

Allocation of taxing rights to source countries under tax treaties

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Outline

- **Why source taxation or why not?**
- **Current treaty source taxation pressure points**
- **Current treaty source taxation issues**

Why source taxation or why not?

- **Why**
 - **Benefit principle**
 - **Economic rents**
- **Why not**
 - **The balance argument**

The balance argument

Interest flows of \$100, source tax 10%/0%, residence tax 30% with credit for source tax

Flows in balance (\$100 both ways)

Tax	Reside		Source	
State A	20	10	30	0
State B	20	10	30	0

Flows not in balance (\$100 flow State B to A)

State A	20	0	30	0
State B	0	10	0	0

The balance data: Australia

- **Ralph Review of Business Taxation 1999**
10 or 5:1 in early 1980s to 1.67:1 in 1999
- **Review International Tax Arrangements 2003**
3.56:1 for 1980 and 1.95:1 for 2000
- **Australian Bureau of Statistics 2007 A\$**
Inward up 201.8b total 1,659.6b
Outward up 125.5b to 987.1b
Total 1.68:1, ratio of increase 1.61:1

The balance data: FDI India

• Flows:	<u>1990-2000 av</u>	<u>2007</u>	<u>2008*</u>
– Inward:	1705	25127	41554
– Outward:	110	17281	17685
• Stock:	<u>1990</u>	<u>2000</u>	<u>2008</u>
– Inward:	1657	17517	23288
– Outward:	124	1859	61765

UN World Investment Report 2009 fact sheet
All in US\$ millions [* Distorted)

The balance data: FDI Australia

• Flows:	<u>1990-2000 av</u>	<u>2007*</u>	<u>2008</u>
– Inward:	6946	44330	46774
– Outward:	3192	16806	35938
• Stock:	<u>1990</u>	<u>2000</u>	<u>2008</u>
– Inward:	73664	111139	272174
– Outward:	30507	85385	194721

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Australian treaty response

- **Pre-1999 extensive source taxation under treaties**
- **1999 Ralph Report**
 - Reduce dividend withholding rates, accept non-discrimination articles, update major treaties
- **2003 RITA Report**
 - Reduce interest and royalty withholding tax rates, eliminate source tax on shares (except land rich)
 - Facilitate conduit taxation relief
- **2009 Henry Review**
 - Maintain source taxation of business income (mining)
 - Eliminate interest withholding tax?

Why not source taxation?

- **Tax competition**
- **Larger or smaller pie argument: national v global interests**
- **Distortion of gross basis taxes**
- **Losses**
- **Administration**

Current treaty source taxation pressure points

- **OECD v UN**
 - Coverage
 - Process
 - Resources
- **Electronic commerce/technology**
- **Business restructuring**
- **Cross border portfolio investment**
- **Arbitrage**

Current treaty source taxation issues

- - Permanent establishments

- **Insurance**
 - **Knights of Columbus, American Income Life**
- **Services**
 - **2008 OECD Commentary**
- **Commissionnaires**
 - **2009 IFA Cahiers**
- **Travelling salesmen**
 - **2003 OECD Commentary change**

Current treaty source taxation issues

Transfer pricing

- **Commercial factors**
- **Restructures and risk shifting**
 - FAR to KERT
 - OECD Discussion Papers
- **Methodologies**
- **Intangibles**
 - Places of creation, ownership, use
- **Attribution of profits to PEs**
 - UN response

Current treaty source taxation issues

-- Company shareholder taxation

- **Source tax is tax on company profits**
- **Dividends**
 - **Emerging norm of zero for FDI**
 - **Shift to approximate integration**
- **Capital gains on shares**
 - **Alignment with dividend treatment**
 - **OECD v UN**
- **Interest and thin capitalisation**
 - **OECD approach misconceived?**
 - **Essentially a bargain over overall source tax rate on business income**

Current treaty source taxation issues

- - Royalties and technical fees

- **Personal or business use**
 - **Software**
 - **Digital products**
 - **Technical fees**
- **Exclusive distributorships**
 - **OECD 2008**
- **Assignment v licence**
 - **OECD 2008**

Current treaty source taxation issues

- - Cross-border portfolio investment

- **REITs OECD 2007-2008**
 - **Income/gains from real property at source**
 - **Use of corporate flow through versus transparent flow through vehicles**
- **CIVs OECD 2009**
 - **Practical difficulties of relief at investor level**
 - **Treaty shopping concerns if relief at CIV level**
- **Pension funds OECD 2005**

Current treaty source taxation issues

- - Arbitrage

- **Entities**
 - **Partnership report: can source countries apply it?**
 - **Spread of treaty provisions**
- **Securities and asset ownership**
 - **Treaties largely irrelevant?**
 - **What is solution?**

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