1990

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT (INTERNATIONAL AGREEMENTS) BILL 1990

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,

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

15458/90 Cat. No. 90 5137 2

INDEX TO CONTENTS

ITEM	PAGE
General Outline	3
Financial Impact Statement	3
Main features	3
Notes on Clauses	9
Schedule 1 - Australia/China Agreement	13
Schedule 2 - Australia/Sri Lanka Agreement	33
- Australia/Fiji Agreement	55

GENERAL OUTLINE

This Bill will amend the Income Tax (International Agreements) Act 1953 to give the force of law in Australia to three comprehensive double taxation agreements - between Australia and China, Australia and Sri Lanka, and Australia and Fiji - covering various forms of income flows between the two countries. The agreement with China was signed in Canberra on 17 November 1988, the agreement with Sri Lanka in Canberra on 18 December 1989 and the agreement with Fiji in Canberra on 15 October 1990.

FINANCIAL IMPACT

The agreements with China, Sri Lanka and Fiji are not expected to have a significant effect on revenue.

MAIN FEATURES

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

Under the terms of the agreements:

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

- Business profits are to be taxed only in the country of residence of the recipient unless they are derived by a resident of one country through a branch or other "permanent establishment" in the other country; in that case, the other country may tax the profits attributable to that branch or other prescribed "permanent establishment", and in the case of the Sri Lankan and Fijian agreements profits attributable to related sales or business activities.

- Profits from the international operations of ships and aircraft are generally taxed only in the country of residence of the operator. Each agreement allows the other country to tax, at normal domestic rates, profits from the operations of ships or aircraft confined solely to places within that other country. The Sri Lankan agreement also provides reduced taxing rights to the other country over profits from other shipping operations in that country. (In relation to China the existing airline profits agreement between the two countries will continue to govern the taxation of profits from the operation of aircraft).

- Dividends, interest and royalties may be taxed in the country of source, but there are general limits on the tax that the source country may charge on such income flowing to residents of the other country. For the Chinese and Sri Lankan agreements these limits are 15 per cent for dividends and 10 per cent for interest and royalties. A 20 per cent limit applies for dividends, 10 per cent for interest and 15 per cent for royalties in the agreement with Fiji.

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

- Income from professional services and other similar activities will generally be taxed only in the country of residence of the recipient.

  However, the other country may also tax the income where it is attributable to activities performed from a fixed base of the recipient in the other country; if the recipient is present in that other country for a period or periods of broadly 6 months or more; or, in the case of the Fijian agreement, if the remuneration exceeds $A8000 or its Fijian dollar equivalent in a year of income and is paid by a resident of or a permanent establishment in the other country.

- Income from dependent personal services, that is, employees' remuneration, will generally be taxable in the country where the services are performed.

  However, under the Chinese and Sri Lankan agreements the income will be exempt in the country where the services are performed if the income is derived during a short visit or visits

(of broadly less than 6 months); the remuneration is paid by, or on behalf of, an employer who is not a resident of the country visited, and, the remuneration is not an expense of a permanent establishment or a fixed base which the employer has in the country visited; for the Fijian agreement, the income will be exempt in the country in which the services are performed if it is derived during a short visit or visits not exceeding in the aggregate 90 days and the income is taxed by the country of residence of the employee.

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

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

- Income derived by public entertainers from their activities as such is generally to be taxed by the country in which the activities are performed. However, each of the agreements provide for an exemption where the activity is, in the case of the Chinese Agreement, conducted under a cultural exchange plan between the respective governments, or, in the case of the Sri Lankan and Fijian agreements, funded out of public funds of the other country.

- Pensions will generally be taxed only in the country of residence of the recipient, except for certain Government service pensions, which are taxable only in the country from which the pension is paid.

- Students resident in one country who are temporarily present in the other country solely for the purpose of their education will be exempt from tax in the country visited in respect of payments made from abroad for the purposes of their maintenance or education. The agreements with China and Fiji extend a similar exemption to trainees.

- Professors and teachers are specifically covered by the agreements with China and Fiji, which provide for remuneration derived by professors or teachers during visits to the other country of up to two years duration for the purpose of teaching or carrying out advanced study or research at an educational institution to generally be taxed only in the country of residence of the recipient.

- Dual residents (i.e. persons who are resident of both countries to an agreement according to the

domestic taxation laws of those countries) are, in accordance with specified criteria, to be treated for the purposes of the respective agreements as being residents of only one country.

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

- Exchange of information and consultation between the taxation authorities of Australia and the respective countries is authorised.

- Double taxation relief is to be allowed by the country of residence where it taxes income, profits or gains which, under an agreement, may also be taxed in the other country, as follows:

  - in Australia, by allowance of a credit against Australian tax on income, profits or gains derived by a resident of Australia from sources in the agreement country for the tax paid in that other country. In the case of a dividend payment from a company resident in the relevant agreement country to a related Australian resident company, the tax to be credited by Australia includes the "underlying" tax paid in respect of the profits out of which the dividend is paid.

  - in the agreement country (China, Sri Lanka or Fiji), generally by the allowance of a credit against that country's tax for the Australian tax paid on income, profit or gains derived by residents of that country from sources in Australia, including "underlying" tax credit in the case of China and Sri Lanka for a dividend payment by an Australian resident company to a related company resident in the agreement country.

  - Tax Sparing credit relief is to be provided by Australia in relation to income derived by a resident of Australia from each of the agreement countries which has benefitted from certain development tax incentives of the other country. Broadly, therefore, Australia is to allow as a credit against the Australian tax payable on income derived in the respective agreement countries an amount of tax forgone by those countries on that income under the specified or nominated development incentives as if that tax had been paid.

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

- For dividends, royalties and interest subject to the specified Sri Lankan and Fijian development incentives, tax sparing relief is to apply as if the Sri Lankan or Fijian tax payable but for the relevant development incentive was subject to the source country tax rate limit applicable under the agreement in relation to such income.

- In the case of China and Fiji the relevant development incentives are specified in the agreement and there is provision to nominate incentives of a substantially similar character from time to time in letters to be exchanged for this purpose between the Treasurer and the authorised representative of the other country. In the case of Sri Lanka, provision is made for incentives to be nominated from time to time in letters exchanged between the Treasurer of Australia and the Minister of Finance and Planning of Sri Lanka.

Each agreement will enter into force when diplomatic notes are exchanged between Australia and the agreement country advising each other that the last of the constitutional processes necessary to give the agreement the force of law in the respective countries has been completed.

Upon entering into force, the agreements with China, Sri Lanka and Fiji will have effect:-

- in Australia, for withholding tax purposes in respect of income derived on or after 1 January (for the Fijian agreement) and on or after 1 July (for the Chinese and Sri Lankan agreements) in the calendar year following that in which the relevant agreement enters into force. For all other Australian taxes covered by each agreement, it will first have effect in respect of income (including

profits and gains) of the income year beginning on or after 1 July in the calendar year following that in which the agreement enters into force.

- in China, for all Chinese taxes (including tax withheld at source) in respect of income (including profits and gains) of taxable years beginning on or after 1 January next following the year in which the agreement enters into force.

- in Sri Lanka, for all Sri Lankan taxes in respect of income (including profits and gains) assessable for any year of assessment beginning on or after 1 April in the calendar year next following that in which the agreement enters into force.

- in Fiji, for all Fijian taxes in respect of income, profits or gains derived during any income year beginning on or after 1 January in the calendar year following that in which the agreement enters into force.

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

TAXATION LAWS AMENDMENT (INTERNATIONAL AGREEMENTS) BILL 1990

PART 1 : PRELIMINARY

Clause 1 : Short title etc

This clause formally provides the citation for the Amending Act.

Clause 2 : Commencement

Under subsection 5(1A) of the Acts Interpretation Act 1901, unless the contrary intention appears, every Act is to come into operation on the twenty-eighth day after the day on which it receives the Royal Assent. By subclause 2(1), the amending Act will come into operation on the day on which it receives the Royal Assent, thus enabling early implementation of the agreements to which it relates.

Subclause 2(2) provides for the earlier commencement of section 8 and Part 3 of the amending Act. Once the amending Act has received the Royal Assent, section 8 and Part 3 will be taken to have commenced on the date the Income Tax (International Agreements) Amendment Act (No.2) 1989 (the No.2 Act) received the Royal Assent.

Section 8 of the amending Act provides for the rectification *ab initio* of the text of the copy of the Papua New Guinea Agreement that is set out in Schedule 29 of the Principal Act, so as to omit a superfluous word. The earlier commencement of section 8 provided for by subclause 2(2) is on account of Schedule 29 having been added to the Principal Act by the No.2 Act and is designed to ensure that the rectification has effect from the time of commencement of that Act.

Part 3 provides for amendments of certain provisions of the No.2 Act (refer clauses 11 and 12). The provisions concerned are technical measures that were included in that Act as a consequence of the Income Tax (International Agreements) Amendment Act 1989 (the 1989 Act) not having commenced at the date of introduction of the Bill for the No.2 Act.

The 1989 Act, which was originally designed to give the force of law to a comprehensive taxation agreement with China, lapsed when Parliament was prorogued last year and the relevant provisions are now proposed in the amending Act. Accordingly, the relevant provisions in the No.2 Act have effectively become redundant. These circumstances require that the amendments made by Part 3 of the Amending Act to the No.2 Act be taken to have commenced on the day on which that Act received the Royal Assent.

PART 2 - AMENDMENT OF THE INCOME TAX (INTERNATIONAL AGREEMENTS) ACT 1953

Clause 3 : Principal Act

This clause formally provides that references to the "Principal Act" in Part 2 of this Bill relate to the Income Tax (International Agreements) Act 1953.

Clause 4 : Interpretation

This clause will amend section 3 of the Principal Act which contains a number of definitions for the more convenient interpretation of the Act.

It will insert in subsection 3(1) of the Principal Act definitions referring to the comprehensive taxation agreements with China, Sri Lanka and Fiji, which are being incorporated by the Bill as Schedules to the Principal Act.

Clause 5 : Agreement with the People's Republic of China

Clause 6 : Agreement with Sri Lanka
Agreement with Fiji

These clauses propose the insertion in the Principal Act of new sections 11S, 11V and 11W which will give the force of law in Australia respectively to the comprehensive double taxation agreements with China, Sri Lanka and Fiji with effect respectively from the dates set out in each agreement (as described in the "Main Features" segment of this Memorandum).

It is not possible to indicate in this Bill the dates of entry into force of the respective agreements, as they will each enter into force upon a future exchange of notes as provided for in the agreements (refer Article 27 in the case of the agreements with China and Sri Lanka and Article 28 of the agreement with Fiji). However, section 4A of the Principal Act provides for the date of entry into force of the agreements to be notified by the Treasurer in the Gazette as soon as practicable thereafter. This will provide a readily available and authoritative source from which persons may ascertain the facts of, and the timing of, the dates of entry into force.

New subsection 11S(2) reflects a provision which customarily appears in Australia's double taxation agreements, but which was not included in the agreement with China. It effectively provides that particular income, profits or gains which, under the agreement, Australia may tax in the hands of a resident of China, is to be deemed to have a source in Australia. This provision is designed to ensure that the right given by the agreement for Australia to tax that income is compatible with the domestic law rules with respect to the taxation of

non-residents and eliminates any possible conflict with the domestic law rules as to the source of income.

Proposed subsection 11S(3) relates to the right given by paragraph 2 of Articles 11 and 12 of the agreement with China for each country to tax outgoing interest and royalties, at a limited rate, and the related "source" rules contained in paragraph 5 of Articles 11 and 12. It will ensure that those provisions will not have the unintended effect of subjecting to Australian tax interest or royalties paid by an Australian resident to a Chinese resident where the interest or royalties are an outgoing wholly incurred in carrying on a business in a third country. Such interest or royalties would not be subject to tax under the provisions of the Australian income tax law (sections 128B and 6C of the Income Tax Assessment Act) or, in corresponding circumstances, under any of Australia's other double taxation agreements.

Clause 7 : Schedule 28

This clause will add the Chinese agreement as Schedule 28 to the Principal Act. The text of the agreement is contained in Schedule 1 of this Bill.

Clause 8 : Schedule 29

Clause 8 will give effect to an agreement reached in an exchange of Notes between the Government of Australia and the Government of Papua New Guinea to omit from paragraph 1 of Article 24 of the existing comprehensive taxation agreement with Papua New Guinea a superfluous and unnecessary word. The omission will not affect in any way the interpretation or application of that paragraph. By subclause 2(2) of the Bill, the amendment made to the Papua New Guinea agreement (a copy of which is contained in Schedule 29 of the Principal Act) will have effect from the time of commencement of the Amending Act which inserted Schedule 29 in the Principal Act.

Clause 9 : Schedules 31 and 32

This clause will add the comprehensive double taxation agreements with Sri Lanka and Fiji as Schedules 31 and 32 respectively to the Principal Act. The texts of these agreements are contained in Schedule 2 of this Bill.

PART 3 - AMENDMENT OF THE INCOME TAX (INTERNATIONAL AGREEMENTS) ACT (No.2) 1989

Clause 10 : Principal Act

This clause formally provides that references to the "Principal Act" in Part 3 of this Bill relate to the Income Tax (International Agreements) Amendment Act (No.2) 1989.

Clause 11 : Repeal of section 13

This clause provides for the repeal of section 13 of the Principal Act.

Section 13 contains technical transitional measures to cover the circumstance that, at the time of introduction of the Bill for the Principal Act into the Parliament, the Income Tax (International Agreements) Amendment Act 1989 (the 1989 Act) had not commenced. The 1989 Act, which was originally to give the force of law to the Chinese agreement, has now lapsed, thus removing the necessity for these technical measures.

Briefly, subsection 13(1) of the Principal Act provided for adjustments to the wording of the provisions of the 1989 Act which were intended to insert Schedule 28 into the Income Tax (International Agreements) Act 1953 (the 1953 Act), as a consequence of the Principal Act having added further schedules to the 1953 Act.

Subsection 13(2) provided that if the Principal Act were to commence before the 1989 Act, then the amendments made by the Principal Act to section 11S of the 1953 Act (as proposed to be be inserted by the 1989 Act), were to have effect as if they had commenced immediately after the commencement of the 1989 Act.

Clause 12 : Amendment of Schedule 4

This clause provides for the Principal Act to be amended by omitting from Schedule 4 of that Act the amendments to section 11S as proposed by the (now lapsed) 1989 Act.

The amendments are no longer necessary, as this Bill will insert section 11S in amended form (refer clause 5).

SCHEDULE 1 TO THE BILL

Insertion as Schedule 28 to the Principal Act.

AGREEMENT WITH THE PEOPLE'S REPUBLIC OF CHINA

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

Article 1 - Personal Scope

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

The situation of persons who are dual residents (i.e., residents of both countries) is dealt with in Article 4.

Article 2 - Taxes Covered

This article specifies the existing taxes to which the agreement applies. These are, in the case of Australia, the Australian income tax and the resource rent tax in respect of offshore petroleum projects. For China, its income tax is specified. The article will automatically extend the application of the agreement to any identical or substantially similar taxes which may subsequently be imposed by either country in addition to, or in place of, the existing taxes.

Article 3 - General Definitions

This article provides definitions for a number of the terms used in the agreement. Some other terms are defined in the articles to which they relate.

As with Australia's other modern taxation agreements, "Australia" is effectively defined as including certain external territories and areas of the continental

shelf. By reason of this definition, Australia fully preserves the taxing rights effectively provided by section 6AA of the Income Tax Assessment Act 1936 ("the Assessment Act") in relation to mineral exploration and mining activities carried on by non-residents on its continental shelf areas. The definition is also relevant to the taxation by Australia of shipping profits in accordance with Article 8 of the agreement.

Paragraph 2 makes it clear that, for the purposes of the agreement, the terms "Australian tax" and "Chinese tax" do not include any amount of penalty or interest imposed by the operation of the respective domestic laws of Australia or China.

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

Paragraph 3 of this article provides that where a term is not specifically defined within the agreement that term, unless used in a context that requires otherwise, is to be taken to have the same interpretative meaning ascribed that particular term under the domestic law from time to time in force of the country applying the agreement. The effect of the inclusion in this paragraph of the expression "from time to time in force" is to clarify that a term not defined in the agreement is to be given the meaning it has under that country's domestic law at the time of application of the agreement, rather than the meaning it had when the agreement was negotiated.

Article 4 - Resident

This article sets out the basis on which the residential status of a person is to be determined for the purposes of the agreement. Residential status is one of the criteria for determining each country's taxing rights and is a necessary condition for the provision of double tax relief under the agreement. The concept of residence according to each country's taxation law provides the basic test.

The article also includes "tie-breaker" rules for determining how residency is to be allocated to one or other of the countries for the purposes of the agreement where a taxpayer - whether an individual, a company or other entity - is regarded as a resident under the domestic laws of both countries.

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

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

Paragraphs 5 and 6 of the article contain provisions which are aimed at preventing abuse of the agreement by the use of what is commonly referred to as treaty shopping arrangements, i.e. arrangements designed to establish residential status in either agreement country in order to exploit provisions of the agreement in an unintended way.

Article 5 - Permanent Establishment

Application of various provisions of the agreement (principally Article 7 relating to business profits) is dependent upon whether a person who is a resident of one country has a "permanent establishment" in the other, and if so, whether income derived by the person in the other country is attributable to or effectively connected with that "permanent establishment". The definition of the term "permanent establishment" which this article embodies corresponds closely with definitions of the term in Australia's other double taxation agreements.

The primary meaning of the defined term is expressed in paragraph 1 as being a fixed place of business through which the business of an enterprise is wholly or partly carried on. Other paragraphs of the article are concerned with elaborating on the meaning of the term by giving examples of what may constitute a "permanent establishment" - such as an office, a mine or a farm or forest - and by specifying the circumstances in which a resident of one country shall, or shall not, be deemed to have a "permanent establishment" in the other country.

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

Article 6 - Income from Real Property

By this article, income from real property, including income from the direct use, letting or use in any other form of any land or interest therein, and royalties and other payments relating to the working of, or the exploration for or exploitation of, mines or quarries or other natural resources, may be taxed in the country in which the land, mine, quarry or natural resource is situated.

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

Paragraph 2 defines the term "real property" primarily so that it has the same meaning as it does under the domestic law of each country, i.e., as real property in the case of Australia and immovable property in the case of China. However, the definition is expanded in the case of both countries to include items of property that may not fall within the ordinary meaning of those terms.

The paragraph specifically excludes ships and aircraft from the definition because the treatment of profits arising from their operation is to be determined in accordance with Article 8 (Shipping and Transport).

Paragraph 5 makes it clear that the operational effects of the article extend to income derived from the use or exploitation of real property (within the meaning of the Article) of an enterprise and income derived from such property that is used for the performance of independent professional services. As with other items of income dealt with separately in specific articles of the agreement, income of an enterprise to which this article applies is excluded from the scope of Article 7 (by paragraph 7 of that article) and is therefore taxable in the country in which the property is situated regardless of whether or not the recipient enterprise has a "permanent establishment" in that country. Paragraph 5 also operates to ensure taxing rights by that country over income from such property that is used for the performance of professional services by a resident of the other country, irrespective of whether that income is attributable to a fixed base of that resident.

Article 7 - Business Profits

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

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

Paragraphs 2 and 3 of the Article are anti-profit shifting measures that are designed to ensure that profits of a permanent establishment are determined on the basis of arm's length dealings. Those provisions correspond in their practical effect with comparable provisions in Australia's other double taxation agreements.

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

respect of profits attributable to the purchasing activities undertaken for the head office. It follows, of course, that any expenses incurred by the permanent establishment in respect of those purchasing activities will not be deductible in determining the taxable profits of the permanent establishment.

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

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

Paragraph 8 preserves to each country the right to continue to apply any special provisions in its domestic law relating to the taxation of income from insurance with non-residents. An effect of this paragraph is to preserve for Australia the application of Division 15 of Part III of the Assessment Act.

Paragraph 9 is intended to clarify Australia's right to tax a share of business profits, originally derived by a trustee of a trust estate (other than a corporate unit trust) from the carrying on of a business in Australia, to which a resident of China is beneficially entitled. It ensures that such distributions will be subject to tax in Australia where, in accordance with the principles set out in Article 5, the trustee of the relevant trust estate has a permanent establishment in Australia in relation to that business. It is comparable in effect to subsection 3(11) of the Income Tax (International Agreements) Act 1953, which has a similar effect where the beneficiary is a resident of a country with which Australia had signed a comprehensive taxation agreement on or before 19 August 1984.

Article 8 - Shipping and Air Transport

Under this article the right to tax profits from the operation of ships in international traffic, including profits derived from participation in a pool service, a joint transport operating organisation or an international

operating agency, is generally reserved to the country of residence of the operator.

Any profits derived by a resident of one country from internal traffic in the other country may be taxed in that other country. By reason of the definition of "Australia" contained in Article 3 and the terms of paragraph 4 of this article, any shipments by sea from a place in Australia to another place in Australia, its continental shelf or external territories are treated as forming part of internal traffic. Accordingly, profits derived, for example, from a shipment of goods taken on board, during the course of an international voyage, at Fremantle for delivery to Sydney would be profits from internal traffic.

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

Article 9 - Associated Enterprises

This article authorises the re-allocation of profits between related enterprises in Australia and China on an arm's length basis where the commercial or financial arrangements between the enterprises differ from those that might be expected to operate between independent enterprises dealing at arm's length with one another.

By virtue of paragraph 2 of the article, each country retains the right to apply its domestic law (e.g. Australia's Division 13) to its own enterprises, provided that such provisions are applied, so far as it is practicable to do so, in accordance with the principles of this article.

Where a re-allocation of profits is effected under this article or, by virtue of paragraph 2, under domestic law, so that the profits of an enterprise of one country are adjusted upwards, a form of double taxation would arise if the profits so re-allocated continued to be subject to tax in the hands of an associated enterprise in the other country. Paragraph 3 therefore requires the other country concerned to make an appropriate adjustment to the amount of tax charged on the profits involved with a view to relieving any such double taxation.

Article 10 - Dividends

This article allows both countries to tax dividends flowing between them but in general limits the tax that the country of source may impose on dividends payable to beneficial owners resident in the other country. Under this article, Australia will reduce its

rate of withholding tax on unfranked dividends paid by Australian resident companies to residents of China from 30 per cent to 15 per cent of the gross amount of the dividends. Franked dividend payments will, of course, remain free of withholding tax under Australia's domestic law. The rate of tax to be imposed by China on outgoing dividends that are beneficially owned by a resident of Australia is also limited to 15 per cent.

Paragraph 4 effectively provides that the limitation on the source country's tax is not to apply to dividends derived by a resident of the other country who has a "permanent establishment" or "fixed base" in the country from which the dividends are derived, if the holding giving rise to the dividends is effectively connected with that "permanent establishment" or "fixed base". Where the dividends are so effectively connected, they will be treated as "business profits" or "income from independent personal services" and subject to the source country's tax in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be. In practice, under changes made to Australia's domestic law with the introduction from 1 July 1987 of a full imputation system of company taxation, such dividends that are franked dividends will remain exempt from Australian tax while unfranked dividends will be subject to withholding tax instead of being taxed by assessment.

The purpose of paragraph 5 of this article is to ensure, broadly, against the extra-territorial application by either country of taxing rights over dividend income. It provides that one country will not tax dividends paid by a company resident in the other country unless the person deriving the dividends is a resident of the first country or the holding giving rise to the dividends is effectively connected with a "permanent establishment" or "fixed base" in that country. The paragraph also provides that the first-mentioned country will not levy a tax on the company's undistributed profits.

Article 11 - Interest

This article requires the country of source generally to limit its tax on interest derived by residents of the other country to 10 per cent of the gross amount of the interest. This limitation accords with the general rate of withholding tax applicable under Australia's domestic law.

Paragraph 3 defines the term "interest" for the purposes of the article to mean interest from debt-claims (i.e., indebtedness) of every kind, and all other income that is by the income tax laws of the respective countries assimilated to income from money lent. The latter reference will operate to ensure that the definition

encompasses items of income such as discounts on securities and payments under certain hire purchase agreements which are treated for Australian tax purposes as interest or amounts in the nature of interest, and therefore as falling within the definition of "interest" for withholding tax purposes.

By paragraph 4, interest derived by a resident of one country which is effectively connected with a "permanent establishment" or "fixed base" of that person in the other country will form part of the business profits of that "permanent establishment" or "fixed base" and be subject to the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services). Accordingly, paragraph 4 of Article 11 effectively requires that the 10 per cent source country tax rate limitation specified by Article 11 is not to apply to such interest.

The interest "source" rules set out in paragraph 5 differ from those under Australian law and under Australia's double taxation agreements generally, to the extent that interest paid by an Australian resident that is an expense of a permanent establishment (branch) in a third country is treated by paragraph 5 as having a source in Australia and as thus being potentially liable to Australian tax in accordance with paragraph 2 of the Article. It has been necessary, therefore, to propose an ameliatory amendment of the Income Tax (International Agreements) Act 1953. This is to be found in clause 5 of the Bill (proposed subsection 11S(3)).

The article also contains a general safeguard (paragraph 6) against payments of excessive interest - in cases where there is a special relationship between the persons associated with a loan transaction - by restricting the 10 per cent source country tax rate limitation in such cases to an amount of interest which might be expected to have been agreed upon by persons dealing at arm's length.

Article 12 - Royalties

This article in general limits to 10 per cent of the gross amount of the royalties the tax that the country of source may impose on royalties (as defined in paragraph 3 of the article) paid or credited to beneficial owners resident in the other country. Except for some minor drafting changes, the definition of royalties contained in paragraph 3 accords with that found in Australia's domestic law and other modern double tax agreements.

The 10 per cent limitation is not to apply to natural resource royalties, which, in accordance with Article 6 (Real Property), are to remain taxable in the country of source without limitation of the tax that may be imposed.

In the absence of a double taxation agreement, Australia generally taxes royalties paid to non-residents (other than film and video tape royalties which are taxed at the rate of 10 per cent of the gross royalties), as reduced by allowable expenses, at ordinary rates of tax. The 10 per cent limitation imposed by this article will operate, however, where appropriate, to reduce the tax payable under that normal basis of assessment.

As in the case of dividends and interest, it is specified in paragraph 4 that the 10 per cent limitation of tax in the country of origin is not to apply to royalties effectively connected with a "permanent establishment" or "fixed base" in that country. The point noted above in relation to the interest source rule of paragraph 5 of Article 11 is also relevant in relation to the royalty "source" rule contained in paragraph 5 of this article.

By paragraph 6, if royalties flow between related persons, the 10 per cent source country tax rate limitation will apply only to the extent that the royalties are not excessive.

Article 13 - Alienation of Property

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

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

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

Paragraph 3 specifies that income or gains from the disposal of ships or aircraft operated in international traffic, or associated property (other than real property covered by paragraph 1) shall be taxable only in the country of residence of the operator of the ships or aircraft. This rule corresponds to the taxing rights contained in Article 8 of this agreement for shipping

profits and in the existing agreement with China relating to airline profits, whereby profits from the operation of ships or aircraft in international traffic are to be taxed only by the country of residence of the ship or aircraft operator.

By paragraph 4 income or gains from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property covered by paragraph 1, may be taxed in the country in which such assets or principal assets are situated. The paragraph thus assimilates the treatment of the alienation of those shares or comparable interests to the treatment by paragraph 1 of the alienation of that real property.

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

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

In the event that the operation of this article should result in an item of income or a gain being subjected to tax in both countries, the country of which the person deriving the income or gain is a resident would be obliged by Article 23 (Methods of Elimination of Double Taxation) to allow a credit against its own tax for the tax imposed by the other country.

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

At present, an individual resident in Australia or in China may be taxed in the other country on income derived from the performance in that other country of professional services or other similar independent activities. By this article, such income will continue to be subject to tax in the country in which the services are performed in cases where:

- the recipient has a "fixed base" regularly available in that country for the purposes of performing his or her activities and the income is attributable to activities exercised from that base, or

- the income is derived during a period or periods exceeding 183 days in any consecutive period of 12

months in which the recipient is present in that country.

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

If neither of the tests mentioned above are met, the income will be taxed only in the country of residence of the recipient.

Remuneration derived as an employee and income derived by public entertainers are the subject of other articles of the agreement and are not covered by this article.

Article 15 - Dependent Personal Services

Article 15 provides the basis upon which the remuneration of visiting employees is to be taxed. Generally, salaries, wages, etc. derived by a resident of one country from an employment exercised in the other country will be liable to tax in that other country. However, subject to specified conditions, there is a conventional provision for exemption from tax in the country being visited where only visits of a short-term nature are involved.

The conditions for exemption in the country visited are that the visit or visits not exceed, in the aggregate, 183 days in any consecutive period of 12 months; that the remuneration is paid by, or on behalf of, an employer who is not a resident of the country being visited; and that the remuneration is not deductible in determining taxable profits of a "permanent establishment" or a "fixed base" which the employer has in the country being visited. Where these conditions are met, the remuneration so derived will be liable to tax only in the country of residence. The provisions of this article do not apply, however, in respect of income that is dealt with separately in Articles 16 (Directors' Fees), 17 (Artistes and Athletes), 18 (Pensions), 19 (Government Service), 20 (Professors and Teachers) or 21 (Students and Trainees).

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

Where the source country short-term visit exemption is not applicable, remuneration derived by a resident of Australia from an employment exercised in China may be subject to tax in China. However, the article does not allocate sole taxing rights to China in that situation. Accordingly, Australia would also be entitled to tax that remuneration in accordance with the general rule of the Assessment Act that a resident of Australia remains subject to tax on worldwide income. In common, however, with other situations where the agreement allows both countries to tax a category of income, Australia would be required (pursuant to paragraph 2 of Article 23) as the country of residence of the income recipient, to relieve the double taxation that would otherwise occur.

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

Article 16 - Directors' Fees

Under this article, remuneration derived by a resident of one country in the capacity of a director of a company which is a resident of the other country may be taxed in the latter country.

Article 17 - Artistes and Athletes

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

Paragraph 2 of this article is a safeguarding provision designed to ensure that income in respect of personal activities exercised by an entertainer, whether received by the entertainer or by another person, e.g., a separate enterprise which formally provides the entertainer's services, is taxed in the country in which the entertainer performs, whether or not that other person has a "permanent establishment" or "fixed base" in that country.

Paragraph 3 provides that income derived by an entertainer visiting one of the countries from his or her activities as an entertainer shall be exempt from tax in

that country if the visit is under a plan of cultural exchange between the governments of the two countries.

Article 18 - Pensions

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

It is intended that the operation of this article (and paragraph 2 of Article 19 relating to government service pensions) extend to pension payments made to dependants, for example the widow or children, of the person in respect of whom the pension entitlement accrued where upon that person's death, such entitlement has passed to that person's dependants.

Article 19 - Government Service

Paragraph 1 of this article provides that remuneration, other than a pension, paid to an individual in respect of services rendered in the discharge of functions of a governmental nature by a government (including a State or local authority) of one of the countries will be taxed only in that country. However, such remuneration is to be taxable only in the other country if the services are rendered in that country and the recipient is a resident of that country (as determined in accordance with Article 4) and is a citizen or national of, or ordinarily resides in, that country.

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

Paragraph 3 provides that paragraphs 1 and 2 do not apply where the services are or have been rendered in connection with a trade or business carried on by a government (including a State or local authority). In such cases, the provisions of Article 15 (Dependent Personal Services), 16 (Directors' Fees), 17 (Artistes and Athletes) or 18 (Pensions) as the case may be, apply.

Article 20 - Professors and Teachers

This article applies in respect of professors or teachers who are resident in one country and visit the other country for a period of not more than two years for the purpose of teaching or advanced study or research at an educational institution. In these circumstances, the

remuneration of the professor or teacher for his or her teaching, study or research work are to be exempt from tax in the country visited provided it is subject to tax in the country of residence. The exemption provided by the article does not apply to remuneration received for conducting research if the research is undertaken primarily for the private benefit of a specific person or persons. The income would in those circumstances normally come within the ambit of either Article 14 or 15.

Article 21 - Students and Trainees

This article applies to students and trainees temporarily present in a country solely for the purpose of their education or training who are, or immediately before the visit were, resident in the other country. In these circumstances, the students and trainees will be exempt from tax in the country visited in respect of payments received from abroad for the purposes of their maintenance education or training (even though they may qualify as a resident of the country visited during the period of their visit). The exemption from tax provided by the visited country is treated as extending to maintenance payments received by the student that are made in respect of the maintenance of dependent family members who have accompanied the student or trainee to the visited country.

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

Article 22 - Other Income

This article provides for the allocation between the two countries of taxing rights in relation to items of income not expressly mentioned in the preceding articles of the agreement. The scope of the article is not confined to such items of income arising in one of the Contracting countries; it extends also to income from sources in a third State.

Broadly, such income derived by a resident of one country is to be taxed only in his or her country of residence unless it is derived from sources in the other country, in which case the income may also be taxed in the country of source. Where this occurs, the country of residence of the recipient of the income would be obliged by Article 23 (Methods of Elimination of Double Taxation) to provide double taxation relief.

However, the first-mentioned exclusive taxing

right of the country of residence does not apply to income, other than income from real property as defined in paragraph 2 of Article 6, which is effectively connected with a "permanent establishment" or "fixed base" which a resident of one country has in the other country. In such cases, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, will apply.

Article 23 - Methods of Elimination of Double Taxation

Double taxation does not arise in respect of income flowing between the two countries where the terms of the agreement provide for the income to be taxed only in one country or the other, or where the domestic taxation law of one of the countries frees the income from its tax.

It is necessary, however, to prescribe a method for relieving double taxation in respect of other classes of income which are subject under the agreement to tax in both countries. Australia's other double taxation agreements provide for a credit basis for the relief of double taxation to be applied by Australia and, usually, the other country. In these cases, the country of residence is required to give credit against its tax for the tax of the country of source. This approach has generally been adopted in this agreement.

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

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

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

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

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

Subparagraphs (a), (b), (c), (d), (e) and (f) of paragraph 5 specify the development incentive provisions of China in respect of which the tax sparing provisions of the article apply. The paragraph also makes provision for the Treasurer and the Commissioner of the State Taxation Administration of China to agree from time to time in letters exchanged for that purpose that tax sparing will apply in relation to subsequently introduced Chinese development incentives of a substantially similar character. Section 4A of the Income Tax (International Agreements) Act 1953 (the Principal Act) provides for the particulars of the provisions agreed to in such an exchange of letters to be notified by the Treasurer in the Gazette.

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

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

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

(c) in the case of royalties, 15 per cent of the gross amount, but only where the rate ordinarily levied

under China's law (and not under a specified development incentive) is 15 per cent or more.

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

By reason of paragraph 7, the tax sparing provisions of the article are to apply in relation to income derived in any of the first ten Australian years of income to which the agreement has effect unless Australia and China agree to extend them beyond that period in letters exchanged for this purpose. Section 4A of the Principal Act provides for any such extension to be notified by the Treasurer in the Gazette.

The tax credit relief provisions of Article 23, including the tax sparing relief provisions, reflect the fact that they were negotiated on the basis of the existing Australian and Chinese income tax laws. It is relevant, however, that changes introduced by the Australian Government to the basis of taxing foreign income of Australian residents will lead to changes to the unilateral double tax relief provisions of Australia's domestic law. Certain dividends and branch income derived by Australian residents from China should generally qualify under those changes for exemption from Australian tax. That general exemption could normally be expected to be applicable in respect of such income in lieu of the tax credit and tax sparing relief provisions of Article 23 of this agreement.

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

Article 24 - Mutual Agreement Procedure

One of the purposes of this article is to provide for consultation between the taxation authorities of the

two countries with a view to reaching a satisfactory solution where a taxpayer is able to demonstrate actual or potential subjection to taxation contrary to the provisions of the agreement. A taxpayer wishing to use this procedure must present a case within three years of the first notification of the action giving rise to the taxation not in accordance with the agreement and if, on consideration, a solution is reached, it may be implemented irrespective of any time limits imposed by the domestic tax laws of the relevant country.

The article also authorises consultation between the taxation authorities of the two countries for the purpose of resolving any difficulties regarding the interpretation or application of the agreement and to give effect to it.

Article 25 - Exchange of Information

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

The purposes for which this information may be used and the persons to whom it may be disclosed are restricted along the lines of Australia's other double taxation agreements. In particular, an exchange of information that would disclose any trade, business, industrial or professional secret, or trade process, or which would be contrary to public policy, is not permitted by the article.

Article 26 - Diplomatic and Consular Officials

The purpose of this article is to ensure that the provisions of the agreement do not result in members of diplomatic and consular posts receiving less favourable treatment than that to which they are entitled in accordance with international laws. In Australia, such persons are entitled to certain fiscal privileges under the Diplomatic (Privileges and Immunities) Act 1967 and the Consular (Privileges and Immunities) Act 1972.

Article 27 - Entry into Force

This article provides for the entry into force of the agreement. This will be on the date on which notes are exchanged through the diplomatic channel notifying that the last of such things has been done in Australia and China as is necessary to give the agreement the force of law in both

countries. In the case of Australia the enactment of the legislation which gives the force of law in Australia to the agreement is the necessary prerequisite to the exchange of diplomatic notes taking place.

Once it enters into force, the agreement will have effect in Australia for purposes of withholding taxes in respect of income derived on or after 1 July in the calendar year next following that in which the agreement enters into force. In respect of tax other than withholding tax, the agreement will have effect in Australia in relation to income (which in this case is to be read as including profits and gains covered by the agreement) of any year of income beginning on or after 1 July in the calendar year following that in which it enters into force. Where a taxpayer has adopted an accounting period ending on a date other than 30 June, income (including profits and gains) derived on or after the beginning of the accounting period that has been substituted for the year of income beginning on 1 July in the calendar year following the calendar year in which the agreement enters into force will be subject to the agreement for purposes of Australian taxes other than withholding tax.

In China, the agreement will first have effect in relation to Chinese taxes which are levied in respect of income (including profits and gains) derived during the taxable year beginning on 1 January in the calendar year following that in which the agreement enters into force.

<u>Article 28 - Termination</u>

By this article the agreement is to continue in effect indefinitely. However, either country may give through the diplomatic channel written notice of termination of the agreement on or before 30 June in any calendar year beginning after the expiration of five years from the date of its entry into force.

In that event, the agreement would cease to be effective in Australia for purposes of withholding tax in respect of income derived on or after 1 July in the calendar year next following that in which the notice of termination is given. For other Australian taxes, it would cease to be effective in relation to income (including profits and gains) of any year of income beginning on or after 1 July in the calendar year next following that in which the notice of termination is given. It would cease to be effective in China in relation to income (including profits and gains) of any taxable year beginning on or after 1 January next following that in which the notice of termination is given.

SCHEDULE 2 TO THE BILL

Insertion as Schedule 31 to the Principal Act.

AGREEMENT WITH SRI LANKA

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

Article 1 - Personal Scope

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

The situation of persons who are dual residents (i.e., residents of both countries) is dealt with in Article 4.

Article 2 - Taxes Covered

This article specifies the existing taxes to which the agreement applies. These are, in the case of Australia, the Australian income tax and the resource rent tax in respect of offshore petroleum projects. For Sri Lanka, the agreement applies to its income tax, including the turnover tax imposed on enterprises licensed by the Greater Colombo Economic Commission.

Paragraph 2 of the article will automatically extend the application of the agreement to any identical or substantially similar taxes which may subsequently be imposed by either country in addition to, or in place of, the existing taxes.

Article 3 - General Definitions

Paragraph 1 of this article provides definitions for a number of the terms used in the agreement. Some other terms are defined in the articles to which they relate.

As with Australia's other modern taxation agreements, "Australia" is effectively defined as including certain external territories and areas of the continental shelf. By reason of this definition, Australia fully preserves the taxing rights effectively provided by section 6AA of the Income Tax Assessment Act 1936 (the Assessment Act) in relation to mineral exploration and mining activities carried on by non-residents on the seabed and subsoil of the continental shelf areas. The definition is also relevant to the taxation by Australia of shipping profits in accordance with Article 8 of the agreement.

Paragraph 2 makes it clear that, for the purposes of the agreement, the terms "Australian tax" and "Sri Lankan tax" do not include any amount of penalty or interest imposed by the operation of the respective domestic laws of Australia or Sri Lanka.

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

Paragraph 3 of this article provides that where a term is not specifically defined within the agreement that term, unless used in a context that requires otherwise, is to be taken to have the same interpretative meaning ascribed that particular term under the domestic law from time to time in force of the country applying the agreement. The effect of the inclusion in this paragraph of the expression "from time to time in force" is to clarify that a term not defined in the agreement is to be given the meaning it has under that country's domestic law at the time of application of the agreement, rather than the meaning it had when the agreement was negotiated.

Article 4 - Residence

This article sets out the basis by which the residential status of a person is to be determined for the purposes of the agreement. Residential status is one of the criteria for determining each country's taxing rights and is a necessary condition for the provision of double tax relief under the agreement. The concept of resident

according to each country's taxation law provides the basic test.

The article also includes a set of "tie-breaker" rules for determining how residency is to be allocated to one or other of the countries for the purposes of the agreement where a taxpayer - whether an individual, a company or other entity - qualifies as a dual resident, i.e., as a resident under the domestic laws of both countries.

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

Dual residents remain, however, in relation to each country a resident of that country for the purposes of its domestic law and subject to its tax as such, so far as the agreement allows. Attention is drawn, however, to Article 21 (Income not Expressly Mentioned) which would operate in relation to the dual resident referred to above as if the person were a resident of Sri Lanka and thus preclude Australia from taxing items of income not expressly dealt with by another article of the agreement where the income is derived from sources in Sri Lanka or in a third country.

Article 5 - Permanent Establishment

Application of various provisions of the agreement (principally Article 7, relating to business profits) is dependent upon whether a person who is a resident of one country has a "permanent establishment" in the other, and if so, whether income derived by the person in the other country is attributable to or effectively connected with that "permanent establishment". The definition of the term "permanent establishment" which this article embodies corresponds closely with definitions of the term in Australia's other double taxation agreements.

The primary meaning of the defined term is expressed in paragraph 1 as being a fixed place of business through which the business of an enterprise is wholly or partly carried on. Other paragraphs of the article are concerned with elaborating on the meaning of the term by giving examples of what may constitute a "permanent establishment" - such as an office, a mine or an agricultural, pastoral or forestry property - and by specifying the circumstances in which a resident of one

country shall, or shall not, be deemed to have a "permanent establishment" in the other country.

One particular feature of the article is that it provides that the furnishing of consultancy or other services by an enterprise of one country will constitute a permanent establishment in the other country where those activities continue (for the same or a connected project) within the latter country for a period or periods aggregating more than 183 days within any 12 month period. That feature, and the operation of Article 7, ensures preservation of the "business profits" principle in relation to the allocation between the two countries of taxing rights over fees derived from the furnishing of those services.

This article also embraces the principle that an enterprise should be treated as having a permanent establishment in a Contracting State if there is, under certain conditions, a person acting for it in that State, even though the enterprise may not have a fixed place of business in that State. Paragraph 5 stipulates the conditions under which an enterprise is deemed to have a permanent establishment in the other Contracting State when a person, other than an agent of independent status to which paragraph 7 of the article applies, is acting on its behalf.

Subparagraphs (b) and (d) of paragraph 5 effectively extend the application of the "dependent agent" principle beyond that usually contained in Australia's other agreements. These measures, when combined with the other provisions of this article, ensure that where an enterprise of one country has an ongoing commercial involvement in another country that other country maintains the right to tax income derived from that commercial involvement.

Article 6 - Income from Real Property

By this article, income from real property, including the letting or use in any other form of any land or interest therein, and royalties and other payments relating to the working of, or the exploration for or exploitation of, mines or quarries or other natural resources or rights in relation thereto, may be taxed in the country in which the land, mine, quarry or natural resource is situated.

Paragraph 2 of this article primarily defines the term "real property" so that it has the same meaning as it does under the domestic law of each country. Thus the definition encompasses the concept of real property as applied under Australian domestic law, and the concept of immovable property as applied under Sri Lankan law. The

definition also specifies certain other items of property which may not ordinarily be encompassed by those expressions

The paragraph specifically excludes ships and aircraft from the definition because the treatment of profits arising from their operation is dealt with in Article 8.

Consistent with the usual rule that whatever is affixed to or attached to land forms part of, or becomes part of, the land, the reference to land is required by paragraph 2 to be read as meaning either improved or unimproved land. Accordingly, the definition of real property will encompass, for example, a lease of a building or any other interest in a building.

Paragraph 5 makes it clear that the operational effects of the article extend to income derived from the use or exploitation of real property (within the meaning of the article) of an enterprise and income derived from such property that is used for the performance of independent professional services. As with other items of income dealt with separately in specific articles of the agreement, income of an enterprise to which this article applies is excluded from the scope of Article 7 (by paragraph 6 of that article) and is therefore taxable in the country in which the property is situated regardless of whether or not the recipient enterprise has a "permanent establishment" in that country. Paragraph 5 also operates to ensure taxing rights by that country over income from such property that is used for the performance of professional services by a resident of the other country, irrespective of whether that income is attributable to a fixed base of that resident.

Article 7 - Business Profits

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

The taxing of these profits turn on whether or not they are attributable to a "permanent establishment" of the enterprise in that other country. If they are not, the profits will be taxed only in the country of residence of the taxpayer which carries on the enterprise. If, however, the business of the enterprise is carried on through a "permanent establishment" (as defined in Article 5) in the other country, the country in which the "permanent establishment" is situated may tax the profits of the enterprise that are attributable to that permanent establishment. That country may also generally tax, in the case of this agreement, income attributable to certain related sales of goods or merchandise or other business activities where those sales are made or business activities are carried on within that country other than through the permanent establishment.

Paragraphs 2 and 3 of the article are anti-profit shifting measures that are designed to ensure that profits of a permanent establishment are determined on an arm's length basis. These provisions correspond in their practical effect with comparable provisions in Australia's other double taxation agreements, and with Division 13 of the Assessment Act.

Paragraph 4 provides that no profits are to be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for that enterprise. Subparagraph 6(b) of Article 5 provides that an enterprise shall not be deemed to have a permanent establishment merely by reason of that activity alone. This paragraph complements that provision and is concerned with a permanent establishment which, although carrying on certain business activities in its own right, also undertakes purchasing of goods or merchandise for its head office. Paragraph 4 is designed to make it clear that the profits of the permanent establishment derived from the business activities carried on in its own right will not be increased by adding to them any amount in respect of profits attributable to the purchasing activities undertaken for the head office. It follows, of course, that any expenses incurred by the permanent establishment in respect of those purchasing activities will not be deductible in determining the taxable profits of the permanent establishment.

Paragraph 5 of the article allows the application of provisions of the source country's domestic law (e.g. Australia's Division 13) where, due to the inadequacy of available information, the correct amount of profits attributable to a "permanent establishment" is incapable of determination or the ascertainment thereof presents exceptional difficulties.

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

Paragraph 8 preserves to each country the right to continue to apply any special provisions in its domestic law relating to the taxation of income from insurance with non-residents. An effect of this paragraph is to preserve, in the case of Australia, the application of Division 15 of Part III of the Assessment Act.

Paragraph 9 is intended to clarify Australia's right to tax a share of business profits, originally derived by a trustee of a trust estate (other than a corporate unit trust) from the carrying on of a business in Australia, to which a resident of Sri Lanka is beneficially entitled under the trust estate. It ensures that such distributions will be subject to tax in Australia where, in accordance with the principles set out in Article 5, the trustee of the relevant trust estate has a permanent establishment in Australia in relation to that business. It is comparable in effect to subsection 3(11) of the Income Tax (International Agreements) Act 1953, which has a similar effect where the beneficiary is a resident of a country with which Australia had signed a comprehensive taxation agreement on or before 19 August 1984.

Article 8 - Ships and Aircraft

Under this article the right to tax profits from the operation of ships or aircraft, including profits derived from participation in a pool service, a joint transport operating organisation or an international operating agency, is generally reserved to the country of residence of the operator.

Paragraph 2 provides, however, that profits from such operations may also be taxed by the other country where the profits arise from the operation of ships or aircraft in internal traffic (subparagraph 2(a)). In addition, the other country is given taxing rights over profits from other shipping operations in that other country (by subparagraph 2(b)), but subject to a limited amount in the case of those profits.

That limit is expressed in terms which allows the country which is not the country of residence of the shipping operator to tax profits to which subparagraph 2(b) applies at a rate of tax that is half the rate normally imposed on such profits under its domestic law. However, provision is made for the eventuality that Sri Lanka might subsequently negotiate an agreement with a third country that provides for a lower rate of tax to apply in this situation. In that case, the lower rate will extend to this agreement. Accordingly, should Sri Lanka relinquish under such an agreement the right to tax such profits entirely, then sole taxing rights on such income will effectively revert to the country of residence of the shipping operator.

The provisions of subparagraph 2(b) are relevant in regard to Division 12 of the Assessment Act and its application in practice to a ship owned or chartered by a resident of Sri Lanka that carries passengers, livestock, mail or goods shipped in Australia. Under the provisions of this subparagraph, except where the operations of the ship is confined solely to places within Australia, the

amount of Australian tax payable will be reduced to the lesser of half the amount payable in accordance with Division 12 and the amount payable in accordance with a (lower) rate that Sri Lanka may subsequently agree to in a double taxation agreement with a third country. In the case of profits derived by a resident of Sri Lanka from the operations of ships confined solely to places within Australia (i.e., profits to which subparagraph 2(a) applies), 5 per cent of the amount paid or payable for the carriage provided will be treated as taxable income in Australia in accordance with Division 12.

In the alternative situation, where an Australian owned or chartered vessel operates in Sri Lanka (other than solely between places in that country), the article provides for Sri Lanka to apply its domestic law in accordance with the same restrictions that apply to Australia, i.e., the lesser of half the normal amount payable in Sri Lanka and the amount payable in accordance with a (lower) rate of tax that Sri Lanka may subsequently agree to in a double taxation agreement with a third country.

In relation to the meaning of profits from operations of ships or aircraft confined solely to places in one of the countries (i.e., internal traffic), the effects of the definition of "Australia" contained in Article 3 and the terms of paragraph 4 of this article are that any shipments by air or sea from a place in Australia (including the continental shelf areas and external territories covered by the definition of "Australia") to another place in Australia, are treated as forming part of internal traffic. Accordingly, profits derived, for example, from a shipment of goods taken on board, during the course of an international voyage, at Fremantle for delivery to Sydney would be profits from internal traffic.

Article 9 - Associated Enterprises

This article authorises the re-allocation of profits between related enterprises in Australia and Sri Lanka on an arm's length basis where the commercial or financial arrangements between the enterprises differ from those that might be expected to operate between independent enterprises dealing at arm's length with one another. The article would not generally authorise the re-writing of accounts of associated enterprises where it can be satisfactorily demonstrated that the transactions between such enterprises have taken place on normal open market commercial terms.

By virtue of paragraph 2 of the article, each country retains the right to apply its domestic law (e.g. Australia's Division 13) to its own enterprises, provided that such provisions are applied, so far as it is

practicable to do so, in accordance with the principles of this article.

Where a re-allocation of profits is effected under this article or, by virtue of paragraph 2 under domestic law, so that the profits of an enterprise of one country are adjusted upwards, a form of double taxation would arise if the profits so re-allocated continued to be subject to tax in the hands of an associated enterprise in the other country. To avoid this result, paragraph 3 requires the other country concerned to make an appropriate adjustment to the amount of tax charged on the profits involved with a view to relieving any such double taxation.

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

Article 10 - Dividends

This article allows both countries to tax dividends flowing between them but in general limits the tax that the country of source may impose on dividends payable by companies that are residents of that country under its domestic law to beneficial owners resident in the other country. Under this article, Australia will reduce its rate of withholding tax on unfranked dividends paid by Australian resident companies to residents of Sri Lanka from 30 per cent to 15 per cent of the gross amount of the dividends. Franked dividend payments will, of course, remain free of withholding tax under Australia's domestic law. The rate of tax to be imposed by Sri Lanka on outgoing dividends is also limited to 15 per cent.

Paragraph 4 effectively provides that the limitation provided by paragraph 2 on the source country's tax shall not apply to dividends derived by a resident of the other country who has a "permanent establishment" or "fixed base" in the country from which the dividends are derived, if the holding giving rise to the dividends is effectively connected with that "permanent establishment" or "fixed base". Where the dividends are so effectively connected, the paragraph provides for them to be treated as "business profits" or "income from independent personal services" and subject to the source country's tax on an assessment basis in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be. In practice, however, under changes made to Australia's domestic law with the introduction from 1 July 1987 of a full imputation system of company taxation, such dividends that are franked dividends will remain exempt from Australian tax while

unfranked dividends will be subject to withholding tax instead of being taxed by assessment.

The purpose of paragraph 5 of this article is to preclude the extra-territorial application by either country of taxing rights over dividend income by providing, broadly, that one country will not tax dividends paid by a company resident solely in the other country unless the person deriving the dividends is a resident of the first country or the holding giving rise to the dividends is effectively connected with a "permanent establishment" or "fixed base" in that country.

Article 11 - Interest

This article requires the country of source of interest income to generally limit its tax to 10 per cent of the gross amount of the interest where a resident of the other country is the beneficial owner of the interest. This source country tax rate limitation accords with the general rate of interest withholding tax applicable under Australia's domestic law.

Paragraph 3 defines the term "interest" for the purposes of the article in a way that encompasses items of income such as discounts on securities and payments under certain hire purchase agreements which are treated for Australian tax purposes as interest or amounts in the nature of interest, and therefore as falling within the definition of "interest" for domestic withholding tax purposes.

Paragraph 4 requires that the 10 per cent source country tax rate limitation will not apply to interest derived by a resident of one country which is effectively connected with a "permanent establishment" or "fixed base" of that person in the other country. Such interest is to be subject to the provisions of Article 7 or Article 14.

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

The article also contains a general safeguard (paragraph 6) against payments of excessive interest - in cases where there is a special relationship between the persons associated with a loan transaction - by restricting

the 10 per cent source country tax rate limitation in such cases to an amount of interest which might be expected to have been agreed upon by persons dealing at arm's length.

Article 12 - Royalties

This article in general limits to 10 per cent of the gross amount of the royalties the tax that the country of source may impose on royalties (as defined in paragraph 3 of the article) paid or credited to beneficial owners resident in the other country. The definition of royalties contained in paragraph 3 is consistent with the definition of royalties in subsection 6(1) of the Assessment Act and in Australia's other modern comprehensive tax treaties.

The 10 per cent source country tax rate limitation is not to apply to natural resource royalties, which, in accordance with Article 6, are to remain taxable in the country of source without limitation of the tax that may be imposed.

In the absence of a double taxation agreement, Australia generally taxes royalties paid to non-residents (other than film and video tape royalties which are taxed at the rate of 10 per cent of the gross royalties), as reduced by allowable expenses, at ordinary rates of tax. The 10 per cent limitation imposed by this article will operate, where appropriate, to reduce the tax payable under that assessment basis.

As in the case of dividend and interest income, it is specified in paragraph 4 that the 10 per cent source country tax rate limitation is not to apply to royalties effectively connected with a "permanent establishment" or "fixed base" in that country and to render such royalties subject to Article 7 or Article 14. The royalties "source" rule in paragraph 5 mirrors the "source" rule for interest income contained in paragraph 5 of Article 11.

By paragraph 6, if royalties flow between related persons, the 10 per cent source country tax rate limitation will apply only to the extent that the royalties are not excessive.

Article 13 - Alienation of Property

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

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

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

Paragraph 3 specifies that income or gains from the disposal of ships or aircraft operated in international traffic, or associated property (other than real property covered by paragraph 1) shall be taxable only in the country of residence of the operator of the ships or aircraft. This rule corresponds to the general taxing rule contained in Article 8 in relation to profits from the operation of ships or aircraft in international traffic.

Paragraph 4 assimilates the treatment of income or gains from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property covered by paragraph 1, to the treatment by paragraph 1 of the alienation of that real property.

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

In the event that the operation of paragraph 5 should result in a gain of a capital nature being subjected to tax under the domestic law in both countries, the country of which the person deriving the gain is a resident, as determined in accordance with Article 4, would be obliged by Article 22 (Source of Income) and Article 23 (Methods of Elimination of Double Taxation) to provide double tax relief for the tax imposed by the other country.

It should be noted that Article 21 effectively contains sweep-up provisions in relation to <u>items of income</u> not expressly dealt with in other articles of the agreement.

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

Article 14 - Independent Personal Services

At present, an individual resident in Australia or in Sri Lanka may be taxed in the other country on income derived from the performance in that other country of professional services or other similar independent activities. By this article, such income will continue to be subject to tax in the country in which the services are performed in cases where:

- the recipient has a "fixed base" regularly available in that country for the purpose of performing his or her activities and the income is attributable to activities exercised from that base; or
- the income is derived during a period or periods amounting to or exceeding 183 days in a year of income, or year of assessment, in which the recipient is present in that country.

If neither of the tests mentioned above are met, the income will be taxed only in the country of residence of the recipient.

Remuneration derived as an employee and income derived by public entertainers are the subject of other articles of the Agreement and are not covered by this article.

Article 15 - Dependent Personal Services

Article 15 provides the basis upon which the remuneration of visiting employees is to be taxed. Generally, salaries, wages, etc. derived by a resident of one country from an employment exercised in the other country are treated as having a source in, and as being liable to tax in, that other country. However, subject to specified conditions, there is a conventional provision for exemption from tax in the country being visited where only visits of a short-term nature are involved.

The conditions for this exemption are that the visit or visits not exceed, in the aggregate, 183 days in the year of income, or year of assessment, of the country visited; that the remuneration is paid by, or on behalf of, an employer who is not a resident of the country being visited; and that the remuneration is not deductible in determining taxable profits of a "permanent establishment" or a "fixed base" which the employer has in the country being visited. Where all of these conditions are met, the remuneration so derived will be liable to tax only in the country of residence of the recipient. The provisions of this article do not apply, however, in respect of income that is dealt with separately in Articles 16 (Directors'

Fees), 17 (Entertainers), 18 (Pensions and Annuities), or 19 (Government Service).

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

Where the source country short-term visit exemption is not applicable, remuneration derived by a resident of Australia from an employment exercised in Sri Lanka may be subject to tax in Sri Lanka. However, the article does not allocate sole taxing rights to Sri Lanka in that situation. Accordingly, Australia would also be entitled to tax that remuneration in accordance with the general rule of the Assessment Act that a resident of Australia remains subject to tax on worldwide income. In common, however, with other situations where the agreement allows both countries to tax a category of income, Australia would be required (pursuant to paragraph 1 of Article 23) as the country of residence of the income recipient, to relieve the double taxation that would otherwise occur.

Although that paragraph provides for the double tax relief to be provided by Australia to be in the form of the grant of a credit against the Australian tax for the Sri Lankan tax paid, the "exemption with progression" provisions of section 23AG of the Assessment Act would be applicable in practice, so far as they are relevant, in relation to the employment income derived in the situation described.

Article 16 - Directors' Fees

Under this article, remuneration derived by a resident of one country in the capacity of a director of a company which is a resident of the other country may be taxed in the latter country.

Article 17 - Entertainers and Athletes

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

Paragraph 2 of this article is a safeguarding provision designed to ensure that income in respect of personal activities exercised by an entertainer, whether received by the entertainer or by another person, e.g., a

separate enterprise which formally provides the entertainer's services, is taxed in the country in which the entertainer performs, whether or not that other person has a "permanent establishment" or "fixed base" in that country.

Paragraphs 3 and 4 effectively provide that income derived by an entertainer visiting one of the countries from his or her activities as an entertainer, whether received by the entertainer or by another person, shall be taxed only in the other country if:

- where the income is derived by the entertainer, those activities are substantially funded by public funds of that other country; or
- where the income accrues to another person, that other person is supported substantially from public funds or is a non-profit organisation of the other country.

Article 18 - Pensions and Annuities

Under this article pensions (other than government service pensions referred to in Article 19) and annuities are to be taxed only by the country of residence of the recipient.

It is intended that the operation of this Article (and Article 19 as it relates to a government service pension) extend to pension and annuity payments made to dependants, for example the widow or children, of the person in respect of whom the pension or annuity entitlement accrued where upon that person's death, such entitlement has passed to that person's dependants.

Paragraph 3 of this article provides for alimony or other similar maintenance payments that are made from a source in one country to a resident of the other country to be taxable only in the country from where the payment is made. The basic purpose of this paragraph is to preserve the domestic laws of the respective states in relation to such payments.

Article 19 - Government Service

Paragraph 1 of this article provides that remuneration, other than a pension or annuity, paid to an individual in respect of services rendered in the discharge of governmental functions to a government (including a State or local authority) of one of the countries shall be taxed only in that country. However, such remuneration is to be taxable only in the other country if the services are rendered in that country and the recipient is a resident of that country (as determined in accordance with Article 4)

and is a citizen or national of, or ordinarily resides in that country.

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

Paragraph 3 precludes from the scope of this article remuneration and pensions paid in respect of services rendered in connection with a trade or business carried on by a government (including a State or local authority). Such payments will remain subject to the provisions of Articles 15 (Dependent Personal Services), 16 (Directors' Fees) or 18 (Pensions and Annuities), as the case may be.

Article 20 - Students

This article applies to students temporarily present in a country solely for the purpose of their education who are, or immediately before the visit were, resident in the other country. In these circumstances, a student will be exempt from tax in the country visited in respect of payments received from abroad for the purposes of his or her maintenance or education (even though the student may qualify as resident of the country visited during the period of the visit). The exemption from tax provided by the visited country is treated as extending to maintenance payments received by the student that are made in respect of the maintenance of dependent family members who have accompanied the student to the visited country.

Article 21 - Income Not Expressly Mentioned

This article provides for the allocation between the two countries of taxing rights in relation to items of income not expressly mentioned in the preceding articles of the agreement. The scope of the article is not confined to such income arising in one of the Contracting countries; it extends to income from sources in a third State.

Broadly, such income derived by a resident of one country is to be taxed only by that country unless it is derived from sources in the other country, in which case the income may also be taxed in the other country. Where this occurs, the country of residence of the recipient of the income would be obliged by Article 23 (Methods of Elimination of Double Taxation) to provide double taxation relief.

However, paragraph 3 of the article ensures the application of Article 7 or Article 14, as the case may be,

in respect of income which is effectively connected with a "permanent establishment" or "fixed base" which a resident of one country has in the other country.

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

Article 22 - Source of Income

Paragraph 1 of Article 22 effectively deems income derived by a resident of Sri Lanka which, under the agreement, may be taxed in Australia to have a source in Australia for the purposes of Australia's domestic law. It thus ensures that Australia is empowered, in accordance with its domestic law rule that non-residents are taxable on income derived from sources in Australia, to exercise the taxing rights allocated to it by the agreement over residents of Sri Lanka. Paragraph 2 of this Article is designed to ensure that an item of profits, income or gains derived by a resident of Australia which is taxed by Sri Lanka in accordance with the agreement is treated as income from sources in Sri Lanka for purposes of the tax credit relief obligation provisions of Article 23(1) and Australia's foreign tax credit system, which is the usual mechanism by which Australia fulfils that obligation in relation to profits, income or gains which are taxed, in accordance with the agreement, by both countries.

The article thus avoids any conflict arising under Australia's domestic law source rules. The article is expressed unilaterally in relation to Australia because Sri Lanka's domestic law has much the same effect in relation to Sri Lankan tax as the article will have in relation to Australian tax.

Article 23 - Methods of Elimination of Double Taxation

Double taxation does not arise in respect of income flowing between the two countries where the terms of the agreement provide for the income to be taxed only in one country or the other, or where the domestic taxation law of one of the countries frees the income from its tax.

It is necessary, however, to prescribe a method for relieving double taxation in respect of other classes of income which remain under the agreement subject to tax in both countries. Australia's other double taxation agreements provide for a credit basis for the relief of double taxation to be applied by Australia and, usually, the other country. In these cases, the country of residence is required to give credit against its tax for

the tax of the country of source. This agreement generally follows this approach.

Paragraph 1 of the article provides for Australia to relieve double taxation by allowing a credit against its own tax for Sri Lankan tax paid under the law of Sri Lanka and in accordance with the agreement on income derived by a resident of Australia from sources in Sri Lanka. Where a dividend is paid by a Sri Lankan resident company to an Australian resident company which controls 10 per cent or more of the voting power in the Sri Lankan company, the paragraph provides for the credit allowed by Australia to also take into account, in addition to the Sri Lankan tax paid in respect of the dividends, the underlying Sri Lankan tax paid by the company in respect of the profits out of which the dividend is paid.

Australia's general foreign tax credit system, together with the terms of this article and of the agreement generally, will form the basis of Australia's arrangements for relieving a resident of Australia from double taxation on income arising from sources in Sri Lanka. As in the case of Australia's other double taxation agreements, the source of income rules specified for purposes of the agreement will also apply (by reason of Article 22 in this case) for those purposes.

Accordingly, effect is to be given to the tax credit relief obligation imposed on Australia by paragraph 1 of Article 23 by application of the general foreign tax credit provisions (Division 18 of Part III) of the Assessment Act. This will include the allowance of "underlying" tax credit relief in respect of dividends paid by Sri Lankan resident companies to related Australian companies, including for unlimited tiers of related companies, in accordance with the relevant provisions of the Assessment Act.

Notwithstanding the credit form of relief provided for by paragraph 1 of the article, the "exemption with progression" provisions of section 23AG of the Assessment Act will continue to be applicable, as appropriate, in relation to salary and wages and like remuneration derived by a resident of Australia during a continuous period of "foreign service" in Sri Lanka.

Paragraphs 2, 3 and 4 of Article 23 contain "tax sparing" provisions under which an Australian resident recipient of income on which Sri Lanka - under specified incentive measures - has forgone tax, will obtain tax credit relief as if the Sri Lankan tax forgone had been paid.

The development incentive provisions for which tax sparing relief will be available are those that the Treasurer and the Minister of Finance and Planning of Sri

Lanka agree to from time to time in letters exchanged for that purpose. Section 4A of the Income Tax (International Agreements) Act 1953 (the Principal Act), makes provision for the publication in the Gazette of a notice specifying particulars of the development incentives that are so agreed from time to time.

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

Where a tax sparing credit is allowable, subparagraph 2(b) provides for tax sparing to be granted on the "gross-up and credit" method for the purpose of calculating the Australian tax. In other words, it provides for there to be "grossing-up" for Australian tax assessment purposes of the relevant income by the amount of Sri Lankan tax forgone. For example, in the case of income received by a resident of Australia from Sri Lanka in respect of which Sri Lankan tax has been wholly forgone under an eligible development incentive, the amount included in the income recipient's assessable income in Australia (under subparagraph 2(b)) will be the amount of income received plus the amount of Sri Lankan tax forgone, and a credit will be granted for the Sri Lankan tax forgone.

The tax credit relief provisions of Article 23, including the tax sparing relief provisions, reflect the fact that they were negotiated on the basis of the existing Australian and Sri Lankan income tax laws. It is relevant, however, that changes recently introduced by the Australian Government to the basis of taxing foreign income of Australian residents will lead to changes to the unilateral double tax relief provisions of Australia's domestic law. Certain dividends and branch income derived by Australian residents from Sri Lanka should generally qualify under those changes for exemption from Australian tax. That general exemption could normally be expected to be applicable in respect of such income in lieu of the tax credit and tax sparing relief provisions of Article 23 of the agreement.

Paragraph 5 provides for Sri Lanka to, broadly, allow a credit to Sri Lankan residents in respect of taxes payable in Australia in accordance with the agreement on their Australian source income, against the Sri Lankan tax payable on that income. Where a dividend is paid by an Australian resident company to a Sri Lankan resident company which owns, directly or indirectly, not less than

10 per cent of the shares in the Australian company, the credit allowed by Sri Lanka is also to take into account, in addition to the Australian tax paid in respect of the dividends, the underlying Australian tax paid by the company in respect of the profits out of which the dividend is paid.

Paragraph 6 provides that any income derived by a resident of one country which is effectively exempt from tax in that country under a provision of the agreement may be taken into account in calculating the amount of tax on the remaining income of the resident. The paragraph thus allows for "exemption with progression", such as applicable in respect of exempt overseas employment income under section 23AG of the Assessment Act.

Article 24 - Mutual Agreement Procedure

One of the purposes of this article is to provide for consultation between the taxation authorities of the two countries with a view to reaching a satisfactory solution where a person is able to demonstrate actual or potential imposition of taxation contrary to the provisions of the agreement. A person wishing to use this procedure must present a case to the competent authority of the State of which the person is a resident within three years of the first notification of the action which the taxpayer considers gives rise to taxation not in accordance with the agreement. If, on consideration, a solution is reached, it may be implemented irrespective of any time limits imposed by the domestic tax laws of the relevant country.

The article also authorises consultation between the taxation authorities of the two countries for the purpose of resolving any difficulties regarding the interpretation or application of the agreement and to give effect to it.

Article 25 - Exchange of Information

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

The purposes for which the exchanged information may be used and the persons to whom it may be disclosed are restricted along the lines of Australia's other double taxation agreements. Any information received by a Contracting State shall be treated as secret in the same

manner as information obtained under the domestic laws of that State.

An exchange of information that would disclose any trade, business, industrial or professional secret, or trade process, or which would be contrary to public policy, is specifically not permitted by the article.

Article 26 - Diplomatic and Consular Officials

The purpose of this article is to ensure that the provisions of the agreement do not result in members of diplomatic and consular posts receiving less favourable treatment than that to which they are entitled in accordance with international laws. In Australia, such persons are entitled, for example, to certain fiscal privileges under the Diplomatic (Privileges and Immunities) Act 1967 and the Consular (Privileges and Immunities) Act 1972.

Article 27 - Entry into Force

This article provides for the entry into force of the agreement. This will be on the date on which Notes are exchanged through the diplomatic channel notifying that the last of such things has been done in Australia and Sri Lanka as is necessary to give the agreement the force of law in both countries. In the case of Australia the enactment of the legislation which gives the force of law in Australia to the agreement is the necessary prerequisite to the exchange of diplomatic notes taking place.

Once it enters into force, the agreement will have effect in Australia for purposes of withholding taxes in relation to income derived on or after 1 July in the calendar year next following that in which the agreement enters into force. In respect of tax other than withholding tax, the agreement will first have effect in Australia in relation to income (which in this case is to be read as including profits and gains covered by the agreement) of the Australian year of income beginning on or after 1 July in the calendar year following that in which it enters into force. Where a taxpayer has adopted an accounting period ending on a date other than 30 June, income (including profits or gains) derived on or after the beginning of the accounting period that has been substituted for the year of income beginning on 1 July in the calendar year following the calendar year in which the agreement enters into force will be subject to the agreement for purposes of Australian taxes other than withholding tax.

In Sri Lanka, the agreement will first have effect in respect of income (including profits and gains) assessable for the year of assessment beginning on or after

1 April in the calendar year next following that in which the agreement enters into force.

Article 28 - Termination

By this article the agreement is to continue in effect indefinitely. However, either country may give through the diplomatic channel written notice of termination of the agreement on or before 30 June in any calendar year beginning after the expiration of five years from the date of its entry into force.

In that event, the agreement would cease to be effective in Australia for purposes of withholding tax in relation to income derived on or after 1 July in the calendar year next following that in which the notice of termination is given. For other Australian taxes, it would cease to be effective in relation to income (including profits and gains) of any year of income beginning on or after 1 July in the calendar year next following that in which the notice of termination is given. It would correspondingly cease to be effective in Sri Lanka in relation to income (including profits and gains) assessable for any year of assessment beginning on or after 1 April in the calendar year next following that in which the notice of termination is given.

SCHEDULE 2 TO THE BILL

Insertion as Schedule 32 to the Principal Act.

AGREEMENT WITH FIJI

Subject to some differences, the comprehensive double taxation agreement accords in substantial practical effect with other comprehensive double taxation agreements to which Australia is a party. Like them, the agreement allocates the right to tax some income to the country of source, sometimes at limited rates, while the country of residence is given the sole right to tax other types of income. It also allocates to the respective countries taxing rights in relation to certain gains. It provides that where income, profit or gains may be taxed in both countries, the country of residence, if it taxes, is to allow a credit against its own tax for the tax imposed by the country of source. In the case of Australia, effect is to be generally given to this double tax credit relief obligation by application of the general foreign tax credit system provisions of Australia's domestic law.

Article 1 - Personal Scope

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

The situation of persons who are dual residents (i.e., residents of both countries) is dealt with in Article 4.

Article 2 - Taxes Covered

This article specifies the existing taxes of each country to which the agreement applies. These are, in the case of Australia, the Australian income tax and the resource rent tax in respect of offshore petroleum projects. For Fiji, its income tax (including basic tax and normal tax, the non-resident dividend withholding tax, the interest withholding tax, the royalty withholding tax and the dividend tax) and the land sales tax are specified.

Paragraph 2 of the article will automatically extend the application of the agreement to any identical or substantially similar taxes which may subsequently be imposed by either country in addition to, or in place of, the existing taxes.

Article 3 - General Definitions

Paragraph 1 of this article provides definitions

for a number of the terms used in the agreement. Some other terms are defined in the articles to which they relate. Paragraph 3 of this article addresses terms that are not specifically defined within the agreement. It provides that such a term, unless used in a context that requires otherwise, is to be taken to have the same interpretative meaning ascribed that particular term under the domestic law from time to time in force of the country applying the agreement. The effect of the inclusion in this paragraph of the expression "from time to time in force" is to clarify that a term not defined in the agreement is to be given the meaning it has under the country's domestic law at the time of application of the agreement, rather than the meaning it had when the agreement was negotiated.

As with Australia's other modern taxation agreements, "Australia" is effectively defined in paragraph 1 as including certain external territories and areas of the continental shelf. By reason of this definition, Australia fully preserves the taxing rights effectively provided by section 6AA of the Income Tax Assessment Act 1936 (the Assessment Act) in relation to mineral exploration and mining activities carried on by non-residents on its continental shelf areas. The definition is also relevant to the taxation by Australia of shipping profits in accordance with Article 8 of the agreement.

Paragraph 2 makes it clear that, for the purposes of the agreement, the terms "Australian tax" and "Fiji tax" do not include any amount of penalty or interest imposed by the operation of the respective domestic laws of Australia and Fiji.

This is of particular relevance in determining a taxpayer's entitlement under the double tax relief provisions of Article 25 (Methods of Elimination of Double Taxation) of the agreement. In the case of a resident of Australia, any such penalty or interest component of a liability determined under the domestic taxation laws of Fiji with respect to income that Fiji is entitled to tax under the agreement would not be a creditable "Fiji tax" for purposes of Article 25(2) of the agreement. This result accords with the meaning of "foreign tax" in subsection 6AB(2) of the Assessment Act. Accordingly, such a penalty or interest liability would be excluded from calculations when determining the Australian resident taxpayer's foreign tax credit entitlement in respect of Fiji tax under Article 25(2), pursuant to Division 18 of Part III of the Assessment Act.

Article 4 - Residence

This article sets out the basis on which the residential status of a person is to be determined for the

purposes of the agreement. Residential status is one of the criteria for determining each country's taxing rights and is a necessary condition for the provision of double tax relief under the agreement. The concept of resident according to each country's taxation law provides the basic test.

The article also includes a set of "tie-breaker" rules for determining how residency is to be allocated to one or other of the countries for the purposes of the agreement where a taxpayer - whether an individual, a company or other entity - qualifies as a dual resident, i.e., as a resident under the domestic laws of both countries.

A dual resident, for example, who is deemed by Article 4 to be a resident solely of Fiji would be entitled to any exemption from, or reduction in, Australian tax provided by an article of the agreement in respect of income derived from sources in Australia by a resident of Fiji. For the categories of income which under the agreement remain taxable in both countries, the obligation placed by Article 25 on the country of residence of the recipient of the income to provide double tax relief would in that example rest with Fiji.

Dual residents remain, however, in relation to each country a resident of that country for the purposes of its domestic law and subject to its tax as such, so far as the agreement allows. Attention is drawn, however, to Article 23 (Income Not Expressly Mentioned) which would operate in relation to the dual resident referred to above as if the person were a resident of Fiji and thus preclude Australia from taxing an item of income not expressly dealt with by another article of the agreement where the income is derived from sources in Fiji or in a third country. Paragraph 5 of Article 13 (Alienation of Property) would, however, preserve the application of Australia's domestic capital gains tax rules in relation to gains to which that paragraph applies, on the basis that the dual resident remains a resident of Australia for those purposes.

Article 5 - Permanent Establishment

Application of various provisions of the agreement (principally Article 7 relating to Business Profits) is dependent upon whether a person who is a resident of one country has a "permanent establishment" in the other, and if so, whether income derived by the person in the other country is attributable to or effectively connected with that "permanent establishment". The definition of the term "permanent establishment" which this article embodies corresponds closely with definitions of the term in Australia's other double taxation agreements.

The primary meaning of the defined term is expressed in paragraph 1 as being a fixed place of business through which the business of an enterprise is wholly or partly carried on. Other paragraphs of the article are concerned with elaborating on the meaning of the term by giving examples of what may constitute a "permanent establishment" - such as an office, a mine or an agricultural, pastoral or forestry property - and by specifying the circumstances in which a resident of one country shall, or shall not, be deemed to have a "permanent establishment" in the other country.

As with certain other recently concluded tax treaties, the article provides that the furnishing by an enterprise of one country of consultancy or other services will constitute a permanent establishment in the other country where those activities continue within the latter country for a period or periods aggregating more than 6 months within a 12 month period. That feature, and the operation of Article 7, ensures preservation of the "business profits" principle in relation to the allocation between the two countries of taxing rights over fees derived from the furnishing of those services. This position does not apply, in the case of this agreement, in relation to fees for the supply of management services, which fall within the definition of "royalties" in paragraph 3 of Article 12. Paragraph 6 of Article 7 (see notes below in relation to that paragraph) will ensure that those fees are treated in accordance with Article 12 and as outside the scope of Article 7.

<u>Article 6 - Income from Real Property</u>

By this article, income from real property, including the letting or use in any other form of any land or interest therein, and royalties and other payments relating to the working of, or the exploration for or exploitation of standing timber, mines or quarries or other natural resources, may be taxed in the country in which the land, timber, mine, quarry or natural resource is situated.

It is the usual rule that whatever is affixed to or attached to land forms part of, or becomes part of, the land and this article specifically provides for that result by providing for the reference to land to cover improved or unimproved land. Accordingly, the definition of real property will encompass, for example, a lease of a building or any other interest in a building.

Paragraph 4 makes it clear that the operational effects of the article extend to income derived from the use or exploitation of real property (within the meaning of the article) of an enterprise and income derived from such property that is used for the performance of professional services. As with other items of income dealt with separately in specific articles of the agreement, income of

an enterprise to which this article applies is excluded from the scope of Article 7 (by paragraph 6 of that article) and is therefore taxable in the country in which the property is situated regardless of whether or not the recipient enterprise has a "permanent establishment" in that country. Paragraph 4 also operates to ensure taxing rights by that country over income from such property that is used for the performance of professional services by a resident of the other country, irrespective of whether that income is attributable to a fixed base of that resident.

Article 7 - Business Profits

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

The taxing of these profits depends on whether they are attributable to a "permanent establishment" of the enterprise in that other country. If they are not, the profits will be taxed only in the country of residence of the taxpayer who carries on the enterprise. If, however, a resident of one country carries on business through a "permanent establishment" (as defined in Article 5) in the other country, the country in which the permanent establishment is situated may tax such of the profits of the enterprise that are attributable to the permanent establishment. That country may also generally tax, in the case of this agreement, income attributable to certain related sales of goods or merchandise or other business activities where those sales are made or business activities are carried on within that country other than through the permanent establishment.

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

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

course, that any expenses incurred by the permanent establishment in respect of those purchasing activities will not be deductible in determining the taxable profits of the permanent establishment.

Paragraph 5 of the article allows the application of provisions of the source country's domestic law (e.g. Australia's Division 13) where, due to the inadequacy of available information, the correct amount of profits attributable to a "permanent establishment" is incapable of determination or the ascertainment thereof presents exceptional difficulties.

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

Paragraph 7 preserves to each country the right to continue to apply any special provisions in its domestic law relating to the taxation of income from insurance with non-residents. An effect of this paragraph is to preserve, in the case of Australia, the application of Division 15 of Part III of the Assessment Act.

Paragraph 8 is intended to clarify Australia's right to tax a share of business profits, originally derived by a trustee of a trust estate (other than a corporate unit trust) from the carrying on of a business in Australia, to which a resident of Fiji is beneficially entitled under the trust estate. It ensures that such distributions will be subject to tax in Australia where, in accordance with the principles set out in Article 5, the trustee of the relevant trust estate has a permanent establishment in Australia in relation to that business. It is comparable in effect to subsection 3(11) of the Income Tax (International Agreements) Act 1953, which has a similar effect where the beneficiary is a resident of a country with which Australia had signed a comprehensive taxation agreement on or before 19 August 1984.

Article 8 - Shipping and Air Transport

Under this article the right to tax profits from the operation of ships or aircraft in international traffic, including profits derived from participation in a pool service, a joint transport operating organisation or an international operating agency, is generally reserved to the country of residence of the operator.

However, any shipping or aircraft profits derived by a resident of one country from internal traffic in the other country may be taxed in that other country. By reason of the definition of "Australia" contained in Article 3(1) and the terms of paragraph 4 of this article, any shipments by sea or air from a place in Australia (including the continental shelf and external territories) to another place in Australia, are treated as forming part of internal traffic. Accordingly, profits derived, for example, from a shipment of goods taken on board, during the course of an international voyage, at Fremantle for delivery to Sydney would be profits from internal traffic.

Article 9 - Associated Enterprises

This article authorises the re-allocation of profits between related enterprises in Australia and Fiji on an arm's length basis where the commercial or financial arrangements between the enterprises differ from those that might be expected to operate between independent enterprises dealing at arm's length with one another. The article would not generally authorise therefore the re-writing of accounts of associated enterprises where it can be satisfactorily demonstrated that the transactions between such enterprises have taken place on normal open market commercial terms.

By virtue of paragraph 2 of the article, each country retains the right to apply its domestic law (e.g. Australia's Division 13) to its own enterprises, provided that such provisions are applied, so far as it is practicable to do so, in accordance with the principles of this article.

Where a re-allocation of profits is effected under this article (including pursuant to the domestic law in accordance with paragraph 2), so that the profits of an enterprise of one country are adjusted upwards, a form of double taxation would arise if the profits so re-allocated continued to be subject to tax in the hands of an associated enterprise in the other country. Paragraph 3 therefore requires the other country concerned to make an appropriate adjustment to the amount of tax charged on the profits involved, with a view to relieving any such double taxation.

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

Article 10 - Dividends

This article allows both countries to tax

dividends flowing between them but in general limits the tax that the country of source may impose on dividends payable to beneficial owners resident in the other country. Under this article, Australia will reduce its rate of withholding tax on unfranked dividends paid by Australian resident companies to residents of Fiji from 30 per cent to 20 per cent of the gross amount of the dividends. Franked dividend payments will, of course, remain free of withholding tax under Australia's domestic law. The Fiji rate of withholding tax on dividends paid to residents of Australia is likewise not to exceed 20 per cent of the gross amount of the dividends.

Paragraph 4 effectively provides that the 20 per cent source country tax rate limit is not to apply to dividends derived by a resident of the other country who has a "permanent establishment" or "fixed base" in the country from which the dividends are derived, if the holding giving rise to the dividends is effectively connected with that "permanent establishment" or "fixed base". Where the dividends are so effectively connected, they will be treated as "business profits" or "income from independent personal services" and subject to the source country's tax in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be. In practice, however, under the full imputation system of company taxation contained in Australia's domestic law, such dividends that are franked dividends will remain exempt from Australian tax while unfranked dividends will be subject to withholding tax instead of being taxed by assessment.

The purpose of paragraph 5 of this article is to ensure against the extra-territorial application by either country of taxing rights over dividend income. It does this by providing that one country will not tax dividends paid by a company resident solely in the other country unless the person deriving the dividends is a resident of the first country or the holding giving rise to the dividends is effectively connected with a "permanent establishment" or "fixed base" in that country.

Paragraph 6 preserves the right of either country to impose a "branch profits" tax, should such a tax be provided for in its domestic law, but places a 20 per cent limit on that tax consistent with the tax limit provided by paragraph 2 for the source country tax on outgoing dividend payments. The paragraph also provides that, for the purpose of calculating any undistributed profits tax that may be payable under either country's domestic law, the branch profits tax will not be taken into account but the company will be deemed to have paid dividends of such amount that tax equal to the amount of the branch profits tax would have been payable under paragraph 2. The paragraph will not presently have any practical effect in the case of Australia in the absence of a domestic law

branch profits tax and undistributed profits tax.

Article 11 - Interest

This article requires the country of source generally to limit its tax on interest income to which a resident of the other country is beneficially entitled to 10 per cent of the gross amount of the interest. This limitation will not affect the rate of Australian withholding tax on interest derived by residents of Fiji, which will continue to be imposed at the general rate of 10 per cent applicable under Australia's domestic law.

Paragraph 3 defines the term "interest" for the purposes of the article in a way that encompasses items of income such as discounts on securities and payments under certain hire purchase agreements which are treated for Australian tax purposes as interest or amounts in the nature of interest, and therefore as falling within the definition of "interest" for domestic withholding tax purposes.

Paragraph 4 requires that the 10 per cent source country tax rate limitation will not apply to interest derived by a resident of one country which is effectively connected with a "permanent establishment" or "fixed base" of that person in the other country. Such interest is to be subject to the provisions of Article 7 or Article 14.

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

The article also contains a general safeguard (paragraph 6) against payments of excessive interest - in cases where there is a special relationship between the persons associated with a loan transaction - by restricting the 10 per cent limitation in such cases to an amount of interest which might be expected to have been agreed upon by persons dealing at arm's length.

Article 12 - Royalties

This article in general limits to 15 per cent of the gross amount of the royalties the tax that the country of source may impose on royalties (as defined in paragraph

3 of the article) paid or credited to beneficial owners resident in the other country. Except for the inclusion of the provision of management services in the other country, the definition of "royalties" contained in paragraph 3 is consistent with the definition of royalties in subsection 6(1) of the Assessment Act and in Australia's other modern comprehensive tax treaties.

The 15 per cent limitation is not to apply to natural resource royalties, which, in accordance with Article 6, are to remain taxable in the country of source without limitation of the tax that may be imposed.

In the absence of a double taxation agreement, Australia generally taxes royalties paid to non-residents (other than film and video tape royalties which are taxed at the rate of 10 per cent of the gross royalties), as reduced by allowable expenses, at ordinary rates of tax. The 15 per cent limitation imposed by this article will operate, however, where appropriate to reduce the tax payable under that assessment basis.

As in the case of dividends and interest, paragraph 4 effectively operates to preclude the 15 per cent source country tax rate limitation from applying to royalties effectively connected with a "permanent establishment" or "fixed base" in that country and to render such royalties subject to Article 7 or Article 14. The royalties "source" rule in paragraph 5 mirrors the "source" rule for interest income contained in paragraph 5 of Article 11.

By paragraph 6, if royalties flow between related persons, the 15 per cent source country tax rate limitation will apply only to the extent that the royalties are not excessive.

Article 13 - Alienation of Property

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

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

Paragraph 2 deals with income, profits or gains arising from the alienation of property (other than real property covered by paragraph 1) forming part of the business property of a permanent establishment of an enterprise. It also applies where the permanent establishment (alone or with the whole enterprise) is

alienated. Such income, profits or gains may be taxed in the country in which the permanent establishment is situated, which corresponds to the rules for business profits contained in Article 7.

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

Paragraph 4 assimilates the treatment of income or gains from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property covered by paragraph 1, to the treatment by paragraph 1 of the alienation of that real property.

The article contains a sweep-up paragraph, paragraph 5, which enables each country to tax, according to its domestic law, any gains or profits of a capital nature derived by its own residents or by a resident of the other country from the alienation of any property not specified in the preceding paragraphs of the article. It thus ensures the application of Australia's domestic law rules in relation to the taxation of capital gains and profits as regards the alienation of such property. Should such a gain or profit be taxed pursuant to this paragraph under the domestic law rules of both countries, the country of residence of the recipient of the gain or profit would be obliged - by Article 24 (Source of Income) and Article 25 (Methods of Elimination of Double Taxation) - to provide double tax relief.

It should be noted that Article 23 (Income Not Expressly Mentioned) effectively contains sweep-up provisions in relation to items of income not expressly dealt with in other articles of the agreement.

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

Article 14 - Independent Personal Services

At present, an individual resident in Australia or in Fiji may be taxed in the other country on income derived from the performance in that other country of professional services or other similar independent activities. By this article, such income will continue to be subject to tax in the country in which the services are performed in cases where:

- the recipient has a "fixed base" regularly available in that country for the purposes of performing his or her activities and the income is attributable to activities exercised from that base;

- the person's stay in the other country amounts to or exceeds 183 days in a year of income; or

- it exceeds an amount of $A8000 or its Fijian dollar equivalent in a year of income, and is paid by a resident of that country or by a permanent establishment situated therein.

If none of the tests mentioned above are met, the income will be taxed only in the country of residence of the recipient.

Remuneration derived as an employee and income derived by public entertainers are the subject of other articles of the agreement and are not covered by this article.

Article 15 - Dependent Personal Services

Article 15 provides the basis upon which the remuneration of visiting employees is to be taxed. Generally, salaries, wages, etc. derived by a resident of one country from an employment exercised in the other country are treated as having a source in and as being liable to tax in that other country. However, subject to specified conditions, there is a conventional provision in tax treaties for an exemption from tax to apply in the country being visited where only visits of a short-term nature are involved.

The conditions to be satisfied for the source country exemption to apply under this article are that the visit or visits not exceed, in the aggregate, 90 days in the year of income of the country visited and that the remuneration will be subject to tax in the country of residence.

It is relevant in relation to the latter condition that a visit or visits to Fiji of that duration by a resident of Australia would not normally render the remuneration concerned exempt from Australian tax under section 23AG of the Assessment Act. In any event, the exemption by Fiji of the remuneration derived by a resident of Australia during such a short-term visit or visits to Fiji will ensure that the section 23AG exemption does not apply.

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

this article do not apply, however, in respect of income that is dealt with separately in Articles 16 (Directors' Fees), 17 (Entertainers), 18 (Pensions and Annuities), 19 (Government Service), 20 (Professors and Teachers) or 21 (Australian Government's Bilateral Aid to Fiji).

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

Where the source country short-term visit exemption is not applicable, remuneration derived by a resident of Australia from an employment exercised in Fiji may be subject to tax in Fiji. However, the article does not allocate sole taxing rights to Fiji in that situation. Accordingly, Australia would also be entitled to tax that remuneration in accordance with the general rule of the Assessment Act that a resident of Australia remains subject to tax on worldwide income. In common, however, with other situations where the agreement allows both countries to tax a category of income, Australia would be required (pursuant to paragraph 2 of Article 25), as the country of residence of the income recipient, to relieve the double taxation that would otherwise occur.

Although that paragraph provides for the double tax relief to be provided by Australia to be in the form of the grant of a credit against the Australian tax for the Fiji tax paid, the "exemption with progression" provisions of section 23AG of the Assessment Act would be normally applicable in practice, so far as they are relevant, in relation to the employment income derived in the situation described.

Article 16 - Directors' Fees

Under this article, remuneration derived by a resident of one country in the capacity of a director of a company which is a resident of the other country may be taxed in the latter country.

Article 17 - Entertainers

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

Paragraph 2 of this article is a safeguarding provision designed to ensure that income in respect of

personal activities exercised by an entertainer, whether received by the entertainer or by another person, e.g., a separate enterprise which formally provides the entertainer's services, is taxed in the country in which the entertainer performs, whether or not that other person has a "permanent establishment" or "fixed base" in that country.

Paragraph 3 excludes from the scope of this article income derived by an entertainer (including an athlete) if the visit to the source country is wholly or substantially supported by public funds of the other country. This provision is included to facilitate cultural and sporting exchanges between the two countries.

Article 18 - Pensions and Annuities

Paragraph 1 of this article ensures that pensions (other than government service pensions to which Article 19 applies) and annuities are taxed only by the country of residence of the recipient.

It is intended that the operation of this Article (and Article 19 as it relates to a government service pension) extend to pension and annuity payments made to dependants, for example the widow or children, of the person in respect of whom the pension or annuity entitlement accrued where upon that person's death, such entitlement has passed to that person's dependants.

Paragraph 3 provides that alimony and maintenance payments are taxable only in the country of residence of the payer.

Article 19 - Government Service

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

Paragraph 2 precludes from the scope of this article remuneration, including a pension or annuity, for services rendered in connection with a trade or business carried on by a government. Such remuneration will remain subject to the provisions of Article 15 (Dependent Personal Services), 16 (Directors' Fees) or 18 (Pensions and Annuities), as the case may be.

Article 20 - Professors and Teachers

This article applies in respect of professors or teachers who are resident in one country and visit, for example during sabbatical leave, the other country for a period of not more than two years for the purpose of teaching or advanced study or research at an educational institution. In these circumstances, the remuneration of the professor or teacher for his or her teaching, study or research work are to be exempt from tax in the country visited.

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

Article 21 - Australian Government's Bilateral Aid to Fiji

The purpose of this article is to preserve the relevant position that has been agreed with Fiji under the Australian Government's Bilateral Aid Program to Fiji. This position is, broadly, that salary supplements etc paid from the Aid Fund to Australian residents serving in Fiji are to remain taxable by Australia and exempt from Fiji tax but that Fiji can tax such supplements etc paid to persons ordinarily resident in Fiji or to other non-residents of Australia.

As outlined in paragraphs 25 and 26 of Taxation Ruling No. 2563, salary supplements etc paid from the Aid Fund to an Australian resident serving in Fiji will not qualify for exemption from Australian tax under section 23AG of the Assessment Act - and thus will remain subject to tax in Australia - where this income is exempted from Fiji tax in accordance with this article.

The opening words of the article mean that it overrides Article 15 (Dependent Personal Services), which gives Fiji the general right to tax remuneration derived by a resident of Australia from employment exercised in Fiji.

Article 22 - Students and Trainees

This article applies to students and trainees temporarily present in a country solely for the purpose of

their education or training who are, or immediately before the visit were, resident in the other country. In these circumstances, the students or trainees will be exempt from tax in the country visited in respect of payments received from abroad for the purposes of their maintenance, education or training (even though they may qualify as a resident of the country visited during the period of their visit). The exemption from tax provided by the visited country is treated as extending to maintenance payments received from abroad by the student or trainee that are made in respect of the maintenance of dependent family members who have accompanied the student or trainee to the visited country.

Article 23 - Income Not Expressly Mentioned

This article provides for the allocation between the two countries of taxing rights in relation to items of income not expressly mentioned in the preceding articles of the agreement. The scope of the article is not confined to such items of income arising in one of the contracting countries; it extends also to income from sources in a third State.

Broadly, such income derived by a resident of one country is to be taxed only in his or her country of residence unless it is derived from sources in the other country, in which case the income may also be taxed in the other country. Where this occurs, the country of residence of the recipient of the income would be obliged by Article 25 (Methods of Elimination of Double Taxation) to provide double taxation relief.

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

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

Article 24 - Source of Income

Article 24 effectively deems income, profit or gains derived by a resident of one country which, under the agreement, may be taxed in the other country to be income from sources in the latter country for the purposes of the domestic laws of both countries and Article 25 of the agreement. It thus ensures the jurisdictional (source) right of each country under its domestic law to exercise

the taxing rights allocated to it by the agreement over residents of the other country. It is also designed to ensure that where an item of income, profit or gains is taxable under the agreement by both countries, double taxation relief will be given by the country of residence of the recipient of the income, profit or gains (pursuant to Article 25) in respect of tax levied by the other country in accordance with the taxing rights allocated to it under the agreement. Thus income, profits or gains derived by a resident of Australia which is taxable by Fiji under the agreement will be treated as being foreign income for the purposes of the foreign tax credit provisions of the Assessment Act.

Article 25 - Methods of Elimination of Double Taxation

Double taxation does not arise in respect of income flowing between the two countries where the terms of the agreement provide for the income to be taxed only in one country or the other, or where the domestic taxation law of one of the countries frees the income from its tax.

It is necessary, however, to prescribe a method for relieving double taxation in respect of other classes of income which are subject under the agreement to tax in both countries. Australia's other double taxation agreements provide for a credit basis for the relief of double taxation to be applied by Australia and, usually, the other country. In these cases, the country of residence is required to give credit against its tax for the tax of the country of source. This approach has generally been adopted in this agreement.

Paragraph 1 thus provides for Fiji to relieve double taxation by allowing a credit against its own tax for Australian tax paid under the law of Australia and in accordance with the agreement on income derived by a resident of Fiji from sources in Australia.

Subparagraph 2(a) of the article provides for Australia to relieve double taxation by allowing a credit against its own tax for Fiji tax paid under the law of Fiji and in accordance with the agreement on income derived by a resident of Australia from sources in Fiji. Where a dividend is paid by a Fiji resident company to an Australian resident company which controls 10 per cent or more of the voting power in the Fiji company, subparagraph 2(b) provides for the credit allowed by Australia to also take into account, in addition to the Fiji tax paid in respect of the dividends, the underlying Fiji tax paid by the company in respect of the profits out of which the dividend is paid.

Australia's general foreign tax credit system, together with the terms of this article and of the agreement generally, will form the basis of Australia's

arrangements for relieving a resident of Australia from double taxation on income arising from sources in Fiji. As in the case of Australia's other double taxation agreements, the source of income rules specified for purposes of the agreement will also apply (by reason of Article 24 in this case) for those purposes.

Accordingly, effect is to be given to the tax credit relief obligation imposed on Australia by paragraph 2 of Article 25 by application of the general foreign tax credit provisions of the Assessment Act. This will include the allowance of "underlying" tax credit relief in respect of dividends paid by Fiji resident companies to related Australian companies, including for unlimited tiers of related companies, in accordance with the relevant provisions of the Assessment Act.

Consistent with the position applicable under Fiji's domestic law, this tax credit relief does not extend to the underlying Australian tax paid on the profits and of which a dividend is paid by an Australian resident country to a resident of Fiji.

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

Paragraphs 3 and 4 of Article 25 contain "tax sparing" provisions under which an Australian resident recipient of income on which Fiji - under specified incentive measures - has forgone tax, will obtain tax credit relief as if the Fiji tax forgone had been paid.

The development incentive provisions for which tax sparing relief will be available are those specified in paragraph 3. Paragraph 4 provides for the tax sparing arrangements to apply only in relation to income derived in any of the first five Australian years of income in relation to which this agreement has effect and in any later year of income that may be agreed in an exchange of Letters for this purpose by the authorised representatives of the Governments of Australia and Fiji.

Section 4A of the Principal Act provides for particulars of the provisions agreed in such an exchange of letters to be notified by the Treasurer in the Gazette.

Where a tax sparing credit is allowable, paragraph 3 has the effect that tax sparing is to be granted on the "direct credit" method and not the "gross-up and credit" method for the purposes of calculating the Australian tax. In other words, there will be no "grossing-up" for

Australian tax assessment purposes of the relevant income by the amount of Fiji tax forgone. For example, in the case of income received by a resident of Australia from Fiji in respect of which Fiji tax has been wholly forgone, the amount included in the income recipient's assessable income in Australia will be the amount received, and a credit will be granted for the Fiji tax forgone.

The tax credit relief provisions of Article 25, including the tax sparing relief provisions, reflect the fact that they were negotiated on the basis of the existing Australian and Fijian income tax laws. It is relevant, however, that changes introduced by the Australian Government to the basis of taxing foreign income of Australian residents will lead to changes to the unilateral double tax relief provisions of Australia's domestic law. Certain dividends and branch income derived by Australian residents from Fiji should generally qualify under those changes for exemption from Australian tax. That general exemption could normally be expected to be applicable in respect of such income in lieu of the tax credit and tax sparing relief provisions of Article 25 of the agreement.

Article 26 - Mutual Agreement Procedure

One of the purposes of this article is to provide for consultation between the taxation authorities of the two countries with a view to reaching a satisfactory solution where a person is able to demonstrate actual or potential imposition of taxation contrary to the provisions of the agreement. A person wishing to use this procedure must present a case to the competent authority of the State of which the person is a resident within three years of the first notification of the action the taxpayer considers gives rise to taxation not in accordance with the agreement.

The article also authorises consultation between the taxation authorities of the two countries for the purpose of resolving any difficulties regarding the interpretation or application of the agreement and to give effect to it.

Article 27 - Exchange of Information

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

The purposes for which the exchanged information may be used and the persons to whom it may be disclosed are restricted along the lines of Australia's other double taxation agreements. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State.

An exchange of information that would disclose any trade, business, industrial or professional secret, or trade process or which would be contrary to public policy, is specifically not permitted by the article.

Article 28 - Diplomatic and Consular Officials

The purpose of this article is to ensure that the provisions of the agreement do not result in members of diplomatic and consular posts receiving less favourable treatment than that to which they are entitled in accordance with international laws. In Australia, such persons are entitled to certain fiscal privileges under the Diplomatic (Privileges and Immunities) Act 1967 and the Consular (Privileges and Immunities) Act 1972.

Article 29 - Entry into Force

This article provides for the entry into force of the agreement. This will be on the date on which Notes are exchanged through the diplomatic channel notifying that the last of such things has been done in Australia and Fiji as is necessary to give the agreement the force of law in both countries. In the case of Australia the enactment of the legislation which gives the force of law in Australia to the agreement is the necessary prerequisite to the exchange of diplomatic Notes taking place.

Once it enters into force, the agreement will have effect in Australia for purposes of withholding taxes in respect of income derived on or after 1 January in the calendar year next following that in which the agreement enters into force. In respect of taxes other than withholding tax, the agreement will have effect in Australia in relation to income, profits or gains of any year of income beginning on or after 1 July in the calendar year following that in which it enters into force. Where a taxpayer has adopted an accounting period ending on a date other than 30 June, income, profits and gains derived on or after the beginning of the accounting period that has been substituted for the year of income beginning on 1 July in the calendar year following the calendar year in which the agreement enters into force will be subject to the agreement for purposes of Australian taxes other than withholding tax.

In Fiji, the agreement will first have effect in relation to Fiji taxes which are levied in respect of

income, profits or gains derived during the income year beginning on 1 January in the calendar year following that in which the agreement enters into force.

Article 30 - Termination

By this article the agreement is to continue in effect indefinitely. However, either country may give through the diplomatic channel written notice of termination of the agreement on or before 30 June in any calendar year beginning after the expiration of five years from the date of its entry into force.

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

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

Printed by Authority by the Commonwealth Government Printer

9 780644 201865