Contemporary treaty issues

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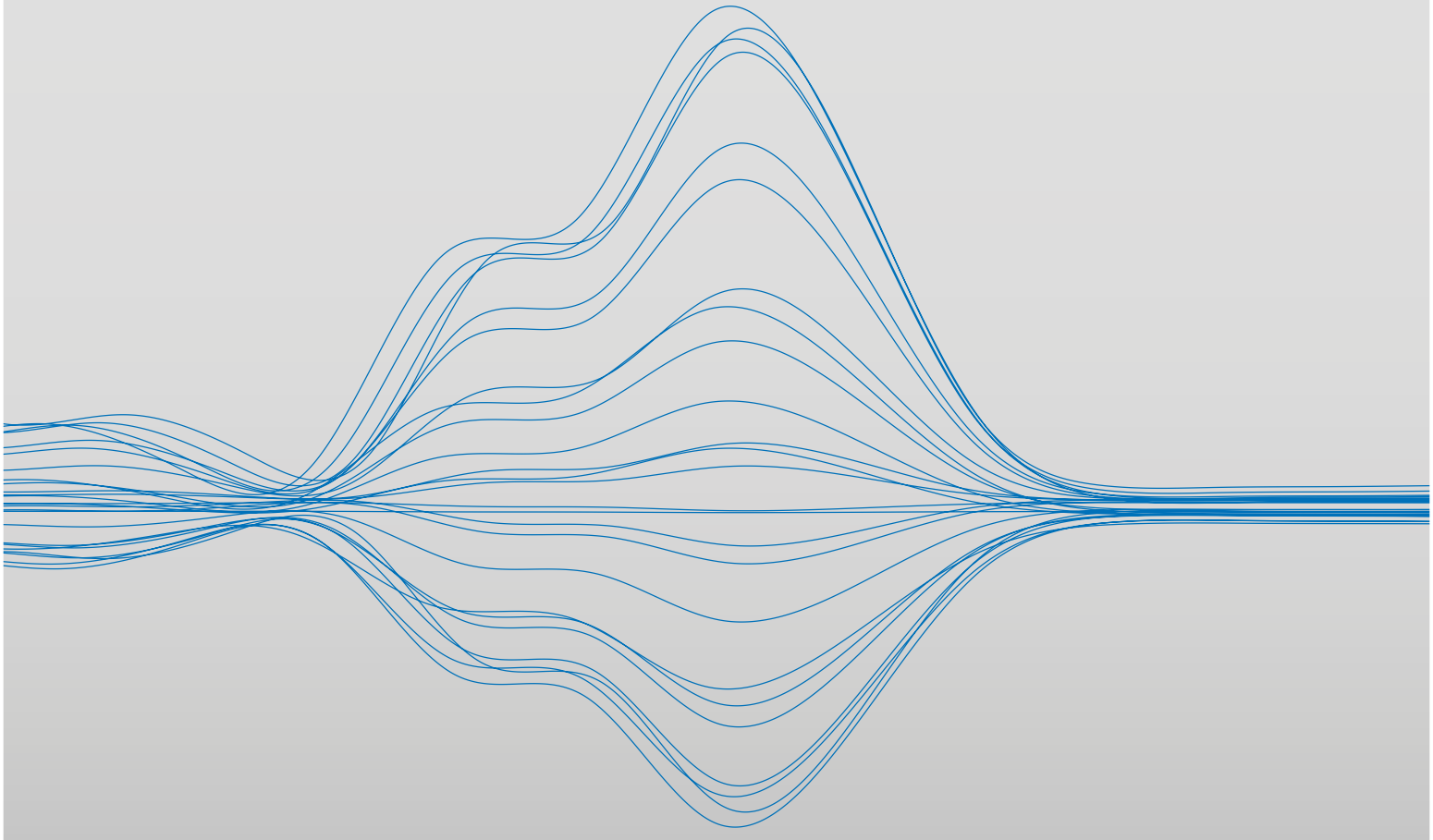

DLA PIPER

Contemporary treaty issues

This is a dynamic time in the evolution of Australia's double tax treaty network following on from the previous government's plans announced on 15 September 2021 to significantly expand the treaty network. Pleasingly, the Albanese Government has strongly supported and further expanded this important treaty initiative.

This article focuses firstly on the overlay of the Multilateral Instrument, particularly the application of the limitation on benefits articles on access to concessional withholding taxes (dividends and royalties) under our covered tax agreements. Secondly, the article deals with special issues including dispute resolution/arbitration, fiscally transparent entities/collective investment vehicles and the recent Maritime Boundary Treaty with Timor-Leste.

Background and introduction

The former Australian Treasurer, the Hon. Josh Frydenberg MP, announced on 15 September 2021 a significant expansion of Australia's double tax treaty network to, among other things, stimulate economic integration through foreign investment and trade.[1]

At the time, it was intended that Australia would enter into 10 new or updated treaties by the end of 2023, the first phase of which would include a revised India/Australia treaty as well as new treaties with Luxembourg and Iceland.

Further revised or new treaties are proposed with Greece, Portugal and Slovenia. According to the then government's media release,[2] 6 of the 10 countries had been identified, with further analysis and consultation planned with a view to determining further treaty updates or renewals. It was anticipated that further candidates for new or revised treaties could potentially include jurisdictions such as Hong Kong, South American countries (eg Brazil), European countries and Timor-Leste.

The former government's plans to significantly expand Australia's treaty network have been continued and further expanded by the new Australian Government. In particular, the new Treasurer, the Hon. Jim Chalmers MP, is known to be highly supportive and committed to expanding the treaty network.[3] As part of the recent Budget, it was announced that a new treaty with Iceland was signed on 12 October 2022.

Critical resources and funding have been committed to support the modernisation and expansion of Australia's treaty network.

Australia currently has 46 bilateral comprehensive tax treaties, which will be significantly expanded by this recent government initiative. The government has continued to welcome public input, recommendations and consultation on key aspects of the proposed treaties.

After a slow period, Australia entered into new treaties with Germany in 2016 and Israel in 2019. Further, in 2018, Australia entered into a comprehensive Maritime Boundary Treaty with Timor-Leste dealing with, or facilitating, the legal, regulatory and taxation framework for petroleum development in the Timor Sea under the revised maritime boundary.

Australia has been a strong supporter of the Multilateral Instrument (or MLI) (*Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*), which was largely operative for certain of our existing treaties from 2019.

While no particular information has been publicly released at this stage, the author expects that various features associated with the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiatives to be pursued with respect to these new/revised treaties, including, for example, those related to transparent entities, permanent establishments, concessional dividends, interest and royalty withholding taxes, limitation of treaty benefits/treaty abuse, and mutual agreement procedures/ dispute resolution/arbitration and related initiatives (i.e. similar to those BEPS features included most particularly in the 2016 Germany/Australia double tax agreement (DTA) (German Treaty).

Australia was an early supporter of BEPS 1.0, including the related OECD/G20 BEPS action plans, and has been actively involved in BEPS 2.0, including the proposed Pillars 1 and 2 that are currently the subject of much global discussion and negotiation.

The proposed treaty network expansion is very timely and well supported, and well under way, as evidenced by the recent introduction into parliament of a Bill to amend to the India/Australia treaty in relation to the tax treatment of certain "technical services" under the existing treaty.[4]

The author also notes reported pressure from several European nations using negotiations on a free trade deal with the European Union as leverage to secure more favourable tax outcomes under proposed treaties, including by way of reduced withholding taxes.[5] In this context, the government announced on 16 November 2022 its intention to enter new negotiations on treaties with Bulgaria, Columbia, Croatia, Cyprus, Estonia, Latvia and Lithuania.[6] It also appears that economic and security interests increasingly overlap.

This article will first focus on the overlay of the Multilateral Instrument, particularly the limitation on benefits/treaty abuse articles on access to concessional withholding taxes (dividends and royalties) under our affected treaties (covered tax agreements (CTAs)). Second, the article will deal with special issues, including dispute resolution/arbitration, fiscally transparent entities/collective investment vehicles and the new Maritime Boundary Treaty with Timor Leste.

Overview and application of the Multilateral Instrument

The Multilateral Instrument is a multilateral tax treaty that enables jurisdictions (including Australia) to quickly modify their bilateral tax agreements to give effect to internationally agreed tax integrity rules and to improve dispute resolution mechanisms, including by way of arbitration.[7] It has been given force of law by way of an amendment to the *International Tax Agreements Act 1953* (Cth).

The Multilateral Instrument emanated from OECD/G20 BEPS action 15.[8]

Australia signed the Multilateral Instrument on 7 June 2017,[9] and it was given the force of law in Australia by the *Treasury Laws Amendment (OECD Multilateral Instrument) Act 2018*, which received royal assent on 24 August 2018.

Australia deposited its instrument of ratification with the OECD Depositary on 26 September 2018 with the effect that the Multilateral Instrument generally entered into force for Australia on 1 January 2019. The effect and timing of modification of individual treaties by the MLI will depend on the adoption of positions taken (and reservations) by each treaty partner at the ratification, acceptance or otherwise approval of the Multilateral Instrument.

An explanatory statement accompanies the Multilateral Instrument and provides clarification of the approach by explaining how it should modify each bilateral tax agreement/treaty.[10]

The ATO also prepares synthesised texts of its understanding of the modifications made to each treaty. The sole purpose of these is to facilitate and assist in the understanding of the impact of the Multilateral Instrument; however, these do not constitute a source of law. The authentic legal texts of the treaties and the Multilateral Instrument take precedence and remain the legal texts applicable.

Key trading and investment partners, including, in no particular order of priority, Canada, Chile, France, India, Indonesia, Japan, Korea, the Netherlands, New Zealand, Singapore and the United Kingdom, have entered into and ratified the Multilateral Instrument with Australia. The US has not signed the MLI – in part due to concerns regarding the integrity provisions/principal purposes test – and our newer treaties reflect the modern approaches to the issues covered by the MLI.

The focus of much of the following commentary will be on the particular practical application of the overlay of the Multilateral Instrument on the UK/Australia DTA (UK Treaty) as a model for further discussion/analysis.

Each bilateral treaty modified is described as a "covered tax agreement" if it is, first, nominated by Australia as a CTA, and second, the bilateral treaty partner has approved the Multilateral Instrument and nominated the Australian treaty as a CTA.[11]

By modifying an existing CTA, the relevant Multilateral Instrument provision generally changes the application of an existing provision without entirely replacing it; that is, it will be applied alongside the existing CTA provision to implement the BEPS measures.[12]

Most importantly, as many of the integrity rules, including the principal purpose test (PPT), contained in the Multilateral Instrument are also included in the OECD model treaty, the OECD commentaries to the OECD model treaty become critically important and reflect the content of the final BEPS reports, including on action 6 dealing with limitation on benefits articles.[13]

Article 7 of the Multilateral Instrument provides a comprehensive "prevention of treaty abuse" provision based on the principal purposes test, which allows revenue authorities to deny treaty benefits (eg tax reductions or exemptions); that is, where one of the principal purposes of an arrangement was to inappropriately obtain such treaty benefits (the principal purposes test).[14]

The PPT in art 7 is generally mandatory for countries that ratify the Multilateral Instrument, and thus its technical and practical application and broader parameters should be well explored and understood.

Essentially, the principal purposes test provides that a benefit will not be granted in respect of an item of income or capital (eg a tax reduction or exemption) where it is reasonable to conclude, having regard to all the relevant facts and circumstances, that:

- one of the principal purposes of an arrangement or transaction was to obtain the treaty benefit directly or indirectly; and
- granting such benefit in the circumstances would not accord with the object and purpose of the provisions of the CTA.[15]

Article 29 (entitlement to benefits) of the OECD model commentary, states that the principal purposes test is intended to "ensure that tax conventions apply in accordance with the purpose for which they were 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".[16]

Dividends

With the overlay of the Multilateral Instrument on various of Australia's double tax treaties (commonly from 1 January 2019), multinational groups should be increasingly aware of the limitation on benefits articles in various of our DTAs. Where applicable, these limitation on benefits articles can deny access to concessional treaty benefits (eg reductions in dividend, interest or royalty withholding tax rates), and these have mainly been implemented by the introduction or expansion of the principal purposes test (PPT).

For the purposes of this analysis, it has generally been assumed that the recipient of the dividend income is the "beneficial owner" and that this income is not "effectively connected" with a permanent establishment in the other jurisdiction; further, the focus is on art 10(7) of the UK Treaty and the principal purposes test.

Broadly, the principal purposes test seeks to distinguish genuine commercial arrangements whose use of the treaty is consistent with the objects of the treaty (to develop closer economic relations including by way of encouraging investment, trade and services between the two countries) from arrangements used to secure treaty benefits by a means that amounts to an improper use of the treaty (eg treaty shopping).

Given the relatively recent implementation of the Multilateral Instrument, we are witnessing an enhanced and expanded Australian Taxation Office (ATO) focus on the potential improper use of Australia's double tax treaties, including through the use of the principal purposes test.

On 1 October 2020, the ATO issued PS LA 2020/2, which essentially provides guidance to ATO staff on the recommended approach to and the internal processes for considering the potential application of the principal or main purpose tests, thereby potentially denying treaty benefits under either Multilateral Instrument – impacted treaties and non-Multilateral Instrument – impacted treaties.

Australia's current double tax treaties (46 treaties) vary considerably in terms of the technical and practical application of these integrity rules. In particular, note that our most recent or modern treaties contain a specific limitation on benefits article (eg the Germany/Australia DTA and the Israel/Australia DTA).

Alternatively, treaties that are subject to the Multilateral Instrument (eg the UK/Australia DTA and the Japan/Australia DTA) have been effectively modified to include and/or apply a principal purposes test type test to limit concessional treaty benefits.

These treaty concessions (and the associated risks) can be substantial; for example, the prima facie dividend withholding tax on unfranked dividends at the rate of 30% could be reduced to 15%/10%/5%/0% under an applicable tax treaty, and the prima facie royalty withholding tax of 30% could be reduced to 15%/10%/5% under an applicable tax treaty.

In particular, third country (ie non-treaty partners such as the Cayman Islands)–based multinational entities/corporations accessing treaty benefits via foreign subsidiaries or joint venture entities may, in particular, be exposed in securing (and being denied/losing) these treaty benefits (eg withholding tax concessions) under these limitation on benefits provisions and/or the principal purposes test.

The use of the 2017 OECD commentary on the *Model Tax Convention on Income and on Capital* (and related guidance), including the Multilateral Instrument concept of the principal purposes test, will be highly relevant/influential in interpreting and applying the limitation on benefits articles and the principal purposes test.[17]

Further, the ATO released TA 2022/2 on 20 July 20222 dealing with treaty shopping arrangements designed to secure reduced dividends or royalty withholding tax rates by the interposition of entities located in a jurisdiction that has a favourable double tax treaty with Australia.

The alert is very brief and explains the ATO concerns from a taxation perspective. It raises the potential application of anti-avoidance rules under the relevant treaty (including the principal purposes test or the main purposes test) as well as the general anti-avoidance provision (Pt IVA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36)) and the diverted profits tax (DPT).

Further, the ATO notes that they are currently reviewing certain international transactions of this nature and engaging with taxpayers and advisers appropriately.

The ATO provides an example of an arrangement involving reduced dividend withholding taxes. It also highlights several relevant characteristics in para 12 of the taxpayer alert. In addition, it refers to the importance of contemporaneous documentation and other objective evidence supporting the commercial rationale (non-tax issues) for the structure/acquisition (see paras 14 and 15). Key issues or attributes to examine include the source of funding, forecast and actual dividend repatriation, common control of relevant entities, and access to expertise and operational efficiencies. It separately provides a useful example of reduced royalty withholding taxes.

The purpose of releasing the taxpayer alert is to raise the awareness of perceived emerging tax risk arrangements or issues.

This taxpayer alert reflects the increasing ATO focus on treaty shopping (eg multinational entities based in non-treaty countries such as the Cayman Islands using treaty countries like the UK to invest in Australia).

Most importantly, the ATO also raises the possibility of utilising the general anti-avoidance rules in Pt IVA, including the DPT, transfer pricing and the debt/equity rules to combat perceived treaty shopping arrangements. In this context, there can be different thresholds of "purpose" necessary, particularly for Pt IVA (dominant purpose). Further, although DPT has a similar "principal purpose"–type test in s 177J ITAA36, it mandates that this requisite purpose be determined by reference to the eight factors listed in s 177D ITAA36 (and prescribes two additional factors), including the form and substance of the scheme, and the timing and manner in which this scheme was carried out.

The author has focused the following comments and analysis on the principal purposes test and how it would or should be applied in practice.

The author has tested the practical application of the overlay of the MLI concept of "principal purpose test" in the context of art 10 (dividends) of the UK Treaty.

At a high level, the main purpose test (MPT) should be interpreted with reference to (and consistent with) the PPT (and most importantly, the object and purpose of tax treaties generally).

The adoption of a PPT-type approach in the context of the main purpose test in art 10(7) of the UK Treaty provides several important advantages in the technical interpretation and practical application of art 10(7), which include, among others:

- the adoption and use of the Multilateral Instrument concept of the principal purposes test;
- the adoption and use of the guidance provided in the 2017 OECD commentary on the *Model Tax Convention on Income and on Capital*;
- the use of various persuasive propositions (see below) as part of the principal purposes test (and related guidance) in respect of the above two documents; and
- diminishing the potential focus on the "effects of the arrangement" from a withholding tax minimisation perspective.

There are five key propositions[18] that should be highlighted, as follows:

- The principal purposes test seeks to distinguish (and focuses on) genuine commercial arrangements whose use of the treaty is consistent with the objects of the treaty (including facilitating and encouraging investment between the two countries), from arrangements used to secure treaty benefits by a means that amount to an improper use of the treaty.
- Where an arrangement is inextricably linked to a "core commercial activity" and its form has not been driven by considerations of obtaining a treaty benefit, it is unlikely that its principal purpose will be considered to be to obtain the treaty benefit.
- It should not be lightly assumed that obtaining a benefit under a tax treaty was one of the principal purposes of the arrangement, and merely reviewing the "effects of the arrangement" will not usually enable a conclusion to be drawn about its purposes.
- Where an arrangement can only be reasonably explained by reason of a benefit that arises under the treaty, it may be concluded that one of the principal purposes of that arrangement was to obtain the benefit.
- All of the evidence must be weighted to determine whether it is reasonable to conclude that an arrangement or transaction was undertaken or arranged for such purpose of obtaining the treaty benefit.

In the author's view, there is strong and robust technical support to adopting a principal purposes test–type approach in the broad context of considering art 10(7) of the UK Treaty.

Several key observations thereon are set out below:

- There is no specific or detailed definition of "main purpose or one of the main purposes" and thus "main" should be read as the same and consistent with "principal" in the context of the main purpose test.
- "Main", according to its ordinary meaning, is ambiguous in the sense that it can include a reference to "principal" or "dominant" as per the *Macquarie Dictionary* and the *Oxford English Dictionary* definitions – a fact acknowledged by the ATO in a different context.[19]
- The explanatory memorandum accompanying the introduction of the 2003 UK Treaty provides little specific guidance on art 10(7) other than in para 1.126 as follows:

  "1.126 The source country rate limits and exemptions available under this Article will not apply where a creation or assignment of shares or other rights in respect of which dividends are paid, has been made with the main objective of, or one of the main objectives of accessing the relief otherwise available under this Article (Article 10, paragraph 7)."

- The use of the term "main purpose" in other Australian double tax treaties (including treaties with New Zealand and Japan) is not helpful or necessarily relevant in the context of art 10(7) of the UK Treaty.
- Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* (Vienna Convention) provide useful guidance in interpreting the terms of the UK Treaty by reference to text, context and its object and purpose (including, among other things, facilitating and encouraging investment/ownership and other transfers/trade between the UK and Australia), as well as resolving any ambiguous meanings.
- Most importantly, art 31(3) requires any "subsequent agreement" between the parties regarding the interpretation of the treaty or the application of its provisions to be taken into account (together with its context) in interpreting the pre-Multilateral Instrument version of the UK Treaty. Given that that the Multilateral Instrument (including its use of the PPT) was signed on 7 June 2017 by each of the UK and Australia, and subsequently ratified and nominated for application to the UK Treaty, it should be regarded as a "subsequent agreement" for this purpose and in this context.

- Further, the explanatory statement to the Multilateral Instrument specifically supports the proposition that similar terms such as "main purpose" are also intended to be covered by the phrase "principal purpose" in art 7(1) of the Multilateral Instrument. Accordingly, the Multilateral Instrument (including the reference to the principal purposes test) should be treated as a "subsequent agreement" and be taken into account in interpreting the main purpose test in the UK Treaty (para 95 of the explanatory statement).
- Accordingly, in view of the above comments on the use and relevance of the 2017 OECD commentary and the Multilateral Instrument concept of PPT, the abovementioned guidance, principles and propositions are highly and most relevant in interpreting and applying the main purpose test in art 10(7) of the UK Treaty.
- There are further arguments in support of the proposition that the meaning of treaties should be viewed as ambulatory (evolving and adapting, not fixed in interpretation) as distinct from static.

While the ATO's public views on ambulatory interpretation are reflected in TR 2001/13, there are also important supporting judicial comments and/or suggestions on ambulatory interpretation, including by Edmonds J in *Virgin Holdings SA v FCT*[20] and *Resource Capital Fund III LP v FCT*,[21] and by Gordon J in *Bywater Investments Ltd v FCT*.[22]

Further, and importantly, the OECD Council recommends that tax administrations/authorities take into account and follow the latest versions of the OECD commentary (as modified from time to time) when interpreting tax treaties.

Ultimately, interpreting and applying the relevant treaty provisions requires an acceptable bilateral approach; however, the above statements of principle and related propositions relating to the interpretation of the UK Treaty are highly persuasive and reflect the preferred approach to statutory interpretation in this context.

Article 31(1) of the Vienna Convention states that the terms used in the treaty should be interpreted in accordance with their ordinary meaning (and in their context and in view of the object and purpose of the treaty).

There is little or no usage of the term "main purpose" in Australian tax legislation (other than in other treaties, eg the Japan and New Zealand treaties). Further, there is little precedent in the UK regarding its application to the UK Treaty.

The likely stronger argument is pursuant to art 31(3) of the Vienna Convention (ie on the basis of the MLI being a "subsequent agreement"). In the author's view, art 31(3) makes it effectively mandatory to take into account the Multilateral Instrument and the concept of "principal purpose test" in the context of main purpose test when applied to arrangements existing prior to the introduction of the Multilateral Instrument.

As the term "main purpose" is not defined in the treaty, reference should be had to art 3(3), which importantly allows/directs reference to Australian domestic law in applying the treaty (particularly Australian domestic tax law).

This interpretative provision is supported by the explanatory memorandum accompanying the introduction of the UK/Australia DTA in 2003, and importantly also states that, if a term not defined in the treaty has an internationally understood meaning in tax treaties and a meaning under the domestic law, the context would normally require that the international meaning be applied.[23]

This guidance further supports the recourse to supplementary means of interpretation, including the 2017 OECD principal purpose test guidance. This approach was also strongly supported by the High Court in *Thiel v FCT*[24] with respect to similar non-defined terms in Australian double tax treaties.

The guidance on the principal purposes test (as set out in the Multilateral Instrument and in the 2017 OECD commentary) should be given primacy, while leaving the 2003 commentary (on the main purpose test) as largely superseded.

In any event, as both the UK and Australia did not make the reservation contained in art 7(15)(a) to not apply art 7(1) of the Multinational Instrument, it appears the PPT should effectively "replace" or apply "in place of" the main purpose test in art 10(7) of the UK Treaty.[25]

In order to strongly support the arrangements as being "genuine commercial arrangements", consistent with the objects of the treaty and/or linked to a "core commercial activity", and not exposed to the application of the "principal purposes test" per art 10(7) of the treaty, there are a range of important indicia related to the commercial substance and broader presence preferred in the UK, including:

- the extent of existing business and broader operations;
- access to skilled executives, management and broader labour force;
- access to capital – debt/equity markets, and broader source of funds/banking for investment;
- business-friendly location and high quality and reliable legal system;
- economic and political stability;
- regional groupings;
- a broader/comprehensive double tax treaty network;
- the location of critical intellectual property (IP) (as applicable);
- the extent of global integration of operations and knowledge sharing (ie synergies);
- practical governance issues;
- timing issues; and
- the amount and frequency of unfranked/partly franked dividends.

Reference to the indicators and examples provided in art 29 of the 2017 OECD commentary is strongly encouraged, as well as to the ATO's comments in paras 11 to 15 and example 2 in TA 2022/2.

Finally, and most importantly, the main purpose test focuses on the subjective purpose of "any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid", and thus objective evidence of the general decision-making process and active decision-making process of key directors and management (eg directors and/or executive committee minutes at the time of the investment decision) will be critical as contemporaneous evidence to properly apply the test.

The 2017 OECD commentary[26] on the principal purposes test states as follows:

"... it is important to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being party to it. What are the purposes of an arrangement or transaction is a question of fact which can only be answered by considering all circumstances surrounding the arrangement or event on a case-by-case basis."

Royalties

Royalty income is subject to royalty withholding tax under s 128B ITAA36, where it is paid by a resident to a non-resident, except where it is wholly incurred by the payer in carrying on business outside Australia at or through a permanent establishment there.

Importantly, a payment will only attract royalty withholding tax if the payment is in respect of a "royalty". The definition of "royalty" for these purposes encompasses the ordinary meaning of the word and the extended statutory definition as set out in s 6(1) of the ITAA36. Both these concepts are explored in more detail below along with the UK treaty definition of "royalty".

Interaction between domestic definitions and treaty definitions

Generally, the domestic royalty withholding tax provisions contained in s 128B ITAA36 are modified by the *International Tax Agreements Act 1953*. Notably, s 4 of the *International Tax Agreements Act 1953* gives the *International Tax Agreements Act 1953* precedence over the domestic royalty withholding tax provisions in the following manner:

- s 17A(5) of the *International Tax Agreements Act 1953* provides that royalty withholding tax does not apply to a payment that is a royalty within the definition of s 6(1) if it is not treated as a royalty under a relevant double tax treaty;

- s 17A(1) of the *International Tax Agreements Act 1953* limits the royalty withholding tax rate to the rate set out in the relevant double tax treaty; and
- in IT 2660, the Commissioner states that the definitions in the double tax treaties are intended to be exhaustive. Importantly, any "royalties" within the ordinary meaning of the term that do not come within the treaty definition are not royalties for the purposes of the double tax treaties.

In *International Business Machines Corporation v FCT*,[27] the Federal Court held that payments made under a software licence agreement were wholly royalties as defined in art 12(4) of the US/Australia DTA (US Treaty). The taxpayers argued that a distinction should be made between payments for the use of IP and payments for the right to use IP such that only part of the payments would be subject to withholding. The court held that the definition of "royalties" applied to both types of payments, highlighting the fact that the use of the IP, without an accompanying right to use, would have been an infringement of the IP right.

In *Task Technology Pty Ltd v FCT*,[28] the Full Federal Court held that licensing payments made by an Australian distributor to a Canadian software supplier were royalties under the Canada/Australia DTA (Canada Treaty). The case depended largely on the application of a proviso in art 12(7) of the Canada Treaty, which excludes certain payments from being royalties under the treaty. If that were applicable, it would then follow that Australian withholding tax would be excluded. The Full Court held that the proviso did not apply to the facts at hand, and therefore the payments were subject to Australian withholding tax.

In *FCT v Seven Network Ltd*,[29] payments to the International Olympic Committee as consideration for the "use" of a television and radio signal that was used by the taxpayer in its live television broadcast in Australia of the Olympics were not considered to be royalties within the meaning of art 12(3) of the Switzerland/Australia DTA (Swiss Treaty), and that it was therefore not required to withhold amounts from these payments. This case was based on a very unique set of facts.

"Royalty" under s 6(1) ITAA36

Section 6(1) expands the meaning of "royalty" to include certain amounts that may not be royalties within the ordinary meaning of that term, and treats as a royalty any amount paid or credited, however described or computed, and whether the payment or credit is periodical or not, to the extent to which it is paid or credited, as the case may be, as consideration for:

"(a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trade mark, or other like property or right;

(b) the use of, or the right to use, any industrial, commercial or scientific equipment;

(c) the supply of scientific, technical, industrial or commercial knowledge or information;

(d) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as is mentioned in paragraph (a), any such equipment as is mentioned in paragraph (b) or any such knowledge or information as is mentioned in paragraph (c);

(da) the reception of, or the right to receive, visual images or sounds, or both, transmitted to the public by:

(i) satellite; or

(ii) cable, optic fibre or similar technology;

(db) the use in connection with television broadcasting or radio broadcasting, or the right to use in connection with television broadcasting or radio broadcasting, visual images or sounds, or both, transmitted by:

(i) satellite; or

(ii) cable, optic fibre or similar technology;

(dc) the use of, or the right to use, some or all of the part of the spectrum (within the meaning of the Radiocommunications Act 1992) specified in a spectrum licence issued under that Act;

(e) the use of, or the right to use:

(i) motion picture films;

(ii) films or video tapes for use in connexion with television; or

(iii) tapes for use in connexion with radio broadcasting; or

(f) a total or partial forbearance in respect of:

(i) the use of, or the granting of the right to use, any such property or right as is mentioned in paragraph (a) or any such equipment as is mentioned in paragraph (b);

(ii) the supply of any such knowledge or information as is mentioned in paragraph (c) or of any such assistance as is mentioned in paragraph (d);

(iia) the reception of, or the granting of the right to receive, any such visual images or sounds as are mentioned in paragraph (da);

(iib) the use of, or the granting of the right to use, any such visual images or sounds as are mentioned in paragraph (db);

(iic) the use of, or the granting of the right to use, some or all of such part of the spectrum specified in a spectrum licence as is mentioned in paragraph (dc); or

(iii) the use of, or the granting of the right to use, any such property as is mentioned in paragraph (e)."

Distinction between royalties and payments for services rendered

In distinguishing between a contract for the supply of know-how and one involving the rendering of services, the Commissioner considers in IT 2660 that there are three distinguishing elements for the supply of know-how:[30]

- a "product" (ie knowledge, information, technique, formula, skills, process, plan, etc) that has already been created or developed or is already in existence is transferred;
- the product that is the subject of the contract is transferred for use by the buyer (ie it is supplied); and
- the property in the product generally remains with the seller. All that is obtained by the buyer is the right to use the product.

By contrast, in a contract involving the performance of services:[31]

- the contractor undertakes to perform services that will result in the creation, development or the bringing into existence of a product (which may or may not be know-how);
- in the course of developing a product, the contractor would apply existing knowledge, skill and expertise – there is not a transfer (ie a supply) of know-how from the contractor to the buyer as such, but a use by the contractor of his knowledge for his own purposes; and
- the product created as a result of the services belongs to the buyer for him to use without having to obtain any further rights in respect of the product. However, in the course of rendering services the contractor would, in most cases, also produce as a by-product a work (eg plan, design, specification, report, etc, which could contain knowledge, etc, not otherwise known to the buyer and which may or may not be protected by patents, etc) in which copyright would subsist. Unless specifically agreed otherwise, the contractor is the owner of such copyright and the buyer or any other person is, by law, precluded from using the property in which the copyright subsists for any purpose other than the purpose for which it was originally designed without first obtaining the approval of the contract. This would not alter the nature of the contract, which would remain one of the performance of services.

In *Tech Mahindra Ltd v FCT*[32] (*Tech Mahindra*), an Indian company that was registered in Australia carried out IT services for Australian clients both from its PE in Australia and by employees located in India. The Federal Court held, among other things, that payments made in Australia for certain services undertaken in India constituted "royalties" under the India/Australia DTA (India Treaty) and that the payments were deemed to have an Australian source. That decision was confirmed on appeal[33] and effectively endorsed by a further decision of the Full Federal Court in *Satyam Computer Services Ltd v FCT*[34] (*Satyam*). It is important to note that royalties for purposes of art 12(3)(g) include payments or credits made as consideration for technical or similar services. Further, Tech Mahindra and Satyam were the same taxpayer/company.

It is highly noteworthy that, along with the proposed new free trade agreement with India, the *International Tax Agreements Act 1953*[35] has been amended to stop Australian taxation on income (payments or credits) derived by non-resident Indian firms from providing technical services remotely (not through a permanent establishment) to Australian customers that are currently subject to art 12(3)(g) of the India/Australia DTA. This income must not be a "royalty" within the s 6(1) definition of a "royalty", and was only taxable in Australia because of the deemed source rule in art 23 of the treaty. The amending legislation for this proposed reform was introduced into parliament on 28 September 2022.[36]

TA 2018/2, TA 2020/1 AND PCG 2021/D4

Broadly, TA 2018/2 outlines the ATO's concerns in relation to international arrangements that mischaracterise intangible assets and/or activities or conditions connected with intangible assets.

Specifically, the principal mischief targeted by the ATO is the mischaracterisations that arise under arrangements that:

- allocate all consideration to tangible goods and/or services;
- allocate no consideration to intangible assets; and
- view intangible assets collectively, or conceal intangible assets.

In relation to arrangements between both related and unrelated parties, the ATO has expressed its concerns about:

- whether intangible assets have been appropriately recognised for Australian tax purposes; and
- whether Australian royalty withholding tax obligations have been met.

The examples in TA 2018/2 consider situations where Australian entities pay undivided consideration for tangible goods, trademarks and know-how to a related/unrelated foreign entity, and no Australian royalty withholding tax is remitted.

Broadly, TA 2020/1 is targeted at certain non-arm's length arrangements and schemes connected with the development, enhancement, maintenance, protection and exploitation (DEMPE) of intangible assets. Broadly, the Commissioner's key concerns relate to the bifurcation of intangible assets and the mischaracterisation of Australian DEMPE activities, and particularly whether the functions performed, assets used and risks assumed by Australian entities in connection with the DEMPE of intangible assets are properly recognised and remunerated in accordance with arm's length principles.

More recently, on 19 May 2021, the ATO released draft PCG 2021/D4, which principally focuses on a broad range of tax risks associated with the DEMPE of intangible assets. While its principal focus is on the potential application of the transfer pricing provisions, it also deals with other associated tax risks including withholding tax, capital gains tax, capital allowances, the general anti-avoidance rule (Pt IVA) and the DPT.

The draft ATO guidance provides specific guidance (and 12 examples) regarding what the ATO considers as high risk or medium risk arrangements, particularly associated with the centralisation, migration or bifurication of intangible assets, non-arm's length licensing arrangements, and research and development arrangements.

The draft ATO guidance focuses on the types and content of documents, and the related evidence multinationals should expect to maintain with respect to their intangible assets, which typically includes, among other things, the legal form of the cross-border distribution, licensing, services and other intangibles access arrangements, commercial considerations, evidence of the relevant intangible assets (eg software) and connected DEMPE activities. Further, contemporaneous explanations on the profit and other tax outcomes are expected to be readily available as well as other documentation dealing with transfer pricing and related reporting requirements, including reportable tax positions.

Further, the ATO issued draft TR 2021/D4 on 25 June 2021, which outlines the ATO's views as to when receipts from the licensing and/or distribution of software will be "royalties" under Australia's domestic law definition. The draft ruling, which will replace existing TR 93/12, has been subject to ongoing consultation, negotiation and submissions.

Similarly, TA 2022/2 (issued on 20 July 2022) deals with the interposition of entities to secure treaty-friendly reductions in royalty withholding (say from the 30% Australian domestic law rate to a low treaty rate of 5%) with respect to royalty and licencing arrangements. The ATO would closely analyse purported commercial justification for these restructures (including superior business environment and operational synergies) as well as contemporaneous documentation providing supporting evidence.

The new Albanese Government has proposed to deny deductions for and/or subject to royalty withholding tax certain perceived "embedded royalties" in consideration paid for tangible goods or services (where insufficient tax is being paid). This proposal is currently the subject of public consultation

and discussions, and should be closely monitored over the coming months.[37] This proposal is potentially far broader than previously foreshadowed in the federal government's pre-election commitments, including its media release of 27 April 2022.[38] Contractual withholding tax gross up clauses are critically important to protect licensees.

Distinction between royalties and a payment for an assignment of IP

In TR 2008/7, a payment for an assignment of copyright is generally treated as royalty under a double tax treaty unless that assignment is more comparable to an outright sale of the copyright, rather than a grant of a right to use a copyright.

The ruling states that an assignment of copyright amounts to an outright sale if:

- it is for the full remaining life of the copyright;
- it extends geographically over an entire country or several countries;
- it is not limited as to the class of acts that the copyright assignee has the exclusive right to do; and
- the amount and the timing of the payment or payments for the assignment are not dependent on the extent of exploitation of the copyright by the assignee.

"Royalty" under the UK Treaty

Article 12(3) of the UK Treaty defines "royalties" as payments or credits, whether periodical or not, and however described or computed, to the extent to which they are made as consideration for:

"(a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trademark or other like property or right;

(b) the supply of scientific, technical, industrial or commercial knowledge or information;

(c) the supply of any ancillary and subsidiary assistance that is furnished as a means of enabling the application or enjoyment of any such item as is mentioned in subparagraph (a) or (b) of this paragraph;

(d) the use of or the right to use:

(i) motion picture films; or

(ii) films or audio or video tapes or disks, or any other means of image or sound reproduction or transmission for use in connection with television, radio or other broadcasting; or

(e) total or partial forbearance in respect of the use or supply of any property or right referred to in this paragraph."

Under art 12(2) of the UK Treaty, the rate of royalty withholding tax is generally limited to 5% of the gross amount of royalties, unless the recipient of the royalties carries on business in Australia through an Australian PE, and the royalties are effectively connected to that Australian PE. In this scenario, art 7 (the business profits article) would apply to the royalties instead.

Broadly, art 12(6) of the UK Treaty restricts the operation of art 12 in cases where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of other income paid exceeds the amount that would have been agreed upon by parties operating at arm's length. The paragraph generally ensures that any excess part of the income does not enjoy the concessional royalty withholding tax rates, but remains taxable according to the domestic law of each country instead.

Examples of cases where a special relationship might exist include payments to an entity:

- who controls the payer (whether directly or indirectly);
- who is controlled by the payer; or
- who is subordinate to a group having common interests with the payer.

Article 7 of the Multilateral Instrument as applicable to the UK Treaty (art 12(7) (principal purpose to obtain treaty benefits)) may potentially apply to any part of the royalties payable to the foreign resident.

Broadly, as discussed in detail above under "Dividends", art 7 of the Multilateral Instrument contains specific rules to counter treaty abuse. The principal purposes test is the default rule in art 7, and will operate to deny tax treaty benefits when, having regard to all relevant facts and circumstances, obtaining that treaty benefit is one of the principal purposes of entering into a specific transaction or arrangement. Australia and the UK have both chosen to adopt the PPT in the UK Treaty.

Benefits to which the PPT may apply

Broadly, the MLI PPT can potentially apply to any "benefit" under a CTA. Depending on the relevant arrangement being considered, it may include a limitation on the taxing rights of a source jurisdiction (such as a tax reduction, exemption, deferral or refund), or the relief from double taxation provided to residents.

Relevantly, the reduced/concessional royalty withholding tax rate under the UK Treaty could potentially be considered a "benefit" to which the PPT could apply.

Please note that all of the guidance on the PPT provided in the comments above under "Dividends" is equally applicable to the potential application of the PPT to royalties.

Associated rule

A party may choose to supplement the application of art 7(1) with an associated rule to enable a competent authority, in consultation with the competent authority of the other party, to grant treaty benefits to a taxpayer (on request), despite a denial under the principal purposes test, if those benefits would nevertheless have been granted in the absence of the arrangement that attracted that denial (art 7(3) and (4)). This rule would modify the application of a principal purposes test in a CTA (art 7(5)).

The associated rule is only operative and effective if both parties to a CTA choose to apply the associated rule in art 7(4) and notify the depositary of their choice (art 7(7)(b)).

One of the principal purposes

Broadly, the PPT seeks to distinguish arrangements entered into or carried out for the purpose of obtaining treaty benefits that are consistent with the object of the treaty from arrangements used to secure treaty benefits by a means that amounts to an improper use of the treaty, or treaty abuse.

Thus, the PPT will not operate to deny a benefit if granting that benefit in the relevant circumstances "would be in accordance with the object and purpose" of the CTA. This ensures that the treaty applies in accordance with the purpose for which it was entered into; that is, to provide benefits in respect of bona fide exchanges of goods and services, and the movements of capital and persons, as opposed to arrangements in which the principal objective is to secure a more favourable tax treatment.

Principal purpose test – threshold

While "principal" is not comprehensively defined in the MLI, there is various guidance under existing Australian integrity provisions (eg the multinational anti-avoidance law and the DPT – see earlier observations/comments) and particularly OECD reports/guidance that provide certain direction and precedent in practically applying the test. Most importantly, the PPT adopts a threshold that is lower than the "sole or dominant purpose" threshold in the general Pt IVA provisions.

Second, the PPT should be established objectively.

The 2017 OECD model treaty commentary, based on the OECD Base Erosion Profit Shifting report on action 6, "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances" (OECD report), provides useful guidance and certain principles for the purposes of interpreting the principal purpose test in art 7(1) of the MLI, which are summarised as follows:

- an objective analysis of the relevant facts and circumstances must be undertaken; merely reviewing the effects of an arrangement will not usually enable a conclusion to be drawn about its purpose;
- however, where an arrangement can only be reasonably explained by the tax benefit obtained, it may be concluded that one of the principal purposes of that arrangement was to obtain the tax benefit; and
- conversely, where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a tax benefit, it is unlikely that its principal purpose will be considered to be to obtain that tax benefit.

Paragraph 12 of LCG 2015/2 cites dictionary definitions for "principal" as referring to "highest in rank, chief, foremost, prominent, leading, main", which offers useful guidance and assistance.

As indicated, many of the above guiding principles have been adopted and highlighted in art 29 (entitlement to benefits) in the OECD model treaty.

It is noteworthy that the ATO has provided binding private rulings on the practical application of the principal purposes test.

Practical application and reference to ATO guidance

In addition to the above guidance, it is highly desirable, and certain additional preferred attributes and indicia of the broader arrangements may include the following:

- where the arrangement may be fairly described as an ordinary commercial dealing and its form has not been driven by considerations of obtaining a treaty benefit, the arrangement should not have the requisite purpose, even though its effect is to obtain a treaty benefit;
- where there is no discrepancy between the substance of what is being achieved under the commercial arrangements and the legal contractual form;
- the arrangement does not involve the transfer/assignment of the valuable IP in order to access the withholding tax concession;
- the arrangement does not involve a change in character of payments or a mischaracterisation of payments, relevantly service fees rather than royalties;
- the functions, assets and risks of each relevant entity in the arrangement – no entities involved in the arrangements have been established in the UK or Australia just for the purpose of accessing the UK Treaty; and
- the arrangement does not involve the use of hybrid entities or instruments.

Mutual agreement procedure – arbitration

In recent years, pursuant to various new DTAs (including in 2016 between Germany and Australia) and global developments with respect to the Multilateral Instrument, the broader international tax community support for arbitration as an attractive/alternative mechanism to resolve certain tax disputes has grown significantly.

In this context, arbitration in the international tax context provides a structured framework for resolving major taxation issues including, where applicable, double tax treaty issues and disputes. Generally, the parties only proceed to arbitration where the two contracting states/revenue authorities cannot agree on a resolution of the issues in dispute for the relevant taxpayer/s.

While not confined to resolving international tax issues, independent and binding arbitration for issues that remain unresolved under the mutual agreement procedure (MAP) is provided for in some of Australia's tax treaties. This is because the relevant tax treaty either:

- already provides for arbitration (eg the German Treaty) or;
- has been modified by Pt VI of the Multilateral Instrument to include arbitration provisions.

A taxpayer may request (in writing) arbitration if an issue in the MAP case remains unresolved by the competent authorities (CAs) within the time period specified in the relevant tax treaty (generally two years).

The Multilateral Instrument and arbitration

Australia has generally adopted mandatory binding arbitration under Pt VI of the Multilateral Instrument subject to all the following conditions:

- disputes that have been the subject of a decision by a court or administrative tribunal will not be eligible for arbitration, or will cause an existing arbitration to terminate;
- breaches of confidentiality by taxpayers or their advisers will terminate the arbitration process;
- disputes involving the application of Australia's general anti-avoidance laws (eg Pt IVA ITAA36), will be excluded from the scope of arbitration; and
- any treaty partners' specific reservations made under art 28(2)(a) of the Multilateral Instrument will limit the scope of issues eligible for arbitration.

The extent of the availability of arbitration in Australia's tax treaties modified by the Multilateral Instrument will depend on the finalised Pt VI adoption positions taken by Australia and its treaty partner. Based on other jurisdictions' known adoption positions, it is expected that at least 16 of Australia's tax treaties will eventually be modified by the Multilateral Instrument to provide for mandatory binding arbitration.

Australia's current tax treaties with Germany and Switzerland already provide for arbitration and will not be modified by the Multilateral Instrument.

Arbitration process

Part VI of the Multilateral Instrument contains the operative provisions of the arbitration process for tax treaties that are modified by the Multilateral Instrument to provide for arbitration. The process is dependent on the position and reservations of Australia and its relevant treaty partner. The specific rules and timeframes should be agreed between the CAs for each country.

For tax treaties that provide for arbitration, the arbitration process can be contained in the memorandum of understanding. The Belgian memorandum of understanding, for example, is operative from 3 March 2021 and prescribes the arbitration process, selection and appointment of arbitrators, timing issues, confidentiality and non-disclosure rules, operating procedures and the effect of arbitration decisions that are generally binding on both contracting states (subject to limited exceptions).

Australia has concluded a memorandum of understanding with several treaty countries, available through the ATO website for each of the UK, Belgium and Switzerland.

Broadly, for Multilateral Instrument and non-Multilateral Instrument arbitration, jurisdictions can adopt one of two types of arbitration process:

- final offer – an independent arbitration panel considers the proposed resolutions submitted by the CAs and chooses, by vote of simple majority, one of the proposed resolutions as the final arbitration decision; or
- independent opinion – an independent arbitration panel considers the position papers (including relevant information) submitted by the CAs, the applicable provisions of the relevant tax treaty and the domestic provisions of both jurisdictions to reach the final arbitration decision.

Australia has adopted the final offer arbitration process under the MLI. As such, the majority of tax treaties modified by the MLI to provide for arbitration will follow this process. An exception is where Australia's treaty partner has adopted independent opinion (eg Japan and Malta). In this case, an independent opinion will be the relevant process for the arbitration proceedings with that treaty partner.

While it is very early in the evolution of the potential arbitration of tax disputes relating to Australia, it is important to acknowledge that the process is largely run by the relevant CAs, and that direct involvement of the impacted taxpayers has to be closely managed and is likely to be less than for formal court processes.

Treaty recognition and eligibility for treaty benefits – Australian collective investment vehicles/managed funds

Issues have typically arisen in recent years for broad range of Australian-based collective investment vehicles (CIVs) in securing treaty relief/benefits (principally dividend and interest withholding tax concessions) for investments in treaty jurisdictions.

For example, certain European countries have denied access to treaty benefits on the basis of abusive schemes (relating to substance, transparency and related aspects). Most particularly, there have been a series of recent Danish "beneficial ownership" cases, including involving hearings before the European Court of Justice.

Australian CIVs, including managed investment trusts (MITs), attribution managed investment trusts (AMITs) and the new corporate collective investment vehicle (CCIVs), are all potentially impacted. While Australian CIVs are often able to secure appropriate withholding tax concessions on income received from overseas investments, some challenges can arise for various reasons, including:

- certain foreign jurisdictions treat Australian CIVs as transparent for tax purposes;
- general questions (eg substance, indirect ownership/ intermediaries etc) about the eligibility for treaty benefits of trusts; and
- difficulties in obtaining certification of the necessary documentation (eg certificate of residency, other documents) on an issuer-by-issuer basis.

However, as a matter of commercial practice and based on various information and experience, Australian MITs/CIVs have been able to secure withholding tax relief on income received from overseas investments. This is generally on the basis that they are treated as a resident for the purposes of the relevant tax treaty and the ATO is able to issue a certificate of residency.

It is noted that some jurisdictions require CIVs to have a certain minimum percentage of Australian tax residents as unitholders/ beneficiaries before granting treaty relief. This approach is also adopted in some of our newer treaties (eg with Germany), which generally require MITs to either be listed on the Australian share market or have a minimum level of Australian unitholders/ beneficiaries to be treated as the beneficial owner and to avoid treaty shopping.

The general Australian position/approach to treaty recognition and eligibility for treaty benefits of CIVs is expected to positively evolve with:

- the current negotiation of new tax treaties;
- the recent implementation of treaties with Germany, Israel and the updated Japanese treaty;
- influential OECD guidance;
- cooperative ATO administration of these issues; and
- broader international developments, including the Multilateral Instrument.

It is anticipated that the provisions dealing with access to treaty benefits by CIVs (including unit trusts) in the German Treaty are in substance reflective of current and future Australian treaty policy on this critical issue. Further, it is expected that certain of the new treaties currently being negotiated by Australia (including with countries such as Luxembourg) will include similar CIV provisions to those contained in the German Treaty.

Germany/Australia DTA

Briefly, certain key observations are made below on the German Treaty, which specifically provides for Australian CIVs to be eligible for treaty benefits in certain specified circumstances.

FISCALLY TRANSPARENT VEHICLES – ART 1(2)

Article 1(2) recognises the flow-through nature of wholly/partly fiscally transparent vehicles, and provides for treaty benefits to flow-through to the underlying investors. However, the treaty also recognises the practical difficulties which may arise for the ultimate investors in widely-held investment vehicles to claim treaty benefits individually, and has made certain concessions to allow for an investment vehicle itself to claim treaty benefits in certain circumstances (see below).

CERTAIN "COLLECTIVE INVESTMENT VEHICLES" MAY CLAIM TREATY BENEFITS – ART 4(4)

This article essentially operates as an *exception* to the general operation of art 1(2), and provides for a CIV to claim treaty benefits in its own right. A CIV is defined under art 3(1)(l) to include an Australian managed investment trust (which is a Div 6 trust).

At a high level, art 4(4) affords treaty benefits to a CIV by treating the CIV as an individual resident in the country in which it is established, and as the beneficial owner of the relevant CIV income, subject to the CIV meeting certain conditions. This allows the CIV to claim treaty benefits directly under arts 6 to 20 of the German Treaty (including reduced dividend and interest withholding tax rates).

INTEGRITY PROVISIONS UNDER ART 4(4)

To prevent treaty shopping by third country investors, art 4(4) contains certain integrity measures by requiring a CIV to satisfy the conditions below before it can claim treaty benefits:

- the CIV must be established in Australia, and listed and regularly traded on a recognised stock exchange in Australia;
- at least 75% of the value of the beneficial interests in the CIV are owned by residents of the country in which the CIV is established; or
- at least 90% of the value of the beneficial interests in the CIV are owned by equivalent beneficiaries (broadly, residents of any other country with which the country in which the income arises has a tax treaty).

Corporate collective investment vehicle regime

The Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021 established the CCIV regime from 1 July 2022.

Briefly, under the new CCIV regime, an eligible CCIV is a company limited by shares but which (including sub-funds) is deemed as having a trust relationship and governed by the broader trust (including Div 6 ITAA36) taxation rules (deeming principle). The purpose of the regime is to provide eligible CCIVs with the same tax treatment as AMITs. The deeming principle deems a trust relationship to exist between the CCIV, the business, assets and liabilities referrable to a particular sub-fund, and the relevant class of members. The deeming principle operates for the purposes of all taxation rules (unless expressly excluded). Importantly, the relevant members of the CCIV are treated as beneficiaries of the relevant CCIV sub-fund trust. Further, the flow-through tax treatment ensures that amounts derived and attributed to member/beneficiaries retain the character they had in the hands of the trustee of the relevant CCIV sub-fund trust.

The important adoption of trust principles should be noted throughout the new CCIV regime, including for double tax treaty purposes:

- the objective is to leverage the existing trust taxation framework and existing flow-through regime;
- the CCIV is a company vehicle limited by shares; however, it is effectively treated as a trust where eligible for taxation purposes. It is intended to be a viable alternative investment vehicle to the existing trust-based managed investment schemes (MITs);
- members of each CCIV sub-fund trust are generally taken to have a vested and indefeasible interest in a share of the income and capital of the trust (akin to present entitlement);
- this regime links into withholding tax concessions for MITs, withholding MITs and related vehicles;
- a CCIV sub-fund does not have a separate legal personality;
- the tax policy objective is to ensure that members/beneficiaries secure flow-through status of income entitlements, including by way of deeming the trust relationship;
- the deeming rule provides a concessional mechanism for determining when a beneficiary is taken to be "presently entitled" to a share of the trust income for an income year; and

- generally, Australian double tax treaties are prioritised where any inconsistency arises with our domestic Australian tax rules. However, the CCIV provisions clarify that the deeming principle has priority in these circumstances, giving rise to the current double tax treaty protection and recognition issues. Accordingly, these treaty recognition issues will need to be addressed on a treaty-by-treaty (and/or case-by-case) basis, including by reference to case law, OECD guidance and the overlay of the Multilateral Instrument.

2017 OECD commentary

The 2017 OECD commentary to art 1 states that, for treaties that do not have a specific provision dealing with CIVs, a CIV may qualify for treaty benefits provided that the following requirements are satisfied:

- the CIV is a "person";
- the CIV is a "resident" of a contracting state; and
- the CIV is a "beneficial owner" of the income that it receives.

The OECD has given extensive consideration to the application of tax treaties to the income of widely held CIVs, regardless of their legal form. Unlike the OECD partnership report, which emphasises transparency in the delivery of treaty benefits, the OECD approach to CIVs favours entity-level qualification for treaty benefits, safeguarded if necessary by integrity rules that take account of the residence or status of their participants. This reflects the impracticability of applying transparent methods directly to the income of a widely held entity to determine treaty benefits. These findings were set out in a 2010 OECD report, *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles* (the CIV report).[39]

The OECD commentary on art 1 was significantly modified in 2010 to introduce certain developments regarding the application of tax treaties to CIVs. These principles were further enshrined in the 2017 OECD commentary.

The decision of the Full Federal Court in *FCT v Resource Capital Fund IV*,[40] dealing with two corporate limited partnerships, provides some general support for the "look through" of fiscally transparent entities (in this case, partnerships) in the context of the application of tax treaties. However, it is advisable to focus on the emerging Australian tax policy approach (consistent with OECD recommendations) to CIVs as reflected in the German Treaty.

Timor-Leste: 2018 Maritime Boundary Treaty

On 6 March 2018, the governments of Timor-Leste and Australia entered into the Maritime Boundary Treaty dealing with, among other things, new permanent maritime boundaries in the Timor Sea, north of Australia. The treaty implemented the transition of several oil and gas fields (including Bayu-Undan, Buffalo and Kitan) and established a special regime for the Greater Sunrise fields.

This treaty and the related arrangements are unique and, in many ways, extraordinary, positively settling issues that had been unresolved for many years between the two states.

The treaty, ratified on 30 August 2019, established new legal, regulatory and taxation frameworks for the development of petroleum in the Timor Sea.

The Australian Government introduced new Div 417 of *the Income Tax Assessment Act 1997* (Cth) to support the implementation of the new treaty, which provided special taxation arrangements for the "transitioned petroleum activities" dealing with, among other things, capital allowances, CGT, tax losses, foreign income tax offsets and transfer pricing.

Conclusion

This is a dynamic time in the evolution of Australia's double tax treaty network and related arrangements. This article covers key recent developments, foreshadows further imminent activities and notes other contemporary developments. By way of postscript, and evidencing the pace of change, the ATO has recently released a draft of proposed changes to TR 2005/5 regarding the availability of the exemption from interest withholding tax for US and UK financial institutions.[41]

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