EXPLANATORY MEMORANDUM

Title of instrument

The Double Taxation Relief (Taxes on Income) (Australia) Order 2003.

Legislative Powers

This Order is made under section 788 Income and Corporation Taxes Act 1988 and section 277 Taxation of Chargeable Gains Act 1992.

Affirmative Resolution

This draft Order is subject to affirmative resolution. Further details of the double taxation convention scheduled to the draft Order are annexed to this memorandum.

European Convention on Human Rights

The Paymaster General (Dawn Primarolo) has confirmed that, advice provided to her confirms that, the provisions of this draft Order are compatible with the European Convention on Human Rights.

Policy Background to the instrument

Double taxation conventions aim to eliminate the double taxation of income or gains arising in one State and paid to residents of another State. They do this by dividing the taxing rights that each treaty partner has under its domestic law over the same income and gains. They provide additional protection for taxpayers by specific measures combating discrimination in tax treatment. More generally, Conventions benefit the taxpayer by ensuring certainty of treatment and, as far as possible, by reducing compliance burdens. Double taxation conventions also serve an Exchequer protection role by including provisions to combat avoidance and evasion - not least by measures providing for the exchange of information between Revenue authorities. They also encourage and maintain an international consensus on the appropriate tax treatment of cross border economic activity and thus promote international trade and investment.

Regulatory Impacts

There are no significant regulatory impacts but taxpayers may, in some cases, have to make a claim to the Inland Revenue or the other country's fiscal authority in order to benefit from the convention. However, taxpayers will benefit from reduced compliance burdens and, in many cases, from having to deal with just one fiscal authority.

Financial Effects

The nature of a double tax convention is that one or both of the contracting states gives up all or part of their taxing rights so that a given source of income is taxed only once. Measured against a baseline of single taxation only, conventions do not therefore generally have an exchequer cost; rather, by encouraging cross border economic activity, they can lead to an increase in tax revenue. But where double taxation is unrelieved, the economic activity in question, and hence the higher tax revenue attributable to it, will often be only temporary.

Extent

The draft Order applies to the whole of the United Kingdom of Great Britain and Northern Ireland.

ANNEXE

GENERAL

All the United Kingdom's recent Double Taxation Conventions largely follow the approach adopted in the OECD's *Model Tax Convention on Income and on Capital*. This Convention continues that approach. In addition, it reflects changes in policy and legislation in the United Kingdom since the entry into force of the existing Agreement between the two countries, which this new Convention replaces.

NOTES ON DETAILS

ARTICLE 1 – PERSONS COVERED

The Convention is to apply to persons who are residents of one or both of the Contracting States (the United Kingdom and Australia).

ARTICLE 2 – TAXES COVERED

This Article gives a definition of the taxes to which the Convention is to apply.

The existing Australian taxes to which the Convention applies are the income tax, the resource rent tax in respect of offshore projects and the fringe benefits tax.

The existing United Kingdom taxes to which the Convention applies are the income tax, the corporation tax and the capital gains tax.

The Convention is to apply also to any identical or substantially similar taxes subsequently imposed by either country in addition to or in place of the taxes mentioned above. A provision on these lines is usually included in our Conventions.

ARTICLE 3 – GENERAL DEFINITIONS

This Article defines a number of terms used in the Convention and provides a rule for determining the meaning of terms not defined in the Convention.

ARTICLE 4 – RESIDENCE

This Article establishes the meaning of "resident of" the United Kingdom or Australia and lays down detailed rules for dealing with situations where individuals or other persons (including "dual listed" companies) may be considered residents of both countries for tax purposes under their respective domestic law.

ARTICLE 5 – PERMANENT ESTABLISHMENT

This Article provides the definition of “permanent establishment” (PE) and departs from the OECD Model in certain particulars. It expands the examples of a “fixed place of business” to include “a mine, an oil or gas well, a quarry or any other place relating to the exploration for or exploitation of natural resources”. It also provides that an enterprise is considered to have a PE if it carries on supervisory or consultancy activities for more than twelve months in connection with a building site, construction, or installation project; if it maintains substantial equipment for rental or other purposes for more than twelve months, or if it employs someone to manufacture or process goods or merchandise.

Taken with Article 7, this Article prescribes the circumstances and manner in which businesses of one country may be taxed on their profits in the other.

ARTICLE 6 – INCOME FROM REAL PROPERTY

This Article allows the country in which the property is situated to tax income from real (i.e. immovable) property.

ARTICLE 7 – BUSINESS PROFITS

This Article departs from the OECD Model by preserving the right of a country to tax profits from insurance with non residents. Subject to this, unless an enterprise of one country carries on business in the other through a permanent establishment situated there, its profits will be taxable only in its country of residence.

Where the enterprise has a permanent establishment in the other country, that country will be entitled to tax profits attributable to the permanent establishment.

ARTICLE 8 – SHIPPING AND AIR TRANSPORT

This Article provides that profits of an enterprise from the operation of ships or aircraft in international traffic, other than that confined to places in the other country, will be taxable only in the country in which the enterprise is resident. It also provides that profits derived from participation in a pool, joint business or international operating agency and profits from the incidental rental on a bareboat basis of ships or aircraft and from the incidental use, maintenance or rental of containers shall likewise be taxable only in the country in which the operator is resident.

ARTICLE 9 – ASSOCIATED ENTERPRISES

This Article provides that appropriate adjustments may be made in determining the profits of an enterprise of one country where conditions made or imposed between the enterprise and an associated enterprise of the other

country differ from those that would be made between independent enterprises.

Where such an adjustment is made to the profits of an enterprise by one country, the other country will make an appropriate adjustment to the amount of tax charged on those profits, in order to relieve the economic double taxation which might otherwise arise as a result of an adjustment by just one country. The competent authorities of each country may consult for this purpose.

ARTICLE 10 – DIVIDENDS

This Article contains the rules for the taxation of dividends paid by a company which is resident of one country to a resident of the other.

Paragraph (1) provides that dividends paid by a company resident in one country (the source country) to a resident of the other country may be taxed in that other country.

Paragraph (2) provides that such dividends may also be taxed in the source country, but if the beneficial owner is a company resident in the other country that holds at least 10 per cent of the voting power in the company paying the dividends, the tax will not exceed 5 per cent of the gross amount. In all other cases the rate of tax in the source country is not to exceed 15 per cent of the gross amount of the dividends, provided the beneficial owner is a resident of the other country.

Paragraph (3) provides an exception to paragraph (2). Subject to certain conditions prescribed here, dividends are exempted from tax in the country of source if they are beneficially owned by a company resident in the other country that has owned shares representing 80 per cent or more of the voting power of the company paying the dividends for a 12-month period ending on the date the dividend is declared.

Paragraph (4) defines the term “dividends”.

Paragraph (5) provides that where a resident of one country receives dividends from the other country and carries on business in that other country through a permanent establishment there, with which the holding from which the dividend arises is effectively connected, the provisions of paragraphs (1), (2) and (3) shall not apply. The taxation of the dividends is then governed by Article 7 (Business Profits).

Paragraph (6) rules out the extra-territorial taxation by one country of dividends paid by a company which is a resident only of the other country. The first country will not tax the dividends unless they are connected with a permanent establishment or a fixed base there or are paid to a resident of that country. There is a similar provision concerning undistributed profits.

Paragraph (7) an anti-abuse provision, ensures that the provisions of the Article will not apply if the shares or other rights in respect of which the dividend is paid were created or assigned mainly to take advantage of the Article.

Paragraph (8) defines the term “principal class of shares”.

ARTICLE 11 – INTEREST

This Article contains the rules for the taxation of interest paid by a resident of one country to a resident of the other.

Paragraph (1) provides that interest arising in one country and paid to a resident of the other may be taxed in that other country, if the recipient is the beneficial owner of the interest.

Paragraph (2) provides that such interest may also be taxed in the country in which it arises but, if the recipient is the beneficial owner of the interest, the rate of tax imposed by that country will not exceed 10 per cent of the gross amount.

Paragraph (3) provides an exception to paragraph (2). Interest is exempted from tax in the country in which it arises if it is beneficially owned by the government or central bank of the other country, or by a financial institution of the other country which is unrelated to, and dealing wholly independently with, the payer of the interest.

Paragraph (4) substitutes the rule in paragraph (2) for that in paragraph (3) in circumstances where interest is paid as part of an arrangement involving back-to-back loans and other economically equivalent arrangements.

Paragraph (5) defines the term “interest”.

Paragraph (6) provides that where a resident of one country receives interest from the other country and carries on business in that other country through a permanent establishment there, with which the debt claim in respect of which the interest is paid or credited is effectively connected, the provisions of paragraphs (1) and (2), sub-paragraph (b) of paragraph (3) and paragraph (4) shall not apply. The taxation of interest is then governed by Article 7 (Business Profits).

Paragraph (7) provides rules for determining in which country interest arises.

Paragraph (8) provides that where, because of a special relationship between the payer and the recipient, the amount of interest paid or credited is excessive, the relief under the Article will apply only to the interest that would be payable at “arm’s length”.

Paragraph (9), an anti-abuse provision, ensures that the provisions of the Article will not apply if the debt claim on which the interest is paid was created or assigned mainly to take advantage of the Article.

ARTICLE 12 – ROYALTIES

This Article contains the rules for the taxation of royalties arising in one country and derived by a resident of the other.

Paragraph (1) provides that royalties arising in one country and paid to a resident of the other may be taxed in that other country, if the recipient is the beneficial owner of the royalties.

Paragraph (2) provides that such royalties may also be taxed in the country in which they arise but, if the recipient is the beneficial owner of the royalties, the rate of tax imposed by that country will not exceed 5 per cent of the gross amount.

Paragraph (3) defines the term “royalties”.

Paragraph (4) provides that where a resident of one country receives royalties from the other country and carries on business in that other country through a permanent establishment there, with which the right or property in respect of which the royalties are paid is effectively connected, the provisions of paragraphs (1) and (2) shall not apply. The taxation of royalties is then governed by Article 7 (Business Profits).

Paragraph (5) provides rules for determining in which country royalties arise.

Paragraph (6) provides that where, because of a special relationship between the payer and the recipient, the amount of royalty paid is excessive the relief under the Article will apply only to the royalty that would be payable at “arm’s length”.

Paragraph (7), an anti-abuse provision, ensures that the provisions of the Article will not apply if the rights on which the royalties are paid were created or assigned mainly to take advantage of the Article.

ARTICLE 13 – CAPITAL GAINS

This Article contains the rules for the taxation of income or gains deriving from the alienation of property situated in one country by a resident of the other.

Paragraph (1) provides that income or gains derived from the alienation of real property in one country by a resident of the other may be taxed in the country where the property is situated.

Paragraph (2) provides that income or gains arising from the alienation of movable property relating to a permanent establishment maintained in the other country may be taxed in that other country.

Paragraph (3) provides that income or gains derived by a resident of one country from the alienation of ships or aircraft operated in international traffic shall be taxable only in the country where the taxpayer is resident.

Paragraph (4) provides that income or gains derived by a resident of one country from the alienation of shares in a company (or an interest in a partnership or trust) whose value is attributable mainly to real property in the other country, may be taxed in that other country.

Paragraph (5) provides that accumulated income or gains of an individual, initially resident in one country who, on leaving that country, elects in accordance with its tax law to defer payment of tax that would otherwise be payable at the time of departure (notwithstanding that the income or gains have not been realised by that time) shall, if the individual becomes resident in the other country and subsequently alienates the property concerned there, only be taxed in that other country.

Paragraph (6) preserves the domestic law right of each country to tax capital gains except as provided in paragraphs (1) to (5).

Paragraph (7) imports the definition of “real property” employed in Article 6.

Paragraph (8) imports the rules for determining the situation of interests or rights employed in paragraph (3) of Article 6.

Paragraph (9), an anti-abuse provision, preserves the right of the United Kingdom to tax income or gains from the alienation of any property by a person (including an individual, company or trustee) who is a resident of the United Kingdom at any time during the tax year in which the property is alienated, or has been so resident at any time during the preceding six years.

ARTICLE 14 – INCOME FROM EMPLOYMENT

Paragraph (1) provides that, in general, employment income of a resident of one country can be taxed in the other country if the employment is exercised there.

Paragraph (2) provides an exception to the general rule where an employee is present in the other country for not more than 183 days in any twelve-month period beginning or ending in the fiscal year concerned, the remuneration is paid by or on behalf of an employer who is not a resident of the other country and the remuneration is not tax deductible by a permanent establishment which the employer has in the other country. Where all these conditions are satisfied the remuneration will be taxable only in the employee’s country of residence.

Paragraph (3) provides that the remuneration of someone working on a ship or aircraft operated in international traffic can be taxed in the country where the operator is resident.

Paragraph (4) provides that this Article is also to apply to the remuneration of a director of a company.

ARTICLE 15 – FRINGE BENEFITS

This Article provides that fringe benefits (as these are defined in Australian legislation) are to be taxed only in the country which would have the primary taxing right under the Convention if the value of the benefit was paid as ordinary employment income.

ARTICLE 16 – ENTERTAINERS AND SPORTSPERSONS

Paragraphs (1) and (2) provide that income in respect of the personal activities of entertainers and sportspersons can be taxed in the country in which those activities are exercised, whether it accrues to the entertainer or sportsperson or to some other person (e.g. a company controlled by him/her).

ARTICLE 17 – PENSIONS AND ANNUITIES

Paragraph (1) provides that pensions (including pensions paid in respect of government service) and annuities will be taxable only in the country where the pensioner is resident.

Paragraph (2) defines the term “annuity”.

ARTICLE 18 – GOVERNMENT SERVICE

Paragraph (1) provides that in general, remuneration paid to an individual in respect of services rendered to a country, or to a political sub-division or local authority of a country, will be taxable only in that country. If however the services are carried out in the other country by one of that country’s own nationals resident there or by a resident who, although not a national, did not become a resident solely to render the services, then that other country will have the sole taxing right.

Paragraph (2) provides an exception to the rules in paragraph (1). In the case of remuneration or pensions arising in connection with a trade or business, the provisions of Article 14, 15 or 16 are to apply.

ARTICLE 19 – STUDENTS

This Article provides that payments for the maintenance or education of visiting students will not be taxed in the country visited, provided the payments are made from sources outside that country.

ARTICLE 20 - OTHER INCOME

Paragraphs (1) and (3) provide that any item of income, wherever arising, not specifically covered elsewhere in the Convention, will be taxed by the country of which the beneficial owner is a resident, and may also be taxed in the other country if it is derived from a source in that other country.

Paragraph (2) provides that the provisions of Paragraph (1) will not apply, other than to income from real property, if the right or property in respect of which the income is paid is effectively connected with a permanent establishment maintained in the country of source. In that case, the provisions of Article 7 will apply.

Paragraph (4) provides that where, because of a special relationship between the payer and the recipient, the amount of income paid is excessive the relief under the Article will apply only to the income that would be payable at "arm's length".

Paragraph (5), an anti-abuse provision, ensures that the provisions of the Article will not apply if the rights on which the income is paid were created or assigned mainly to take advantage of the Article.

ARTICLE 21 – SOURCE OF INCOME

This Article provides that income or gains derived by a resident of the United Kingdom and taxable in Australia under one or more of Articles 6 to 8 and 10 to 16 and 18 of the Convention, are deemed for the purposes of Australian tax law to arise from sources in Australia.

ARTICLE 22 – ELIMINATION OF DOUBLE TAXATION

This Article sets out the methods by which double taxation is to be eliminated.

Paragraph (1) provides the details of how United Kingdom tax will be allowed as a credit against Australian tax. In the case of a dividend paid by a company resident in the United Kingdom to a company resident in Australia controlling at least 10 per cent of the voting power in the paying company, the credit will include the United Kingdom tax payable by the United Kingdom company in respect of the portion of its profits out of which the dividend is paid.

Paragraph (2) provides the details of how Australian tax shall be allowed as a credit against United Kingdom tax. In the case of a dividend paid by a company resident in Australia to a company resident in the United Kingdom controlling at least 10 per cent of the voting power in the paying company, the credit will take account of the Australian tax payable by the Australian company in respect of the profits out of which the dividend is paid.

Paragraph (3) provides that, for the purposes of paragraphs (1) and (2), income or gains owned by a resident of one country, which may be taxed in the other country under the Convention, will be deemed to arise from sources in that other country.

ARTICLE 23 - LIMITATION OF RELIEF

Paragraph (1) provides that where tax on any income or gains is determined in one country by reference only to the amount actually remitted to or received in that country, relief given in the other country under the Convention will be restricted to that part of the income or gains that is taxed in the first-mentioned country.

Paragraph (2) provides that income or gains that are exempted from tax in one country because the recipient is a temporary resident of that country will not qualify for relief under the Convention in the other country.

ARTICLE 24 - PARTNERSHIPS

This Article provides that members of a partnership may be taxed in their country of residence on their individual shares of the income or gains of the partnership, even if the partnership is treated as a taxable unit under the law of the other country.

ARTICLE 25 - NON-DISCRIMINATION

Subject to certain conditions, and on lines recommended by the OECD, this Article provides that neither country shall impose discriminatory taxes (or requirements) on the nationals, permanent establishments and enterprises of the other.

ARTICLE 26 - MUTUAL AGREEMENT PROCEDURE

This Article permits a resident of one country, who feels that the actions of one or both countries will result for that person in taxation that is not in accordance with the terms of the Convention, to present his/her case to the competent authority of the country of which s/he is resident, or, if the case comes under paragraph 1 of Article 25, of the country of which that person is a national. It also provides that the competent authorities of the two countries

may endeavour to resolve difficulties in the application or interpretation of the Convention.

ARTICLE 27 - EXCHANGE OF INFORMATION

This Article provides for the exchange of certain information between the competent authorities of the two countries. No information containing trade etc. secrets or information the disclosure of which would be contrary to public policy will be exchanged.

ARTICLE 28 – MEMBERS OF DIPLOMATIC MISSIONS OR PERMANENT MISSIONS AND CONSULAR POSTS

This Article makes it clear that the provisions of the Convention are not to affect the tax privileges that diplomatic and consular officials are entitled to under international law and under the provisions of special agreements such as the Vienna Convention on Diplomatic Relations.

ARTICLE 29 - ENTRY INTO FORCE

Paragraph (1) provides that each country will notify the other that it has completed the procedures required by its law to bring the Convention into force. The Convention will enter into force on the date of the later of these notifications. It will take effect in the United Kingdom in respect of tax withheld at source on I July next following the date of entry into force, in respect of corporation tax on 1 April next following that date, and in respect of capital gains tax and income tax generally from 6 April next following that date. It will take effect in Australia in respect of tax withheld at source on 1 July next following the date of entry into force, in respect of fringe benefits tax on 1 April next following that date and in respect of other Australian tax on 1 July next following that date.

Paragraph (2) provides that the United Kingdom/Australia Double Taxation Agreement signed in 1967, as amended by the Protocol signed in 1980, (“the Agreement”) will be terminated on the entry into force of the Convention. Payment of United Kingdom dividend tax credits under the Agreement will cease in respect of dividends paid on or after 1 July following the entry into force of the Convention.

Paragraph (3) continues any relief from tax due to a visiting Professor or Teacher under Article 16 of the Agreement until the time that it would have expired in accordance with that Article if the Agreement had remained in force.

ARTICLE 30 – TERMINATION

This Article provides that the Convention may be terminated by either country giving notice on or before 30 June in any calendar year, following a minimum life of at least 5 years.

EXCHANGE OF NOTES

The Exchange of Notes contained in Part II to the Schedule constitutes a formal agreement between the Governments of both countries, and clarifies the intended interpretation of certain parts of the Convention.