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HOUSE OF REPRESENTATIVES

INTERNATIONAL TAX AGREEMENTS AMENDMENT BILL (No. 1) 2009

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Treasurer, the Hon Wayne Swan MP)

***T**able of contents*

Glossary	1
General outline and financial impact	3
Chapter 1 Australia-British Virgin Islands Agreement	9
Chapter 2 Australia-Isle of Man Agreement	19
Chapter 3 Regulation impact statement for the British Virgin Islands Agreement and the Isle of Man Agreement.....	31

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
Agreements Act	<i>International Tax Agreements Act 1953</i>
ATO	Australian Taxation Office
BVI	British Virgin Islands
BVI Agreement	<i>Agreement between the Government of Australia and the Government of the British Virgin Islands for the Allocation of Taxing Rights with Respect to Certain Income of Individuals</i>
Commissioner	Commissioner of Taxation
FBTAA 1986	<i>Fringe Benefits Tax Assessment Act 1986</i>
IoM	Isle of Man
IoM Agreement	<i>Agreement between the Government of Australia and the Government of the Isle of Man for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments</i>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>

General outline and financial impact

What will this Bill do?

This Bill amends the *International Tax Agreements Act 1953* (Agreements Act) to give the force of law in Australia to the following tax agreements:

- The *Agreement between the Government of Australia and the Government of the British Virgin Islands for the Allocation of Taxing Rights with Respect to Certain Income of Individuals* (BVI Agreement), which was signed in London on 27 October 2008; and
- The *Agreement between the Government of Australia and the Government of the Isle of Man for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments* (IoM Agreement), which was signed in London on 29 January 2009.

These Agreements contain articles that are based on corresponding articles contained in Australia's bilateral tax treaties.

The BVI Agreement is the first agreement of its type signed between Australia and a low-tax jurisdiction and was signed in conjunction with the *Agreement for the Exchange of Information Relating to Taxes* between Australia and the British Virgin Islands (BVI), which was signed in London on 27 October 2008.

The IoM Agreement is the second agreement of this type and was signed in conjunction with the *Agreement for the Exchange of Information with Respect to Taxes* between Australia and the Isle of Man (IoM), which was signed in London on 29 January 2009.

Who is affected by this Bill?

Individuals who are residents of Australia and/or the BVI or the IoM who derive income from pensions and retirement annuities (in the case of the IoM Agreement only) or the provision of government services, or receive payments in their capacity as visiting students or business apprentices.

Residents of Australia or the IoM that wish to contest a transfer pricing adjustment made by the Australian or IoM tax authorities.

How the legislation is structured

The Agreements Act gives the force of law in Australia to Australia's tax treaties which appear as Schedules to that Act. The provisions of the *Income Tax Assessment Act 1936* (ITAA 1936), the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) are incorporated into and read as one with the Agreements Act. The provisions of the Agreements Act (including the terms of the tax treaties) take precedence over provisions of the:

- ITAA 1936 (other than the general anti-avoidance rules under Part IVA);
- ITAA 1997; and
- FBTAA 1986 (other than section 67 which is an anti-avoidance rule).

In what way does this Bill change the *International Tax Agreements Act 1953*?

The Agreements Act is amended to insert the text of the BVI Agreement and the IoM Agreement as Schedules to that Act, which will give them the force of law.

When will these changes take place?

From the date of Royal Assent.

When will these Agreements enter into force, and from what date will they have effect?

The BVI Agreement

The BVI Agreement will enter into force on the date of the last exchange of diplomatic notes notifying that the domestic procedures to give it the

force of law have been completed. In Australia, enactment of the legislation giving the BVI Agreement the force of law along with tabling it in Parliament are prerequisites to the exchange of diplomatic notes.

Once it enters into force the BVI Agreement will apply as follows

Application in Australia

In respect of any income year beginning on or after 1 July in the calendar year next following the date on which the BVI Agreement enters into force.

Application in the BVI

In respect of any income year beginning on or after 1 January in the calendar year next following the date on which the BVI Agreement enters into force.

The IoM Agreement

The IoM Agreement will enter into force on the date of the last exchange of diplomatic notes notifying that the domestic procedures to give it the force of law have been completed. In Australia, enactment of the legislation giving the IoM Agreement the force of law along with tabling it in Parliament are prerequisites to the exchange of diplomatic notes.

Once it enters into force the IoM Agreement will apply as follows

Application in Australia

In respect of any income year beginning on or after 1 July in the calendar year next following the date on which the IoM Agreement enters into force.

Application in the IoM

In respect of any income year beginning on or after 5 April in the calendar year next following the date on which the IoM Agreement enters into force.

The financial impact of this Bill

The impact of both the BVI Agreement and the IoM Agreement on the forward estimates has been estimated as negligible.

Compliance costs

No significant compliance costs are expected to result from the entry into force of the BVI Agreement and the IoM Agreement.

Summary of regulation impact statement

The BVI Agreement

Regulation impact on business

Impact: Minimal.

Main points:

- The BVI Agreement is likely to have an impact on Australian individuals providing services to an Australian government (including a state or local government) in the BVI; Australian students and business apprentices temporarily residing in the BVI for education or training purposes; the Australian Government and the Australian Taxation Office (ATO).
- The BVI Agreement will promote a closer bilateral relationship between Australia and the BVI by eliminating double taxation of certain income derived by individuals, specifically government employees, students and business apprentices.
- In conjunction with the *Agreement for the Exchange of Information Relating to Taxes* between Australia and the BVI, the BVI Agreement will provide for greater cooperation between tax authorities to prevent tax avoidance and evasion.

No material costs to taxpayers have been identified as likely to arise from the BVI Agreement but there is likely to be a small, unquantifiable administration cost.

The IoM Agreement

Regulation impact on business

Impact: Minimal.

Main points:

- The IoM Agreement is likely to have an impact on recipients of Australian source pensions or retirement annuities who reside in the IoM; individuals providing services to an Australian government (including a state or local government) in the IoM; Australian students and business apprentices temporarily residing in the IoM for education or training purposes; the Australian Government and the ATO.
- The IoM Agreement will also have an impact on Australian residents (including non-individuals) that wish to contest a transfer pricing taxation adjustment made by the IoM tax authority.
- The IoM Agreement will promote a closer bilateral relationship between Australia and the IoM by eliminating double taxation of certain income derived by individuals, specifically pension recipients, government employees, students and business apprentices.
- In conjunction with the *Agreement for the Exchange of Information with Respect to Taxes* between Australia and the IoM, the IoM Agreement will provide for greater cooperation between tax authorities to prevent tax avoidance and evasion.

No material costs to taxpayers have been identified as likely to arise from the IoM Agreement but there is likely to be a small, unquantifiable administration cost.

Chapter 1

Australia-British Virgin Islands Agreement

Outline of chapter

1.1 Schedule 1 to this Bill amends the *International Tax Agreements Act 1953* (Agreements Act) and inserts Schedule 48 into the Agreements Act, which is the *Agreement between the Government of Australia and the Government of the British Virgin Islands for the Allocation of Taxing Rights with Respect to Certain Income of Individuals* (BVI Agreement). This chapter explains the rules that apply in the BVI Agreement. All legislative references are to Schedule 48, unless otherwise stated.

Context of amendments

1.2 The BVI Agreement was signed in London on 27 October 2008. There is no pre-existing agreement of this type between Australia and the British Virgin Islands (BVI). The BVI Agreement was signed in conjunction with the *Agreement for the Exchange of Information Relating to Taxes* between Australia and the BVI, which will establish a legal basis for the exchange of tax information between the two countries. Jointly, the two agreements will promote greater economic and administrative cooperation between the two countries.

Summary of new law

Main features of this Agreement

- 1.3 The main features of the BVI Agreement are as follows:
- Income from government service will generally be taxed only in the country that pays the remuneration. However, the remuneration shall be taxed only in the other country where the services are rendered in that other country by a resident of that other country who is a national of that other country or did not become a resident of that other country for the purpose of rendering the services.

- Payments made from abroad to visiting students and business apprentices for the purposes of their maintenance, education or training will be exempt from tax in the country visited.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Certain income derived by residents of Australia and the BVI from government service will be taxed only by the country for which the services were rendered.	Australian source income of foreign residents, and foreign source income of Australian residents, is generally subject to Australian tax.
Certain payments received by visiting students and business apprentices will be exempt from tax in the country visited.	Some payments received by students and business apprentices may be taxable in Australia, depending on the circumstances.

Detailed explanation of new law

1.4 This Schedule gives effect to the BVI Agreement, which is inserted as Schedule 48 to the Agreements Act and deals with the allocation of taxing rights with respect to certain income of individuals.

Article 1 — Persons Covered

1.5 This Article establishes the scope of the application of the BVI Agreement by providing for it to apply to persons (defined as individuals) who are residents of one or both of the countries. *[Article 1]*

1.6 The application of the BVI Agreement to persons who are dual residents (ie, residents of both countries) is dealt with in Article 4 (*Resident*).

Article 2 — Taxes Covered

1.7 This Article specifies the existing taxes of each country to which the BVI Agreement applies. This is, in the case of Australia, the federal income tax. *[Article 2, subparagraph 1(a)]*

1.8 For the BVI, the BVI Agreement applies to taxes on income or profits as imposed by BVI law. *[Article 2, subparagraph 1(b)]*

1.9 The application of the BVI Agreement will be automatically extended to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of, the existing taxes. The competent authorities of the two countries are required to notify each other in the event of a significant change to the taxation law of the respective countries, within a reasonable period of time after those changes. *[Article 2, paragraph 2]*

Article 3 — Definitions

Definition of Australia

1.10 The definition of ‘Australia’ follows corresponding definitions in Australia’s modern tax treaties. ‘Australia’ is defined to include certain external territories and areas of the continental shelf. *[Article 3, subparagraph 1(a)]*

Definition of the British Virgin Islands

1.11 The **British Virgin Islands** is defined to mean the territory of the Virgin Islands as referred to in the Virgin Islands Constitution Order 2007. *[Article 3, subparagraph 1(b)]*

Definition of competent authority

1.12 The ‘competent authority’ is the person or institution specifically authorised to perform certain actions under the BVI Agreement. For example, the competent authorities are required to notify each other of any significant changes to the tax law of their respective countries, and to exchange information in accordance with Article 7 (*Exchange of Information*).

1.13 In the case of Australia, the **competent authority** is the Commissioner of Taxation (Commissioner) or an authorised representative of the Commissioner. In the case of the BVI, the **competent authority** is the Financial Secretary or an authorised representative of the Financial Secretary. *[Article 3, subparagraph 1(c)]*

Definition of contracting party

1.14 **Contracting party** means Australia or the BVI, as the context requires. *[Article 3, subparagraph 1(d)]*

Definition of national

1.15 In the case of Australia, a **national** is any person who is an Australian citizen *[Article 3, sub-subparagraph 1(e)(i)]*. In the case of the BVI,

a **national** is any person who belongs to, or is a permanent resident of, the BVI [Article 3, sub-subparagraph 1(e)(ii)]. The Virgin Islands Constitution Order 2007 prescribes the circumstances under which a person ‘belongs’ to the BVI.

Definition of person

1.16 For the purposes of the BVI Agreement, a **person** is an individual. [Article 3, subparagraph 1(f)]

Definition of tax

1.17 The term **tax** means either Australian tax or BVI tax, depending on the context. [Article 3, subparagraph 1(g)]

Terms not specifically defined

1.18 A term that is not specifically defined in the BVI Agreement shall have (unless the context requires otherwise) the meaning that it has under the domestic taxation law of the country applying the BVI Agreement at the time of its application. In that case, the term’s domestic taxation law meaning will have precedence over the meaning it may have under that country’s other domestic laws. [Article 3, paragraph 2]

1.19 The same term may have different meaning and a varied scope within different Acts relating to specific taxation measures. For example, goods and services tax definitions are sometimes broader than income tax definitions. The definition more specific to the type of tax should be applied in such cases. For example, where the matter subject to interpretation is an income tax matter, but definitions exist in either the ITAA 1936 or the ITAA 1997 and the *A New Tax System (Goods and Services Tax) Act 1999*, the income tax definition would be the relevant definition to be applied.

Article 4 — Resident

1.20 This Article sets out the basis upon which the residential status of a person is to be determined for the purposes of the BVI Agreement. Residential status is a criterion for determining each country’s taxing rights and is a necessary condition for the provision of relief under the BVI Agreement. In the case of Australia, a person’s residence is determined according to Australia’s taxation law [Article 4, subparagraph 1(a)]. In the case of the BVI, residence is determined by reference to the person’s liability to pay BVI tax [Article 4, subparagraph 1(b)].

Special residency rules

1.21 A person is not a resident of a country, for the purposes of the BVI Agreement, if that person is liable to tax in that country in respect only of income from sources in that country [Article 4, paragraph 2]. In the Australian context, this would mean, for example, that Norfolk Island residents, who are generally only subject to Australian tax on Australian source income, are not residents of Australia for the purposes of the BVI Agreement. Accordingly, the BVI will not have to forego tax in accordance with the BVI Agreement on income derived by Norfolk Island residents (which will not be subject to Australian tax).

Dual residents

1.22 Tie-breaker rules are included for determining residency, for the purposes of the BVI Agreement, if an individual qualifies as a dual resident, that is, a resident of both countries in accordance with paragraph 1 of Article 4. These rules, in order of application, are:

- If the individual has a permanent home available in only one of the countries, the person is deemed to be a resident solely of that country for the purposes of the BVI Agreement [Article 4, subparagraph 3(a)].
- If the individual has a permanent home available in both countries or in neither, then the person's residential status takes into account their personal or economic relations with Australia and the BVI, and the person is deemed for the purposes of the BVI Agreement to be a resident only of the country with which they have the closer personal and economic relations [Article 4, subparagraph 3(a)].
- Residency will be determined on the basis of an individual's nationality where the foregoing tests are not determinative [Article 4, subparagraph 3(b)].
- If the individual is a national (as defined in subparagraph 1(e) of Article 3 of the BVI Agreement) of both countries, or of neither, the competent authorities will endeavour to resolve the question of treaty residence by mutual agreement [Article 4, subparagraph 3(c)].

1.23 In relation to Australia, a dual resident remains a resident for the purposes of Australian domestic law. Accordingly, that person remains liable to tax in Australian as a resident, insofar as the BVI Agreement allows.

Article 5 — Government Service

1.24 Salary and wage type income, other than government service pensions or annuities, paid to an individual for services rendered to a government of one of the countries (including a political subdivision or local authority, eg, a state or local government in Australia or the BVI), is to be taxed only in that country. However, such remuneration will be taxable only in the other country if the services are rendered in that other country and:

- the recipient is a resident of, and a national of, that other country; or
- the recipient is a resident of that other country and did not become a resident of that country solely for the purpose of rendering the service (eg, if the recipient is a permanent resident of that other country).

[Article 5, paragraph 1]

Business income

1.25 However, salaries, wages and other similar remuneration in respect of services rendered in connection with a trade or business carried on by any governmental authority referred to in paragraph 1 of Article 5 of the BVI Agreement is excluded from the scope of the Article. Such remuneration will remain subject to the domestic taxation laws of the two countries. *[Article 5, paragraph 2]*

Article 6 — Students

Exemption from tax

1.26 This Article applies to students or business apprentices who are temporarily present in one of the countries solely for the purpose of their education or training if they are, or immediately before the visit were, resident in the other country. In these circumstances, payments from abroad received by the students or business apprentices solely for their maintenance, education or training will be exempt from tax in the country visited. This will apply even though the student or apprentice may qualify as a resident of the country visited during the period of their visit.

[Article 6]

Employment income

1.27 Where, however, a BVI student visiting Australia solely for educational purposes undertakes employment in Australia, for example,

part-time work with a local employer, the income earned by that student as a consequence of that employment may be subject to tax in Australia.

1.28 For business apprentices, this Article only applies where the apprentice's remuneration consists solely of subsistence payments, made from abroad, to cover training or maintenance. Remuneration for service, that is, salary equivalents, falls for consideration under domestic taxation law.

1.29 In the case of a BVI business apprentice visiting Australia solely for training purposes, it may therefore be necessary to distinguish between remuneration for service and a payment for the apprentice's maintenance or training. The quantum of the payment will be relevant in such cases.

1.30 A payment for maintenance or training would not be expected to exceed the level of expenses likely to be incurred to ensure the apprentice's maintenance and training (ie, a subsistence payment). If the remuneration is similar to the amounts paid to persons who provide similar services who are not business apprentices (ie, salary equivalent), this would generally indicate that the payments constitute income from employment that would fall for consideration under domestic taxation law. Likewise, if that business apprentice undertakes any other employment in Australia, the income earned from that employment may be subject to tax in Australia.

1.31 In these situations, the payments received from abroad for the student's or apprentice's maintenance, education or training will not, however, be taken into account in determining the tax payable on the employment income that is subject to tax in Australia. No Australian tax would be payable on the employment income if the student or apprentice qualifies as a resident of Australia during the visit and the taxable income of the student or apprentice does not exceed the tax-free threshold applicable to Australian residents for income tax purposes.

Article 7 — Exchange of Information

1.32 Article 7 authorises and limits the exchange of information by the competent authorities to information that is foreseeably relevant to the administration of the BVI Agreement.

1.33 The exchange of information is subject to the provisions of the *Agreement for the Exchange of Information Relating to Taxes*, which was signed by the two countries on 27 October 2008 [Article 7]. After that agreement enters into force and takes effect, it will provide for full exchange of information that is foreseeably relevant to the administration of the taxation laws of the two countries. It also contains safeguards to protect taxpayers' rights. For example:

- confidentiality rules to ensure that information exchanged is only disclosed to authorised recipients; and
- limitations to ensure that the competent authorities do not exceed domestic laws and normal administrative procedures in the course of obtaining and supplying information.

Article 8 — Entry into Force

Date of entry into force

1.34 The BVI Agreement will enter into force on the date of the last exchange of diplomatic notes notifying that the domestic procedures to give it the force of law have been completed. In Australia, enactment of the legislation giving the BVI Agreement the force of law along with tabling it in Parliament are prerequisites to the exchange of diplomatic notes. Entry into force is also conditional upon the related *Agreement for the Exchange of Information Relating to Taxes* between the two countries being in force at that time.

Date of application in Australia

1.35 Following entry into force, the BVI Agreement will take effect in Australia in respect of any income year beginning on or after 1 July in the calendar year next following the date on which it enters into force. [Article 8, subparagraph (a)]

1.36 Where a taxpayer has adopted an accounting period ending on a date other than 30 June, the accounting period that has been substituted for the year of income beginning on 1 July in the calendar year next following the date on which the BVI Agreement enters into force will be the relevant year of income for the purposes of the application of Australian tax.

Date of application in the BVI

1.37 Following entry into force, the BVI Agreement will take effect in the BVI in respect of any income year beginning on or after 1 January

in the calendar year next following the date on which it enters into force.
[Article 8, subparagraph (b)]

Article 9 — Termination

1.38 The BVI Agreement is to continue in effect indefinitely. However, either country may give written notice of termination of the BVI Agreement through the appropriate channel. [Article 9, paragraph 1]

Cessation in Australia

1.39 In the event of either country terminating the BVI Agreement, it would cease to be effective in Australia in the year of income beginning on or after 1 July in the calendar year next following that in which the notice of termination is given. [Article 9, subparagraph 2(a)]

Cessation in the BVI

1.40 In the event of its termination, the BVI Agreement would correspondingly cease to be effective in the BVI for any year of income beginning on or after 1 January in the calendar year next following that in which the notice of termination is given. [Article 9, subparagraph 2(b)]

Cessation in other circumstances

1.41 The BVI Agreement will also terminate and cease to be effective if the *Agreement for the Exchange of Information Relating to Taxes* between the two countries is terminated. In that event, the BVI Agreement would terminate, for both countries, on the first day of the month following the expiration of a period of six months after receipt of notification of termination of the exchange of information agreement. [Article 9, paragraph 3]

Chapter 2

Australia-Isle of Man Agreement

Outline of chapter

2.1 Schedule 1 to this Bill amends the *International Tax Agreements Act 1953* (Agreements Act) and inserts Schedule 49 into the Agreements Act, which is the *Agreement between the Government of Australia and the Government of the Isle of Man for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments* (IoM Agreement). This chapter explains the rules that apply in the IoM Agreement. All legislative references are to Schedule 49, unless otherwise stated.

Context of amendments

2.2 The IoM Agreement was signed in London on 29 January 2009. There is no pre-existing agreement of this type between Australia and the IoM. The IoM Agreement was signed in conjunction with the *Agreement on the Exchange of Information with Respect to Taxes* between Australia and the IoM, which will establish a legal basis for the exchange of tax information between the two countries. Jointly, the two agreements will promote greater economic and administrative cooperation between the two countries.

Summary of new law

Main features of this Agreement

- 2.3 The main features of the IoM Agreement are as follows:
- Income from pensions and retirement annuities will generally be taxed only in the country of residence of the recipient, provided the income is subject to tax in that country.
 - Income from government service will generally be taxed only in the country that pays the remuneration. However, the remuneration shall be taxed only in the other country where

the services are rendered in that other country by a resident of that other country who is a national of that other country or did not become a resident of that other country for the purpose of rendering the services.

- Payments made from abroad to visiting students and business apprentices for the purposes of their maintenance, education or training will be exempt from tax in the country visited.
- A non-binding administrative mechanism will be established to assist taxpayers to seek resolution of transfer pricing disputes.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Pensions and retirement annuities derived by residents of Australia and the IoM will be taxed only by the country of residence, provided such income is taxed in that country.	Australian source income of foreign residents, and foreign source income of Australian residents, is generally subject to Australian tax.
Certain income derived by residents of Australia and the IoM from government service will be taxed only by the country for which the services were rendered.	Australian source income of foreign residents, and foreign source income of Australian residents, is generally subject to Australian tax.
Certain payments received by visiting students and business apprentices will be exempt from tax in the country visited.	Some payments received by students and business apprentices may be taxable in Australia, depending on the circumstances.
The competent authorities of Australia and the IoM will endeavour to resolve taxpayers' disputes arising from transfer pricing adjustments that contravene the arm's length principle.	No equivalent.

Detailed explanation of new law

2.4 This Schedule gives effect to the IoM Agreement, which is inserted as Schedule 49 to the Agreements Act and principally deals with the allocation of taxing rights with respect to certain income of individuals.

Article 1 — Persons Covered

2.5 This Article establishes the scope of the application of the IoM Agreement by providing for it to apply to persons who are residents of one or both of the countries. *[Article 1]*

2.6 The application of the IoM Agreement to persons who are dual residents (ie, residents of both countries) is dealt with in Article 4 (*Resident*).

Article 2 — Taxes Covered

2.7 This Article specifies the existing taxes of each country to which the IoM Agreement applies. This is, in the case of Australia, the federal income tax. *[Article 2, subparagraph 1(a)]*

2.8 For the IoM, the IoM Agreement applies to taxes on income or profits (referred to as Manx tax). *[Article 2, subparagraph 1(b)]*

2.9 The application of the IoM Agreement will be automatically extended to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of, the existing taxes. The competent authorities of the two countries are required to notify each other in the event of a significant change to the taxation law of the respective countries, within a reasonable period of time after those changes. *[Article 2, paragraph 2]*

Article 3 — Definitions

Definition of Australia

2.10 The definition of ‘Australia’ follows corresponding definitions in Australia’s modern tax treaties. ‘Australia’ is defined to include certain external territories and areas of the continental shelf. *[Article 3, subparagraph 1(a)]*

Definition of the Isle of Man

2.11 The *Isle of Man* is defined to mean the island of the Isle of Man. *[Article 3, subparagraph 1(c)]*

Definition of competent authority

2.12 The ‘competent authority’ is the person or institution specifically authorised to perform certain actions under the IoM Agreement. For example, the competent authorities are required to notify each other of any significant changes to the tax law of their respective

countries, to communicate for the purposes of Article 8 (*Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments*) and to exchange information in accordance with Article 9 (*Exchange of Information*).

2.13 In the case of Australia, the **competent authority** is the Commissioner of Taxation (Commissioner) or an authorised representative of the Commissioner. In the case of the IoM, the **competent authority** is the Assessor of Income Tax or an authorised delegate. [Article 3, subparagraph 1(b)]

Definition of party

2.14 **Party** means Australia or the IoM, as the context requires. [Article 3, subparagraph 1(d)]

Definition of national

2.15 **National** means any individual possessing the nationality or citizenship of Australia or the IoM. [Article 3, subparagraph 1(e)]

Definition of person

2.16 **Person** includes an individual, a company and any other body of persons. [Article 3, subparagraph 1(f)]

Definition of tax

2.17 The term **tax** means either Australian tax or IoM (Manx) tax, depending on the context. [Article 3, subparagraph 1(g)]

Definition of transfer pricing adjustment

2.18 A ‘transfer pricing adjustment’ is an adjustment made by the tax authorities of Australia or the IoM to the profits of an enterprise, based on the application of domestic transfer pricing laws [Article 3, subparagraph 1(h)]. For Australia, such laws are contained in Division 13 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936).

Terms not specifically defined

2.19 A term that is not specifically defined in the IoM Agreement shall have (unless the context requires otherwise) the meaning that it has under the domestic taxation law of the country applying the IoM Agreement at the time of its application. In that case, the term’s domestic taxation law meaning will have precedence over the meaning it may have under that country’s other domestic laws. [Article 3, paragraph 2]

2.20 The same term may have different meaning and a varied scope within different Acts relating to specific taxation measures. For example, goods and services tax definitions are sometimes broader than income tax definitions. The definition more specific to the type of tax should be applied in such cases. For example, where the matter subject to interpretation is an income tax matter, but definitions exist in either the ITAA 1936 or the *Income Tax Assessment Act 1997* and the *A New Tax System (Goods and Services Tax) Act 1999*, the income tax definition would be the relevant definition to be applied.

Article 4 — Resident

2.21 This Article sets out the basis upon which the residential status of a person is to be determined for the purposes of the IoM Agreement. Residential status is a criterion for determining each country's taxing rights and is a necessary condition for the provision of relief under the IoM Agreement. In the case of Australia, a person's residence is determined according to Australia's taxation law [*Article 4, subparagraph 1(a)*]. In the case of the IoM, residence is determined according to the IoM's taxation law [*Article 4, subparagraph 1(b)*].

Special residency rules

2.22 A person is not a resident of a country, for the purposes of the IoM Agreement, if that person is liable to tax in that country in respect only of income from sources in that country [*Article 4, paragraph 2*]. In the Australian context, this would mean, for example, that Norfolk Island residents, who are generally only subject to Australian tax on Australian source income, are not residents of Australia for the purposes of the IoM Agreement. Accordingly, the IoM will not have to forego tax in accordance with the IoM Agreement on income derived by Norfolk Island residents (which will not be subject to Australian tax).

Dual residents

2.23 Tie-breaker rules are included for determining residency, for the purposes of the IoM Agreement, if an individual qualifies as a dual resident, that is, a resident of both countries in accordance with paragraph 1 of Article 4. These rules, in order of application, are:

- If the individual has a permanent home available in only one of the countries, the person is deemed to be a resident solely of that country for the purposes of the IoM Agreement [*Article 4, subparagraph 3(a)*].

- If the individual has a permanent home available in both countries or in neither, then the person's residential status takes into account their personal or economic relations with Australia and the IoM, and the person is deemed for the purposes of the IoM Agreement to be a resident only of the country with which they have the closer personal and economic relations [*Article 4, subparagraph 3(a)*].
- Residency will be determined on the basis of an individual's nationality where the foregoing tests are not determinative [*Article 4, subparagraph 3(b)*].
- If the individual is a national (as defined in subparagraph 1(e) of Article 3 of the IoM Agreement) of both countries, or of neither, the competent authorities will endeavour to resolve the question of treaty residence by mutual agreement [*Article 4, subparagraph 3(c)*].

2.24 Where a non-individual is a dual resident, the entity will be deemed, for the purposes of the IoM Agreement, to be a resident of the country in which its place of effective management is located. [*Article 4, paragraph 4*]

2.25 In relation to Australia, a dual resident remains a resident for the purposes of Australian domestic law. Accordingly, that person remains liable to tax in Australian as a resident, insofar as the IoM Agreement allows.

Article 5 — Pensions and Retirement Annuities

2.26 Pensions and retirement annuities are taxable only by the country of which the recipient is a resident, provided such income is subject to tax in that country. If such income is not subject to tax in that country, the income may be taxed by the country from which the relevant payments were made. [*Article 5, paragraph 1*]

Meaning of retirement annuity

2.27 In the case of Australia, ***retirement annuity*** means a superannuation annuity payment within the meaning of the taxation laws of Australia [*Article 5, subparagraph 2(a)*]. That is, a superannuation annuity as defined by Regulation 995-1.01 of the *Income Tax Assessment Regulations 1997*, which took effect from 1 July 2007.

2.28 In the case of the IoM, ***retirement annuity*** means an annuity payment within the meaning of the taxation laws of the IoM. [*Article 5, subparagraph 2(b)*]

2.29 However, the competent authorities may agree that any other similar periodic payment be regarded as a ‘retirement annuity’. [*Article 5, subparagraph 2(c)*]

Article 6 — Government Service

2.30 Salary and wage type income, other than government service pensions or annuities, paid to an individual for services rendered to a government of one of the countries (including a political subdivision or local authority, eg, a state or local government in Australia or the IoM), is to be taxed only in that country. However, such remuneration will be taxable only in the other country if the services are rendered in that other country and:

- the recipient is a resident of, and a national of, that other country; or
- the recipient is a resident of that other country and did not become a resident of that country solely for the purpose of rendering the services (eg, if the recipient is a permanent resident of that other country).

[*Article 6, paragraph 1*]

Business income

2.31 However, salaries, wages and other similar remuneration in respect of services rendered in connection with a trade or business carried on by any governmental authority referred to in paragraph 1 of Article 6 of the IoM Agreement is excluded from the scope of the Article. Such remuneration will remain subject to the domestic taxation laws of the two countries. [*Article 6, paragraph 2*]

Article 7 — Students

Exemption from tax

2.32 This Article applies to students or business apprentices who are temporarily present in one of the countries solely for the purpose of their education or training if they are, or immediately before the visit were, resident in the other country. In these circumstances, payments from abroad received by the students or business apprentices solely for their maintenance, education or training will be exempt from tax in the country visited [*Article 7*]. This will apply even though the student or apprentice may qualify as a resident of the country visited during the period of their visit.

Employment income

2.33 Where, however, an IoM student visiting Australia solely for educational purposes undertakes employment in Australia, for example, part-time work with a local employer, the income earned by that student as a consequence of that employment may be subject to tax in Australia.

2.34 For business apprentices, this Article only applies where the apprentice's remuneration consists solely of subsistence payments, made from abroad, to cover training or maintenance. Remuneration for service, that is, salary equivalents, falls for consideration under domestic taxation law.

2.35 In the case of an IoM business apprentice visiting Australia solely for training purposes, it may therefore be necessary to distinguish between remuneration for service and a payment for the apprentice's maintenance or training. The quantum of the payment will be relevant in such cases.

2.36 A payment for maintenance or training would not be expected to exceed the level of expenses likely to be incurred to ensure the apprentice's maintenance and training (ie, a subsistence payment). If the remuneration is similar to the amounts paid to persons who provide similar services who are not business apprentices (ie, salary equivalent), this would generally indicate that the payments constitute income from employment that would fall for consideration under domestic taxation law. Likewise, if that business apprentice undertakes any other employment in Australia, the income earned from that employment may be subject to tax in Australia.

2.37 In these situations, the payments received from abroad for the student's or apprentice's maintenance, education or training will not, however, be taken into account in determining the tax payable on the employment income that is subject to tax in Australia. No Australian tax would be payable on the employment income if the student or apprentice qualifies as a resident of Australia during the visit and the taxable income of the student or apprentice does not exceed the tax-free threshold applicable to Australian residents for income tax purposes.

Article 8 — Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments

2.38 This Article provides for consultation between the competent authorities of the two countries for the purpose of endeavouring to resolve disputes, between a resident of one country and the tax authority of the

other country, concerning transfer pricing adjustments purportedly made not in accordance with the arm's length principle. *[Article 8, paragraph 2]*

2.39 The term 'arm's length principle' refers to the requirement that businesses price their related party international dealings according to what truly independent parties acting independently would reasonably be expected to have done in the same situation. The Commissioner would apply the 'arm's length principle' when reviewing business transactions in the context of Division 13 of Part III of the ITAA 1936.

2.40 A person wishing to use this mutual agreement procedure must present their case to the competent authority of their country of residence within three years of the first notification of the transfer pricing adjustment. This procedure operates independently of, and in addition to, domestic legal remedies available to taxpayers. *[Article 8, paragraph 1]*

Article 9 — Exchange of Information

2.41 Article 9 authorises and limits the exchange of information by the competent authorities to information that is foreseeably relevant to the administration of the IoM Agreement.

2.42 The exchange of information is subject to the provisions of the *Agreement on the Exchange of Information with Respect to Taxes*, which was signed by the two countries on 29 January 2009 *[Article 9]*. After that agreement enters into force and takes effect, it will provide for exchange of information that is foreseeably relevant to the administration of the taxation laws of the two countries. It also contains safeguards to protect taxpayers' rights. For example:

- confidentiality rules to ensure that information exchanged is only disclosed to authorised recipients; and
- limitations to ensure that the competent authorities do not exceed domestic laws and normal administrative procedures in the course of obtaining and supplying information.

Article 10 — Entry into Force

Date of entry into force

2.43 The IoM Agreement will enter into force on the date of the last exchange of diplomatic notes notifying that the domestic procedures to give it the force of law have been completed. In Australia, enactment of the legislation giving the IoM Agreement the force of law along with tabling it in Parliament are prerequisites to the exchange of diplomatic

notes. Entry into force is also conditional upon the related *Agreement on the Exchange of Information with Respect to Taxes* between the two countries being in force at that time.

Date of application in Australia

2.44 Following entry into force, the IoM Agreement will take effect in Australia in respect of any income year beginning on or after 1 July in the calendar year next following the date on which it enters into force. *[Article 10, subparagraph (a)]*

2.45 Where a taxpayer has adopted an accounting period ending on a date other than 30 June, the accounting period that has been substituted for the year of income beginning on 1 July in the calendar year next following the date on which this Agreement enters into force will be the relevant year of income for the purposes of the application of such Australian tax.

Date of application in the IoM

2.46 Following entry into force, the IoM Agreement will take effect in the IoM in respect of any income year beginning on or after 5 April in the calendar year next following the date on which it enters into force. *[Article 10, subparagraph (b)]*

Article 11 — Termination

2.47 The IoM Agreement is to continue in effect indefinitely. However, either country may give written notice of termination of the IoM Agreement through the appropriate channel. *[Article 11, paragraph 1]*

Cessation in Australia

2.48 In the event of either country terminating the IoM Agreement, it would cease to be effective in Australia in the year of income beginning on or after 1 July in the calendar year next following that in which the notice of termination is given. *[Article 11, subparagraph 2(a)]*

Cessation in the IoM

2.49 In the event of its termination, the IoM Agreement would correspondingly cease to be effective in the IoM for any year of income beginning on or after 5 April in the calendar year next following that in which the notice of termination is given. *[Article 11, paragraph 2(b)]*

Cessation in other circumstances

2.50 The IoM Agreement will also terminate and cease to be effective if the *Agreement for the Exchange of Information with Respect to Taxes* between the two countries is terminated. In that event, the IoM Agreement would terminate, for both countries, on the first day of the month following the expiration of a period of six months after receipt of notification of termination of the exchange of information agreement.
[Article 11, paragraph 3]

Chapter 3

Regulation impact statement for the British Virgin Islands Agreement and the Isle of Man Agreement

Policy objective

The BVI Agreement

3.1 The objective of the *Agreement between the Government of Australia and the Government of the British Virgin Islands for the Allocation of Taxing Rights with Respect to Certain Income of Individuals* (BVI Agreement) is to promote closer economic and administrative cooperation between Australia and the British Virgin Islands (BVI), by reducing some of the taxation barriers to trade and investment between the two countries.

3.2 The BVI Agreement was signed in conjunction with the *Agreement for the Exchange of Information Relating to Taxes* between Australia and the BVI, which will promote greater cooperation between the taxation authorities of the two countries to prevent tax avoidance and evasion.

The IoM Agreement

3.3 The objective of the *Agreement between the Government of Australia and the Government of the Isle of Man for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments* (IoM Agreement) is to promote closer economic and administrative cooperation between Australia and the Isle of Man (IoM), by reducing some of the taxation barriers to trade and investment between the two countries.

3.4 The IoM Agreement was signed in conjunction with the *Agreement for the Exchange of Information with Respect to Taxes* between Australia and the IoM, which will promote greater cooperation between the taxation authorities of the two countries to prevent tax avoidance and evasion.

Implementation options

3.5 The internationally accepted approach to meeting the policy objectives specified above is to conclude a bilateral tax agreement.

Assessment of impacts

Impact group identification

The BVI Agreement

- 3.6 The BVI Agreement is likely to have an impact on:
- individuals providing services to an Australian government (including a state or local government) in the BVI;
 - Australian students and business apprentices temporarily residing in the BVI for education or training purposes;
 - the Australian Government, and
 - the Australian Taxation Office (ATO).

The IoM Agreement

- 3.7 The IoM Agreement is likely to have an impact on:
- recipients of Australian source pensions or retirement annuities who reside in the IoM;
 - individuals providing services to an Australian government (including a state or local government) in the IoM;
 - Australian students and business apprentices temporarily residing in the IoM for education or training purposes;
 - Australian entities that wish to contest a transfer pricing adjustment made by the IoM tax authority;
 - the Australian Government; and
 - the ATO.

Analysis of costs/benefits

Assessment of costs

Revenue costs

3.8 The impact of the BVI Agreement and the IoM Agreement on the forward estimates has been estimated as negligible.

Administration costs

3.9 The administrative impacts on the ATO from the changes made by any new bilateral tax agreements (including tax treaties) are considered to be low. General enquiries may arise and some formal interpretive advice, such as private binding rulings, may be required concerning the application of the agreement. ATO staff, taxpayers and tax professionals will need to be made aware of the entry into force of the BVI Agreement and the IoM Agreement. Therefore a number of ATO information products will need to be updated. This is normal in the context of any new tax treaty or bilateral agreement.

3.10 The cost of negotiation and enactment of the BVI Agreement and the IoM Agreement is minimal and has mostly been borne by the Treasury and the ATO. There will be an unquantified but small cost in terms of parliamentary time and drafting resources in enacting the proposed new arrangements.

Taxpayer costs

3.11 No material additional costs to taxpayers have been identified as likely to arise from the BVI Agreement or the IoM Agreement. These agreements are expected to simplify the taxation obligations of the entities that fall within their scope.

Other costs

3.12 The BVI Agreement and the IoM Agreement would constrain government policy flexibility in relation to the taxation of BVI and IoM individuals. However, as the provisions of the BVI Agreement and the IoM Agreement are consistent with the Government's general tax treaty policy, and are based on broad and generally accepted taxation principles, the impact of such a loss of flexibility would be minimal. Ultimately, the BVI Agreement and the IoM Agreement could be terminated if they were found to contravene government policy but such termination is rare in international treaty practice and would likely be resisted by those individuals who will benefit from these Agreements.

Consultation

3.13 The negotiation of the BVI Agreement and the IoM Agreement was not conducted in the public domain and, consequently, no public consultation was undertaken. They were negotiated in conjunction with the negotiation of the *Agreement for the Exchange of Information Relating to Taxes* (in the case of the BVI), and the *Agreement for the Exchange of Information with Respect to Taxes* (in the case of the IoM), which were also conducted outside the public domain.

3.14 The State and Territory Governments have been consulted through the Commonwealth-State/Territory Standing Committee on Treaties. Information on the negotiation of the BVI Agreement and the IoM Agreement was included in the six-monthly schedule of treaties to state and territory representatives.

3.15 The proposed BVI Agreement and IoM Agreement have also been considered by the Commonwealth Joint Standing Committee on Treaties, which provides for public consultation in its hearings.

Conclusion and recommended option

3.16 The proposed BVI Agreement and IoM Agreement are consistent with the Government's tax treaty policy and is the only option available to implement the policy objective stated above.

