

24 September 2008

INTERNATIONAL TAX AGREEMENTS AMENDMENT BILL (NO. 2) 2008

Second Reading

Mr BRADBURY (Lindsay) (1.35 p.m.) — I rise in support of the International Tax Agreements Amendment Bill (No. 2) 2008 and to add my comments to the debate, having listened to the member for Cowan and his comments in relation to the large proportion of South Africans that account for his constituency. Whilst obviously it is important for those people, I think that we should acknowledge that this is a big issue in terms of trade more generally for Australia and really does go a long way towards augmenting the very strong bilateral trade relationship that Australia and the Republic of South Africa have.

The bill essentially incorporates into Australian law the protocol amending the double tax agreement that is currently in place between Australia and the Republic of South Africa. That agreement is the Agreement between the Government of Australia and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, and Protocol of 1999. The protocol makes a number of amendments and has in large part been triggered by the most favoured nation status clause that exists within the existing double tax agreement between the two countries. In 2003 when Australia entered into the double tax agreement with the United Kingdom—which is the Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains—the most favoured nation status clause within our double tax agreement with the Republic of South Africa required us to take action to update that agreement with South Africa to ensure that comparable terms were passed on to South Africa. The protocol implements a number of technical amendments.

It is worth reflecting on the significance of Australia's relationship with South Africa. South Africa is Australia's largest trading partner in Africa. It is our 21st largest trading partner. In 2007, South African investment in Australia was \$1.2 billion and Australian investment in South Africa was approximately \$893 million. We are a net trade exporter to South Africa. Australia is ranked 12th on the list of South Africa's principal export destinations, and Australia is the 16th largest exporter of goods and services to South Africa. South Africa has a population of around 47 million people. We have strong bilateral ties with South Africa, and these are evidenced in some of the other bilateral agreements that the two countries have entered into. They include conventions and agreements that relate to extradition, defence information, air services and science and technology. So it is a significant relationship, and the significance is recognised through the existence of the most favoured nation obligation within the double tax agreement.

In considering the impact of the changes, it is worth reflecting on what a double tax agreement is and what the effect of implementing a double tax agreement is—or, in this case, an amendment through the protocol to the double tax agreement. Double tax agreements are entered into by the contracting states

and they set out the means by which each of those contracting states is to tax gains that occur either in respect of their residents or in respect of activities that have a source that relates to their jurisdiction. Obviously in a global economy where flows of money, investment and capital are occurring across borders on not only a daily basis but a minute by minute basis, it is important to avoid double taxation. Individuals, corporations and entities right across the globe would be discouraged from investing in other nations if their productive efforts were to be taxed not only in the country where that gain was to be sourced but also back in their hands in their resident country. That would lead to a situation of double taxation. Where the two contracting states have met their obligations in relation to integrity—the integrity of their tax systems, the integrity of the systems that allow for an appropriate flow of information and an exchange of information to combat some of the practices of tax avoidance that might exist—countries come together and seek to allocate taxation rights to ensure that the principle that one should not be double taxed is, at least in general terms, upheld.

This protocol makes a number of specific technical changes that go a long way towards addressing those particular issues. I note that one of the key elements of the protocol is to update the provisions in relation to the prevention of tax discrimination. The protocol introduces new rules in this regard. They broadly align with the international tax treaty practice and protect Australian nationals and businesses operating in South Africa—and vice versa. It is a measure designed to ensure some freedom of investment between the two countries.

In respect of dividends, I note that there are some changes brought about as a result of article 5 of the protocol, which, in effect, substitutes new provisions in article 10 of the original double tax agreement. The new dividends article provides for a withholding tax rate limit of five per cent for all non-portfolio intercorporate dividends. That replaces the existing zero rate for non-portfolio intercorporate dividends where those dividends are paid out of profits that have already borne the full rate of company tax. A 15 per cent rate applies for all other dividends.

It is important to note that these measures really do bring about some harmonisation with the OECD model tax convention. The changes that have been made in respect of non-portfolio intercorporate dividends, and the withholding tax rate that is applicable therein, were negotiated in the context of the South African government's recent announcement, in their 2007-08 budget, of changes that they are making to their system of taxing corporate profits. These changes include the phasing out of the secondary tax on companies, which is not subject to treaty limitations, and they will be introducing a new dividend tax on shareholders. The implementation of these changes to domestic South African law is subject to the renegotiation of dividend withholding tax rates by South Africa in several of its tax treaties. In particular, that involves the tax treaty that exists with Australia.

Australian non-portfolio investment in South Africa will benefit; I think we will benefit greatly from the reduced total South African tax on corporate profits which will be brought about as a result of these measures. Franked dividends paid to South African residents will continue to be exempt from withholding tax, which is standard practice right across the international tax arena.

In terms of interest, article 6 of the protocol, which effectively amends article 11 of the double tax agreement, relates to the taxation of interest. Source country tax on interest will continue to be limited to 10 per cent. However, importantly, there have been some changes that ensure that no tax will be chargeable in the source country on the interest derived by the government of the other country or from

the investment of official reserve assets or financial institutions resident in the other country. This is a particular exemption that is commonplace in some of the other more recent double tax agreements that Australia has entered into. Those exemptions will, of course, be subject to safeguards to discourage tax avoidance.

The general limit for royalties—perhaps the most typical example of those payments is payments in respect of the granting of intellectual property rights—will be reduced from 10 per cent to five per cent. The protocol provides that amounts derived from equipment leasing, including container leasing, will be excluded from the royalty definition. These amounts will either be treated as profits from the international transport operations article or under the business profits article.

In addition to these measures, the protocol also contains an expanded list of taxes. It contains a refined definition of ‘permanent establishment’. It contains provisions which align capital gains tax treatment more closely with Australian law and the OECD practice. Significantly, improved integrity measures are contained within the protocol to provide for a more effective exchange of information on a broader range of taxes, including the goods and services tax. I note that this particular agreement was entered into prior to the implementation of the goods and services tax in Australia. This is a standard measure that is being introduced into all of our renegotiated tax agreements.

That is a summary of some of the key elements, in a technical sense, that will be implemented by the incorporation of the protocol into Australian law. It is worth noting that this particular agreement has been considered by the Joint Standing Committee on Treaties, and the committee has recommended that binding treaty action be taken. In the course of its deliberations the Joint Standing Committee on Treaties engaged in a fairly extensive process of consultation. I note from the national interest analysis that has been prepared in respect of this agreement that Treasury sought comments from the business community regarding issues that might be raised during the negotiations with South Africa. That involved consultations with the Tax Treaties Advisory Panel which, of course, includes members such as the Business Council of Australia, CPA Australia, the Corporate Tax Association, the Institute of Chartered Accountants, the International Fiscal Association, the Investment and Financial Services Association, the Law Council of Australia, the Minerals Council of Australia and the Taxation Institute of Australia. In addition to that, there has been consultation with the state and territory governments through the Commonwealth-State Standing Committee on Treaties. So there has been extensive consultation.

I would like to turn to the broader issue of withholding taxes and comment also on some of the developments in relation to this government’s efforts to establish Australia as a financial services hub. It is important to understand conceptually what withholding tax is. We have double taxation agreements which seek to allocate taxation rights but, notwithstanding the particular provisions of any double tax agreement, where income is derived in a country that is not the country of residence of the particular individual or entity that is deriving that gain, it is commonplace throughout the tax world for the source country to seek a share of the income tax that might be secured by the government in respect of those gains. The easiest way to do that is to impose a withholding tax.

I note the recent comments of the shadow Treasurer on some of the other measures that this government has pursued in relation to very significant reductions in withholding tax rates and distributions from managed investment trusts. In responding to the Treasurer’s ministerial statement earlier this week, the new shadow Treasurer made the following statement:

It is symptomatic of a government that ... says it wants to promote Australia as a financial services hub and then reduces withholding tax for foreigners.

Implicit in that quote is the notion that there is some contradiction between the two propositions—proposition A being to try and secure a place for ourselves as a financial services hub, and proposition B being a desire to reduce withholding taxes. I cannot for the life of me see where the contradiction exists. There is no such contradiction. In fact, if you were looking for tangible ways to attract greater investment to this country, one of the key means would be to reduce withholding taxes. That has been universally acknowledged right throughout the financial services sector.

The first plank of the financial services hub initiatives was the reduction in withholding tax rates, which was implemented as a result of legislation that passed through the parliament earlier this year. This government has taken the existing rate of 30 per cent—one of the highest withholding tax rates in the world in respect of managed investment trust distributions—and is in the process of implementing a staged set of reductions which will ultimately reduce that withholding tax rate to 7.5 per cent in future years. It will be reduced to 22.5 per cent in the 2008-09 year and to 15 per cent in the 2009-10 year. In that year it will be a final withholding tax, as opposed to a non-final one. In future years we foresee reductions down to 7.5 per cent.

The significance of these measures cannot be underestimated, because they send a very clear message to international capital that Australia is a very favourable destination in which they may choose to invest. One of the strongest signals that we can send is the taxation regime that is in existence. If we combine that measure with the continued revision of our double tax agreements, of which the incorporation of this protocol forms an integral part, we see that the government is very much committed to ensuring that the taxation requirements that are imposed domestically, but also those that have effect on international investors, will create a regime that will attract as much investment in Australia as possible.

We have here before the House a very significant example of Australia's bilateral relationship with South Africa. It is a relationship that we value, and by implementing this protocol we are making good on the most favoured nation obligations contained within the double tax agreement. I commend the bill to the House.