Treasury Laws Amendment (International Tax Agreements) Bill 2019

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Date introduced: 19 September 2019
House: House of Representatives
Portfolio: Treasury

Commencement: Schedule 1 commences on the day after Royal Assent. Schedule 2 commences on the first 1 January, 1 April, 1 July or 1 October after Royal Assent. All other sections, on the day after Royal Assent. The amendments do not come into effect until entry into force of the Australia-Israel Convention.

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bill’s home page, or through the Australian Parliament website.
When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the Federal Register of Legislation website.
All hyperlinks in this Bills Digest are correct as at November 2019.
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The Bills Digest at a glance

The *Treasury Laws Amendment (International Tax Agreements) Bill 2019* (the Bill) contains two schedules.

Summary of the Bill

**Schedule 1** of the Bill amends the *International Tax Agreements Act 1953* to give effect 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* (herein referred to as the *A-I Tax Convention*).

**Schedule 2** of the Bill amends the *Income Tax Assessment Act 1997* and the *International Tax Agreements Act 1953* to create a new deemed source rule in domestic law. The new rule has the effect of deeming income, profits or gains of a non-resident, that are sourced in Australia under the term of a tax agreement, as being taxable in Australia. This rule will be automatically applied to future tax treaties rather than needing to be individually negotiated, as is current practice.

In order for the *A-I Tax Convention* to become effective, it will need to be legislated by both the Australian and Israeli Parliaments. It is for this reason that the Bill is currently before Parliament.
Purpose of the Bill

The purpose of the Treasury Laws Amendment (International Tax Agreements) Bill 2019 (the Bill) is to make necessary amendments to the International Tax Agreements Act 1953 (ITAA 1953) to give effect to the A-I Tax Convention.¹ The Bill enables the Convention to be given force under Australian law before ratification happens.

The Bill also incorporates a new ‘deemed source rule’ into the Income Tax Assessment Act 1997 (ITAA 1997).²

Structure of the Bill

The Bill contains two schedules:

• Schedule 1 implements the A-I Tax Convention into Australian law and
• Schedule 2 incorporates into the ITAA 1997 a new deemed source rule.

Background

Australia currently has entered into 45 international tax treaties³ (although the Australia-Greece Tax Convention only focusses on the taxation of international air transport).⁴ However, given the Australia-Greece Tax Convention is not a full double tax agreement, it is often stated that Australia has entered into 44 tax treaties.⁵

Generally, tax conventions (also referred to as double tax agreements) seek to achieve two main goals:

• the first is to clarify, standardise, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial, or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation⁶

1. 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 (A-I Tax Convention) itself aims to:
   • eliminate double taxation on income
   • reduce the opportunity for tax avoidance
   • resolve issues around tax residency
   • provide greater certainty for people working in either country
   • better enable tax authorities to resolve conflicts and inconsistencies between the two countries' tax systems and
   • establish data sharing.

2. See, for example, The Treasury, The digital economy and Australia’s corporate tax system, discussion paper, Treasury, Canberra, October 2018, pp. 5–7, which notes that Australia’s corporate tax system uses the concepts of source of income and residence of an individual to determine which activities and income are subject to tax in Australia. Generally, Australian residents will be taxed on their worldwide income (unless exempted under a tax convention) and non-residents on their Australian sourced income.

As discussed below, in the context of tax agreements, Australia usually incorporates a deemed source rule into its tax treaties, in order to create a legally enforceable taxing right in Australia. A ‘deemed source rule’ broadly creates a legal fiction for deeming that certain items of income arise in Australia even though that income may not actually physically arise in that country.

3. A treaty is a formal written agreement entered into by actors in international law. It may also be known as an international agreement, protocol, covenant, convention, pact, or exchange of letters, among other terms.


5. Parliamentary Joint Standing Committee on Treaties (JSCOT), Report 187, Oil stock contracts—Hungary; MRA UK; trade in wine UK; MH17 Netherlands; air services: Thailand, Timor—Leste, PNG; work diplomatic families—Italy; double taxation—Israel, Canberra, October 2019, p. 58.

• the second is to improve administrative co-operation in tax matters, notably through exchange of information and assistance in collection of taxes, for the purpose of preventing tax evasion and avoidance.\(^7\)

To assist in achieving these goals, since 1955 the OECD has published its *Model Tax Convention on Income and on Capital* (the Model Tax Convention). Among other things, the Model Tax Convention represents a consensus framework,\(^8\) which countries can use as the basis for concluding or revising bilateral tax conventions,\(^9\) ensuring a uniform approach to resolving the most common problems that arise in international taxation.\(^10\) The OECD notes that the Model Tax Convention:

> ... plays a crucial role in removing tax related barriers to cross border trade and investment. It is the basis for negotiation and application of bilateral tax treaties between countries, designed to assist business while helping to prevent tax evasion and avoidance. The OECD Model also provides a means for settling on a uniform basis the most common problems that arise in the field of international double taxation.\(^11\)

The Model Tax Convention contains 30 Articles and provides explanation of and commentary on those articles to assist in their interpretation. The Model Tax Convention also allows countries to ‘reserve’ their position on certain articles (i.e. it allows countries to state where they do not agree, or will not incorporate, an Article into their domestic law). The 2017 Model Tax Convention numbers over 2,600 pages and is directly relevant to the interpretation of equivalent articles in the A-I Tax Convention.\(^12\)

**History of the Australia-Israel Tax Convention**

On 17 September 2015, Treasurer Joe Hockey issued a press release stating:

> As part of the Government’s ongoing efforts to strengthen and deepen our relationship with Israel, we are announcing our intention to commence negotiations on a new Double Taxation Agreement between our two countries.\(^13\)

Treasurer Hockey also stated that the tax agreement would:

• reduce the incidence of double taxation between the two countries

• present opportunities for Australian businesses to take greater advantage of Israel’s knowledge-based economy, particularly in the areas of biotechnology, ICT, education and training and

• encourage Israeli companies to view Australia as a regional base and supplier of sophisticated goods and services.\(^14\)

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7. Ibid.
8. In general terms, a consensus framework is a multi-stakeholder platform outlining the shared principles that should guide the conduct of the various parties in terms of their regulatory arrangements. It sets our expectations for collaboration and interaction among the relevant parties.
14. Ibid.
On 23 February 2017, the Prime Ministers of Australia and Israel announced their commitment to conclude a tax treaty in a joint media statement:

Leaders committed to support the expansion of trade, investment and commercial links between Australia and Israel, for their mutual benefit and prosperity. Leaders welcomed the signature of a bilateral Air Services Agreement facilitating enhanced air links between our countries. They also welcomed the signing of an MOU between airline companies from both countries, which will enhance connectivity between Australia and Israel, expanding business and tourism links. They resolved to work towards concluding a Double Taxation Agreement which would remove tax impediments to bilateral economic activity and enhance the integrity of our respective tax systems. They welcomed the success of the Working Holiday Visa arrangement in promoting greater tourism flows.  

Following several years of negotiations, Australia and Israel signed the A-I Tax Convention on 28 March 2019.

What is the A-I Tax Convention?

The A-I Tax Convention is based on the OECD Model Tax Convention and sets out a number of agreed rules and procedures as to how Australia and Israel will apply their tax rules in relation to:

- the payment of dividends, interest and royalty expenses from Australia to Israel (and vice versa)\(^{17}\)
- fringe benefits provided by an Israeli or Australian employer\(^{18}\) and
- income or profits earned (or sourced) in Australia or Israel (i.e. providing relief from double taxation).\(^{19}\)

The A-I Tax Convention also seeks to, amongst other things:

- create mutual agreement procedures for eliminating double taxation and resolving conflicts of interpretation of the A-I Tax Convention\(^{20}\)
- clarify residency rules so as to make it clearer as to when a person or entity will be a tax resident of each country\(^{21}\)
- implement exchange of information procedures for exchanging taxpayer information between the tax administrations of both countries\(^{22}\)
- outline agreed upon procedures to minimise the chance of fiscal evasion or unreported income\(^{23}\) and
- detail procedural frameworks and processes for resolving tax disputes.\(^{24}\)

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15. M Turnbull (Prime Minister of Australia) and B Netanyahu (Prime Minister of the State of Israel), Joint statement, media release, [22 February 2017].
17. A-I Tax Convention, Articles 10 to 12.
18. Ibid., Article 14(3).
19. Ibid., including Articles 7, 14, 21 and 23.
20. Ibid., Article 25.
21. Ibid., Articles 4 and 5.
22. Ibid., Article 26.
23. Ibid., including Articles 1(2) and 22.
Warning: All viewers of this digest are advised to visit the disclaimer appearing at the end of this document. The disclaimer sets out the status and purpose of the digest.

Why is Australia entering a tax treaty with Israel?

The National Interest Analysis of the A-I Tax Convention outlines a number of reasons as to why Australia should enter into a tax treaty with Israel. These are summarised below:

- reducing barriers to investment and trade: it is anticipated that the A-I Tax Convention will remove barriers for Australian and Israeli businesses undertaking business activities in both countries. In particular, Australian business should be more easily able to access Israeli intellectual property as a result of reduced royalty withholding tax rates
- increased certainty and reduced compliance costs for taxpayers: it is expected that removing the incidence of double taxation will reduce uncertainty around tax outcomes as well as reduce compliance costs associated with preparing and lodging tax returns in multiple jurisdictions and
- establishing a more effective framework to prevent international fiscal evasion and avoidance: the A-I Tax Convention directly incorporates a number of Base Erosion and Profit Shifting (BEPS) recommendations, including rules to prevent treaty shopping and to facilitate greater cooperation between Australian and Israeli tax authorities and a formal process for the exchange of taxpayer information between Australia and Israel.\textsuperscript{25}

It should also be noted that Israel was the third most popular destination for disclosures made under Project DO-IT,\textsuperscript{26} totalling 231 disclosures.\textsuperscript{27}

Why does the A-I Tax Convention need to be legislated?

The general position under Australian law is that treaties which Australia has joined or signed are not directly and automatically incorporated into Australian law. Signature and ratification do not, of themselves, make treaties operative domestically. Treaty obligations need to be incorporated into Australian law, thus enabling legislation is necessary to implement and render those obligations operative and enforceable under Australian law.

If new legislation is required to implement the treaty, the normal practice is to require that it be passed before Australia brings the treaty into force. This is because subsequent Parliamentary passage of the necessary legislation cannot be presumed, entailing a risk that Australia could find itself legally bound by an international obligation which it could not fulfil.\textsuperscript{28}

As noted by the Explanatory Memorandum to the Bill, the effect of the amendments to the International Tax Agreements Act 1953 will be to give the provisions of the A-I Tax Convention priority over provisions of the Income Tax Assessment Acts 1936 and 1997, Fringe Benefits Tax Act 1986, and any imposition Acts (except to the extent there are anti-avoidance rules contained in these Acts).\textsuperscript{29}


\textsuperscript{27} N Khadem, 'Tax amnesty nets billions as ATO warns it will hunt evaders', The Sydney Morning Herald, 10 December 2014, p. 4.

\textsuperscript{28} Department of Foreign Affairs and Trade (DFAT), 'Treaty making process', DFAT website.

\textsuperscript{29} Explanatory Memorandum, Treasury Laws Amendment (International Tax Agreements) Bill 2019, p. 7. This is due to the effect of subsections 4(1) and 4AA(2) of the ITAA 1953.
The new deemed source rule

In *Federal Commissioner of Taxation v Mitchum* the High Court held that, notwithstanding the text of a treaty, Australia was not able to tax income unless that income was sourced in Australia. As such, it has become preferred practice for Australia’s tax treaties to include a specific Article that provides that where income, profits or gains are allocated to Australia under the terms of the treaty, those profits, incomes or gains will be deemed to be sourced in Australia. As such, this means that in each instance a tax treaty is entered into, Australia must either individually negotiate the inclusion of this rule or legislate an equivalent source rule for the treaty in the ITAA 1953.

Schedule 2 of the Bill enshrines this position into law for all treaties entered into on or after 28 March 2019.

As stated in the Explanatory Memorandum, this will not affect existing treaties as the new rule will be prospective and in any event existing tax conventions are already subject to a deemed source rule.

Committee consideration

*Senate Standing Committee for the Selection of Bills*

The Senate Standing Committee for the Selection of Bills recommended that the Bill should not be referred to a committee for inquiry.

*Senate Standing Committee for the Scrutiny of Bills*

The Senate Standing Committee for the Scrutiny of Bills had no comment on the Bill.

*Joint Standing Committee on Treaties*

*Report 187: Oil Stock Contracts—Hungary; MRA UK; Trade in Wine UK; MH17 Netherlands; Air Services: Thailand, Timor–Leste, PNG; Work Diplomatic Families—Italy; Double Taxation—Israel* (Report 187) of the Joint Standing Committee on Treaties (JSCOT) included its consideration on the A-I Tax Convention at pages 57 to 66.

JSCOT supported the A-I Tax Convention between Australia and Israel and in Recommendation 6 of Report 187 recommends that binding treaty action be taken:

> The Committee notes that the Convention adds to Australia’s existing network of 44 tax treaties and is consistent with Australia’s established treaty practice, including that it reflects multiple OECD model conventions.

> Specifically, the Committee acknowledges the benefits of the Convention reducing tax barriers for Australian and Israeli individuals and businesses, as well as enhancing the integrity of cross-border dealings by preventing tax evasion and avoidance.

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32. See, for example, section 115 of the ITAA 1953, which applies in respect of the *Agreement between the Government of Australia and the Government of the People’s Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*.
The Committee supports the Convention and recommends that binding treaty action be taken.\textsuperscript{36}

**Position of major interest groups**

The A-I Tax Convention appears to be supported by Australian and Israeli business groups, with a general theme being that it will better facilitate Australia-Israel business ties and open up further bilateral trade and investment. For example, the Australia-Israel Chamber of Commerce (AICC) is supportive of the A-I Tax Convention, with national chairman Leon Kempler stating there is ‘tremendous excitement’ within Israel and Australian industry about the prospect of a tax treaty\textsuperscript{37} and that the A-I Tax Convention will:

... strengthen economic and financial links between Australia and Israel, provide greater investment certainty and reduce the cost of doing business. There are now 20 Israeli companies listed on the ASX and we expect more to list in the coming months.\textsuperscript{38}

The Israeli embassy also expects the A-I Tax Convention will lead to more Israeli companies listing on the ASX, with Israeli Embassy spokesperson Eman Amasha reported as stating:

Overall, this agreement represents the strengthening trade ties between Israel and Australia and provides a platform for the further growth of business operations and investment cooperation in both markets.\textsuperscript{39}

These views are also shared by Executive Council of Australian Jewry president Robert Goot who was reported as stating that the treaty would improve trade and investment by removing tax barriers.\textsuperscript{40}

Australian law firm Arnold Bloch Leibler also supports the A-I Tax Convention, contending:

Existing trade between the countries is worth over $1 billion in addition to cross-border investment. In recent years, many Israeli based companies have chosen to list on the ASX in order to diversify their access to capital and take advantage of the superior liquidity offered by the Australian market. At present there are 20 Israeli companies listed on the ASX, rivalling the United Kingdom’s 29 (the UK currently being the dominant destination for Israeli investment in Europe). We expect this number to rise.

The new treaty will promote further trade and investment between the two countries, and gives Australia a position alongside other Asian trading partners such as China, India and Japan with whom Israel already has double taxation agreements.\textsuperscript{41}

Ben Butler writing in the Weekend Australian also considered that the A-I Tax Convention could benefit Australian businesses looking to expand into Israel:

A treaty that eliminated the double taxation of profits between the two countries would be good news for Australian companies and individuals seeking to invest in Israel such as Seek co-founder Paul Bassat’s tech fund, Square Peg Capital, and James Packer of Crown Resorts, who now lives amid speculation the [Israeli] government will legalise casinos.\textsuperscript{42}

\begin{itemize}
  \item \textsuperscript{36} JSCOT, \textit{Report 187}, op. cit., pp. 65–66.
  \item \textsuperscript{37} B Butler, ‘Talks on setting up Israel tax treaty’, \textit{The Weekend Australian}, 17 September 2016, p. 33.
  \item \textsuperscript{38} G Narunsky, ‘Bilateral trade to increase’, \textit{The Australian Jewish News}, 5 April 2019, p. 4.
  \item \textsuperscript{39} Ibid.
  \item \textsuperscript{40} J Levi, ‘ScoMo talks tax’, \textit{The Australian Jewish News}, 23 September 2016, p. 4.
  \item \textsuperscript{41} Arnold Bloch Leibler, ‘Australia and Israel sign a new tax treaty’, Arnold Bloch Leibler Insights, updated 2 April 2019.
  \item \textsuperscript{42} B Butler, ‘Talks on setting up Israel tax treaty’, op. cit., p. 33.
\end{itemize}
Financial implications
The Explanatory Memorandum to the Bill states that the Bill is ‘expected to have an unquantifiable cost to revenue over the forward estimates’. 43

Statement of Compatibility with Human Rights
As required under Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011 (Cth), the Government has assessed the Bill’s compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The Government considers that the Bill is compatible. 44

Parliamentary Joint Committee on Human Rights
At the time of writing, the Parliamentary Joint Committee on Human Rights has not reported on the Bill.

Key issues and provisions

Schedule 1: Australia-Israel Tax Convention
Section 3AAA of the ITAA 1953 lists the current tax agreements covered by that Act. Item 1 amends section 3AAA(1) to include the ‘Israel Convention’ so as to implement the treaty, thus giving it the force of law.

As discussed above and noted in the Explanatory Memorandum, the A-I Tax Convention broadly follows the OECD’s Model Tax Convention on Income and on Capital, 45 and incorporates over 2,000 pages of technical and complex supporting materials. The Explanatory Memorandum provides a good high level explanation of the A-I Tax Convention and each of the articles, as does the National Interest Analysis document prepared by the Treasury. 46 It should also be noted that the A-I Tax Convention has been subject to significant consultation and review, including a Treasury consultation process 47 and review by JSCOT. 48

In light of this, the Digest does not examine each of the Articles in detail. Rather the Digest draws attention to some of the key features of the A-I Tax Convention, specifically:

• the scope of the treaty, including taxes covered, taxpayers subject to the A-I Tax Convention and the definitions of Australia and Israel

• the modifications to withholding tax rates on dividends, interest and royalty payments

• a summary of the OECD’s BEPS measures adopted in the A-I Tax Convention

• new exchange of information rules and

• specific rules relating to anti-discrimination and arbitration.

Each of these are discussed in more detail below.

44. The Statement of Compatibility with Human Rights can be found at pages 57 to 60 of the Explanatory Memorandum to the Bill.
47. The Treasury, Tax treaty between Australia and Israel, Treasury website, August 2019.
Scope of the A-I Tax Convention

Articles 1, 2 and 3 of the A-I Tax Convention outline its scope. Specifically, Article 1 details the persons covered, Article 2 the taxes covered and Article 3 contains a definition of Australia and Israel for the purposes of the A-I Tax Convention.

Person covered

Article 1 provides that the A-I Tax Convention applies to persons who are residents of Australia and/or Israel (referred to in the A-I Tax Convention as the Contracting States). Article 3 states that the term person includes an individual, company and any other body of persons.

Article 1, paragraph 2 contains a specific rule relating to the recognition of income derived through a fiscally transparent arrangement or entity (for example income derived from a partnership or trust distribution). In this situation, Article 1, paragraph 2 provides that for the purposes of the A-I Tax Convention, that income will be deemed to be income of the person to the extent that tax laws of Israel or Australia recognise that income as being derived by that person.

Article 4 contains specific rules as to when a person will be a resident of Australia or Israel for the purposes of the A-I Tax Convention. These rules do not substantively differ from the OECD model, and are well explained at pages 12 to 14 of the Explanatory Memorandum to the Bill.

Taxes covered

Article 2 of the A-I Tax Convention stipulates that the following taxes are covered:

- Israel taxes covered include:
  - income and company tax (including capital gains tax)
  - taxes on gains from the alienation of property according to Israel’s Real Estate Taxation Law and
  - taxes imposed under Israel’s Petroleum Profits Taxation Law.
- Australian taxes covered include the following taxes imposed under the federal law of Australia:
  - Australian income tax
  - resource rent taxes and
  - fringe benefits tax.

As such, Australian state taxes such as payroll tax and stamp duties, as well as state-based mining royalties are not covered under the A-I Tax Convention.

Definition of Australia and Israel

Article 3 of the A-I Tax Convention contains a definition of what is meant by the terms ‘Australia’ and ‘Israel’. This is an important element of the treaty, as the treaty amongst other things applies to persons of Australia and Israel.

Article 3, sub-paragraph (1)(a) defines Israel as meaning:

... the State of Israel and when used in a geographical sense includes its territorial sea, as well as those maritime areas adjacent to the outer limit of the territorial sea, including seabed and subsoil thereof over which the State of Israel, under the laws of the State of Israel and in accordance with international law, exercises its sovereign or other rights and jurisdiction.

49. As stated in paragraph 2 of the Protocol to the A-I Tax Convention, the term ‘income’ has a wide meaning and includes profits or gains.

As noted at paragraph 1.38 of the Explanatory Memorandum:

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.

**Article 3, sub-paragraph (1)(b) adopts the following definition of Australia:**

... the term "Australia", when used in a geographical sense, excludes all external territories other than:

1. the Territory of Norfolk Island;
2. the Territory of Christmas Island;
3. the Territory of Cocos (Keeling) Islands;
4. the Territory of Ashmore and Cartier Islands;
5. the Territory of Heard Island and McDonald Islands; and
6. the Coral Sea Islands Territory,

and includes any area adjacent to the territorial limits of Australia (including the Territories specified in this subparagraph) in respect of which there is for the time being in force, consistently with international law, a law of Australia dealing with the exploration for or exploitation of any of the natural resources of the exclusive economic zone or the seabed and subsoil of the continental shelf.

**New withholding tax rates**

Generally, where an Australian resident makes a payment of a dividend, interest or royalty to a non-resident, withholding tax will be imposed on that transaction. The withholding tax is payable by the entity or person making that payment and will be imposed at a rate of ten per cent on interest payments and 30 per cent on dividend or royalty payments unless varied by Australia’s DTA’s.  

**Articles 10, 11 and 12** have the effect of modifying the rates of withholding taxes imposed on payments of dividends, interest and royalties between residents of Australia and Israel. The effect of these Articles is summarised by Deloitte and replicated in Table 1.

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Table 1: summary of withholding tax rates under the A-I Tax Convention

<table>
<thead>
<tr>
<th>Dividends</th>
<th>Rate</th>
<th>Conditions include</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nil</td>
<td>5%</td>
<td>The beneficial owner holds directly less than 10% of the voting power in the company paying the dividends, and the beneficial owner is</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• A Contracting State or subdivision thereof, including a government investment fund [note 1];</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• The Reserve Bank of Australia or the Bank of Israel;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• In the case of Australia – a “recognised pension fund” or other resident carrying on complying superannuation activities; or</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• In the case of Israel – a “recognised pension fund” whose income is exempt or Israeli resident receiving dividends from a pension plan provided by a Provident Fund.</td>
</tr>
<tr>
<td></td>
<td>15%</td>
<td>All other cases</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Interest</th>
<th>Rate</th>
<th>Conditions include</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nil</td>
<td>5%</td>
<td>The beneficial owner of the interest is a Contracting State or subdivision thereof, including a government investment fund, the Reserve Bank of Australia or the Bank of Israel [note 1 and note 2].</td>
</tr>
<tr>
<td></td>
<td>5%</td>
<td>The beneficial owner of the interest is an unrelated financial institution.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The beneficial owner of the interest is [note 2]:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• In the case of Australia – a “recognised pension fund” or other resident carrying on complying superannuation activities; or</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• In the case of Israel – a “recognised pension fund” whose income is exempt or Israeli resident receiving interest from a pension plan provided by a Provident Fund.</td>
</tr>
<tr>
<td></td>
<td>10%</td>
<td>All other cases</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Royalties</th>
<th>Rate</th>
<th>Conditions include</th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Note 1: In order for a Contracting State or subdivision thereof, or a government investment fund to get the benefit of the treaty provision above, the dividends or interest are to be derived from the investment of monies that are and will remain public funds.
- Note 2: The reduced rate of taxation on interest per the treaty provision above is not operative where the beneficial owner of the interest is in a position to control or influence the key decision-making of the issuer of the debt-claim. In that case, the treaty provides that the rate of tax may be at 10%.

Source: Deloitte Australia, Tax insights – Australia and Israel: double tax treaty, 11 April 2019.

**OECD BEPS Recommendations**

As part of Australia’s commitment to addressing multinational tax avoidance, the A-I Tax Convention adopts a number of the OECD’s recommendations for addressing BEPS. The specific Articles giving effect to, or incorporating the OECD’s BEPS recommendations are captured at paragraph 1.11 of the Explanatory Memorandum of the Bill, and replicated below in Table 2.
Table 2: summary of BEPS recommendations incorporated into the A-I Tax Convention

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


In response to a question on notice, the Treasury provided JSCOT with a table outlining how the A-I Tax Convention incorporates the OECD BEPS Action Items. For completeness, this has been replicated below in Table 3.

Table 3: summary of specific BEPS recommendations incorporated into the A-I Tax Convention

<table>
<thead>
<tr>
<th>Relevant Article of the Australia-Israel tax treaty</th>
<th>OECD Action Item</th>
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<tbody>
<tr>
<td><strong>Title and Preamble</strong></td>
<td>This gives effect to an OECD/G20 Base Erosion and Profiting Shifting (BEPS) Action 6 recommendation (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances). It clarifies the object and purpose of the treaty also includes avoiding opportunities for non-taxation or reduced taxation through tax evasion or avoidance.</td>
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<td><strong>Persons covered (Article 1)</strong></td>
<td>This gives effect to a BEPS Action 2 recommendation (Neutralising the Effects of Hybrid Mismatch Arrangements). It will ensure that such income is not subject to double taxation, without granting treaty benefits in inappropriate circumstances (such as where neither country treats the income as belonging to one of its residents under its domestic law).</td>
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</table>

Treaty benefits will be available for income derived by or through fiscally transparent entities or arrangements (such as partnerships and trusts) but only to the extent that the income is treated as the income of one of the country’s residents under that country’s domestic law.
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<td><strong>Permanent establishment (PE) (Article 5)</strong> A PE will be deemed to exist in respect of the following activities:</td>
<td>Collectively, these integrity rules give effect to <strong>BEPS Action 7</strong> recommendations (Preventing the Artificial Avoidance of PE Status) and will help guard against abusive arrangements intended to circumvent the PE definition. The existence of a PE in a country enables that country to tax local business profits derived by that PE.</td>
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<td>• A building site or construction project, that lasts for more than 9 months; or carrying out of the related supervisory or consultancy activities that exceeds 183 days or more in any 12 month period.</td>
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<td>• Natural resource activities (including the operation of substantial equipment) that exceeds 90 days or more in any 12 month period.</td>
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<td>• Certain preparatory or auxiliary activities, such as warehousing or purchasing goods, are excluded from the definition of PE.</td>
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<td>• Integrity provisions will be included to prevent related parties from circumventing the above PE time thresholds by splitting contracts, or from fragmenting their preparatory or auxiliary activities to avoid having a PE.</td>
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<tr>
<td>A PE will also be deemed to exist where a person (agent) acts on behalf an enterprise, unless that agent is acting in a truly independent capacity. This will ensure that the activities of dependent agents of foreign enterprises fall within the definition of a PE.</td>
<td></td>
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<tr>
<td><strong>Business profits (Article 7)</strong> Transfer pricing adjustments are generally limited to seven years. This time 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</td>
<td>This gives effect to an OECD <strong>BEPS Action 14</strong> recommendation (Making Dispute Resolution Mechanisms More Effective). It will help prevent late adjustments to provide greater taxpayer certainty.</td>
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<tr>
<td><strong>Associated enterprises (Article 9)</strong> Where one country adjusts the taxable income of a resident enterprise to reflect the arm’s-length conditions of a transaction with an associated enterprise, the other country will be required to make a correlative adjustment. Time limits apply for the commencement of transfer pricing adjustments</td>
<td>This gives effect to an OECD <strong>BEPS Action 14</strong> recommendation (Making Dispute Resolution Mechanisms More Effective). It will help prevent late adjustments to provide greater taxpayer certainty.</td>
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| **Dividends (Article 10)**  
The source (of the dividend) country may tax outbound dividends up to the following limits:  
- Zero - for dividends derived by governments (including government investment funds), central banks, tax exempt pension funds or Australian residents carrying out complying superannuation activities on direct holdings of no more than 10 per cent;  
- 5% - of the gross amount of the dividend for intercorporate dividends paid to companies that hold 10 per cent or more of the paying company throughout a 365 day period;  
- 15% - in all other cases.  | The 365-day holding period requirement for dividends attracting the 5 per cent rate gives effect to an OECD BEPS Action 6 recommendation (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances).  
It will help guard against potential abuse cases where a company with a holding of less than the specified holding percentage increases its holding shortly before the dividends are paid for the purpose of securing the benefits of the provision. |
| **Alienation of property (Article 13)**  
Income, profits or gains from the disposal of immovable property (such as land) or of shares or comparable interests in land-rich entities may be taxed in the country where the property is situated (as a primary taxing right), and a secondary taxing right is provided to the alienator’s country of residence.  
An integrity rule will ensure that the rule for land-rich entities will apply if the relevant conditions are met at any time during the 365 days preceding the disposal. Income, profits or gains from the disposal of PE assets may be taxed in the country where the PE is located, as well as in the country where the enterprise is resident.  
Income, profits or gains from the disposal of ships or aircraft operated in international traffic, as well as from the disposal of other assets pertaining to those operations, will be taxable only in the country of residence of the operator.  
Residual capital gains may be taxed in the country the alienator is a resident, as well as in the country where the property is located (if the alienator is not the beneficial owner).  | The 365-day integrity rule gives effect to an OECD BEPS Action 6 recommendation (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances).  
It will help guard against potential abuse cases where a company alters its asset mix prior to disposal to ensure it is not land rich on the date of disposal. |
### Relevant Article of the Australia-Israel tax treaty

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<th><strong>Limitation on benefits (Article 22)</strong></th>
<th><strong>OECD Action Item</strong></th>
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<tr>
<td>The treaty includes a rule denying treaty benefits, in certain circumstances, if a principle purpose of an arrangement or transaction is to a treaty benefit.</td>
<td>This gives effect to an OECD BEPS Action 6 recommendation (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances). This ensures that the treaty should apply in accordance with the purposes for which it was entered into, that is, 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.</td>
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<tr>
<th><strong>Mutual agreement procedure (MAP) (Article 25)</strong></th>
<th><strong>OECD Action Item</strong></th>
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<tr>
<td>Taxpayers will have three years in which to seek the revenue authorities’ assistance in the resolution of tax disputes arising from the application of the treaty. Protocol paragraph 12 establishes a competent authority notification process, to ensure that the competent authorities of Australia and Israel are made aware of MAP requests that are submitted and, therefore, are able to give their views on whether the request is accepted or rejected, and whether the person’s objection is considered to be justified.</td>
<td>This gives effect to an OECD BEPS Action 14 recommendation (Making Dispute Resolution Mechanisms More Effective) and ensures the efficient operation of the MAP dispute resolution mechanism for taxpayers.</td>
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</table>


### Exchange of information

**Article 26** of the A-I Tax Convention sets out rules and procedures for the exchange of information between the Australian Taxation Office (ATO) and Israeli Ministry of Finance. **Article 26, paragraph 1** stipulates that information may be exchanged to the extent that it is foreseeably relevant for carrying out the provision of the A-I Tax Convention or enforcement of domestic laws covered by the A-I Tax Convention. This is a departure from the OECD Model Tax Convention, which allows information relating to any taxes to be exchanged.  

Other points to note include:

- the exchange of information is not limited to residents of Australia or Israel – that is, information about non-residents can be exchanged.

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• any information exchanged under the Article will be afforded the same level of secrecy as if that information was obtained in the other country – that is, Australia’s taxpayer secrecy provisions will apply to information obtained from Israel under Article 26.54
• information cannot be exchanged where the relevant tax authority would not be able to obtain that information under their domestic laws. Similarly, information cannot be exchanged where its supply would disclose any trade, business, industrial, commercial or professional secret or trade process, or the disclosure would be contrary to public policy.55

Anti-discrimination and arbitration rules

Articles 24 and 25 of the A-I Tax Convention contain non-discrimination rules and mutual agreement procedures. Broadly:

• Article 24 provides that under the A-I Tax Convention nationals of Australia and Israel cannot be treated less favourably than nationals of the other country in the same circumstances. This non-discrimination rule is also extended to permanent establishments.56 However, unlike the OECD Model Tax Convention, Article 24 does not extend these non-discrimination rules to residents of third countries.57
• Article 25 provides a mechanism for resolving taxpayer disputes or resolving difficulties arising from the application of the A-I Tax Convention. This is achieved through a mutual agreement procedure (MAP) whereby Australian and Israeli tax authorities are required to endeavour to resolve the dispute. Importantly, taxpayers will have three years in which to bring a complaint under a MAP process. More information about MAP can be found on the ATO website.58

What rules or laws are not impacted by the A-I Tax Convention?

As noted in the Article 1 of the Protocol to the A-I Tax Convention, the following domestic rules are outside the scope of the A-I Tax Convention:

• measures designed to address thin capitalisation and dividend stripping
• measures designed to address transfer pricing
• controlled foreign company and transferor trust rules
• measures to ensure that taxes can be effectively collected and recovered, including conservancy measures
• foreign occupational company rules and
• general anti-avoidance rules.

Further, the A-I Tax Convention does not include an Article requiring the other country to provide assistance in collecting taxes. As noted by Deloitte, only six of Australia’s 45 treaties include such a provision, and it is not usual practice for Israel to include such an Article.59

Schedule 2: The new deemed source rule

Schedule 2 of the Bill inserts a new Division 764 into the ITAA 1997. Specifically, proposed subsection 764-5(1) of the ITAA 1997 provides that income, profits or gains will have a source in

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54. Ibid., Article 26, paragraph 2.
55. Ibid., Article 26, paragraph 3.
56. Ibid., Article 24, paragraph 2.
58. ATO, 'Mutual agreement procedure', ATO website, last modified 24 June 2019.
59. Deloitte Australia, Tax insights – Australia and Israel: double tax treaty, 11 April 2019, p. 3.
Australia if, for the purpose of an international tax agreement, the income, profits or gains of a foreign resident are taxable in Australia under the terms of that tax agreement.

Therefore, the effect of this is that the new deemed source rule will treat income, gains or profits as being sourced in Australia where an international tax agreement allocates Australia a right to tax that income, gain or profit in respect of a resident of a foreign country or territory for the purposes of that international tax agreement. 60

Proposed subsection 764-5(2) of the ITAA 1997 stipulates that proposed subsection 764-5(1) of the ITAA 1997 will apply to international tax agreements made on or after 28 March 2019.

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