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International Tax Agreements Amendment Bill (No.1) 2009

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International Tax Agreements Amendment Bill (No.1) 2009

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Links: The *relevant links* to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at http://www.comlaw.gov.au/.

Purpose

To amend the *International Tax Agreements Act 1953* (the Tax Agreements Act) to incorporate into Australian law two tax agreements with each of the British Virgin Islands and the Isle of Man.

Background

Brief Description of the Bill

Both the British Virgin Islands and the Isle of Man were once identified by the OECD as having the characteristics of tax havens.[1]

One characteristic of tax havens is their secrecy with regard to income that might otherwise be assessable in other countries. The main way that this problem is being dealt with by other countries is through bi-lateral agreements for the sharing of tax information.

Australia has recently entered such Tax Information Exchange Agreements with the British Virgin Islands and the Isle of Man. To give legal effect to these agreements, no new legislation is required. These agreements are not the subject of this Bill. Rather, this Bill gives legal effect to two other agreements that Australia with these two countries. These latter agreements—which are in the nature of double tax agreements—do require

1. OECD, Towards Global Tax Co-operation, Report To The 2000 Ministerial Council Meeting And Recommendations By The Committee On Fiscal Affairs, Progress in Identifying and Eliminating Harmful Tax Practices, OECD, 2000, p. 17, viewed 13 May 2009, http://www.oecd.org/dataoecd/9/61/2090192.pdf

legislation in order to be incorporated in Australian law. The agreements incorporated into the Tax Agreements Act by this Bill set out some rules for determining which country will have taxing rights over certain income of a limited class of individuals who have relevant connections with both countries.

The fact that that Allocation of Taxing Rights Agreements need to be given effect by legislation may give the impression that they are the more important of the two. From Australia's perspective, however, Tax Information Sharing Agreements have primacy. The Allocation of Taxing Rights Agreements—the subject of this Bill—are offered by Australia to these other countries as part of a package of benefits to encourage them to conclude a Tax Information Exchange Agreement.[2] Although not directly the subject of this Bill, the Tax Information Exchange Agreements are given some attention in this digest in order to establish the context for the operation of the Allocation of Taxing Rights Agreements that are the subject of this Bill.

What is a tax haven?

Income earned in tax havens does not have some special status in the laws of other countries such as Australia. Such income is generally assessable in the same way as other income.

> There is no philosopher's stone that, through alchemy, transforms Australian or foreign source income derived by an Australian resident into non-taxable income in Australia by the mere transmission through, or concealment in, a tax haven.[3]

The features that gives tax havens that status are principally their low tax rates and secrecy. Information about income earned in those countries simply does not come to the attention of taxing authorities in other countries unless it is volunteered. Such countries tend to offer or be perceived to offer themselves as places where non-residents can escape tax in their country of residence.

Why are tax havens bad for other countries?

The OECD says that tax havens:

- erode the tax bases of other countries
- increase the complexity of the tax systems of other countries

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2. Department of Treasury, *National Interest Analysis [2009] ATNIA 4*, tabled before Joint Standing Committee on Treaties on 3 February 2009, viewed 12 May 2009, http://www.aph.gov.au/house/committee/jsct/3february2009/tor.htm

3. Michael D'Ascenzo (Commissioner of Taxation), *Tax Havens and Tax Administration*, Australian Taxation Office, December 2008, Foreword, viewed 26 May 2009, http://www.ato.gov.au/content/downloads/LBI_46908_Tax_Havens_w.pdf

- put greater burdens and costs on tax administration as well as on compliant taxpayers
- reduce taxpayer confidence in the integrity and fairness of the tax system, and in government in general, and
- distort financial and real investment flows.[4]

International efforts to deal with tax havens

In 1996, OECD Ministers requested that the OECD develop measures to counter the use of tax havens, amongst other 'harmful tax practices', because of the effects that they have on the erosion of the tax base of other countries, amongst other reasons.[5] The G7 Heads of State endorsed that request at their 1996 summit.[6] This began the OECD's ongoing project to identify and eliminate harmful tax practices.

The 1998 OECD report that resulted from that request identified some of the features of tax havens.[7] These included low or no effective tax rates, lack of transparency in the way a tax regime works and a lack of effective exchange of information with other countries.[8] The OECD undertook at that stage to develop a list of tax havens within one year.[9] The result of that work was a report published in 2000 which included both the British Virgin Islands and the Isle of Man in a list of countries that met the OECD's criteria for tax havens.[10]

By 2004, however, most of the countries identified as meeting the tax haven criteria—including the British Virgin Islands and the Isle of Man—had committed to principles of transparency and the effective exchange of information. This step stopped them being branded 'uncooperative' according to the processes established under the OECD's program.[11] The Isle of Man committed to these principles on 13 December 2000[12] and the

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4. OECD, *The OECD's Project on Harmful Tax Practices: the 2001 Progress Report,* published 2001, viewed 25 May 2009, http://www.oecd.org/dataoecd/60/5/2664450.pdf

5. OECD, *Harmful Tax Competition: An Emerging Issue*, Committee on Fiscal Affairs, 1998, p. 3, viewed 12 May 2009, http://www.oecd.org/dataoecd/33/1/1904184.pdf

6. OECD, *Harmful Tax Competition*, 1998, p. 3.

7. OECD, Harmful Tax Competition, 1998

8. OECD, *Harmful Tax Competition*, 1998, p. 27.

9. OECD, *Harmful Tax Competition*, 1998, p. 9.

10. OECD, *Towards Global Tax Co-operation*, p. 17.

11. OECD, Towards Global Tax Co-operation, p. 19.

12. J Kissack (Chief Secretary, Isle of Man), *Letter of Commitment*, 13 December 2000, viewed 25 May 2009, http://www.oecd.org/dataoecd/12/53/1903624.pdf

British Virgin Islands on 2 February 2002,[13] in each case by a formal letter of commitment as required by the OECD. A list of countries that have committed to improving transparency and establishing effective exchange of information in tax matters is listed on the OECD website.

The effective exchange of tax information:

> … enables governments to ensure that their own tax laws are being complied with, particularly where cross-border transactions are involved …
>
> … Exchange of information between tax authorities is widely recognised as an effective means of deterring and discovering non-compliance in cross-border transactions. Both the OECD and United Nations model tax conventions include a provision that permits tax authorities to exchange information. …
>
> … where effective exchange of information is present, a country's ability to enforce its own tax rules is enhanced.[14]

The way in which a country's commitment to transparency and the effective exchange of information is manifested is in the signing of Tax Information Exchange Agreements. The Australian Taxation Office describes Tax Information Exchange Agreements as:

> an important tool in Australia's efforts to combat offshore tax evasion. The agreements will provide for the effective exchange of information between Australia and its Tax Information Exchange Agreement partners, promote fairness and enhance Australia's ability to administer and enforce its domestic tax laws[15]

Australia has now signed Taxation Information Exchange Agreements with five countries formerly identified by the OECD as having tax haven characteristics. They are; Bermuda (on 15 November 2005), Antigua and Barbuda (on 1 February 2007), Netherlands Antilles (on 1 March 2007), the British Virgin Islands (on 28 October 2008) and the Isle of Man (on 29 January 2009).

As tax revenues decline due to the effects of the global financial crisis, there has been even greater political interest in dealing with international tax evasion, including tax havens. As the OECD records in its recent 2009 report *Overview of the OECD's Work on countering International Tax Evasion*:

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13. R O'Neal (Chief Minister, British Virgin Islands), *Letter of Commitment*, 2 February 2002, viewed 25 May 2009, http://www.oecd.org/dataoecd/30/44/2079036.pdf

14. OECD, *The OECD's Project On Harmful Tax Practices: The 2001 Progress Report,* OECD, 2001, p. 5, viewed 26 May 2009, http://www.oecd.org/dataoecd/60/5/2664450.pdf

15. Australian Taxation Office, 'Countries that have a tax information exchange agreement (TIEA) with Australia', ATO website, viewed 1 June 2009, http://www.ato.gov.au/corporate/content.asp?doc=/content/00161158.htm

> In July 2008, the G8 Heads of State and government urged *"all countries that have not yet fully implemented the OECD standards of transparency and effective exchange of information in tax matters to do so without further delay, and encourage the OECD to strengthen its work on tax evasion and report back in 2010"*. Similarly, the action plan issued by the G20 following its meeting in November 2008 recognised the importance of the OECD work in this area and urged that failures to implement the standards should be "vigorously addressed".[16]

A measure of the heightened efforts being made in relation to tax havens is the high number of information exchange agreements that have recently been signed or announced. Since November 2008, almost 30 agreements have been signed or announced around the world.

The tax agreements with the British Virgin Islands and the Isle of Man

Australia recently signed two agreements with each of the British Virgin Islands and the Isle of Man. The British Virgin Islands is a self governing crown colony of the United Kingdom located in the north-eastern Caribbean Sea. The Isle of Man is a self-governing dependent territory of the British Crown, located in the Irish Sea.

These are the full titles of the two agreements with British Virgin Islands:

1. *Agreement between the Government of Australia and the Government of the British Virgin Islands for the Exchange of Information Relating to Taxes* signed in London on 27 October 2008 (called "The Exchange of Information Agreement" or TIEA in this digest)

2. *Agreement between the Government of Australia and the Government of the British Virgin Islands for the Allocation of Taxing Rights with Respect to Certain Income of Individuals* signed in London on 27 October 2008 (called the Allocation of Taxing Rights Agreement")

These are the full titles of the two agreements with the Isle of Man:

1. *Agreement between the Government of Australia and the Government of the Isle of Man on the Exchange of Information with Respect to Taxes* signed in London on 29 January 2009

2. *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* signed in London on 29 January 2009

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16. OECD, *Overview Of The OECD's Work On Countering International tax Evasion*, OECD, 21 April 2009, p. 2, viewed 26 May 2009, http://www.oecd.org/dataoecd/32/45/42356522.pdf

For both of these countries, the first agreement concerns the exchange of information relating to income and taxes (Tax Information Exchange Agreements). These agreements are intended to assist in uncovering income from countries that were once (at least) identified as tax havens. No further legislation or regulation is required in order to implement these Agreements.[17] Australia is able to fulfil its obligations under these agreements under an existing provision of the legislation: Section 23 of the Tax Agreements Act enables some of the Commissioner's existing powers—like information gathering powers—to be used for the purpose of meeting Australia's obligations under an international taxation agreement such as this.

The other kind of agreement deals with the allocation of taxing rights between Australia and the other country ('Allocation of Taxing Rights Agreements'). These are of a similar nature to the better known 'double tax agreements', an expression that tends to be used for agreements with major trading partners that have comparable tax systems. Neither the British Virgin Islands nor the Isle of Man have comparable tax systems.

These Allocation of Taxing Rights Agreements set out rules for determining which country is entitled to tax certain income of certain individuals who may have relevant connections with both countries. For instance, under British Virgin Islands agreement, certain Government employees of the British Virgin Islands working in Australia will not be taxed in Australia. In the absence of this agreement, it is possible that at least some of these people would be subject to tax in Australia. Because this second kind of agreement may be at odds with Australian tax legislation, it must be given effect by formally incorporating the agreement into Australian tax legislation and giving it priority over that law.

What does this Bill do?

The Bill itself simply incorporates the Allocation of Taxing Rights Agreements into the Tax Agreements Act, most of which consists of annexed agreements that have been concluded with other countries. The operative provisions of the Bill simply give effect to the incorporation of the agreements into the Act. It is the terms of the agreements that are incorporated by the Bill that are the focus of the following explanation.

With one minor exception in relation to the Isle of Man, both agreements allocate taxing rights between Australia and the two other countries in order to prevent double taxation. The Isle of Man agreement also establishes a mechanism to assist in the resolution of disputes arising from transfer pricing adjustments made to taxpayers' income by the revenue authorities of Australia or the Isle of Man.

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17. Treasury, *National Interest Analysis [2009] ATNIA 7*, published March 2009, viewed 1 June 2009, http://www.aph.gov.au/house/committee/jsct/12march2009/tor.htm

The scope of people affected by both agreements is very limited. Both agreements are concerned with government employees and students. The Isle of Man agreement is also concerned with retirees.

The British Virgin Islands agreement

Articles 5 and 6 contain the main operative provisions of the agreement.

Under Article 5 of the British Virgin Islands agreement, each country has sole taxing rights over the salaries they pay to their own employees working for their own government in the other country. For instance, a British Virgin Islands resident who works in Australia in a British Virgin Islands government office would have their salary taxed by British Virgin Islands and not Australia. That is, Australia forgoes its taxing rights over the salaries of those British Virgin Islands government employees, working in government services for non-commercial purposes, in Australia.

Article 6 of the British Virgin Islands agreement obliges Australia to not tax maintenance, education or training payments received by British Virgin Islands students or business apprentices who are temporarily studying in Australia if those payments are made from outside Australia.

The Isle of Man Agreement

Articles 5, 6 and 7 are the main operative provisions of the agreement.

Under Article 5, Australia must not tax pensions and retirement annuities paid from Australia to residents of the Isle of Man if that income is subject to tax in the Isle of Man. On the other hand, Australia can tax pensions and retirement annuities paid from the Isle of Man to residents of Australia.

Article 6 of the agreement has the same effect as Article 5 of the British Virgin Islands agreement. That is, each country has sole taxing rights over the salaries they pay to their own employees working for their own government in the other country. An Isle of Man resident who works in Australia in an Isle of Man government office would have their salary taxed by the Isle of Man and not Australia. That is, Australia forgoes its taxing rights over the salaries of those Isle of Man government employees, working in government services for non-commercial purposes, in Australia.

Article 7 of the Isle of Man agreement has the same effect as Article 6 of the British Virgin Islands agreement. That is, it obliges Australia not to tax maintenance, education or training payments received by Isle of Man students or business apprentices who are temporarily studying in Australia if those payments are made from outside Australia.

Article 8 is unique to the Isle of Man agreement. It obliges the relevant agency in each country to try to resolve disputes arising from transfer pricing adjustments made to taxpayer's income by the revenue authorities of each country.

Committee consideration

The Bill has not been referred to any Committee. However, according to usual practice, all four agreements have been considered by the Joint Standing Committee on Treaties. The Committee recommended that binding treaty action be taken.[18]

Financial implications

The Explanatory Memorandum says that the measure implemented by this Bill will have negligible financial effect.

Main provisions

Item 3 inserts **new sections 11ZM and 11ZN** into the Tax Agreements Act to provide that on the date that the agreements come into force, the provisions of the agreements have the force of law in Australia.

Item 4 of Schedule 1 to the Bill inserts, as **Schedules 48** and **49** to the Tax Agreements Act, the agreements with the British Virgin Islands and the Isle of Man respectively.

Concluding comments

The Bill gives legislative force to two minor agreements with the Isle of Man and the British Virgin Islands. On their terms, these two agreements are of little significance to Australia. They have been entered into by Australia in order to provide an inducement to the other countries—both of which have previously been identified by the OECD as tax havens—to enter into tax information sharing agreements with Australia. These latter agreements are intended to enable other countries to obtain information about income earned in tax havens in a limited range of circumstances. Tax information sharing

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18. C Bowen, 'Second reading speech: International Tax Agreements Amendment Bill (No. 1) 2009, Federal Financial Relations Bill 2009', House of Representatives, *Debates*, 19 March 2009, pp. 3240–3241, viewed 1 June 2009, http://www.aph.gov.au/hansard/reps/dailys/dr190309.pdf

agreements with both the British Virgin Islands and the Isle of Man were signed on the same day as the agreements that are the subject of this Bill.

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