

Two taxation Agreements with the Isle of Man

Introduction

3.1 This chapter considers two treaties:

- an *Agreement between the Government of Australia and the Government of the Isle of Man on the Exchange of Information with Respect to Taxes*; and
- an *Agreement between the Government of Australia and the Government of the Isle of Man for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments*.

3.2 The purpose of the first Agreement, commonly referred to as a taxation information exchange agreement (TIEA), is to establish a legal basis for the exchange of tax information between Australia and the Isle of Man (IoM).

3.3 The second Agreement (the taxing rights Agreement) is part of a package of benefits that is being offered to the IoM to encourage it to conclude the TIEA. The Agreement provides for the allocation of taxing rights of certain cross-border income derived by the residents of both countries, and establishes a mechanism to help resolve disputes arising from transfer pricing adjustments.¹

3.4 The Isle of Man (IoM) is a self-governing colony of the British Crown, located in the Irish Sea. It has a low-tax structure and is known internationally as a centre for incorporating 'offshore companies'. Low-tax jurisdictions can be used in arrangements designed to avoid paying tax

¹ Taxing Rights Agreement Nation Interest Analysis (NIA), paras 4 and 7; Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, p. 5.

elsewhere. In particular, assets and income that are subject to Australian tax can be concealed by their secrecy laws.²

- 3.5 Treasury informed the Committee that the level and type of economic activity between Australia and the IoM is not fully known, however data held by the Australian Transaction Reports and Analysis Centre (AUSTRAC) indicates that for the 2007-08 year, there was about \$340 million entering Australia from the IoM, and about \$350 million going to the IoM from Australia. Treasury noted that a number of these exchanges are legitimate.³

Agreement between the Government of Australia and the Government of the Isle of Man on the Exchange of Information with Respect to Taxes (TIEA)

Obligations

- 3.6 This Agreement permits the Commissioner for Taxation to request and receive certain information held in the IoM.⁴
- 3.7 Article 1 obliges both Parties to exchange information where the information is foreseeably relevant to the administration and enforcement of the Parties' domestic tax laws, including the collection of taxes and the investigation and prosecution of tax matters.⁵
- 3.8 The Parties are obliged to provide such information when requested to do so in writing (Article 5(1)). There is no provision in the Agreement to authorise voluntary or unsolicited exchange of information between the Parties.⁶
- 3.9 Where the Commissioner of Taxation does not hold the information necessary to comply with the request, Australia must use all relevant information gathering measures to provide the requested information even if not required for Australian domestic tax purposes (Article 5(2)).⁷
- 3.10 Information must be provided as promptly as possible (Article 5(7)) and must be kept confidential (Article 8).⁸

2 Tax Information Exchange Agreement National Interest Analysis (TIAE NIA) , paras 4 and 12.

3 TIEA NIA, para 12; Mr Malcolm Allen, *Transcript of Evidence*, pp. 1-3.

4 TIEA NIA, para 6.

5 TIEA NIA, para 16.

6 TIEA NIA, para 16.

7 TIEA NIA, para 19.

8 TIEA NIA, para 20.

Effectiveness of taxation information exchange agreements

- 3.11 The Committee raised concerns that the proposed TIEA, and other similar agreements, may be limited in their effectiveness. In particular, the proposed TIEA provides that information must be proven to be ‘foreseeably relevant’ to domestic tax laws before it can be exchanged.
- 3.12 The Committee queried whether tax authorities would be able to establish information as ‘foreseeably relevant’ to domestic tax law without first accessing that information. The Committee therefore questioned whether the provision would undermine the ability of tax authorities to access certain information, and whether the proposed TIEA would in fact improve present arrangements.
- 3.13 Treasury told the Committee that the provision on ‘foreseeably relevant’ information is a standard feature of international exchange of information agreements and explained the origin of the provision:
- The principle behind [the provision] is that you should not engage in what we call fishing expeditions. You need to have a certain amount of information about a person or a company before you make a request. You cannot make a speculative request for information that you may not necessarily need.⁹
- 3.14 The Australian Taxation Office (ATO) submitted that currently, under the *Mutual Assistance in Criminal Matters Act 1987*, Australia is only permitted to request assistance from the IoM in criminal tax matters, and not in civil tax matters. Under this arrangement, the IoM has the discretion to authorise or deny such a request. Treasury stated that the proposed TIEA improves this arrangement through requiring the IoM to provide information that is ‘foreseeably relevant’ to both civil and criminal tax matters.¹⁰
- 3.15 The Committee raised further concerns regarding the burden of proof required to establish information as ‘foreseeably relevant’. Treasury informed the Committee that, in civil tax matters, the burden of proof required to access information is much lower than for criminal cases, and that the ‘foreseeably relevant’ standard in the TIEA would mostly apply to civil tax matters.¹¹

9 Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, p. 3.

10 Australian Taxation Office, *Submission No. 5*, p. 1; Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, p. 3.

11 Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, p. 3.

Reasons to take treaty action

- 3.16 Treasury informed the Committee that the TIEA is an important element of Australia's ongoing commitment to the efforts of the Organisation for Economic Co-operation and Development (OECD) to curb tax avoidance and evasion.¹²
- 3.17 Treasury stated that the TIEA effectively overrides bank secrecy. The Committee was told that the entry into force of the proposed TIEA would be consistent with the April 2009 statement of the G20 condemning bank secrecy, and would accord with the current international impetus in eradicating harmful tax practices.¹³
- 3.18 Treasury submitted that agreements such as the proposed TIEA will reduce the degree by which tax evasion practices can exacerbate economic downturns, as may have occurred in the current global financial crisis.¹⁴
- 3.19 Treasury further stated that the TIEA will provide an important tool for Australia to better administer and enforce its tax laws. It was argued that the Agreements will establish the legal and administrative frameworks needed to support information exchange, and will prevent such frameworks from being hindered by bank secrecy laws.¹⁵
- 3.20 Treasury submitted that the TIEA will discourage taxpayers from participating in abusive tax arrangements by increasing the probability of detection.¹⁶
- 3.21 The ATO stated that, in terms of tax evasion, the IoM presents a midrange risk. The Committee was informed that the main risk arises when persons with IoM bank accounts (including persons from third countries) become residents of Australia. As Australian residents, aspects of their income may come under the jurisdiction of the ATO. Without the proposed TIEA, the ATO has no scope to access the IoM-based income-related information of these taxpayers.¹⁷
- 3.22 Treasury noted that the TIEA is the fifth Agreement of this kind for Australia. Other Agreements have been signed with Bermuda, Antigua and Barbuda, the Netherlands Antilles and the British Virgin Islands.¹⁸

12 Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, p. 1.

13 Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, pp. 3-6.

14 Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, p. 4.

15 Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, pp. 1-2.

16 TIEA NIA, paras 8 and 14.

17 Mr Malcolm Allen, *Transcript of Evidence*, 11 May 2009, pp. 2 and 4.

18 TIAE NIA, para 7.

Costs and implementation

- 3.23 There will be a small administrative and financial impact on the ATO, associated with processing requests for information. A Memorandum of Understanding will be concluded between the two countries to clarify costs that will be borne by the ATO.¹⁹
- 3.24 Treasury informed the Committee that the ATO may incur further costs in providing technical assistance to the IoM, given the IoM's relative inexperience in exchange of information procedures, but that these are expected to be minimal. The Committee was told that such assistance may include conducting conferences and providing training, as well as any other assistance required to set up the administrative processes needed to support the exchange of information.²⁰
- 3.25 No further legislation is required to implement the TIEA.²¹

Agreement between the Government of Australia and the Government of the Isle of Man for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments (taxing rights Agreement)

Obligations

- 3.26 The taxing rights Agreement provides for the allocation of taxing rights over the income of certain individuals and obliges the Governments of the two jurisdictions to endeavour to resolve any disputes arising from transfer pricing adjustments. It only applies to persons who are residents for taxation purposes of Australia or the IoM.²²
- 3.27 Australia is obliged to forego its taxing rights over certain income derived by retirees, government employees and students who are residents of the IoM:
- Under Article 5, Australia cannot tax Australian-source pensions and retirement annuities paid to residents of the IoM. Article 5 permits Australia to tax IoM-source pensions and retirement annuities paid to Australian residents.

19 TIEA NIA, paras 24 and 25.

20 TIEA NIA, para 24; Mr Malcolm Allen, *Transcript of Evidence*, 11 May 2009, pp. 5-6.

21 TIEA NIA, para 23.

22 Taxing Rights Agreement NIA, para 10.

- Under Article 6, Australia cannot tax the salaries of government employees of the IoM working in Australia in government service for non-commercial purposes. Australia and the IoM will therefore have sole taxing rights over the salaries that they pay to individuals undertaking government functions.
 - Under Article 7, Australia cannot tax maintenance, education or training payments received by students or business apprentices from the IoM who are temporarily studying in Australia, where those payments are made from outside Australia. Other income will remain liable to Australian tax.²³
- 3.28 Article 8 obliges the taxation authorities of Australia and the IoM to endeavour to resolve disputes arising from transfer pricing adjustments.²⁴

Reasons to take treaty action

- 3.29 Treasury submitted that the Agreement will relieve double taxation on certain income derived by residents of Australia and the IoM. In particular, Treasury stated that the taxing rights Agreement will benefit students and retirees living abroad, who receive government assistance.²⁵
- 3.30 The ATO told the Committee that the IoM would not enter into the accompanying TIEA without the additional incentive of this taxing rights Agreement. The Committee was told that the taxing rights Agreement will increase the IoM's credibility as an offshore financial centre.²⁶
- 3.31 This Agreement is consistent with provisions contained in Australia's more comprehensive bilateral tax treaties.²⁷

Costs and implementation

- 3.32 Treasury submitted that the taxing rights Agreement will have a financial impact on the ATO, however this is expected to be minimal given the small number of taxpayers likely to be affected by the Agreement. The ATO submitted that in 2006 there were only 689 persons born in the IoM living in Australia, a small number of which would be receiving an income or pension from the IoM Government. Thus, the ATO stated that the cost of the proposed taxing rights Agreement would be negligible and rounded to zero.²⁸

23 Taxing Rights Agreement NIA, paras 12 to 14.

24 Taxing Rights Agreement NIA, para 15.

25 Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, pp. 2 and 5.

26 Mr Malcolm Allen, *Transcript of Evidence*, 11 May 2009, p. 5.

27 Taxing Rights Agreement NIA, para 4.

28 Taxing Rights Agreement NIA, para 17; Australian Taxation Office, *Submission No. 5*, p. 1.

3.33 Treasury stated that minor amendments will be required to the *International Tax Agreements Act 1953* to give effect to the taxing rights Agreement. Treasury informed the Committee that these amendments were introduced into Parliament in March 2009, prior to the Committee's review of the proposed taxing rights Agreement. Treasury informed the Committee that this occurred due to reasons of drafting efficiency. Treasury stated that it was convenient for the Attorney-General's Department to draft and introduce the amendments in conjunction with similar amendments needed to bring into force a different Agreement with the British Virgin Islands which had already been reviewed by the Committee.²⁹

Future treaty action for both Agreements

- 3.34 The Agreements do not provide for the negotiation of future legally binding instruments, amendments or appendices to the existing Agreements. However the Agreements may be amended following the consent of both Parties.³⁰
- 3.35 Treasury told the Committee that the proposed TIEA does not cover indirect taxes, such as a goods and services taxes, because the IoM does not have such a tax system. Treasury considered that, if the need arose, the TIEA could possibly be broadened in the future to cover such taxes.³¹
- 3.36 The TIEA provides that either Party may terminate the Agreement six months after their written notice of termination is received by the other Party. Following termination, both Parties would continue to be bound by the confidentiality obligations of the Agreement.³²
- 3.37 The taxing rights Agreement provides that either Party may terminate the Agreement from 1 July in the calendar year following that in which written notice of termination is given. Also, the Agreement would terminate upon termination of the accompanying TIEA.³³

29 Taxing Rights Agreement NIA, para 16; Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, p. 2.

30 TIEA NIA, para 29; Taxing Rights Agreement NIA, para 21.

31 Mr Gregory Wood, *Transcript of Evidence*, 11 May 2009, p. 7.

32 TIEA NIA, para 31.

33 Taxing Rights Agreement NIA, para 23.

Consultation

- 3.38 Relevant Commonwealth Ministers, the ATO and State and Territory Governments were consulted in development of the both Agreements. Public consultation was not undertaken.³⁴

Conclusion and recommendations

- 3.39 To give effect to the taxing rights Agreement, amendments to the *International Tax Agreements Act 1953* were introduced into the Parliament in March 2009, prior to the Committee's review of the proposed Agreement. The reason given for this unusual course of action was to aid drafting efficiency. The Committee considers this to be an inadequate justification for pre-emptive legislative action.
- 3.40 The Committee notes the practice, agreed between successive Governments and the Joint Standing Committee on Treaties, for the Committee to conclude its reviews of proposed treaty actions and to table its findings in the Parliament before legislation is introduced to give effect to commitments under treaties, allowing for rarely employed national interest exceptions. The Committee considers this to be a fundamentally important principle and urges the Government to be mindful of its agreements with the Committee in this regard.
- 3.41 The Committee recognises the importance of international efforts to combat offshore tax evasion and to establish consistent standards of tax governance between Australia and countries such as the Isle of Man. The Committee also recognises the domestic tax benefits arising from taxation Agreements that discourage the use of certain countries as tax havens. The Committee therefore recommends that binding treaty action be taken for both Agreements.

34 TIEA NIA, Attachment on Consultation; Taxing Rights Agreement NIA, Attachment on Consultation.

Recommendation 7

The Committee supports the *Agreement between the Government of Australia and the Government of the Isle of Man on the Exchange of Information with Respect to Taxes* and recommends that binding treaty action be taken.

Recommendation 8

The Committee supports the *Agreement between the Government of Australia and the Government of the Isle of Man for the Allocation of Taxing Rights with Respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in Respect of Transfer Pricing Adjustments* and recommends that binding treaty action be taken.

Kelvin Thomson MP

Chair

