this article the protocol will form an integral part of the Belgian agreement and will enter into force on the fifteenth day after the date on which notes are exchanged through the diplomatic channel notifying that the last of such things has been done in Australia and in Belgium as is necessary to give the protocol the force of law in both countries. As mentioned earlier in this memorandum, the protocol will be given the force of law in Australia by new section 11CA that is to be inserted in the Income Tax (International Agreements) Act 1953 by clause 4 of the Bill (see notes on that clause).

Upon entering into force, the protocol will have effect in Australia in relation to any year of income beginning on or after 1 July in the calendar year immediately following that in which the protocol enters into force. In Belgium, the protocol will have effect on income of any accounting period beginning on or after 1 January in the calendar year immediately following that in which the protocol enters into force.

AGREEMENT WITH MALTA

Subject to some minor differences, the agreement accords in substantial practical effect with other comprehensive taxation agreements to which Australia is a party. Like them, the agreement allocates the right to tax some income to the country of source, sometimes at limited rates, while the country of residence is given the sole right to tax other types of income. It contains provisions to the effect that where income may be taxed in both countries, the country of residence, if it taxes, is to allow a credit against its own tax for the tax imposed by the country of source.

Article 1 - Personal Scope

The agreement will apply to persons (which term includes companies) who are residents of either Australia or Malta.

The situation of persons who are dual residents (i.e. residents of both countries) is dealt with in Article 4.

Article 2 - Taxes Covered

This article specifies the existing taxes to which the agreement applies. These are, in broad terms, the Australian income tax and the Maltese income tax. The article will automatically extend the application of the agreement to any identical or substantially similar taxes which may subsequently be imposed by either country in addition to, or in place of, the existing taxes.

Article 3 - General Definitions

This article provides definitions for a number of the terms used in the agreement. Some other terms are defined in the articles to which they relate and terms not defined in the agreement are to have the meaning which they have under the taxation law of the country applying the agreement.

As with Australia's other modern taxation agreements, "Australia" is defined as including external territories and areas of the continental shelf. By reason of this definition, Australia retains taxing rights in relation to mineral exploration and mining activities on its continental shelf. The definition is also relevant to the taxation by Australia of shipping and airline profits in accordance with Article 8 of the agreement.

Article 4 - Residence

This article sets out the basis on which the residential status of a person is to be determined for the purposes of the agreement. Residential status is one of the criteria for determining each country's taxing rights and is a necessary condition for the provision of relief under the agreement. Residence according to each country's taxation law provides the basic test. The article also includes rules for determining how residency is to be allocated to one or other of the countries for the purposes of the agreement where a taxpayer - whether an individual, a company or other entity - is regarded as a resident under the domestic laws of both countries.

Article 5 - Permanent Establishment

Application of various provisions of the agreement (principally Article 7) is dependent upon whether a person resident of one country has a "permanent establishment" in the other, and if so, whether income derived by the person in the other country is effectively connected with that "permanent establishment". The definition of the term "permanent establishment" which this article embodies corresponds closely with definitions of the term in Australia's other double taxation agreements.

The primary meaning of the defined term is expressed in paragraph (1) as being a fixed place of business through which the business of an enterprise is wholly or partly carried on. Other paragraphs of the article are concerned with elaborating on the meaning of the term by giving examples of what may constitute a "permanent establishment" - such as an office, a mine or an agricultural property - and by specifying the circumstances in which a resident of one country shall, or shall not, be deemed to have a "permanent establishment" in the other country.

Article 6 - Income from Real Property

By this article, income from real property, including income from the direct use, letting or use in any other form of any land or interest therein, and royalties and other payments in respect of the working of or the right to work or to explore for, mineral deposits, oil or gas wells, quarries or other places of extraction or exploitation of natural resources, may be taxed in the country in which the land, mine, quarry or natural resource is situated or where the exploration may take place.

Income to which this article applies is excluded from the scope of Article 7 (by paragraph (7) of that article) and is therefore taxable in the country of source regardless of whether or not the recipient has a "permanent establishment" in that country.

Article 7 - Business Profits

This article is concerned with the taxation of business profits derived by a resident of one country from sources in the other country.

The taxing of these profits depends on whether they are attributable to a "permanent establishment" of the taxpayer in that other country. If they are not, the profits will be taxed only in the country of residence of the taxpayer. If, however, a resident of one country carries on business through a "permanent establishment" (as defined in Article 5) in the other country, the country in which the "permanent establishment" is situated may tax profits attributable to the establishment.

The article provides for profits of the "permanent establishment" to be determined on the basis of arm's length dealing. These provisions correspond in their practical effect with comparable provisions in Australia's other double taxation agreements, and with the revised Division 13 that was inserted in the Assessment Act in 1982.

Paragraph (5) of the article allows the application of provisions of the source country's domestic law (e.g. the revised Australian Division 13) where the correct amount of profits attributable to a "permanent establishment" is incapable of determination or the ascertainment thereof presents exceptional difficulties, for example, where there is insufficient information available to determine the profits of the "permanent establishment" on the basis of arm's length dealing.

Paragraph (9) preserves to each country the right to continue to apply any special provisions in its domestic law relating to the taxation of income from insurance with non-residents.

Article 8 - Shipping and Air Transport

Under this article the right to tax profits from the operation of ships or aircraft in international traffic, including profits derived from participation in a pool service, a joint transport operating organisation or an international operating agency, is generally reserved to the country of residence of the operator.

Any profits derived by a resident of one country from internal traffic in the other country may be taxed in that other country. By reason of the definition of "Australia" contained in Article 3 and the terms of paragraph (4) of this Article, any shipments by air or sea from a place in Australia to another place in Australia, its continental shelf or external territories are treated as forming part of internal traffic.

By virtue of Malta's Merchant Shipping Act 1973, a company resident in Malta is not generally liable to income tax on the profits earned from qualifying ships. Paragraph (5) is intended as a safeguarding measure to ensure that there is no unwarranted avoidance of Australian tax by Australian or other non-Maltese shipowners who, by transferring their ships to Malta, would otherwise be able to obtain exemption from Australian tax under Article 8 of this agreement, and from Malta tax under the terms of Malta's merchant shipping law.

By paragraph (5), a Malta company may be taxed in Australia on the profits from the operation of ships in international traffic (as defined in Article 3) where more than 25% of that company's capital is owned by persons who are not residents of Malta, unless the company can prove that the profits are not relieved from Malta tax under the Merchant Shipping Act 1973, or under any identical or substantially similar provision.

Article 9 - Associated Enterprises

This article authorises the re-allocation of profits between related enterprises in Australia and Malta 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 independent enterprises dealing at arm's length with one another.

By virtue of paragraph (2) of the article, each country retains the right to apply its domestic law (e.g. the revised Australian Division 13) to its own enterprises, provided that such provisions are applied, so far as it is practicable to do so, in accordance with the principles of this article.

Where a re-allocation of profits is effected 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, a form of double taxation would arise if the profits so re-allocated continued to be subject to tax in the hands of an associated enterprise in the other country. Paragraph (3) requires the other country concerned to make an appropriate adjustment to the amount of tax charged on the profits involved with a view to relieving any such double taxation.

Article 10 - Dividends

This article in general limits the tax that the country of source may impose on dividends payable to beneficial owners resident in the other country. Under this article, Australia will reduce its rate of withholding tax on dividends paid to residents of Malta from 30 per cent to 15 per cent of the gross amount of the dividends.

Under the Maltese system of taxing company profits and dividends, the income tax on company profits distributed as dividends is treated, in effect, as tax paid by shareholders on the dividends. Reflecting this, the agreement provides that the Maltese tax payable by Australian residents on the gross amount of dividends received from a Maltese company is to not exceed the company tax chargeable on the profits out of which the dividends are paid. However, where the dividends are paid out of profits of a company which are subject to special Maltese investment incentive measures, the Maltese tax will be limited to such a lower rate as applies by virtue of those measures. Where the Maltese tax payable on the dividends is less than the company tax chargeable on the profits from which the dividends are paid, the difference is refundable to the dividend recipient.

Paragraph (4) provides that the limitation on the source country's tax will not apply to dividends derived by a resident of the other country who has a "permanent establishment" or "fixed base" in the country from which the dividends are derived, if the holding giving rise to the dividends is effectively connected with that "permanent establishment" or "fixed base". In those cases, the dividends will be taxed at normal rates in accordance with the provisions of Article 7 or Article 14, as the case may be.

The purpose of paragraph (5) of this article is to ensure, broadly, that one 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 holding giving rise to the dividends is effectively connected with a "permanent establishment" or "fixed base" in that country.

Article 11 - Interest

This article requires the country of source generally to limit its tax on interest derived by residents of the other country to 15 per cent of the gross amount of the interest. This limitation will not affect the rate of Australian withholding tax on interest derived by residents of Malta which will continue to be imposed at the rate of 10 per cent under Australia's domestic law.

Interest derived by a resident of one country which is effectively connected with a "permanent establishment" or "fixed base" of that person in the other country will form part of the business profits of that establishment or "fixed base" and be subject to the provisions of Article 7 or Article 14. Accordingly, paragraph (4) of Article 11 requires that the 15 per cent limitation is not to apply to such interest.

The article also contains a general safeguard (paragraph (6)) against payments of excessive interest - in cases where there is a special relationship between the persons associated with a loan transaction - by restricting the 15 per cent limitation in such cases to an amount of interest which might be expected to have been agreed upon by persons dealing at arm's length.

Article 12 - Royalties

This article in general limits to 10 per cent of the gross amount of the royalties the tax that the country of source may impose on royalties paid to beneficial owners resident in the other country.

The 10 per cent limitation is not to apply to natural resource royalties, which, in accordance with Article 6, are to remain taxable in the country of source without limitation of the tax that may be imposed.

In the absence of a double taxation agreement, Australia generally taxes royalties paid to non-residents (other than film and video tape royalties which are taxed at the rate of 10 per cent of the gross royalties), as reduced by allowable expenses, at ordinary rates of tax.

As in the case of dividends and interest, it is specified in paragraph (4) that the 10 per cent limitation of tax in the country of origin is not to apply to royalties effectively connected with a "permanent establishment" or "fixed base" in that country.

By paragraph (6), if royalties flow between related persons, the 10 per cent limitation will apply only to the extent that the royalties are not excessive.

Article 13 - Alienation of Property

Under this article, income or gains from the alienation of real property (as defined in Article 6) may be taxed in the country in which that property is situated.

By paragraph (2), income or gains from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property, may be taxed in the country in which the assets or the principal assets of the company are situated.

Article 14 - Independent Personal Services

At present, an individual resident in Australia or in Malta may be taxed in the other country on income derived from the performance in that other country of professional services or other similar independent activities. The purpose of this article is to ensure that such income will continue to be taxed in the country in which the services are performed where one or more of the following three tests are met, provided that, in all three cases, the income derived is attributable to activities performed in accordance with those three tests. These tests are that:

- the recipient has a "fixed base" regularly available in that country for the purpose of performing his or her activities;
- the income is derived during a period or periods aggregating more than 183 days in a year of income or, in the case of Malta, in the year immediately preceding the year of assessment, in which the recipient is present in that country; or
- the recipient derives from residents of that country, during the relevant income year, gross remuneration exceeding $A12,500, or its Maltese equivalent, from performing his or her activities in that country. This amount may be varied by agreement between the Treasurer of Australia and the Minister responsible for finance in Malta.

If none of the tests mentioned above are met, the income will be taxed only in the country of residence of the recipient.

Remuneration derived as an employee and income derived by public entertainers are the subject of other articles of the agreement and are not covered by this article.

Article 15 - Dependent Personal Services

Article 15 provides the basis upon which the remuneration of visiting employees is to be taxed. Generally, salaries, wages, etc. derived by a resident of one country from an employment exercised in the other country will be liable to tax in that other country. However, subject to specified conditions, there is a conventional provision for exemption from tax in the country being visited where only visits of a short-term nature are involved. The conditions for exemption are that the visit or visits not exceed, in the aggregate, 183 days in the year of income or, in the case of Malta, in the year immediately preceding the year of assessment, of the country visited, that the remuneration is paid by, or on behalf of, an employer who is not a resident of the country being visited, that the remuneration is not deductible in determining taxable profits of a "permanent establishment" or a "fixed base" which the employer has in the country being visited, and that the remuneration is subject to tax in the country of residence. Where these conditions are met, the remuneration so derived will be liable to tax in the country of residence.

By paragraph (3) of the article, income from an employment exercised aboard a ship or aircraft operated in international traffic is to be taxed in the country of residence of the operator.

Article 16 - Directors' Fees

Under this article, remuneration derived by a resident of one country in the capacity of a director of a company which is a resident of the other country is to be taxed in the country where the company is resident.

Article 17 - Entertainers

By this article, income derived by visiting entertainers (including athletes) from their personal activities as such will continue to be taxed in the country in which the activities are exercised, irrespective of the duration of the visit.

Paragraph (2) of this article is a safeguarding provision designed to ensure that income in respect of personal activities exercised by an entertainer, whether received by the entertainer or by another person, e.g., a separate enterprise which formally provides the entertainer's services, is taxed in the country in which the entertainer performs, whether or not that other person has a "permanent establishment" or "fixed base" in that country.

Article 18 - Pensions and Annuities

Under this article pensions and annuities, including government pensions, are with one exception to be taxed only by the country of residence of the recipient.

The exception is that any pensions or allowances in respect of wounds, disabilities or death caused by war, or in respect of war service, which are exempt from tax in the paying country, will also be exempt in the country of residence.

Article 19 - Government Service

Paragraph (1) of this article provides that remuneration, other than a pension or annuity, in respect of services rendered to a government (including a State or local government) of one of the countries will be taxed only in that country. However, such remuneration is to be taxable only in the other country if the services are rendered in that country and the recipient is a citizen of, or ordinarily resides in, that country.

Paragraph (2) provides, in effect, that paragraph (1) does not apply where the services are rendered in connection with a trade or business carried on by a government. In such a case, the provisions of Articles 15 or 16 apply.

By paragraph (3), where the remuneration is paid under a development assistance programme of one country, out of funds exclusively supplied by that country, to a specialist or volunteer seconded to the other country with the consent of that other country, that remuneration is to be taxed only in the country which provides the funds.

Article 20 - Students

This article applies to students temporarily present in a country solely for the purpose of their education at a university, college, school or other similar educational institution who are, or immediately before the visit were, resident in the other country. In these circumstances, the students will be exempt from tax in the country visited in respect of payments received from abroad for the purposes of their maintenance or education.

Article 21 - Income Not Expressly Mentioned

This article provides rules for the allocation between the two countries of taxing rights in relation to items of income not expressly mentioned in the preceding articles of the agreement.

Broadly, such income derived by a resident of one country is to be taxed only in his or her country of residence unless it is derived from sources in the other country, in which case the income may also be taxed in the country of source.

However, the first-mentioned exclusive taxing right of the country of residence does not apply where the income is effectively connected with a "permanent establishment" or "fixed base" which a resident of one country has in the other. In such cases, the provisions of Article 7 or Article 14, as the case may be, will apply.

Article 22 - Sources of Income

Article 22 specifies the source of various classes of income, for the purposes of ensuring that each country is empowered to exercise the taxing rights allocated to it by the agreement over residents of the other country and that, as intended by the agreement, double taxation relief will be given by the country of residence in respect of tax levied by the country of source in accordance with the taxing rights allocated to it under the agreement. The provision obviates any question of income not having, by domestic law rules, a source in the country that is, by the agreement, entitled to tax that income in the hands of a resident of the other country.

Article 23 - Methods of Elimination of Double Taxation

Double taxation does not arise in respect of income flowing between the two countries where the terms of the agreement provide for the income to be taxed only in one country or the other, or where the domestic taxation law of one of the countries frees the income from its tax. It is necessary, however, to prescribe a method for relieving double taxation in respect of other classes of income which are subject to tax in both countries. Australia's other comprehensive taxation agreements provide for a credit basis for the relief of double taxation to be applied by Australia and, usually, the other country. In these cases, the country of residence is required to give credit against its tax for the tax of the country of source. This approach has generally been adopted in this agreement.

By paragraph (1) of the article, Australia will relieve double taxation by allowing a credit against its own tax for Maltese tax on income derived by a resident of Australia from sources in Malta. Credit will be allowed by Australia for the Maltese tax on dividends derived from Malta by individuals and on interest and royalties derived from Malta by individuals and companies in respect of which the tax of that country is limited in accordance with Articles 10, 11 and 12 of this agreement.

Paragraph (2) of the article acknowledges that dividends received by an Australian company from a Maltese company are in effect freed from Australian tax by the rebate under section 46 of the Assessment Act. This is to continue, but paragraph (2) also provides that if this rebate ceased to be allowed, Australia and Malta will enter into negotiations in order to establish new provisions concerning the credit to be allowed by Australia against its tax on the dividends.

Section 23(q) of the Assessment Act will continue to exempt from Australian tax other income of Australian residents that is taxed in Malta. In these cases, since there will be no Australian tax payable, there is no call for allowance of credits.

The agreement contains "tax sparing" provisions which are broadly similar to those included in Australia's agreements with Singapore, the Philippines, Malaysia and Republic of Korea. Under these provisions, which are contained in paragraphs (3) and (4) of this article, Australia will tax an Australian recipient of dividends, interest or royalties on which Malta - under agreed incentive measures - has forgone its tax as if Maltese tax forgone had been paid.

Sub-paragraph (a) of paragraph (3) provides that, for the purposes of the tax sparing credit to be allowed by Australia, the tax forgone by Malta is that tax which, but for the provisions of the Maltese Aids to Industries Ordinance 1959, or any other provisions which are agreed by Australia and Malta in an exchange of letters to be of a substantially similar character, would have been payable on dividends (taxed at the reduced rate applicable under sub-paragraph (2)(b)(ii) of Article 10 of the agreement), interest or royalties, and effectively limits the tax sparing credit for Maltese tax to 15 per cent of the gross amount of the dividends and 10 per cent of the gross amount of the interest and royalties. Proposed sub-section 11N(4) (see notes on clause 5 of the Bill) will provide for particulars of the provisions agreed in the exchange of letters referred to above to be notified in the Gazette.

Where a tax sparing credit is allowed, sub-paragraph (b) of paragraph (3) has the effect that the Maltese income concerned is to be grossed-up, for purposes of calculating the Australian tax thereon, by the amount of tax sparing credit. For example, in the case of interest and royalties received from Malta, in respect of which Maltese tax has been wholly forgone, the amount included in assessable income in Australia will be the amount received, plus 10 per cent of the amount.

By reason of paragraph (4), the tax sparing provisions outlined above will not apply after 30 June 1989 unless Australia and Malta agree to extend them beyond that date. Proposed sub-section 11N(5) (see notes on clause 5 of the Bill) will provide for advice of any such extension to be notified in the Gazette.

For its part Malta will, broadly, allow a credit to Maltese residents, in respect of taxes payable in Australia on their Australian source income, against the Maltese tax payable on that income. Where a dividend is paid by an Australian resident company to a Maltese resident company which controls 10 per cent or more of the voting power in the Australian company, the credit allowed by Malta shall also take into account, in addition to the Australian tax paid in respect of the dividends, the Australian tax paid by the company in respect of the profits out of which the dividend is paid.

Paragraph (6) of the article relates to the Maltese "remittance" basis of taxing certain income. Broadly, this basis results in only that part of the relevant overseas earnings that is remitted to or received in Malta by a resident of Malta being subject to Maltese tax. This paragraph will also ensure that Australia is not to exempt or reduce its tax on income that, because it is not remitted to or received in Malta by the Maltese resident who derives it, is not subject to Maltese tax.

Article 24 - Mutual Agreement Procedure

One of the purposes of this article is to provide for consultation between the taxation authorities of the two countries with a view to reaching a satisfactory solution where a taxpayer is able to demonstrate actual or potential subjection to taxation contrary to the provisions of the agreement. A taxpayer wishing to use this procedure must present a case within three years of the first notification of the action giving rise to the taxation not in accordance with the agreement and if, on consideration, a solution is reached, it may be implemented irrespective of any time limits imposed by domestic tax laws of the relevant country.

The article also authorises consultation between the taxation authorities of the two countries for the purpose of resolving any difficulties regarding the interpretation or application of the agreement and to give effect to it.

Article 25 - Exchange of Information

This article authorises the two taxation authorities to exchange information necessary for the carrying out of the agreement or of domestic laws concerning the taxes to which the agreement applies. The purposes for which this information may be used and the persons to whom it may be disclosed are restricted along the lines of Australia's other comprehensive taxation agreements.

The exchange of information that would disclose any trade, business, industrial or professional secret or trade process or which would be contrary to public policy is not permitted by the article.

Article 26 - Diplomatic and Consular Officials

The purpose of this article is to ensure that the provisions of the agreement do not result in members of diplomatic and consular posts receiving less favourable treatment than that to which they are entitled in accordance with international laws. In Australia, such persons are entitled to fiscal privileges under the Diplomatic (Privileges and Immunities) Act and the Consular (Privileges and Immunities) Act.

The article contains in paragraph (2) a safeguard aimed at ensuring that the officials concerned cannot, by the combined effect of the provisions of the agreement and of the fiscal privileges accorded to diplomatic and consular officials, escape taxation in both countries. A further safeguard in paragraph (3) will ensure that the benefits of the agreement will not apply to international organisations, to organs or officials thereof, or to diplomatic or consular staff of a third country who, although present in one of the countries, are not treated as residents by either country.

Article 27 - Entry into Force

This article provides for the entry into force of the agreement. This will be on the date on which notes are exchanged through the diplomatic channel notifying that the last of such things has been done in Australia and Malta as is necessary to give the agreement the force of law in both countries.

Once it enters into force, the agreement will have effect in Australia, for purposes of withholding tax, in respect of income derived on or after 1 January in the calendar year next following that in which the agreement enters into force and, in respect of tax other than withholding tax, in relation to income of any year of income beginning on or after 1 July in the calendar year next following that in which the agreement enters into force. Where a taxpayer has adopted an accounting period ending on a date other than 30 June, the beginning of the accounting period that has been substituted for the year beginning on 1 July in the year in which the agreement first has effect will be the date from which the agreement will take effect in respect of tax other than withholding tax. In Malta, the agreement will have effect in relation to taxes which are levied for the year of assessment beginning on 1 January in the second calendar year following that in which the agreement enters into force and for any subsequent year of assessment.

Article 28 - Termination

By this article the agreement is to continue in effect indefinitely. However, either country may give through the diplomatic channel written notice of termination of the agreement on or before 30 June in any calendar year beginning after the expiration of five years from the date of its entry into force. In that event, the agreement would cease to be effective in Australia, for withholding tax purposes, in respect of income derived on or after 1 January in the calendar year next following that in which the notice of termination is given and, for tax other than withholding tax, in relation to income of any year of income beginning on or after 1 July in the calendar year next following that in which the notice of termination is given. It would cease to be effective in Malta in relation to taxes which are levied for the year of assessment beginning on 1 January in the second calendar year following that in which the notice of termination is given and for subsequent years of assessment.

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