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JOINT COMMITTEE ON TREATIES

Monday, 8 September 2003

Members: Ms Julie Bishop *(Chair),* Mr Wilkie *(Deputy Chair),* Senators Bartlett, Kirk, Mason, Marshall, Stephens, Tchen and Santoro and Mr Adams, Mr Bartlett, Mr Ciobo, Mr Martyn Evans, Mr Hunt, Mr Peter King and Mr Bruce Scott

Senators and members in attendance: Senators Kirk, Marshall and Tchen and Mr Adams, Ms Julie Bishop, Mr Ciobo, Mr Peter King and Mr Wilkie

Terms of reference for the inquiry:

Treaties tabled in September 2003

WITNESSES

ADAMSON, Ms Margaret Anne, Assistant Secretary, European Union and Western Europe Branch, Department of Foreign Affairs and Trade 1

FEWSTER, Mr Alan, Executive Director, Treaties Secretariat, Legal Branch, Department of Foreign Affairs and Trade 1

KOURTEFF, Mr Michael James, Executive Officer, Americas Branch, Department of Foreign Affairs and Trade 1

MANNING, Mr Greg, Principal Legal Officer, Public International Law Branch, Office of International Law, Attorney-General's Department 1

McBRIDE, Mr Paul David, Unit Manager, Tax Treaties Unit, International Tax and Treaties Division, Revenue Group, Department of the Treasury 1

PARKER, Mr David John, General Manager, International Tax and Treaties Division, Revenue Group, Department of the Treasury 1

PARTINGTON, Mr Allan John, Senior Adviser, Costings and Quantitative Analysis Unit, Tax Analysis Division, Department of the Treasury 1

PICKERING, Mrs Ariane Robin, Specialist Adviser, Tax Treaties, International Tax and Treaties Division, Revenue Group, Department of the Treasury 1

WILD, Mr Russell, Executive Officer, International Law and Transnational Crime Section, Legal Branch, Department of Foreign Affairs and Trade 1

Committee met at 10.02 a.m.

ADAMSON, Ms Margaret Anne, Assistant Secretary, European Union and Western Europe Branch, Department of Foreign Affairs and Trade

FEWSTER, Mr Alan, Executive Director, Treaties Secretariat, Legal Branch, Department of Foreign Affairs and Trade

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PICKERING, Mrs Ariane Robin, Specialist Adviser, Tax Treaties, International Tax and Treaties Division, Revenue Group, Department of the Treasury

CHAIR—Good morning. I declare open this meeting of the Joint Standing Committee on Treaties. Public hearings on sitting Monday's have traditionally been occupied with discussions on treaties tabled in the previous sitting week or period. Today the committee will break with that tradition in order to examine two treaties that are due to be tabled tomorrow. For that reason, the national interest analyses for those treaties have been made available to the committee and will be publicly available as soon as the treaty texts are tabled in the parliament tomorrow.

The subject of this morning's hearing is two double taxation agreements between Australia and the United Kingdom, and Australia and Mexico. I understand that witnesses from the Department of the Treasury will provide evidence on the substance of those proposed treaty actions, supported by witnesses from the Department of Foreign Affairs and Trade and the Attorney-General's Department. I should remind witnesses that today's proceedings are being broadcast by the Department of the Parliamentary Reporting Staff. Should this present any problems for witnesses, it would be helpful if they would raise the issue now.

To begin our hearing, we will take evidence on the Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on

Income and on Capital Gains, done at Canberra on 21 August 2003, and an associated exchange of notes. I call representatives from the Department of the Treasury.

Although the committee does not require you to give evidence under oath, I advise you that the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House and the Senate. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of the parliament. Would one of you like to make some introductory remarks before we proceed to questions?

Mr Parker—I have prepared an introductory statement which covers the UK and Mexican treaties together. I am happy to split that if it would be convenient for the committee.

CHAIR—If you are going to make the same points in respect of each treaty, I would be happy for you to proceed with your general comments that relate to both.

Mr Parker—That might save some time. I have some introductory comments, some comments on the UK and some comments on Mexico which I will take in turn. We welcome the opportunity to present to this committee the proposed revised double tax treaty with the United Kingdom and the proposed new double tax treaty with Mexico. It is our view that the proposed treaty actions will bring significant benefits for Australia, and we have sought, in the national interest analysis and in our presentation before you today, to respond to some of the committee's requests at earlier hearings to provide a deeper analysis of the economic effects of these treaties.

By way of context, the UK treaty will replace the existing treaty, which was negotiated more than 20 years ago and which needed updating to reflect changes to Australian and UK treaty policy and business practices. The Mexican treaty will extend Australia's treaty network in Latin America and complete our network of treaties with the NAFTA countries. Broadly, the objectives of these treaties can be categorised as follows. Firstly, they aim to promote the flow of investment, trade and skilled personnel between the two countries by eliminating double taxation and providing a reasonable element of legal and fiscal certainty for commerce between the respective countries. Secondly, they aim to improve the integrity of the tax system by creating a framework through which the tax administrations of both countries can prevent international fiscal evasion and eliminate double taxation. Thirdly, they aim to develop and improve bilateral relations with the countries concerned. Fourthly, they aim to maintain Australia's position in the international tax community. At the highest level, these treaties form part of the network of tax treaties which ultimately support Australia's geopolitical, strategic, security and regional interests.

As mentioned, Treasury has been working with the committee to provide more information to assist in its evaluation of treaties. The challenge here is similar to evaluating any government program. That is, when looking at a program it is possible to say with relative precision what the cost of the program is. For example, we can say quite precisely how much the government spends on education, health or other programs. The benefits of those programs are relatively clear and self-evident, in terms of better health outcomes, better education and so forth, but quantifying those benefits becomes a difficult exercise in empirical analysis.

It is similar in the case of treaties—that is, it is reasonably possible to make a firm estimate of the up-front headline cost of a treaty action. The benefits of the treaty are relatively clear and

transparent, being in the form of promotion of commerce between the countries, but again, taking the next step to quantify those benefits is relatively difficult. Nevertheless, in the national interest analysis before you and in our presentation we have tried to take some additional steps, as you have requested previously.

In relation to the UK treaty, we focused on two key issues to begin to unpick this question of the effects of treaties. The first issue is to determine the incidence of the taxes that apply under the treaties. This is a question of who really pays the taxes that are subject. For example, a number of withholding taxes under the treaties are taxes which are levied on flows of income paid to foreigners, but the person who pays those taxes is often the Australian person who is paying the flow of income. This is a case where the tax is passed back to the Australian resident payer. So it does not necessarily follow that taxes have their ultimate incidence where they are levied. A simple example is that the GST is paid by business, but the incidence of the GST falls on consumers; the tax is passed through to consumers in final prices.

The second step in beginning to unpick the effect of these treaties is to look at the second-round effects of the taxes and tax changes once the incidence of these taxes is determined. In looking at the effects under these treaties, we focused on three key areas. The first is the effect of the tax changes in promoting increased investments by contributing to a larger and more quickly growing economy, which will have a flow-on benefit to trade and employment throughout the economy. The second effect is the reduction in the cost of business inputs through lower withholding taxes, which in many instances is passed back to Australian payers. This makes business in Australia more profitable; in turn, it pays additional tax. Thirdly, we looked at the effect of reduced claims for foreign tax credits as a result of reductions in UK withholding tax rates imposed on flows to Australia. All of these have second-round effects on revenue gathered by the payment of corporate taxes in Australia.

As we have previously explained, there is no internationally accepted methodology for analysing these benefits. We have put together a framework which is in the NIA. It attempts to quantify the benefits which flow as a result of the treaty and analyse the forms those benefits take. What we believe that we have shown in the NIA is that, despite the cost of the UK treaty, its entering into force will provide a long-lasting positive economic benefit to Australia.

Given those introductory remarks, I would now like to focus on some of the particular elements of the treaty actions. The proposed UK treaty was signed in Canberra on 21 August 2003 by the Treasurer for Australia. If we look at its context, the treaty will enhance the economic relations between Australia and the UK. Australia’s investment and trade relationship with the UK is the largest Australia has with any European country. Overall, Australia and the UK have a very significant economic relationship. The UK is Australia’s second largest source of inwards foreign investment, the second largest destination for outwards Australian investment, our third largest trading partner and our sixth largest merchandise trading partner. This treaty therefore represents a significant step in facilitating a competitive and modern tax treaty network for Australian companies.

The proposed new treaty achieves a balance of outcomes that will provide Australia with a competitive tax framework for international trade and investment while ensuring the Australian revenue base is sustainable and suitably protected. It ensures that Australia can effectively apply its taxing rights in respect of Australian sourced business profits, the exploitation of its natural

resources and the sale of significant Australian assets. The integrity of the tax system will be enhanced and government revenues will be protected through the strengthened framework for the exchange of information between the revenue authorities in the respective countries and the mechanism for settling interjurisdictional disputes.

The new treaty will substantially reduce withholding tax on certain dividend, interest and royalty payments in line with the outcomes achieved in the recent amending protocol with the United States treaty. This will provide long-term benefits for business, making it cheaper for Australian based businesses to obtain intellectual property, equity and finance for expansion. It will also remove obstacles currently inhibiting Australian corporate expansion offshore.

The mechanisms and broad magnitudes of these effects are set out in the national interest analysis, taking account of the incidence and likely second-round effects of these taxes, as explained in my introductory comments. It is also important that this treaty is viewed in the context of Australia's treaty network and what is occurring in treaties with our key investment partners. The recent entry into force of the Australia and United States amending protocol has triggered an obligation upon Australia to enter into discussions with eight, mostly European, countries to provide a similar outcome to that given to the United States.

The UK, as our second largest trade and investment partner, understandably sought a deal that would place them on an equal footing with both the United States and Europe. In negotiating this treaty, Australia achieved a treaty with our second most important investment partner that was as internationally competitive as possible and that ensures that Australia continues to be an attractive destination for foreign investment. The treaty also ensures that Australian companies investing offshore do so, to the greatest extent possible, on an equal footing with other international investors.

It is also worth noting that, although withholding taxes in the proposed treaty are significantly lower than in the existing treaty with the UK, when compared with other European Union countries which are moving to a zero withholding tax position, our rates on withholding taxes are still relatively high, viewed in that international context. What the government has achieved with both the US and UK treaties is a policy position that reduces costs on inputs and encourages direct investment while at the same time exercising an appropriate level of source country taxation. This is consistent with Australia's position as a net capital importing country.

As stated, the key purpose of this treaty is to facilitate trade and investment between our two nations. However, it also contains a number of measures that are intended to protect or extend our right to tax. In particular, the proposed treaty contains comprehensive provisions that will protect Australia's right to impose capital gains tax, including the provision that would allow the source country to tax capital gains not otherwise dealt with in the treaty. The context here is that the existing UK treaty was signed before the passage of the Australian capital gains tax framework and was brought in silent on the approach to be taken to capital gains.

In summary, the proposed treaty package will produce a positive economic benefit for Australia. Gains include a large and faster growing Australian economy, with flow-on effects to employment, trade and investment and a more outwards focus for Australian business. The withholding tax cost to revenue of the proposed treaty is expected to be more than offset by a consequential increase in future corporate taxes and GDP boosted gains to revenue.

CHAIR—We will now consider in tandem the Agreement between the Government of Australia and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and protocol done at Mexico City on 9 September 2002.

Mr Parker—I now pass to the Mexican treaty. The proposed Mexican treaty was signed in Mexico City on 9 September 2002. It is a new, comprehensive taxation convention that contains provisions for avoidance of double taxation and the prevention of fiscal evasion in relation to income flowing between Australia and Mexico. Australia's trade and investment relationship with Mexico is the largest that Australia has with any Latin American country. While Mexico does not figure among Australia's top 10 international trade relationships, the size of the Mexican economy, which is the ninth largest in the world, and its growth performance—it has been growing by around four per cent per annum since the mid-1990s—underline the potential importance of the economic relationship.

Broadly speaking, measures in the proposed treaty will provide the following benefits. The integrity of the tax system will be enhanced and government revenues will be protected through clarification of the right of jurisdictions to tax under the proposed treaty. It will protect Australia's rights to tax profits, income and gains earned by Mexican residents who undertake activities in Australia by giving priority to source tax rights where shared rights are allocated. The proposed treaty locks in withholding tax rates on certain dividend, interest and royalty payments. This will provide long-term benefits for business and remove obstacles currently inhibiting Australian corporate expansion into Mexico, in particular, long-term certainty on the tax treatment of their investments. Finally, it will add to Australia's existing tax treaty network, expanding the international economic framework within which many of Australia's international trade and investment activities occur. It also completes Australia's tax treaty network with the North American Free Trade Area countries.

The direct cost to revenue from implementing the proposed treaty's withholding tax provisions—that is, compared with withholding tax rates which would apply in the absence of a treaty—is estimated to be approximately $2 million per annum. However, this is likely to be offset by a reduction in Australian tax credit claims for Mexican taxation flowing from the reduction in Mexican withholding tax on flows of income back to Australia.

The proposed treaty also provides, for the first time, a framework for the exchange of information between the revenue authorities of the respective countries and the establishment of a mechanism for settling jurisdictional disputes. The two tax administrations can also use the so-called mutual agreement procedure to develop a common interpretation and resolve differences in the application of the proposed treaty. This framework will enable the tax authorities of both countries to cooperate in dealing with fiscal evasion.

I will now make some very brief concluding comments. In summary, while the proposed UK treaty is expected to have a significant cost in terms of reduced withholding tax receipts, this is expected to be more than offset by future tax revenues flowing from a larger, faster growing and more dynamic Australian economy. The proposed Mexican treaty will have only a very small impact on the forward estimates that is likely to be much more than offset by gains to tax revenues from the improved profitability of Australian companies with operations in Mexico.

CHAIR—Thank you, Mr Parker. I suggest that we ask questions on a more general basis about the two agreements and then go to the individual agreements if that suits the committee. You were talking about the network of countries with which we have these agreements. How many are there in the network now, including these two—Mexico and the UK?

Mr Parker—There are about 40.

CHAIR—Are there others in the pipeline that we want to see in the network with whom agreements have not yet been concluded?

Mr Parker—There are a number which are going to be renegotiated going forward—the government has made a decision about the renegotiation of treaties with our key investment partners as part of the review of international tax arrangements—or where negotiations are to be completed and which are going to commence under that framework. There is also the possibility of extending so-called exchange of information agreements with a number of countries which have been classified as tax havens. This is an international exercise coming out of a program which is being run by the OECD which is looking to put together a network of international treaties to deal with the problem of tax havens.

CHAIR—We will come back to the OECD network on tax havens, but on this network of double tax agreements—there are about 40—what are the criteria we adopt in determining which countries we will conclude a double taxation agreement with?

Mr Parker—I can attack that at a broad level, and then I might pass over to some of my colleagues so they can deal with some of the specifics. At a broad level, we look at our major trading partners—those which are significant players in the international economic environment and where Australia has significant investments in them or they have significant investments in Australia. It is broadly looking at the degree of economic integration between Australia and the foreign country. There are also a number of treaties at a lower level dealing with airline profits and exchange of information arrangements as well. That is a broad explanation.

CHAIR—So those that have double tax agreement status are the 40 in the network that you mentioned?

Mr Parker—Yes.

CHAIR—Are there any obvious candidates outside that network of 40, currently? The United Kingdom would be an obvious one, and we have only just got this agreement before us. Are there any others?

Mr Parker—We have had a treaty with the UK for a long time; this is a revision. We have just done the Mexico one.

CHAIR—Perhaps I should refine the question. How many should be in the network and have never been and how many are we updating the agreements with to reflect the protocol or the standard that is currently before us?

Mrs Pickering—Most of our future program is focused on revising and renegotiating the existing network, because they are our key investment partners. We are also looking to expand our network a little bit—for example, further into South America, where we have major interests, and possibly into some of the other emerging economies in Europe, such as Turkey, which is another one that is on the program.

CHAIR—Are we driving this or is it coming from the other countries or is it a mutual pursuit?

Mrs Pickering—It is a bit of all of those. Obviously, we are trying to limit our program as much as possible to the ones that are most important to Australia, but at the same time we are also getting pressure from other countries to negotiate with us.

CHAIR—Mr Parker, you were talking about the difficulties in a methodology to ascertain the cost, and this committee has heard a great deal about that issue in the past—about a methodology for quantifying the benefits and the costs and the like. Does the ATO monitor the effect of these treaties at regular intervals or at all to ascertain whether there is some sort of net benefit at the end of the day? For example, we signed off on the US protocol some 12 months ago—is there an analysis done in retrospect to see how these treaties are panning out and whether they are meeting expectations or not? Is there a net benefit analysis?

Mr Parker—The ATO's focus on this comes from their perspective as tax administrators rather than broader policy analysis. If you ask them what their perspective on tax treaties is they will tell you that this one is an essential part of their administration of the tax affairs of Australian residents who are active in international trade and investment—that is, broadly, companies which have activities in both Australia and the UK—and that it is also an essential part of their administration of the tax affairs of foreign investors into Australia.

These tax treaties provide a framework for the tax administrations in the respective countries to cooperate. They provide for an exchange of information so that the Australian Taxation Office is able to get information from foreign tax administrations which helps them to build up the complete picture of non-residents' investment into Australia.

There is also a range of automatic exchange of information where a number of foreign tax jurisdictions provide the Australian Tax Office with bulk downloads of data on interest and dividend flows, for example. There is also the potential for them to cooperate as between the ATO and a foreign jurisdiction to undertake a simultaneous audit of a large taxpayer that is operative in both countries. If you were to ask the business community their perspective on tax treaties and we have done that in our consultations with the Business Council of Australia—

CHAIR—I appreciate that there were consultations at the time of the Ralph report, but have you or anybody gone back to business, say, post the US protocol, and done a survey on the benefits that they see?

Mr Parker—Yes, we have. We have gone back to them and asked them their perspective on tax treaties and where they would like to see them heading. It is important to note that, if we are looking at the US treaty, in particular, which only came into effect on 1 July of this year—

CHAIR—I am just using that as an example.

Mr Parker—there is no such data about.

Mr WILKIE—We have got 40 of these joint tax agreements.

CHAIR—Here is another one.

Mr WILKIE—How long have we had them in place?

Mr Parker—I can talk in general about the overall framework. The tax treaty framework goes back decades. It has been gradually built up. There are approximately 200 countries in the world. The overall framework for tax treaties is just a fact of life that it has to be a bilateral treaty network—so we do a treaty with the US, the UK and so forth. There is no mechanism to have multilateral arrangements. This is because countries have very different tax arrangements and it is a matter of knitting them together, which means it is inherently bilateral. It is inefficient, but that is a fact of life. Ultimately, over the very long term, we can expect the number of tax treaties to rise commensurately.

Mr WILKIE—We are talking specifically here about double taxation agreements.

Mr Parker—That is right.

Mr WILKIE—If we have double taxation agreements with 40 countries, how long have we had those agreements in place?

Mrs Pickering—About 40 years. No, longer than that—at least half a century.

Mr WILKIE—I find it difficult then to believe that, if we have had these things in place for half a century, no-one has gone back to look at them to determine whether there is actually a net benefit as opposed to an expectation of a net benefit.

Mr Parker—I was going to mention that we have an ongoing dialogue with the Business Council of Australia on tax treaties. It would not surprise you to know that they are very strongly supportive of the tax treaty network.

Mr WILKIE—I am sure they would be if they are paying less tax. But I am talking about the benefit or loss to Australia, not just business.

Mr Parker—It is not just a question of paying less tax. The tax treaties put together tax systems in different countries into a patchwork. Those tax systems would otherwise be incompatible in a variety of ways. It could lead to double taxation where two countries are taxing the same income, which is obviously going to have a dampening effect on international trade and investment. In other cases, it can lead to non-taxation of income or of transactions. Putting them together means that ideally there is one layer of tax applied as between the different countries who sort out their different claims to tax on source and resident basis.

Mr WILKIE—We appreciate the process and understand where you are coming from there. What I am talking about is an assessment of any net gain or loss to Australia from having these agreements. Do we have an assessment process in place?

Mr Parker—As I said in my opening comments, we can say that there are a number of benefits, which we can take as being self-evident; but actually quantifying the effect of those is extremely difficult. We would have to essentially work out by one means or another what would be the economic relationship in the absence of the treaty. We would have to construct an alternative reality—in the economic jargon: 'What is the counterfactual?' It is simply not an observable thing. We cannot look at two different states and simply divine the difference between them.

CHAIR—We do it all the time.

Senator MARSHALL—You said that the costs to Australia would be offset against our economic growth and the continued profitability of our companies. You cannot say that the costs are going to be offset by something but be unable to quantify what those offsets will be or be able to measure them or look back to see whether the costs are in fact offset. You cannot claim that something is going to be offset and then not come to the table with some evidence that there has been offsetting.

Mr Parker—We will come to the table—

Mr ADAMS—You justify it by saying it is more than offset by the profitability of the Australian companies and their growth.

CHAIR—There must be a historical perspective that we can look at as well.

Mr ADAMS—If you are going to say that, where is your source and how do you back it up?

Mr Parker—You have asked for this kind of information before. We will have a document to table for the committee which attempts the exercise in the case of the UK. It looks at what might be the results in the absence of the UK treaty. But I cannot say the outcome is a benefit of X dollars. It is just not an economically feasible question to ask. There is no way that we can get the information that will be needed to construct the model to do that in a feasible way.

CHAIR—Can a model be done? Okay, that is talking about projections forward, but we have had some sort of agreement with the UK for some time and this is a revision of it.

Mr ADAMS—Two hundred years.

CHAIR—Yes, about that. Historically then, is there not some modelling that can be done taking into account trends in the relationship and how it has progressed in the past in terms of the different factors that one could look at historically and then translate it into some sort of forward projection and say, 'This is what's likely to happen,' and then when you get down the track say, 'This is what did happen.' I assume economists do that all the time.

Mr Parker—We can do that. The paper that we will put before you on the past effects of the UK treaty does that. But the key point here is that it is not just the tax treaty which affects the relationship between the UK and Australia. There are a myriad of other factors.

CHAIR—Absolutely, and the variables would be taken into account.

Mr Parker—There is a problem of measuring those variables.

Senator MARSHALL—I am interested in which ones mean success or failure. How do we actually judge that at the end of the day? Is it a little bit of this measure and a little bit of that one? What about if we get all of that one but none of this one? How do you put a model together to measure that so that we can say that this is in the overall benefit?

Mr Parker—At the very broadest level, if you tax something you tend to depress the level of activity. What tax treaties do, by removing double taxation, is reduce the level of tax on international trade and investment as between countries and, therefore, you would expect there to be more of it. That is the counterfactual that you would get by looking into the past. That is what this paper does, but it does not go to the next step and say, 'In the absence of the treaty, we would expect the reduction in UK investment into Australia to be X dollars.' We just do not think that that is a feasible economic problem to solve.

CHAIR—You were talking about a paper that specifically arises from the UK treaty but addresses the sorts of methodology issues that we have raised in the past. Is that right?

Mr Parker—There are two bits of paper before you. One is the NIA—the national interest analysis—which begins to unpick the effect of the changes in the withholding taxes in the proposed UK treaty and comes up with some numbers, some estimates based on some economic modelling done by Mr Partington and others. The second piece of paper, which we are going to give you today, looks backwards and talks about what might have been the likely effects of not having a treaty. That is the counterfactual. But it does not go to the point of unpicking the degree of the relationship between Australia and the UK; it does not say, 'This much is due to history, our colonial roots with them, and this much is due to tax.' It is just not a feasible question to answer.

CHAIR—I understand that. When do you propose giving it to the committee?

Mr Parker—We can give it to you today.

CHAIR—After the hearing?

Mr Parker—We can table that now.

CHAIR—It is not the impact statement—it is another document?

Mr McBride—When we last met, in report 52 you asked that when we amend an existing treaty you would like an assessment of the costs and benefits of the treaty pre-amendment, and that is what we have done. That is what we have brought with us today.

CHAIR—In relation to the United Kingdom?

Mr McBride—Yes. The Mexican treaty is a new treaty, so we are not amending anything.

CHAIR—If you would be happy to table that, we would be happy to receive it. I am not sure that everybody is going to have an opportunity to read it and then ask questions on it but we can certainly try to absorb as much as we can. Legislation will be introduced to implement these agreements. When is it proposed to be introduced?

Mr Parker—It is supposed to be introduced on Thursday, 11 September.

CHAIR—Hence you will table the treaty on Tuesday, which is why we are having a hearing today. Could you explain how the double taxation agreements with the UK and Mexico prevent international tax evasion? Perhaps that will be a nice segue into Mr Adams's questions about this separate network on tax havens.

Mr Parker—Broadly speaking, the treaties set up a legal tax framework to deal with international transactions between the two countries. Tax administration is all about getting hold of information. In the case of trade between Australia and the UK and Australia and Mexico, only part of the information set that is relevant and which the Australian authorities can directly get access to under various administration acts exists in Australia. The tax treaties set up a framework for cooperation between the Australian Taxation Office and the relevant administration authorities in the UK and Mexico. They permit cooperation between those authorities. They provide a framework by which information can be provided on request, or automatically between the authorities.

For example, the Australian Tax Office is looking at the tax affairs of a multinational company trading both in Australia and the UK. It can make a request to the revenue authorities in the UK to provide information that they may be able to get access to in the UK, which bears on the investment position and on income flows. In the absence of being able to get hold of that information, it was much harder for them to administer the tax arrangements. So it is simply a question of information.

Mr ADAMS—You said there were several countries now working on it and I think the OECD has a series of treaties to deal with tax havens. Can you expand on that?

Mr Parker—The OECD has a number of programs running here. This goes back to the year 2000, when OECD ministers met and approved a report which was put together by the so-called Committee on Fiscal Affairs, dealing with the issue of harmful tax competition. Since then the Committee on Fiscal Affairs, on which Australia is represented, have been working on taking forward that work agenda. There are broadly two streams in the harmful tax competition project.

Mr ADAMS—Harmful tax competition?

Mr Parker—Yes. One is to look at what we call preferential tax regimes in OECD countries. These are special regimes designed to attract business from another country. The element of that work has been designed to modify or limit the harm from those regimes. Later this year a report

will be published by the OECD—the 2003 annual report—which deals with all of the preferential regimes identified in OECD countries. So that is the first stream.

Mr ADAMS—There will be a report later in the year from the OECD.

Mr Parker—Yes. The second stream of work is to deal with tax havens. Tax havens offer a place where nonresidents can establish business arrangements which act as a conduit of income—a place to hold their investments where the income will flow out of a country, through the tax haven to wherever. The problem with a tax haven comes at several levels: firstly, they have a very low rate of tax; and, secondly, they are effectively trading in secrecy. It is impossible for the revenue authorities in countries that are not tax havens to get access to the information and enforce the tax arrangement, so it becomes a black hole. The OECD harmful tax practices stream, so far as havens are concerned, is directed at setting up a network of exchange of information treaties with those countries.

The program has been running for a number of years. Again, in the 2003 annual report, which we hope will be published later in the year, it will specify where this program has got to. From memory there are 42 jurisdictions—don't hold me precisely to that number—identified in earlier annual reports as being tax havens. Most of these jurisdictions are now called participating jurisdictions, because they have given a commitment to enter into exchange of information treaties with the OECD countries.

That program has largely been driven by the agreement amongst the OECD countries that, ultimately in the absence of information exchange agreements with these jurisdictions, jointly the OECD countries would enter into what are called coordinated defensive measures, which is the passage of law that will make it much more difficult for residents in these countries to deal with the tax havens. So that is the stick; the carrot is: enter into a treaty, and then we will not legislate in that way to make it difficult.

Mr ADAMS—There were issues about money being held in places like Switzerland—the Swiss banks—and certain agreements have been reached there, I understand. Is that right?

Mr Parker—That is right. Another stream of work going on within the OECD addresses bank secrecy of this sort. This is an area where there is not complete agreement amongst the countries of the OECD and it is an issue which is continuing to be worked upon. A number of countries in the OECD have various levels of bank secrecy arrangements—you have mentioned Switzerland—and this is another area of ongoing work where countries wish to be able to get access to information within those countries. Most of these countries permit the exchange of information where there are so-called criminal tax matters—serious frauds, tax evasion and are the like. It is possible to get access—or at least conceptually possible—in these cases. The program on bank secrecy is attempting to pare back the level at which one can get access to this information from banks.

Mr ADAMS—There are two levels on the tax havens and harmful tax practices. I think some small countries have used taxation as an advantage for their economy. I can appreciate their position over and above tax havens where people are not paying their taxes.

I would like to come back to the broader issue of double taxation, the globalisation of capital and the ability of sovereign states to gain their tax from those corporations. Double taxation sets up lines of communication with other countries in which one's capital is invested. How is the world looking at that from a treaty point of view? You say this is bilateral. Where are the conferences looking at corporations paying their taxes?

Mr Parker—I mentioned in response to an earlier question that we are inherently in a bilateral world rather than in a multilateral tax world, given the different tax arrangements which apply in different countries and the need to knit them together. Although it is inherently bilateral, that does not necessarily mean that the administration of tax arrangements is inherently bilateral. There is the potential under the network of treaties for tax administrations in any number of countries who are within a treaty network to cooperate and undertake what you might call a simultaneous audit of a company in a range of countries. That potential certainly exists.

Mr ADAMS—What will the UN and Northern Ireland double taxation agreement cost the budget of the Australian government?

Mr Parker—In the NIA the cost is mentioned over the three forward estimate years as being $100 million per annum, in effect.

Mr ADAMS—It is $100 million per year for the three coming years?

Mr Parker—That is right.

Mr ADAMS—And what is it for the fourth year?

Mr McBride—It will be $90 million for 2004-05 and 2005-06 and then it will be $100 million progressively.

Senator TCHEN—Earlier, the committee asked you a number of questions regarding the benefits to Australia. My understanding of your answers is that the recognition of benefits is essentially intuitive because they are very difficult to quantify. I am prepared to accept that intuitive benefit, although I note that often matters which are counterintuitive are important. In the NIA—and I presume you mean that the treaty will be beneficial to Australia—in paragraph 31 you said that the Australian DWT changes are expected to improve the flow of FDI from the United Kingdom to Australia. That is the intuitive benefit. The assumption here is that the increased flow of FDI is beneficial to the Australian economy. Has anyone looked at whether that benefit is an indefinite benefit, or a diminishing return benefit?

You also said the amount of increase in FDI is very difficult to predict but it could be significant because international flows of FDI are thought to be highly sensitive to a country's tax rate. In other words, if a country changes the tax rate it will encourage FD, but changing a tax rate reduces revenue. That is intuitive, too. The question is always whether the increased benefit of FDI matches the decrease in revenue.

I assume that the double tax agreement with the UK is net beneficial to Australia. Today we are also being asked to consider the double tax agreement with Mexico. Mexico is a developing country. It will be in even greater need of FDI than Australia. If we have a double tax agreement

with Mexico, the benefit of the flow-on to Mexico must be of a similar nature to what we expect the benefit of this double tax agreement with the United Kingdom to be. Isn't that so? In fact, in your NIA for Mexico you described how it will benefit Australian companies investing in Mexico. Would that treaty then, by the same token, produce net disbenefit to Australia?

Mr Parker—There are a number of questions embedded in what you have said. In terms of the way that we think about this and the intuitive level of benefits which you mentioned at the outset, in my answers to the earlier questions about the benefits of treaties I took them to be questions about the benefits of the treaty network writ large—the whole picture. In these paragraphs of the NIA we look at the benefits which accrue as a result of a very specific tax change. Paragraph 31 and the footnote mention the effect of changes in dividend withholding tax. I am happy to run you through that if you would like.

Essentially, we have looked at the aggregate effect on tax of the reduction in dividend withholding taxation. We then looked at the overall sensitivity of foreign investment flows to tax rates and came up with an estimate, which is in the footnote, of an increased inflow of FDI into Australia as a result of that. It is a number estimated by Mr Partington given the information that it was possible to garner there. To calculate that number you work out the effect of tax on the back of an envelope, set up a little model, crank the handle and the number pops out.

It is possible, as we have done in the NIA, to begin to build up a picture of particular tax changes. You asked me if there are diminishing returns from the flow of investment. This gets into an unsettled area of economics where there is a debate that has been going on for a decade or so about what drives growth in the economy. I do not propose to get into that; it is highly technical. But it does precisely go to the question you asked about whether there are diminishing returns. The traditional economic model says that there are diminishing returns to capital in an economy. That is, in one sense, an intuitively attractive proposition—the more capital you throw at it, the more capital you eventually have, and the return tends to decline. As I said, there is a debate going on about that and there has been for some time. Most macroeconomic models run by research institutions around the world have it embedded in their basic assumptions that there are diminishing returns to capital investment.

The next question which you asked was: if we say it is of benefit to Australia to have foreign investment flowing in from the UK, does that necessarily imply that there is a disbenefit from having additional Australian investment offshore, going to Mexico? It does not necessarily follow—

Senator TCHEN—I am sorry, Mr Parker, but, as I indicated earlier, I have to leave. I am sure the committee will be happy to hear the rest of your comments.

CHAIR—Yes, please continue Mr Parker. We will cope without Senator Tchen.

Senator TCHEN—Mr Parker, I am happy to accept your earlier comment in terms of general double tax treaties or international treaty arrangements, but, in terms of these specific cases—and these NIAs are looking at specific cases—can I suggest that, even if you only have back-of-the-envelope type models, the committee might benefit from some indication from you as to how the back-of-the envelope model works because at the moment we just have a bare statement that it works. You also said that there could potentially be diminishing returns in FDI, and that is

recognised in various complicated theorems. Again, the committee probably does not require you to explain the theory in full, but could you at least put it in and say, 'Yes, there are other possible drawbacks.' How do we handle it when we reach that point of diminishing return? I think the committee would be interested to hear those comments.

CHAIR—Thank you, Senator. Did you want to respond to those comments in any way, Mr Parker?

Mr Parker—Yes, I wanted to pick up on the question of whether outwards investment from Australia implies a disbenefit to Australia. We have said in the NIA for Mexico that we expect the new framework to enhance Australian investment in Mexico. It does not follow directly that investment outwards is a bad thing. Certainly that means that Australia does not have the physical capital in place of an Australian investing that it might otherwise have because that investor is investing in Mexico, but an Australian will invest in Mexico as opposed to investing in Australia if they believe that the return on the investment in Mexico is higher than it is in Australia. They will allocate their global capital in such a way that the rate of return that they are expecting to get is higher. So to the extent that that income flows back to Australia, the benefits of that higher rate of return on capital will flow back to Australia.

In terms of Senator Tchen's final questions, I am not sure how much I can add without talking for a rather long time about some of the underlying macroeconomics here. My response to the final point that he mentioned—which was the question: how do we handle it when we get to the point of diminishing returns on investment?—is that that is not really a question for governments. We are talking here about, largely, rational investors. When they get to a position where they believe that the return has diminished to a point where is not worth them investing, they will not; they will invest somewhere else.

Mr KING—I want to ask you a bit about background. You indicated in one of the reports that the interesting increase in UK inbound investment in Australia might be a result of the reformed tax system in Australia, perhaps portfolio decisions and perhaps differing priorities in world investment arrangements. One of the things that interests me is the history of UK investment in Australia. I was wondering whether you are able to give us more specific guidance on that. Do you have a view as to whether any of those factors are prioritised or are they equally important? You do not need to give a long answer on this, just a yes or no, or whatever you think will suffice.

Mr Parker—The fact that there has been a tax treaty between the UK and Australia is a very significant matter.

Mr KING—So you are saying that the tax treaty background has really been quite important to that increased investment?

Mr Parker—Yes.

Mr KING—When was the tax treaty first made?

Mr Parker—I think it was made in 1946.

Mr KING—It has increased six per cent in the last few years; what is the reason for that?

Mr Parker—Over that very long period it is undoubtedly the case that the fact that a tax treaty exists between the UK and Australia was a significant factor underpinning those flows of investment.

Mr KING—Maybe; but there are a lot of wealthy individuals and businesses in the United Kingdom who have invested for a long time in Australia. I am wondering whether you see that as important or whether you see the regime that you have just referred to or our reformed tax environment as being the critical decision behind the recent changes—the recent increase.

Mr Parker—I think that they are all important. But saying, 'Is it the changed security environment in the world? Is it the changed tax arrangements in Australia? Is it the fact that the UK economy has been performing very well for the last five years or so? Is it some other factor? Is it the fact that the European economies have not been performing very well vis-a-vis Australia, so that Australia becomes a very attractive place of investment?'—unpicking all of those is a difficult thing to do. There will be joint effects there. The facts that Australia has been performing very well economically, that employment growth has been very strong, that inflation has been low and that we have a stable political environment are all relevant.

Mr KING—Is there any indication as to where the flow of investment is going? Is it property? Is it resources? Is it shares? Where is it going?

Mr Parker—I do not have that information in front of me. We could attempt to find out.

Mr KING—How about the other way around: what is the flow of Australian outbound investment into the UK? What is the movement there?

Mr Parker—I will have to take that on notice. We will attempt to give you information on that side of things.

Mr KING—There is no need to worry about that.

Ms Adamson—I would be able to give a figure on outward investment, but I would not be able to describe exactly where that investment was going.

Mr KING—There is a lot of Australian investment in the UK at the moment—in shopping centres and all sorts of things.

Ms Adamson—The level of Australian investment in the UK was worth $71 billion or 15.5 per cent of our total overseas investment. This is at 30 June 2002.

Mr KING—So it is very significant.

Ms Adamson—It is very significant.

Mr KING—What is it as a percentage of UK inbound investment? Do you know?

Ms Adamson—That I cannot give you, I am afraid, from the information I have in front of me, but we would certainly be able to provide you with that figure.

Mr Parker—The UK is the second-largest; the US is first and the UK is second.

Mr KING—So, if the UK is 26 per cent, what is the US?

Mr Parker—We could work that out for you.

Mr Partington—It is around 30 per cent, but we would have to check that figure.

Mr KING—So those two countries make up more than half of the inbound investment into Australia?

Mr Parker—Yes.

Mr KING—But you are not able to tell us where the investment from the UK is going in Australia—into what sectors of the economy.

Mr Parker—I do not have that information in front of me, but we will endeavour to find out what information is available.

Mr KING—There is no need to worry about that. Thank you very much; your report is comprehensive.

ACTING CHAIR (Mr Wilkie)—The current treaty came into force in 1967. Obviously, this new agreement was signed again on 21 August. Why is the legislation being brought forward this week? What is the urgency?

Mr Parker—The treaty text contains a number of start dates for the coming into effect of the reduction in dividend withholding tax, for the new regime as it applies to fringe benefits tax and the like. We can give you the precise details of those start dates if you like.

ACTING CHAIR—Are they this year or next year?

Mr Parker—They are progressive.

Mrs Pickering—If we get the treaty into force by 31 March next year then they will come into effect for UK taxes from 6 April, for fringe benefits tax from 1 April and for Australian other taxes from 1 July. So there are different dates for the different kinds of taxes.

Mr McBride—It is explained in article 29 of the text, which is part of the NIA.

ACTING CHAIR—Basically my question relates to the urgency of bringing forward the legislation this week, given that this committee would normally report—probably at the earliest—on 3 November and part of the treaty making process which the government has introduced is that we would review and report prior to implementing legislation being introduced

into the House. Why has this legislation been introduced this week, a month and a half before we even get to report? To me, it is a flouting of the treaty making process. This is what I am trying to get to the bottom of: is the government flouting its own process or is the department wanting to bring forward the legislation itself?

Mr McBride—I think both countries were keen for this treaty to enter into effect.

ACTING CHAIR—Yes, but we have a process in this country of dealing with treaties whereby the treaty process comes before our committee to make recommendations to government prior to them supposedly introducing legislation. What we are getting in this committee on a regular basis is legislation being introduced into parliament before we have even had a chance to report on the actual treaty itself or the legislation. I am trying to find out why this legislation is being introduced in this case prior to us having an opportunity to report. Given that the timeline starts on 31 March, I would have thought there are enough sitting days between now and then to get this legislation through the parliament and the treaty ratified.

Mr McBride—For a treaty to take effect business needs some time to adjust its systems. It cannot enter into force one day and take effect the next, or business will not be in a position—

ACTING CHAIR—But they know what is the text of the legislation. They know that the treaty is going through. Why does the legislation have to be passed now prior to the reporting of this committee?

Mr Parker—No, the legislation does not have to be passed prior to the reporting—

ACTING CHAIR—But it is being introduced before we have been able to make recommendations regarding it.

Mr Parker—And it can sit on the table until you make your report.

ACTING CHAIR—Yes, but I still think it is a flouting of the process. What is the urgency of bringing it forward this week?

Mr Parker—There are a number of requirements in terms of legislation being introduced, as you know; we are not telling you anything there. Originally it was intended that some of these treaties with the UK would enter into force earlier than the final text. But in the negotiation that was put back, recognising the need for passage of the legislation through the Australian parliament. So it is being introduced. It can sit on the table. As long as it is passed by 31 March next year, the treaty will enter into force according to its principles, to its draft. If it is passed after that then it defaults—

Mrs Pickering—It actually has to be passed way before 31 March because there are other processes that need to happen before it can actually enter into force. It has to enter into force by 31 March.

Mr McBride—We need to give business the opportunity to prepare for the changes that come with the treaty. So the time frames are actually quite tight. We recognise the committee's concerns. A lot of what we have done since signature has been to try to cater to the committee as

soon as possible. We have given you the NIA prior to it being tabled and we have turned up here a week later. Introduction of legislation was actually put back a little to accommodate also. So we think we have done as much as we can to accommodate the committee's concerns, mindful of the fact that both we and the UK are committed to bringing the treaty into effect as soon as possible.

ACTING CHAIR—Do you believe the legislation is controversial?

Mr McBride—Time will tell.

ACTING CHAIR—Too true. I have one question on the national interest analysis. I see that we have a number of reasons for Australia to take the proposed treaty action, which is fine. Apart from the $100 million that we are going to lose, are there any other considerations that we should look at in terms of negatives?

Mr Parker—I don't think so. The NIA stands on its own four feet, I think.

Mr ADAMS—These days we often set goals and benchmarks on the way, just to see that these double taxation treaties are working in our favour, that we are achieving something by giving up $100 million from our budget process. Where is the process of checking this—achievement of goals or whatever?

Mr Parker—The treaty includes a mutual commitment between Australia and the UK to review the operation of the treaty every five years.

Mr ADAMS—That is hardly rigorous though, is it?

Mr Parker—A number of considerations bear on that. The fact is that, as we have talked about, it is difficult to look at—

Mr ADAMS—If they don't work, we can just say, 'This caused it.' We have given away this amount of money to the corporate sector but if it doesn't work, we have got all these reasons to say why it has not worked. A dilemma for me as a member of this committee is that there are no mechanisms here to measure, to assess, to say whether this is in the public interest at all.

Mrs Pickering—If it is any comfort to the committee, there are globally over 1,500 double tax agreements in effect. Some countries resisted the idea of getting into double tax agreements. A few of them have now decided that it is actually in their interests to go into double tax agreements, because they were finding that they were not getting the investment that they were hoping to get. As part of a bigger picture there is a generally recognised benefit for treaties, albeit no countries that we are aware of have been able to actually put dollar figures onto what those benefits are.

Mr ADAMS—How much is it costing the UK budget by having double taxation with us? We wouldn't know that, would we?

Mrs Pickering—We do not have those figures.

Mr ADAMS—So we do not know if this is a plus for us, again. It is another dilemma.

Mrs Pickering—The hope of treaties is that they are win-win for both countries, not that one wins at the expense of the other. For that reason we do have treaties between developing countries and developed countries. Developing countries have as many, if not more, treaties than developed countries have. There are seen as being benefits for both countries.

Mr ADAMS—I am well aware of that.

Mr CIOBO—In paragraph 21 of the NIA you say that any investment effects the proposed Mexico treaty will produce will be small but nonetheless positive. Is there a particular core that you are referring to when you say that they will be positive? Is there is a relative tax advantage that is given rise to? What is driving that?

Mr Parker—There are a number of reductions in withholding tax that are put in place by the treaty. In the absence of a treaty, the default withholding tax arrangements apply, which are very significant in many cases. We are talking about a 30 per cent withholding tax on a variety of dividend flows. It is important to recognise here that these withholding taxes apply to gross income. It is a flow from one country to another. Taxed at 30 per cent, it is more than likely that that tax is higher than the actual net profit that is accrued to the resident in another country. In those circumstances, the withholding tax arrangements are a very significant dampener on investment, obviously. Bringing them back to lower levels, as is done in both the Mexican and UK treaties, in a sense opens the door for investment to take place. Withholding taxes are still there in some parts, so the door is not completely open. But the benefits that we would expect to flow as a result include Australian investment into Mexico.

Mexico is a rapidly growing economy. It is next door to the United States, the largest economy in the world. The two-way trade flows between Mexico and the United States are very significant indeed. So to the extent that Australian companies want to, say, export into the United States or into Mexico or Canada or other parts of Latin America, in certain circumstances it will be attractive for them to invest into Mexico.

Mr CIOBO—With respect to the disparity in terms of investment, I think I saw reference to a figure of $200 million invested from Australia into Mexico, with virtually no investment by Mexico into Australia. Those benefits would principally be deriving to Australians looking at expanding into Mexico—is that correct?

Mr Parker—That is right.

Mr CIOBO—In talking about the benefits that flow to Australia as a result of this, would it be reasonable for people to harbour concerns that, because of the relative benefits that may flow and because of the potential opportunities that exist, we may see increased investment in Mexico at the expense of investment locally?

Mr Parker—Just to prepare the context for that, I might ask Ariane Pickering to give you some additional information on the changes in withholding tax that will flow as a result of the treaty.

Mrs Pickering—Mexico actually has some quite high withholding tax rates, which would operate as a significant blocker. For example, some of their withholding tax rates on interest are as high as 32 per cent; on royalties they are as high as 32 per cent or 25 percent.

Mr CIOBO—Are all of those on gross amounts?

Mrs Pickering—Those are all on gross amounts. So, by bringing them down to the 10 per cent level, for example, it is a much more reasonable cut on those. But it also means that, to the extent that the income is not taxed in Mexico, because of the reduced withholding tax rates, we actually pick up that tax back in Australia, because the Australian residents will be taxed on their worldwide basis rather than having the reduction of withholding taxes operating as some exemption for those companies. So to some extent it effectively works as a transfer of revenue to Australia, because we will be picking up the difference between the gross taxation—the withholding tax rate—and the marginal taxation.

Mr CIOBO—Are you saying then that the actual net impact on Australia is neutral?

Mrs Pickering—It should in fact be positive in that case.

Mr CIOBO—Positive in that regard?

Mrs Pickering—Yes, and it should not operate as a conduit for people investing in Mexico rather than Australia, because they will still be taxed on their worldwide income. So the net result should be the same for the person whether they invest in Australia or in Mexico.

Mr CIOBO—So how does it end up being positive for Australia?

Mrs Pickering—To the extent that we do not have to give credit for the Mexican withholding taxes, it is a benefit to Australia.

Mr CIOBO—I noticed as well in annexure 1 there was reference to the panel that was consulted—representatives from the Law Council, the Business Council et cetera. It stated that the panel raised issues concerning the drafting of article 13(2) and that this was addressed with the Mexican government. What were those issues?

Mrs Pickering—From recollection, when we were negotiating the Mexican treaty we were still dealing with the Lamesa Holdings decision of our courts here, and we were trying to draft a provision that ensured that, where we have what are called ‘land rich companies’, where you have alienation of shares in those companies, we are able to still tax them in Australia. So the drafting was simply a matter of saying, ‘How do we make sure that the provision operates the way that we want it to operate?’ I think you will see that the drafting ended up very much the same as the drafting that we have in the UK treaty and other treaties that have been negotiated since that time.

Mr CIOBO—I saw that exports have been growing at 27 per cent each year—the figure is something like that—for the last five or six years. Do you do modelling on the potential benefits flowing to Australian companies, the likely impact on exports if we get a greater Australian

presence in Mexico and what sort of revenues we might start to see flowing from that? Is that part of your assessment or not?

Mr Parker—Traditionally, it has not been. That is a level of detail which has not been gone into in the analysis.

CHAIR—I have a couple of questions on the UK agreement. In the NIA annexure on the consultation aspect, there was reference to the fact that a number of those consulted recommended going further than the changes negotiated in the US protocol. They wanted the UK one to go further. What further recommendations were raised? What sort of things were people seeking that were not in the US protocol?

Mrs Pickering—They were seeking things like even lower withholding tax rates, for example.

CHAIR—On what basis? What was their justification?

Mrs Pickering—That was on the basis that the lower the tax withholding rate, the better it is for business and the easier it is to enable the flows.

CHAIR—The reason given for not going further was that we were looking for uniformity and, given that the US protocol contained particular elements, we did not want to have the UK protocol differing. In retrospect, should we have considered these recommendations in the US context?

Mrs Pickering—We certainly did consider them in the US context, but what we were seeking then—as we are seeking with the UK—was a balance between source and residence based taxation to make sure that we protect our revenue base to an appropriate level, as well as enable the flows as best we can.

CHAIR—What exactly is meant by a more residence based treaty policy?

Mrs Pickering—In the tax treaties we have two bases of taxation. The residence basis is that residents are taxed on their worldwide income. The source basis is that nonresidents and residents are taxed on income arising from sources within a country. The treaty seeks a balance between residence taxation, which is taxation of a country's own residents no matter where they derive their income, and source taxation, which taxes nonresidents on their local income. Traditionally, we have sought to protect our revenue base as much as possible by having a stronger focus on source taxation—that is, by taxing nonresidents on their Australian sourced income. The shift in the last few treaties has been towards saying, 'There are benefits from claiming less source taxation and focusing more on residence based taxation'—that is, focusing more on the taxation of our own residents. That is the shift that we have seen in the US and that we are also seeing in the UK treaty.

Mr Parker—This is manifested in the reduction in withholding taxes. Withholding tax is a tax on source, so the reduction in that moves us more towards residence based taxation. It aligns the Australian tax framework more with international norms. There is a model OECD treaty which is, essentially, based around residence taxation. We are still off to one side of that with a

fairly significant degree of source taxation, reflecting the fact that we are a capital-importing country. We have moved more towards residence based taxation, but we have not gone all the way.

Mr WILKIE—I want to clarify something I said earlier regarding when we would be reporting. I mentioned 3 November. The latest date that we would have to report on this, if the treaty were tabled on 11 September, would be 24 November—which is 15 sitting days from now. But if something needs to be reported on earlier, we will obviously fast-track it. I am absolutely opposed to the situation where legislation is introduced prior to us reporting, because we can accommodate that if we have to.

CHAIR—You should probably take that up with somebody in government. Thank you all for your appearance here this morning. We appreciate the input.

Resolved (on motion by **Mr Wilkie**):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

Committee adjourned at 11.30 a.m.