

Joint Standing Committee on Treaties

Convention between the Government of Australia and the Government of the State of Israel for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance

ANSWER TO QUESTION ON NOTICE

Division/Agency: Corporate and International Tax Division, Treasury

Reference: Hansard page 17 (16 September 2019)

Question:

Senator AYRES: There are two sets of problems, aren't there? One is double taxation and the other is tax evasion. The language around this is weighted towards the double taxation. I don't understand what the amount of double taxation is—what is the scale of the problem? Perhaps people might assert that a dollar of double taxation is a bad thing and we should just solve that problem. I just want to get a sense of how big the problem is. And, on the tax evasion side, I'm interested as well in what do the experts—what does the government believe the scale of that problem is, and how likely is the instrument to mitigate against that?

Ms Ram: We have data from the ABS indicating that in 2018 the level of Australian investment in Israel is around \$1 billion, and that Israeli investment in Australia is around \$310 million. That would be expected to benefit from the tax treaty and the reduction of tax barriers in the tax treaty. The second-round effects, which could be expected to include increases in trade and investment, do not form part of the costings. So our costings reflect merely first-round effects; we do not quantify the second-round effects. As to the scale of the tax evasion issue, I don't know if the ATO would want to comment on that. I think I mentioned a number of the integrity provisions that the tax treaty contains. They implement recommendations which are required of us through the OECD and they are expected to improve or decrease opportunities for tax avoidance in Australia.

Senator AYRES: I don't want to labour this point too much longer because I think what you're saying is that it's not possible to do the trick that I'm asking you to do, which is to quantify either the problem or the proposed benefits. Is it possible to get, on notice, a table that sets out the operative provisions of the OECD arrangement and the extent to which this arrangement addresses those operating principles? Does that make sense?

Ms Ram: Yes, we can do that.

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The table below sets out how the *Convention between the Government of Australia and the Government of the State of Israel for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance* incorporates the OECD Base Erosion and Profit Shifting Action Items.

Relevant Article of the Australia-Israel tax treaty	OECD Action Item
<p>Title and Preamble</p> <p>The express purpose of the treaty is to eliminate double taxation with respect to taxes on income without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements).</p>	<p>This gives effect to an OECD/G20 Base Erosion and Profiting Shifting (BEPS) Action 6 recommendation (<i>Preventing the Granting of Treaty Benefits in Inappropriate Circumstances</i>).</p> <p>It clarifies the object and purpose of the treaty also includes avoiding opportunities for non-taxation or reduced taxation through tax evasion or avoidance</p>
<p>Persons covered (Article 1)</p> <p>Treaty benefits will be available for income derived by or through fiscally transparent entities or arrangements (such as partnerships and trusts) but only to the extent that the income is treated as the income of one of the country's residents under that country's domestic law.</p>	<p>This gives effect to a BEPS Action 2 recommendation (<i>Neutralising the Effects of Hybrid Mismatch Arrangements</i>).</p> <p>It will ensure that such income is not subject to double taxation, without granting treaty benefits in inappropriate circumstances (such as where neither country treats the income as belonging to one of its residents under its domestic law).</p>
<p>Permanent establishment (PE) (Article 5)</p> <p>A PE will be deemed to exist in respect of the following activities:</p> <ul style="list-style-type: none"> A building site or construction project, that lasts for more than 9 months; or carrying out of the related supervisory or consultancy activities that exceeds 183 days or more in any 12 month period. Natural resource activities (including 	<p>Collectively, these integrity rules give effect to BEPS Action 7 recommendations (<i>Preventing the Artificial Avoidance of PE Status</i>) and will help guard against abusive arrangements intended to circumvent the PE definition. The existence of a PE in a country enables that country to tax local business profits derived by that PE.</p>

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<p>the operation of substantial equipment) that exceeds 90 days or more in any 12 month period.</p> <ul style="list-style-type: none">• Certain preparatory or auxiliary activities, such as warehousing or purchasing goods, are excluded from the definition of PE.• Integrity provisions will be included to prevent related parties from circumventing the above PE time thresholds by splitting contracts, or from fragmenting their preparatory or auxiliary activities to avoid having a PE. <p>A PE will also be deemed to exist where a person (agent) acts on behalf an enterprise, unless that agent is acting in a truly independent capacity. This will ensure that the activities of dependent agents of foreign enterprises fall within the definition of a PE</p>	
<p>Business profits (Article 7)</p> <p>Transfer pricing adjustments are generally limited to seven years. This time limit does not apply on a finding of fraud, gross negligence or wilful default, or where an audit has commenced in relation to the profits of the enterprise within a period of 10 years</p>	<p>This gives effect to an OECD BEPS Action 14 recommendation (<i>Making Dispute Resolution Mechanisms More Effective</i>). It will help prevent late adjustments to provide greater taxpayer certainty.</p>
<p>Associated enterprises (Article 9)</p> <p>Where one country adjusts the taxable income of a resident enterprise to reflect the arm's-length conditions of a transaction with an associated enterprise, the other country will be required to make a correlative</p>	<p>This gives effect to an OECD BEPS Action 14 recommendation (<i>Making Dispute Resolution Mechanisms More Effective</i>). It will help prevent late adjustments to provide greater taxpayer certainty.</p>

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adjustment.	
Time limits apply for the commencement of transfer pricing adjustments	
Dividends (Article 10) The source (of the dividend) country may tax outbound dividends up to the following limits: <ul style="list-style-type: none">• Zero - for dividends derived by governments (including government investment funds), central banks, tax exempt pension funds or Australian residents carrying out complying superannuation activities on direct holdings of no more than 10 per cent;• 5% - of the gross amount of the dividend for intercorporate dividends paid to companies that hold 10 per cent or more of the paying company throughout a 365 day period; 15% - in all other cases	<p>The 365-day holding period requirement for dividends attracting the 5 per cent rate gives effect to an OECD BEPS Action 6 recommendation (<i>Preventing the Granting of Treaty Benefits in Inappropriate Circumstances</i>).</p> <p>It will help guard against potential abuse cases where a company with a holding of less than the specified holding percentage increases its holding shortly before the dividends are paid for the purpose of securing the benefits of the provision.</p>
Alienation of property (Article 13) Income, profits or gains from the disposal of immovable property (such as land) or of shares or comparable interests in land-rich entities may be taxed in the country where the property is situated (as a primary taxing right), and a secondary taxing right is provided to the alienator's country of residence. An integrity rule will ensure that the rule for land-rich entities will apply if the relevant conditions are met at any time during the 365 days preceding the disposal. Income, profits or gains from the disposal of	<p>The 365-day integrity rule gives effect to an OECD BEPS Action 6 recommendation (<i>Preventing the Granting of Treaty Benefits in Inappropriate Circumstances</i>).</p> <p>It will help guard against potential abuse cases where a company alters its asset mix prior to disposal to ensure it is not land rich on the date of disposal.</p>

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PE assets may be taxed in the country where the PE is located, as well as in the country where the enterprise is resident.

Income, profits or gains from the disposal of ships or aircraft operated in international traffic, as well as from the disposal of other assets pertaining to those operations, will be taxable only in the country of residence of the operator.

Residual capital gains may be taxed in the country the country where the alienator is a resident, as well as in the country where the property is located (if the alienator is not the beneficial owner).

Limitation on benefits (Article 22)

The treaty includes a rule denying treaty benefits, in certain circumstances, if a principle purpose of an arrangement or transaction is to a treaty benefit.

This gives effect to an OECD BEPS Action 6 recommendation (*Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*).

This ensures that the treaty should apply in accordance with the purposes for which it was entered into, that is, to provide benefits in respect of bona fide exchanges of goods and services and movements of capital and persons, as opposed to arrangements whose principal objective is to secure a more favourable tax treatment.

Mutual agreement procedure (MAP) (Article 25)

Taxpayers will have three years in which to seek the revenue authorities' assistance in the resolution of tax disputes arising from the application of the treaty.

Protocol paragraph 12 establishes a competent authority notification process, to ensure that the competent authorities of

This gives effect to an OECD BEPS Action 14 recommendation (*Making Dispute Resolution Mechanisms More Effective*) and ensures the efficient operation of the MAP dispute resolution mechanism for taxpayers

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Australia and Israel are made aware of MAP requests that are submitted and, therefore, are able to give their views on whether the request is accepted or rejected, and whether the person's objection is considered to be justified