

National Interest Analysis [2010] ATNIA 22

with attachment on consultation

**Convention between Australia and the Republic of Chile for the Avoidance of Double Taxation
with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion, and
Protocol,
Santiago, 10 March 2010**

[2010] ATNIF 9

Regulation Impact Statement

NATIONAL INTEREST ANALYSIS: CATEGORY 2 TREATY

SUMMARY PAGE

**Convention between Australia and the Republic of Chile for the Avoidance of Double Taxation with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion, and Protocol,
done at Santiago on 10 March 2010
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Nature and timing of proposed treaty action

1. The proposed treaty action is to bring into force the *Convention between Australia and the Republic of Chile for the Avoidance of Double Taxation with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion, and Protocol* (the proposed Convention).
2. The proposed Convention was signed on 10 March 2010. The proposed Convention will enter into force, pursuant to Article 29, on the date of the last notification through the diplomatic channel between the Contracting States confirming that each State has completed their domestic requirements to bring the proposed Convention into force.
3. The provisions of the proposed Convention will take effect in Australia in four stages, namely:
 - a) in respect of withholding tax, on income derived on or after the first day of the second month following entry into force;
 - b) in respect of fringe benefits tax, on fringe benefits derived on or after 1 April in the year following entry into force;
 - c) in respect of other tax, on income derived in the year beginning 1 July following entry into force; and
 - d) in respect of administrative provisions, upon entry into force.

Overview and national interest summary

4. The key objectives of the proposed Convention are to:
 - a) promote closer economic cooperation between Australia and Chile by reducing taxation barriers caused by the double taxation of income derived by residents of either Contracting State; and
 - b) improve the integrity of the tax system by providing the framework through which the tax administrations of Australia and Chile can prevent international fiscal evasion.
5. The proposed Convention also aims to improve certainty for Australian businesses looking to expand into Chile and for other Australian taxpayers by establishing an internationally accepted framework for the taxation of cross-border transactions which is based upon the OECD *Model Tax Convention on Income and on Capital*.

6. In this manner the proposed Convention is expected to promote trade and investment between Australia and Chile and enhance the taxation arrangements for Australians engaged in cross-border transactions, thereby improving the wellbeing of the Australian people.

Reasons for Australia to take the proposed treaty action

Reducing barriers to bilateral investment and trade

7. The proposed Convention is expected to reduce barriers to bilateral trade and investment, primarily by reducing withholding taxes on dividend, interest and royalty payments between the two countries. Rather than taking unilateral action to reduce withholding taxes under domestic law, Australia has adopted the approach of agreeing to any such reductions on a bilateral basis. This approach 'locks in' the withholding tax limits in both countries, ensuring a steady financial framework for business between the proposed Convention partner countries.

8. In particular, the proposed Convention reduces Australian dividend withholding tax rate limit from 30 per cent to 5 per cent on intercorporate dividends on holdings of at least 10 per cent (Article 10). This will promote direct investment into Australia by reducing tax impediments and thus making Australia a more attractive location for investment by Chilean multinationals.

9. In the case of Australian investment in Chile, the proposed Convention, while preserving the application of Chile's Additional Tax payable, establishes a framework to address business concerns about the lack of competitiveness for Australian investments in Chile compared to investments in Chile by our competitors.

10. The proposed Convention locks in reduced rates of interest withholding tax on Chilean sourced interest paid to Australian lenders (Article 11). It also contains most favoured nation clauses that either reduce the rate of tax Chile may charge to a rate between 15 and 10 per cent or oblige Chile to inform Australia if it provides more favourable treatment of interest derived by financial institutions and governments in a subsequent treaty with another country and to enter into negotiations with a view to providing Australia with the same treatment (Article 11(4)) and Protocol Item 6 respectively). These clauses will assist in maintaining the competitiveness of Australian lenders and their dealings in Chile into the future.

11. The proposed Convention reduces royalty withholding tax in both countries from 30 per cent to 5 per cent for equipment royalties and 10 per cent for other royalties (Article 12). Reduced Chilean withholding taxes on royalty payments are likely to encourage Chilean businesses to source intellectual property from Australia. While the Australian company remains legally liable for tax on royalty income earned in Chile, contracts will often include provisions (known as 'gross up clauses') requiring the Chilean company to absorb this tax. Consequently, lower withholding taxes on royalties are expected to reduce the costs for Chilean businesses of accessing Australian intellectual property. Likewise the lower royalty withholding tax rate is expected to reduce the costs for Australian businesses of accessing Chilean intellectual property. It also contains a 'most favoured nation' obligation with respect to Chilean withholding tax rates on royalties (Protocol Item 7). This will assist in maintaining the competitiveness of Australian business and their dealings in Chile into the future.

12. The proposed Convention also provides an agreed basis for determining the allocation of profits within a multinational company and whether the profits on related party dealings by members of a multinational group operating in both countries reflect the pricing that would be adopted by independent parties (Articles 7 and 9). Tax treaties are therefore an important tool in dealing with international profit shifting through transfer pricing.

13. More generally, the proposed Convention will provide important benefits to Australians looking to expand into Chile. It will establish an internationally accepted framework for the taxation of cross-border transactions. Thus reducing investor risk and providing some degree of legal and fiscal certainty – unlike domestic laws which can be amended unilaterally. It also includes rules to prevent tax discrimination of nationals.

Establishing a framework to prevent international fiscal evasion

14. The proposed Convention establishes a framework to prevent international tax evasion through the inclusion of rules to allow the tax administrations to exchange taxpayer information. These rules meet the internationally agreed tax standard for exchange of information which was developed by the OECD. This standard has been endorsed by the G20 and the United Nations Committee of Experts on International Cooperation in Tax Matters. This framework will support global action on improving information exchange and transparency.

Compliance and administrative cost reduction benefits

15. The proposed Convention does not impose any greater obligations on the residents of Australia than Australian domestic tax laws would otherwise and in some cases reduces the obligations of Australians operating or investing in Chile (for example Article 7 concerning business profits). Given this and the fact that the proposed Convention is broadly consistent with international norms, it is expected to reduce compliance costs for those taxpayers with cross-border dealings between the Contracting States.

Obligations

16. Articles 6 to 21 allocate taxing rights in respect of certain types of income and fringe benefits between the two countries. To reduce or eliminate double taxation Australia and Chile have agreed in certain situations to limit taxing rights over various types of income dealt under these Articles. For example Articles 10 to 12 impose limits on the rate of tax which may be imposed by the country of source (ie, the country where the payment arises) on dividends, interest or royalties. However, the limits in Articles 10 and 11 concerning dividends and interest respectively, do not apply in a reciprocal manner. For example, Chile does not impose dividend withholding tax on foreign investors. Rather it has a unique two tiered system of taxing profits, comprising the First Category Tax and the Additional Tax. The proposed Convention preserves this system of taxation in Chile. In the case of pension income, the proposed Convention allocates an exclusive right to tax to the country of residence of the pensioner (Article 18). It also provides an agreed basis for determining the allocation of profits within a multinational company and whether the profits on related party dealings by members of a multinational group operating in both countries reflect the pricing that would be adopted by independent parties (Article 9).

17. Article 23 of the proposed Convention sets out a general obligation for both countries to relieve double taxation on cross-border income by permitting tax paid under the other country's laws and in accordance with the proposed Convention, to be allowed as a credit against tax payable under their own laws.

18. Article 24 contains a general non-discrimination principle, requiring each country to treat nationals of the other country no less favourably than it treats its own nationals regarding taxation and any connected requirements. There is a general exception where laws are intended to prevent tax evasion or aid research or development. This article can be amended via an Exchange of Notes.

19. Article 25 establishes procedures for dispute resolution, including a mechanism for taxpayers to present complaints to their country of residence, irrespective of the remedies provided by the domestic laws of those States, where they consider that they have been taxed not in accordance with the proposed Convention. The country receiving a complaint that appears to be justified must endeavour to resolve it, either unilaterally or by mutual agreement with the other country. Difficulties or doubts regarding interpretation or application of the proposed Convention shall be resolved by mutual agreement between the Contracting States. A dispute between the Contracting States which may also involve the application of the General Agreement on Trade in Services may be brought before the Council for Trade in Services by consent of both States.

20. Article 26 provides obligations for the exchange of information between both countries, including a specific obligation to gather and provide information upon request. Article 26(2) imposes a correlative obligation on the country receiving any such information to treat it as secret in the same manner as information obtained under its domestic laws. Article 26(3) allows either country to decline to supply information in certain circumstances. Specifically, a request may be denied where: (i) it would require implementation of administrative measures at variance with Contracting States' domestic law or administrative practice; (ii) the information requested is not obtainable under the laws or in the normal course of administration of the Contracting State; or (iii) it would involve disclosure of a trade or business secret or would be contrary to public policy (for example, if it would breach human rights obligations). These circumstances, which act as a safeguard to protect Australia's interests and taxpayer's rights, accord with the OECD Model Tax Convention on Income and on Capital.

21. Article 27 provides rules to ensure that benefits conferred by the proposed Convention will only apply in appropriate circumstances. It also allows for consultation between the Contracting States where it is perceived that benefits may not be within those contemplated or intended under the proposed Convention.

22. Item 5 of the Protocol obliges the two countries to consult if Chile agrees in a treaty to limit the Additional Tax charged in Chile, or if either country imposes tax in excess of 42 per cent on dividends and the underlying profits out of which such dividends are paid, with a view to amending the taxation of dividends. Article 2(2) of the proposed Convention requires each country to notify the other of any significant changes to laws relating to the taxes to which the proposed Convention applies.

23. Items 6 and 7 of the Protocol impose a most favoured nation obligation on Chile, requiring Chile to inform Australia if it provides more favourable treatment of (i) interest derived by a financial institution or by a government (ii) royalties or (iii) excludes payments for industrial, commercial or scientific equipment from the meaning of royalties, in any subsequent tax treaty with another country, with the view to renegotiating the proposed Convention to provide the same treatment for Australia. The effect of the most favoured nation clause is also discussed above at paragraph 10.

Implementation

24. Amendments to the *International Tax Agreements Act 1953* will be made prior to the proposed Convention entering into force, to give the proposed Convention the force of law in Australia. No action is required by the States or Territories. There will be no change to the existing roles of the Commonwealth, or the States and Territories, in tax matters as a consequence of implementing the proposed Convention.

Costs

25. Treasury has estimated the impact of the first round effects on forward estimates as ‘not zero but rounded to zero’.

26. No other material costs have been identified as likely to arise from the implementation of the proposed Convention. In contrast the establishment of a treaty between Australia and Chile which is broadly consistent with international norms would generally be expected to reduce compliance costs for taxpayers.

27. There would be a small, unquantifiable cost in administering the changes made by the proposed Convention, including minor implementation costs to the Australian Taxation Office (ATO) in educating the taxpaying public and ATO staff concerning the new arrangements. There are also ‘maintenance’ costs to the ATO and the Department of the Treasury in terms of dealing with inquiries, rulings and other interpretative decisions and mutual agreement procedures (including advance pricing arrangements). However, these costs will continue to be managed within existing agency resources.

Regulation Impact Statement

28. A Regulation Impact Statement is attached.

Future treaty action

29. The proposed Convention does not provide for the negotiation of future legally binding instruments, although it does require both countries to consult on amendment to the dividend provisions as discussed in paragraph 19.

30. The proposed Convention does not contain specific amendment procedures, however it may be amended from time to time by mutual consent of both countries.

31. Items 6 and 7 of the Protocol oblige Chile to enter into negotiations with Australia if Chile has provided more favourable treatment of certain interest or royalties in a tax treaty with any other country, with a view to providing at least the same treatment to Australia (see paragraph 23).

32. As discussed at paragraph 21 above, Article 27 allows the relevant authorities of the Contracting States to consult and recommend amendments to ensure that the proposed Convention fulfils aims of avoiding international double taxation. Any such amendments would be subject to Australia’s domestic treaty-making process, including tabling in Parliament and consideration by the Joint Standing Committee on Treaties.

Withdrawal or denunciation

33. Either country can terminate the proposed Convention after a period of five years from the date of its entry into force, provided written notice of termination is given at least six months prior to the end of a calendar year (Article 30). Termination by Australia would be subject to Australia's domestic treaty-making process. The proposed Convention would then cease to be effective, in the case of Australia, from either the first day of the second month after the termination notice is given (in respect of withholding tax on income derived by a non-resident), or 1 April or 1 July next following the date on which the notice of termination is given (in respect of fringe benefits tax or other Australian tax respectively).

Contact details

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ATTACHMENT ON CONSULTATION

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CONSULTATION

34. The then Prime Minister and Chilean President issued a joint communiqué announcing the commencement of negotiations for a tax treaty between Australia and Chile on 14 July 2005. Following this announcement Treasury invited submissions from stakeholders and the wider community on the proposed Convention. Treasury also sought comments from the business community through the Tax Treaties Advisory Panel, members of which include:

- a) Australian Bankers' Association
- b) Australian Chamber of Commerce and Industry
- c) Australian Financial Markets Association.
- d) Business Council of Australia
- e) CPA Australia
- f) Corporate Tax Association
- g) Institute of Chartered Accountants in Australia
- h) International Fiscal Association
- i) Investment and Financial Services Association
- j) Law Council of Australia
- k) Minerals Council of Australia
- l) Taxation Institute of Australia
- m) Property Council of Australia

35. In general, business and industry groups recognised that Australia has strong and growing business interests in Chile and endorsed the conclusion of a tax treaty. In particular, business and industry groups strongly supported reductions in withholding taxes on dividends, royalties, interest and payments for services.

36. The State and Territory Governments have been consulted through the Commonwealth-State Standing Committee on Treaties. Information on the negotiation of the proposed Convention was included in the schedule of treaties to State and Territory representatives from July 2005.