National Interest Analysis [2013] ATNIA 17

with attachment on consultation

Convention between Australia and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, with Protocol

(Sydney, 30 July 2013)

[2013] ATNIF 21

NATIONAL INTEREST ANALYSIS: CATEGORY 2 TREATY

SUMMARY PAGE

Convention between Australia and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, with Protocol (Sydney, 30 July 2013) [2013] ATNIF 21

Nature and timing of proposed treaty action

1. The proposed treaty action is to bring into force the *Convention between Australia and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, with Protocol* (the proposed Convention). The proposed Convention was signed on 30 July 2013. Following its entry into force, pursuant to Article 27(3), the proposed Convention will replace the *Agreement between Australia and Switzerland for the Avoidance of Double Taxation with respect to Taxes on Income* [1981] ATS 5, and its Protocol (the existing Agreement), which was signed on 28 February 1980.

2. The proposed Convention will enter into force, pursuant to Article 27(1), on the date of the last notification through the diplomatic channel between Australia and Switzerland confirming that each country has completed its domestic requirements to bring the proposed Convention into force. The provisions of the proposed Convention will take effect in Australia in four stages, namely:

a) in respect of fringe benefits tax, on fringe benefits provided on or after 1 April next following entry into force;
b) in respect of withholding tax on income derived by a resident of Switzerland, on income derived on or after 1 January next following entry into force;
c) in respect of other Australian tax, on income, profits or gains of any income derived in the income year beginning 1 July next following entry into force; and
d) in respect of exchange of information (Article 25), to information that relates to taxation or business years in course on, or beginning on or after, 1 January next following entry into force.

Overview and national interest summary

3. The key objective of the proposed Convention is to update the existing bilateral tax arrangements, to align them with current Australian and international tax policy settings. This is expected to encourage trade and investment, which will further enhance economic relations between Australia and Switzerland, and to enhance tax system integrity.

4. In particular, the proposed Convention will strengthen the administrative assistance arrangements between Australian and Swiss revenue authorities, by permitting the exchange of taxpayer information to help address tax evasion. The existing Agreement does not provide a legal basis for this type of cooperation. In this regard, the proposed Convention is consistent with ongoing international efforts, supported by the G20, to improve tax system integrity. Bilaterally, it reflects the efforts of both countries to improve international standards of tax transparency and information exchange.

Reasons for Australia to take the proposed treaty action

Reducing barriers to bilateral trade and investment

5. The proposed Convention is expected to reduce taxation barriers to bilateral trade and investment, primarily by reducing source country taxes on cross-border payments of dividends, interest and royalties. Rather than taking unilateral action to reduce such taxes (which are imposed as withholding taxes in Australia), Australia has adopted the approach of agreeing to such reductions on a reciprocal bilateral basis. This approach 'locks in' the tax limits in both countries, thus ensuring a stable tax framework for business between Australia and its tax treaty partners.

6. The proposed Convention will fulfil Australia's 'most favoured nation' obligation, contained in the Protocol to the existing Agreement, to reduce its withholding tax limits on dividends, interest and royalties paid to Swiss residents. The obligation requires Australia to provide Switzerland with the same treatment, with regard to these limits, as that agreed to by Australia in a subsequent treaty with another member state of the Organisation for Economic Cooperation and Development (OECD). The obligation was triggered in 2003 following Australia's agreement to lower the corresponding limits in its tax treaty with the United States of America ([2003] ATS 14). Australia has since agreed to similar treatment in its tax treaties with France ([2009] ATS 13), Finland ([2007] ATS 36), Japan ([2008] ATS 21), New Zealand ([2010] ATS 10), Norway ([2007] ATS 32) and the United Kingdom ([2003] ATS 22).

7. In particular, the proposed Convention will reduce the dividend withholding tax rate limit from 15% to zero on inter-corporate dividends (that is, dividends distributed between two companies arising from a shareholding or participation in the capital of the paying company) on holdings of 80% or more, subject to certain conditions, and to 5% on inter-corporate dividends on other holdings of 10% or more (Article 10). This will promote direct investment and will allow Australian companies to repatriate profits made by certain Swiss subsidiaries back to Australia without facing any further tax. Article 10 will also provide for a zero tax rate on dividends derived by complying Australian superannuation funds and tax-exempt Swiss pension funds, which will help stimulate cross-border investment by such funds.

8. The proposed Convention will reduce the interest withholding tax rate limit from 10% to zero for interest paid to: bodies exercising governmental functions; banks performing central banking functions; banks that are unrelated to, and dealing wholly independently with, the payer; and complying Australian superannuation and tax-exempt Swiss pension funds (Article 11).

9. The proposed Convention will also reduce the royalty withholding tax rate limit from 10% to 5% (Article 12). Reduced source country taxation on royalties is likely to encourage Australian businesses to source intellectual property from Switzerland and vice versa. While Australian withholding taxes on royalties effectively seek to tax the foreign recipients of the royalties, contracts often include provisions (known as 'gross-up' clauses) which effectively transfer the economic burden of the tax onto the payer of the royalties. Reducing these rates is expected to reduce the costs for Australian businesses of accessing Swiss intellectual property.

Increased certainty and reduced compliance costs for taxpayers

10. Where the revenue authority of one country adjusts the taxable income of a resident of the other country, to reflect the arm's-length price of goods or services provided to an associated enterprise, the proposed Convention will require the revenue authority of the other country to make an appropriate adjustment to the amount of tax charged in its jurisdiction in respect of the same income (Article 9). This will help remove double taxation of transactions between associated enterprises.

11. The proposed Convention will allocate taxing rights over fringe benefits provided by employers to their employees to the country that has the primary taxing right over the underlying employment income (Article 15). This will prevent the double taxation of fringe benefits that can otherwise arise, and remain unrelieved, because Australia taxes the provider of the benefit (the employer) as opposed to the recipient (the employee).

12. The proposed Convention will protect taxpayers from one country from tax discrimination in the other country based on their nationality (Article 23). This will ensure that Australian nationals are not subject to more burdensome taxation and connected requirements in Switzerland than Swiss nationals in the same circumstances, and vice versa. This will provide certainty for individuals and businesses that have dealings in both countries.

13. The proposed Convention will provide for the referral of unresolved tax disputes to independent arbitration (Article 24). This will enable taxpayers to seek arbitration in cases where they believe the actions of one or both of the two revenue authorities have resulted in taxation contrary to the provisions of the proposed Convention.

14. Under the proposed Convention, the rules that allocate taxing rights over business profits will apply to beneficiaries of trusts that derive such profits through a permanent establishment located in the source (of the income) country (Protocol, paragraph 5). This will clarify that such beneficiaries are entitled to the benefits of the proposed Convention.

15. The proposed Convention will ensure that complying Australian superannuation funds that derive Swiss-sourced dividends and interest shall be treated as the beneficial owner of such income to the extent that the income is treated as the income of the fund under Australian tax law (Protocol, paragraph 8). This will provide greater certainty for Australian superannuation funds and entitle them to the benefits of the proposed Convention.

Establishing a more effective framework to address international fiscal evasion

16. The proposed Convention will enhance tax system integrity by establishing a framework in which the revenue authorities of Australia and Switzerland can cooperate to detect and prevent tax evasion. In particular, it will provide a legal basis for the exchange of taxpayer information, including bank information, by the revenue authorities (Article 25). The existing Agreement, which reflects Switzerland's long-standing position on bank secrecy, does not authorise tax information exchange for anti-tax evasion purposes.

17. The standard contained in Article 25 is consistent with Article 26 of the OECD *Model Tax Convention on Income and on Capital* and reflects the current international standard endorsed by the Global Forum on Transparency and Exchange of Information for Tax Purposes, the United Nations and the G20. The exchange–of-information rules contained in

Article 25 are expected to discourage the use of Swiss banks as a location for concealing untaxed income and assets, thereby improving taxpayer compliance. In this regard the proposed Convention will enhance Australia's ability to administer and enforce its domestic tax laws.

18. The proposed Convention will also provide an agreed basis for determining the allocation of profits within multinational enterprises 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). This will assist the Australian Taxation Office (ATO) in its ability to respond to international profit shifting through its administration of transfer pricing laws (that is, laws that seek to ensure that the prices charged for goods and services transferred between associated entities reflect market prices).

Obligations

19. Articles 6 to 21 of the proposed Convention allocate taxing rights in respect of certain types of income and fringe benefits between the two countries. The obligations contained in these articles are broadly of a kind already present in the existing Agreement, with the key differences discussed below.

20. Article 2 will clarify that Australia's fringe benefits tax, petroleum resource rent tax and minerals resource rent tax will be included within the scope of the proposed Convention. None of these taxes are explicitly covered by the existing Agreement.

21. Article 5 will define the term 'permanent establishment', which is relevant to determining when a business, which is a resident of one country, will have a taxable presence in the other country. This definition, compared to the corresponding definition in the existing Agreement, will broaden the range of circumstances in which both countries can tax at source business profits derived from construction and mining activities, and the operation of substantial equipment. In addition, integrity rules will help prevent related parties (for example, entities controlled by the same person) from circumventing the permanent establishment time thresholds by splitting contracts (Protocol, paragraph 4).

22. Article 6 will provide that income from immovable property will include income from agriculture or forestry activities, and the definition of 'immovable property' will include leases or other interests in land, property accessory to immovable property and rights to explore for mineral, oil or gas deposits or other natural resources, and to mine those deposits or resources. This will enhance both countries' ability to tax income derived from the use of immovable property located within their jurisdiction.

23. Article 7 will clarify that beneficiaries of trusts that derive business profits through a permanent establishment located in the source country will be deemed to be carrying on a business through that permanent establishment and taxable (in the source country) on their share of the profits attributable to it. This will clarify that taxing rights over business profits derived through a permanent establishment are also intended to apply to business profits derived through a trust.

24. Article 8 will provide that profits from shipping or air transport activities undertaken between two ports within a country will be taxable in that country. This will provide

Australia with exclusive taxing rights over profits derived by Swiss residents from Australian coastal shipping and intra-Australian airline activities.

25. Article 9 will require the revenue authorities to make correlative adjustments to the amount of tax charged on income in certain circumstances to remove double taxation. This will ensure that related-party transactions conducted by members of a multinational group operating in Australia and Switzerland are not double-taxed and reflect the pricing that would be adopted by independent parties.

26. Articles 10, 11 and 12 will apply to the taxation of dividends, interest and royalties respectively. As noted in paragraphs 7 to 9 above, Australia and Switzerland have agreed to reduce the source country tax rate limits that apply to such income from the corresponding rates contained in the existing Agreement. The reduced rates will fulfil Australia's 'most favoured nation' obligation contained in the existing Agreement and will help facilitate bilateral investment and the free movement of capital and technology between the two countries.

27. Article 13 will provide for source country taxation of gains derived from the alienation of immovable property located within its jurisdiction, including from the disposal of interests in land-rich entities. Article 13 will also help prevent double non-taxation (that is, where neither Contracting Party taxes the transaction) by allowing Australia to tax its former resident individuals on capital gains if they alienate property within four years of leaving Australia (Protocol, paragraph 10).

28. Article 15 will prevent the double taxation of fringe benefits by allocating relevant taxing rights to the country that has the primary taxing right over the underlying employment income.

29. Article 18 will provide for pensions and similar payments to be taxed in the recipient's country of residence, provided the recipient is taxable on those payments in that country. If not, the source country may tax the payments. Lump sum payments in respect of retirement, invalidity, disability death or injury may also be taxed in the country of source of the payment. Government pensions paid in respect of past employment will be taxed exclusively in the source country in certain circumstances (Article 19).

30. Article 23 contains a general non-discrimination principle, requiring each country to treat nationals of the other country no less favourably for tax purposes than it treats its own nationals in the same circumstances. A general exception to this principle will apply in respect of laws that are intended to prevent tax abuse, address thin capitalisation (the practice of firms allocating excessive, interest-bearing debt to their Australian operations) or to ensure that taxes can be effectively collected or recovered (Protocol, paragraph 13).

31. Article 24 will establish a dispute resolution procedure, including a mechanism for taxpayers to present complaints to their country of residence, irrespective of the remedies provided by the domestic laws of either country, where they consider that they have been erroneously taxed. 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. The timeframe for initiating such procedure is three years. Article 24 will also permit taxpayers to pursue independent arbitration where a dispute remains unresolved after three years. More generally, the competent authorities of the two countries are required to

endeavour to resolve, by mutual agreement, any difficulties or doubts regarding interpretation or application of the proposed Convention. Finally, any dispute between the two countries as to whether a measure falls within the scope of the General Agreement on Trade in Services can only be brought before the Council for Trade in Services with the consent of both countries.

32. Article 25 will oblige the exchange of tax information between both countries, including a specific obligation to gather and provide information upon request. Article 25(2) will impose 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 25(3) will allow either country to decline to supply information in certain circumstances, for example where: (i) it would require administrative measures at variance with either country's domestic law or administrative practice; (ii) the information requested is not obtainable under the laws or in the normal course of administration of either country; 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 safeguards will protect taxpayers' rights and ensure the article is used appropriately. Article 25 specifically applies to information held by banks and other financial institutions, thereby preventing bank secrecy laws from impeding access to relevant information.

Implementation

33. The implementation of the proposed Convention will require amendment to the *International Tax Agreements Act 1953* to give it the force of law in Australia. The amendment must be effected prior to the proposed Convention entering into force in Australia. The legislative framework required for Australia to fulfil its obligations under Article 25 (Exchange of Information) is contained in section 23 of the *International Tax Agreements Act 1953*. The implementation of the proposed Convention will not affect the existing roles of the Commonwealth, or the States and Territories, in tax matters.

Costs

34. The reciprocal nature of tax treaties means that both countries can expect direct costs and benefits to their revenue bases as a result of changes to their taxing rights and increased taxpayer compliance.

First-round impact of the proposed Convention

35. Treasury has estimated that the revenue costs of reducing Australian withholding tax on dividends, interest and royalties will be offset by the revenue gains arising from enhanced tax system integrity. The establishment of effective exchange-of-information arrangements with Switzerland is expected to discourage the use of Swiss banks to conceal untaxed income and assets. No other material costs have been identified as likely to arise from the implementation of the proposed Convention. As 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 two countries.

36. There would be a small, unquantifiable cost in administering the changes made by the proposed Convention, including minor implementation costs to the 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.

Second- round impact of the proposed Convention

37. The estimated revenue costs and benefits do not take account of any additional revenues that may flow from the second-round impacts generated by the treaty. Second-round impacts include revenue gains from changes in cross-border investment levels, improved access to technology, reduced capital costs, economic growth and job creation. The revenue cost does not therefore take into account anticipated revenue benefits from expected increases in cross-border trade and investment.

Regulation impact statement

38. The Office of Best Practice Regulation in the Department of Finance and Deregulation has been consulted and has confirmed that a Regulation Impact Statement is not required.

Future treaty action

39. The proposed Convention does not provide for the negotiation of future legally binding instruments, nor does it contain specific amendment procedures. However it may be amended from time to time by mutual consent of both countries, pursuant to international law. 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

40. Following its entry into force, either country may terminate the proposed Convention by giving written notice of termination at least six months prior to the end of any calendar year. The proposed Convention would then cease to be effective, in the case of Australia, from the first day of January next following the date on which the notice of termination is given. Termination by Australia would be subject to Australia's domestic treaty-making process.

Contact details

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ATTACHMENT ON CONSULTATION

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CONSULTATION

41. On 9 February 2011, the then Assistant Treasurer announced that "Australia and Switzerland would commence discussions next month to modernise the existing tax treaty" and invited submissions from stakeholders and the wider community.

42. Public consultation was undertaken in February 2011 and over subsequent months. 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

43. In general, business and industry groups endorsed the revision of the existing Agreement. The financial services sector, in particular, supports the conclusion of a new tax treaty with Switzerland, particularly in relation to reductions in withholding taxes on dividends, interest and royalties.

44. 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 biannual updates to the schedule of treaties provided to State and Territory representatives.