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Some distinctive features of Australian tax treaty practice: An examination of their origins and interpretation

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1. PART I: HISTORICAL P

Chart 1: Australian treaties and protocols by decade

Chart 2: Australian new treaty partners by decade

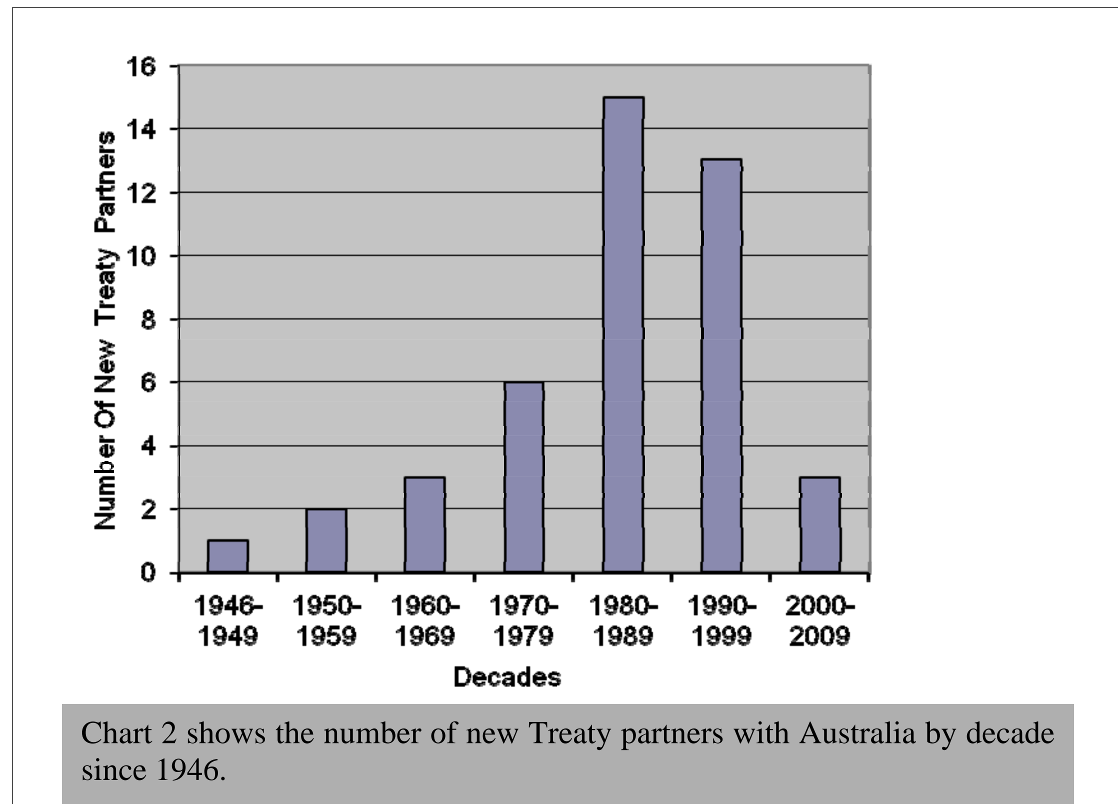

Chart 2 shows the number of new Treaty partners with Australia by decade since 1946.

Chart 3: Australian treaty partners by region by decades

2. PART II: ORIGINS OF DISTINCTIVE FEATURES OF AUSTRALIAN TAXATION TREATIES

As will be discussed in more detail below, Australian taxation treaty practice still has many distinctive features which set it apart from the treaty practice of many OECD countries. Examination of Australian treaty practice between 1980 and the present shows the continuing influence of the Australian model that had developed by 1980. Despite changes in Australian treaty practice since 1980 several idiosyncratic features of the 1980 model persist in current Australian treaty practice. In several instances the archival evidence shows that these features persisted in the Australian model up to 1980 simply because they had always been there and that by 1980 the original reason for inserting these features had been forgotten.

Part II will examine the following features[4] of Australian treaty practice that either continue to be distinctive or have been distinctive and controversial until recently:

- the definition of permanent establishment;

[4] Emphasis has been placed on those distinctive features that have a more general application rather than on those that are only or primarily relevant to particular industries. Emphasis has also been placed on features where currently available archival evidence assists in understanding the origin of the distinctive feature.

- the savings clause in non arm's-length situations;
- treaty articles giving income an Australian source that it would not have under domestic law;
- the other income article;
- not agreeing to and then modifying the non discrimination article;
- capital gains articles; and
- rates of withholding taxes on investment income.

In each case the historical background to these distinctive features will be discussed based on archival evidence[5] that has been available to the author. The argument of the paper is that these distinctive features continue to reflect their origins as part of Australia's attempts to maximise source country taxation in the treaty context or to respond to Australian domestic law concerns. mon astin

definition in the 1945 United States – United Kingdom Treaty.[7] The definition in the 1953 treaty had, however, in the words of the then Australian Commissioner of Taxation, been 'broadened in conformity with Australian aims.'[8] Clearly Australia's aims in this respect were to maximize source based taxation of the Australian branches of foreign enterprises.[9] In addition to indicia of a permanent establishment under the Australia – United Kingdom Double Taxation Treaty of 1946 the draft Australia – United States Treaty proposed that a permanent establishment should include a workshop, oilwell, office, an agency, a management and the use of substantial equipment or machinery. The most interesting inclusion was the specific reference to the use of substantial equipment. The same inclusion had been made in the 12th June 1950 Supplementary Convention to the 1942 United States – Canada Taxation Treaty[10] but had not been made in any other United States treaty up to 1952 and was not made in any other United States treaty for the rest of the 1950s. However, specific reference to 'substantial equipment' was included in several other Canadian treaties of
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A ‘substantial equipment’ provision was also found in Australia’s 1957 Treaty with Canada and 1960 Treaty with New Zealand.

Australia tried unsuccessfully to have a substantial equipment provision included in its 1967 Treaty with the United Kingdom. The Australian Commissioner of Taxation, Sir Edward Cain in correspondence with W H B Johnson the Under Secretary of the United Kingdom Board of Inland Revenue prior to commencement of negotiations on the 1967 Australia – United Kingdom Treaty enclosed what was evidently the definition in the Australian model.[13] Johnson’s response was that while it was helpful to have Australia’s views he was not sure that the Australian draft (particularly paragraph (2)(ii) dealing with substantial equipment) was entirely satisfactory from the United Kingdom viewpoint. Johnson went on to say that he did not think that further discussion could be usefully carried on through correspondence but that it ought to be possible to reach a solution acceptable to both sides in the negotiations.[14]

During the negotiation of the 1967 Treaty in Canberra Australia raised the case of a United States company which had appointed a United Kingdom company as its sole distributor in Australia on a commission basis of its products. The United States company licensed the United Kingdom company to manufacture its products and use its trade marks, reimbursed the costs of manufacture and loaned all the machinery necessary to manufacture its products. The United States company was treated as having an Australian permanent establishment under the Australia – United States Treaty where permanent establishment was defined as including ‘the use for

Two other distinctive features of Australian treaty practice, mentioned in the then Assistant Treasurer's Media Release, originated with the Australia – United Kingdom treaty of 1967. These were including a building or construction, installation or assembly project within the set of examples of a permanent establishment where it existed for more than six months (in contrast to the twelve month requirement in the OECD Model) and deeming supervisory activities for more than six months in connection with a building site, or construction, installation or assembly project to be a permanent establishment.

The Australian Taxation Office Memorandum and a letter from the Acting Second Commissioner of Taxation to the Secretary of the Australian Treasury[22] commenting on the definition of permanent establishment in the United Kingdom draft of the 1967 Treaty noted that it differed in several respects from the Australian model.[23] Among these differences were that the definition did not regard as instances of a permanent establishment an installation project that existed for more than twelve months nor supervisory activities on a building site or a construction, installation or assembly project for more than twelve months. No previous Australian treaty had included installation projects or supervisory activities within the definition of permanent establishment. However, supervisory activities in relation to *inter alia* installation projects with a twelve month time limitation had been deemed to be a permanent establishment under Article II(1)(p)(iv)(aa) of the 1966 United Kingdom – New Zealand Treaty. The Australian Treasurer's submission to cabinet on the decision to commence negotiations for a new treaty with the United Kingdom in 1966 recommended pressing for a more comprehensive definition of permanent

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operation of substantial equipment, in exploration for or exploitation of natural resources for period in aggregate of 90 days in any twelve month period] and Article 5(4)(c) operating substantial equipment for periods in aggregate exceeding 183 days in any twelve month period; Australia – Turkey Treaty, 2010 (not yet in force) Article 5 (3)(b) [operating substantial equipment for more than 6 months in any 12 month period].

[22] W J O'Reilly (Acting Second Commissioner of Taxation) to The Secretary to the Treasury (Sir Richard Randall) and accompanying memorandum, 16th November 1966 'Double Taxation : Re-negotiation of the Present Agreement between the United Kingdom and Australia", National Archives of Australia, Series Number A571 Control Symbol 66/3007 (hereafter '1967 UK – Australia Treaty, Australian Treasury file').22.36 -1.1467 TD.0002;5.5(a)7(e15 Tw[0036iffere)6.7(Archives TD.00c -1.1r T rRArchiv)-7.5(mme

establishment which would include an agency, an oil well and an installation project existing for more than twelve months.[24]

The United Kingdom appears to have reasonably readily agreed to the Australian requests in relation to 'installations' and 'supervisory activities'. The United Kingdom 'Notes of Meetings' of the negotiations in Canberra relating to the 1967 Australian – United Kingdom Treaty record that on the third day the word 'installation' was added to sub-paragraph 2(g) to cover a person who contracts to manufacture, supply and install equipment.[25] It was also agreed on the third day that provision dealing with supervisory activities along the lines in the United Kingdom – New Zealand agreement would be added. It is clear from handwritten notes by an Australian Treasury official that these additions were requested by Australia.[26] The existence of a provision dealing with supervisory activities in the 1966 United Kingdom – New Zealand Treaty presumably made Australia's argument easier on this point.

Precisely how the minimum periods in these paragraphs came to be reduced to six months is not entirely clear. The United Kingdom Notes of Meetings record that on the fourth day, at Australia's request, the minimum period in sub-paragraph 2(g) was agreed to be reduced to six months.[27] The 1967 Treaty with the United Kingdom is the first instance in an Australian treaty with six months being the minimum required period for a building site, construction, installation or assembly project to be classified as a permanent establishment. The Australian Taxation Office Memorandum to the Secretary of the Australian Treasury had indicated that the Australian model of the time required a minimum period of twelve months before an installation project was regarded as a permanent establishment. Handwritten notes by an Australian Treasury official at the negotiations indicate that here Australia asked for the inclusion of a reference to an 'installation' project lasting twelve months and make no mention of a request to reduce the minimum period to six months.[28] When seen in the context of the Australian Taxation Office Memorandum, O'Reilly's (the Acting Second Commissioner of Taxation) letter and McMahon's cabinet submission the reduction in the minimum time to six months was clearly aimed at giving greater scope for source basis taxation of industrial or commercial profits.

From the 1967 Australia – United Kingdom Treaty onwards including 'installation projects' [29] comcabs4 Twntae in an AustraliiesTreasuryroject reduce the miimum uce thfoect wy onuce thng with supervisory actect wy

to six months.[30] All of these features were in the Australian drafts sent to Japan and Singapore in February and August of 1968 respectively. While there are exceptions,

[30] See Australia – Singapore Treaty, 1969, Article 4(2)(i) and Article 4(3)(a) [6 months within a 12 month minimum period]; Australia – Japan Treaty, 1969, Article 3(2)(h) and Article 3(4); Australia – Germany Treaty, 1972, Article 5(2)(h) and Protocol Article 1; Australia – Netherlands Treaty, 1976, Article 5(2)(h) and Article 5(4)(a) [includes installation project and supervisory activities but minimum period is twelve months]; Australia – France Treaty, 1977, Article 4(2)(h) and Article 4(4)(a) [12 months minimum on building sites, construction, installa

most notably the 1982 Australia – United States Treaty, the trend with a developed countries has been to not reduce the minimum time period below twelve months but to reduce it with less developed countries. Also, in some instances, with less developed countries the reference is to 'services, including consulting services' and not to 'supervisory activities', although, in some treaties with developing countries, separate articles refer to services and to supervisory activities.

2.2 Savings clause for domestic law in non arm's length situations

Every Australian Taxation Treaty has contained (either in the treaty itself or in a protocol to it) a savings clause for domestic law in relation to arm's length adjustments in the Business Profits Article and in the Associated Enterprises Article. A similar provision can be found in over 200 current taxation treaties worldwide and in the 2000 Malaysian Model Income Tax Agreement. The progenitor of the savings provisions in all subsequent Australian treaties was introduced in Australia's 1946 Treaty with the United Kingdom.

The background to the provision in the 1946 United Kingdom Treaty was that Australian Boards of Review had determined the profits of oil companies operating in Australia under the then *Income Tax Assessment Act* 1936 (Cth) s136.[31] Section 136 empowered the Commissioner of Taxation to determine the taxable income of a business carried on in Australia that was either: (a) controlled principally by non-residents; (b) carried on by a company in which the majority of shareholders were non-residents; or (c) carried on by a company which (directly or indirectly) held the majority of shares of a non-resident company. The Commissioner's powers could be exercised where it appeared to the Commissioner that the business either produced no taxable income or less taxable income than might otherwise be expected of a business of that nature. On appeal from a determination by the Commissioner, Australian Boards of Review had power to make assessments under s136.

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including consulting services, for a period or periods aggregating 120 days in a 12 month period], Article 5(4)(a) [supervisory activities for more than 6 months]; Australia – South Africa Treaty 1999, Article 5(3) and Article 5(4)(a) [183 days in any 12 month period]; Australia – Slovak Republic Treaty 1999, Article 5(2)(h) [12 month minimum period for building site, construction, installation or assembly project], Article 5(2)(i) [services, including consulting services for a period or periods aggregating six months in a 12 month period], Article 5(4)(a) [supervisory activities for more than 12 months]; Australia – Argentina Treaty 1999, Article 5(2)(h) and Article 5(4)(a); Australia – Romania Treaty 2000, Article 5(2)(h) [9 month minimum on building site, construction, installation or assembly project], Article 5(4) [6 month minimum on supervisory activities]; Australia – Russian Federation Treaty 2000, Article 5(2)(h) [includes installation projects and supervisory activities but minimum period is 12 months]; Australia – Mexico Treaty 2003, Article 5(4) [installation projects and supervisory activities included n same paragraph]; Australia – Chile Treaty 2010 (not yet in force) Article 5(3) [building site, construction or installation project with six months minimum with an aggregation provision in Article 5(5) that takes into account activities by associated enterprises] and Article 5(4)(a) [no specific mention of supervisory activities but refers to services performed by one or more individuals for a period or period in aggregate of 183 days in a twelve month period. In calculating the minimum period the aggregation provision in Article 5(5) also applies]; and Australia – Turkey Treaty 2010 (not yet in force) Article 5(2)(g) [building site or construction or installation or assembly project with a six month minimum].

[31] For contemporary commentary on s136 and the resulting jurisprudence see JAL Gunn, OE Berger, JM Greenwood and RE O'Neill, *Gunn's Commonwealth Income Tax Law And Practice*, Butterworth & Co (Australia) Ltd, Sydney, 1948 at paras [1392] to [1397] and NE Challoner and CM Collins, *Income Tax Law And Practice (Commonwealth)*, Law Book Company Sydney, 1953, at paras [895] to [906].

In the draft treaty prepared by the United Kingdom both the Industrial or Commercial Profits article (Article III) and the Associated Enterprises article (Article IV) contained provisions requiring that profits be determined using the arm's length principle. The relevant portion (paragraph 3) of the draft Industrial or Commercial Profits article stated:

> *'Where an enterprise of one of the territories is engaged in trade or business in the other territory through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to derive in the other territory if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.'*

The draft Associated Enterprises article stated:

> *'Where:*
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> *(a) an enterprise of one of the territories participates directly or indirectly in the management, control or capital of an enterprise of the other territory, or*
>
> *(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one of the territories of an enterprise of the other territory, and*
>
> *(c) in either case conditions are made or imposed between the two enterprises in their commercial or financial relations, which differ from those which would be made between independent enterprises,*
>
> *then any profits which would but for those conditions have accrued to one of the enterprises but by reason of those conditions, have not so accrued may be included in the profits of that enterprise and taxed accordingly.'*

The United Kingdom was concerned that s136 did not in terms require the use of arm's length principles in determining taxable income in these circumstances. Australia was concerned that the United Kingdom draft of the Treaty would require the Australian Commissioner to show that the relevant transaction was not for an arm's length price whereas the Australian appeal provisions required the taxpayer to show that the s136 assessment was excessive. Hence Australia wanted to 'arm's length' provisions in the draft treaty modified so as to leave the operation of s136 unaffected.[32]

Disagreement on this issue resulted in several discussions between officials of the two countries, numerous telegrams between the Australian delegation in London and the Australian Commissioner in Canberra and legal opinions by the Australian Crown Solicitor and the Australian Solicitor General. The Australian Commissioner was concerned that the formula that the Boards of Review had applied was arbitrary and, although it represented an attempt to arrive at what would be an arm's length basis if

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[32] 'Drafting of the UK-Australia Agreement 1946. Cables of Draft of Agreement.' R J Mair to P McGovern 9th May 1946. National Archives of Australia, Series No. A 7303/21 Control Symbol J 245/45/19.

sufficient information were available, it was not truly an arm's length basis.[33] The view of the United Kingdom Board of Inland Revenue was that United Kingdom enterprises were entitled to know that their profits would be determined on an arm's length basis and that preservation of s136 would produce uncertainty for them and would be inconsistent with the arm's length principle which was present in all United Kingdom taxation treaties of the time. In the words of the Secretary of the Board of Inland Revenue at the time:

> *'If ….the agreement were to provide that Section 136 should remain unaffected*

words of the draft saving provision as they might have prevented the taxpayer from exercising appeal rights to have profit determined in accordance with Article III. To meet Australia's con

is found can it be said that actual arm's length consideration has been ascertained. In many cases, as the OECD Transfer Pricing Guidelines recognise[41], one or another method of estimation, some of which are far removed from the search for a comparative uncontrolled transaction, has to be used to determine an arm's length price for a transaction. Arguably in all cases where an estimation method is used it has not been possible or practicable to ascertain an actual arm's length price. Under the current terms of the Business Profits article and the Associated Enterprises article in the OECD Model the adjustment contemplated is to a hypothetical figure based on assumptions rather than to a figure corresponding to an amount charged in an actual situation.[42] Where one treaty partner uses one estimation method and the other treaty partner uses a different estimation method the taxpayer will often invoke the mutual agreement procedure or arbitration in an effort to remove the international economic double taxation that would otherwise result. The result of that lengthy process will often be a pragmatic compromise between the two tax administrations. If the saving provision were not there and the taxpayer were to challenge a transfer pricing adjustment made under s136AD(4) on the basis that it was inconsistent with Australia's treaty obligations under either the business profits or associated enterprises articles of the OECD Model it is likely, in the author's opinion, that the challenge would fail given the hypothetical nature of figure sought to be found under those articles and given the diversity and indirect nature of the methods accepted by the

commercial profits articles of the 1946 Australia – United Kingdom, the 1954 Australia – United States, the 1957 Australia – Canada and the 1960 Australia – New Zealand tax treaties, although it may have been deeming an Australian source for some items of income which would not otherwise exist, was arguably not extending Australia's taxing powers beyond those that existed, albeit on a different basis, under s136.

The industrial or commercial profits article in the 1966 United Kingdom draft tax treaty sent to Australia as part of the negotiations that led to the 1967 Australia – United Kingdom Tax Treaty did not contain a source rule. The definition of industrial or commercial profits did include income from the furnishing of services of employees or other personnel.[47] In commenting on the draft Australian tax officials recognised the inclusion was necessary to enable the country of source to tax profits of public entertainer companies but observed that a source rule along the lines of those in Australia's earlier tax treaties was necessary given that the ordinary source rules might mean that the income of the company arose outside Australia.[48]

The comment has to be seen in the context of the then recent High Court decision in *FCT v Mitchum* (1965) 113 CLR 401 under which it was uncertain when the income a company which provided the services of a public entertainer would have an Australian source. In *FCT v Mitchum* the actor, Robert Mitchum, who was not an Australian resident at any relevant time, entered into a contract in June 1959 with a Swiss company to be employed to provide consulting services (including performing) to the producer on behalf of the Swiss company in relation to two motion pictures and to be paid $50,000 for each motion picture for a period a 12 weeks with two weeks free. The Swiss company agreed to lend Mitchum's services to Warner Bros. Pictures Inc

(California) nor from Warners (London) for the services he performed. The Swiss company subsequently assigned its rights under the contract with Warners (California) to a Californian company DRM Productions Inc and Warners (California) then paid DRM Productions Inc the consideration it had agreed to pay the Swiss company in relation to Mitchum's services connected with *The Sundowners*. DRM Productions Inc then paid Mitchum in the United States $50,000 in discharge of the Swiss

> *services of public entertainers or athletes such as are referred to in Article 15'.*[51]

The United Kingdom objected that the Australian draft would deem there to be an Australian source and enable Australia to get tax in circumstances where this might not be possible under Australian domestic law. The United Kingdom view was that it was justifiable to ensure that a treaty did not open up avenues for avoidance but it was 'quite another matter' to use a treaty to make good gaps in domestic anti avoidance legislation.[52] It is possible that the United Kingdom reference to domestic anti avoidance legislation was to *Income Tax Assessment Act* 1936 s136 discussed above. In *FCT v Mitchum* (1965) 113 CLR 401 no attempt had been made under s136 to assess the Swiss company which loaned Mitchum's services to Warner Brothers for the filming of *The Sundowners* in Australia. This may have reflected doubts as to whether the Swiss company was carrying on business in Australia for the purposes of s136. The Australian alternative draft would have deemed the Swiss company to be carrying on business in Australia in these circumstances. This would have opened up the possibility of a s136 assessment and the deemed source rule in the industrial and commercial profits article. The United Kingdom, however, did not object to the presence of the deemed source rule in relation to profits determined under the arm's length principle in both the industrial or commercial profits article and the associated enterprises article and both of these articles in the final treaty contained the deemed source rule.

The solution to the public entertainers problem which was ultimately reached in the negotiations, at Australia's request[53], was to exclude supplying the services of public entertainers from the definition of industrial or commercial profits.[54] Australia had previously indicated that it wanted Article 15 (dealing with Artistes and Athletes) strengthened to cover companies which supplied the services of entertainers.[55] During negotiations it was then agreed that, as it was conceivable that Australian courts might in some circumstances deem income from 'employment, etc.' exercised in Australia to have a non Australian source, a source rule was necessary in Articles 13, 14 and 15 (professional services, dependent personal services and entertainers respectively).[56] This is the first unambiguous example of a continuing Australian treaty practice of deeming there to be an Australian source where there might not be an Australian source outside the treaty.

Interestingly the United Kingdom does not appear to have objected to the existence of a deemed source rule in this context although, as noted above it objected to such an

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[51] 'Notes Of Meetings In Canberra', Third Day, 4th April1967, Afternoon Session, p3, 1967 UK – Australia Treaty Inland Revenue file

[52] 'Notes Of Meetings In Canberra', Third Day, 4th April1967, Afternoon Session, p3, 1967 UK – Australia Treaty Inland Revenue file

[53] Notes of discussions 13/3/67 – 14/4/67, 1967 UK- Australia Treaty Australian Treasury file, handwritten notes by an Australian Treasury official, 5th April 1967 'Article 4 (Cont)'. The handwritten notes record that this was at Australia's request and was based on the form of the Australia – New Zealand treaty which excluded such profits from the definition of industrial and commercial profits.

[54] Notes of Meetings, Third Day, 4th April1967, Morning Session, p3, and Notes of Meetings, Fourth Day, 5th April1967, Morning Session, p2, 167 UK – Australia Treaty Inland Revenue file.

[55] Notes of Meetings, First Day, 31st March 1967, Afternoon Session, p4, 1967 UK – Australia Treaty Inland Revenue file.

[56] Notes of Meetings, Fifth Day, 6th April 1967, Morning Session, p1, 1967 UK – Australia Treaty Inland Revenue file.

origins of the policy nor its apparent current rationale make it necessary to limit the operation of a treaty source rule by a domestic law provision. The approach taken in the Australia – Germany Treaty of 1972 (of allowing Australia to deem, in its domestic law, income which it was entitled to tax under the treaty to have an Australian source) referred to above would, in the author's view, be far preferable to the current Australian approach.

2.4 The 'other income' article

Australian tax treaty practice varies from the OECD Model by partially reversing the effect of the 'other income' article. Under Article 21 of the OECD Model income not dealt with in preceding articles in the Model (other than income paid in respect of a right or property effectively connected with a permanent establishment through which a non resident carries on business in the source country) is to be taxed exclusively on a residence basis. Australian tax treaties, however, typically add an additional provision the effect of which is to give the source country the right to tax income from sources in that country not otherwise dealt with. This variation from the OECD Model dates from the 1980 Australia – Canada Treaty Article 21(2). In most cases the version of the 'other income' article in Australian tax treaties is either identical with or substantially similar to the equivalent article in the United Nations Double Taxation Convention of 1978 and the United Nations Double Taxation Convention of 1980.

As will be seen below, prior to the 1980 Australia – Canada Treaty, Australia had received requests to include an 'other income' article in its treaties but had refused to do so. It will be argued below that the failure to include an 'other income' article in Australian treaties prior to 1980 and the modification of the 'other income' article in Australian treaties after 1980 both reflect the longstanding Australian emphasis on source basis taxation. It will be further argued in this paper that the failure to include an 'other income' article in Australian treaties prior to 1980 was part of their distinctive structure and that this distinctive structure should be taken into account in interpreting particular articles in those treaties.

2.4.1 Initial rejection of 'other income' article in 1967 United Kingdom Treaty

The United Kingdom draft of September 1966 which was to form the basis for the negotiation of the 1967 Australia – United Kingdom Taxation Treaty contained an 'other income' article which gave the country of residence exclusive right to tax income not expressly mentioned in other articles.[63] During the negotiation of the Treaty in Canberra in March and April 1967 the Australian delegation clearly rejected the draft article. The United Kingdom notes of the negotiation record that the article 'contradicts the Australian's general philosophy concerning the taxation of income flowing abroad and they cannot accept it as it stands.' The notes record that the Australians were prepared to accept the results of the article as regards third country tax. It was observed that if the article were to be so restricted then there would be nothing in the Treaty dealing with alimony, but this was seen as being of comparatively minor importance. Australia at the time regarded alimony as exempt to the recipient and as non deductible to the payer. Restricting the article to third country tax was not seen to create problems in relation to trusts as both the United Kingdom

[63] Article 20 of United Kingdom Draft, September 1966, 1967 UK – Australia Treaty Inland Revenue File.

and Australia treated income flowing through a trust in which beneficiaries had an absolute interest as retaining its original identity. The notes comment that the absence of another income article would only be felt in the case of discretionary trusts which would be treated on an empirical basis. The notes then record that 'It was in consequence agreed that the Article should be amended to restrict its scope to third-country tax'.[64]

In the final version of the 1967 Australia – United Kingdom Taxation Treaty Article 18 dealt with the income of dual residents from third countries. The effect of the article was that, where the dual resident was treated as a resident of one only of the two treaty countries, the dual resident was exempt from tax in the other treaty country on income from a third country.[65] A corresponding provision was often inserted in subsequent Australian Tax Treaties prior to the Australia – Canada Treaty of 1980.[66] Provisions of this nature appear to have been unique to Australian treaties of the period.

It is reasonably clear from the notes that, by restricting the other income article to third-country taxes both parties considered that they would retain full taxing rights in relation to income not otherwise dealt with in the Treaty. This is particularly evident from the Australian comment that the original article, which gave exclusive taxing rights to the residence country, contradicted Australia's general philosophy concerning the taxation of income flowing abroad. The restriction of the other income article to third country taxes was thus both consistent with the 'colonial model' structure of earlier Australian treaties and was intended to maximise the scope for source country taxation. Maximising source country taxation was consistent with Australia's fiscal interests in relation to most of the countries (the United Kingdom 1946, the United States 1953, Canada 1957 and New Zealand 1960) with which it had concluded taxation treaties at up to 1967. In 1967 Australia was a net capital importer from all of these countries except New Zealand. At the conclusion of the negotiation of the 1967 Australia – United Kingdom Treaty Australia was to embark on negotiations with Japan in relation to whom it was also a net capital importer.

2.4.2 The inclusion of an 'other income' article in the 1980 Canada Tax Treaty

As discussed in Part I Australia became a member of the OECD in 1972 and as a consequence had entered into tax treaties with many of the then OECD member states.

[64] 'Notes Of Meetings In Canberra; March – April 1967' 1967 UK – Australia Treaty Inland Revenue File. Fifth Day, 6th April 1967, Afternoon Session, p.2. The Australian delegation made similar points on the first day of negotiations. See Notes Of Meetings, First Day 31st March 1967, Afternoon Session, p.5.

[65] Correspondence between officials indicates that restricting the exemption to dual residents was intended to circumvent planning by single residents involving diverting income to third countries to obtain the benefit of the exemption. See ET Cain to WHB Johnson,16th June 1967, Inland Revenue file, Part II; FB Harrison to Chief Inspector (Mr Williams), Australian Agreement, 27th June 1967; FB Harrison, Comments on the amendments proposed in the attachments to Mr Cain's letter of 16th June 1967, Inland Revenue file, Part II; To: Mr Harrison, 3rd July 1967, 1967 UK – Australia Treaty Inland Revenue file, Part II; WHB Johnson to ET Cain, 4th September 1967, Inland Revenue file, Part II;[65] ET Cain to The Commonwealth Treasurer (William McMahon) 8th September 1967, 1967 UK – Australia Treaty Australian Treasury file.

[66] See, for example, Australia – Singapore Treaty 1969 (prior to amendments by subsequent Protocols) Article 16; Australia – Germany Treaty 1972, Article 20; Australia – Netherlands Treaty 1976, Article 22.

1978 and 1980 respectively. Archival sources relevant to the negotiation of the 1980 Australia – Canada Tax Treaty were not available to the author at the time of writing of this paper. Hence the author does not have documentary evidence of influence of the United Nations Draft Model on the other income article in the Australia – Canada Treaty of 1980 but given the similarities in effect and the relatively close proximity in time influence from the United Nations Draft Model seems at least possible.

The next Australian tax treaty to contain an other income article was the 1982 Australia – United States Treaty. There the 'other income' article exactly corresponded with the 1978 Draft UN Model and thus differed from both the OECD Model and the US Model.[70] Archival sources relevant to the negotiation of the 1982 Australia – United States Tax Treaty were not available to the author at the time of writing this paper. However, the following comment United States Congress Joint Committee on Taxation Explanation of the Treaty may indicate that the UN Model, or at least considerations relevant to the development of the UN Model, influenced several aspects of the Treaty:

> *'The proposed treaty resembles in a few respects a treaty between a developed country and a developing country. In these respects, it does not conform to the U.S. model treaty. It provides for relatively high rates of source country withholding taxes and it provides permanent establishment rules that permit taxation of enterprises in cases where the U.S. model treaty would not. In addition, its non discrimination provision does not apply to existing rules. Although Australia is not so industrialized as the United States, it is a developed country. Australia is, however, a capital importer. Also, on balance, it can be argued that the proposed treaty is the product of a hard bargaining over a period of 14 years and is better for U.S. interests than the existing treaty.'*[71]

As noted in Part I from the 2001 Protocol to the Australia – United States Tax Treaty of 1982 Australian tax treaty policy shifted to a more residence based tax treaty policy. Under the Protocol Australia lowered its rate of withholding taxes on investment income and subsequently, in its 2003 Treaty with the United Kingdom agreed to a modified form of the non-discrimination article.[72] The change in policy reflected an awareness of the increased engagement of Australian business in offshore investment and the fact that Australia was a net capital exporter in many of its bi-lateral relationships. Despite these changes the 'other income' article in Australian tax treaties generally[73] still follow the model established in the 1980 Australia – Canada Treaty and in the 1982 Australia – United States Treaty, modified in more recent

[70] Compare Article 21 of the Australia – United States Double Taxation Treaty of 1982 with Article 21 of the 1977 OECD Model, Article 21 of the 1978 Draft United Nations Model, Article 21 of the 1980 United Nations Model and Article 21 of the 1996 United States Model.

[71] Tax Analysts, *Worldwide Tax Treaties*, United States, Australia, Joint Committee on Taxation Explanation (JCS-15-83, May 24, 1983)

[72] Australia – United Kingdom Double Taxation Treaty 2003, Article 25. Compare Article 24 OECD Model.

[73] One exception is the Australia – Sweden Treaty of 1981. The Australia – Italy Treaty of 1983 contains the income of dual resident/third country tax article but not the standard Australian other income article of the period. Article 22 of the Australia – China Treaty of 1990 differs from the standard Australian 'other income' article but arguably produces a similar end result.

treaties to reflect changes in Australian taxation of capital gains as discussed below[74], irrespective of whether Australia is a net capital importer or a net capital exporter in the relationship with the treaty partner in question.[75] The persistence of this feature in Australian tax treaty practice reflects: (a) the continued influence at the level of detail of prior Australian tax treaty practice on both the Australian draft and on the expectations of Australian treaty partners: (b) the fact that in overall terms Australia is still a net capital importer and that moving to a more residence based tax treaty practice in this and other respects would have a revenue cost to Australia.

2.5 Not agreeing to and then modifying the non discrimination article

Between its 1967 and 2003 Tax Treaties with the United Kingdom a distinctive feature of Australian tax treaty practice was to refuse to agree to the non discrimination article. As will be seen below, with one exception, throughout this period Australia managed to persuade its treaty partners to omit the non discrimination article in their treaties with Australia.

2.5.1 The 1967 United Kingdom Treaty

The United Kingdom draft of September 1966 contained a non discrimination article. None of Australia's previous Double Taxation Treaties had contained a non discrimination article and, moreover, a non discrimination article had not been requested by Australia's treaty partner in any of those earlier treaties. A Japanese draft sent to Australia in 1964 during preliminary negotiations had included a non discrimination article which the Australian negotiators rejected. Australia did not conclude a taxation treaty with Japan until 1969.[76]

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[74] See, for example, Australia – United Kingdom Treaty 2003, Article 20(3) and Australia – Japan Treaty 2008 , Article 21(2).

[75] See Australia – United Kingdom Treaty 2003, Article 20(3); Australia – United States Treaty 1982, Article 21(3); Australia – Canada Treaty 1980, Article 21(2); Australia – New Zealand Treaty 1995, Article 22(1); Australia – Japan Treaty 2008, Article 21(2); Australia – France Treaty 2006, Article 20(3); Australia – Malaysia Treaty 1981, Article 21(3); Australia – Denmark Treaty 1981, Article 21(2); Australia – Ireland Treaty1983, Article 23(2); Australia – Korea Treaty 1983, Article 22(2); Australia – Norway Treaty 2006, Article 21(3); Australia – Malta Treaty 1984, Article 21(2); Australia-Finland Treaty 2006, Article 20(3); Australia – Austria Treaty 1986, Article 21(2); Australia – Papua New Guinea Treaty 1989, Article 21(2); Australia – Thailand Treaty 1989, Article 22(2); Australia – Sri Lanka Treaty 1990, Article 21(2); Australia – Fiji Treaty 1990, Article 23(2); Australia – Hungary Treaty 1991, Article 22(3); Australia – Kiribati Treaty 1991, Article 21(2); Australia – India Treaty 1991, Article 22(2); Australia – Poland Treaty 1991, Article 22(1); Australia – Indonesia Treaty 1992, Article 22(2); Australia – Vietnam Treaty 1993, Article 21(2); Australia – Spain Treaty 1992, Article 21(2); Australia – Czech Republic Treaty 1995, Article 21(2); Australia – Taipei Treaty 1996, Article 21(2); Australia – South Africa Treaty 1999, Article 21(3); Australia – Slovak Republic Treaty 1999, Article 21(2); Australia – Argentina Treaty 1999, Article 22(2): Australia – Romania Treaty 2000, Article 21(2); Australia – Russia Treaty 2000, Article 21(3); Australia – Mexico Treaty 2002, Article 21(3); Australia – Chile Treaty 2010 (not yet in force), Article 21(3); Australia – Turkey Treaty 2010 (not yet in force), Article 21(3).

[76] The Japanese draft of 1964 is contained in Australian Taxation Office file 'Double Tax – Australia – Japan Tokyo Papers and Agreement Negotiation Records' National Archives of Australia, Series

Australian tax officials reviewing the 1966 United Kingdom draft pointed out respects in which Australian domestic tax law currently discriminated between residents and non residents and respects in which the article would limit Australia's future freedom of action. The Acting Second Commissioner of Taxation commented in a letter to the Secretary of the Treasury, 'Even if it were re-drafted to permit us to continue all our present "discriminations" it would still be clearly restrictive on future policy'.[77]

A similar attitude was evident at the ministerial level. The Treasurer's submission to cabinet on the September 1966 United Kingdom draft noted that the proposed article would conflict with certain provisions of Australian law such as the restriction of the inter-corporate rebate to resident companies. The Treasurer commented that, 'While it might be possible to negotiate provisions with sufficient qualification to make them compatible with our law, I think it would be best to avoid any provisions on "non-discrimination".'[78]

During the afternoon session of the first day of negotiations on the 1967 Australia – United Kingdom Treaty in Canberra the Australian delegation indicated that the article was not acceptable to Australian ministers.

> *negotiable: in fact, for Australia the inclusion or exclusion of the clause could not be weighed in the overall balance of concession and counterconcession.'*[87]

Cain's comment is consistent with the more general point he made in the negotiations, that, as Japan had initiated the negotiations it could not expect greater concessions than those that Australia had given to the United Kingdom in the 1967 Australia – United Kingdom Treaty.[88] The final version of the 1969 Australia – Japan Treaty did not contain a non discrimination article.

The absence of a non discrimination article from the Australian draft sent to Singapore in August 1968 does not appear to have been raised in the negotiation of the treaty and the final version of the treaty did not contain a non discrimination article.[89]

Australia maintained its opposition to the non discrimination article throughout the 1970s, 1980s and 1990s. The basis of Australia's objection to the non discrimination article in the early 1970s was set out in de

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Subsequent Australian treaties contain similar carve outs, with varying degrees of precision[95], from the Non Discrimination article. Australia's 2006 treaty with France does not contain a non discrimination article. It is understood that France would not agree to the carve outs from the non discrimination article that Australia was seeking.

2.6 Capital gains articles

Australia's first taxation treaty, with the United Kingdom in 1946, unlike the 1945 United Kingdom – United States Treaty, did not contain a capital gains article. Nor did either party to the negotiations ever propose that the Australia – United Kingdom Treaty of 1946 contain a capital gains article. This was understandable as neither Australia nor the United Kingdom at the time taxed capital gains as a general rule. Under the 'colonial model'[96] structure of the 1946 treaty the intention was clearly that domestic rules were to operate in relation to items not specifically dealt with in the treaty. This can be seen from the correspondence at the time[97] and the treatment ultimately given to interest and mineral royalties in the Treaty and from the definition of industrial and commercial profits. The Treaty defined 'industrial and commercial profits' in terms which excluded items that were either dealt with under the distributive articles of the treaty or in relation to which the source country was intended to retain full taxing rights. Hence income in the form of dividends, interest, rents, royalties, management charges, or remuneration for personal services was excluded from the definition. The treaty contained distributive rules for dividends, some royalties (but significantly neither mineral royalties nor film royalties) and personal services but not for the other items excluded from the definition of industrial and commercial profits. Defining 'industrial and commercial profits' in this way and not dealing with items where the source country was intended to retain full taxing rights were to become structural features of the treaties that Australia entered into until

article would thus seem natural to United Kingdom tax officials as it would mirror the structure of United Kingdom domestic law taxing capital gains.

During the afternoon of the first day of negotiations in Canberra on the 1967 United Kingdom – Australia Treaty the Australians pointed out that, although Australia had no capital gains tax at present, the existence of the article would 'tie their hands' in relation to the United Kingdom if they ever introduced one in the future. The United Kingdom pointed out that the draft article was reciprocal but that an article based on the OECD Model was an alternative if Australia did not like the draft article. The Australians questioned the need for the article and indicated that they would prefer that the article be dropped altogether something which the United Kingdom delegation indicated they would consider.[101] Handwritten notes by an Australian Treasury official observe that the political climate, in the Senate for example, was against CGT and that the inclusion of the article might prevent passage of the Treaty through the Senate.[102] The article is not mentioned again in either official record of the discussions until the fifth day where both official records confirm that the article was to be omitted.[103] It is clear from the notes of the meeting that the Australian delegation considered that by not including a capital gains tax article in the treaty Australia would retain full rights to levy capital gains tax on United Kingdom residents if it subsequently introduced a capital gains tax.

Australia's 1969 Treaty with Japan[104] and its 1969 Treaty with Singapore[105] did not contain a capital gains article and retained the 'colonial model' structure. The 1972 Australia – Germany Treaty did not contain a capital gains or an alienation of property article.

The 1976 Australia - Netherlands Treaty was the first Australian treaty to contain an alienation of property article. The article gave the source country the right to tax income from the alienation of real property, rights to exploit or explore for natural resources, and shares in companies the assets of which consisted wholly or principally of real property or rights to exploit natural resources situated in the source country. The article, however, differed from the OECD Model in several respects. First, its title was 'Alienation of Property' not 'Capital Gains'. Secondly, it referred to 'income from the alienation of property'. Thirdly, it referred only to the limited range of possible forms of income from the alienation of property referred to above. Fourthly, it did not contain a catch all provision equivalent to Article 13(3) of the 1963 Draft

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[101] Notes Of Meetings, First Day, 31st March 1967, Morning Session, p4, 1967 UK – Australia Treaty Inland Revenue file. See also Notes of discussions 13/3/67 – 14/4/6, 1967 UK – Australia Treaty Australian Treasury file, handwritten notes by an Australian Treasury official, 31st March 1967.

[102] See also Notes of discussions 13/3/67 – 14/4/6, 1967 UK – Australia Treaty Australian Treasury file, handwritten notes by an Australian Treasury official, 31st March 1967..

[103] Notes Of Meetings, Fifth Day, 6th April 1967, Morning Session, p1, 1967 UK – Australia Treaty Inland Revenue file. Report of discussions on 6th April 1967, Australian Treasury file. The Australian record makes it clear that the article was omitted at Australia's request.

[104] Neither the February 1964 Draft nor the January 1968 capital gains o 'Alienation 3(preas)]T4-20.43 0 TDrt.9(y)-6.5t artic

> *'6. Gains of a capital nature from the alienation of property, other than that referred to in the preceding paragraphs shall be taxable only in the Contracting State of which the alienator is a resident.'*

2.7 Rates of withholding taxes on investment income

Consistent with the Australian policy of maximizing source basis taxation, Australian rates of tax on investment income beginning with its 1946 Treaty with the United Kingdom have always been high by OECD standards. Between the 1967 Australia – United Kingdom Treaty and the 2002 Protocol to the Australia – United States Treaty Australian tax rates in treaties on investment income were remarkably consistent. From the 2002 Protocol to the Australia – United States Treaty of 1982 Australia has lowered its treaty rates of withholding tax on some dividends and royalties but its treaty rates, particularly on interest, remain high by OECD standards.

Prior to the 1946 Australia – United Kingdom Treaty, Australia taxed all Australian sourced income derived by non residents on an assessment basis at relevant marginal

(2) Australian source dividends paid by

States delegation to agree to a uniform 15% rate on all dividends [117]apparently arguing that this would mean that the total level of Australian tax on dividends flowing to the United States would approximate the tax previously payable on such dividends prior to recent Australian tax increases and noting that there had still been substantial United States investment in Australia when taxes had been at the previous levels.[118] Australia also appears to have argued that a uniform rate would encourage the joint supply of capital to Australian companies by Australian and United States investors without United States investors suffering taxation disadvantages.[119] The Australian Commissioner of Taxation advised the Treasurer that a lesser reduction in Australian tax on dividends would not encourage United States investment in Australia, that a uniform rate would encourage Australian – United States joint contributions to capital, and that any greater reduction in Australian tax on dividends would benefit the United

royalties.[126] Article XII permitted Australian residents deriving mineral royalties from the United States to continue to be taxed on a 30% gross withholding tax basis or to lodge a return claiming expenses and to have tax imposed at a rate appropriate to the net income.[127]

As was the case with the 1946 Australia

United Kingdom Treaty, Australia would gain revenue in the 100% subsidiary situation but would lose revenue in the 25% subsidiary situation. They pointed out that that, because of the availability of a United Kingdom credit for underlying tax for United Kingdom companies having at least 10% of the voting power in the paying company, the United Kingdom revenue would generally not benefit in these cases from any reduction in the Australian tax on dividends below 15%. They noted, however, that the United Kingdom's 1966 Treaty with New Zealand had applied a 15% source country rate to all dividends. By this stage Australia imposed withholding tax on dividends at the rate of 30% but still taxed interest and royalties paid to non residents on an assessment basis although during the course of negotiations Australia advised the United Kingdom of its intention to introduce a withholding tax on interest and to alter its taxation of royalties paid to non-residents. On interest they pointed out that neither the 1946 Australia – United Kingdom Treaty nor the 1966 New Zealand – United Kingdom Treaty contained an interest article and advised that this meant that full source country taxing rights were retained in relation to interest. On royalties they contrasted the draft article with the equivalent provision in the United Kingdom – New Zealand treaty. That treaty imposed an upper tax rate of 10% on the source taxation of royalties except in the case of royalties effectively connected with a permanent establishment. The officials commented that under the United Kingdom – New Zealand treaty motion picture royalties were excluded with the effect that they remained taxable under the provisions of the law of each country. The officials noted that New Zealand currently levied taxes equivalent to 11% of the gross rentals of British films.[130]

The Australian Treasurer recognised that any new treaty with the United Kingdom would stand as 'something of a precedent'. The Treasurer's submission to cabinet

question was reserved for further discussion later.[133] The United Kingdom raised the issue of rates again on the morning session of the second day suggesting that the OECD rates of 15% for portfolio dividends and 5% for non portfolio dividends apply. The United Kingdom also suggested that the OECD definition of the type of company qualifying for the lower rate be adopted but did not consider this test sacrosanct.[134]

subsidiaries.[137] During the negotiations and in subsequent correspondence rates of source country tax on investment income we

but (except in the case of back to back loans) no source country tax was payable on interest derived by financial institutions dealing independently with the payer. Where interest was effectively connected with a permanent establishment or fixed base of the lender in the source country then the interest was taxable under the business profits article or independent personal services article.[142] The rate on royalties was reduced to 5% but, as had been the case under the original treaty, royalties were taxable under the business profits or independent personal services article where the royalty was effectively connected with a permanent establishment or fixed base in the source country of the person beneficially entitled to the royalties.[143]

By the late 1990s investment flows in and out of Australia were changing. While Australia remained a net capital importer there had been a significant increase in both non portfolio and portfolio outbound investment by Australians.[144] This led the Australian Board of Taxation in 2003 to recommend that, in future, Australia should move towards a more residence based treaty policy. The Board of Taxation also recommended that the key country treaties be reviewed and kept up to date in line with the recommendation of moving towards a more residence based treaty policy. Furthermore the Board of Taxation recommended that in future Australia should enter into treaty negotiations with other countries in the order of the most important investment partners with Australia.[145] The Government accepted these recommendations and they generally have been reflected in Australia's subsequent treaty practice.

3. PART III: CONCLUSION

Although Australian tax treaty policy and practice since 2001 has moved closer to OECD norms (particularly in the rates of withholding tax imposed and in agreeing to the non discrimination article) this paper has sought to demonstrate that Australian tax treaty policy and practice still has many distinctive features. In virtually every case there is evidence that these distinctive features were a product of Australia's emphasis on source basis taxation and in many instances were responses to Australian domestic law concerns. Even in two areas in which Australian practice has clearly moved closer to OECD norms, withholding tax rates and the non discrimination article Australian policy and practice still differs from the OECD Model. Current Australian treaty withholding tax rates are at the outer limits of the OECD Model (and exceed it in the case of royalties) and, as has been seen above, the Australian non discrimination article has savings clauses in relation to several Australian domestic law provisions and is not acceptable to some Australian treaty partners such as France. Even in the case of capital gains, where the modern Australian article closely aligns with the OECD Model, many extant Australian tax treaties contain a capital gains article in similar form to the article in the 1988 Australia – China Treaty which gives the source country the right to tax capital gains not otherwise mentioned in the article.

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[142] United States – Australia Protocol 2001, Article 7 of the Protocol amending Article 11 of the Treaty.

[143] United States – Australia Protocol 2001, Article 8 of the Protocol amending Article 12 of the Treaty.

[144] The Review of Business Taxation in 1999 noted that whereas in the first half of the 1980s Australian outbound investment represented only 20% of inbound investment by the late 1990s it represented 60%. Australia, Review of Business Taxation, *A Tax System Redesigned*, Canberra, 1999, at p679.

[145] Australia, Board of Taxation, *International Taxation: A Report To The Treasurer: Volume 1 – The Board's Recommendations*, Canberra, 2003, pp 89 to 97, Recommendations 3.5, 3.7 and 3.8.

Hence, the pervasive influence of the emphasis on source basis taxation in Australian tax treaty practice and policy up to 2001 remains evident in many of the detailed provisions in Australian tax treaties. If Australia is to move to a more residence based treaty practice then significant rethinking needs to take place in relation to the articles discussed in this paper and in other distinctive articles that are products of Australia's earlier emphasis on source basis taxation.