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THE PARLIAMENT OF THE COMMONWEALTH

OF AUSTRALIA

HOUSE OF REPRESENTATIVES

INCOME TAX (INTERNATIONAL AGREEMENTS) AMENDMENT BILL 1989

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,

the Hon. P.J. Keating, M.P.)

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GENERAL OUTLINE

This Bill will amend the Income Tax (International Agreements) Act 1953 to give the force of law in Australia to a comprehensive double taxation agreement between Australia and The People's Republic of China covering various forms of income flows between the two countries. The agreement was signed in Canberra on 17 November 1988.

FINANCIAL IMPACT

The double taxation agreement with China is not expected to have a significant effect on revenue.

MAIN FEATURES

The double taxation agreement with China is designed to avoid double taxation of income flowing between Australia and China and to prevent fiscal evasion of taxes covered by it. It will complement an existing taxation agreement between Australia and China relating to airline profits. Double taxation is avoided under the comprehensive agreement by allocating taxing rights between the two countries in relation to certain categories of income and by setting out how relief from double taxation is to be provided where income may be taxed by both countries. The basis provided by the agreement for allocating taxing rights and providing double taxation relief is substantially similar to that adopted in Australia's other modern comprehensive double taxation agreements.

The agreement provides that certain categories of income are to be taxed as follows:

- Income from real property (which includes natural resources royalties) is taxable in full by the country in which the property is situated.
- 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.
- Profits from international operations of ships will be taxed only in the country of residence of the operator.

- 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 dividends and 10 per cent for interest and royalties.

- Income or gains from the alienation of real property may be taxed in full by the country in which the property is situated. Subject to that rule and other specific rules in relation to business assets and some shares, capital gains are to be taxed in accordance with the domestic law of each country.

- Income from professional services and other similar activities 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, or where the recipient is present in that other country for a period or periods exceeding 183 days in aggregate in any consecutive period of 12 months.

- Income from dependent personal services, 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 or fixed base in, the country visited, the income will be exempt in the country visited.

- Government officials will generally be taxed only in their home country.

- Directors' fees and similar payments may be taxed in the country of residence of the paying company.

- Income derived by public entertainers from their activities as such, other than under a cultural exchange plan between the two Governments, is to be taxed by the country in which the activities are performed.

- <u>Pensions</u> will generally be taxed only in the country of residence of the recipient, except for certain Government service pensions, which are taxable only in the other country.

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

- <u>Remuneration derived by professors or teachers</u> during visits to the other country of up to two years duration for the sole purpose of teaching or carrying out advanced study or research will generally be taxed only in the the country of residence.

- <u>Dual residents</u> (i.e. residents of both Australia and China 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.

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

- <u>Exchange of information</u> and consultation between the taxation authorities of each country is authorised.

- <u>Double taxation relief</u> is to be allowed by the country of residence where it taxes income (including gains) which, under the agreement, may also be taxed in the other country, as follows:

  - <u>in Australia</u>, by allowance of a credit against Australian tax on income derived by a resident of Australia from sources in China for the Chinese tax paid in respect of the income. In the case of a dividend payment from a Chinese resident company to a related Australian resident company, the tax to be credited by Australia includes the "underlying" tax paid in respect of the profits out of which the dividend is paid

    The tax credit relief to be provided by Australia is to include "tax sparing" relief in relation to income derived from China by a resident of Australia which has benefited from certain specified development tax incentives of China. The agreement therefore provides for Australia to provide a credit against the Australian tax payable in respect of that income for the Chinese tax forgone for Australian assessment purposes under those development incentives as if that tax had been paid. This tax sparing relief is to be provided by the "direct credit"method, which means that the amount of income received will not be "grossed-up" by the amount of Chinese tax forgone for Australian assessment purposes before allowance of the tax credit.

For dividends and interest subject to the specified Chinese development incentives, tax sparing relief will apply as if Chinese tax at the relevant treaty limit rates of 15 per cent and 10 per cent respectively had applied. For royalties subject to those incentives, tax sparing relief will apply on the basis of a deemed Chinese tax rate of 15 per cent of the gross amount of the royalties (compared with the treaty rate limit of 10 per cent), for as long as China's general domestic rate of tax on royalties is not reduced below that rate.

- <u>in China</u>, generally by the allowance of a credit against Chinese tax for the Australian tax paid on income (or gains) derived by residents of China from sources in Australia, including "underlying" tax credit in the case of a dividend payment by an Australian resident company to a related Chinese resident company.

The agreement will enter into force on the date on which Australia and China exchange diplomatic notes advising each other that the last of the constitutional processes necessary to give the agreement the force of law in the respective countries has been completed.

Upon entering into force, the agreement will have effect in Australia for withholding tax purposes in respect of income derived by non-residents on or after 1 July in the calendar year following that in which it enters into force. For all other Australian taxes covered by the agreement, it will first have effect in respect of income of the income year beginning on or after 1 July in the calendar year after that in which it enters into force. It will have effect in China for all Chinese taxes (including tax withheld at source) in respect of income of taxable years beginning on or after 1 January in the calendar year next following the year in which the agreement enters into force.

Notes on the clauses of the Bill are given below and these are followed by a more detailed explanation of the articles of the double taxation agreement.

Clause 1 : Short title etc

This clause formally provides the citation for the Amending Act, and that references to the "Principal Act" in the Bill relate to the Income Tax (International Agreements) Act 1953.

Clause 2 : Commencement

Under Subsection 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.

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.

It will insert in subsection 3(1) of the Principal Act a definition of the term 'the Chinese agreement'. This term is defined to mean the comprehensive double taxation agreement with China which is, by clause 5 of the Bill, to be incorporated as Schedule 28 to the Principal Act.

Clause 4 : Agreement with the People's Republic of China

This clause proposes the insertion in the Principal Act of a new section - section 11S - which will give the force of law in Australia to the comprehensive double taxation agreement with China with effect from the dates set out in Article 27 of the agreement and provide for certain other matters.

By subsection 11S (1), the Chinese 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 July 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.

Subsection 11S (2) provides for the date on which the agreement enters into force (in accordance with Article 27) 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 agreement. Because, under the terms of the agreement, it will enter into force upon a future exchange of notes, it is not possible to indicate in this Bill the date of entry into force.

Subsection 11S (3) relates to the "tax sparing" provisions of Article 23 of the double taxation agreement, under which Australia is to treat tax forgone by China under certain specified development incentives as if it had been paid for purposes of giving a credit for Chinese tax against Australian tax imposed on relevant income derived by Australian residents.

The Chinese development incentives concerned are specified in paragraph 5 of Article 23. That paragraph also provides for tax sparing to apply in relation to income benefiting from development incentives introduced by China subsequent to the date of signature of the agreement which are agreed by the Treasurer of Australia and his counterpart in China in letters exchanged for that purpose to be of a substantially similar character to the specified incentives.

By subsection 11S (3), provision is made for publication in the Gazette of a notice specifying particulars of those Chinese development incentives that are so agreed from time to time.

Subsection 11S (4) provides for the publication in the Gazette of a notice specifying any date agreed to by Australia and China in letters exchanged in accordance with the provisions of paragraph 7 of Article 23 of the agreement. That paragraph provides that the "tax sparing" provisions of paragraphs 4, 5 and 6 of Article 23 shall apply for the first ten years of income in relation to which the agreement has effect and in any later year of income that may be agreed by the Treasurer and his Chinese counterpart in an exchange of letters.

Subsection 11S (5) reflects a provision which customarily appears in Australia's double taxation agreements, but which was not included in the agreement with China. It effectively provides that particular income which, under the agreement, Australia may tax in the hands of a resident of China, is to be deemed to have a source in Australia. This provision is designed to ensure that the right given by the agreement for Australia to tax that income is compatible with the domestic law rules with respect to the taxation of non-residents and eliminates any possible conflict with the domestic law rules as to the source of income.

Proposed subsection 11S (6) relates to the right given by paragraph 2 of Articles 11 and 12 of the agreement for each country to tax outgoing interest and royalties, at a limited rate, and the related "source" rules contained in paragraph 5 of Articles 11 and 12. It will ensure that those provisions will not have the unintended effect of subjecting to Australian tax interest or royalties paid by an Australian resident to a Chinese resident where the interest or royalties are an outgoing wholly incurred in carrying on a business in a third country. Such interest or royalties would not be subject to tax under the provisions of the Australian income tax law (section 128B and 6C of the Income Tax Assessment Act) or, in corresponding circumstances, under any of Australia's other double taxation agreements.

Clause 5 : Schedule 28

This clause will add the comprehensive double taxation agreement as Schedule 28 to the Principal Act.

AGREEMENT WITH THE PEOPLE'S REPUBLIC OF CHINA

Subject to some differences, the agreement accords in substantial practical effect with other double 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 China.

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 the case of Australia, the Australian income tax and the resources rent tax in respect of offshore petroleum projects. For China, its income tax is specified. 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 effectively defined as including certain 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 profits in accordance with Article 8 of the agreement.

Article 4 - Resident

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. The article also contains provisions which are aimed at preventing the abuse of the agreement by the use of what is commonly referred to as treaty shopping arrangements, i.e. arrangements designed to establish residential status in either country in order to exploit provisions of the agreement in an unintended way.

Article 5 - Permanent Establishment

Application of various provisions of the agreement (principally Article 7 relating to business profits) is dependent upon whether a person who is a 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 a farm or forest - 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.

One particular feature of the article is that it provides that the furnishing by an enterprise of one country of consultancy or other services will constitute a permanent establishment in the other country where those activities continue (for the same or a connected project) within the latter country for a period or periods aggregating more than 6 months within a 12 month period. That feature, and the operation of Article 7, ensures preservation of the "business profits" principle in relation to the allocation between the two countries of taxing rights over such fees.

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 relating to the working of, or the exploration for or exploitation of, mines or quarries or other natural resources, may be taxed in the country in which the land, mine, quarry or natural resource is situated.

Consistent with the usual rule that whatever is affixed to or attached to land forms part of, or becomes part of, the land, the reference to land is to be read as meaning either improved or unimproved land. Accordingly, the definition of real property will encompass, for example, a lease of a building or any other interest in a building.

As with other items of income dealt with separately in specific articles of the agreement, 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 a "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 of the Income Tax Assessment Act.

Paragraph 6 of the article allows the application of provisions of the source country's domestic law (e.g. Australia's Division 13) where, due to the inadequacy of available information the correct amount of profits attributable to a "permanent establishment" is incapable of determination or the ascertainment thereof presents exceptional difficulties.

Paragraph 8 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.

Paragraph 9 is intended to clarify Australia's right to tax a share of business profits, originally derived by a trustee of a trust estate (other than a corporate unit trust) from the carrying on of a business in Australia, to which a resident of China is beneficially entitled. It ensures that such distributions will be subject to tax in Australia where, in accordance with the principles set out in Article 5, the trustee of the relevant trust estate has a permanent establishment in

Australia in relation to that business. It is comparable in effect to sub-section 3(11) of the Income Tax (International Agreements) Act 1953, which has a similar effect where the beneficiary is a resident of a country with which Australia had signed a comprehensive taxation agreement on or before 19 August 1984.

Article 8 - Shipping and Air Transport

Under this article the right to tax profits from the operation of ships 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 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.

Paragraph 5 makes it clear that the airline profits agreement between Australia and the People's Republic of China which was signed in Beijing on 22 November 1985 continues to apply notwithstanding the conclusion of the comprehensive taxation agreement.

Article 9 - Associated Enterprises

This article authorises the re-allocation of profits between related enterprises in Australia and China 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. Australia's 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 allows both countries to tax dividends flowing between them but 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 unfranked dividends paid by Australian resident companies to residents of China from 30 per cent to 15 per cent of the gross amount of the dividends. Franked dividend payments will, of course, remain free of withholding tax under Australia's domestic law.

Paragraph 4 provides that the limitation provided by paragraphs 1 and 2 on the source country's tax shall 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". Where the dividends are so effectively connected, they will be treated as "business profits" or "income from independent personal services" and subject to the source country's tax in accordance with the provisions of Article 7 or Article 14, as the case may be. In practice, under changes made to Australia's domestic law with the introduction from 1 July 1987 of a full imputation system of company taxation, such dividends that are franked dividends will remain exempt from Australian tax while unfranked dividends will be subject to withholding tax instead of being taxed by assessment.

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. The paragraph also provides that the first-mentioned country will not levy a tax on the company's undistributed profits.

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 10 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 China which will continue to be imposed at the rate of 10 per cent under Australia's domestic law.

Paragraph 3 defines the term "interest" for the purposes of the article to mean interest from debt-claims (ie, indebtedness) of every kind, and all other income that is by the income tax laws of the respective countries assimilated to income from money lent. The latter reference will operate to ensure that the definition encompasses items of income such as discounts on securities and payments under certain hire purchase agreements which are treated for Australian tax purposes as interest or amounts in the nature of interest, and therefore as falling within the definition of "interest" for withholding tax purposes.

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 "permanent 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 10 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 10 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.

The interest "source" rules set out in paragraph 5 differ from those under Australian law and under Australia's double taxation agreements generally to the extent that interest paid by an Australian resident that is an expense of a permanent establishment (branch) in a third country is treated by paragraph 5 as having a source in Australia. It has been necessary, therefore, to propose an ameliatory amendment of the Income Tax (International Agreements) Act. This is to be found in clause 4 of the Bill (proposed sub-section 11S(6)).

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 (as defined in paragraph 3 of the Article) paid or credited 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. The point noted above in relation to the interest source rule of paragraph 5 of Article 11 is also relevant in relation to the royalty "source" rule contained in paragraph 5 of this article.

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

This article allocates between the respective countries taxing rights in relation to income or gains arising from the alienation of real property (as defined in Article 6) and other items of property.

By paragraph 1, income or gains from the alienation of real property may be taxed by the country in which the property is situated. The definition of real property and the situs rules for such property in Article 6 apply for purposes of this paragraph.

Paragraph 2 deals with income or gains arising from the alienation of property (other than real property covered by paragraph 1) forming part of the business property of a permanent establishment of an enterprise or pertaining to a fixed base used for performing independent personal services. It also applies where the permanent establishment (alone or with the whole enterprise) or the fixed base is alienated. Such income or gains may be taxed in the country in which the permanent establishment or fixed base is situated, which corresponds to the rules for business profits and for income from independent personal services contained in Articles 7 and 14.

Paragraph 3 specifies that income or gains from the disposal of ships or aircraft operated in international traffic, or associated property (other than real property covered by paragraph 1) shall be taxable only in the country of residence of the operator of the ships or aircraft. This rule corresponds to the taxing rights contained in Article 8 of this agreement and in the agreement with China relating to airline profits, whereby profits from the operation of ships or aircraft in international traffic are to be taxed only by the country of residence of the ship or aircraft operator.

By paragraph 4 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 covered by paragraph 1 may be taxed in the country in which such assets or principal assets are situated. The paragraph thus assimilates the treatment of the alienation of those shares or comparable interests to the treatment by paragraph 1 of the alienation of that real property.

The article contains a sweep-up paragraph, paragraph 5, which enables each country to tax, according to its domestic law, any gains of a capital nature derived by a resident of the other country from the alienation of any property not specified in paragraphs 1, 2, 3, and 4 of this article. It thus preserves the application of Australia's domestic law rules in relation to the taxation of capital gains as regards the alienation of such property.

As indicated earlier, because the income or gains concerned are dealt with separately by this article,it also applies independently of the "business profits" provisions Article 7. And in the event that the operation of this article should result in an item of income or a gain being subjected to tax in both countries, the country of which the person deriving the income or gain is a resident would be obliged by Article 23 to allow a credit against its own tax for the tax imposed by the other country.

Article 14 - Independent Personal Services

At present, an individual resident in Australia or in China 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. By this article, such income will continue to be subject to tax in the country in which the services are performed in cases where the recipient has a "fixed base" regularly available in that country for the purposes of performing his or her activities and the income is attributable to activities exercised from that base, or where the income is derived during a period or periods exceeding 183 days in any consecutive period of 12 months in which the recipient is present in that country.

The application of that "183 days rule" will necessarily require that regard be had to consecutive periods of 12 months that overlap different Australian income years. Where an assessment is raised for an Australian income year in the case of an individual who is a resident of China and who commenced a visit or visits to Australia during that income year, the "183 day rule" may be applied on the basis of the information provided in the relevant return of income as to the period or periods that the individual was in Australia and is expected to be in Australia during a consecutive period of 12 months.

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 any consecutive period of 12 months; that the remuneration is paid by, or on behalf of, an employer who is not a resident of the country being visited; and 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. Where these conditions are met, the remuneration so derived will be liable to tax in the country of residence. The provisions of this article do not apply, however, in respect of income that is dealt with separately in Articles 16, 18, 19, 20, or 21 of the agreement.

By paragraph 3 of the article, income from an employment exercised aboard a ship or aircraft operated in international traffic is to be taxed only 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 may be taxed in the latter country.

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.

Paragraph 3 provides that income derived by an entertainer visiting one of the countries from his or her activities as an entertainer shall be exempt from tax in that country if the visit is under a plan of cultural exchange between the governments of the two countries.

Article 18 - Pensions

Under this article pensions paid in consideration of past employment (other than government service pensions referred to in paragraph 2 of Article 19) and social security system payments are to be taxed only by the country of residence of the recipient.

Article 19 - Government Service

Paragraph 1 of this article provides that remuneration, other than a pension, paid to an individual in respect of services rendered to a government (including a State or local authority) 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 or national of, or ordinarily resides in, that country.

Paragraph 2 provides that any pension paid by a government (including State or local authority) of one country in respect of services rendered to that government may be taxed only in that country, unless the recipient is a resident of, and a citizen or a national of, the other country, in which case the pension is to be taxed only in the other country.

Paragraph 3 provides, in effect, that paragraphs 1 and 2 do not apply where the services are rendered in connection with a trade or business carried on by a government. In such cases, the provisions of Articles 15, 16, 17 or 18, as the case may be, apply.

Article 20 - Professors and Teachers

This article applies in respect of professors or teachers who are resident in one country and visit the other country for a period of not more than two years for the purpose of teaching or advanced study or research at an educational institutional In these circumstances, the remuneration of the professor or teacher for his or her teaching, study or research work are to be exempt from tax in the country visited provided it is subject to tax in the other country. The exemption provided by the article does not apply to remuneration received for conducting research if the research is undertaken primarily for the private benefit of a specific person or persons.

Article 21 - Students and Trainees

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

By paragraph 2 such students and trainees will receive the same treatment for income tax purposes as residents of the country visited in respect of grants, scholarships and remuneration not covered by paragraph 1. Visiting students and trainees from China will thus be treated for Australian income tax purposes as residents of Australia so far as concerns such grants, scholarships and remuneration.

Article 22 - Other Income

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 to income, other than income from real property as defined in paragraph 2 of Article 6, which is effectively connected with a "permanent establishment" or "fixed base" which a resident of one country has in the other country. In such cases, the provisions of Article 7 or Article 14, as the case may be, will apply.

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 double 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.

Paragraph 2 of the article thus provides for Australia to relieve double taxation by allowing a credit against its own tax for Chinese tax paid under the law of China and in accordance with the agreement on income derived by a resident of Australia from sources in China. (By paragraph 8 of the article, profits, income or gains that are derived by a resident of Australia and subjected to Chinese tax in accordance with the terms of the agreement are deemed to be income derived from sources in China.) Where a dividend is paid by a Chinese resident company to an Australian resident company which controls 10 per cent or more of the voting power in the Chinese company, paragraph 3 provides for the credit allowed by Australia to also take into account, in addition to the Chinese tax paid in respect of the dividends, the underlying Chinese tax paid by the company in respect of the profits out of which the dividend is paid.

Australia's general foreign tax credit system, together with the terms of this article and of the agreement generally, will form the basis of Australia's arrangements for relieving a resident of Australia from double taxation on income arising from sources in China. As in the case of Australia's other double taxation agreements, the source of income rules specified for purposes of the agreement will also apply for those purposes.

Accordingly, effect is to be given to the tax credit relief obligation imposed on Australia by paragraphs 2 and 3 of Article 23 by application of the general foreign tax credit provisions of the Income Tax Assessment Act. This will include the allowance of "underlying" tax credit relief in respect of dividends paid by Chinese resident companies to related Australian companies, including for unlimited tiers of related companies, in accordance with the relevant provisions of the Assessment Act.

Notwithstanding the credit form of relief provided for by paragraph 2 of the article, the "exemption with progression" provisions of section 23AG of the Income Tax Assessment Act will be applicable, as appropriate, in relation to salary and wages and like remuneration derived by a resident of Australia during a continuous period of foreign service in China.

Paragraphs 4, 5, 6 and 7 of Article 23 contains "tax sparing" provisions under which an Australian resident recipient of income on which China - under specified incentive measures - has forgone tax, will obtain tax credit relief as if the Chinese tax forgone had been paid.

Subparagraphs (a),(b),(c),(d),(e) and (f) of paragraph 5 specify the development incentive provisions of China in respect of which the tax sparing provisions of the Article apply. They will also apply in relation to other development incentive provisions that may be introduced by China subsequent to the date of signature of the agreement which the Australian Treasurer and the Commissioner of the State Taxation Administration of China agree from time to time in letters exchanged for that purpose to be of a substantially similar character. Proposed subsection 11S(3) (see notes on clause 4 of the Bill) will provide for particulars of the provisions agreed in such an exchange of letters to be notified by the Treasurer in the Gazette.

Paragraph 6 of the article applies in relation to dividend, interest and royalty income to which Articles 10, 11, and 12 of the agreement apply and which have benefited from an exemption from, or reduction of, Chinese tax on that income in accordance with a development incentive specified in paragraph 5. It effectively provides for tax sparing credit relief to be granted by Australia in relation to that income on the basis of a deemed rate of Chinese tax paid of -

(a) in the case of dividends, 15 per cent of the gross amount of the dividends

(b) in the case of interest, 10 per cent of the gross amount; and

(c) in the case of royalties, 15 per cent of the gross amount, but only where the rate ordinarily levied under China's law (and not under a specified development incentive) is 15 per cent or more.

Where a tax sparing credit is allowable, paragraph (4) has the effect that tax sparing is to be granted on the "direct credit" method and not the "gross-up and credit" method for the purposes of calculating the Australian tax. In other words, there will be no "grossing-up" for Australian tax assessment purposes of the relevant income by the amount of Chinese tax forgone. For example, in the case of income received from China in respect of which Chinese tax has been wholly forgone, the amount included in assessable income in Australia will be the amount received, and a credit will be granted for the Chinese tax forgone.

By reason of paragraph 7, the tax sparing provisions of the article are to apply in relation to income derived in any of the first ten years of income to which the agreement has effect unless Australia and China agree to extend them beyond that period. Proposed subsection 11S(4) (see notes on clause 4 of the Bill) will provide for any such extension to be notified by the Treasurer in the Gazette.

For its part China will, broadly, allow a credit to Chinese residents in respect of taxes payable in Australia in accordance with the agreement on their Australian source income, against the Chinese tax payable on that income. Where a dividend is paid by an Australian resident company to a Chinese resident company which owns not less than 10 per cent of the shares in the Australian company, the credit allowed by China shall also take into account, in addition to the Australian tax paid in respect of the dividends, the underlying Australian tax paid by the company in respect of the profits out of which the dividend is paid.

The tax credit relief provisions of Article 23, including the tax sparing relief provisions, reflect the fact that they were negotiated on the basis of the existing Australian and Chinese income tax laws. It is relevant, however, that changes already foreshadowed by the Australian Government to the basis of taxing foreign income of Australian residents may lead to changes to the unilateral double tax relief provisions of Australia's domestic law. If, as has been indicated, certain dividends and branch income derived by Australian residents from China should generally qualify in the future for exemption from Australian tax, that general exemption would normally be expected to be made available in respect of such income in lieu of the tax credit and tax sparing relief provisions of Article 23 of the agreement.

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 double 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 certain fiscal privileges under the Diplomatic (Privileges and Immunities) Act and the Consular (Privileges and Immunities) Act.

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 China 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 taxes in respect of income derived on or after 1 July in the calendar year next following that in which the agreement enters into force. In respect of tax other than withholding tax, the agreement will have effect in Australia in relation to income of any year of income beginning on or after 1 July in the calendar year following that in which it 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 China, the agreement will first have effect in relation to Chinese taxes which are levied for the taxable year beginning on 1 January in the calendar year following that in which the agreement enters into force.

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 purposes of withholding tax in respect of income derived on or after 1 July in the calendar year next following that in which the notice of termination is given. For other Australian taxes, it would cease to be effective 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 China in relation to income of any taxable year beginning on or after 1 January next following that in which the notice of termination is given.

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