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The influence of domestic tax reviews on Australia's network of international tax treaties

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Abstract

The academic writing of Professor John Taylor on double tax treaties, particularly his meticulous documenting of the history of Australia's tax treaty network, is well known to international tax scholars. In honour of his contribution to this field of literature, we humbly attempt to contribute to the historical analysis of Australia's tax treaty network by testing and documenting the influence of domestic tax reviews conducted since 1999 on tax treaties negotiated or renegotiated in Australia over the same period. In the last 25 years, three significant reviews have extended recommendations beyond domestic tax reform to propose policy changes to the international tax treaty network. The Review of Business Taxation in 1999, the Board of Taxation's Review of International Taxation Arrangements in 2002-2003, and the Australia's Future Tax System review in 2010 made recommendations specifically relating to the tax treaty network. Between 1999 and 2023, the 25-year period of this study, Australia signed 33 tax treaties and protocols, thereby providing an ideal setting for examining the influence of tax reviews on tax treaty policy. This article examines the recommendations from the three reviews and considers their influence on Australia's tax treaty network. It notes the exemplary work of John Taylor in the analysis of the history of Australia's tax treaty policy and practices and provides a recommended approach to a future review of Australia's tax treaty network, concluding that a comprehensive review is not only warranted but long overdue.

Keywords: international taxation, double tax treaties, review of taxation, tax treaty policy

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1. INTRODUCTION

Professor John Taylor's academic writing on double tax treaties, particularly his meticulous documenting of the history of Australia's tax treaty network, is well known to international tax scholars.[1] In honour of his contribution to this field of literature, we humbly attempt to contribute to the historical analysis of Australia's tax treaty network by testing and documenting the influence of domestic tax reviews conducted since 1999 on tax treaties negotiated or renegotiated in Australia over the same period.

Australia has a long history with double tax treaties and is currently a party to 47 agreements,[2] each of which is considered an important part of Australia's international tax regime. The first treaty, entered into with the United Kingdom in 1946,[3] was the genesis of Australian tax treaty policy. It was negotiated at a time when Australia was a dominion of the British Commonwealth and a net importer of capital from the United Kingdom. At that time, the primary purpose of the United Kingdom–Australia double tax agreement (titled the *Agreement Between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*) was to remove the possibility of double taxation on United Kingdom investment in Australia. Attempts to relieve double taxation through the domestic United Kingdom Dominion Income Tax Relief regime were inadequate and failed to alleviate economic double taxation on dividend income derived from Australia.[4] Hence, as part of the treaty negotiations, Australia agreed to limit the source state's taxing rights in exchange for a foreign tax credit that could replace the Dominion Income Tax Relief system for United Kingdom residents.[5]

Throughout the 1950s to the 1970s, Australia's tax treaty network slowly expanded, with a second treaty entered into with the United States in 1953,[6] followed by Canada in 1957, New Zealand in 1960, and Japan and Singapore in 1969.[7] In 1971, Australia

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[1] See, for example, C John Taylor, 'The Negotiation and Drafting of the UK–Australia Double Taxation Treaty of 1946' [2009] (2) *British Tax Review* 201 ('The Negotiation and Drafting of the UK–Australia Double Taxation Treaty'); C John Taylor, '"I Suppose I Must Have More Discussion on This Dreary Subject": The Negotiation and Drafting of the UK–Australia Double Taxation Treaty of 1946' in John Tiley (ed), *Studies in the History of Tax Law, Vol 4* (Hart Publishing, 2010) 213; C John Taylor, 'Twilight of the Neanderthals, or Are Bilateral Double Taxation Treaty Networks Sustainable?' (2010) 34(1) *Melbourne University Law Review* 268; C John Taylor, 'Some Distinctive Features of Australian Tax Treaty Practice: An Examination of Their Origins and Interpretation' (2011) 9(3) *eJournal of Tax Research* 294 ('Some Distinctive Features of Australian Tax Treaty Practice').

[2] As at February 2024, the treaty with Iceland has not yet been incorporated into Australian law, a step necessary for its operation, and the treaty with Portugal has been signed on 30 November 2023 but has not come into force.

[3] *Agreement Between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, signed 29 October 1946, 17 UNTS 181 (entered into force 3 June 1947 and terminated 8 May 1968) ('Australia–UK Double Tax Agreement (1946)').

[4] See C John Taylor, 'The History of Australia's Double Tax Conventions', in Michael Lang and Ekkehart Reimer (eds), *The History of Double Taxation Conventions in the Pre-BEPS Era* (IBFD Publications, 2021) 623 ('The History of Australia's Double Tax Conventions'). In this chapter, Taylor described the details of Australia negotiating and signing tax treaties from 1946 to 1960, which were valuable historical archival documents for studying and researching Australian tax policy.

[5] Taylor, 'The Negotiation and Drafting of the UK–Australia Double Taxation Treaty', above n 1.

[6] Taylor, 'The History of Australia's Double Tax Conventions', above n 4.

[7] See Australian Treasury, 'Income Tax Treaties' (Web Page) <https://treasury.gov.au/tax-treaties/income-tax-treaties>.

joined the Organisation for Economic Co-operation and Development (OECD), with the treaty network subsequently extending to member countries, especially those in Europe. Amongst a total of seven tax treaties signed in the 1970s, five were with OECD members, namely Germany, New Zealand, France, Netherlands, and Belgium.[8] All, bar New Zealand, were European countries and those with which Australia was likely to strengthen economic connections. While Australia's treaty network has continued to expand with OECD member countries, the 1980s also saw a shift in focus to Asian countries. This shift in focus was driven by a change in economic policy to a more open economy and a dramatic tariff reduction, the removal of capital controls, and the floating of the currency. During this period, Australia signed tax treaties with Asian countries such as China, the Republic of Korea, Malaysia, Sri Lanka and Thailand, as well as continuing to expand the network by adding more European countries such as Austria, Denmark, Finland, Ireland, Italy, Malta, Norway, Sweden, and Switzerland. Following the 1980s, the number of new treaties declined but treaties continued to be negotiated when new trading partners emerged in Asia, such as India, Indonesia and Vietnam, and in Europe with the dismantling of the Iron Curtain and the expansion of the European Union.

Throughout the same period, starting in 1950 with the Spooner Committee,[9] Australia has had a history of tax reviews.[10] This long history of tax reviews has, however, resulted in little in the way of genuine and successful reform,[11] and, until 1999, there was also little in the way of suggested reform to Australia's network of double tax treaties. Consequently, a reconciliation of Australia's tax treaty network and tax reviews was simply not possible. However, this recently changed, and in the last 25 years, there have been three significant reviews that extended recommendations beyond domestic tax reform to propose policy changes to the international tax treaty network.

The first review to specifically deal with Australia's tax treaty network was the 1999 Review of Business Taxation,[12] known as the Ralph Review, which provided four recommendations that directly addressed Australia's tax treaty network with a policy objective of finding a balance between residence and source taxing rights. The second review took place in 2002 when the Board of Taxation was tasked to examine high-level aspects of the double tax agreement policy and processes.[13] Its report, as a response to

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[8] Australia signed an air profit agreement, rather than a double tax agreement, with Italy in 1972 and with Greece in 1977, so these two agreements are not counted here although Greece joined the OECD in 1961 and Italy joined in 1962. The Australia–New Zealand tax treaty signed in 1972 is also counted into the six treaties signed with the OECD members, although New Zealand joined the OECD in 1973.

[9] Commonwealth Committee on Taxation (ES Spooner, chair). Evans and Krever note that the Committee became a standing committee to which the Treasurer referred particular matters (there were over 50 such referrals) on income tax over the period 1950 to 1954: Chris Evans and Richard Krever, 'Tax Reviews in Australia: A Short Primer' in Chris Evans and Richard Krever (eds), *Australian Business Tax Reform in Retrospect and Prospect* (Thomson Reuters, 2009) 3, 3, n 2. There had also been the two Royal Commissions on Taxation in 1921-23 and 1934.

[10] Evans and Krever, above n 9.

[11] Ibid 4-11; Michael Dirkis, 'Tax Change or Tax Reform: Business Tax Reform Evaluated' in Geoffrey Lehmann (ed), *Business Tax Reform: Meet the Critics* (Australian Tax Research Foundation, 2007) 17, 47.

[12] See Review of Business Taxation (John Ralph, chair), *A Tax System Redesigned: More Certain, Equitable and Durable* (1999) <https://treasury.gov.au/review/review-of-business-taxation> ('Review of Business Taxation').

[13] See Board of Taxation, *International Taxation Arrangements: A Report to the Treasurer* (2003) <https://taxboard.gov.au/consultation/international-taxation-arrangements> ('Review of International Taxation Arrangements').

the Review of International Taxation Arrangements, contained four separate recommendations relating to Australia's tax treaty network and focused on a move towards a more residence-based treaty policy along with a more up-to-date process for treaty negotiations. The third review to consider tax treaties was the Australia's Future Tax System review, known as the Henry Review, with its report released in 2010.[14] The Henry Review made two recommendations relating to the treaty network, both specifically dealing with interest withholding tax.

This article examines the recommendations coming out of these three reviews and considers their influence on Australia's tax treaty network over the last 25 years. It does so as, unlike previous reviews, the three domestic reviews during this period, the Review of Business Taxation in 1999, the Board of Taxation Review into International Taxation Arrangements in 2002-2003, and Australia's Future Tax System review in 2010, made recommendations specifically relating to the tax treaty network. Further, between 1999 and 2023, the 25-year period of this study, Australia signed 33 tax treaties and protocols, thereby providing an ideal setting for an examination of the influence of tax reviews on treaty policy.[15]

Following this introduction, section 2 of this article analyses the 1999 Review of Business Taxation, while section 3 considers the 2002-2003 Board of Taxation Review of International Tax Arrangements. Section 4 examines the Australia's Future Tax System review. Section 5 notes John Taylor's exemplary work in analysing the history of Australia's tax treaty policy and practices. Further, it provides a recommended approach to a future review of Australia's tax treaty network, concluding that a comprehensive review is not only warranted but long overdue.

2. THE REVIEW OF BUSINESS TAXATION

The first review to specifically deal with Australia's tax treaty network was the 1998-1999 Review of Business Taxation, known as the Ralph Review. The Review Committee, consisting of three Australian businessmen, John Ralph (Chairman), Rick Allert, and Bob Joss, was established in 1998 to conduct a review into the reform of the Australian tax system. In 1999, the Ralph Committee submitted its report containing eight parts and 280 recommendations. Of those 280 recommendations, four specifically dealt with Australia's tax treaty network,[16] with a stated policy objective of finding a balance between source- and residence-based taxing rights.[17] The four recommendations, numbered 22.21 to 22.24, were set out in the section headed 'Improving Australia's Double Taxation Agreements'.[18] Specifically, these four recommendations dealt with dividend withholding taxes, non-discrimination articles, prioritising renegotiated treaties with trading partners, and a review of the treaty policy

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[14] See Australia's Future Tax System Review Panel (Dr Ken Henry, chair), *Australia's Future Tax System: Report to the Treasurer* (2009) <https://treasury.gov.au/review/the-australias-future-tax-system-review/final-report> ('Henry Review').

[15] Note that this involves 27 countries as three protocols were signed by Malaysia, and tax treaties and protocols were signed with New Zealand, Finland, Norway, and France respectively.

[16] Review of Business Taxation, above n 12. Some recommendations in the report were indirectly relevant to the Australian tax treaties, for example, Recommendation 20.1 for applying an imputation credit for foreign dividend withholding taxes up to a 15 per cent tax rate, which is relevant to the application of the Article on the method to relieve double taxation when Australia is in the position of the residence state. This study considers those recommended measures directly addressing tax treaty issues.

[17] Ibid Recommendation 22.24 (Review of DTA Policy').

[18] Ibid 677-680 ('Improving Australia's Double Taxation Agreements').

to ensure it reflected a balanced taxation of international investment and changed investment patterns.

On 11 November 1999, the then Treasurer, The Honourable Peter Costello MP, announced The New Tax System: Stage 2 Response,[19] supporting the four recommendations relating to Australia's tax treaty network. In doing so, it was stated that the double tax agreement policy had, to date, reflected that Australia had traditionally been a capital-importing country but that the increasing amount of Australian investment abroad required a greater focus in double tax agreements on the taxation of foreign source income.[20] The implementation of this policy and the adoption of each of the recommendations is reflected in a change in treaty position as discussed below.

2.1 Reduction in dividend withholding taxes (DWT)

The first recommendation, contained in Recommendation 22.21, provided that in negotiating double tax agreements, Australia should endeavour to reduce dividend withholding tax rates on non-portfolio investment. This measure aimed to complement the recommended imputation credit for foreign dividend withholding taxes up to 15 per cent, with the motivation for reducing the rates of withholding taxes being to facilitate cross-border direct investment by lowering the tax cost of repatriation of profits (dividends) at the border. The Review noted that Australia had traditionally sought a rate of 15 per cent in its treaties reflecting its position as a net capital importer, with dividend withholding tax unilaterally reduced to zero on franked dividends after the introduction of the imputation system in 1987. However, this left Australian investors offshore receiving no complementary benefits when investing overseas in treaty partner countries. A rate of 5 per cent, as the international standard, was recommended in most cases as it retained some source country taxation of the profits in the hands of the shareholders.[21]

Prior to the Review of Business Taxation, six of Australia's tax treaties had provisions that reduced withholding tax on non-portfolio dividends below 15 per cent.[22] This is in stark contrast to the treaties signed after the Review, suggesting that the recommendation was adopted. Of the 33 treaties and protocols signed by Australia since the Review, 22 have contained articles that lower the dividend withholding tax rates on non-portfolio dividends. Of the 22 treaties and protocols entered into, 10 were treaties signed with new treaty partners, eight were new tax treaties signed with existing treaty partners, thereby replacing existing treaties, and four were protocols signed with the treaty partners to amend existing double tax agreements. While 15 per cent was the default rate prior to the Review, post-Review, the negotiated dividend withholding tax rate on non-portfolio dividends ranged from 10 per cent down to zero, with 5 per cent, the international standard recommended by the Review, being the most frequently

[19] See Hon Peter Costello (Treasurer), 'The New Business Tax System: Stage 2 Response' (Media Release, 11 November 1999) <https://ministers.treasury.gov.au/ministers/peter-costello-1996/media-releases/new-business-tax-system-stage-2-response>.
[20] Ibid Attachment G ('Allocating Income Between Countries').
[21] Review of Business Taxation, above n 12, Recommendation 22.21 ('Lower Rates of DWT on Non-Portfolio Investment').
[22] Czech Republic (1995), France (1989), Philippines (1979), Taiwan (1996), Thailand (1989) and Vietnam (1992).

negotiated position.[23] Of note is the 1982 United States–Australia tax treaty, specifically mentioned in the Review, which had a rate of 15 per cent, being re-negotiated in the 2001 US Protocol, to a rate of 5 per cent or zero where the shares owned represent 80 per cent or more of the voting power of the company paying the dividends (subject to treaty shopping protections). Many subsequent treaties have introduced a similar provision. Further treaties and the relevant rates are noted in Table 1.

Table 1: DWT Rates for Non-Portfolio Dividends in Australian Tax Treaties/Protocols Concluded Since 1999

Treaty Partner States	DWT for portfolio dividends	DWT for non-portfolio dividends*
Double Tax Agreements signed with new treaty partners		
Argentina	15%	10%
Chile	15%	5%
Iceland	15%	0% or 5%
Israel	15%	5%
Mexico	15%	0%
Romania	15%	5%
Russia	15%	5%
Turkey	15%	5%
Portugal	10%	5%
Double Tax Agreements signed with existing treaty partners to replace a previous treaty		
Finland	15%	0% or 5%
France	15%	0% or 5%
Germany	15%	0% or 5%
Japan	10%	0% or 5%
New Zealand	15%	0% or 5%
Norway	15%	0% or 5%
Switzerland	15%	0% or 5%
The U.K.	15%	0% or 5%
Protocols signed with existing treaty partners to amend the existing Tax Treaties		
Canada	15%	5%
Malaysia	15%	0%
South Africa	15%	5%
The U.S.	15%	0% or 5%

*A rate of zero per cent will apply on intercorporate non-portfolio dividends where the recipient holds directly at least 80 per cent of the voting power of the company paying the dividend, subject to certain conditions.

[23] The Review noted that there were cases of zero, for example, in the case of countries in the European Union.

2.2 Non-discrimination articles

The second recommendation of the Review of Business Taxation, contained in Recommendation 22.22,[24] stated that in accordance with international norms, Australia should agree to a non-discrimination article in future double tax agreements. By including a non-discrimination article, Australia ensures that a non-resident is treated no less favourably than a comparable resident. The Review Committee noted that, at the time, Australia was the only OECD country that did not include a non-discrimination article in its treaties as this position was regarded as originally necessary to protect Australia's source country taxing rights and narrow base prior to the introduction of capital gains tax in 1985. The Review Committee believed that such an article was necessary to ensure Australia's good record in the area, to protect Australian enterprises expanding overseas, and so as to not hinder future negotiations. In this regard, it was suggested that renegotiating treaties had been difficult because of a lack of a non-discrimination clause and that a change in policy would greatly assist the process.

Prior to the Review of Business Taxation, the only Australian tax treaty with a non-discrimination article was the Australia–United States treaty signed in 1982 (and entering into force in 1983). At that time, the United States negotiators were adamant that a non-discrimination article be included in the treaty and Australian negotiators agreed but reached an arrangement that the article would not be given force of law in Australia and would not create private law rights of appeal.[25] It provided, however, for consultation between the two governments and expressed the best intentions of the parties to achieve the stated aims.[26] In the legislation bringing the treaty into Australian law, however, the non-discrimination article in the Australia–United States treaty (1982) was not included and consequently has never been given the force of domestic law in Australia.[27]

Subsequent to the Review of Business Taxation, 14 more treaties were entered into containing non-discrimination articles. Five of these 14 treaties were with new treaty partners,[28] and seven were new treaties signed with the existing treaty partners to replace prior treaties,[29] with the remaining two being protocols to amend the existing double tax agreements between Australia and the treaty partners.[30] The language in all 14 articles is similar, generally stating that 'Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to

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[24] Review of Business Taxation, above n 12, Recommendation 22.22 ('Inclusion of a Non-Discrimination Article').

[25] For a comprehensive discussion of the negotiations and the resulting agreement, see C John Taylor, 'Much Ado about Non-discrimination in Negotiating and Drafting of the 1982 Australia–US Taxation Treaty' in Peter Harris and Dominic de Cogan (eds), *Studies in the History of Tax Law, Vol 10* (Hart Publishing, 2021) 253.

[26] Explanatory Memorandum to the Income Tax (International Agreements) Amendment Bill 1983.

[27] Li Na, Kerrie Sadiq and Richard Krever 'Can Australia's Double Tax Treaties Invalidate State Real Estate Taxes?' (2024) 113(1) *Tax Notes International* 47, 48.

[28] Chile (2010), Israel (2019), Turkey (2010), Iceland (2022) and Portugal (2023). As noted at n 2 above, the treaty with Iceland has not yet been incorporated into Australian law, a step necessary for its operation, and the treaty with Portugal has been signed but has not come into force.

[29] United Kingdom (2003), Norway (2006), Finland (2006), Japan (2008), New Zealand (2009), Switzerland (2013) and Germany (2015).

[30] South Africa (2008) and India (2011).

which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected'.[31]

The format of these 14 non-discrimination articles also tends to follow the format of Article 24 of the *OECD Model Tax Convention on Income and on Capital* (OECD Model Tax Convention). However, perhaps surprisingly, the taxes covered by these treaties vary somewhat. As a result, the extent of protection offered by the non-discrimination clauses in these 14 jurisdictions is different. The relevant articles can be divided into four categories. The most restrictive versions of the non-discrimination article, found in five treaties,[32] limit its application to taxes explicitly covered by the treaty, normally the income tax and sometimes the fringe benefits tax and petroleum resource rent tax. In one case, that of Chile, the taxes covered are extended to include, for non-discrimination purposes, Australia's federal indirect tax, the goods and services tax. In only five cases[33] are Australia's DTAs consistent with the OECD Model Tax Convention, where the scope of the non-discrimination article is extended to cover any taxation or taxes of every kind and description, with this construction, on its face, including subnational state taxes. However, there may be some doubt about this interpretation given the explicit addition in three treaties, Finland, Japan, and New Zealand, extending the scope of the non-discrimination article to taxes of every kind and description imposed by a contracting state or a political subdivision.[34] More recently, the reach of non-discrimination articles to state taxes has arisen due to higher state sales taxes being imposed on foreign investors. Legislation has now been passed to include in the *International Tax Agreements Act 1953* a provision that ensures the non-discrimination clause in treaties only extends to income and associated fringe benefits, not state taxes.[35]

2.3 Priority to trading partners

The third recommendation, contained in Recommendation 22.23,[36] provided that priority should be given to renegotiating ageing double tax agreements with major trading partners to make them consistent with Australia's current treaty policy and with decisions concerning tax reform. The Review Committee noted that, at that time, treaties with the United Kingdom and Japan dated to 1967 and 1969, respectively. Further, although the current United States Convention dated from 1983, essentially it reflected a bargain struck in the early 1970s, and none of these treaties properly reflected modern tax treaty policy or took into account emerging tax treaty issues such as arbitration, assistance in recovery, data protection, and offshore activities.

The tax treaties and protocols that Australia has concluded since 1999 consist of the following three categories; new tax treaties, existing tax treaties that were renegotiated, and protocols signed to amend existing tax treaties. Since 1999, there have been 11 new

[31] See, for example, the Australia–Chile tax treaty signed in 2010: *Convention Between Australia and the Republic of Chile for the Avoidance of Double Taxation with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion*, signed 10 March 2010, [2013] ATS 7 (entered into force 8 February 2013) art 24 ('Australia–Chile Double Tax Agreement').
[32] The United Kingdom, Turkey, Israel, Iceland, and Portugal.
[33] Norway, South Africa, India, Switzerland, and Germany.
[34] Li et al, above n 27, 48.
[35] *Treasury Laws Amendment (Foreign Investment) Act 2024*.
[36] Review of Business Taxation, above n 12, Recommendation 22.23 ('Priority for DTAs with Major Trading Partners').

treaty partners with no discernible geographical pattern. These treaties range from Argentina (1999), Slovakia (1999), South Africa (1999), Romania (2000), Russia (2000), Mexico (2002), Chile (2010), and Turkey (2010), to the more recent treaties with Israel (2019), Iceland (2022), and Portugal (2023). On the other hand, renegotiated treaties with existing partners reflect a more traditional approach, with those countries being the United Kingdom (2003), Finland (2006), France (2006), Norway (2006), Japan (2008), New Zealand (2009), Switzerland (2013) and Germany (2015). Further, protocols signed are also consistent with the targeted countries for renegotiation as they include the United States of America (2001), Canada (2002), Malaysia (1999, 2002 and 2010), Vietnam (2002), New Zealand (2005), South Africa (2008), Belgium (2009), Finland (2009), Singapore (2009), India (2011), Norway (2011), and France (2018).

Consistent with the recommendations of the Review of Business Taxation, Australia focused on updating its existing network to reflect modern tax treaty policy. Australia indeed made efforts to renegotiate the ageing tax treaties with its trading partners, especially those particularly listed by the Review, namely the United States, the United Kingdom, and Japan, through concluding new double tax agreements to replace the prior ones or signing protocols to amend their existing double tax agreements. However, it should be noted that some ageing tax treaties with contracting states in Asia and Europe have still not been renegotiated despite many of these jurisdictions being major trading partners where Australian residents have investments or have been carrying out cross-border transactions. For example, the Philippines (1979), Ireland (1983), China (1988), and Thailand (1989), all fall within this category.

2.4 A review of treaty policy

The fourth recommendation, contained in Recommendation 22.24,[37] provided that to assist Australia's competitiveness, its overall treaty policy should be reviewed in order to ensure that it reflected a balanced taxation of international investment and changed investment patterns. This broad recommendation, perhaps the most significant of the four, acknowledged the changing landscape in the Australian economy, particularly from one of traditionally being a net capital importer to an increasingly large amount of capital exports. Statistics provided in the Report suggested that in the first half of the 1980s, Australian investment abroad was only 10 to 20 per cent of the volume of foreign investment in Australia, but by the late 1990s, Australian investment abroad was approximately 60 per cent of the level of foreign investment in Australia.[38] The aim of reviewing treaty policy was to ensure an appropriate balance of source- and residence-based taxing rights to encourage both inbound and outbound investment.

As John Taylor noted, it is extremely rare for government material on Australian tax treaty policy and practice to be made public.[39] An exception occurred in 2008[40] when

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[37] Ibid Recommendation 22.24, above n 17.

[38] Ibid; Review of Business Taxation (John Ralph, chair), *A Strong Foundation: Discussion Paper, Establishing Objectives, Principles and Processes* (1998) 24, Fig 2.3.

[39] See Christopher John Taylor, 'A Critical Assessment of the Origins and Continued Validity of Variations in Australian Tax Treaties from the OECD Model' (PhD Thesis, University of Sydney, 2016) 21 <https://ses.library.usyd.edu.au/bitstream/handle/2123/15785/?sequence=2> ('A Critical Assessment').

[40] Hon Chris Bowen (Assistant Treasurer and Minister for Competition Policy and Consumer Affairs), 'Australia's Tax Treaty Negotiation Policy' (Media Release, 25 January 2008) <https://ministers.treasury.gov.au/ministers/chris-bowen-2007/media-releases/australias-tax-treaty-negotiation-policy#attach>.

the government at the time commissioned a review of Australia's tax treaty policy and provided feedback on submissions received.[41] A formal report was not published. However, a media release indicated that '[s]ubmissions presented a range of suggestions to improve Australia's treaty policy and provided recommendations for the treaty program. Submissions called on the Government to prioritise negotiating tax treaties with emerging economies in our region and countries with which Australia has most favoured nation (MFN) obligations'.[42]

Seven key themes were identified from the consultation process and made public.[43] The first was the need to prioritise the emerging economies of China and India as well as other countries in the region, such as Singapore, Hong Kong, Indonesia, the Philippines, Malaysia, Thailand, and countries that would position Australia as a regional headquarters for United States, United Kingdom, and European multinational companies.[44] The remaining themes included a more residence-based approach, lower dividend and royalty withholding tax rates, provisions to deal with real estate investment trusts, treatment of capital gains, transfer pricing audits, and arbitration clauses. Of note is that many of these themes are consistent with the Board of Taxation Review in 2002 rather than the Review of Business Taxation that preceded it, perhaps due to its intervening effect and its more comprehensive consideration of Australia's treaty network.

Subsequent to the 2008 Review and feedback provided by the government, two consultation processes have been conducted into the expansion of Australia's tax treaty network. In September 2021, the Treasury sought submissions from stakeholders on the key outcomes Australia should seek in negotiating these tax treaties and other issues related to Australia's treaty network.[45] Forty-one submissions were received, with 35 of those publicly available. However, the federal government did not provide a response to those submissions or address key themes. On 13 March 2024, another consultation was announced with the Australian government seeking stakeholder views on key outcomes it should seek in entering into tax treaty negotiations with Brazil, New Zealand, the Republic of Korea, Sweden, and Ukraine as part of its expansion of Australia's tax treaty network.[46] At the time of writing, submissions have not been made public and the federal government has not provided feedback.

3. The Board of Taxation's Review of International Taxation Arrangements

The Board of Taxation, a non-statutory advisory body charged with contributing a business and broader community perspective to improving the design of taxation laws and their operation, was charged in 2002 with reviewing Australia's international

[41] Hon Chris Bowen (Assistant Treasurer and Minister for Competition Policy and Consumer Affairs), 'Australia's Tax Treaties – Industry's Message to Government' (Media Release, 26 June 2008) <https://ministers.treasury.gov.au/ministers/chris-bowen-2007/media-releases/australias-tax-treaties-industrys-message-government> ('Australia's Tax Treaties – Industry's Message to Government').
[42] Ibid.
[43] Ibid.
[44] Ibid.
[45] Australian Treasury, 'Expanding Australia's Tax Treaty Network' (Consultation, 16 September 2021) <https://treasury.gov.au/consultation/c2021-208427>.
[46] Australian Treasury, 'Expanding Australia's Tax Treaty Network' (Consultation, 13 March 2024) <https://treasury.gov.au/consultation/c2024-506070>.

taxation arrangements from four principal areas. These areas consisted of the dividend imputation system's treatment of foreign source income, the foreign source income rules, the overall treatment of conduit income, and the high-level aspects of the double tax agreement policy and processes. In February 2003, the Board of Taxation delivered its Report to the Treasurer, which was subsequently made public on 13 May 2003 as Volume 1 and Volume 2 of the Board's Report.[47]

From a broad policy perspective, the Board endorsed the direction of the government at the time in moving to a more residence-based approach in its tax treaties.[48] It noted that the existing treaties tended to emphasise source through their wide definition of permanent establishment and relatively high withholding tax ceiling on dividends, interest, and royalties. The Board expressed the view that it believed 'the source-based [double tax agreement] policy has detrimental impacts on Australian firms investing offshore because it exposes them to high taxes in tax treaty partner countries.'[49] and suggested Australia's tax treaty policy should move towards a more residence-based treaty policy in substitution for the treaty model based on the source taxation of income'.[50] The consequence of this overarching view was that the Board's recommendations were generally broader and more aggressive than the earlier Review of Business Taxation.

The broad recommendations were made in an attempt to update Australia's tax treaty negotiation policy to reflect a change from being a significant capital importer to having a more equal inflow and outflow of investments. The Board expressed the view that '[t]he distorting effects of source-based taxes may mean that resulting economic efficiency gains for both inbound and outbound investment will exceed revenue foregone by moving to a residence-based policy for [double tax agreements]'.[51] The Board also commented on the 2001 Amending Protocol with the United States (2001 US Protocol), citing it as an example of a move towards residence-based taxing rights but one that still has greater source-taxing emphasis than the OECD Model Tax Convention.[52]

While numerous recommendations dealt peripherally with treaty issues,[53] and other recommendations supported the views expressed in the Review of Business Taxation,[54] four substantive recommendations that had the potential to lead to changes in Australia's tax treaty network can be identified. The Board suggested these four recommendations as potential solutions to what it saw as the overarching challenges to

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[47] Board of Taxation, Review of International Taxation Arrangements, above n 13. Volume 3 of the Report involving confidential submissions was not released by the Treasurer.
[48] Ibid vol 1, 11.
[49] Ibid para 3.55.
[50] Ibid 94; there is some incidental discussion of tax treaties elsewhere in the report, eg, at 105-106.
[51] Ibid 93; there is some incidental discussion of tax treaties elsewhere in the report, eg, at 105-106.
[52] *Protocol Amending the Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income of 6 August 1982 ([1983] ATS 16),* signed 27 September 2001, 2260 UNTS 117 (entered into force 12 May 2003) ('2001 US Protocol'). See <https://www.austlii.edu.au/au/other/dfat/treaties/2003/14.html>.
[53] For example, Recommendation 3.13 provided that a non-resident for treaty purposes should be treated as a non-resident for all purposes of income tax law, as an alternative to the current dual resident company provisions. See Board of Taxation, Review of International Taxation Arrangements, above n 13, vol 1, 10.
[54] For example, lowering the dividend withholding tax on non-portfolio dividends, priority in renegotiating tax treaties with major trading partners.

Australia's tax treaty network. Numbered 3.5 to 3.8, the four recommendations were found in the section discussing '[promotion of] Australia as a location for internationally-focused companies'.[55] Specifically, these four recommendations dealt with a move towards a more residence-based treaty policy, rejecting the application of capital gains tax to the sale by non-residents of non-resident interposed entities with underlying Australian assets (apart from land, discussed below), prioritising treaty negotiations with investment partners, and improvements around the processes on negotiating tax treaties.

3.1 A more residence-based treaty policy

In line with the Board's overarching comments, Recommendation 3.5 of the Report suggested a move towards a more residence-based treaty policy in substitution for the treaty model based on the source taxation of income.[56] The emphasis within this recommendation was placed on withholding taxes based on the argument that higher levels of withholding tax may disadvantage Australian companies operating offshore against local competitors and against competitors resident in countries that negotiate lower withholding tax rates.[57] This recommendation was consistent with Australia increasingly becoming a capital-exporting nation. It was suggested that future treaties should be negotiated or renegotiated in line with the 2001 US Protocol and that treaties should eliminate the dividend withholding tax for most franked and unfranked non-portfolio dividends, reduce the royalty withholding tax rate, and reduce the interest withholding tax rate to zero for financial institutions.[58] These changes would have the resulting effect of reducing both tax paid by non-residents on Australian sourced income and reducing the cost to Australian businesses investing in treaty partner countries.

A review of Australia's negotiated or renegotiated treaties since 2002 indicates that dividend withholding tax rates have been reduced and are listed in Table 1 above. There has also been a change in policy in relation to interest withholding taxes for financial institutions and a reduction in the rate of royalty withholding taxes. Treaties negotiated since 2002 have generally adopted a zero per cent rate for interest withholding taxes for financial institutions. This includes the treaties with the UK, France, Norway, Finland, Japan, New Zealand, Switzerland, Germany, Iceland, and South Africa. The treaties with Chile and Portugal provide for a reduced rate of 5 per cent on interest paid by financial institutions. Royalty withholding tax in treaties negotiated since 2002 are generally at the rate of 5 per cent (UK, France, Norway, Finland, Japan, New Zealand, Chile, Switzerland, Germany, Israel, South Africa), with the more recent treaties of Iceland and Portugal increasing the rate to 10 per cent.

Three treaties negotiated in or post-2002 contain a zero per cent dividend withholding tax rate – the treaty signed with Mexico in 2002, the protocol signed with Malaysia in the same year, and the treaty signed with France in 2006. Each, however, adopts a different approach. The treaty entered into with Mexico in 2002[59] provides a reciprocal

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[55] Board of Taxation, Review of International Taxation Arrangements, above n 13, vol 1, 89-97.
[56] Ibid vol 1, 3.
[57] Ibid vol 1, 93.
[58] Ibid.
[59] *Agreement Between the Government of Australia and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, signed 9 September 2002, 2453 UNTS 3 (entered into force 31 December 2003).

approach of eliminating dividend withholding tax on franked non-portfolio dividends.[60] In contrast, the treaty with France in 2006 provided a unilateral approach where France and Australia, in the position of the source state, committed to imposing a zero per cent dividend withholding tax rate on dividends paid out of profits that have borne the normal rate of company tax and those dividends are paid to a company which, in the case of Australia, holds directly at least 10 per cent of the voting power of the company paying the dividends, or in the case of France, holds directly at least 10 per cent of the capital of the company paying the dividends.[61]

The 2002 protocol with Malaysia adopted a different approach to the Mexico and France treaties. Specifically, the protocol provided that when Australia is the source country, no tax shall be charged on dividends to the extent to which those dividends have been '"franked" in accordance with Australia's law relating to tax, if the person beneficially entitled to those dividends is a company (other than a partnership) which holds directly at least 10 per cent of the voting power in the company paying the dividends'.[62] When Malaysia is the source country, 'no tax shall be charged on dividends paid by a company which is resident in Malaysia for the purposes of Malaysian tax being dividends to which a resident of Australia is beneficially entitled, in addition to the tax chargeable in respect of the income or profits of the company paying the dividends'.[63] Consequently, Malaysia committed to exempting the dividend withholding tax on dividends, regardless of whether the dividends were franked or unfranked and whether they were portfolio or non-portfolio in nature.

By far the most significant development during this period was the introduction of a zero rate of dividend withholding tax on inter-corporate dividends where the beneficial owner of the dividends is a company that owns directly shares representing at least 80 per cent of the voting power of the company paying the dividends for the 12-month period ending on the date on which entitlement to the dividends is determined. The policy rationale for this reduction is to remove distortions in the raising of capital for direct investment that results from the more favourable terms that applied in many of the earlier treaties.

3.2 Not extending capital gains tax to sale of shares in non-resident companies

The Review of Business Taxation had, in 1999, proposed that capital gains tax should apply to the sale by non-residents of non-resident interposed entities with underlying Australian assets.[64] The Board of Taxation, in Recommendation 3.6, disagreed with

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[60] Ibid Art 10.2.

[61] *Convention Between the Government of Australia and the Government of the French Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion*, signed 20 June 2006, 2614 UNTS 63 (entered into force 1 June 2009) Art 10.2(a).

[62] *Agreement Between the Government of Australia and the Government of Malaysia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, signed 20 August 1980, 1334 UNTS 237 (entered into force 26 June 1981) Art 10.2(a)(ii) (as amended by the *Second Protocol Amending the Agreement Between the Government of Australia and the Government of Malaysia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income as Amended by the First Protocol of 2 August 1999*, signed 28 July 2002, 2651 UNTS 105 (entered into force 23 July 2003) Art 2 ('Second Protocol to the Australia–Malaysia Double Tax Agreement')).

[63] Ibid Art 10.2(b) as amended by the Second Protocol to the Australia–Malaysia Double Tax Agreement, above n 62, Art 2.

[64] Review of Business Taxation, above n 12, Recommendation 21.7 ('Avoidance of Tax on Capital Gains by Non-Residents').

such a proposal on the basis that it would be difficult to comply with and hard to enforce.[65] Further, such an extension of Australia's capital gains tax regime would cause inadvertent breaches for overseas investors with a relatively small revenue gain in terms of Australian taxes collected.[66]

When Australia introduced a capital gains tax in 1985, two important issues arose in relation to double tax agreements. The first was how existing treaties applied in relation to capital gains tax, and the second was how future double tax agreements would deal with it. Consistent with Australia's broad-source taxing policy, the Australian Taxation Office (ATO) had taken the position that pre-capital gains tax treaties do not limit taxing rights.[67] Australia also preserved domestic law source taxing rights over capital gains in treaties negotiated after the introduction of the capital gains tax up to 2003. The provisions operated to ensure the capital gains tax is paid on gains by non-residents on shares in resident private companies and non-portfolio interests in public companies. However, capital gains tax did not extend to the sale of shares by non-residents in non-resident companies that hold Australian assets.

The application of the capital gains tax provisions to non-resident shareholders who hold shares in non-resident companies with underlying Australian assets had previously been decided by the court in *Lamesa Holdings*.[68] In that case, it was held that non-residents were not liable for capital gains tax when selling interests of interposed entities whose underlying value is principally derived from Australian real property.[69] In that case, a Dutch company – Lamesa Holdings – sold an interest held in Australian real property via three interposed companies. The shares disposed of by Lamesa Holdings were held in a first-tier Australian company. The Federal Court supported the arguments of Lamesa Holdings, finding that Australia could not tax the gains because the alienation of property article (Article 13) of the Australia–Netherlands income tax treaty (1976)[70] only dealt with gains from the disposal of shares in companies with direct ownership of land and related interests.

Subsequent to *Lamesa Holdings*, the Australian government amended the *International Tax Agreements Act 1953* by inserting section 3A to clarify the meaning of terms used in the alienation of property article in Australia's tax treaties.[71] The Australian government intended to use this new section 3A to override all treaties with limited wording by stipulating that they were to be read as if they applied to profits on the sale of companies with both direct and indirect, through other entities, interests in real property or related interests.[72] While the treaty override was technically legal under Australian law as opposed to international law, as tax treaties only have full application

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[65] Ibid vol 1, 94.
[66] Ibid 93.
[67] ATO, 'Income Tax and Capital Gains Tax: Capital Gains in Pre-CGT Tax Treaties', Taxation Ruling TR 2001/12, now withdrawn.
[68] *Federal Commissioner of Taxation v Lamesa Holdings BV* (1997) 77 FCR 597.
[69] See Robert Deutsch and Nolan Sharkey, 'Australia's Capital Gains Tax and Double Taxation Agreements' (2002) 56(6) *Bulletin for International Taxation* 228; Nikki Teo, 'Australia' in Guglielmo Maisto (ed), *Taxation of Companies on Capital Gains on Shares under Domestic Law, EU Law and Tax Treaties* (IBFD Publications, 2013).
[70] *Agreement Between Australia and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, signed on 17 March 1976, 1029 UNTS 135 (entered into force 27 September 1976).
[71] See the Taxation Laws Amendment Bill (No 11) 1999.
[72] Ibid.

when incorporated into domestic law, the move did not enhance Australia's reputation as a reliable treaty partner.[73] Secondly, Australia concluded eight treaties,[74] in the form of new tax treaties or protocols to amend the prior treaties, with a provision ensuring Australia taxes the transfer of interest directly or indirectly derived principally from the Australian real property.

Domestic law was also amended in 2006 with the *Income Tax Assessment Act 1997* now providing that non-resident shareholders are subject to Australia's capital gains tax rules on the disposal of interests in an entity that holds taxable Australian real property if the entity's underlying value is principally derived from real property located in Australia. As such, from a domestic law perspective, non-residents are taxed on capital gains in respect of certain capital gains tax events happening to Australian property by broadly limiting these assets to real property situated in Australia.[75] Where, however, a non-resident disposes of an indirect interest in Australian real property through one or more interposed entities, the Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No 4) Bill indicates that the amending provision has the effect that the legislation is consistent with Australian and OECD Model Tax Convention practice by applying the capital gain taxes on disposal of interposed resident or non-resident entities by non-residents where more than 50 per cent of the value of the interposed entity is derived from Australian real property.[76] Further, the Explanatory Memorandum notes that Australia has a double tax agreement source country taxing right in respect of capital gains/losses from interests in entities whose assets consist principally of Australian real property, even where held indirectly through a chain of entities.

The Board of Taxation rejected any proposal that the capital gains tax should be extended to shares in non-resident companies as proposed by the Review of Business Taxation. It noted that while the issue has been well understood internationally for many years, very few countries have sought to extend their capital gains tax to shares in foreign companies. The Board's recommendation was to align Australian treaty provisions with the international norm. That is, apart from land-rich companies, capital gains tax should not be levied on non-residents when they dispose of shares in domestic companies, whether portfolio or non-portfolio interests.[77] This approach is consistent with both Australian treaty policy and domestic policy, as outlined above.[78]

Currently, 20[79] of the 47 Australian tax treaties contain a provision in Article 13 allocating the taxing rights to Australia over non-residents' alienation of interests

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[73] Richard Krever, 'Tax Treaties and the Taxation of Non-Residents' Capital Gains' in Arthur J Cockfield (ed), *Globalization and Its Tax Discontents: Tax Policy and International Investments, Essays in Honour of Alex Easson* (University of Toronto Press, 2010) 212.
[74] Argentina (1999), Canada (protocol 2002), Malaysia (protocol 1999), Mexico (2002), Romania (2000), Russia (2000), Slovakia (1999), South Africa (1999, and protocol 2008).
[75] Philip Bender, 'Double Tax Treaties and the New Regime for Capital Gains Taxation of Non-Residents' (2007) 36(1) *Australian Tax Review* 49.
[76] Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No 4) Bill 2006.
[77] Board of Taxation, Review of International Taxation Arrangements, above n 13, vol 1, para 3.57.
[78] See Hon Peter Costello (Treasurer), 'International Tax Reforms' (Media Release, 10 May 2005) attachment B <https://ministers.treasury.gov.au/ministers/peter-costello-1996/media-releases/international-tax-reforms>.
[79] Argentina (1999), Canada (protocol 2002), Chile (2010), Finland (2006), France (2006), Germany (2015), Israel (2019), Japan (2008), Malaysia (protocol 1999), Mexico (2002), New Zealand (2009), Norway (2006), Romania (2000), Russia (2000), Slovakia (1999), South Africa (1999, and protocol 2008), Switzerland (2013), Turkey (2010), UK (2003), Iceland (2022), Portugal (2023).

directly or indirectly held in immovable (real) property-rich companies located in Australia. Fifteen of these treaties were signed or amended by relevant protocols since 2002. The typical text of such a specific provision with a principal test of either 'more than 50 per cent of the value' or 'principally attributable' is as follows:

> Income, profits or gains derived by a resident of a Contracting State from the alienation of any shares, comparable interests or other rights deriving more than 50 per cent of their value directly or indirectly from immovable (real) property situated in the other Contracting State may be taxed in that other State.[80]

or

> Income, profits or gains derived by a resident of a Contracting State from the alienation of any shares or other interests in a company, or of an interest of any kind in a partnership or trust or other entity, where the value of the assets of that company, partnership, trust, or other entity, whether they are held directly or indirectly (including through one or more interposed entities, such as, for example, through a chain of companies), is principally attributable to real property situated in the other Contracting State, may be taxed in that other State.[81]

The description of the 'real property' in these tax treaties varies from both the OECD Model Tax Convention and the *United Nations Model Double Taxation Convention between Developed and Developing Countries* (UN Model Tax Convention), which use the civil law term 'immovable property'. In contrast, Australia prefers to use the common law term 'real property'. The assumption underlying this rule is that gains from the sale of real property are unambiguously connected with the source jurisdiction and that jurisdiction merits first access to taxing rights from the gains.[82] At the same time, the treaties recognise other gains may be directly related to real property or derive from it such as mineral exploration rights and mining rights. Australian treaties commonly extend the application of the article to these ancillary property rights or include them in the definition of real property covered by Article 6 of the treaty, which often includes both the interest in or over land and natural resources, given that Australia is a resource-rich country.

3.3 Priorities in negotiation

The Board commented that in recent times, priority had been given to relatively minor investment partners in extending the network.[83] In addition to keeping key treaties up to date with Recommendation 3.5, in Recommendation 3.7, the Board affirmed the Review of Business Taxation's suggestion to renegotiate tax treaties with existing major trading partners rather than extend the tax treaty network to countries with which Australia has little trade or investment. However, it was recognised that political and economic events could also affect negotiation priorities at particular times.[84] The Board stressed the need

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[80] Australia–Chile Double Tax Agreement, above n 31, Art 13(4).

[81] *Agreement Between the Government of Australia and the Government of the Argentine Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, signed 27 August 1999, 2117 UNTS 3 (entered into force 31 December 1999) Art 13(2).

[82] Richard Krever and Kerrie Sadiq, 'Non-Residents and Capital Gains Tax in Australia' (2019) 67(1) *Canadian Tax Journal* 1.

[83] Board of Taxation, Review of International Taxation Arrangements, above n 13, vol 1, 91.

[84] Ibid.

to take into account the fact that negotiations were underway at the time with the United Kingdom and Germany, the need to update pre-capital gains tax treaties, and the countries Australia may be obliged to approach because of the most favoured nations clauses in existing treaties.[85]

The eight countries listed as being priority countries were the Netherlands, France, Switzerland, Italy, Norway, Finland, Austria, and the Republic of Korea on the basis that the United States treaty had been renegotiated and the most favoured nations clause on rates of withholding tax would apply. To date, Australia has renegotiated four, either through new treaties or updating protocols – Finland in 2006, Norway in 2006, France in 2006, and Switzerland in 2013. The earlier treaties with The Netherlands (1976), Italy (1982), the Republic of Korea (1982), and Austria (1986) are yet to be renegotiated.

Similarly, the Board suggested that if the new treaties with the United Kingdom or Germany contained non-discrimination clauses, Australia would be obliged to enter into an equivalent clause with France, Finland, the Republic of Korea, Spain, and South Africa. To date, of these listed countries, the non-discrimination articles have only been added to treaties with Finland (2006) and South Africa (2008).

3.4 Improving consultation arrangements

An overarching concern of the Board was that double tax agreements were negotiated largely in secret.[86] It noted that while the process had become more open to consultation with the Australian Taxation Office Tax Treaties Advisory Panel and direct dealings with specific taxpayers, the balance remained on the side of secrecy.[87] Further, it was noted that stakeholders were invited to comment only after the negotiation process was almost complete and that any subsequent discussion focused on technical wording rather than matters of policy.[88]

The Board recommended that Australia follow best practice on consultation in relation to double tax treaties in the same way as other countries do for treaties. The overarching conclusion in Recommendation 3.8 was that 'the consultation processes on negotiating tax treaties be improved by adopting processes similar to those of the Board's consultation report as adopted by the Government for domestic tax legislation'.[89] To achieve such an objective, the Board suggested that the Tax Treaties Advisory Panel should be maintained with an improved approach by having more frequent meetings, input into the formation of basic policy as well as technical details, flexible membership to allow affected taxpayers to be consulted on relevant treaties, and the publishing of an Australian model tax treaty.[90]

The Treasurer at the time responded that 'consultation processes similar to domestic tax legislation will be adopted wherever possible, including direct consultation with key industry stakeholders and seeking submissions from the public on forthcoming negotiations. However, these processes will be adapted to reflect the fact that treaties represent a negotiated outcome between two governments and must work within the

[85] Ibid vol 1, 94.
[86] Ibid 90.
[87] Ibid.
[88] Ibid, vol 1, 96.
[89] Ibid 97.
[90] Ibid 96.

broad framework of established treaty practice'.[91] However, publishing an Australian model tax treaty was expressly rejected, with the Treasurer stating that '(it) is not proposed to publish an Australian model tax treaty. Such models can rapidly become out of date, and publication also reduces flexibility'.[92]

4. AUSTRALIA'S FUTURE TAX SYSTEM REVIEW

The Australian government, in its 2008-09 Federal Budget, announced a comprehensive 'root and branch' review of Australia's tax system, aimed at positioning Australia to deal with its 'social, economic and environmental challenges and enhance economic, social and environmental wellbeing'.[93] The Review, known colloquially as the Henry Review, after its Chair, Dr Ken Henry AC, had its findings made public on 2 May 2010. The recommendations, 138 in total, were designed to meet the challenges that Australia would face over a 40-year period, thereby adopting a medium- to long-term view of Australia's tax and transfer system. Of the 138 recommendations, two specifically related to Australia's tax treaty network, with both addressing withholding tax rates and aimed at reducing distortions in how foreign debt is accessed. The two recommendations are complementary, with Recommendation 33 providing that financial institutions operating in Australia should generally not be subject to interest withholding tax on interest paid to non-residents and Recommendation 34 suggesting that '[c]onsideration should be given to negotiating, in future tax treaties, or amendments to treaties, a reduction in interest withholding tax to zero so long as there are appropriate safeguards to limit tax avoidance'.

The two recommendations were a response to industry concerns[94] as it was considered that Australian businesses were discouraged from borrowing money from the international capital market due to higher interest rates, a result of withholding tax rates being built into the cost of debt. The Australia's Future Tax System Review Panel agreed and found that interest withholding tax on foreign capital invested in Australia in the form of debt, while subject to low tax rates, negatively affected the financial sector by distorting the way foreign debt is accessed.[95] The targeted recommendation aimed to cover authorised deposit-taking institutions such as banks, building societies, and credit unions, as well as other financial institutions, to enable greater debt borrowing. To facilitate a zero rate of withholding tax, the Review Panel suggested that the interest withholding tax could be removed through the use of tax treaties, with the example given of the United States–Canada double tax agreement.[96]

This recommendation has been adopted in subsequent treaties, as discussed above in section 3.1.

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[91] Hon Peter Costello (Treasurer), 'Review of International Tax Arrangements' (Media Release, 13 May 2003) <https://ministers.treasury.gov.au/ministers/peter-costello-1996/media-releases/review-international-taxation-arrangements-0>.
[92] Ibid attachment E.
[93] Henry Review, above n 14.
[94] Bowen, 'Australia's Tax Treaties – Industry's Message to Government', above n 41; Richard J Vann, 'Australia's Future Tax Treaty Policy' in Chris Evans and Richard Krever (eds), *Australian Business Tax Reform in Retrospect and Prospect* (Thomson Reuters, 2009) 401.
[95] Henry Review, above n 14, vol 1, 181.
[96] Ibid 182.

5. A RECOMMENDED APPROACH TO REVIEWING AUSTRALIA'S TAX TREATY POLICY

The broad observations of the Board of Taxation's Review of International Taxation Arrangements in 2002-03 are perhaps more telling than any of the specific recommendations coming out of the three reviews examined. Reviews are generally designed to take stock of the current flaws in a system, make recommendations to address challenges, and future-proof the regulatory regime. The Board of Taxation's observations are feasibly the most telling in terms of Australia's tax treaty policy and the approaches to negotiations. Not only did it note the fact that double tax agreements are negotiated largely in secret,[97] but also that the treaty negotiation agenda was largely due to earlier inactivity and the practice of giving priority to extending the network to relatively minor investment partners.[98] It also noted that political events may affect negotiation priorities at particular times.[99]

Consistent with prior studies that have undertaken an historical analysis of tax reform as a result of tax reviews,[100] this study finds that recommendations over the last 25 years that specifically relate to Australia's tax treaty network have had limited response from the government in terms of formalising Australia's tax treaty policy. This is not to say that recommendations coming out of the reviews are inconsistent with developments. The most significant reforms relate to the withholding taxes and changes to the capital gains tax provisions as well as the non-discrimination articles as discussed above. Recommendations, being at the government's discretion, have been selectively implemented, with little consideration of administrative recommendations such as priorities in negotiation and improving consultation arrangements. Within the context of tax treaties, this is perhaps in part because the reviews were conducted in a piecemeal way without a comprehensive review of Australian tax treaty policy.

This article proposes a comprehensive review of Australia's tax treaty policy. To do so, an investigation into the current policy, as well as what the policy should look like moving into the future, is required. We suggest that this raises two broad issues. First, Australia's position on what it will negotiate within treaties needs to be determined. Second, Australia's process of treaty negotiation should be established and transparent.

As to the first, the broad question of what Australia's position is on whether it should adopt a source-based or a residence-based treaty policy, needs to be established. To date, a consensus has not been reached as reflected in current treaties, although traditionally, there has been a bias towards source taxation. This is reflected in a number of features in current treaties, such as a wide definition of permanent establishment, which increases Australia's taxing rights over non-residents' business operations in Australia, and relatively high withholding tax rate ceilings for dividends, interest and royalties derived by non-residents from Australia, although this is of little significance in the current treaty network.[101]

In line with a decision as to whether Australia's approach is one of source-based treaty policy or residence-based treaty policy, there needs to be clear guidelines as to what taxing rights Australia is not prepared to give up and what taxing rights it is prepared to

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[97] Board of Taxation, Review of International Taxation Arrangements, above n 13, vol 1, 90.
[98] Ibid 91.
[99] Ibid.
[100] Evans and Krever, above n 9.
[101] Board of Taxation, Review of International Taxation Arrangements, above n 13, vol 1, para 3.50.

negotiate. As a resource-rich country, Australia needs to take into account the competing imperatives of ensuring tax policy facilitates foreign investment while ensuring taxing rights and revenue are not forgone. A move towards a residence-based approach requires economic interests such as natural resources to be taken into account to ensure tax from the exploitation of its natural resources is collected. Currently, this is captured by ensuring taxing rights on income from or relevant to natural resources in articles dealing with permanent establishments and articles dealing with income from immovable property and alienation of property in its tax treaties. To date, Australia has made a reservation to Article 5, paragraph 1 of the OECD Model Tax Convention, reserving the right to treat an enterprise as having a permanent establishment in a state if it carries on activities relating to natural resources or operates substantial equipment in that state with a certain degree of continuity, or a person – acting in that state on behalf of the enterprise – manufactures or processes in that state goods or merchandise belonging to the enterprise.

Australia has also made a reservation to Article 6 of the OECD Model Tax Convention, reserving the right to include rights relating to all natural resources under the article. In Australian treaty practice, the use of agricultural, pastoral, or forestry property in the list of examples of a permanent establishment has existed since Australia signed its first tax treaty with the United Kingdom in 1946.[102] Currently, in all treaties except the 2010 Turkish treaty,[103] Australia's 47 tax treaties, in addition to the core elements of the definition in both the UN and OECD Model Tax Conventions, specifically include in the permanent establishment article agricultural, pastoral, or forestry property as one of the fixed places provided as examples of a permanent establishment, regardless of whether the partner states are developed countries or developing countries.

In contrast to these reservations, there are certain taxing rights that Australia seems to be prepared to give up during negotiations or after a treaty has been introduced into Australian law. As such, we suggest that both the giving up of taxing rights and the method by which taxing rights and obligations under treaties need to be reviewed.

The most recent example of treaty override is Australia's negotiation with India and its desire to conclude the *Australia–India Economic Cooperation and Trade Agreement* (AI-ECTA) in 2022 to achieve its free trade objectives. In this case, it agreed with India to stop taxing certain Indian offshore technical services. In *Tech Mahindra Ltd v Federal Commissioner of Taxation*[104] in 2016, and *Satyam Computer Services Limited*

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[102] Article II, para (1)(j) of the Australia–UK Double Tax Agreement (1946), above n 3, defined the term 'permanent establishment' as 'a branch or other fixed place of business and includes a management, factory, mine, or agricultural or pastoral property, but does not include an agency in the other territory unless the agent has, and habitually exercises, authority to conclude contracts on behalf of such enterprise otherwise than at prices fixed by the enterprise or regularly fills orders on its behalf from a stock of goods or merchandise in that other territory'. It did not include 'forestry' property.

[103] Note, in Article 5(1) of the Australia–Finland tax treaty (2006), the term 'permanent establishment' is specifically defined as 'an agricultural, pastoral or forestry property situated in Australia': *Agreement Between the Government of Australia and the Government of Finland for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion*, signed 20 November 2006, 2512 UNTS 3 (entered into force 10 November 2007) Art 5(1).

[104] *Tech Mahindra Limited v Federal Commissioner of Taxation* (2016) 250 FCR 287. See further Richard Krever and Jonathan Teoh, 'The *Tech Mahindra* Case – Royalties Derived Through a PE' (2016) 84(1) *Tax Notes International* 33; Anton Joseph, 'Double Tax Agreements – More Sword than Shield' (2019) 26(2) *International Transfer Pricing Journal* 122.

v Federal Commissioner of Taxation[105] in 2018, the courts determined that by virtue of the deemed source rule in Article 23 of the India–Australia tax treaty, payments to Indian residents were deemed to have an Australian source and, therefore, should be assessable under Australian domestic law.[106] The Indian government, in response and as part of the negotiations process of the AI-ECTA in 2021 and 2022, requested that the Australian government remove these tax barriers.

According to government reports, through exchanging side letters on the signature day of the AI-ECTA, Australia agreed to amend 'domestic taxation law to stop the taxation of offshore income of Indian firms providing technical services to Australia' in a similar timeframe as the AI-CETA.[107] To fulfil its commitment, the Australian Treasury, on 28 September 2022, submitted a Bill to the Parliament, namely the Treasury Laws Amendment (Australia-India Economic Cooperation and Trade Agreement Implementation) Bill 2022, with the intention of amending the *International Tax Agreements Act 1953.*[108] The Bill proposed to introduce section 11J into the *International Tax Agreements Act 1953*, which states that certain payments are not royalties for the purposes of the India–Australia treaty.[109] Consequently, section 11J ensures Australia is prevented from taxing the payments and credits made to Indian residents by Australian customers for technical services provided remotely and covered by Article 12(3)(g) of the India–Australia tax treaty.[110]

The second broad issue that needs to be addressed in a comprehensive review of Australia's tax treaty network is the process and transparency of Australia's treaty policy and negotiation practices. This is a key step in providing greater transparency and certainty for all stakeholders, especially cross-border businesses. This would be in stark contrast to the current approach of successive governments dealing tangentially with treaty issues or because of court cases and behind closed doors.[111] The current Australian policy is to not publish a model convention. If this policy is to remain, a comprehensive treaty policy review could be used as guidance. At this time, it is unclear whether Australia follows the OECD Model Tax Convention or the UN Model Tax Convention, as neither has been strictly followed.

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[105] *Satyam Computer Services Limited v Federal Commissioner of Taxation* (2018) 266 FCR 502.

[106] See C John Taylor and Richard J Vann, 'Source Rules in Tax Treaties and Domestic Law: Satyam Case' in Michael Lang, Alexander Rust, Jeffrey Owens, Pasquale Pistone, Josef Schuch, Claus Staringer, Alfred Storck, Peter Essers, Eric CCM Kemmeren, Cihat Öner and Daniël S Smit (eds), *Tax Treaty Case Law around the Globe 2019* (Linde Verlag and IBFD Publications, 2020) 187. See further Celeste M Black, 'Digitalisation and Broadcasting: Evaluating the Application of Royalty Withholding Tax to Digitalised Business Models' (2019) 48(4) *Australian Tax Review* 264.

[107] The side letters exchanged between Australia (Hon Dan Tehan, Minister for Trade, Tourism and Investment) and India (Hon Piyush Goyal, Minister of Commerce and Industry, Consumer Affairs, Food and Public Distribution and Textiles) on 2 April 2022. See Department of Foreign Affairs and Trade, 'Australia–India ECTA Official Text' <https://www.dfat.gov.au/trade/agreements/in-force/australia-india-ecta/australia-india-ecta-official-text> (accessed 8 November 2023).

[108] See Treasury Laws Amendment (Australia-India Economic Cooperation and Trade Agreement Implementation) Bill 2022, sch 1, cl 3.

[109] *Treasury Laws Amendment (Australia-India Economic Cooperation and Trade Agreement Implementation) Act 2022* (Cth) Sch 1, which commenced on the day that the Economic Cooperation and Trade Agreement entered into force (29 December 2022).

[110] The *Income Tax (International Agreements) Amendment Act (No 2) 1991* (Cth) amended domestic legislation to give force to the India–Australia tax treaty (1991).

[111] Vann, above n 94.

Currently, there is a bias towards the OECD Model Tax Convention. However, this has not been explicitly stated. When Australia signed its first treaty with the United Kingdom in 1946, the OECD Model Tax Convention had not been published. Australia became a member of the OECD in 1971, which means it should '(w)hen concluding new bilateral conventions or revising existing bilateral conventions, conform to the Model Tax Convention, as interpreted by the Commentaries thereon'.[112] Hence, Australia, logically, should follow the OECD Model Tax Convention when concluding tax treaties with partner states, particularly with more advanced economies that are also fellow members of the OECD. However, the OECD Model Tax Convention works on the assumption that in terms of economic relations of any one country with the entire group of OECD countries overall, outbound and inward investment flows and initiation of cross-border business transactions would roughly equate with one another, so the bias in favour of residence countries would yield about the same tax revenue as a system biased towards source country taxation of cross-border income.[113]

Australia's willingness to adopt different stances in negotiations with OECD and non-OECD members, often yielding taxing rights to developing and transitional countries, is documented in the literature.[114] Most of Australia's tax treaties are however with OECD members. Of the current 47 Australian tax treaties, 29 were signed with the OECD member states, which represents 62 per cent of the current treaty partners of Australia. Seven of the total of eight countries, that have not signed tax treaties with Australia so far, that are on Australia's planned treaty negotiations agenda are OECD countries.[115]

The question of which Model Convention to follow is perhaps the most vexing for Australia. In terms of its relationship with large OECD member states, Australia is generally a net capital importer, leaving it in a similar position to less developed countries with large OECD treaty partners. In this respect, it would be to Australia's advantage to use the UN Model Tax Convention as a model when negotiating treaties with most other OECD members. At the same time, Australia is a capital exporter with many poorer regional neighbours, and it would be to Australia's benefit if tax treaties with these jurisdictions followed the OECD Model Tax Convention. On the other hand, it would be expected by fellow OECD members that Australia would follow the OECD Model Tax Convention in treaties with other OECD members, and poorer regional treaty partners would hope Australia would recognise their need for a greater share of taxing rights over the income generated in their territories and rely more on the UN Model Tax Convention when negotiating treaties with these jurisdictions.

Scholars such as John Taylor have noted this distinctive feature of Australia's treaty network and tested the Australian treaty provisions in the context of determining

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[112] According to OECD Council, *Recommendation of the Council Concerning the Model Tax Convention on Income and on Capital*, adopted by the Council on 23 October 1997, C(97)195/FINAL, para I(2).

[113] OECD, *Draft Double Taxation Convention on Income and Capital* (OECD Publishing, 1963).

[114] Kathrin Bain, Richard Krever and Anthony van der Westhuysen, 'The Influence of Alternative Model Tax Treaties on Australian Treaties' (2011) 26(1) *Australian Tax Forum* 31.

[115] The OECD countries on the Australian agenda for negotiating tax treaties are Colombia, Estonia, Latvia, Lithuania, Slovenia, Greece, and Luxembourg. See Hon Andrew Leigh (Assistant Minister for Competition, Charities and Treasury and Assistant Minister for Employment), 'Tax Treaty Network Expansion' (Media Release, 16 November 2022) <https://ministers.treasury.gov.au/ministers/andrew-leigh-2022/media-releases/tax-treaty-network-expansion>. It means that amongst the 37 OECD member states, only Costa Rica is not yet on Australia's treaty negotiation plan.

whether they follow the OECD Model Tax Convention or the UN Model Tax Convention.[116] Taylor examined the definition of a permanent establishment, the savings clause in non-arm's length provisions, treaty articles giving income an Australian source that it would not have under domestic law, the 'other income' article, the experience of not agreeing to and then modifying the non-discrimination article, the capital gains articles and rates of withholding taxes on investment income in the Australian tax treaties from 1946 to 2011. He argued that although Australian tax treaty policy and practice since 2001 has moved closer to the OECD norms, they still have many distinctive features as a product of Australia's emphasis on source-based taxation as well as responding to Australian domestic law concerns.[117]

Further, Taylor, in 2012, examined the factors that influenced Australian taxation treaty practice in the period from 1946 to 1976, including the economic factors, cultural and political considerations, domestic law considerations, model treaties of the partner states, treaty practice of third countries, model conventions developed by the League of Nations, the OECD and UN, and the development of an Australian model treaty. He argued that:

> For most of the period, Australian entry into taxation treaties was linked to an expectation of encouraging greater foreign investment in Australia while maintaining a relatively high level of source country taxing rights and obtaining bi-lateral measures of use in combating international tax avoidance. For most of the period, Australian domestic law considerations and prior Australian treaty practice were major factors affecting the technical content of Australian treaties. While gradually moving closer to the OECD model, Australian treaties in this period differ from the model in their structural and certain technical features. Towards the end of the period the relatively insignificant revenue impact of new treaties and Australia's membership of the OECD influence Australia in entering into new treaties as a normal link between civilised and friendly countries.[118]

In 2016, Taylor submitted his PhD thesis to the University of Sydney with the title 'A Critical Assessment of the Origins and Continued Validity of Variations in Australian Tax Treaties from the OECD Model' where he reviewed the development of Australia's tax treaty policy and practice since 1946, listed the variations of the Australian tax treaties from the OECD Model Tax Convention and explained the original rationale of this variation based on the relevant archival documents.[119]

The work of John Taylor in the analysis of the history of Australia's tax treaty policy and practices is exemplary. Much of his research demonstrates the disparity in approaches. Consequently, a comprehensive review of the tax treaty network in Australia is not only warranted but long overdue.

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[116] Taylor, 'Some Distinctive Features of Australian Tax Treaty Practice', above n 1.
[117] Ibid.
[118] C John Taylor, 'Factors Influencing Australian Taxation Treaty Practice 1946-1976' (2012) 27(3) *Australian Tax Forum* 571.
[119] Taylor, 'A Critical Assessment', above n 39.