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Double Taxation Convention with Japan[1]

Introduction

4.1 This agreement replaces an existing 1969 agreement with Japan and will bring taxation arrangements between Australia and Japan into line with Australia's recent tax treaties. [2] A complete treaty revision was prompted by a number of factors, including changing business operations, the significance of the trade relationship and the age of the existing agreement between the two countries. [3]

4.2 The key objectives of the agreement are to:

- promote closer economic cooperation by reducing barriers to trade and investment caused by overlapping taxing jurisdictions; and
- upgrade the framework to prevent tax evasion. [4]

4.3 Japan has been Australia's largest export market for 40 years with bilateral merchandise trade totalling A$54.5 billion in 2007. [5] Japan is

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1 Full Title: Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income, and Protocol, done at Tokyo on 31 January 2008.

2 Regulation Impact Statement (RIS), para 2.29.

3 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, p. 43.

4 National Interest Analysis (NIA), para 3.

5 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, p. 44.

also Australia's third largest investor, with a total stock of investment worth A$51 billion at the end of 2006. [6]

The revised agreement

4.4 The Committee was advised that the proposed treaty is generally consistent with recent tax treaties concluded by Australia and includes a number of changes from the existing treaty.[7] The key differences are reduced rates of withholding taxes (WHT) on dividends, interest and royalties, and improved integrity measures, particularly relating to rules for the exchange of information on tax matters. The treaty also introduces rules for real property which align the Capital Gains Tax treatment closely with that of the Organisation for Economic Cooperation and Development (OECD).[8]

4.5 Treasury advised that it sought greater clarity in the revised agreement. The organisations that would be subject to exemptions for interests to withholding taxes have been expanded to include the Australian Export Finance and Insurance Corporation, the public authority that manages the investments of Australia's Future Fund, the Japan Bank for International Cooperation, and Nippon Export and Investment Insurance.[9]

4.6 Treasury summarised the other key changes to the agreement as:

- The inclusion of anti-treaty shopping provisions in relation to withholding tax rates on dividends, interest and royalties;
- The inclusion of a comprehensive limitation on the benefits clause to ensure treaty benefits pass only to qualified persons;
- Rules to prevent tax discrimination;
- Updated provisions for the taxation of business profits from natural resource activities, building sites and the operation of substantial equipment;
- New rules to deal with the taxation of income derived through business trusts; and

6 RIS, para 2.12.

7 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, pp. 43-44.

8 NIA, para 4.

9 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, p. 44.

- Provisions preventing double exemption of income derived by temporary residence.[10]

4.7 The treaty will also reduce tax impediments to the cross-border movement of people, capital and technology between Australia and Japan and facilitate cooperation between the taxation authorities to reduce fiscal evasion.[11]

Reasons for Australia to take treaty action

4.8 Reduced WHT on dividend, interest and royalty payments is expected to reduce barriers to bilateral trade and investment resulting from the overlapping tax jurisdictions between the two countries. Treasury told the Committee that:

> [b]usinesses on both sides of the relationship will face greater certainty about who has the right to tax, greater certainty around resolving disputes about tax and lower withholding taxes more generally.[12]

4.9 It is also anticipated that it will be cheaper for Australian businesses to obtain business loans and intellectual property from Japan and that Japanese businesses will be encouraged to make direct investments into Australia by the reduced WHT on dividend payments from an Australian subsidiary to its Japanese parent company. The treaty will also provide important benefits to Australian businesses looking to expand into Japan, including easier repatriation of profits back into Australia, greater certainty for Australian businesses looking to expand offshore, and a competitive advantage to Australian lenders and owners of intellectual property.[13] Treasury advised that:

> [r]eductions in withholding taxes will provide long-term benefits for business through lowering the costs of intellectual property, equity and finance for the expansion of Australian business.[14]

10 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, p. 44.

11 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, p. 44.

12 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, p. 45.

13 NIA, Attachment E.

14 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, p. 44.

4.10 The Committee understands that the treaty also enhances the existing treaty framework to prevent international tax evasion by updating the exchange of information rules in line with the 2005 OECD standard.[15]

Costs

4.11 Treasury estimates that the first round effects on forward estimates will be $345 million resulting from the reductions in dividend, interest and royalty withholding tax rates.[16] There may be additional costs as Australia will be obliged to enter into negotiations to provide similar WHT reductions to other countries with 'most favoured nation' clauses.[17] Treasury informed the Committee that the Government is currently determining the priorities for future negotiations for eight other treaties with 'most favoured nation' obligations.[18]

4.12 Treasury advised that compliance costs are expected to be reduced through closer alignment with recent Australian and international treaty practice.[19] Administrative costs associated with implementation will be managed with existing ATO and Treasury resources.[20]

4.13 Although Treasury has not costed the flow on effects from the treaty, the Committee notes that it expects there could be an increase in foreign investment in Australia and economic activity, resulting in increases in other forms of tax collection.[21] Mr Michael Rawstron of the Treasury told the Committee:

> … if you look at the trading relationship between Australia and Japan, it is significant. It is our No. 1 export market. It is the second-largest overall trade and investment relationship of all Australia's economic relationships around the world. Basically, from the discussions and consultations we had with industry when we were putting the treaty together and consulting with business, it is quite clear that there is an

15 NIA, para 10.
16 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, p. 44.
17 NIA, para 16.
18 Mr Martin Jacobs, *Transcript of Evidence,* 8 May 2008, p. 47.
19 NIA, para 17.
20 NIA, para 18.
21 NIA, para 21.

expectation of enhanced investment in Australia from the Japanese sector, particularly in natural resources.[22]

Implementation

The treaty will enter into force on the thirtieth day after the exchange of diplomatic notes indicating approval in accordance with the legal procedures of each State. The provisions of the treaty will take effect in two stages, being applicable from 1 January or 1 July in the calendar year following entry into force.[23]

Prior to the treaty coming into force in Australia, the *International Tax Agreements Act 1953* will be amended by incorporating the treaty text as a schedule to the Act.[24]

Consultation

4.14 Consultation with the business community occurred through the Tax Treaties Advisory Panel.[25] Submissions from stakeholders and the wider community were invited more broadly in November 2006. Business and industry groups supported similar outcomes to those in the 2003 United Kingdom Tax Convention and 2001 United States Protocol. The Committee notes that the proposed treaty will provide similar outcomes to those treaties.

4.15 States and Territories were consulted via the Standing Committee on Treaties.

22 Mr Michael Rawstron, *Transcript of Evidence,* 8 May 2008, p. 45.

23 NIA, para 1.

24 NIA, para 15.

25 Members include the Business Council of Australia, CPA Australia, Corporate Tax Association, Institute of Chartered Accountants in Australia, International Fiscal Association, Investment and Financial Services Association, Law Council of Australia, Minerals Council of Australia, Taxation Institute of Australia, and Property Council of Australia. NIA, Attachment A, para 1.

Conclusion and recommendation

4.16 The Committee accepts that this agreement will revise taxation arrangements between Australia and Japan, bringing them into line with Australia's other recent tax treaties, and that it will reduce barriers to trade and investment between the two countries and aid in the prevention of tax evasion.

Recommendation 7

The Committee supports the ***Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*** **and recommends that binding treaty action be taken.**