



12th August 2014

Manager
Tax Treaties Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via Email: taxtreatiesunit_consultation@treasury.gov.au

Dear Treasury,

Australia's Tax Treaty Negotiation Program

The Australian Financial Markets Association (AFMA) represents the interests of over 130 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets.

AFMA welcomes the opportunity to provide a submission in relation to countries with which Australia should seek to negotiate or update Double Taxation Treaties (**Treaties**). As a general principle, AFMA supports the expansion of Australia's Treaty network given the encouragement that Treaties provide to trade and investment between participating jurisdictions. Treaties reduce the possibility of double taxation and enhance the free flows of capital through reductions in terms of withholding tax. These are particularly important for Australia given its reliance on foreign funds as a net importer of capital. A strong and internationally best-practice Treaty network will ensure that Australian companies continue to be competitive globally and Australia remains an attractive destination for international investment.

New Treaty – Hong Kong

AFMA is of the view that, in terms of jurisdictions with which AFMA believes that it may be desirable for Australia to negotiate a Treaty, Hong Kong is a standout candidate.

As Treasury would be aware, Hong Kong has in recent times engaged in a concerted effort to expand its Treaty network, such that since 1 January 2010 the number of Treaties concluded has increased from 4 to 30, with a further 14 jurisdictions currently in negotiations. These include OECD and ASEAN countries. Based on comments from the Hong Kong Commissioner for Inland Revenue, these treaties help bolster the economic and trade connections between the two jurisdictions. They also provide a framework for effective exchange of information to enhance tax transparency. The efforts from Hong Kong have resulted in commendation from the OECD.

Australia's commercial interests in Hong Kong are extensive. Based on the most recent data available from the Australian Consulate-General, Hong Kong is Australia's 14th largest export market and 20th largest trading partner. Importantly, Hong Kong is Australia's sixth largest source of foreign investment, with investment exceeding \$50 billion.

Hong Kong clearly has a dominant role as a regional finance centre and is a gateway for significant investment into Asia, particularly mainland China. Indeed, as described by the Australian Consulate-General:

“Australian trade and investment in Hong Kong relies in large part on Hong Kong's role as an international financial and business centre ... and trend leader for China. Hong Kong is also a sophisticated and affluent market for Australian goods and services in its own right. Hong Kong's emphasis on financial and professional services, environmental protection, education, tourism and information technology development are providing significant new areas of potential for further co-operation, trade and bilateral investment between Hong Kong and Australia.”

Both current and previous Governments have undertaken recent regional initiatives to enhance the economic relationships between Australia and Asia, including those articulated in the the Asian Century White Paper, the recently concluded free-trade agreements with China and Korea and the ability for direct conversion of Australian Dollars into Renminbi. The conclusion of a Treaty with Hong Kong would be an important additional step in cementing Australia's prominence in Asia.

The conclusion of a Treaty with Hong Kong, particularly one with a financial institutions exemption from withholding tax, will support the reliance that Australia has on foreign capital to fund its growth by effectively lowering the cost of funds for Australian businesses. The default (non-Treaty) withholding rates of 10% on interest and 30% on dividends and royalties effectively stymie many transactions between Australia and Hong Kong, particularly financial transactions that are high-volume but low margin, such that the overall tax impost would exceed the revenue generated from the transaction.

A Treaty with Hong Kong will also ensure that funds that are resident in Hong Kong will be eligible to participate in the Australian Investment Manager Regime, which (as currently drafted) is limited to jurisdictions with which Australia has either a Treaty or an

Exchange of Information Agreement. This is particularly important in the context of the developments in relation to the Asia Region Funds Passport.

Finally, a Treaty with Hong Kong will also, in AFMA's view, assist with the initiatives of the OECD, backed by the G-20, to enhance global transparency including, but not limited to, the implementation of the Common Reporting Standard.

Renegotiating Treaties – Germany, Canada and China

Germany and Canada

Australia's Treaties with Germany and Canada are somewhat dated, being finalised in 1972 and 2002 (latest protocol) respectively. As a result, the drafting of these Treaties is inconsistent with Australia's other OECD trading partners.

In particular, AFMA submits that the Treaties with Germany and Canada be renegotiated with a view to including articles that:

- Provide an exemption from interest withholding tax for interest paid to or from an unrelated financial institution; and
- Allow for an exemption from dividend withholding tax for dividends paid by a company in one jurisdiction to a substantial shareholder in the other.

Such amendments will ensure that trade and investment between Australia and these jurisdictions will not be commercially disadvantaged vis-à-vis other OECD jurisdictions.

China

The Treaty between Australia and China, in AFMA's view, requires renegotiation insofar as it does not effectively provide relief from Chinese capital gains tax in respect of the disposal of portfolio investments in Chinese companies. Such renegotiation will place Australian investors on an equal footing vis-à-vis investors from other jurisdictions and is an important step in allowing access to the Chinese capital markets.

The issue arises as the existing Treaty does not provide any protection from Chinese capital gains tax in respect of gains arising from the disposal of a non-controlling interest in Chinese companies. This is inconsistent with other Treaties that China has concluded, such as that with the United Kingdom, whereby China has conceded taxing rights to the jurisdiction of residence in respect of shareholdings of less than 25%, to the extent that the Chinese company is not land-rich.

Key Outcomes in Treaty Negotiation

AFMA and its members have experienced considerable difficulty in interpreting various Treaties, including discrepancies and ambiguity. To that end, AFMA makes the following comments with respect to some of the key outcomes that Australia should seek in negotiating Treaties:

Uniformity

AFMA acknowledges that each Treaty is negotiated having regard to the particular circumstances relevant to trade between the respective countries. However, a bespoke approach to each Treaty results in complexity and increased costs to business in pursuing trade on an international basis. Accordingly, we recommend that to the extent possible, uniformity is achieved in the negotiation of definitions and rates across Treaties.

Substantial Equipment Articles

The business profits article of most Treaties establishes that where business is conducted through a permanent establishment in a particular country, the net gains of that permanent establishment are taxed in that country. Similarly, most Treaties provide that interest may be taxed in both the country in which it arises and the “home” country of the lender, with the tax rate in the country in which the interest arises limited by the Treaty.

These principles may result in ambiguity in respect of leasing businesses where a resident of one jurisdiction leases assets to a resident in another jurisdiction. Under certain Treaties, the mere existence of substantial equipment will be sufficient to crystallise a permanent establishment, regardless as to whether the lessor is operating such equipment. However, this approach is not necessarily consistent. This results in differences as to whether or not a permanent establishment is crystallised and, if so, whether a business is conducted at or through such a permanent establishment.

Accordingly, in negotiating future Treaties, AFMA would recommend that the Treaty specifically exclude leased assets from the definition of a permanent establishment and/or confirming that the mere ownership of leased assets does not constitute the carrying on of a business at or through that permanent establishment.

Royalty Withholding Tax – Payments for Use of Equipment

AFMA members have identified a discrepancy between older and newer Treaties as to whether payments made for the use of industrial or commercial equipment, such as under a lease arrangement, constitute royalties for withholding tax purposes. Where such withholding tax is imposed, it may be greater than the economic returns arising from the leasing transaction.

Accordingly, AFMA recommends that Treaties specifically provide for a zero withholding tax rate on lease payments with respect to industrial or commercial equipment.

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AFMA would be pleased to provide any additional information that Treasury would like in relation to the issues raised above. Please contact me on (02) 9776 7996 if you would like to discuss further.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Rob Colquhoun', written in a cursive style.

Rob Colquhoun
Director, Policy