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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

INCOME TAX (INTERNATIONAL AGREEMENTS) AMENDMENT BILL 1991

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,

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

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A. GENERAL OUTLINE

What will the Bill do?

- The Bill will amend the Income Tax (International Agreements) Act 1953 to give the force of law in Australia to two comprehensive agreements for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. The respective agreements cover the various forms of income flows between Australia and Hungary and Australia and Kiribati.

Who will be affected by the agreements in the Bill?

- Any taxpayers who, for the purposes of either agreement, are residents of one of the two countries party to that agreement and who derive income, profits or gains from the other country that is a party to that agreement.

The financial impact of the Bill

- The operation of the agreements contained in this Bill is not expected to have a significant effect on revenue.

B. INTRODUCTION

What do we mean by double taxation?

- Australia's double taxation agreements (DTAs) are primarily concerned with relieving juridical double taxation, which can be described broadly as subjecting the same income derived by a taxpayer during the same period of time to comparable taxes under the taxation laws of two different countries.

Why are DTA's necessary?

. Relief from double taxation is desirable because of the harmful effects it can have on the expansion of trade and the movement of capital and people between countries. A DTA supplements the unilateral double tax relief provisions in the respective countries domestic laws and clarifies the taxation position of income flows between them.

What is the purpose of Australia's DTAs?

. Australia's DTAs are designed to:

(A) PREVENT DOUBLE TAXATION AND PROVIDE A LEVEL OF SECURITY ABOUT THE TAX RULES THAT WILL APPLY TO PARTICULAR INTERNATIONAL TRANSACTIONS BY:-

- allocating taxing rights between the contracting countries over different categories of income;
- specifying rules to resolve dual claims in relation to the residential status of a taxpayer and the source of income; and
- providing, where a taxpayer considers that taxation treatment has not been in accordance with the terms of a DTA, an avenue for the taxpayer to present a case for determination to the relevant taxation authorities.

(B) PREVENT AVOIDANCE AND EVASION OF TAXES ON VARIOUS FORMS OF INCOME FLOWS BETWEEN THE TREATY PARTNERS BY:

- providing for the allocation of profits between related parties on an "arm's length" basis;

What is the purpose of Australia's DTAs? - continued

- generally preserving application of domestic law rules that are designed to address transfer pricing and other international avoidance practices; and
- providing for exchanges of information between the respective tax authorities.

How is the legislation structured?

- DTAs to which Australia is a partner appear as Schedules to the Income Tax (International Agreements) Act 1953 (IT(IA)A). That Act gives the force of law in Australia to those DTAs. The provisions of the IT(IA)A are incorporated into and read as one with the Income Tax Assessment Act 1936 (ITAA). In any cases of inconsistency, the IT(IA)A provisions (including the terms of the DTAs) generally override the ITAA provisions.

C. MAIN FEATURES OF THE NEW DTAs

Under the terms of the DTAs with Hungary and Kiribati:

Income from real property

- may be taxed in full by the country in which the property is situated. Income from real property includes natural resource royalties.

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:		
(A) Ships	.	may be taxed only in the country of residence of the operator in the case of the DTA with Hungary. Such profits may be taxed by both the country of residence of the operator and the other country (with the other country reducing its tax on those profits by one half) in the case of the DTA with Kiribati.
(B) Aircraft	.	may be taxed only in the country of residence of the operator.
(C) Road Transport Vehicles	.	may be taxed only in the country of residence of the operator in the case of the DTA with Hungary.
Dividends, interest and royalties	.	may generally be taxed in both countries, but there are general limits on the tax that the source country may charge on dividends flowing to residents of the other country. These limits are, in the case of the DTA with Hungary, 15 per cent for dividends and 10 per cent for interest and royalties. In the case of the DTA with Kiribati, the limits are 20 per cent for dividends, 15 per cent for royalties and 10 per cent for interest.
Income, profits or gains from the alienation of property	.	income, profits 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, remuneration derived by a resident of one country in respect of professional services rendered in the other country may, in certain circumstances, be taxed in the latter country if it is derived through a fixed base there of the person concerned.
Income from dependent personal services	. that is, employee's 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 subject to tax in the country of residence, the income will be generally exempt in the country visited.
Government officials remuneration	. will generally be taxed only in the country for which government services are rendered.
Directors' fees and similar payments	. may be taxed in the country of residence of the paying company.
Income derived by public entertainers	. may be taxed by the country in which the activities are performed.
Pensions and annuities	. (including government service pensions) may be taxed only in the country of residence of the recipient.
Income of visiting students and trainees	. will be exempt from tax in the country visited so far as concerns payments made from abroad for the purposes of their maintenance, education or training.

Income of visiting professors and teachers	. under the DTA with Hungary, remuneration derived during a visit to the other treaty party country of up to two years duration for the sole purpose of teaching or carrying out advance study or research at an educational institution will generally be taxed only in the country of residence of the recipient.
Profits of associated enterprises	. may be taxed on the basis of dealings at arm's length.
Exchange of information and consultation	. the respective DTAs authorise the exchange of information and consultation between the relevant taxation authorities.
Dual residents	. i.e., for each agreement, persons (including companies) - who are residents of both Australia and the other country according to the domestic law of each country, are, in accordance with specified criteria, to be treated for the purposes of the agreement, as being residents of only one country.
Source rules	. are prescribed in each agreement to the effect that income, profits or gains derived by a resident of one country which, under the agreement may be taxed in the other country, shall be treated as being sourced in the latter country.
Double taxation relief for income taxable by both countries	. is to be provided by the country of residence under each agreement as follows:-
	- <u>in Australia</u>, by allowance of a credit against Australian tax on income, profits or gains derived by a resident of Australia from sources in the other country. In the case of a dividend payment from a

Double taxation relief for income taxable by both countries - continued

company resident in the other country 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.

- tax sparing credit relief is to be provided by Australia in relation to income derived by a resident of Australia from Kiribati which has benefited from certain development incentives provided by Kiribati. Australia will provide 'tax sparing' by granting a credit against the Australian tax payable in respect of that income for the Kiribati tax forgone under those development incentives as if that tax had been paid.

- in Hungary under the terms of that particular DTA, Hungary will generally allow an exemption from Hungarian tax on income or gains derived by a resident of Hungary from sources in Australia. With dividends, however, double tax relief will be provided by the allowance of a credit against Hungarian tax for the Australian tax paid.

- in Kiribati under the terms of that particular DTA, Kiribati will generally allow a credit against Kiribati tax for the Australian tax paid on income, profits or gains derived by residents of Kiribati from sources in Australia.

D. THE STRUCTURE OF THE BILL

In what way does the Bill change the Act?

. The Bill will make the following changes to the Income Tax (International Agreements) Act 1953:

. it will insert in subsection 3(1) definitions of "the Hungarian agreement" and "the Kiribati agreement" and insert new sections 11X and 11Y which will give the force of law in Australia to those agreements.

. it will add the text of each agreement as Schedules 33 and 34 respectively.

When will these changes take place?

. each DTA will enter into force on the date of exchange of diplomatic notes between Australia and the respective treaty partner country. Such diplomatic notes will formally advise that all the requirements necessary to give the DTAs the force of law in each country have been finalised.

When the agreements enter into force from what date will they have effect?

. The DTA with Hungary will have effect :

- <u>in Australia</u>, for withholding tax purposes, in respect of income derived on or after 1 July in the calendar year next following the calendar year during which the agreement enters into force; and for other Australian taxes in respect of income, profits or gains of any year of income beginning on or after 1 July in the calendar year next following the calendar year in which the agreement enters into force.

- <u>in Hungary</u>, for all Hungarian taxes (including tax withheld at source) in respect of income, profits or gains of taxable years

When the agreements enter into force from what date will they have effect? - continued

beginning on or after January in the calendar year following the year in which the agreement enters into force.

- The DTA with Kiribati will have effect :

  - <u>in Australia</u>, for withholding tax purposes, in respect of income derived on or after 1 July next following the date on which the agreement enters into force; and for other Australian taxes, in respect of income, profits or gains of any year of income beginning on or after 1 July next following that in which the agreement enters into force.

  - <u>in Kiribati</u>, for all Kiribati taxes in respect of income, profits or gains of any tax year beginning on or after 1 January next following the date in which the agreement enters into force.

E. DETAILED NOTES ON CLAUSES

An explanation of the various articles of each double taxation agreement follows.

AGREEMENT WITH HUNGARY

Subject to some differences, the comprehensive agreement accords in substantial practical effect with other comprehensive double taxation agreements to which Australia is a party. Like them, the agreement allocates a taxing right over some income or gains 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 or gains. It provides that where income or gains may be taxed in both countries, the country of residence, if it taxes, is to allow double tax relief for the tax imposed by the country of source. In the case of Australia, effect is given to the double taxation relief obligations arising under the double taxation agreement by application of the general foreign tax credit system provisions of Australia's domestic law, or relevant exemption provisions of the law where applicable.

Article 1 - Personal Scope

This article establishes the scope of application of the agreement, by providing for it to apply to persons (which term includes companies) who are residents of one or both countries.

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 petroleum resource rent tax in respect of offshore projects. For Hungary, its income tax on individuals and profit taxes are specified.

Paragraph 2 of 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.

Paragraph 3 makes it clear that, for the purposes of the agreement, the terms "Australian tax" and "Hungarian tax" do not include any amount of penalty or interest imposed by the operation of the respective domestic laws of Australia or Hungary.

This is of particular relevance in determining a taxpayer's entitlement under the double tax relief provisions of Article 24 of the agreement. In the case of a resident of Australia, any such penalty or interest component of a liability determined under the domestic taxation laws of Hungary with respect to income that Hungary is entitled to tax under the agreement would not be a creditable "Hungarian tax" for purposes of Article 24(2) of the agreement. This result accords with the meaning of "foreign tax" in subsection 6AB(2) of the ITAA . Accordingly, such a penalty or interest liability would be excluded from calculations when determining the Australian resident taxpayer's foreign tax credit entitlement under Article 24(2), pursuant to Division 18 of Part III of the ITAA.

Article 3 - General Definitions

Paragraph 1 of 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. Paragraph 2 of this article provides that where a term is not specifically defined within the agreement that term, unless used in a context that requires otherwise, is to be taken to have the same interpretative meaning ascribed that particular term under the domestic law from time to time in force of the country applying the agreement. The effect of the inclusion in this paragraph of the expression "from time to time in force" is to clarify that a term not defined in the agreement is to be given the meaning it has under that country's domestic law at the time of application of the agreement. This is designed to obviate the need for research into the meaning such a term had when the agreement was negotiated.

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 fully preserves the taxing rights effectively provided by section 6AA of the ITAA in relation to mineral exploration and mining activities carried on by non-residents on the seabed and subsoil of the continental shelf areas to which section 6AA applies. The definition is also relevant to the taxation by Australia of shipping profits in accordance with Article 8 of the agreement.

Article 4 - Residence

This article sets out the basis by 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. The concept of resident according to each country's taxation law provides the basic test.

The article also includes a set of "tie-breaker" 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 - qualifies as a dual resident, i.e., as a resident under the domestic laws of both countries.

A dual resident, for example, who is deemed by Article 4 to be a resident solely of Hungary would be entitled to any exemption from, or reduction in, Australian tax provided by an article of the agreement in respect of income derived from sources in Australia by a resident of Hungary. For the categories of income which under the agreement remain taxable in both countries, the obligation placed by Article 24 on the country of residence of the recipient of the income to provide double tax relief would in that example rest with Hungary.

Dual residents remain, however, in relation to each country a resident of that country for the purposes of its domestic law and subject to its tax as such so far as the agreement allows. Attention is drawn, however, to Article 22 (Income Not Expressly Mentioned) which would operate in relation to the dual resident referred to above as if that person were a resident of Hungary and thus preclude Australia from taxing items of income not expressly dealt with by another article of the agreement where the income is derived from sources in Hungary, or items of income derived from sources in a third country. Paragraph 5 of Article 13 would, however, preserve the application of Australia's capital gains tax rules in relation to gains to which that paragraph applied on the basis that the dual resident remains a resident of Australia for those purposes.

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 or production through which the activities of an enterprise are 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, 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. Those paragraphs generally correspond with the comparable paragraphs of Australia's existing double taxation agreements.

Article 6 - Income from Real Property

By this article, income from real property, including the 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 or rights in relation thereto, 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.

Paragraph 4 makes it clear that the operational effects of paragraphs 1 and 3 of the article extend to income derived from the use or exploitation of real property of an enterprise and income derived from real property that is used for the performance of independent professional services. Accordingly, application of this article, when read with Articles 7 and 14, to such income effectively ensures that the treaty partner country in which the real property is situated may impose tax on the income derived from that property by an enterprise of the other country or independent professional person resident in that other country irrespective of whether or not that income is attributable to a "permanent establishment" of such an enterprise, or fixed base of such a person, situated in the first mentioned country.

Ships and aircraft are specifically excluded from the scope of this article because the treatment of profits arising from their operation is to be determined in accordance with Article 8.

Article 7 - Business Profits

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

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

Paragraphs 2 and 3 of the article, provide 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.

Paragraph 4 provides that no profits are to be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for that enterprise. Subparagraph (b) of paragraph 3 of Article 5 provides that an enterprise shall not be deemed to have a permanent establishment merely by reason of that activity alone. This paragraph complements that provision and is concerned with a permanent establishment which, although carrying on certain business activities in its own right, also undertakes purchasing of goods or merchandise for its head office. Paragraph 4 is designed to make it clear that the profits of the permanent establishment derived from the business activities carried on in its own right will not be increased by adding to them any amount in respect of profits attributable to the purchasing activities undertaken for the head office. It follows, of course, that any expenses incurred by the permanent establishment in respect of those purchasing activities will not be deductible in determining the taxable profits of the permanent establishment.

Paragraph 5 of the article allows for 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 6 effectively provides that where income is otherwise specifically dealt with under other articles of the agreement the operational effect of those particular articles is not overridden by Article 7. The paragraph thus specifies a general rule of interpretation to the effect that categories of income that are the subject of other articles of the agreement are to be treated in accordance with the terms of those articles and as outside the scope of this article except where otherwise provided, e.g. by paragraph 4 of Article 10 (see the notes below on that paragraph).

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 provided that if the relevant law in force in either Contracting State at the date of signature of this agreement is varied (otherwise than in minor respects so as not to affect its general character) the Contracting States shall consult with a view to agreeing to any amendment of this paragraph that may be appropriate. This paragraph preserves in the case of Australia the application of Division 15 of Part III of the ITAA .

Paragraph 9 is intended to ensure that the principles of the article will apply in relation to business profits derived (indirectly) by a resident of one of the Contracting States, as a beneficiary of a trust estate. In the case of Australia, for example, it clarifies Australia's right to tax in accordance with this article 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 through a permanent establishment in Australia, to which a resident of Hungary is beneficially entitled under the trust estate. 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 subsection 3(11) of the IT(IA)A, which has a similar effect where a beneficiary of a trust is a resident of a country with which Australia had signed a double taxation agreement on or before 19 August 1984.

Article 8 - Ships, Aircraft and Road Transport Vehicles

Under this article the right to tax profits from the operation of ships, aircraft or road transport vehicles, 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. It is not usual Australian tax treaty practice to bring profits from the operation of road transport vehicles within the scope of this article but an exception was made on this occasion because of the volume of road transport vehicle operations between Hungary and adjacent countries.

Nevertheless, any profits derived by a resident of one country from internal traffic in the other country (i.e. from operations confined solely to places in the other country) may be taxed in that other country. Paragraph 4 of the article defines the scope of "operations confined solely to places in one 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, sea or road transport from a place in Australia (including the continental shelf areas and external territories covered by the definition of "Australia") to another place in Australia, are treated as forming part of internal traffic. Accordingly, profits derived, for example, from a shipment of goods taken on board, during the course of an international voyage, at Fremantle for delivery to Sydney would be profits from internal traffic and would fall within the scope of section 129 of the ITAA. As such 5 per cent of the profit derived from internal traffic would be deemed to be taxable income of the operator for Australian tax purposes.

Article 9 - Associated Enterprises

This article authorises the re-allocation of profits between related enterprises in Australia and Hungary 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 wholly at arm's length with one another. The article does not however authorise the re-writing of accounts of associated enterprises where it can be satisfactorily demonstrated that the transactions between such enterprises have taken place broadly on normal open market commercial terms.

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. To avoid this result, paragraph 3 requires the other country concerned to make an appropriate compensatory adjustment to the amount of tax charged on the profits involved with a view to relieving any such double taxation.

It would generally be necessary for the affected enterprise to make application to the competent authority of the country not initiating the re-allocation of profits for an appropriate compensatory adjustment to be made to reflect the re-allocation of profits made by the competent authority of the other treaty partner country.

Article 10 - Dividends

This article broadly 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 by companies that are residents of that country under its domestic law 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 Hungary 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. The rate of withholding tax to be imposed by Hungary on outgoing dividends is also limited to 15 per cent.

Paragraph 4 provides that the limitation provided by paragraph 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, the paragraph provides for them to be treated as "business profits" or "income from independent personal services" and subject to the source country's tax on an assessment basis in accordance with the provisions of Article 7 or Article 14, as the case may be. In practice, however, 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 at the rate of 15 per cent instead of being taxed by assessment.

The purpose of paragraph 5 of this article is to preclude the extra-territorial application by either country of taxing rights over dividend income by providing, 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 of interest income to generally limit its tax to 10 per cent of the gross amount of the interest where a resident of the other country is the beneficial owner of the interest. This source country tax rate limitation accords with the general rate of interest withholding tax applicable under Australia's domestic law.

Paragraph 3 defines the term "interest" for the purposes of the article in a way that 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 domestic 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 source country tax rate limitation is not to apply to such interest.

The interest "source" rules set out in paragraph 5 accord with the scheme of the interest withholding tax provisions of Australia's domestic law. Those rules operate to allow Australia to tax interest to which a resident of Hungary is beneficially entitled where the interest is paid by a resident of Australia and is not an expense of a business carried on by the Australian resident through a permanent establishment in a country outside Australia. Australia may also tax interest paid by a resident of Hungary to which another Hungarian resident is beneficially entitled if it is an expense incurred by the payer of the interest in carrying on a business in Australia through a permanent establishment.

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 source country tax rate 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.

Paragraph 7 formally provides for certain interest income that would normally qualify for exemption from taxation in the country in which it is derived under the international doctrine of sovereign immunity to be treated as exempt from tax in that country.

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 definition of royalties contained in paragraph 3 is consistent with the definition of royalties in subsection 6(1) of the ITAA and in Australia's other modern comprehensive tax treaties.

The 10 per cent source country tax rate 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 interest income, it is specified in paragraph 4 that the 10 per cent source country tax rate limitation is not to apply to royalties effectively connected with a "permanent establishment" or "fixed base" in that country. The royalties "source" rule in paragraph 5 effectively corresponds in the case of Australia with the deemed source rule contained in section 6C of the ITAA for royalties paid to non-residents of Australia. It broadly mirrors the "source" rule for interest income contained in paragraph 5 of Article 11.

By paragraph 6, if royalties flow between related persons, the 10 per cent source country tax rate 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 the 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 assets 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 respectively.

Paragraph 3 specifies that income or gains from the disposal of ships, aircraft or road transport vehicles 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, aircraft or road transport vehicles. This rule corresponds to the taxing rule contained in Article 8 in relation to profits from the operation of ships, aircraft or road transport vehicles in international traffic.

Paragraph 4 assimilates the treatment of 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, to the treatment by paragraph 1 of the alienation of that real property.

The article contains a sweep-up paragraph, paragraph 5, <u>in relation to capital gains</u> which enables each country to tax, according to its domestic law, any gains of a capital nature derived by its own residents or by a resident of the other country from the alienation of any property not specified in the preceeding paragraphs of the article. It thus ensures the application of Australia's domestic law rules in relation to the taxation of capital gains as regards the alienation of such property.

Paragraph 5 of this article operates independently of Article 22, which contains sweep-up provisions in relation to <u>items of income</u> not expressly dealt with in other articles of the agreement.

As indicated generally earlier, income or gains from the alienation of property that fall within the scope of this article are not affected by the "business profits" provisions of Article 7. 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, as determined in accordance with Article 4, would be obliged by Article 24 to provide double tax relief for the tax imposed by the other country.

<u>Article 14 - Independent Personal Services</u>

At present, an individual resident in Australia or in Hungary 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.

If the above test is not met, the article requires that the income 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 generally provides the basis upon which the remuneration of visiting employees is to be taxed. The provisions of this article do not apply, however, in respect of income that is dealt with separately in Articles 16 (Directors' Fees), 18 (Pensions and Annuities), 19 (Government Service), 20 (Professors and Teachers), or 21 (Students and Trainees) of the agreement.

Generally, salaries, wages, etc., derived by a resident of one country from an employment exercised in the other country may 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 certain visits of a short-term nature are involved.

The conditions for this exemption are that the visit or visits not exceed, in the aggregate, 183 days in the year of income 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; and that the remuneration is not borne by (in the sense 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 all of these conditions are met, the remuneration so derived will be liable to tax only in the country of residence of the recipient.

By paragraph 3 of the article, income from an employment exercised aboard a ship, aircraft or road transport vehicle operated in international traffic may be taxed in the country of residence of the operator if the domestic law of that country allows this.

Where the short-term visit exemption is not applicable, remuneration derived by a resident of Australia from an employment exercised in Hungary may be subject to tax in Hungary. However, the article does not allocate sole taxing rights to Hungary in that situation.

Accordingly, Australia would also be entitled to tax that remuneration in accordance with the general rule of the ITAA that a resident of Australia remains subject to tax on worldwide income. In common, however, with other situations where the agreement allows both countries to tax a category of income, Australia would be required in this situation (pursuant to Article 24(2)), as the country of residence of the income recipient, to relieve the double taxation that would otherwise occur.

Although that paragraph provides for the double tax relief to be provided by Australia to be in the form of the grant of a credit against the Australian tax for the Hungarian tax paid, the "exemption with progression" provisions of section 23AG of the ITAA could be expected to operate in practice, so far as they are relevant, to provide double tax relief in relation to the employment income derived in the situation described.

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 and Athletes

By this article, income derived by visiting entertainers (including athletes) from their personal activities as such will generally continue to be taxed in the country in which the activities are exercised, irrespective of the duration of the visit. It is considered that the words "income derived by entertainers ....from their personal activities as such..." extend the application of this article to income generated from promotional and associated kinds of activities engaged in by the entertainer while present in the visited country.

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 excludes from the scope of this article income derived from activities performed by a non-profit organisation or an entertainer (including an athlete) if the visit to the source country is substantially supported by public funds and the activities are not performed for the purpose of profit. This provision is included to facilitate cultural and sporting exchanges between the two countries. Should paragraph 3 be applicable, the provisions of Article 14 or Article 15 may apply to the income depending upon the nature of the activity.

Article 18 - Pensions and Annuities

Paragraph 1 of this article ensures that pensions (including government pensions) and annuities are taxed only by the country of residence of the recipient.

It is intended that the operation of this article extend to pension and annuity payments made to dependants, for example the widow or children, of the person in respect of whom the pension or annuity entitlement accrued where upon that person's death, such an entitlement has passed to that person's dependants.

Article 19 - Government Service

Paragraph 1 of this article provides for remuneration, other than a pension or annuity, that is, salary and wage type income, paid to an individual in respect of services rendered to a government (including a State or local authority) of one of the countries to 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 other country and the recipient is a resident of that country as determined in accordance with Article 4 and is a citizen or ordinarily resides in that country.

Paragraph 2 effectively precludes from the scope of this article remuneration of this type for services rendered in connection with a trade or business carried on by a government, which will remain subject to the provisions of Article 15 (Dependent Personal Services) or Article 16 (Directors' Fees), as the case may be.

Article 20 - Professors and Teachers

This article applies in respect of professors or teachers who are resident in one country and visit, for example during sabbatical leave, 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 institution. In these circumstances, the remuneration received by the professor or teacher for that teaching, study or research work are to be exempt from tax in the country visited provided it is, or upon the application of this article will be, subject to tax in the country of residence. In the latter respect, the application of this article to exempt from Hungarian tax remuneration derived by an Australian resident teacher visiting Hungary will operate to cause the remuneration to be excluded from the scope of the "exemption with progression" provisions of section 23AG of the ITAA, so that it will remain subject to Australian tax.

The exemption provided by the article does not however apply to remuneration received for conducting research if the research is undertaken primarily for the private benefit of a specific person or persons. For example, where a professor or teacher who is a resident of one country receives a grant or is otherwise paid by an enterprise to undertake, in the other country, work associated with the refinement and further development of a particular product that is to be commercially marketed by that organisation, the income so received by the professor or teacher will not fall within the operational scope of this article but will come within the ambit of either Article 14 or Article 15.

Article 21 - Students and Trainees

This article applies to students and trainees temporarily present in one of the treaty partner countries 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 or 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 (even though they may qualify as a resident of the country visited during the period of their visit). The exemption from tax provided by the visited country is treated as extending to maintenance payments received by the student or trainee that are made in respect of the maintenance of dependant family members who have accompanied the student or trainee to the visited country.

Where however, a student or trainee from Hungary who is visiting Australia solely for educational or training purposes undertakes some part time work (for example, working at night in a restaurant) with a local employer or, during a semester break undertakes work with a local employer, the income earned by that student or trainee as a consequence of that employment may, as provided in Article 15, be subject to tax in Australia. In this situation the payments received from abroad for the purposes of the student's or trainee's maintenance or education will not however be taken into account in determining the tax payable on the employment income that is subject to tax in Australia.

Taxation Ruling No. IT 2268 sets out general guidelines relating to the residential status for Australian tax purposes of overseas students studying in Australia and will generally be relevant to the application of Australian tax in relation to income derived by visiting students and trainees that are not exempted from Australian tax by reason of an article of this type in a double taxation agreement.

Article 22 - Income Not Expressly Mentioned

This article provides rules for the allocation between the two countries of taxing rights in relation to items of income, wherever arising, not expressly mentioned in the preceding articles of the agreement. The scope of the article is not confined to items of income arising in one of the contracting countries expressly dealt with in another article of the agreement; it extends also to income from third States.

Broadly, such income derived by a resident of one country is to be taxed only by that country unless it is derived from sources in the other country, in which case the income may also be taxed in the other country. Where this occurs, the country of residence of the recipient of the income would be obliged by Article 24 to provide double taxation relief.

It should be noted that this article effectively contains "sweep-up" provisions in relation to items of income not expressly dealt with in other articles of the agreement and that paragraph 5 of Article 13 effectively "sweeps-up" capital gains not dealt with otherwise in Article 13.

Paragraph 2 of the article ensures the application of Article 7 or Article 14, as the case may be, in respect of income which is effectively connected with a "permanent establishment" or "fixed base" which a resident of one country has in the other country.

Article 23 - Source of Income

Article 23 effectively deems income, profit or gains derived by a resident of one country which, under the agreement, may be taxed in the other country to have a source in the latter country for the purposes of Article 24 and the domestic income tax laws of the respective countries. It thus ensures the jurisdictional right of each country to exercise the taxing rights allocated to it by the agreement over residents of the other country. It is also designed to ensure that where an item of income, profit or gains is taxable also by the country of residence of the recipient, double taxation relief will be given by that country (pursuant to Article 24) in respect of tax levied by the other country in accordance with the taxing rights allocated to it under the agreement. The provision resolves any conflict in domestic law source rules and thus obviates any question of income, profit or gains not having, by domestic law rules, a source in the country that is, by the agreement, entitled to tax that income, profit or gains in the hands of a resident of the other country.

Article 24 - 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 remain under the agreement 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 article also reflects that approach.

Subparagraph 1(a) of the article provides for Hungary to grant an exemption from Hungarian tax on income or gains (other than dividends) derived by a resident of Hungary which, under the terms of the agreement, may be taxed in Australia. In regard to dividends, subparagraph 1(b) provides that double tax relief is to be granted by Hungary by allowing a credit against its own tax for Australian tax paid on the dividends.

Subparagraph 2(a) of the article provides for Australia to relieve double taxation by allowing a credit against its own tax for Hungarian tax paid under the law of Hungary and in accordance with the agreement on income derived by a resident of Australia from sources in Hungary. Where a dividend is paid by a Hungarian resident company to an Australian resident company which controls 10 per cent or more of the voting power in the Hungarian company, subparagraph 2(b) provides for the credit allowed by Australia to also take into account, in addition to the Hungarian tax paid in respect of the dividends, the underlying Hungarian 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 thus form the basis of Australia's arrangements for relieving a resident of Australia from double taxation on income arising from sources in Hungary. 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 subparagraphs 2(a) and (b) of Article 24 by application of the general foreign tax credit provisions (Division 18 of Part III) of the ITAA. This will include the allowance of "underlying" tax credit relief in respect of dividends paid by Hungarian resident companies that are related to Australian companies, including for unlimited tiers of related companies, in accordance with the relevant provisions of the ITAA.

Notwithstanding the credit form of relief provided for by subparagraph (a) of paragraph 2 of the article, the "exemption with progression" provisions of section 23AG of the ITAA will continue to 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 Hungary. Likewise, dividends and branch profits derived from Hungary which are exempted from Australian tax where derived by an Australian company under measures related to the introduction in Australia of the foreign income accruals system (eg, sections 23AH or 23AJ of the ITAA) will continue to qualify for exemption from Australian tax under those provisions.

Article 25 - 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 person is able to demonstrate actual or potential imposition of taxation contrary to the provisions of the agreement. A person wishing to use this procedure must present a case to the competent authority of the State of which the person is a resident within three years of the first notification of the action the taxpayer considers gives rise to taxation not in accordance with the agreement. 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. In cases which are not provided for, the competent authorities may also consult to identify appropriate ways by which double taxation may be eliminated through amendment of the agreement.

Article 26 - Exchange of Information

This article authorises and limits the exchange of information by the two taxation authorities to information that is necessary for the carrying out of the agreement or for the administration of domestic laws concerning the taxes to which the agreement applies. The limitation placed on the kind of information authorised to be exchanged effectively means that information access requests relating to taxes not within the coverage provided by Article 2, for example sales taxes, do not have to be complied with.

The purposes for which the exchanged 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. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State.

An 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 also specifically not permitted by the article.

Article 27 - 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, for example, to certain fiscal privileges under the Diplomatic (Privileges and Immunities) Act 1967 and the Consular (Privileges and Immunities) Act 1972.

Article 28 - 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 Hungary as is necessary to give the agreement the force of law in both countries. In the case of Australia the enactment of the legislation which gives the force of law in Australia to the agreement is the necessary prerequisite to the exchange of diplomatic Notes taking place.

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 first have effect in Australia in relation to profits, income or gains of the Australian 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, profits, income, or gains derived on or after the beginning of the accounting period that has been substituted for the year beginning on 1 July in the calendar year following the calendar year in which the agreement enters into force will be subject to the agreement for purposes of Australian tax other than withholding tax.

In Hungary, the agreement will first have effect in relation to Hungarian withholding tax for income derived on or after 1 January in the calendar year following that in which the agreement enters into force. For other Hungarian tax, it will first have effect in relation to profits, income or gains of its year of income beginning on 1 January in the calendar year following that in which the agreement enters into force.

Article 29 - 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 profits, income or gains 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 correspondingly cease to be effective in Hungary in relation to withholding tax on income derived on or after 1 January in the calendar year subsequent to that in which the notice of termination is given, and in respect of other Hungarian tax in relation to income of any year of income beginning on or after 1 January next following that in which the notice of termination is given.

AGREEMENT WITH KIRIBATI

The double taxation agreement with Kiribati accords in substantial practical effect with Australia's other double taxation agreements with regional developing countries. 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 also allocates to the respective countries taxing rights in relation to certain gains. It provides that where income, profit or gains 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. In the case of Australia, effect is generally given to this double tax credit relief obligation by application of the general foreign tax credit system provisions of Australia's domestic law, or relevant exemption provisions of the law where applicable. This agreement contains some "tax sparing" provisions, whereby Australia will recognise for foreign tax credit purposes tax forgone by Kiribati under certain of its pioneer industry development incentives.

Article 1 - Personal Scope

This article establishes the scope of the application of the agreement, by providing for it to apply to persons (which term includes companies) who are residents of one or both countries.

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 of each country to which the agreement applies. These are, in the case of Australia, the Australian income tax and the resource rent tax in respect of offshore petroleum projects. Inclusion in the article of the words "imposed under the federal law of Australia" makes it clear that the agreement only applies to federal taxes and does not apply to any taxes or charges levied by a State or Territory Government. For Kiribati, its income tax is specified.

Paragraph 2 of 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.

Paragraph 2 also imposes a duty on Australia and Kiribati to notify each other within a reasonable period of time of any substantial changes to their respective laws to which the agreement applies.

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.

As with Australia's other modern taxation agreements, "Australia" is effectively defined in paragraph 1 as including certain external territories and areas of the continental shelf. By reason of this definition, Australia fully preserves the taxing rights effectively provided by section 6AA of the ITAA in relation to mineral exploration and mining activities carried on by non-residents on its continental shelf areas. The definition is also relevant to the taxation by Australia of shipping profits in accordance with Article 8 of the agreement.

"Kiribati" is also defined in a way that will encompass in a geographical sense areas adjacent to the islands forming the Republic of Kiribati which have been, or may in the future be, recognised under international law and designated under the laws of Kiribati as areas over which the Republic has sovereignty, sovereign rights or jurisdiction in relation to, for example, fishing activities or other activities relating to the exploration for and exploitation of the resources of the sea, the seabed and its subsoil.

The term "tax" means "Australian tax" or "Kiribati tax" as required but is specifically defined not to include any amount of penalty or interest imposed by the operation of the respective domestic laws of Australia or Kiribati.

This is of particular relevance in determining a taxpayer's entitlement under the double taxation relief provisions of Article 23 of the agreement. In the case of a resident of Australia, any such penalty or interest component of a liability determined under the domestic taxation laws of Kiribati with respect to income that Kiribati is entitled to tax under the agreement would not be a creditable "Kiribati tax" for the purposes of Article 23(2) of the agreement. This result is consistent with the meaning of "foreign tax" in subsection 6AB(2) of the ITAA. Accordingly, such a penalty or interest liability would be excluded from calculations when determining the Australian resident taxpayer's foreign tax credit entitlement under Article 23(2), pursuant to Division 18 of Part III of the ITAA.

Paragraph 2 of this article addresses terms that are not specifically defined within the agreement. It provides that such a term, unless used in a context that requires otherwise, is to be taken to have the same interpretative meaning ascribed that particular term under the domestic law from time to time in force of the country applying the agreement. The effect of the inclusion in this paragraph of the expression "from time to time in force" is to clarify that a term not defined in the agreement is to be given the meaning it has under that country's domestic law at the time of application 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. The concept of resident according to each country's taxation law provides the basic test.

The article, specifically paragraphs 3 and 4, provide a set of "tie-breaker" 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 - qualifies as a dual resident, i.e., as a resident under the domestic laws of both countries.

A dual resident, for example, who is deemed by Article 4 to be a resident solely of Kiribati would be entitled to any exemption from, or reduction in, Australian tax provided by an Article of the agreement in respect of income derived from sources in Australia by a resident of Kiribati. For the categories of income which under the agreement remain taxable in both countries, the obligation placed by Article 23 on the country of residence of the recipient of the income to provide double tax relief would in that example rest with Kiribati.

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 attributable to or 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. The other paragraphs of the article generally correspond with comparable paragraphs included in double taxation agreements concluded earlier by Australia. They are concerned with elaborating on the meaning of the term by giving examples (by no means intended to be exhaustive) of what may constitute a "permanent establishment" - such as an office, a mine, an agricultural, pastoral or forestry property, or a building site or construction, installation or assembly project which lasts more than 90 days - 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.

As with certain other recently concluded tax treaties, the article, specifically subparagraph 4(b), provides that the furnishing, by an enterprise of one country, of services including consultancy, management or administrative 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 90 days in any year of income or tax year. It should be noted that subparagraph 4(b) provides for this reference to services, "including consultancy, management or administrative services" to be read as including the performance of such services by personnel posted to one of the Contracting States by an enterprise of the other Contracting State.

The effect of subparagraph 4(b), when combined with the operation of Article 7, ensures the preservation of the "business profits" principle in relation to the allocation between Australia and Kiribati of taxing rights over fees derived from the furnishing of consultancy, management or administrative services.

Subparagraph 4(c) provides that an enterprise will have a permanent establishment in one of the Contracting States if substantial equipment is being used in that State by, for or under contract with the enterprise. The term "substantial equipment" in this agreement is taken to include, amongst other things, a vessel such as a fishing, fuel debunkering or survey vessel.

Article 6 - Income from Real Property

By this article, income from real property, including the 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 standing timber, mines or quarries or other natural resources, may be taxed in the country in which the land, timber, mine, quarry or natural resource is situated.

It is the usual rule that whatever is affixed to or attached to land forms part of, or becomes part of, the land. This article specifically addresses this aspect, by providing for the reference to land to cover 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.

Paragraph 4 makes it clear that the operational effects of the article extend to income derived from the use or exploitation of real property (within the meaning of the article) of an enterprise and income derived from such property that is used for the performance of independent professional services. As with other items of income dealt with separately in specific articles of the agreement, income of an enterprise to which this article applies is excluded from the scope of Article 7 (by paragraph 6 of that article) and is therefore taxable in the country in which the property is situated regardless of whether or not the recipient enterprise has a "permanent establishment" in that country. Paragraph 4 also operates to ensure taxing rights by that country over income from such property that is used for the performance of professional services by a resident of the other country, irrespective of whether that income is attributable to a fixed base of that resident.

Article 7 - Business Profits

This article is concerned with the taxation of business profits derived by an enterprise carried on 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 enterprise in that other country. If they are not, the profits will be taxed only in the country of residence of the taxpayer who carries on the enterprise. 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 such of the profits of the enterprise that are attributable to the permanent establishment. In the case of this agreement, this article also effectively provides for income attributable to certain related sales of goods or merchandise or other business activities to be taxed by the country in which the permanant establishment is situated where those sales are made or business activities are carried on within that country other than through the permanent establishment.

Paragraphs 2 and 3 of the article provide for profits of a "permanent establishment" to be determined on the basis of arm's length dealings. These provisions correspond in their practical effect with comparable provisions in Australia's other double taxation agreements.

Paragraph 4 provides that no profits are to be attributed to a permanent establishment by reason of the mere purchase by the permanent establishment of goods or merchandise for that enterprise. Subparagraph (c) of paragraph 3 of Article 5 provides that an enterprise shall not be deemed to have a permanent establishment merely by reason of that activity alone. This paragraph complements that provision and is concerned with a permanent establishment which, although carrying on certain business activities in its own right, also undertakes purchasing of goods or merchandise for its head office. Paragraph 4 is designed to make it clear that the profits of the permanent establishment derived from the business activities carried on in its own right will not be increased by adding to them any amount in respect of profits attributable to the purchasing activities undertaken for the head office. It follows, of course, that any expenses incurred by the permanent establishment in respect of those purchasing activities will not be deductible in determining the taxable profits of the permanent establishment.

Paragraph 5 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 7 preserves to each country the right to continue to apply any special provisions in its domestic law relating to the taxation of "profits from insurance with non-residents". The phrase "profits from insurance with non-residents" is intended to include reinsurance payments to non-residents.

Paragraph 8 is intended to ensure that the principles of the article will apply in relation to business profits derived (indirectly) by a resident of one of the Contracting States as a beneficiary of a trust estate. In the case of Australia, for example, it clarifies Australia's right to tax in accordance with this article 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 through a permanent establishment in Australia, to which a resident of Kiribati 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 subsection 3(11) of the IT(IA)A, which has a similar effect where a beneficiary of a trust is a resident of a country with which Australia had signed a double taxation agreement on or before 19 August 1984.

Article 8 - Ships and Aircraft

This article specifies in effect that profits from the operation of aircraft in international traffic shall be subject to tax only in the country of residence of the operator.

On the other hand, it provides for both countries to tax profits from the operation of ships in international traffic. However, it requires the country from which profits from freights etc is derived in the course of international shipping traffic by a resident of the other country to reduce by one-half the tax that would have been payable under its domestic law but for this article.

This means, in the case of Australia, that the tax presently levied under section 129 of the ITAA on 5 per cent of the gross fares or freight charges receivable in respect of the outward carriage from Australia of passengers, mails or freight would be required to be reduced by one-half in the case of a ship operated by a resident of Kiribati in international traffic. So far as concerns Kiribati, its domestic law presently deems one-half of a payment in respect of a shipment from another country to Kiribati to be sourced in and subject to Kiribati tax. It too will be obligated by this article to reduce by one-half the tax it would otherwise impose on this basis in respect of a shipment from Australia to Kiribati where the shipping operator is a resident of Australia.

By paragraph 3, however, both airline and shipping profits derived from voyages or operations confined solely to places in one country (i.e., effectively profits derived other than from international traffic) will remain subject to the tax normally imposed on the profits in that country.

Paragraph 5 of the article defines the scope of operations confined solely to places in one country. By reason of the definition of "Australia" contained in Article 3 and the terms of paragraph 5 of this article, any shipments by air or sea from a place in Australia (including the continental shelf areas and relevant external territories) to another place in Australia, are effectively treated as such operations. Accordingly, profits derived, for example, from a shipment of goods taken on board, during the course of an international voyage, at Brisbane for delivery to Sydney would be profits from operations confined solely to places in Australia and not be treated as profits from international traffic for the purposes of this article.

Article 9 - Associated Enterprises

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

By virtue of paragraph 2 of the article, each country retains the right to apply its domestic anti-profit shifting provisions (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 compensatory 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 broadly 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 Kiribati from 30 per cent to 20 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. The Kiribati rate of withholding tax on dividends paid to residents of Australia is likewise not to exceed 20 per cent of the gross amount of the dividends.

Paragraph 4 effectively provides that the 20 per cent source country tax rate limit is not to 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 (Business Profits) or Article 14 (Independent Personal Services), as the case may be. In practice, under the full imputation system of company taxation contained in Australia's domestic law, such dividends that are franked dividends will remain exempt from Australian tax while unfranked dividends will be subject to withholding tax at the rate of 20 per cent instead of being taxed by assessment.

The purpose of paragraph 5 of this article is to ensure against the extra-territorial application by either country of taxing rights over dividend income. It does this by providing 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 operation of the article is limited to the taxation of dividends and is not intended to affect in any way the imposition in either country, in accordance with its domestic law where applicable, of a tax on branch profits of a non-resident company.

Article 11 - Interest

This article requires the country of source generally to limit its tax on interest income to which a resident of the other country is beneficially entitled 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 Kiribati, which will continue to be imposed at the general rate of 10 per cent applicable under Australia's domestic law.

Paragraph 3 defines the term "interest" for the purposes of the article in a way that 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 domestic withholding tax purposes.

Paragraph 4 requires that the 10 per cent source country tax rate limitation will not apply to 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. Such interest is to be subject to the provisions of Article 7 or Article 14.

The interest "source" rules set out in paragraph 5 accord with the scheme of the interest withholding tax provisions of Australia's domestic law. Those rules will therefore operate to allow Australia to tax interest to which a resident of Kiribati is beneficially entitled where the interest is paid by a resident of Australia and is not an expense of a business carried on by the Australian resident through a permanent establishment in a country outside Australia. Australia may also tax interest to which a resident of Kiribati is beneficially entitled where the interest is paid by another resident of Kiribati and it is an expense incurred by that person in carrying on a business in Australia through a permanent establishment.

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 source country tax rate 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 15 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 definition of "royalties" contained in paragraph 3 is consistent with the definition of royalties in subsection 6(1) of the ITAA and in Australia's other modern comprehensive tax treaties.

The 15 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. The 15 per cent limitation imposed by this article will operate, however, where appropriate, to reduce the tax payable under the assessment basis.

As in the case of dividends and interest, paragraph 4 effectively operates to preclude the 15 per cent source country tax rate limitation from applying to royalties effectively connected with a "permanent establishment" or "fixed base" in that country and to render such royalties subject to Article 7 or Article 14. The royalties "source" rule in paragraph 5 is consistent, in the case of Australia, with the deemed source rule contained in section 6C of the ITAA for royalties paid to non-residents and broadly mirrors the "source" rule for interest income contained in paragraph 5 of Article 11.

By paragraph 6, if royalties flow between related persons, the 15 per cent source country tax rate 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, profits or gains arising from the alienation of real property (as defined in Article 6) and other items of property.

By paragraph 1, income, profits 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, profits or gains arising from the alienation of property (other than real property covered by paragraph 1) forming part of the business assets of a permanent establishment of an enterprise. It also applies where the permanent establishment (alone or with the whole enterprise) is alienated. Such income, profits or gains may be taxed in the country in which the permanent establishment is situated, which corresponds to the rules for business profits contained in Article 7.

Paragraph 3 specifies that income, profits 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 primary taxing right accorded by Article 8 for profits from the operation of ships or aircraft in international traffic to the country of residence of the operator.

Paragraph 4 assimilates the treatment of 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, 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 its own residents or by a resident of the other country from the alienation of property not specified in the preceding paragraphs of the article. It thus ensures the application of Australia's domestic law rules in relation to the taxation of capital gains as regards the alienation of such property.

Should any income, profits or gains derived by a resident of one country from the alienation of property be taxed pursuant to this article by both countries, the country of residence of the recipient of the income, profits or gains would be obliged by Article 23 (Methods of Elimination of Double Taxation) to provide double tax relief.

As indicated earlier, because the income, profits or gains concerned are dealt with separately by this article, it applies independently of the "business profits" provisions of Article 7.

<u>Article 14 - Independent Personal Services</u>

At present, an individual resident in Australia or in Kiribati 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 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
- income exceeding A$8000 (or its equivalent in any other currency) is derived in a 12 month period from a resident or permanent establishment of that country; or
- the income is derived during a period or periods exceeding 90 days in any year of income or tax year in which the recipient is present in that country.

It should be noted that paragraph 2 of the article allows for the monetary limit referred to in the second dot point above to be varied in the light of future changes in monetary values.

If none of the tests mentioned above are met, the article requires that the income 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 generally provides the basis upon which the remuneration of visiting employees is to be taxed. The provisions of this article do not apply, however, in respect of income that is dealt with separately in Articles 16, 18 or 19 of the agreement.

Generally, salaries, wages, etc., derived by a resident of one country from an employment exercised in the other country may 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 certain visits of a short-term nature are involved. The article contemplates, of course, that the remuneration may continue to be taxed in the country of residence of the recipient under its domestic law.

By paragraph 2, the conditions for the short-term visits exemption are that:

- the visit or visits not exceed, in the aggregate, 90 days in the year of income or tax year of the country visited;
- the remuneration is paid by, or on behalf of, an employer who is not a resident of the country being visited;
- 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
- the remuneration is, or upon the application of this article will be, subject to tax in the country of residence of the visiting employee.

Where all of these conditions are met, the remuneration so derived will be liable to tax only in the country of residence of the recipient.

Paragraph 3 of the article operates notwithstanding the provisions of paragraphs 1 and 2. Its purpose is to allow income from an employment exercised aboard a ship or aircraft operated in international traffic to be taxed in the country of residence of the operator of the ship or aircraft if the domestic law of that country also allows this.

Article 16 - Directors' Fees

This article, which is common to Australia's double taxation agreements, provides for 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 to be taxed in the latter country.

<u>Article 17 - Entertainers</u>

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. The words "income derived by entertainers.....from their personal activities as such..." extend the application of this article to income generated from promotional and associated kinds of activities engaged in by the entertainer while present in the visited country.

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.

<u>Article 18 - Pensions and Annuities</u>

Paragraph 1 of this article ensures that pensions (including government service pensions) and annuities are taxed only by the country of residence of the recipient.

It is intended that the operation of this article extend to pension and annuity payments made to dependants, for example the widow or children, of the person in respect of whom the pension or annuity entitlement accrued where upon that person's death, such an entitlement has passed to that person's dependants.

Paragraph 3 addresses the position of alimony and other maintenance payments and provides that the taxing right be allocated solely to the country of residence of the payer. The purpose of this paragraph is to remove any possibility of double taxation of such payments arising by reason of the treatment accorded such payments under the respective domestic laws. In the case of Australia, those payments will generally remain exempt from Australian tax under the ITAA in the hands of the recipient and non-deductible to the payer.

Article 19 - Government Service

Paragraph 1 of this article provides for remuneration, other than a pension or annuity, (that is, salary and wage type income) paid by a government (including a State or local authority) of one of the countries to an individual in respect of services rendered in the discharge of governmental functions to be taxed only in that country. However, such remuneration, not being a pension or annuity, is to be taxable only in the other country if the services are rendered in that country and the recipient is a resident of that country as determined in accordance with Article 4 <u>and</u> is a citizen or national of <u>or</u> ordinarily resides in, that country.

Paragraph 2 effectively precludes from the scope of this article remuneration of this type, for services rendered in connection with a trade or business carried on by a government. Such remuneration will remain subject to the provisions of Article 15 (Dependent Personal Services) or 16 (Directors' Fees), as the case may be.

<u>Article 20 - Students and Trainees</u>

This article applies to students and trainees temporarily present in one of the treaty partner countries 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 or 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 (even though they may qualify as a resident of the country visited during the period of their visit). The exemption from tax provided by the visited country is treated as extending to maintenance payments received from abroad by the student or trainee that are made in respect of the maintenance of dependent family members who have accompanied the student or trainee to the visited country.

<u>Article 21 - Income Not Expressly Mentioned</u>

This article provides 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. The scope of the article is not confined to such items of income arising in one of the contracting countries; it extends also to income from sources in a third State.

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 other country. Where this occurs, the country of residence of the recipient of the income would be obliged by Article 23 (Methods of Elimination of Double Taxation) to provide double taxation relief.

Paragraph 3 of the article nevertheless ensures the application of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, in respect of income which is effectively connected with a "permanent establishment" or "fixed base" which a resident of one country has in the other country.

It should be noted that this article effectively contains "sweep-up" provisions in relation to items of income not expressly dealt with in other articles of the agreement and that paragraph 5 of Article 13 (Alienation of Property) effectively "sweeps-up" capital gains not dealt with otherwise in Article 13.

Article 22 - Source of Income

Article 22 effectively deems income, profits or gains derived by a resident of one country which, under the agreement, may be taxed in the other country to be income from sources in the latter country for the purposes of the domestic laws of both countries and Article 23 of the agreement. It thus ensures the jurisdictional (source) right of each country under its domestic law to exercise the taxing rights allocated to it by the agreement over residents of the other country. It is also designed to ensure that where an item of income, profit or gains is taxable under the agreement by both countries, double taxation relief will be given by the country of residence of the recipient of the income (pursuant to Article 23) in respect of tax levied by the other country in accordance with the taxing rights allocated to it under the agreement. Thus income derived by a resident of Australia which is taxable by Kiribati under the agreement will be treated as being foreign income for the purposes of the ITAA, including the foreign tax credit provisions of that Act.

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 also been adopted in this agreement.

Paragraph 1 of the article thus provides for Australia to relieve double taxation by allowing a credit against its own tax for Kiribati tax paid under the law of Kiribati and in accordance with the agreement on income derived by a resident of Australia from sources in Kiribati. Where a dividend is paid by a Kiribati resident company to an Australian resident company which controls 10 per cent or more of the voting power in the Kiribati company, paragraph 2 requires the credit allowed by

Australia to also take into account, in addition to the Kiribati tax paid in respect of the dividends, the underlying Kiribati 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 Kiribati. As in the case of Australia's other double taxation agreements, the source of income rules specified by Article 22 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 1 and 2 of Article 23 by application of the general foreign tax credit provisions of the the ITAA. This will include the allowance of "underlying" tax credit relief in respect of dividends paid by Kiribati resident companies that are related to Australian resident companies, including for unlimited tiers of related companies, in accordance with the relevant provisions of the ITAA.

Notwithstanding the credit form of relief provided for by paragraph 1 of the article, the "exemption with progression" provisions of section 23AG of the ITAA 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 Kiribati. Likewise, dividends and branch profits derived from Kiribati which are exempted from Australian tax where derived by an Australian resident company under provisions related to the introduction in Australia of foreign income accruals tax system (eg. sections 23AH or 23AJ of the ITAA) will continue to qualify for exemption from Australian tax under those provisions.

Paragraphs 3, 4, 5 and 6 of Article 23 deal with "tax sparing" under which an Australian resident recipient of income on which Kiribati - under specified development incentive measures - has forgone tax, will obtain tax credit relief as if the Kiribati tax forgone had been paid.

Those development incentive provisions for which "tax sparing" credit relief will be available are specified in subparagraph 4(a) whilst subparagraph 4(b) provides the mechanism by which tax sparing may be extended to other incentive measures in the future. Details of the Kiribati incentive provisions specified in subparagraph 4(a) are as follows:

Section 82 of the Kiribati Income Tax Act 1990

This section provides for Schedule 8 of the Act to apply with respect to the declaration of pioneer industries and otherwise as provided in the Schedule.

Schedule 8 of the Kiribati Income Tax Act 1990

This Schedule provides for the President of Kiribati, acting on advice of the Cabinet, to declare, by order, any company which proposes to carry on a business in Kiribati of a kind or type specified in the order to be a pioneer company with respect to that business; and that the company will be exempt from income tax or subject to a concessional rate of tax. The Schedule provides that, in formulating its advice, the Cabinet shall have regard to the economic and any other benefit likely to accrue to Kiribati from the making of such an order and that it would be in the public interest.

Subsection 90(4) of the Kiribati Income Tax Act 1990

This subsection provides for a declaration, to be made by order, in relation to dividends, interest, royalties and certain other payments made from Kiribati to a non-resident. The order may be made on broadly the same basis as for an order made under Schedule 8 and may declare a taxpayer to be exempt from withholding tax or income tax, or to be subject to a concessional rate of tax, on a particular payment or transaction.

By virtue of paragraph 5, however, a tax sparing credit will not be available for the "Kiribati tax forgone" in respect of payments attributable to the provision of services provided to an Australian resident unless the services are in the nature of tourism or communication services or in respect of manufacturing, mining, construction, fishing or agricultural activities carried on in Kiribati.

By reason of paragraph 6, the tax sparing provisions of the article are to apply only in relation to income derived in the first 10 Australian years of income to which the agreement has effect by virtue of subparagraph (a)(ii) of Article 27 (the "Entry into Force" Article), and in any later years of income that may be agreed by Australia and Kiribati in letters exchanged for that purpose. Section 4A of the Principal Act provides for the publication in the Gazette of a notice specifying any later years of income which may be so agreed.

Paragraph 7 provides for Kiribati to allow a credit to residents of Kiribati in respect of taxes payable in Australia in accordance with the agreement against the Kiribati tax payable on that income.

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 person is able to demonstrate actual or potential imposition of taxation contrary to the provisions of the agreement. A person wishing to use this procedure must present a case to the competent authority of the State of which the person is a resident within 3 years of the first notification of the action the taxpayer considers gives rise to taxation not in accordance with the agreement.

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 and limits the exchange of information by the two taxation authorities to information that is necessary for the carrying out of the agreement or for the administration of national laws concerning the taxes to which the agreement applies. The limitation placed on the kind of information authorised to be exchanged effectively means that information access requests relating to taxes not within the coverage provided by Article 2 (Taxes Covered), for example sales taxes or State/Territory type taxes, are not within the scope of the article.

The purposes for which the exchanged 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. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the national laws of that State.

An 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 also specifically 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 1967 and the Consular (Privileges and Immunities) Act 1972.

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 Kiribati as is necessary to give the agreement the force of law in both countries. In the case of Australia the enactment of the legislation which gives the force of law in Australia to the agreement is the necessary prerequisite to the exchange of diplomatic Notes taking place.

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 next following the date on 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, profits or gains of any year of income beginning on or after 1 July next following the date on which the agreement enters into force. Where a taxpayer has adopted an accounting period ending on a date other than 30 June, the agreement will first have effect in respect of tax other than withholding tax from the commencement date of the accounting period that has been substituted for the year of income commencing 1 July following the entry into force of the agreement.

In Kiribati, the agreement will first have effect in relation to Kiribati taxes which are levied in respect of income, profits or gains of its tax year beginning on or after 1 January next following the date on 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 5 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 next following the date on which the notice of termination is given. For other Australian taxes, it would cease to be effective in relation to income, profits or gains of any year of income beginning on or after 1 July next following the date on which the notice of termination is given.

The agreement would cease to be effective for purposes of Kiribati tax in respect of income, profits or gains of any tax year beginning on or after 1 January next following that in which the notice of termination is given.

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