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

Introduction

2.1 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 Agreement will replace an existing Agreement which was signed on 28 February 1980.[1]

2.2 The Agreement was tabled in the Commonwealth Parliament on 11 December 2013.

Overview and national interest summary

2.3 The National Interest Analysis (NIA) explains that the Agreement will update the existing bilateral tax arrangements between Australia and Switzerland and align them with current Australian and international tax policy settings. This is expected to encourage trade and investment, which

1 National Interest Analysis [2013] ATNIF 21 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* done at Sydney, 30 July 2013 [2013] ATNIF 21 (hereafter referred to as 'NIA'), para 1.

will further enhance economic relations between the two countries, and enhance tax system integrity.[2]

2.4 The Agreement 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 Agreement 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.[3]

Reasons for Australia to take the proposed treaty action

2.5 The following information on the claimed benefits to Australia of the proposed treaty action is taken from the NIA.

Reducing barriers to bilateral trade and investment

2.6 The Agreement 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.[4]

2.7 The Agreement 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

2 NIA, para 3.

3 NIA, para 4.

4 NIA, para 5.

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).[5]

2.8 The Agreement will reduce the dividend withholding tax rate limit from 15 per cent 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 per cent or more, subject to certain conditions, and to 5 per cent on inter-corporate dividends on other holdings of 10 per cent 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.[6]

2.9 The Agreement will reduce the interest withholding tax rate limit from 10 per cent 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).[7]

2.10 The Agreement will also reduce the royalty withholding tax limit from 10 to 5 per cent (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.[8]

Increased certainty and reduced compliance costs for taxpayers

2.11 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 Agreement will require

5 NIA, para 6.
6 NIA, para 7.
7 NIA, para 8.
8 NIA, para 9.

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.[9]

2.12 The Agreement 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).[10]

2.13 The Agreement 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.[11]

2.14 The Agreement 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 Agreement.[12]

2.15 Under the Agreement, 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 Agreement.[13]

2.16 The Agreement 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 Agreement.[14]

9 NIA, para 10.
10 NIA, para 11.
11 NIA, para 12.
12 NIA, para 13.
13 NIA, para 14.
14 NIA, para 15.

Establishing a more effective framework to address international fiscal evasion

2.17 The Agreement 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.[15]

2.18 Treasury outlined how the changes would enhance the existing arrangements regarding tax integrity and secrecy:

> … a non-discrimination article has been inserted in this treaty—there was no article in the previous treaty or the current treaty. The mutual agreement procedure article has been updated to include for the possibility of arbitration of tax disputes, and the exchange-of-information rules have been updated so that when the treaty enters into force the two countries can now exchange taxpayer information for the purpose of preventing tax evasion. Under the existing treaty such information can only happen for the purpose of preventing double taxation or for administering the treaty in other ways.[16]

2.19 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 Agreement will enhance Australia's ability to administer and enforce its domestic tax laws.[17]

2.20 Asked about the extent of tax evasion between Australia and Switzerland, the Australian Taxation Office (ATO) acknowledged the difficulty of placing a dollar figure on the issue but told the Committee that over 188 000 transactions took place between the two countries during the 2012-

15 NIA, para 16.

16 Mr Gregory Wood, Manager, Tax Treaties Unit, Tax System Division, Treasury, *Committee Hansard*, Canberra, 10 February 2014, p. 7.

17 NIA, para 17.

13 financial year involving over $41 billion.[18] Although the Australian Transaction Reports and Analysis Centre (AUSTRAC) cannot identify entity type from information reported on bank to bank funds movements, the ATO advised that of these transactions 52 547 could be attributed to 20 249 individuals and 44 481 to 7 278 companies.[19] These transactions account for nearly $16 billion. However no details of entities could be supplied for nearly 81 000 of the transactions, totalling over $22.5 billion.[20] While many of these transactions are legitimate the Agreement will provide a 'screening mechanism' to identify those that may not be.[21]

2.21 Although the provisions of the Agreement cannot be exercised retrospectively, the ATO assured the Committee that they will be a useful deterrent and may encourage compliance with Australian tax law.[22] The Treasury emphasised that the lack of retrospectivity would not prevent investigation of existing accounts.[23]

2.22 The Agreement 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 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).[24]

2.23 Questioned on the most effective way to stem loss of revenue through profit-shifting, the Treasury suggested a two-part solution:

> … the first is better compliance activity… with this treaty there are much more robust information-sharing arrangements. More broadly, there is the automatic exchange of information standard that is being developed by the OECD and the G20, so all G20 countries are acting in concert to limit the extent and the ease with which profit shifting and evasion happen. Then there is the issue … of ensuring one's own tax system and tax settings are right and

18 Mr Grant Goodwin, Executive Director, Exchange of Information Unit, Transparency Practice, Internationals, Public Groups and International, Australian Taxation Office (ATO), *Committee Hansard*, Canberra, 10 February 2014, p. 8.

19 Australian Taxation Office (ATO), *Submission 2*.

20 ATO, *Submission 2*.

21 Mr Gerry Antioch, General Manager, Tax System Division, Revenue Group, Treasury, *Committee Hansard*, Canberra, 10 February 2014, p. 12.

22 Mr Goodwin, ATO, *Committee Hansard*, Canberra, 10 February 2014, p. 7.

23 Mr Wood, Treasury, *Committee Hansard*, Canberra, 10 February 2014, p. 11.

24 NIA, para 18.

> competitive. Profit shifting happens presumably because people find that it is profitable to locate in another jurisdiction, and so ensuring that tax policy and tax settings are right also helps in stemming the leakage.[25]

Obligations

2.24 **Articles 6 to 21** allocate taxing rights in respect of certain types of income and fringe benefits between the two countries. The obligations contained in these articles are of a kind already present in the existing Agreement, with the key differences discussed below.[26]

2.25 **Article 2** clarifies that Australia's fringe benefits tax, petroleum resource rent tax and minerals resource rent tax will be included within the scope of the Agreement. None of these taxes are explicitly covered by the existing Agreement.[27]

2.26 **Article 5** defines 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. [28]

2.27 **Article 6** provides 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.[29]

2.28 **Article 7** clarifies 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.[30]

25 Mr Antioch, Treasury, *Committee Hansard*, Canberra, 10 February 2014, p. 8.
26 NIA, para 19.
27 NIA, para 20.
28 NIA, para 21.
29 NIA, para 22.
30 NIA, para 23.

2.29 **Article 8** provides that profits from shipping or air transport activities undertaken between two ports within a country will be taxable in that country.[31]

2.30 **Article 9** requires the revenue authorities to make correlative adjustments to the amount of tax charged on income in certain circumstances to remove double taxation.[32]

2.31 **Article 10, 11 and 12** applies to the taxation of dividends, interest and royalties respectively, reducing the source country tax rate limits that apply to such income from the corresponding rates contained in the existing Agreement.[33]

2.32 **Article 13** provides 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.[34]

2.33 **Article 15** prevents 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.[35]

2.34 **Article 18** provides 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.[36]

2.35 **Article 19** provides for government pensions paid in respect of past employment to be taxed exclusively in the source country in certain circumstances.[37]

2.36 **Article 23** requires 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.[38]

2.37 **Article 24** establishes 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. It will also permit taxpayers to pursue independent arbitration where a dispute remains unresolved after three years.[39]

31 NIA, para 24.
32 NIA, para 25.
33 NIA, para 26.
34 NIA, para 27.
35 NIA, para 28.
36 NIA, para 29.
37 NIA, para 29.
38 NIA, para 30.
39 NIA, para 31.

2.38 **Article 25** obliges the exchange of tax information between both countries, including a specific obligation to gather and provide information upon request. **Article 25(2)** imposes 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)** allows either country to decline to supply information in certain circumstances.[40]

Implementation

2.39 The implementation of the Agreement requires 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 Agreement 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 Agreement will not affect the existing roles of the Commonwealth, or the States and Territories, in tax matters.[41]

Costs

2.40 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.[42]

First-round impact of the Agreement

2.41 Treasury estimates 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 Agreement. As the Agreement is broadly consistent with international norms, it is expected to

40 NIA, para 32.

41 NIA, para 33.

42 NIA, para 34.

reduce compliance costs for those taxpayers with cross-border dealings between the two countries.[43]

2.42 There would be a small, unquantifiable cost in administering the changes made by the Agreement, 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 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.[44]

Second-round impact of the Agreement

2.43 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.[45]

2.44 The Committee sought clarification regarding the actual cost of implementing the Agreement. The Treasury estimated that the reduction in withholding tax would amount to a loss of approximately $70 million and admitted that there was no provision in forward estimates to cover this loss.[46]

Conclusion

2.45 The Committee is aware of the ongoing need to improve the integrity and transparency of the tax system and combat tax evasion and profit-shifting. The revision and modernisation of the Australian-Switzerland treaty is an important step in this process. The Committee also welcomes the benefits that will flow to individuals and businesses with cross-border dealings between the two countries.

2.46 The Committee supports Australia's ratification of the Agreement and recommends that binding treaty action be taken.

43 NIA, para 35.

44 NIA, para 36.

45 NIA, para 37.

46 Mr Wood, Treasury, *Committee Hansard*, Canberra, 10 February 2014, p. 11.

Recommendation 1

The Committee supports the *Convention between Australia and the Swiss Confederation for the Avoidance of Double Taxation with respect to Taxes on Income* and recommends that binding treaty action be taken.