

2019

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

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TREASURY LAWS AMENDMENT (INTERNATIONAL TAX AGREEMENTS)  
BILL 2019

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EXPLANATORY MEMORANDUM

(Circulated by authority of the  
Treasurer, the Hon Josh Frydenberg MP)



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## ***Table of contents***

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|  |    |
|--|----|
| Glossary.....  | 1  |
| General outline and financial impact.....                        | 3  |
| Chapter 1      The Australia-Israel Convention .....             | 5  |
| Chapter 2      Australia’s deemed source rule .....              | 49 |
| Chapter 3      Statement of compatibility with human rights..... | 57 |



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# Glossary

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The following abbreviations and acronyms are used throughout this Explanatory Memorandum.

| <b><i>Abbreviation</i></b> | <b><i>Definition</i></b>   |
|----------------------------|--|
| Agreements Act             | <i>International Tax Agreements Act 1953</i>   |
| Assessment Acts            | The ITAA 1936 and ITAA 1997  |
| BEPS                       | Base Erosion and Profit Shifting   |
| Convention                 | <i>Convention between the Government of Australia and the Government of the State of Israel for the Elimination of Double Taxation with respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance</i> |
| FBT Act                    | <i>Fringe Benefits Tax Assessment Act 1986</i>   |
| G20                        | <i>Group of 20</i>   |
| Israel                     | The State of Israel  |
| ITAA 1936                  | <i>Income Tax Assessment Act 1936</i>  |
| ITAA 1997                  | <i>Income Tax Assessment Act 1997</i>  |
| OECD                       | Organisation for Economic Cooperation and Development  |
| OECD Model                 | OECD Model Tax Convention on Income and on Capital   |
| OECD Model Commentary      | OECD Model Convention Commentaries (contained in the OECD Model Tax Convention on Income and Capital Full Version (as it read on 21 November 2017))  |



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## ***General outline and financial impact***

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### **The Australia-Israel Convention and deemed source rule**

This Bill amends the Agreements Act to give force of law to the *Convention between the Government of Australia and the Government of the State of Israel for the Elimination of Double Taxation with respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance* (the Convention). This process is part of Australia's domestic procedure for implementing its tax treaties.

This Bill also introduces a domestic source of income rule to ensure that Australia can exercise its taxing rights under the Convention and future international tax agreements.

***Date of effect:*** The amendments commence on the day after they receive the Royal Assent. However, the Convention itself must first enter into force before it can take effect. For entry into force, Australia and Israel must exchange instruments of ratification on the completion of their domestic implementation procedures.

***Proposal announced:*** On 23 February 2017, Australia and Israel announced their commitment to conclude a tax treaty in a joint media statement (Joint Statement by Prime Ministers of Israel and Australia, Media Release of 23 February 2017 refers). On 28 March 2019, the Australian Government announced it has signed the Convention (New tax treaty signed with Israel, Media Release of 28 March 2019 refers).

***Financial impact:*** The Bill is estimated to have an unquantifiable cost to revenue over the forward estimates.

***Human rights implications:*** This Bill does not raise any human rights issue. See *Statement of Compatibility with Human Rights* — Chapter 3.

***Compliance cost impact:*** The Convention is consistent with international norms and no significant additional compliance costs are anticipated as result of its entry into force.





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# **Chapter 1**

## **The Australia-Israel Convention**

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### **Outline of chapter**

1.1 This Bill amends the Agreements Act to give force of law to the Convention.

### **Context of amendments**

1.2 The Convention was signed in Canberra, Australia, on 28 March 2019. It improves bilateral tax arrangements between Australia and Israel by alleviating double taxation of income. It also enables greater administrative cooperation in tax matters, including through information exchange, to help reduce tax evasion and avoidance.

1.3 Countries commonly seek to eliminate double taxation and, particularly since the Final Reports of the OECD/G20 *Base Erosion and Profit Shifting Project* in 2015, mitigate tax evasion and avoidance through tax treaties. In 2019, Australia had bilateral tax treaties in place with over 40 jurisdictions.

1.4 The Convention broadly follows the OECD Model. OECD members and many other countries use the OECD Model as the basis of bilateral conventions to eliminate double taxation. This helps to ensure a uniform approach to resolving the most common problems that arise in international taxation.

### **Double taxation**

1.5 A key objective of the Convention is to alleviate the double taxation that results from the interaction of the Australian and Israeli tax systems. The OECD defines double taxation as the imposition of comparable taxes in two (or more) countries on the same taxpayer in respect of the same taxable income or capital.

1.6 Australia and Israel, like most countries, tax income on both a ‘source’ and ‘residence’ basis. For example, Australia usually taxes Australian residents on income from both domestic and foreign sources, and taxes non-residents on income from Australian sources.

1.7 Double taxation can occur when there is an overlap of source and/or residence taxing rights, such as when a person who is resident in one country derives income from another.

1.8 Under the Convention, Australia and Israel agree to restrict their respective taxing rights to alleviate double taxation. The Convention allocates taxing rights between Australia and Israel over different categories of income including business profits, dividends, interest, royalties and pensions. The Convention also provides for relief from double taxation where both countries have a right to tax the same income, and for the resolution of disputes where the two countries attempt to tax the same income.

## Tax evasion and avoidance

1.9 Another key objective of the Convention is to prevent tax evasion and avoidance. This is made clear in the title and the preamble of the Convention which clarify that Australia and Israel do not intend the provisions of the Convention to create opportunities for tax evasion and avoidance.

1.10 As members of the Inclusive Framework on BEPS, Australia and Israel are committed to the implementation of the OECD/G20 BEPS Project. That project provides governments with solutions, designed to be implemented domestically and through treaty provisions, for closing the gaps in existing international tax rules that allow corporate profits to disappear or be artificially shifted to low/no tax environments. These solutions are outlined in the *Base Erosion and Profit Shifting 2015 Final Reports*.

1.11 The Convention adopts a range of the integrity provisions recommended by the BEPS Project. These are outlined in the table below.

| <i>Australia-Israel Convention provisions</i>  | <i>BEPS Project 2015 Final Reports</i> |
|--|--|
| Title  | Action 6                               |
| Preamble   | Action 6                               |
| Article 1 (Persons covered), paragraph 2   | Action 2                               |
| Article 5 (Permanent establishment), paragraphs 5, 6, 7, 9, 10 and subparagraph 8(a) | Action 7                               |
| Article 7 (Business profits), paragraph 9  | Action 14                              |
| Article 9 (Associated enterprises), paragraph 4                                      | Action 14                              |
| Article 10 (Dividends), subparagraph 2(a)  | Action 6                               |
| Article 13 (Alienation of property), paragraph 2                                     | Action 6                               |
| Article 22 (Limitation on Benefits)  | Action 6                               |
| Article 25 (Mutual agreement procedures), paragraphs 1, 2 and 3                      | Action 14                              |

## Summary of new law

1.12 This Bill amends the Agreements Act to give the Convention the force of law in Australia.

1.13 Key features of the Convention include:

- Reduced withholding tax rates to create a more favourable bilateral investment environment and also make it cheaper for Australian business to access foreign capital and technology;
- Rules to reduce potential double taxation, which can deter investment; and
- Providing greater tax certainty to taxpayers in both jurisdictions.

1.14 Importantly, the Convention also includes OECD/G20 BEPS treaty-related recommendations, in line with Australia’s ongoing commitment to tackling international tax avoidance practices.

## Comparison of key features of new law and current law

| <i>New law</i>                                    | <i>Current law</i> |
|---|--------------------|
| The Convention has the force of law in Australia. | Not applicable.    |

## Detailed explanation of new law

1.15 These amendments list the ‘Israeli Convention’ as a current agreement that is given the force of law by the Agreements Act. *[Schedule 1, item 2, subsection 5(1) (table item relating to Convention) of the Agreements Act]*

1.16 The effect of this listing is that the provisions of the Convention are prioritised over the provisions of the Assessment Acts (other than Part IVA of the ITAA 1936), the FBT Act, and any imposition Acts to the extent of any inconsistency (see sections 4 and 4AA of the Agreements Act).

1.17 The amendments define the ‘Israeli Convention’ as the Convention, and its protocol, entered into between the Government of Australia and the Government of the State of the Israel on 28 March 2019 in Canberra. *[Schedule 1, item 1, subsection 3AAA(1) (definition of Israeli Convention) of the Agreements Act]*

1.18 The Convention is based on the OECD Model. Consistent with the way that Australia negotiates its tax treaties, the OECD Model Commentary is directly relevant to the interpretation of the equivalent provisions of the Convention.<sup>1</sup>

1.19 The following section provides an overview of the provisions of the Convention. As the OECD Model Commentary explain the provisions of the Convention that are identical to the equivalent provision in the OECD Model, the overview focusses on the departures from the OECD Model that were agreed to by Australia and Israel.

1.20 Where particular provisions of the Convention are not explained in the following section, it is because those provisions are aligned with the equivalent provision in the OECD Model and their operation is explained by the OECD Model Commentary.

## The Australia-Israel Convention

### *Title and preamble*

1.21 The title and the preamble are a general statement of the object and purpose of the Convention. The title and preamble provide that the Convention is for: the elimination of double taxation concerning taxes on income; and, the prevention of tax evasion and avoidance, including through the provisions of the treaty.

1.22 As the title and preamble form part of the context of the Convention, they serve an important role in interpreting the provisions of the Convention. This is consistent with the general rule of treaty interpretation in Article 31(1) of the Vienna Convention on the Law of Treaties, which provides that a ‘treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.’

### *Article 1 – Persons covered*

1.23 Article 1 establishes that the Convention applies to all ‘persons’ who are residents of one or both of Australia and Israel. [*Article 1, paragraph 1*]

1.24 ‘Persons’ is defined to include an individual, company and any other body of persons. [*Article 3, subparagraph 1(j)*]

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<sup>1</sup> The OECD Model and the OECD Model Commentary can be accessed online at: <https://www.oecd.org/tax/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm>; and <https://www.oecd.org/tax/treaties/model-tax-convention-on-income-and-on-capital-2017-full-version-g2g972ee-en.htm>

1.25 Article 1 helps to ensure that the benefits of the Convention for income derived by or through entities that are wholly or partly fiscally transparent (for example, certain partnerships and trusts) are granted in appropriate cases, but only to the extent that the income is treated as the income of a resident of Australia or Israel under their respective domestic laws. *[Article 1, paragraph 2]*

1.26 In the case of Australia, entities that are treated as wholly or partly fiscally transparent for Australian tax purposes include partnerships and trusts. Such entities include partnerships that are subject to Division 5 of Part III of the ITAA 1936 (but not corporate limited partnerships that are subject to Division 5A of Part III). They also include trusts that are subject to Division 6 of Part III of the ITAA 1936 where the beneficiary of the trust is presently entitled or specifically entitled to the income and/or gains of the trust, as well as trusts that are subject to Division 276 (but not a public trading trust subject to Division 6C of Part III).

1.27 The reference to ‘income’ in this Article has a wide meaning, and is to be read as including ‘profits or gains’. *[Protocol, paragraph 2]*

1.28 Using the term ‘income’ in this way is intended to put beyond doubt that the various forms of income that may be taxable in Australia are within scope of this Article.

1.29 Paragraph 3 confirms the general principle that the Convention does not restrict in any way Australia or Israel’s right to tax their own residents, except where this is intended. *[Article 1, paragraph 3]*

1.30 The paragraph lists the Articles of the Convention that affect the taxation of a resident of Israel or Australia. To the extent there are any differences between the Articles listed in this paragraph and the corresponding paragraph in the OECD Model it is because the Article in the Convention does not affect the taxation of a resident.

### ***Article 2 – Taxes covered***

1.31 Article 2 specifies that taxes on income are covered by the Convention. Article 2 also specifies the existing taxes to which the Convention particularly applies to. *[Article 2]*

1.32 In Israel, these taxes are: the income tax and company tax (including tax on capital gains); the tax on gains from the alienation of property according to the Real Estate Taxation Law; and the Petroleum Profits Taxation Law. *[Article 2, subparagraph 3(a)]*

1.33 In Australia, these taxes are: the income tax; resources rent tax; and the fringe benefits tax. *[Article 2, subparagraph 3(b)]*

1.34 The Convention also applies to any identical or substantially similar taxes that Australia or Israel may implement domestically in the future. The competent authorities of Australia and Israel (the Australian

and Israeli tax authorities) are required to notify each other of any significant changes to their taxation laws. *[Article 2, paragraph 4]*

1.35 Article 2 departs slightly from the OECD Model to reflect that in Australia and Israel taxes on income are collected at the federal level and not by political subdivisions or local authorities. *[Article 2, paragraph 1]*

### ***Article 3 – General definitions***

1.36 Article 3 provides definitions of and rules of interpretation for basic terms and key concepts that are used throughout the Convention that apply for all purposes. Certain other terms are defined in other articles of the Convention, such as ‘resident of a Contracting State’ (Article 4) and ‘Permanent Establishment’ (Article 5).

1.37 The term ‘Israel’ means the State of Israel, inclusive of its territorial sea and adjacent maritime areas. *[Article 3, subparagraph 1(a)]*

1.38 Australia’s implementation of the Convention is without prejudice to Australia’s support for a two-state solution to the conflict between Israel and the Palestinians, including the resolution of final status issues. For the purposes of the Convention, Australia interprets references to ‘the State of Israel’ in accordance with Australia’s obligations under international law and UN Security Council resolutions. Nothing in Australia’s implementation implies recognition by Australia of any claims to disputed territories.

1.39 The definition of ‘Australia’ in the Convention follows the model set out in Australia’s other modern tax treaties. The definition excludes all external territories, but adds back certain external territories by further exception. The definition includes areas adjacent to Australia (and the relevant Territories) which are subject to a domestic law dealing with the exploration for and exploitation of natural resources of the exclusive economic zone, or the seabed and subsoil of the continental shelf. *[Article 3, subparagraph 1(b)]*

1.40 The terms ‘a Contracting State’ and ‘the other Contracting State’ mean Australia and Israel and are used interchangeably to refer to Australia and Israel, as the context requires. *[Article 3, subparagraph 1(c)]*

1.41 The definition of ‘company’ in the Convention means any body corporate or any entity which is treated as a company or a body corporate for tax purposes. *[Article 3, subparagraph 1(d)]*

1.42 This definition is broadly consistent with the definition in the OECD Model, which refers to any entity that is treated as a body corporate for tax purposes. The definition is adapted to reflect that Australia’s income tax laws do not use the expression ‘body corporate’.

1.43 The term ‘competent authority’ means the Commissioner of Taxation for Australia and the Minister of Finance for Israel, and their authorised representatives. *[Article 3, subparagraph 1(e)]*

1.44 The term ‘enterprise’ applies to the carrying on of any business. *[Article 3, subparagraph 1(f)]*

1.45 The term ‘business’ includes the performance of professional services and of other activities of an independent character. *[Article 3, subparagraph 1(k)]*

1.46 Consistent with the OECD Model, these definitions read together clarify that, under the Convention, business activities are considered to constitute an enterprise, regardless of the meaning of that term under domestic law.

1.47 The terms ‘enterprise of a Contracting State’ and ‘enterprise of the other Contracting State’ mean an enterprise carried on by a resident of Australia and Israel, and are used interchangeably to refer to Australia and Israel, as the context requires. *[Article 3, subparagraph 1(g)]*

1.48 The term ‘international traffic’ means any transport by a ship or aircraft, except when that transport is between points in a Contracting State, and the enterprise that operates the ship or aircraft is from the other Contracting State. *[Article 3, subparagraph 1(h)]*

1.49 This definition is used to preserve the right of a Contracting State to tax transportation that occurs domestically, even when it is carried out by an enterprise of the other State. The definition follows the alternative formulation to the standard OECD model that is provided for in paragraph 6.3 of the 2017 OECD Model Commentary on the definition.

1.50 The term ‘national’ means any individual possessing the nationality or citizenship of a Contracting State, and any legal person, company, partnership or association in accordance with a Contracting State’s domestic laws. *[Article 3, subparagraph 1(i)]*

1.51 The terms ‘person’ includes an individual, a company and any other body of persons. *[Article 3, subparagraph 1(j)]*

1.52 The term ‘tax’ means Australian tax or Israeli tax as the context requires, but excludes any penalty or interest imposed under Australia and Israel’s domestic laws. *[Article 3, subparagraph 1(l)]*

1.53 The taxes covered by the Convention are stipulated in Article 2 (Taxes Covered). The specific exclusion for penalties and interest is not contained in the OECD Model, but is a standard feature of Australia’s tax treaties. The exclusion reflects that penalties and interest are not treated as a tax under Australia’s income tax laws. As such, the Convention does not restrict the Commissioner of Taxation’s ability to levy penalties or interest where Australia has a right to tax, and Australia is not required to provide relief under the Convention for penalty or interest charges.

1.54 The term ‘recognised pension fund’ of a Contracting State extends the OECD Model definition to ensure that it applies appropriately to Australian superannuation funds. *[Article 3, subparagraph 1(m)]*

1.55 The changes ensure that Australian superannuation funds are covered by the definition, irrespective of the requirement that an entity or arrangement of a State be treated as a separate legal entity under the taxation laws of the State. This addition resolves the issue identified in paragraph 10.6 of the OECD Model Commentary on the definition, which recognises that in some States, a pension fund might not constitute a separate legal person.

1.56 The definition of recognised pension fund in the Convention also expands on the condition in sub-subparagraph 1(m)(ii), which covers entities or arrangements that are established and operated exclusively to invest funds for entities or arrangements that provide retirement benefits. The extension covers the investment of a life insurance company’s funds, to the extent those funds support retirement income products provided by the life insurance company. This extension reflects the fact that Australia’s superannuation system also extends to life insurance companies.

1.57 A term not defined in the Convention has the same meaning that it has under the domestic law of the Contracting State applying the Convention. The definition of a relevant term under a Contracting State’s taxation law has precedence over its meaning under other domestic laws. *[Article 3, paragraph 2]*

#### ***Article 4 – Resident***

1.58 Article 4 does not differ substantively from the corresponding Article in the OECD Model.

1.59 The Article provides a basic rule that defines the term ‘resident’ for the purposes of the Convention as any person who is liable to tax as a resident of Australia or Israel, or is liable to tax by reason of domicile, place of management, place of incorporation or any criterion of a similar nature. *[Article 4, paragraph 1]*

1.60 The Convention applies on the basis that a person is a resident of either Australia or Israel.

1.61 Article 4 contains a series of tie-breaker rules for determining the country of residence for an individual who is a resident of both Australian and of Israel under the basic residence rule. *[Article 4, paragraph 2]*

1.62 The tie-breaker rules are based on the equivalent provision in the OECD Model. Consistent with the OECD Model, the rules apply hierarchically (for example, the second tie-breaker rule only applies if an individual’s residence cannot be determined under the first rule). The final



tie-breaker rule provides that the competent authorities of Australia and Israel shall endeavour to resolve the individual's residence by mutual agreement. *[Article 4, subparagraph 2(d)]*

1.63 The requirement to endeavour to determine an individual's residence by mutual agreement is a departure from the equivalent provision in the OECD model, which obliges the competent authorities to settle the question of residency.

1.64 Article 4 also contains a tie-breaker rule for persons other than individuals that are residents of both Australia and Israel under the basic residence rule. This rule provides that the competent authorities of Australia and Israel shall seek to determine by mutual agreement, which country the dual-resident is a resident of for the purposes of the Convention. In reaching such agreement, the competent authorities must consider the dual-resident's place of effective management, place of incorporation or constitution, and any other relevant factors. *[Article 4, paragraph 3]*

1.65 Factors relevant to tie-breaker determinations may vary over time but are likely to include considerations such as:

- where the meetings of the entity's board of directors or equivalent body are usually held;
- where the chief executive officer and other senior executives usually carry on their activities;
- where the senior day-to-day management of the entity is carried on;
- where the entity's headquarters are located;
- which jurisdiction's laws govern the legal status of the entity;
- where its accounting records are kept; and
- whether determining that the entity is a resident of one jurisdiction but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention.

1.66 If the competent authorities cannot agree on a dual-resident's residence status, Article 4(3) will treat the dual-resident as neither a resident of Australia nor Israel for the purposes of the Convention. As a result, such residents will not be able to enjoy the benefits under the Convention. *[Article 4, paragraph 3]*

1.67 This tie-breaker rule is based on the equivalent provision in the OECD Model. However, in contrast to the OECD Model, the competent authorities are not authorised to agree to extend the benefits of the Convention to a person where they cannot agree on a person's residence

status. This departure is aligned with Australia's position in respect of Article 4 of the *Multilateral Convention to Implement Tax Treaty Measures to Prevent Base Erosion and Profit Shifting*.

1.68 Although the Convention may deem certain dual-residents to not be Australian residents for the purposes of enjoying benefits under the Convention (either because they are treated as a resident of Israel, or residents of neither Australia nor Israel), such persons remain a resident for the purposes of Australian domestic tax law. This is because the residence rule in the Convention does not affect the characterisation of a person's residence under Australia's domestic law. Accordingly, such a person remains liable for taxation in Australia as a resident, insofar as is permitted under the Convention.

### ***Article 5 – Permanent establishment***

1.69 Article 5 introduces the concept of 'permanent establishment', which is used to determine the rights of a Contracting State to tax the profits of an enterprise of the other Contracting State. This concept is central to the operation of Articles 7 (Business profits), 10 (Dividends), 11 (Interest), 12 (Royalties), 13 (Alienation of property), 14 (Income from employment), 21 (Other income) and 24 (Non-discrimination).

1.70 Article 5 applies the primary definition of 'permanent establishment' in the OECD Model. The definition applies for the purposes of the Convention and provides that a 'permanent establishment' is a fixed place of business through which an enterprise conducts its business. *[Article 5, paragraph 1]*

1.71 Article 5 also includes a non-exhaustive list of examples of places of business that constitute permanent establishments under paragraph 1. This list is based on the OECD Model but contains two variations. *[Article 5, paragraph 2]*

1.72 First, it expands the OECD Model example concerning a mine, an oil or gas well, a quarry or any other place of extraction of natural resources to include places of 'exploration' and 'exploitation' as permanent establishments under paragraph 1. *[Article 5, subparagraph 2(f)]*

1.73 This expansion reflects Israel's reservation outlined in paragraph 198 of the OECD Model Commentary on Article 5. Its inclusion is also consistent with paragraph 48 of the OECD Commentary on Article 5.

1.74 Second, consistent with the majority of Australia's other modern tax treaties, 'permanent establishment' is explicitly applied to agricultural, pastoral or forestry property. *[Article 5, subparagraph 2(g)]*

1.75 This reflects Australia's policy to retain taxing rights over the use of Australian land for primary production activities.

1.76 Consistent with the OECD Model, Article 5 further holds that a building site or a construction or installation project constitutes a permanent establishment. However, the Convention reduces the OECD Model's 12 month threshold for a site or project to be considered a permanent establishment to nine months. *[Article 5, paragraph 3]*

1.77 The truncation of the 12 month threshold to nine months further bolsters Australia's source-based taxation rights concerning its natural resources.

1.78 Article 5 deems three additional activities as permanent establishments, in line with Australia's reservations on Article 5 of the OECD Model Commentary. *[Article 5, paragraph 4]*

1.79 First, consistent with Australia's reservation to Article 5, set out in paragraph 202 of the OECD Model Commentary, Article 5 deems supervisory or consultancy activities connected to a building site or construction or installation project (exceeding 183 days in any 12 month period) to be a permanent establishment. *[Article 5, subparagraph 4(a)]*

1.80 This reservation reflects Australia's concerns that Article 5 of the OECD Model may not be broad enough to cover supervisory activities and consultancy activities which are not supervisory but of a similar character.

1.81 Second, Article 5 deems natural resource activities exceeding 90 days in any 12 month period to be a permanent establishment. In other words, a permanent establishment is deemed to exist where an enterprise of one country carries on natural resource exploration or exploitation activities (including operating substantial equipment) in the other country for a period or periods exceeding, in the aggregate, 90 days in any 12 month period. *[Article 5, subparagraph 4(b)]*

1.82 This provision preserves Australia's ability to tax profits from activities concerning Australian natural resources. This provision is consistent with Australia's reservation to paragraph 1 of Article 5 of the OECD Model, as noted in paragraph 188 of the OECD Model Commentary. *[Article 5, subparagraph 4(b)]*

1.83 Further, the provision establishes a duration test expressed as a period or periods exceeding, in aggregate, 90 days in any 12 month period. This lower duration test is consistent with international practice established in offshore activities articles. *[Article 5, subparagraph 4(b)]*

1.84 Finally, Article 5 provides that a permanent establishment is deemed to exist where an enterprise operates substantial equipment in a country for one or more periods which exceed, in aggregate, 183 days in any 12 month period. *[Article 5, subparagraph 4(c)]*

1.85 The meaning of the term ‘substantial’, in the context of the phrase, ‘substantial equipment’, is determined on the relevant facts and circumstances of each individual case. *[Article 5, subparagraph 4(c)]*

1.86 Factors such as size, quantity or value of the equipment, or the role of the equipment in income producing activities are relevant considerations. Examples of substantial equipment include:

- industrial earthmoving equipment used in road or dam building;
- manufacturing or processing equipment used in a factory; or
- oil or drilling rigs, or platforms and other structures used in the petroleum, gas or mining industries.

1.87 The inclusion of the operation of substantial equipment in subparagraphs 4(b) and 4(c) of Article 5 reflects Australia’s concerns about the shortcomings of the concept of a ‘fixed place of business’ in the OECD Model definition of permanent establishment. *[Article 5, paragraph 1]*

1.88 Australia’s experience is that the permanent establishment provision in the OECD Model may be inadequate to deal with high value mobile activities, in particular those involving the use of substantial equipment.

1.89 For example, the inclusion of the operation of substantial equipment as a permanent establishment ensures the definition of permanent establishment covers activities such as where vessels are used as platforms of offshore oil and gas activities. Such activities are places of business through which an enterprise carries on a business in Australia. However, the mobile nature of a vessel platform means they may not satisfy the requirements in the OECD Model for a place of business to be fixed. The inclusion of this provision makes clear that such activities are covered by the definition of permanent establishment and the Convention.

1.90 The reference to ‘operation’ and ‘operates’ in subparagraphs 4(b) and 4(c) ensure that only the active use of substantial equipment is covered by Article 5. *[Article 5, subparagraphs 4(b) and 4(c)]*

1.91 This means that an enterprise that merely leases substantial equipment to another person for that other person’s own use in a country would not be deemed to have a permanent establishment in that country under these provisions.

1.92 For example, if an Israeli enterprise itself operates a mobile crane at an Australian port for more than 183 days in a 12 month period, the enterprise would be deemed to have a permanent establishment in Australia under subparagraph 4(c) of this Article. If that Israeli enterprise merely leases the mobile crane to another person and that other person operates the crane at an Australian port for its own purposes, the Israeli

enterprise would not be deemed to have a permanent establishment in Australia under subparagraph 4(c) of this Article. However, if that other person operates the crane for or on behalf of the Israeli enterprise in Australia, the Israeli enterprise would be considered to operate the crane in Australia.

1.93 Article 5 further sets out rules for aggregating the time spent on particular projects by closely related enterprises for the purpose of paragraphs 3 and 4. *[Article 5, paragraph 5]*

1.94 These provisions prevent enterprises from circumventing the permanent establishment time thresholds by splitting. They are consistent with paragraph 52 of the OECD Model Commentary for Article 5, which notes that the time threshold has been the subject of some abuse, and that although contract splitting activities may fall within the scope of anti-avoidance rules, "...some States may nevertheless wish to deal expressly with such abuses".

1.95 Article 5 also contains a list of preparatory or auxiliary activities that are exceptions to the general definition of permanent establishment in paragraph 1 of Article 5, consistent with the equivalent provision in the OECD Model. These exceptions are subject to an anti-fragmentation rule that applies where business operations are split between locations. These exceptions *[Article 5, paragraphs 6 and 7]*

1.96 Article 5 also deems a permanent establishment to exist where a person, other than an independent agent, acts on behalf of an enterprise, even though the enterprise may not have a fixed place of business (within the meaning of paragraphs 1 and 2) in a Contracting State, under stipulated conditions. *[Article 5, paragraph 8]*

1.97 The conditions set out in the Convention are consistent with those of the OECD Model, with the exception of subparagraph 8(b) which extends the Article to cover situations where a person acts on behalf of another in the manufacturing or processing of goods or merchandise. *[Article 5, subparagraph 8(b)]*

1.98 This variation prevents an enterprise that undertakes manufacturing or processing activities in a country through an intermediary from avoiding tax in that country. Its inclusion reflects Australia's reservation to Article 5 of the OECD Model outlined at paragraph 188 of the OECD Model Commentary on Article 5. This reflects Australia's policy to retain taxing rights over profits from manufacturing or processing activities conducted in Australia on behalf of others, particularly in relation to mineral resources.

1.99 Paragraph 12 is an Australian specialty and there is no equivalent in the OECD Model. It provides that the principles set out in Article 5 apply when determining whether a permanent establishment exists in a third country, or a third country enterprise has a permanent

establishment in Australia or Israel. This is particularly the case when applying the source rules in Articles 11(7) (Interest) and 12(5) (Royalties).  
*[Article 5, paragraph 12]*

### **Article 6 – Income from immovable property**

1.100 Consistent with the OECD Model, Article 6 states that ‘immovable property’ is defined in accordance with the laws of the country in which it is located. Immovable property includes, for example, leases and other interests in or over land, livestock and equipment used in agriculture and forestry. The Convention adds to this definition to clarify that the right to explore or mine for mineral, oil or gas deposits or other natural resources are also immoveable property, and that these rights and interests are located in the country where the exploration or mining may take place. *[Article 6, paragraphs 2 and 3]*

1.101 These provisions enhance Australia’s ability to tax income generated by Israeli residents from mining interests and rights located in Australia.

1.102 Article 6 further establishes that income generated by a resident of one state from immovable property located in the other state may be taxed in that other state. *[Article 6, paragraph 1]*

1.103 This includes income from the direct use, leasing of, or use in any other form, of immovable property, as well as income from the immovable property of an enterprise. *[Article 6, paragraph 4 and 5]*

1.104 Some of Australia’s tax treaties exclude profits of an enterprise from agriculture or forestry from the operation of this Article. Such profits are generally dealt with under Article 7 (Business Profits) of Australia’s tax treaties. Under this Convention, the allocation of taxing rights over such profits is determined by Article 6. Accordingly, profits from the relevant activities may be taxed in Australia where the immoveable property is situated in Australia, irrespective of whether the enterprise has a permanent establishment in Australia.

1.105 In the case of agriculture and forestry activities, an enterprise would in any event generally have a permanent establishment in the country in which the property is situated.

### **Article 7 – Business profits**

1.106 Article 7 provides for the taxation of business profits. The Article is based on the OECD Model text of Article 7 and its Commentary as they read before 22 July 2010. This approach is consistent with Australia’s reservation to Article 7 of the OECD Model outlined in paragraph 99 of the OECD Commentary on Article 7.

1.107 The Article provides that the business profits of a resident of one country may only be taxed in the other country if those profits are

attributable to the carrying on of a business through a permanent establishment, as defined in Article 5 (Permanent Establishment), in that other country. *[Article 7, paragraph 1]*

1.108 The profits of a permanent establishment are to be determined for the purposes of this Article on the basis of arm's length dealings. *[Article 7, paragraph 2 and 3]*

1.109 The Convention modifies a number of the standard OECD Model provisions to clarify the way the arm's length principle is to be applied. These provisions are consistent with corresponding provisions in Australia's other tax treaties, and with internationally accepted concepts more generally.

1.110 The Convention supplements the standard OECD Model reference in paragraph 2 of Article 7 to a permanent establishment 'dealing wholly independently with the enterprise of which it is a permanent establishment', so that it also includes a reference to 'other enterprises with which it deals'. *[Article 7, paragraph 2]*

1.111 This addition recognises that the permanent establishment of an enterprise also has dealings with other enterprises, and ensures that in working out the profits that are attributable to the permanent establishment, those dealings must also be on an arm's length basis.

1.112 The Convention also supplements the standard reference in paragraph 3 of Article 7 to the expenses of an enterprise that must be allowed as deductions. In addition to being expenses incurred for the purposes of the permanent establishment, the expenses must be ones that would be deductible if the permanent establishment were an independent entity which paid those deductions. *[Article 7, paragraph 2]*

1.113 The Convention contains an additional rule that preserves the operation of any domestic rules that Australia or Israel have for determining the tax liability of a person, provided that such laws are applied consistently with the principles of Article 7. *[Article 7, paragraph 4]*

1.114 This provision is a standard feature of Australia's tax treaties, and puts beyond doubt that domestic rules that apply the arm's length principle can be relied upon to determine a person's tax liability.

1.115 The Protocol to the Convention also clarifies that the reference to 'income' in paragraph 6 of Article 7 has a wide meaning, and includes profits and gains. *[Protocol, paragraph 2]*

1.116 Article 7 also contains a provision that excludes profits from any form of an insurance business from the application of Article 7. *[Article 7, paragraph 7]*

1.117 This exclusion means that Australia and Israel retain the right to tax the income of non-resident insurers and re-insurers under their respective domestic laws. The provision is consistent with Australia's

reservation to Article 7 of the OECD Model, and preserves the application of Division 15 of Part III of the ITAA 1936 (Insurance with non-residents).

1.118 Article 7 contains a further rule to ensure that the Article applies appropriately to business profits that a resident of Australia or Israel derives through one or more interposed trust estates. This rule specifies that such a resident is deemed to have carried on the business of the trust through a permanent establishment located in the other country. *[Article 7, paragraph 8]*

1.119 This provision is consistent with Australia's reservation to Article 7 of the OECD Model, and ensures that Article 7 does not prevent Australia from taxing the beneficiary of a trust estate on the basis that the trustee, rather than the beneficiary, is the entity that has a permanent establishment in Australia.

1.120 In the course of negotiations, Australia and Israel agreed that this provision was designed to ensure that Australia could continue to tax the beneficiaries of a trust estate. It was also agreed that the provision did not restrict Israel's ability to continue to tax a trust according to its laws (for example, the provision does not infer that the trust no longer carries on a business or that it does not have a permanent establishment). *[Protocol, paragraph 3]*

1.121 Article 7 also provides a general seven year limit on the time that Australia and Israel can adjust the profits that are attributable to a permanent establishment. The seven year limit applies from the end of the taxable period in which the profits would have been attributable to the permanent establishment. The limit does not apply on a finding of fraud, gross negligence or wilful default, or where an audit has commenced in relation to the profits of the enterprise within a period of 10 years from the end of the taxable year in which the profits would have been attributable to the permanent establishment *[Article 7, paragraph 9]*

1.122 This provision is based on the wording recommended in paragraph 39 of the BEPS Action 14 2015 Final Report as an alternative provision for inclusion in the OECD Model Commentary on Article 7 of the OECD Model. The seven year period is broadly consistent with the general limitation period that applies for transfer pricing adjustments in respect of permanent establishments under Subdivision 815-C of the ITAA 1997.

### ***Article 8 – Shipping and air transport***

1.123 Article 8 provides that profits from international shipping or air transport are taxable only in the country of residence of the operator. *[Article 8, paragraph 1]*



1.124 Notwithstanding the general rule in paragraph 1, Article 8 also stipulates that profits from international shipping or air transport activities, including from leased containers used in such activities, may be taxed in the other country where the transport and offloading occurs within that other country. *[Article 8, paragraphs 2 and 4]*

1.125 This approach to the coverage of the profits from domestic sea and air transportation, which gives effect to source-country taxing rights over internal traffic, is endorsed in OECD Model Commentary.

1.126 The provisions of Article 8 also apply to profits from the participation in a pool, joint business or an international operating agency. *[Article 8, paragraph 3]*

### ***Article 9 – Associated enterprises***

1.127 Article 9 deals with adjustments to profits that may be made for tax purposes where transactions have been entered into between associated enterprises (parent and subsidiary companies under common control) on other than arm's length terms.

1.128 This Article would not generally authorise the rewriting of accounts of associated enterprises where it can be satisfactorily demonstrated that the transactions between such enterprises have taken place on normal, open market commercial terms.

1.129 Paragraphs 1 and 3 of the Convention's Article 9 are paragraphs 1 and 2 respectively of the OECD Model. Amendments to the wording reflect Australia's consistent treaty practice. *[Article 9, paragraphs 1 and 3]*

1.130 The term 'might be expected to operate' in paragraph 1 is included to broadly conform to Australia's treaty practice and allows adjustments where it is not possible to determine the conditions that 'would have been made or occurred' between the associated enterprises.

1.131 These wording variations address Australia's concerns that the appropriate benchmark for determining the conditions that exist, or are made or imposed, between associated enterprises should have regard to whether those dealings between the enterprises occurred on a truly independent basis. *[Protocol, paragraph 4]*

1.132 Paragraph 2 is a departure from the OECD Model. It preserves the application of Australia's domestic transfer pricing rules. This is consistent with Australia's reservation to the OECD Model's Article 9 in the OECD Model Commentary. *[Article 9, paragraph 2]*

1.133 Article 9 also provides a general seven year limit on the time that Australia and Israel can initiate transfer pricing adjustments in respect of separate legal entities. The seven year limit applies from the end of the taxable period to which the adjustment relates. The limit does not apply

on a finding of fraud, gross negligence or wilful default, or where an audit has commenced in relation to the profits of the enterprise within a period of 10 years from the end of the taxable year in which the profits would have accrued to the enterprise. *[Article 9, paragraph 4]*

1.134 This provision is based on the wording recommended in paragraph 39 of the BEPS Action 14 2015 Final Report as an alternative provision for inclusion in the OECD Model Commentary on Article 9 of the OECD Model. The seven year period is broadly consistent with the general limitation period that applies for transfer pricing adjustments in respect of separate legal entities under Subdivision 815-B of the ITAA 1997.

### ***Article 10 – Dividends***

1.135 Article 10 allocates taxing rights over dividends paid between Australia and Israel.

1.136 The Article follows the standard OECD Model approach of generally permitting source based taxation of a dividends paid by a resident company of one country to a resident of the other country. *[Article 10, paragraph 1]*

1.137 The Article also provides that:

- certain cross-border intercorporate dividends are subject to a maximum 5 per cent rate of tax in the source country;
- dividends beneficially owned by a Government or a recognised pension fund (derived from complying superannuation activities) are not taxable in the source country;
- a maximum 15 per cent rate of tax in the source country may be applied on all other dividends, and to distributions from Israeli Real Estate Investment Trusts (REIT);
- dividends paid in respect of a holding which is effectively connected with a permanent establishment are to be dealt with under Article 7 (Business Profits); and
- the extraterritorial application by either country of taxing rights over dividend income is not permitted.

### *Definition of ‘dividend’*

1.138 The term ‘dividend’ is defined in the Article as:

- income from shares or other rights, not being debt-claims, participating in profits; and
- other amounts that are subject to the same taxation treatment as income from shares by the laws of the State of which the

company making the distribution is a resident for the purposes of its tax.

*[Article 10, paragraph 5]*

1.139 This definition is based on the equivalent provision in the OECD Model, but contains three key variations.

1.140 First, the definition does not refer to ‘jouissance’ shares or rights, as the term is not used in Australia or Israel’s domestic tax laws.

1.141 Second, the definition uses the term ‘other amounts’ instead of ‘income from other corporate rights’. This removes any doubt as to whether the definition can be applied to certain deemed dividends that might not be characterised as ‘income’ (such as bonus shares and certain capital distributions), as well as to distributions from certain non-corporate entities (such as deemed dividends received from trusts).

1.142 Finally, the reference to ‘for the purposes of its tax’ in respect of the residence of the company making a distribution is intended to ensure that the domestic law characterisation of a company as a resident of a country is retained, even where the general residence tie-breaker rule would ordinarily prevent the company from being the resident of that country for the purposes of the treaty. This rule ensures that the correct tax laws are used to define the meaning of ‘dividend’ when applying the dual-resident company rule in paragraph 8 of Article 10.

1.143 The Protocol to the Convention also specifies that the term ‘dividend’ does not include ‘distributions by an Israeli REIT’. *[Protocol, subparagraph 5(b)]*

1.144 This reflects that distributions by Israeli REITs are specifically dealt with in the Article.

*Maximum rates of withholding tax*

1.145 The Article sets the standard maximum rates of taxation for the country in which a dividend is sourced. These rates are 5 per cent for certain intercorporate dividends, and 15 per cent for other dividends, and are based on the standard approach in the OECD Model. *[Article 10, paragraph 2]*

1.146 For the 5 per cent rate for intercorporate dividends to apply, the beneficial owner of the dividends must be a company that directly holds at least 10 per cent of the voting power in the company paying the dividends throughout a 365 day period that includes the day that the dividends are paid. *[Article 10, subparagraph 2(a)]*

1.147 This holding period requirement differs from the holding period requirements that are included in some of Australia’s existing tax treaties, which generally require the holding period to be satisfied at the time the dividend is declared. In contrast, the holding period in Article 10 of the

Convention can be for any 365 day period that includes the day of the payment of the dividends. Thus, under paragraph (2)(a) of Article 10, the holding period may straddle the dividend payment date. This approach is consistent with the approach in the OECD Model.

1.148 However, in contrast to the OECD Model, Article 10 of the Convention uses a minimum of 10 per cent voting power in a company (instead of 25 per cent of the capital) as the threshold for determining when the intra-corporate dividend rate applies. The focus on voting power is Australia's consistent treaty practice, and has previously been endorsed by the OECD (see, for example, paragraph 15 of the Commentary to Article 10 of the 2008 OECD Model).

1.149 Consistent with Australia's reservation to paragraph 2 of Article 10 of the OECD Model, the Convention does not contain a provision authorising the competent authorities of Australia or Israel to settle, by mutual agreement, the mode of application of the limits in paragraph 2.

#### *Israeli Real Estate Investment Trusts*

1.150 Article 10 of the Convention makes specific provision for Israeli REITs. These provisions provide distributions from Israeli REITs to Australian residents with treatment equivalent to that which applies to general dividend payments (that is, a maximum rate of taxation of 15 per cent by Israel). *[Article 10, paragraph 3]*

1.151 For the purposes of Article 10, an 'Israeli REIT' is defined in the Protocol to the Convention as a 'Real Estate Investment Fund' according to Article 64A2 of the Israeli Income Tax Ordinance. *[Protocol, subparagraph 5(a)]*

#### *Exemption for Governments and recognised pension funds*

1.152 Article 10 of the Convention also provides an exemption from source country taxation for certain dividends that are beneficially owned by a government, or recognised pension fund, of Australia or Israel.

1.153 Dividends which are beneficially owned by Australia or Israel, or one of their political subdivisions or local authorities (including a government investment fund), are not taxable in the source country if they hold no more than 10 per cent of the voting power in the company paying the dividends. *[Article 10, subparagraph 4(a)]*

1.154 The 10 per cent threshold ensures that the exemption only applies where the beneficial owner of the dividends holds a portfolio interest in the company paying the dividends, and is consistent with Australia's long-standing practice in respect of sovereign immunity.

1.155 The exemption also applies to the central banks of Australia and Israel (the Reserve Bank of Australia and the Bank of Israel, respectively),

and to the recognised pension funds of Australia and Israel. *[Article 10, subparagraphs 4(b) to (d)]*

1.156 The Protocol to the Convention also clarifies that dividends are regarded as being derived by Australia or Israel (or one of their political subdivisions, local authorities or government investment funds) if the dividends are derived from the investment of monies that are and will remain public funds. *[Protocol, paragraph 6]*

1.157 The requirement that the invested monies (for example, the monies that were used to acquire shares in respect of which the dividends are paid) remain public monies ensures that the benefits of the exemption do not flow to individuals acting in a private capacity.

1.158 The exemption for recognised pension funds of Israel applies to a fund of Israel whose income is exempt from tax in Israel. The exemption for recognised pensions funds of Israel also extends to residents of Israel that derive the dividends in respect of a pension plan that has been approved as a Provident Fund under the Control of Financial Services Act (Provident Funds) 2005. Consistent for the requirements of Israeli pension funds, the dividends derived in respect of a Provident Fund must not be taxed in Israel. *[Article 10, subparagraph 4(d)]*

1.159 The exemption for recognised pension funds of Australia applies where the fund derives dividends from the carrying on of complying superannuation activities. The exemption also applies to another resident of Australia that carries on such activities. This extension recognises that Australia's superannuation system extends to other entities, such as life insurance companies. *[Article 10, subparagraph 4(c)]*

1.160 The exemption for dividends beneficially owned by Australian pension funds does not require the dividends to be exempt from tax in Australia. This approach reflects that Australian superannuation funds have concessional tax arrangements (which can include tax exemptions), but not full tax exemptions in all cases.

*Dividends effectively treated as business profits*

1.161 Paragraphs 1, 2, 3 and 4 of Article 10 do not apply to dividends that are effectively connected with a permanent establishment of the beneficial owner of the dividends that is located in the country where the dividends are sourced. The taxation of such dividends is instead dealt with by Article 7 (Business Profits). *[Article 10, paragraph 6]*

1.162 This exception is based on the OECD Model, but adapted so that it also applies to Israeli REITS.

*Extra-territorial taxation precluded*

1.163 Article 10 limits the extra-territorial application, by either Australia or Israel, of taxing rights over dividend income. Broadly, a

country is precluded from taxing dividends paid by a company that is a resident solely of the other country, unless:

- The person that derives the dividends is a resident of the first country; or
- The shareholding that gives rise to the dividends is effectively connected with a permanent establishment in the first country.

*[Article 10, paragraph 7]*

1.164 This provision ensures that source country taxation does not extend to the distribution of profits, which may already be taxed in accordance with the provisions of the Convention, to the company's shareholders that are unconnected to the source country. The provision is based on the OECD Model but contains two deviations.

1.165 First, the provision is adapted so that it also applies to distributions made by Israeli REITS.

1.166 Second, the reference to dividends being 'beneficially owned' by a resident replaces the standard OECD approach that requires the dividends to be 'paid' to a resident. This approach ensures that the limitation applies appropriately where the recipient of the dividend payments is not the beneficial owner.

1.167 The Protocol to the Convention also clarifies the understanding that was reached in negotiations on paragraph 7, that the reference to the beneficial owner of the dividends does not oblige Australia or Israel to provide a benefit under the convention for taxation by the other country of dividends that are not paid, but are beneficially owned, by a resident of that other country. *[Protocol, subparagraph 5(c)]*

Tie-breaker preservation rule

1.168 The limitation on extra-territorial taxation does not apply to dividends that are paid by a dual-resident company that is deemed to be a resident only of Australia or Israel because of the residency tie-breaker rule in Article 4 (Resident). Where such dividends are beneficially owned by a resident of the country to which the dual-resident company's residency was allocated under the treaty, Article 10 applies as though the dual-resident company was a resident of the other country. *[Article 10, paragraph 8]*

1.169 The effect of this rule is that the country of source can continue to tax dividends paid by a dual-resident company whose residency is allocated to the other country. Australia's consistent treaty practice is to include this provision to prevent dual-resident companies being established in Australia to allow untaxed Australian profits to be paid to shareholders resident in a treaty partner country or a third country, without any Australian tax at either the company or shareholder level.

**Article 11 – Interest**

1.170 Article 11 allocates taxing rights over interest paid between Australia and Israel.

1.171 The Article follows the standard OECD Model approach of generally permitting source based taxation of interest paid between residents of each country. *[Article 11, paragraph 2]*

1.172 The Article also provides that:

- interest derived by financial institutions and recognised pension funds is subject to a maximum 5 per cent rate of tax in the source country;
- interest derived by a Government is generally exempt from tax in the source country;
- a maximum 10 per cent rate of tax in the source country may be applied to other interest payments;
- interest paid in respect of a debt-claim that is effectively connected with a permanent establishment are to be dealt with under Article 7 (Business Profits);
- interest is generally deemed to arise in the payer’s country of residence; and
- the concessional arrangements for interest only apply to the amount that would be expected to be paid under arm’s length dealing between independent parties.

*Definition of ‘interest’*

1.173 The term ‘interest’ is defined in the Article as:

- income from debt-claims of every kind (whether or not secured by a mortgage and whether or not carrying a right to participate in the debtor’s profits);
- income from government securities;
- income from bonds and debentures; and
- income which is subjected to the same taxation treatment as income from money lent by the law of the source country.

*[Article 11, paragraph 5]*

1.174 This definition is based on the equivalent provision in the OECD Model but extends that definition to include income that is subjected to the ‘same taxation treatment as income from money lent’ by the law of the source country. This extension ensures that income that is effectively treated as interest under a State’s domestic law is dealt with by Article 11, and is consistent with Australia’s reservation to Article 11 of the OECD

Model outlined in paragraph 45 of the OECD Model Commentary on Article 11.

*Maximum rates of withholding tax*

1.175 The Article sets the standard maximum rates of taxation for the country in which interest arises. These rates are 5 per cent of the gross amount of interest derived by a financial institution or recognised pension fund, and 10 per cent of the gross amount of interest in other cases.

*[Article 11, paragraph 2]*

Five per cent rate for financial institutions

1.176 A maximum 5 per cent rate of source country taxation applies to the gross amount of interest derived by a financial institution, which is unrelated to and deals wholly independently with the payer, provided the financial institution is a resident of the other country and is the beneficial owner of the interest.

1.177 The reduced rate recognises that the general 10 per cent source country tax rate on gross interest can be excessive given the cost of their funds.

1.178 For the purposes of this Article, the term ‘financial institution’ means a bank or other enterprise substantially deriving its profits by raising debt finance in the financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance. *[Article 10, subparagraph 2(a)]*

1.179 The Protocol to the Convention clarifies that the term ‘financial institution’ does not include an insurance company, a ‘lending fund’, a corporate treasury or a member of a group that performs the financing services of the group. *[Protocol, paragraph 7]*

1.180 The term ‘lending fund’ refers to an entity that is formed by investors and has the primary purpose of making investments through interest bearing loans. *[Protocol, paragraph 7]*

1.181 This clarification was included at Israel’s request. In the course of negotiations, Israel advised that they had not previously agreed to a concessional rate for financial institutions, and requested that the Convention make it clear that the concessional rate did not apply to entities that were established primarily using private funds.

1.182 Such funds would not ordinarily fall within the definition of ‘financial institution’, which requires debt to be financed through the financial markets or from deposits. However, the specific reference to a lending fund puts this position beyond doubt.

1.183 The reduced rate for financial institutions is not available for interest paid as part of an arrangement involving back-to-back loans, or



arrangements that are economically equivalent and intended to have a similar effect. *[Article 10, subparagraph 2(a)]*

1.184 The restriction for such arrangements is directed at preventing related party and other debt from being structured through financial institutions to gain access to the concessional rate under the Convention. The restriction applies to any interest paid on the component of a loan that is considered to be back-to-back. In such cases, the general 10 per cent rate limit applies.

1.185 An example of a back-to-back arrangement is a transaction or series of transactions structured in such a way that:

- an Israeli financial institution receives or is credited with an item of interest arising in Australia; and
- the financial institution pays or credits, directly or indirectly, all or substantially all of that interest (at any time or in any form, including commensurate benefits) to another person who, if it received the interest directly from Australia, would not be entitled to similar benefits with respect to that interest.

1.186 However, a back-to-back arrangement would generally not include a loan guarantee provided by a related party to a financial institution.

#### Five per cent rate for recognised pension funds

1.187 Consistent with the exemption from dividend withholding tax in Article 10 (Dividends), the 5 per cent rate for recognised pension funds of Israel applies to a fund of Israel whose income is exempt from tax in Israel. The reduced rate for recognised pensions funds of Israel also extends to residents of Israel that derive the interest in respect of a pension plan that has been approved as a Provident Fund under Israel's Control of Financial Services Act (Provident Funds) 2005. Consistent with the requirements of Israeli pension funds, the interest derived in respect of a Provident Fund must not be taxed in Israel. *[Article 11, subparagraph 2(b)(ii)]*

1.188 Similarly, the reduced rate of withholding for recognised pension funds of Australia applies where the fund derives interest from the carrying on of complying superannuation activities. The reduced rate also applies to another resident of Australia that carries on such activities. This extension recognises that Australia's superannuation system extends to other entities, such as life insurance companies. *[Article 11, subparagraph 2(b)(i)]*

1.189 The reduced rate of withholding for interest derived by Australian pension funds does not require the interest to be exempt from tax in Australia. This approach reflects that Australian superannuation funds have concessional tax arrangements (which can include tax exemptions), but not full tax exemptions in all cases.

1.190 The reduced rate does not apply to a recognised pension fund, or to another that can access the reduced rate, where the beneficial owner of the interest is able to control or influence the key decision-making of the issuer of the debt-claim. *[Article 11, paragraph 4]*

1.191 This restriction ensures that the reduced rate is only applicable where the beneficial owner of the interest is an arm's length lender who does not play an active role in the management or operation of the entity paying the interest. This reflects that the reduced rate is intended to apply to 'passive' investments by the lender, which exclude debt arrangements that convey special rights or obligations, or that are entered into where the lender plays an active role in the other entity because of some other arrangement (such as a substantial shareholding).

*Exemption for Governments*

1.192 Article 11 of the Convention also provides an exemption for interest that arises in either Australia or in Israel, and that is beneficially owned by the other country or one of their political subdivisions or a local authority (including a government investment fund). *[Article 11, paragraph 3]*

1.193 The exemption also applies to interest that is beneficially owned by the central banks of Australia and Israel (the Reserve Bank of Australia and the Bank of Israel, respectively). *[Article 11, paragraph 3]*

1.194 Consistent with the restriction on the concessional rate that applies to recognised pension funds, the exemption from source based taxation does not apply where the beneficial owner of the interest is able to control or influence the key decision-making of the issuer of the debt-claim. *[Article 11, paragraph 4]*

1.195 This restriction is consistent with the scope of Australia's domestic sovereign immunity rules, which are limited to the passive investments.

1.196 The Protocol to the Convention also clarifies that interest is regarded as being derived by Australia or Israel (or one of their political subdivisions, local authorities or government investment funds) if the interest is derived from the investment of monies that are and will remain public funds. *[Protocol, paragraph 6]*

1.197 The requirement that the invested monies (for example, the monies lent to the borrower under a loan arrangement) remain public monies ensures that the benefits of the exemption do not flow to individuals acting in a private capacity.

*Interest effectively treated as business profits*

1.198 Paragraphs 1, 2, 3, and 4 of Article 11 does not apply to interest that is effectively connected with a permanent establishment of the beneficial owner of the interest that is located in the country where the

interest arises. The taxation of such interest is instead dealt with by Article 7 (Business Profits). *[Article 11, paragraph 6]*

1.199 This exception is consistent with the OECD Model.

*Deemed source of interest*

1.200 Article 11 contains a rule that generally deems interest to arise in the country in which the payer is a resident. *[Article 11, paragraph 7]*

1.201 This deeming rule is based on the equivalent provision in the OECD Model.

1.202 However, the provision in the Convention contains an additional rule that deems interest to arise in the country that a dual-resident payer is deemed to be *not* a resident of because of paragraphs 2 or 3 of Article 4 (Resident). This rule only applies where the interest is allowed as a deduction for the payer in that country against income that is also derived in that country. *[Article 11, paragraph 7]*

1.203 This extension is consistent with Australia's long-standing treaty practice of retaining source based taxing rates over certain interest paid by dual-residents whose residency is allocated to another country because of the residency tie-breaker rules in Article 4 (Resident). The provision follows a different formulation to that generally used in Australia's tax treaties as it refers to instances where the payer of the interest receives a deduction for the payment against their other Australian income. The provision does not apply where the payer does not receive an offsetting deduction for the payment.

1.204 Neither of the above deemed source rules apply to interest payments that are an expense of a person that is incurred in carrying on a business through a permanent establishment. In such cases, the interest is deemed to arise in the country in which the permanent establishment is situated. *[Article 11, paragraph 7]*

1.205 This provision is based on the equivalent provision in the OECD Model. However, in contrast to the OECD Model, the provision in the Convention is not limited to permanent establishments that are located in the Contracting States (that is, Australia or Israel). As such, interest can be deemed to arise in a third country where it is connected to a permanent establishment of the payer in such a country.

*Related persons*

1.206 Article 11 contains a general safeguard against payments of excessive interest where a special relationship exists between the parties to a loan transaction (or between those parties and some other person). In such cases, the beneficial treatment provided by Article 11 is limited to the amount of interest that would have been expected to have been agreed to if the parties to the loan arrangements were dealing at arm's length.

Any excess part of the interest continues to be taxable according to the domestic laws of Australia and Israel and the other provisions of the Convention. [*Article 11, paragraph 8*]

1.207 This provision is based on the equivalent provision in the OECD Model. The provision contains a minor departure clarifying that the ‘beneficial owner’ referred to in the OECD Model is the owner of the interest. This clarification does not affect the substantive operation of the provision.

### ***Article 12 – Royalties***

1.208 Article 12 allocates taxing rights over royalties paid or credited between Australia and Israel.

1.209 In contrast to the OECD Model, which allocates taxing rights over royalties on an exclusive residency basis, Article 12 of the Convention also permits source based taxation of royalties that arise in Australia or in Israel. [*Article 12, paragraphs 1 and 2*]

1.210 The Article provides that:

- royalties that arise in Australia or Israel and that are beneficially owned by a resident of the other country may be subject to a maximum 5 per cent rate of tax in the country in which they arise;
- royalties that are effectively connected with a permanent establishment of the beneficial owner are to be dealt with under Article 7 (Business Profits);
- royalties are generally deemed to arise in the payer’s country of residence; and
- the concessional arrangements for royalties only apply to the amount that would be expected to be paid or credited under arm’s length dealing between independent parties.

### ***Definition of ‘royalty’***

1.211 The definition of ‘royalty’ in the Article expands on the equivalent definition in the OECD Model.

1.212 These extensions generally ensure that the definition in the Convention is aligned with the definition in Australia’s domestic income tax law. As a result of these changes, the definition in Article 12 to the Convention is structured differently to that in the OECD Model.

1.213 In contrast to the OECD Model, which refers to payments that are received as consideration, the definition in the Convention expands on the reference to payments so that the definition applies to ‘payments or

credits, whether periodical or not, and however described or computed, to the extent to which they are made as consideration'. *[Article 12, paragraph 3]*

1.214 The definition of royalty in the Convention includes payments or credits made as consideration for:

- the use of, or right to use, intellectual property, as well as the supply of any assistance that is ancillary and subsidiary to such use;
- the supply of scientific, technical, industrial or commercial knowledge or information, as well as the supply of any assistance that is ancillary and subsidiary to such use;
- the use of, or right to use, motion picture films, or any tapes or discs, or any other means of reproduction or transmission;
- the use of, or right to use, radiofrequency spectrum;
- the use of, or right to use, industrial, commercial or scientific equipment; or
- not supplying or granting another person any property or right that is covered by the definition.

*[Article 12, paragraph 3]*

1.215 In contrast to the part of the definition in OECD Model that refers to 'information concerning industrial, commercial or scientific experience', the definition of royalty in the Convention refers to the supply of such information or knowledge. *[Article 12, subparagraph 3(b)]*

1.216 This expanded reference ensures that the definition covers the full range of technical know-how that may be supplied as a royalty.

1.217 In contrast to the part of the definition in OECD Model that includes a general reference to 'artistic work... including cinematograph films', the definition in the Convention refers specifically to 'motion picture films and films or audio or video tapes or disks, or other means of image or sound reproduction or transmission for use in connection with television, radio or other broadcasting'. *[Article 12, subparagraph 3(d)]*

1.218 This expanded reference is included to ensure that this part of the definition is capable of being applied in the context of modern technological developments. This approach reflects Australia's consistent treaty practice. However, in practical terms, the general reference to 'artistic work' in the OECD Model is likely to include each of the specific extensions in this part of the definition.

1.219 The definition of royalty in the Convention also applies to payments or credits made for the use of, or right to use, the radio frequency spectrum specified in a spectrum licence. *[Article 12, subparagraph 3(e)]*

1.220 This provision is not included in the OECD Model. The provision commonly included in Australia's tax treaties and is aimed to preserve Australia's ability to tax payments (or credits) that arise in Australia for the use in Australia of any part of the radio frequency spectrum specified in an Australian spectrum licence. The extension also ensures that the definition of royalty in the Convention is aligned with Australia's domestic definition.

1.221 Article 12 also treats as a royalty amounts paid or credited in respect of forbearance to grant to third persons rights to use property covered by this Article. *[Article 12, subparagraph 3(g)]*

1.222 This provision is not included in the OECD Model, and ensures that such payments are subject to tax as a royalty payment under the terms of this Article.

1.223 The Protocol to the Convention also clarifies that the term 'royalties' does not include payments or credits made as consideration for the use of any equipment used in the transport of goods or merchandise if such use is directly connected or ancillary to the operation of ships or aircraft in international traffic. In such cases, the provisions of paragraph 4 of Article 8 (Shipping and Air Transport) of the Convention apply. *[Protocol, paragraph 8]*

*Royalties effectively treated as business profits*

1.224 Article 12 does not apply to a royalty that is effectively connected with a permanent establishment of the beneficial owner of the royalty that is located in the country in which the royalty arises. The taxation of such royalties is instead dealt with by Article 7 (Business Profits). *[Article 12, paragraph 4]*

1.225 This exception is consistent with the OECD Model, but adapted to reflect that the definition of 'royalty' in the Convention also includes amounts that are 'credited'.

*Deemed source of royalties*

1.226 Article 12 contains a rule that generally deems royalties to arise in the country in which the payer is a resident. *[Article 12, paragraph 5]*

1.227 While there is no equivalent provision in Article 12 of the OECD Model, this deeming rule follows the provision that is included in Article 11 (Interest) of the Convention, which is based on the deeming rule for Article 11 (Interest) of the OECD Model.

1.228 The provision contains an additional rule that deems a royalty to arise in the country that a dual-resident payer is deemed to be *not* a resident of because of paragraphs 2 or 3 of Article 4 (Resident). This rule only applies where the royalty is allowed as a deduction for the payer in that country against income that is also derived in that country. *[Article 12, paragraph 5]*

1.229 This extension is consistent with Australia's long-standing treaty practice of retaining source based taxing rates over certain royalties paid by dual-residents whose residency is allocated to another country because of the residency tie-breaker rules in Article 4 (Resident). The provision follows a different formulation to that generally used in Australia's tax treaties as it refers to instances where the payer of the royalty receives a deduction for the payment against their other Australian income. The provision does not apply where the payer does not receive an offsetting deduction for the payment.

1.230 Neither of the above deemed source rules apply to royalties payments that are an expense of a person that is incurred in carrying on a business through a permanent establishment. In such cases, the royalty is deemed to arise in the country in which the permanent establishment is situated. *[Article 12, paragraph 5]*

1.231 As with the deeming rule for interest in Article 11 (Interest), royalties can be deemed to arise in a third country where they are connected to a permanent establishment of the payer in such a country.

#### *Related persons*

1.232 Article 12 contains a general safeguard against payments or credits of excessive royalties where a special relationship exists between the parties to a transaction (or between those parties and some other person). In such cases, the beneficial treatment provided by Article 12 is limited to the amount of royalties that would have been expected to have been agreed to if the parties to the arrangements were dealing at arm's length. Any excess part of the royalty continues to be taxable according to the domestic laws of Australia and Israel and the other provisions of the Convention. *[Article 12, paragraph 6]*

1.233 This provision is based on the equivalent provision in the OECD Model. The provision contains minor departures clarifying that the 'beneficial owner' referred to in the OECD Model is the owner of the royalty. The provision is also modified to reflect that the definition of royalty in the Convention extends to amounts that are credited. These modifications do not affect the substantive operation of the provision.

#### *Article 13 – Alienation of property*

1.234 Article 13 allocates taxing rights over income arising from the alienation of immovable property and moveable property. Paragraphs 1 to 4 of Article 13 align the equivalent provisions in the OECD Model.

1.235 The reference to 'income' in this Article has a wide meaning, and is to be read as including 'profits or gains'. *[Protocol, paragraph 2]*

1.236 Using the term in this way is intended to put beyond doubt that a gain from the alienation of property, which in Australia may be income or

a profit under ordinary concepts, is to be taxed in accordance with this Article.

1.237 Article 13 permits source based taxation of income from the alienation of immovable property by the country in which the property situated. *[Article 13, paragraph 1]*

1.238 The Article also permits source country taxation of income from the alienation of any shares or comparable interests (for example, in a partnership or trust) by a country. The provision only applies where, at any time during the 365 days preceding the alienation, more than half of the value of such interests related to immovable property located in that country. *[Article 13, paragraph 2]*

1.239 This rule is designed to deal with arrangements involving the effective alienation of incorporated immovable property, or like arrangements. It ensures that capital or revenue gains on disposal of a foreign resident's interests in certain assets are taxable by Australia. Such treatment applies whether the immovable property is held directly or indirectly through a chain of interposed entities. The rule refers to 'any shares', whereas the OECD Model simply refers to 'shares'. This expanded reference is intended to make it clear that the provision has the broadest possible application.

1.240 Article 13 permits source country taxation by a country of income from the alienation of moveable property that forms part of the business property of a permanent establishment located in that country. *[Article 13, paragraph 3]*

1.241 The Article also assigns exclusive residence based taxation for income that an enterprise that operates ships or aircraft in international traffic derives from the alienation of such ships or aircraft, or from movable property related to their operation. *[Article 13, paragraph 4]*

1.242 This provision aligns with the equivalent provision in the OECD Model. However, as noted above in respect of Article 3 (General Definitions), the definition of 'international traffic' used in this Convention is based on the alternative formulation provided in the OECD Model Commentary.

1.243 Article 13 contains a 'sweep up' rule that generally assigns exclusive taxing rights over an enterprise's gains from the alienation of property that is not otherwise dealt with in the Article to the enterprise's country of residence. *[Article 13, paragraph 5]*

1.244 This aspect of the sweep-up rule is based on the equivalent provision in the OECD Model. However, in contrast to the other provisions in Article 13 of the Convention, the sweep-up rule refers specifically to 'gains'. This means that the broad reference to 'income' in Article 13 is not relevant to the sweep-up rule, which applies to a more



limited class of ‘gains’. As such, any income or profits that are not also gains are dealt with as business profits under Article 7 (Business Profits), or as ‘other income’ under Article 21 (Other Income).

1.245 The sweep-up rule in the Convention also contains an exception that applies where the alienator of the property is not the beneficial owner of the gains. In such cases, the gains from the alienation of property may also be taxed in the country in which the property is situated. *[Article 13, paragraph 5]*

1.246 This exception is not contained in the OECD Model. It ensures that source country taxation can apply to gains that are made by a fiscally transparent entity such as a trust.

1.247 The Protocol also clarifies that the general allocation of taxation to a residence country does not restrict Australia or Israel’s ability to tax income, profits or gains that a person is treated as having derived up to the time of a change in residency. *[Protocol, paragraph 9]*

1.248 This ensures that Australia and Israel can tax their former residents on unrealised income, profits or gains that accrued up to the time they changed residency.

1.249 In addition, Article 13 does not affect Australia or Israel’s right to tax income from the alienation of property derived by a person who ceases to be a resident of their country in certain circumstances. This rule applies to a person that was a resident at any time during the year of income in which the property was alienated, or had been a resident at any times during the five preceding years. *[Article 13, paragraph 6]*

1.250 This provision preserves the operation of ‘exit taxes’ that are applied to a person who ceases to be a resident of Australia or Israel. However, the five year limit means that any exit taxes that apply after a person ceases to be a resident (for example, because they have deferred effect) cannot be applied after the time limit expires. In such cases, any income from the alienation of an asset that would otherwise be subject to an exit tax in the former country of residency is taxable in the new country of residency (subject to the other provisions of the Article).

#### ***Article 14 – Income from employment***

1.251 Article 14 provides that income from employment (that is, salaries, wages and similar remuneration) earned by an individual may only be taxed in their state of residence. *[Article 14, paragraph 1]*

1.252 However, if the individual’s employment occurs in the other state, then their salary, wages or similar remuneration may be taxed in that state, subject to certain conditions and exceptions (or example in respect of short-term visits, employment on a ship or aircraft and fringe benefits). *[Article 14, paragraphs 1 to 4]*

1.253 Article 14 additionally allocates taxing rights of fringe benefits. The effect is that fringe benefits can only be taxed in the state that has been allocated the right, under the Convention, to tax income from the employment to which the fringe benefit relates. *[Article 14, paragraph 5]*

1.254 Article 14 expressly defers to the provisions of Articles 15 (Directors' Fees), 17 (Pensions), 18 (Government Service) and 19 (Professors, Teachers and Researchers) that also concern salaries, wages and similar remuneration. *[Article 14, paragraph 1]*

#### ***Article 15 – Directors' fees***

1.255 Article 15 provides that the directors' fees and other similar payments earned by a resident of one state may be taxed in the country of residence of the company receiving the directorship services. *[Article 15]*

#### ***Article 16 – Artistes and sportspersons***

1.256 Article 16 provides that income earned by a resident of one state as an artiste (that is, an entertainer) or sportsperson in the other state, may be taxed in that other state. *[Article 16, paragraph 1]*

1.257 If income from an entertainer or sportsperson's performance accrues to another person, it may be taxed in the state where the performance takes place, notwithstanding Articles 7 (Business Profits) and 14 (Income from Employment). *[Article 16, paragraph 2]*

1.258 However, the income of visiting entertainers and sportspersons is taxable only in the individual's country of residence if the visit is supported wholly or mainly by public funds of the individual's country of residence. *[Article 16, paragraph 3]*

1.259 This will foster publicly-funded artistic and sporting visits between Australia and Israel.

#### ***Article 17 – Pensions***

1.260 Article 17 provides that pensions and other similar periodic remuneration may only be taxed in the recipient's country of residence, subject to the provisions of Article 18 (Government Service). *[Article 17, paragraph 1]*

1.261 However, if certain lump sum pension payments and other similar remuneration arise in the source state and are paid to a resident of the other state, the source state may tax the payment. Source state taxation only applies where the payment is made from a recognised pension fund, is made under a retirement benefit scheme, or in consequence of retirement, invalidity, disability or death, or by way of compensation for injuries. *[Article 17, paragraph 2]*

1.262 The Protocol to the Convention explains that the term 'retirement benefit scheme' means an arrangement that an individual

participates in to secure retirement benefits. The Protocol also provides examples of such schemes in Australia, all of which are effectively treated as part of Australia's superannuation. [*Protocol, paragraph 10*]

***Article 18 – Government service***

1.263 Article 18 provides that income (that is, salaries, wages and other similar remuneration) paid to an individual by a state for the individual's government service are only taxable in that state. However, such income is taxable only in the other state, if the individual who earns the income is a resident of that state, provided they did not become a resident solely to render the services, or they are a national of that country. [*Article 18, paragraph 1*]

1.264 Government pensions and other similar remuneration are taxable only in the source country unless the person is both a resident and a national of the other country, in which case the pension is taxable only in the residence country. [*Article 18, paragraph 2*]

1.265 The Protocol to the Convention also clarifies that the term 'pensions and other similar remuneration' includes both periodic payments and lump sum payments. [*Protocol, paragraph 11*]

***Article 19 – Professors, teachers and researchers***

1.266 Article 19 was included at Israel's request. It exempts from tax remuneration for teaching or research received by a professor, teacher or researcher who is resident of one state while they are teaching or engaging in research at an educational institution in the other state. This tax exemption applies for a period of two years or less. [*Article 19, paragraph 1*]

1.267 However, this exemption only applies to remuneration for research if it is undertaken in the public interest. [*Article 19, paragraph 2*]

***Article 20 – Students***

1.268 Article 20 provides that payments received from abroad by visiting students and business apprentices where those payments are made for the purposes of their maintenance, education or training will not be taxed. [*Article 20*]

1.269 Payments received by visiting students or business apprentices from employment are covered by other Articles.

***Article 21 – Other income***

1.270 Article 21 provides for the taxation of any form of income that is not dealt with by the earlier Articles of the Convention.

1.271 Any such income that is beneficially owned by a resident of Australia or Israel is taxable only in that country, unless the income arises

in the other country. Where the income arises in the other country, that country may also tax the income. *[Article 21, paragraph 1]*

1.272 This approach differs from that provided in the OECD Model, which allocates exclusive taxing rights on the basis of residency. The departure is consistent with Australia's reservation to the OECD Model.

1.273 Where income may be taxed in both countries in accordance with this Article, the country of residence of the beneficial owner of the income is obliged by Article 23 (Relief from Double Taxation) to provide double taxation relief.

1.274 The reference to income that is 'beneficially owned' by a resident is a further departure from the equivalent provision in the OECD Model. This departure clarifies that residence of the beneficial owner is relevant, rather than the residence of the recipient (to the extent they are different).

1.275 Article 21 also provides an exemption to the general rule for income from a right or property that is effectively connected to a permanent establishment. In such cases, Article 7 applies to allocate the taxing right of that other income to the country in which the permanent establishment is situated. *[Article 21, paragraph 2]*

1.276 This provision is based on the equivalent provision in the OECD Model, but is adapted to reflect that paragraph 1 refers to a resident who is the 'beneficial owner' of the income.

1.277 Article 21 contains a general safeguard against amounts of income that are excessive because of a special relationship that exists between the parties to a transaction (or between those parties and some other person). In such cases, Article 21 only applies to the amount if the income that would have been expected to have agreed to between the parties to the arrangements had they been dealing at arm's length. Any excess amount continues to be taxable according to the domestic laws of Australia and Israel and the other provisions of the Convention. *[Article 21, paragraph 3]*

1.278 This provision is not contained in Article 21 (Other Income) of the OECD Model but is based on the provisions in the OECD Model that are contained in Articles 11 (Interest) and 12 (Royalties).

### ***Article 22 – Limitation on benefits***

1.279 Article 22 ensures that the benefits of the Convention are denied where one of the principal purposes of an arrangement or transaction that has been entered into is to obtain a benefit under the Convention. The Article provides that treaty benefits under the Convention are not be granted for an item of income, if it can be reasonably concluded that the obtaining of the benefit was one of the principal purposes of an arrangement or transaction that resulted in that benefit, unless it is

established that the granting of that benefit is in accordance with the object and purpose of the relevant provisions of the Convention. *[Article 22]*

1.280 The Article adopts the wording of the Principal Purpose Test in the OECD Model and is intended to ensure that the Convention should apply in accordance with the purposes for which it was entered into, i.e. to provide benefits in respect of bona fide exchanges of goods and services and movements of capital and persons, as opposed to arrangements whose principal objective is to secure a more favourable tax treatment.

### ***Article 23 – Relief from double taxation***

1.281 Article 23 provides the rules to reduce double taxation. Under the Convention Australia and Israel agree to restrict their respective taxing rights to avoid double taxation. The Convention broadly follows the OECD Model for the alleviation of double taxation with the Convention adopting the credit method of relief from double taxation. Under this method the residence country is required to give credit against its tax for the tax of the source.

1.282 Israel provides for relief from double taxation by allowing a deduction against its own tax for Australian tax paid under the law of Australia and in accordance with the Convention on income derived by a resident of Israel from sources in Australia. The deduction shall not exceed the related income. *[Article 23, paragraph 1]*

1.283 Australia provides for relief from double taxation by allowing a credit against its own tax for Israeli tax paid under the law of Israel and in accordance with the Convention on income derived by a resident of Australia from sources in Israel. *[Article 23, paragraph 2]*

1.284 This is primarily achieved through Australia's domestic tax provisions that provide for tax credits, such as the foreign income tax offset rules in Division 770 of the ITAA 1997. Australia also provides exemption for certain amounts of income which means that there is no Australian tax Australia from having to provide a credit against Australian tax (for example, certain branch profits are exempt under section 23AH of the ITAA 1936 and certain non-portfolio dividend distributions are exempt under Subdivision 768-A of the ITAA 1997).

1.285 Profits, income and gains owned by a resident of Australia or Israel which may be taxed in the other country in accordance with the terms of the Convention are deemed for the purposes of the article to arise from sources in that other country. *[Article 23, paragraph 3]*

### ***Article 24 – Non-discrimination***

1.286 Article 24 provides the rules to prevent tax discrimination. Article 24 implements the provisions of the OECD Model with some departures.

*Discrimination based on nationality*

1.287 Under the Convention, Australia and Israel agree that nationals of one country shall not be treated less favourably than nationals of the other country in the same circumstances. That is, the treatment in respect of taxation or any connected requirement cannot be other or more burdensome than for a national of the other country. This principle applies to both the taxation itself and any requirement connected with such taxation. *[Article 24, paragraph 1]*

*Non-residents of Australia and Israel*

1.288 The Convention departs from the OECD Model in excluding the final sentence of paragraph 1 of Article 24 (Non-discrimination) of the OECD Model, which states that Article 24 applies to persons who are neither resident of Australia nor Israel. Consequently, residents of third countries are not able to seek the benefits of this provision.

*Non-discrimination and permanent establishments*

1.289 Paragraph 2 forbids a country from levying tax less favourably on permanent establishments of the other country than on the country's own enterprises carrying on the same activities. This applies to all residents of a treaty country, irrespective of their nationality, who have a permanent establishment in the other country. *[Article 24, paragraph 2]*

1.290 The Article should not be construed as obliging a country to provide residents of the other country any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents. *[Article 24, paragraph 3]*

*Deductions for payments to foreign residents*

1.291 The two countries must allow the same deductions for interest, royalties and other disbursements paid to residents of the other country as they do for payments to their own residents. However, the two countries are allowed to reallocate profits between associated enterprises on an arm's-length basis in accordance with paragraph 1 of Article 9 (Associated Enterprises), and to limit deductions in accordance with paragraph 8 of Article 11 (Interest) and paragraph 6 of Article 12 (Royalties). The Convention departs from the OECD Model in excluding the deductibility of debts owed to a resident of the other country. That is, for the purpose of determining the taxable capital for the application of Israel's capital taxes, debts owed by an Israeli enterprise to an Australian resident is not deductible under the same conditions as if they were owed to an Israeli resident. *[Article 24, paragraph 4]*

*Enterprises owned or controlled abroad*

1.292 Paragraph 5 forbids a country from giving less favourable treatment to an enterprise, the capital of which is owned or controlled,

wholly or partly, directly or indirectly by one or more residents of the other country. That is, Australian companies owned or controlled by Israeli residents may not be given other or more burdensome treatment than similar locally owned or controlled Australian companies. *[Article 24, paragraph 5]*

*Taxes to which this Article applies*

1.293 Paragraph 6 departs from the OECD Model so that instead of applying to taxes of every kind and description, the Article applies only to those taxes covered by Article 2 (Taxes Covered) of the Convention. *[Article 24, paragraph 6]*

#### ***Article 25 – Mutual agreement procedure***

1.294 Article 25 provides for a procedure for resolving difficulties and disputes arising from the application of the Convention. It provides for the consultation between the competent authorities of the two countries with a view to reaching a solution in cases where a person is able to demonstrate actual or potential imposition of taxation contrary to the provisions of the Convention. *[Article 25, paragraphs 1 and 2]*

1.295 The Protocol to the Convention also notes that Australia and Israel agree that their respective competent authorities will implement a notification process for cases that are presented to them by a person under paragraph 1 of Article 25. This process is to be used when the competent authority to which a case is presented does not consider the person's objection to be justified. *[Protocol, paragraph 12]*

1.296 Article 25 also obliges the competent authorities of the two countries to endeavour to resolve by mutual agreement any difficulties or doubts that arise regarding the interpretation or application of the treaty. The competent authorities may also consult together for the elimination of double taxation in cases not provided for in the Convention. *[Article 25, paragraph 3]*

1.297 The competent authorities are permitted to communicate directly with each other without having to go through diplomatic channels. This may be done by electronic means (for example, email or web conferencing), letter, telephone, direct meetings or any other convenient means. *[Article 25, paragraph 4]*

#### ***Article 26 – Exchange of information***

1.298 Article 26 obliges the competent authorities to exchange information as is foreseeably relevant for carrying out the provisions of the Convention or to the administration or enforcement of domestic laws concerning the taxes covered by the Convention. The information is not restricted to persons covered under the treaty and may therefore cover persons who are not residents of either Australia or Israel. However, the

information is restricted to taxes covered by the Convention. *[Article 26, paragraph 1]*

1.299 Article 26 departs from the OECD Model in that the competent authorities can only request and obtain information concerning taxes covered by the Convention. This means that taxes not covered by the Convention under the general rules of Article 2 (Taxes Covered) are not within the scope of the article. *[Article 26, paragraph 1]*

1.300 It is intended that the Article extend to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of these taxes. *[Article 2, paragraph 4]*

1.301 Article 26 provides the purposes for which the exchanged information may be used and the persons to whom it may be disclosed, and limitations on the exchange of information, in a manner which is consistent with the approach taken in the OECD Model. *[Article 26, paragraphs 2 and 3]*

1.302 When requested, a country is required to obtain and supply information using its domestic information gathering powers even though the country may not require the information for its own tax purposes. Australia would recognise this obligation to obtain relevant information for treaty partner countries, even in the absence of an explicit provision to this effect. *[Article 26, paragraph 4]*

1.303 Paragraph 5 ensures that the limitations to information exchange contained in paragraph 3 cannot be used to prevent the supply of information solely because the information is held by a bank, other financial institution, a nominee or a person acting in an agency or a fiduciary capacity, or because it relates to ownership interests in a person. *[Article 26, paragraph 5]*

#### ***Article 27 – Members of diplomatic missions and consular posts***

1.304 Article 27 provides that the provisions of the Convention do not result in members of diplomatic missions and consular posts receiving less favourable treatment than that to which they are entitled to in accordance with the general rules of international law or under the provisions of special agreements. *[Article 27]*

1.305 Such persons are entitled, for example, to certain fiscal privileges under the *Diplomatic Privileges and Immunities Act 1967* and the *Consular Privileges and Immunities Act 1972* which reflect Australia's international diplomatic and consular obligations.

#### ***Article 28 – Protocol***

1.306 Article 28 provides that the Protocol to the Convention is an integral part of the Convention. *[Article 28]*



1.307 This Article incorporates the provisions of the Protocol into the Convention. The Protocol is explained in further detail below. Particular provisions of the Protocol are also referenced throughout this explanatory memorandum where those provisions are relevant to a specific Article.

***Article 29 – Entry into force***

1.308 Article 29 provides for the entry into force of the Convention. Australia and Israel shall notify each other in writing, through the diplomatic channels, that the country has completed their domestic requirements for the entry into force of the Convention. The Convention enters into force on the date of the last notification. *[Article 29]*

1.309 In Australia, enactment of the legislation giving the force of law in Australia to the Convention, is the necessary prerequisite to the exchange of diplomatic notes taking place.

*Date of application for Australian taxes*

Withholding tax

1.310 The provisions of the Convention apply in Australia in respect of withholding tax on income that is derived by a resident of Israel, in relation to income derived on or after 1 January next following the date on which the Convention enters into force. *[Article 29, subparagraph a(i)]*

Fringe benefits tax

1.311 The Convention applies in Australia in respect of fringe benefits tax in relation to fringe benefits provided on or after 1 April next following the date on which the Convention enters into force. *[Article 29, subparagraph a(ii)]*

Other Australian taxes

1.312 The Convention applies to other Australian taxes concerning income, profits, or gains of any year of income beginning on or after 1 July next following the date on which the Convention enters into force. *[Article 29, subparagraph a(iii)]*

*Date of application of Israeli taxes*

Withholding tax

1.313 The Convention applies in Israel to tax withheld at source concerning amounts paid on or after the first day of January of the calendar year following the year in which the Convention entered into force. *[Article 29, subparagraph b(i)]*

Other Israeli taxes

1.314 The Convention applies to other Israeli taxes levied for periods beginning on or after the first day of January for the calendar year

following the year in which the Convention enters into force. *[Article 29, subparagraph b(ii)]*

### **Article 30 – Termination**

1.315 Article 30 provides that the Convention continues in effect indefinitely. However, either country may terminate the Convention by giving notice of termination at least six months before the end of any calendar year beginning after the expiration of five years from the date of the Convention's entry into force. Termination is by written notice through the diplomatic channels. *[Article 30]*

#### *Cessation date for Australian taxes*

##### Withholding tax

1.316 In the event of termination the Convention will cease to apply in Australia in respect of withholding tax in relation to income that is derived by a resident of Israel on or after 1 January next following the date on which the notice of termination is given. *[Article 30, subparagraph (a)(i)]*

##### Fringe benefits tax

1.317 In the event of termination the Convention will cease to apply in Australia in respect of fringe benefits tax in relation to fringe benefits provided on or after 1 April next following the date on which the notice of termination is given. *[Article 30, subparagraph (a)(ii)]*

##### Other Australian taxes

1.318 In the event of termination, the Convention will cease to apply to other Australian taxes in relation to income, profits or gains of any year of income beginning on or after 1 July next following the date on which the notice of termination is given. *[Article 30, subparagraph (a)(iii)]*

#### *Cessation date for Israeli taxes*

##### Withholding tax

1.319 In event of termination, the Convention will cease to apply to tax withheld at source in relation to amounts paid on or after 1 January of the calendar year following the year in which the notice of termination is given. *[Article 30, subparagraph (b)(i)]*

##### Other Israeli taxes

1.320 In the event of termination, the Convention will cease to apply to other Israeli taxes levied for periods beginning on or after the first day of January of the calendar year following the year in which the notice of termination is given. *[Article 30, subparagraph b(ii)]*

### **Protocol**

1.321 The Protocol is an integral part of the Convention because of Article 28. The Protocol sets out a number of positions that were agreed to in the course of negotiations.

1.322 The Protocol provides that nothing in the Convention prevents the application of Australia or Israel's domestic laws that are designed to prevent the avoidance or evasion of taxes. [*Protocol, paragraph 1*]

1.323 The Protocol includes a number of examples of types of laws that are designed for this purpose. However, the Protocol is not limited to the listed examples as it applies to anti-avoidance laws more generally.

1.324 The types of laws that are listed in the Protocol include:

- thin capitalisation and dividend stripping rules;
- transfer pricing rules;
- controlled foreign company and transferor trust rules;
- foreign occupational company rules; and
- Australia and Israel's general anti-avoidance rules.

1.325 The Protocol also notes that a number of departures from the OECD Model were included in the Convention to conform to Australia or Israel's consistent treaty practice. [*Protocol, paragraphs 13 and 14*]

1.326 Other issues covered by the Protocol that are relevant to specific Articles are explained above in the context of those Articles.

## **Application**

1.327 The amendments commence on the day after they receive the Royal Assent. However, the Convention itself must first enter into force before it can take effect. For entry into force, Australia and Israel must exchange instruments of ratification on the completion of their domestic implementation procedures.



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## **Chapter 2**

# **Australia's deemed source rule**

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### **Outline of chapter**

2.1 This Bill introduces a domestic source of income rule to ensure that Australia can exercise its taxing rights under the Convention and future international tax agreements.

2.2 All legislative references in this Chapter are to the ITAA 1997 unless otherwise stated.

### **Context of amendments**

2.3 It has been Australia's preferred practice to negotiate the inclusion of a source of income ('source') rule in its tax treaties – see for example Article 22 of the New Zealand Convention ([2010] ATS 10), Article 22 of the Canadian Convention ([1981] ATS 14) and Article 22 of the Chilean Convention ([2013] ATS 7).

2.4 These source rules overcome a decision of the High Court in 1965 (*Federal Commissioner of Taxation v Mitchum*), where the Court held that Australia could not tax certain income even when the treaty allocated the taxing right to Australia, because the income was not 'sourced' in Australia.

2.5 In general terms, Australia's treaty based source rules address this issue by providing that income, profits or gains that are permitted to be taxed by Australia under the relevant treaty are taken to be sourced in Australia for the purposes of Australia's domestic tax rules. The treaty based source rules are given the force of law by section 5 of the Agreements Act, and apply for the purposes of the Assessment Acts. The treaty rules prevail in the event of any inconsistency with a provision of the Assessment Acts, other than the general anti-avoidance rule in Part IVA of the ITAA 1936 (see section 4 of the Agreements Act).

2.6 A specific source rule was not included in the Convention. Where a source rule is not included in the text of a particular tax treaty, Australia's consistent practice has been to instead legislate an equivalent source rule for the treaty in the Agreements Act – see for example section 11S of the Agreements Act, which applies in respect of the Chinese Convention. As with the treaty based source rules, these source rules also apply for the purposes of the Assessment Acts and prevail in the event of

any inconsistency with a provision of those Acts, other than Part IVA of the ITAA 1936.

2.7 The treaty specific source rules enable Australia to exercise the taxing rights allocated to it under a treaty. These source rules can have the effect of assigning an Australian source to income that would otherwise not be treated as being sourced in Australia. As foreign residents are generally taxed on their Australian sourced income, the treaty specific source rules can trigger a tax liability for a foreign resident that would not otherwise exist.

2.8 The definition of Australian source is located in subsection 995-1(1). This definition was introduced when the ITAA 1997 was first enacted. The definition refers to amounts of ordinary or statutory income that are derived from sources in Australia for the purposes of the ITAA 1936.

## **Summary of new law**

2.9 This Bill amends the ITAA 1997 to introduce a new deemed source of income rule that ensures Australia can exercise its taxing rights under the Convention and future international tax agreements. The Bill does not affect existing Conventions (all of which already have specified source rules either in the relevant Convention itself or the Agreements Act).

2.10 The new deemed source rule enables Australia to exercise the taxing rights allocated to it under the Convention and any future international agreements. The effect of the deemed source rule is consistent with the specific source rules that apply for each of Australia's existing tax treaties, and ensures there is a consistent approach for all future treaties.

2.11 This approach means that Australia will no longer need to secure agreement to include its specific source rule in the course of negotiating a tax treaty, or legislate a specific rule where such agreement cannot be secured. This is appropriate, as the characterisation of source (and other matters that go to establishing a tax liability) are ultimately a matter for the domestic laws of each Contracting State.

2.12 Consistent with this principle (that source is ultimately a domestic matter), the rule is located in a new Division of the ITAA 1997 (Division 764). Although the location of the provision is different to the other treaty specific source rules (which are in the Agreements Act), the deemed source rule is given the same priority as those treaty rules. This ensures a consistent approach to source in respect of Australia's tax treaties, irrespective of the treaty source rule that applies.

2.13 To facilitate including the deemed source rule in the new Division 764, the amendments also amend the existing definition of 'Australian source'. These changes clarify that the definition of Australian source in the ITAA 1997 includes, but is not limited to, the rules about Australian source in the ITAA 1936.

## Comparison of key features of new law and current law

| <i>New law</i>   | <i>Current law</i>  |
|--|---|
| A general source rule ensures that income that Australia is permitted to tax under an international agreement is deemed to be sourced in Australia. This rule applies to the Convention and any future international agreements. | Treaty specific source rules have previously been either included in the relevant bilateral tax treaty, or implemented unilaterally through the Agreements Act. |

## Detailed explanation of new law

### Deemed source rule for international agreements

2.14 The amendments introduce a deemed source rule that applies in respect of the Convention and any future international agreements.

2.15 This rule provides that 'income, profits or gains' have an Australian source if:

- for the purposes of an international tax agreement, the income profits or gains are those of a person who is a resident of a foreign country or foreign territory; and
- the effect of the agreement is that the income, profits or gains may be taxed in Australia.

*[Schedule 2, item 1, subsection 764-5(1)]*

2.16 This deemed source rule applies for the purposes of 'this Act'. The reference to 'this Act' includes provisions of the ITAA 1997, ITAA 1936 and certain provisions of the *Taxation Administration Act 1953* (see the definition of 'this Act' in subsection 995-1(1)). *[Schedule 2, item 1, subsection 764-5(1)]*

2.17 The rule only applies to international tax agreements that were made on or after 28 March 2019, which is the day the Convention was signed. *[Schedule 2, item 1, subsection 764-5(2)]*

2.18 This ensures that the source rule will apply to the Convention and any new agreements entered into, but does not apply to any existing

agreements. In the event that it is not appropriate for the deemed source rule to apply to a future agreement, the effect of the deemed source rule can be limited at the time that the legislation implementing the agreement is enacted.

2.19 The effect of this rule in determining when an amount is sourced in Australia is consistent with the existing source rules contained in Australia's tax treaties, and the treaty specific rules in the Agreements Act. To ensure this consistency, the deemed source rule is formulated in a way that closely aligns with those existing rules. However, the rule has been necessarily adapted to ensure that it can be applied to international agreements generally (in contrast to the specific rules that apply to a single treaty).

2.20 In broad terms, the deemed source rule treats income, profit, or gains as being sourced in Australia where Australia is allocated a right to tax the amount under an international tax agreement. The deeming rule only applies to income, profits or gains of a person who is treated as a resident of a foreign country or foreign territory for the purposes of the agreement.

2.21 The phrase 'income, profits or gains' draws directly from the concepts that are used in Australia's tax treaties (which are based on the OECD Model).

2.22 The reference to an 'international tax agreement' means an agreement that is given the force of law by the Agreements Act (as per section 5 of that Act). This term 'international tax agreement' extends to agreements that are not double tax treaties, the deemed source rule is also capable of applying to such agreements. However, for this to occur, the agreement must also allocate Australia taxing rights in respect of the income of a foreign resident.

2.23 The residency requirement ensures that the deemed source rule does not apply to persons who are an Australian resident for the purposes of the relevant agreement. This is appropriate because although Australian residents are generally taxed on their worldwide income, some provisions (including tax exemptions) are based on a resident having foreign sourced income. For example, section 23AG of the ITAA 1936 provides a tax exemption to Australian residents for certain foreign income derived from foreign services.

2.24 The reference to a person being a resident of a 'foreign country' is applicable to any international tax agreement that Australia has with another country. The term 'foreign country' takes on its meaning from section 2B of the *Acts Interpretation Act 1901*. The reference to a person being a resident of a 'foreign territory' is applicable to any international tax agreement that Australia has with a territory, rather than a country. Under Australia's existing agreement of this kind, a person's residence is



defined in respect of such territories. The term 'foreign' is used to distinguish a territory that is a counter-party to an agreement from Australia's external territories.

2.25 The deemed source rule does not require the person who is actually taxed in Australia on the income, profits or gains to be the person who is a resident of a foreign country or foreign territory under an agreement (although in most cases they will be one and the same). For example, where an entity is treated as fiscally transparent by a treaty partner country but not by Australia, the deemed source rule could still apply to the income, profits or gains of the entity. For this to occur the agreement must permit Australia to tax the income, profits or gains in the hands of a resident of the treaty partner country (for example, in the hands of a partner of the corporate limited partnership).

2.26 In contrast to the existing treaty specific source rules, which refer to particular Articles in the relevant treaty, the deemed source rule refers to the treaty in its entirety. Despite this difference in approach, the actual scope of the deemed source rule is the same. This is because the Articles that are *not* specified in the specific treaty rules do not allocate taxing rights. As a result, the more general reference in the new deemed source rule does not have any operation in respect of these types of provisions. For example, Articles 1 to 5 in most of Australia's existing tax treaties cover the scope of the treaty and its various definitions. These rules do not allocate taxing rights between Australia and the other country. Because of this, there is no basis for triggering the deemed source rule in respect of these Articles. Adopting a more general reference to the treaty is preferable for a general rule of this kind because the Articles contained in individual international tax agreement, and their numbering, differs from agreement to agreement.

2.27 Consistent with the way that the existing treaty related source rules apply, this rule takes priority over any other rule that determines source in the ITAA 1997 or ITAA 1936, other than the general anti-avoidance rule in Part IVA of the ITAA 1936. [*Schedule 2, item 1, subsection 764-5(3)*]

2.28 In practice, the only source rules in the Assessment Acts that could be inconsistent with the deemed source rule are those that treat an amount as *not* being from an Australian source.

2.29 The existing treaty related source rules are given priority over the provisions of the Assessment Acts (other than Part IVA of the ITAA 1936) and any Act imposing tax because of subsection 4(2) of the Agreements Act. The rules are also given priority over any provisions of the *Fringe Benefits Tax Assessment Act 1986* because of subsection 4AA(2) of the Agreements Act.

2.30 In contrast to the priority rules in the Agreements Act (which apply to that Act generally), the priority rules for the deemed source rule do not refer to the imposition acts or the *Fringe Benefits Tax Assessment Act 1986*. This does not result in a difference in scope because those Acts do not have any provisions that refer to an amount being Australian sourced (while an imposition Act may ultimately impose tax on an amount of income that is Australian sourced, the assessment of such tax is determined under the Assessment Acts).

2.31 The deemed source rule is, however, subject to the specific rule in subsection 3AA(2) of the Agreements Act. That provision disregards the specific treaty based source rules for the purposes of working out the source of certain income from funds management activities. Consistent with this approach, the deemed source rule only applies for the purposes of working out the source of income that is covered by that provision when the other treaty related rules also apply. [*Schedule 2, item 4, paragraph 3AA(2)(d) of the Agreements Act*]

## **Division 764 – Source rules & Australian source generally**

2.32 The amendments create a new Division (Division 764) to facilitate the introduction of the new deemed source rule for international agreements. [*Schedule 2, item 1, Division 764*]

2.33 It is expected that, over time, any new provisions that have general application in respect of source would be included in this Division (including any existing provisions that are re-written as part of some other process).

2.34 As part of these amendments, some modifications are made to the existing definition of ‘Australian source’ in the ITAA 1997. These changes clarify that the definition of Australian source in the ITAA 1997 includes, but is not limited to, the rules about Australian source in the ITAA 1936. [*Schedule 2, item 2, subsection 995-1(1) (definition of Australian source)*]

2.35 These changes are not intended to alter the meaning or scope of the existing definition of Australian source. Reframing the definition as an inclusive definition makes it clear that the ordinary meaning of ‘Australian source’ is directly relevant to the ITAA 1997, rather than relevant through the concepts in the ITAA 1936.

2.36 This approach is not intended to change the relevance of existing concepts and common law principles for determining source. This is consistent with the scope of the original definition. Although that definition referred to amounts being derived from an Australian source for the purposes of the ITAA 1936, the meaning of that concept in the context of the ITAA 1936 has always been determined having regard to established principles and jurisprudence about source.

2.37 Similarly, the changes do not disturb or disrupt any provision that includes an amount of income in assessable income on a basis other than source (such as paragraph 6-10(5)(b)).

2.38 In working out whether a particular amount is Australian sourced or not, regard must be had to any specific provision in the ITAA 1936 or ITAA 1997 that relate to source. Examples of specific statutory provisions that deem an amount to be sourced in Australia are subsections 6B(2A), 6C(1A), 6CA(2), 6CA(3) and 26E(1) of the ITAA 1936. The new deemed source rule for international agreements (explained above) is another example of a provision that has this effect.

2.39 Conversely, any provisions that provide that a particular amount is not sourced in Australia must also be taken into account. Examples of specific statutory provisions that have this effect are subsections 83A-25(2), 83A-110(2) and 276-820(7), items 8 and 9 in the table in subsection 230-310(4).

### **Technical correction to the Agreements Act**

2.40 The amendments also correct an incorrect cross-reference in section 3AA to the specific source rule that applies in respect of the earlier agreement with Germany. [*Schedule 2, item 3, paragraph 3AA(2)(c) of the Agreements Act*]

2.41 A specific source rule was included in the Agreements Act in respect of the previous agreement with Germany. This rule was re-written to preserve its operation when the German Convention was renegotiated in 2015 and given force of law in 2016. However, the reference to this rule in section 3AA was not updated to reflect its new location. The amendments correct this cross-reference to ensure that it refers to the updated source rule.

### **Application**

2.42 While amendments described in this Chapter generally apply from the time that they commence, the deemed source rule applies in respect of any international tax agreements that are made on or after 28 March 2019. While this includes the Convention, as noted above, the Convention will only take effect after it enters into force.



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## **Chapter 3**

# **Statement of compatibility with human rights**

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### **Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

#### ***Treasury Laws Amendment (International Tax Agreements) Bill 2019***

3.1 This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### **Overview**

3.2 This Bill amends the Agreements Act to give force of law to the Convention. This process is part of Australia's domestic procedure for implementing its tax treaties.

3.3 This Bill also introduces a domestic source of income rule to ensure that Australia can exercise its taxing rights under the Convention and future international tax agreements.

#### **Human rights implications**

3.4 This Bill engages the following human rights:

- the right to protection from arbitrary or unlawful interference with privacy under Article 17 of the International Covenant on Civil and Political Rights (ICCPR); and
- the right to protection from discrimination under Articles 2(1) and 26 of the ICCPR and Article 2(1) of the International Convention on the Elimination of All Forms of Racial Discrimination (ICERD).

#### ***Protection from arbitrary or unlawful interference with privacy***

3.5 The Bill engages the right to protection from arbitrary or unlawful interferences with privacy in Article 17 of the ICCPR by implementing Article 26 (Exchange of Information) of the Convention. Article 26 provides that Australian and Israeli taxation authorities shall exchange such information as is foreseeably relevant to the implementation of the Convention, or the enforcement domestic laws

concerning the taxes covered by Article 2 (Taxes Covered) of the Convention. *[Article 26, paragraph 1]*

3.6 The right in Article 17 of the ICCPR may be subject to permissible limitations, where these limitations are authorised by law and are not arbitrary. For an interference with the right to privacy to be permissible, the interference must be authorised by law, be for a reason consistent with the ICCPR and be reasonable in the particular circumstances. The UN Human Rights Committee has interpreted the requirement of ‘reasonableness’ to imply that any interference with privacy must be proportional to the end sought and be necessary in the circumstances of any given case.

#### *Analysis*

3.7 The purpose of Article 26 is to enable taxation authorities to correctly apply, administer and enforce the provisions of this Convention, which aims to eliminate double taxation on income without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. This is a legitimate and globally recognised aim.

3.8 Article 26 of the Convention is a standard feature of the OECD Model. Any departures from the OECD Model in Article 26 are to accommodate Australia and Israel’s domestic policies on information exchange, privacy and related issues.

3.9 Information exchange improves the ability of Australian and Israeli taxation authorities to conduct timely compliance activity and better protect the integrity of their respective tax system. It also enables Australia and Israel to help prevent tax evasion and improve global tax compliance. This is consistent with ongoing international efforts, supported by the G20, to improve tax system integrity.

3.10 As members of the Inclusive Framework on BEPS, Australia and Israel are committed to the implementation of the OECD/G20 BEPS Project. That project provides governments with solutions, designed to be implemented domestically and through treaty provisions, for closing the gaps in existing international tax rules that allow corporate profits to disappear or be artificially shifted to low/no tax environments. Information exchange between Australian and Israeli taxation authorities, in accordance with Article 26 of the Convention, is therefore a core part of an international framework for combatting tax evasion and improving global tax compliance.

3.11 Article 26 balances the information needs of taxation authorities with the need to protect taxpayers from arbitrary or unlawful interference with their privacy. The standard of ‘foreseeable relevance’ provides for the exchange of information in tax matters to the widest possible extent and, at the same time, clarifies that Australia and Israel are not at liberty to

engage in ‘fishing expeditions’ or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. *[Article 26, paragraph 1]*

3.12 Any information shared between Australian and Israeli taxation authorities will be treated as secret, in the same manner as taxation information obtained by the authority under domestic taxation laws. Australian and Israeli taxation authorities must take all reasonable measures to protect confidential information from any unauthorised disclosure. *[Article 26, paragraph 2]*

### ***Protection from discrimination***

3.13 The Bill engages the right to equal protection of the law and non-discrimination contained in the ICCPR and ICERD. Discrimination under the ICCPR and ICERD comprises differential treatment (a distinction, exclusion or restriction) on the basis of a prohibited ground, which nullifies or impairs the enjoyment of human rights.

3.14 The Convention contains a number of provisions relating to the taxation of individuals. Article 24 (Non-discrimination) of the Convention also contains rules to protect nationals and businesses of Australia and Israel from tax discrimination in the other country, while ensuring that laws intended to maintain tax system integrity continue to apply.

3.15 Article 24 of the Convention enhances the non-discrimination principle by ensuring that Australia or Israel cannot subject nationals or businesses of the other country to less favourable tax treatment than that which applies to their own nationals or businesses who are in similar circumstances. In this context, ‘similar circumstances’ relates to tax residence status. Differential tax treatment on the basis of residency is permitted under the Convention, provided that such treatment applies equally to the nationals of both countries

3.16 Differential treatment on the basis of a person’s residence is a proportionate means of achieving the Bill’s legitimate objective, as this approach follows the Organisation for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital, which has been largely adopted by most countries, with some variations.

## **Conclusion**

3.17 This Bill is consistent with the right to privacy, as the exchange of information under the Convention is neither arbitrary nor unlawful. Various safeguards are in place to protect the information that is exchanged.

3.18 The Bill is also consistent with, and enhances, the right to protection from discrimination. Any differential treatment that is permitted by the Convention on the basis of residency is proportionate to

the pursuit of a legitimate aim and consistent with established international tax principles.