

Chapter 7

Parliament's intention expressed in the 2003 amendment

7.1 Treasury emphasised the *International Tax Agreements Amendment Act 2003* (Act No. 123 of 2003) (2003 amending Act) as Parliament's most recent 'statement' on the taxation power of treaties, using this as justification for the retrospective application of the bill to 1 July 2004 (the first financial year after the statement).¹

7.2 The 2003 amending Act amended the *International Tax Agreement Act 1953* (ITAA 1953) to give force to the United Kingdom Convention and the United Mexican States Agreement. The 2003 amending Act also made amendments to subsection 170(14) of the *Income Tax Assessment Act 1936* (ITAA 1936) to provide a 'generic description' of transfer pricing articles.

7.3 Treasury argued that paragraph 3.5 of the Explanatory Memorandum (EM) to the 2003 amending Act 'contained explicit statements' that certain provisions of tax treaties could be used to make transfer pricing adjustments on an arm's length basis.²

Submitters' views

7.4 Some submitters, however, were not persuaded that there was a specific announcement in Parliament in 2003 that pertained to the measures in the bill.³ Chevron contended:

...the reference to an 'indication by Parliament' in 2003 appears to refer to discussions regarding the renegotiation of Australia's Double Tax Agreement with the United Kingdom. The related material in no way suggests, infers or provides that the treaty should be an alternative to, or override, our domestic laws.⁴

7.5 In addition, the Rule of Law Institute of Australia argued:

We can find no evidence that this was the intention of Parliament. No Member of Parliament who spoke in reference to the original Bills said anything which would convey that was the intent. There is nothing in the second reading speeches which offers any support nor anything in the Senate... Explanatory Memorandum on Tax Bills do not represent in

1 Explanatory Memorandum, Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012, p. 3.

2 Explanatory Memorandum, Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012, paragraph 1.17, pp 7–8.

3 The Tax Institute, *Submission to Consultation Paper*, p. 12; Chevron Australia Pty Ltd, *Submission 16*, p. 6; Law Council of Australia, *Submission 9*, pp 1–2; Institute of Chartered Accountants in Australia, *Submission 19*, p. 1.

4 Chevron Australia Pty Ltd, *Consultation Paper Submission*, p. 4.

practice the intention of Parliament, but the Commissioner's interpretation of the Bill.⁵

7.6 PricewaterhouseCoopers (PwC) attached an article to its submission which argued that the amendment in the 2003 amending Act does not directly relate to treaty provisions, but to amendments to section 170(14) of the ITAA 1936. It argued that any intention by Parliament to use treaties as a taxing power should be outlined explicitly in the EM in its discussions of Article 9 for ease of reference for treaty partners, and this is not the case:

Paragraph 3.5 of the EM to the UK [Double Tax Agreement] DTA does not directly relate to the UK DTA. Rather, it relates to amendments to s 170(14), specifically the definition of the term "relevant provision", to reflect the replacement of the existing UK DTA text in the Agreements Act.

If the comments are intended to reflect Parliament's intention that art 9 can be applied in a way which imposes tax, this should be noted in the section of the EM which deals with art 9 of the UK DTA which is not the case. In particular, given that this would represent significant departure from international practice, such a reference would be expected. That is, taxpayers reading the EM to determine the implications of the DTA on their financial situation would expect this information to be highlighted, rather than having to read an obscure and dated EM to a specific amendment provision.⁶

7.7 PwC also provided a full copy of the EM to the 2003 amending Act in which it highlighted a number of extracts it suggested 'sets out Parliament's understanding of how tax treaties work, including their purpose'. These extracts contrast with the position adopted by Treasury and are outlined below.

7.8 In introductory comments, the EM to the 2003 amending Act stated:

Tax treaties allocate to the country of source, sometimes at limited rates, a taxing right over certain income, profits or gains derived by residents of the treaty partner country...

Australia's tax treaties are primarily concerned with relieving juridical double taxation, which can be described broadly as subjecting the same income of a taxpayer to comparable taxes under the taxation laws of two different countries.⁷

7.9 Continuing on as part of the general outline, the EM to the 2003 amending Act stated:

5 Rule of Law Institute of Australia, *Submission 20*, p. 2.

6 Peter Collins et al, 'The smoke and mirrors around the "stage one" transfer pricing reforms', *The Tax Specialist*, June 2012, p. 215.

7 Explanatory Memorandum, International Tax Agreement Bill 2003, p. 4, http://www.austlii.edu.au/au/legis/cth/bill_em/itaab2003389/memo1.html (accessed 10 August) in PricewaterhouseCoopers, additional information, exhibit A, received 31 July 2012.

Australia's tax treaties are designed to:

- avoid double taxation and provide a level of security about the tax rules that will apply to particular international transactions by:
 - o allocating taxing rights between the countries over different categories of income;
 - o specifying rules to resolve dual claims in relation to the residential status of a taxpayer and the source of income; and
 - o providing a taxpayer with an avenue to present a case for determination by the relevant taxation authorities where the taxpayer considers there has been taxation treatment contrary to the terms of a tax treaty; and
- **prevent avoidance and evasion of taxes on various forms of income flows between the treaty partners by:**
 - o providing for the allocation of profits between related parties on an arm's length basis;
 - o **generally preserving the application of domestic law rules that are designed to address transfer pricing and other international avoidance practices;** and
 - o providing for exchanges of information between the respective taxation authorities. (emphasis added by PwC).⁸

Amendment to subsection 170(14) – definition of 'relevant position'

7.10 Item 1 of Schedule 3 of the 2003 amending Act amended subsection 170(14) of the ITAA 1936 on the definition of 'relevant provision'.

7.11 The amendments set out in the 2003 amending Act replaced paragraph 170(14)(a) of the ITAA 1936. The repealed section stated that 'relevant provision' means:

(a) paragraph (3) of Article 5, or paragraph (1) of Article 7, of the United Kingdom agreement or a provision of any other double taxation agreement that corresponds with either of those paragraphs;⁹

7.12 The 2003 amending Act replaced paragraph 170(14)(a) with the following 'generic description' of 'relevant provision' (paragraph b is included for context):

(a) a provision of a double taxation agreement that attributes to a permanent establishment or to an enterprise the profits it might be expected to derive if it were independent and dealing at arm's length; or

8 Explanatory Memorandum, International Tax Agreement Bill 2003, p. 4, http://www.austlii.edu.au/au/legis/cth/bill_em/itaab2003389/memo1.html (accessed 10 August) in PricewaterhouseCoopers, additional information, exhibit A, received 31 July 2012.

9 Income Tax Assessment Act 1936 (Act No. 30 of 2003), volume 11, p. 136, <http://www.comlaw.gov.au/Details/C2004C04679> (accessed 10 August 2012).

(b) paragraph 7, 8 or 9 of Article 5, or Article 7, of the Taxation Code in Annex G to the Timor Sea Treaty or a provision of any other international tax sharing treaty that corresponds with any of those paragraphs or that Article.¹⁰

7.13 The EM to the 2003 Act outlined that the new definition of 'relevant provision' is a consequential amendment of replacing the former UK tax treaty with the new UK treaty. It replaced references to specific provisions in the UK Convention with a 'generic description of the relevant provisions found in Australia's tax treaties'.¹¹ The EM to the 2003 Act stated:

3.5 Subsections 170(9B) and (9C) of the ITAA 1936 deal with time limits for amending income tax assessments for the purpose of giving effect to a relevant provision. Paragraph (a) of the definition for relevant provision in subsection 170(14) defines relevant provision as paragraph (3) of Article 5 or paragraph (1) of Article 7 of the existing tax treaty with the United Kingdom (currently defined as United Kingdom agreement within subsection 170(14)), or a provision of any other tax treaty that corresponds with either of those paragraphs. **These paragraphs in Australia's tax treaties allow for adjustments to the profits of permanent establishments or associated enterprises on an arm's length basis.**

3.6 This amendment replaces the references to the provisions in the existing tax treaty with the United Kingdom with a broad, generic description of the relevant provisions found in Australia's tax treaties. Examples of such provisions in Australia's tax treaties are paragraph 2 of Article 7 (Business profits) and paragraph 1 of Article 9 (Associated enterprises) of the new tax treaty with the United Kingdom). Substituting this general description will reduce the need to amend the definition of relevant provision as a result of future tax treaty changes.

3.7 As a consequence of the change to a generic description of paragraph (a) of the definition of relevant provision, the definition of United Kingdom agreement in subsection 170(14) is no longer necessary and will be repealed by this bill (emphasis added by Treasury).¹²

10 *Income Tax Assessment Act 1936*, http://www.austlii.edu.au/au/legis/cth/consol_act/itaa1936240/s170.html (accessed 10 August 2012).

11 Explanatory Memorandum, International Tax Agreement Bill 2003, p. 140.

12 Explanatory Memorandum, International Tax Agreement Bill 2003, p. 140; see Treasury, *Submission 21*, p. 21.

7.14 The 2003 EM provides examples of 'relevant provisions' in Australia's tax treaties as paragraph 2 of Article 7 (Business profits) and paragraph 1 of Article 9 (Associated enterprises) of the new tax treaty with the United Kingdom.¹³

7.15 To provide context, paragraph 1 of Article 9 (Associated enterprises) of the treaty with the United Kingdom states:

Where:

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State;

and in either case conditions operate between the two enterprises in their commercial or financial relations which differ from those which might be expected to operate between independent enterprises dealing wholly independently with one another, then any profits which might, but for those conditions, have been expected to accrue to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.¹⁴

7.16 Treasury emphasised that the EM for the Act demonstrated Parliament's intention that the Commissioner can use the 'relevant provisions' of a tax treaty to make adjustments to the profits of permanent establishments and associated enterprises.¹⁵

Committee view

7.17 Consistent with its comments in the previous chapter, the committee reiterates that the bill confirms Parliament's intention on treaty tax powers as expressed in amending Acts passed by the Parliament dating back to 1982. The 2003 amending Act is a further expression of this uniform position.

13 Paragraph 2, Article 7 of the UK Convention states: 'Subject to the provisions of paragraph 3 of this Article, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated in that other State, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment or with other enterprises.'
<http://law.ato.gov.au/atolaw/view.htm?docid=RPC/19530082/Sch1-Agt0-Art7> (accessed 24 July 2012).

14 United Kingdom Convention,
<http://law.ato.gov.au/atolaw/view.htm?docid=RPC/19530082/Sch1-Agt0-Art9> (accessed 24 July 2012).

15 Treasury, *Submission 21*, p. 21.

7.18 The 2003 amending Act provides a 'generic description' of relevant treaty Articles that can be used by the Commissioner to make adjustments on an arm's length basis and thus provides further evidence of the taxation power of treaties consistent with the provisions in the bill before the committee.