Tuesday, 26 May 2015

AmCham

Mr. Henry Louie
Deputy Director
International Tax Treaties Division
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Also by Email: Henry.louie@treasury.gov

Dear Mr. Louie,

RE: The Case for Renegotiating and Modernizing the US-Australia Bilateral Tax Treaty

It was a great pleasure for me and a delegation from the American Chamber of Commerce in Australia (AmCham) to call on you and your team in Washington last year. In that meeting, we expressed our view that Australia should be prioritized as a negotiating partner as the U.S. Treasury sets its forward program for future bilateral tax negotiations with other economic partners, and we took on board your comments and suggestions.

With this letter we are responding directly to your request to provide a considered AmCham view on what the elements of a re-negotiated U.S.-Australia Bilateral Tax Treaty might include - a sort of "wish list" of possible outcomes that reflect the desires and concerns of our membership. It has taken us some time to collect and collate those views, and in so doing we have also revamped and reinvigorated our AmCham Taxation Committee, whose work this represents. This Committee is chaired by Chris Morris of PwC-Sydney and includes a distinguished group of taxation experts and specialists from other AmCham member companies.

Our AmCham group is coming back to Washington June 22-25. During our time there, having now submitted our formal views, we would welcome the opportunity for another discussion on this issue with your team. I realize that you personally will be abroad then so I would ask that we meet instead with colleagues. Thank you in advance for your accessibility and openness to our views.

As background, I should also add that AmCham is Australia's largest international Chamber of Commerce and premier international business organization. Since our founding in 1961, we have helped to promote and encourage the two-way flow of trade and investment between the United States and Australia.

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We have a consistent track record of constructive engagement in consultations on matters such as this one, including 15 years ago when the 2001 "Protocols" were being negotiated and ten years ago during the successful negotiation of the Australia-U.S. Free Trade Agreement (AUSFTA). AmCham is considered *the* voice of U.S. business in Australia, and a respected voice of Australian business in the United States. With offices in Sydney, Melbourne, Brisbane, Adelaide and Perth and some 1,000 corporate members, AmCham represents key U.S. corporations and investors in Australia, as well as many Australian companies with an interest and/or presence in the U.S.

In response to the Australian Treasury's call last year for submissions to Australia's future tax treaty negotiation program, AmCham was pleased to present our considered views. Our main point was that we believe it is vitally important to give the United States, Australia's most important economic partner, the highest possible priority as the Australian Treasury sets its future agenda for tax treaty negotiations. It is our view that the economic relationship is also a vital one for the U.S. and deserves to be maintained at the highest possible level, in terms of putting into place state-of-the-art trade arrangements like the pending Trans-Pacific Partnership (TPP), the bilateral Defence Cooperation Trade Treaty, and, the tax arrangements in effect between our two countries.

As you know, the U.S.-Australia Tax treaty has not been revised since 2001, and as a result contains outdated and obsolete provisions that impede trade, investment, and commerce between Australia and the U.S. In particular, the ongoing U.S. taxation of Australian Superannuation is an avoidable barrier and additional cost to bilateral trade and investment which is frequently brought to our attention by AmCham members and others outside our Chamber. We welcome this opportunity again to bring their views to your consideration. I should add that, over the past year, the volume of the negative public debate here in Australia about the "unfair" taxation of Australian superannuation has become quite loud. It now involves Americans retired in Australia, Americans working in Australia, and many Australian citizens who have acquired a tax liability vis-à-vis the IRS and now discover themselves taxed on income that they had always thought exempt from taxation.

The major area of concern for our members - both American and Australian - is the high cost of doing business in Australia. We are therefore committed to doing everything possible to promote positive change to reduce that high cost of doing business here. One contributor to the high cost of doing business here is the U.S. taxation of Australian Superannuation. This cost is borne not just by individuals, but also by the organizations that employ them. This is an issue not just for citizens and taxpayers of both countries, but for general business and commerce as well. It impacts on trade and investment and it is a barrier to the cross-border movement of talent and capital.

Also, the Treaty, as it stands, is not in line with the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital. As you know, it is also not in line with the United States' own Model Income Tax Convention provisions (which exempt approved overseas pension plans from taxation).

Furthermore, as the U.S. Ambassador and the U.S. Embassy in Canberra seek ways to mobilize Australian Superannuation funds for investment into the United States and particularly into infrastructure renewal in America, it seems timely to review whether the taxation provisions for such investment can be optimized to promote such inward investment.

What, then, are the provisions of the existing Treaty that AmCham would suggest addressing?

1. First and foremost, we suggest fixing the U.S. Taxation of Australian Superannuation:

- Australian Superannuation plans are treated as Funded & Vested non-qualified retirement plans for U.S. tax purposes.

- A U.S. citizen or resident participating in an Australian Superannuation fund is subject to U.S. tax on the Employer Contributions to the fund. This can also apply to an Australian working temporarily in the U.S.

- U.S. citizens and Australian Green card holders remain subject to U.S. taxation on their worldwide income and where these individuals are residing in Australia (as Australian tax residents), their Australian Superannuation fund is subject to the U.S. tax rules and reporting.

- Where the individual is "Highly Compensated" the Vested Accrued Benefit (i.e. growth in the fund) is subject to U.S. tax.

- Australian citizens and permanent residents can only withdraw amounts from their Superannuation funds upon retirement.

- Currently the U.S. - Australia Tax Treaty does not provide any relief to delay the taxation until actual withdrawal (unlike the agreement with the U.K. and similar treaties).

- Superannuation funds pay a 15% contribution tax (on receiving employer contributions) and up to a 15% earnings tax (on the fund earnings) which are taken out of the individual's funds. Under U.S. rules, the individual is not entitled to receive a credit for this tax.

- There are various types of Superannuation funds in Australia, such as Employer funds, Industry funds, Retail funds, Self-Managed Superannuation Funds etc., that are genuine Superannuation funds and the U.S. tax rules in each of these funds may vary (some with more added complexity).

Proposed Amendments to the U.S.-Australia Tax Treaty to address the adverse impact of U.S. taxation of Australian Superannuation

- A new tax treaty article should be introduced in the U.S.-Australia Tax Treaty as per the 2006 U.S. Model Income Tax Convention (Article 18 - Pension Funds). An extract of the article is **attached.**

- Article 1(4)(a) of the U.S.-Australia Tax Treaty should be amended to include Article 18 (1) to provide relief to U.S. citizens

  "(4) The provisions of paragraph (3) shall not affect:

  (a) the benefits conferred by a Contracting State under paragraph (2) of Article 9 (Associated Enterprises), paragraph (1) or (2) or (6) of Article 18 (Pension, Annuities, Alimony and Child Support)....."

2. Fiscally Transparent Entities (Articles 1 and 4)

The current U.S. treaty has a very uncommon article that purports to deal with FTEs, such as partnerships and trusts (refer Article 4(1)(b)(iii)). The article deems certain FTEs to be a resident of the U.S. (either wholly or to an extent) for the purposes of the treaty.

This article is problematic in many respects, including the way in which it interacts with the Limitation on Benefits article (Article 16) added in 2001. Article 4(1)(b)(iii) is an extremely uncommon article, both from a U.S. tax treaty perspective and from an Australian tax treaty perspective. This is the only treaty that Australia has with such an article. The U.S. had one other similar article in its treaty with New Zealand, although this has been replaced via a 2008 Protocol.

By contrast, the 2006 U.S. model adopts a far simpler approach to dealing with fiscally transparent entities - refer to Article 1(6).

The U.S. / New Zealand treaty now adopts a provision along the lines of Article 1(6), 2006 U.S. model) dealing with FTEs. In the Australia / New Zealand treaty, Australia has also adopted language that is effectively the same as Article 1(6), 2006 U.S. model.

We would endorse this approach in any revisions to the Australia / U.S. double tax treaty. Given the 2006 U.S. model and the similar approach adopted in the Australia / New Zealand treaty, it would be expected that this revision should be achievable.

3. Pension and Superannuation Funds (Article 4)

The status of Australian superannuation funds under Australia's tax treaties is not always clear.

For all foreign pension funds (including U.S. pension funds) investing into Australia, Australia has already unilaterally provided a tax exemption at least in respect of dividends and interest income, via the imputation system and s128B(3)(jb). Australian superannuation funds are exposed to source country tax on dividend and interest income derived from the U.S.

The 2006 U.S. model expressly recognises pension funds as a resident in the country in which they are established. Australia has also adopted this same position in respect of pension and superannuation funds under the recent Australia / Switzerland treaty.

Such specific recognition of pension / superannuation funds also facilitates the exemptions discussed below regarding dividends and interest. It also permits pension funds to rely on the business profits article in respect of gains on disposal.

We would endorse this approach in any revisions to the Australia / U.S. double tax treaty.

4. Permanent Establishment (Article 5)

The U.S. Model provides as follows in respect of attributing profits to a permanent establishment:

> "For this purpose, the profits to be attributed to the permanent establishment shall include only the profits derived from the assets used, risks assumed and activities performed by the permanent establishment."

This "attributable to" concept incorporates the arm's length principle in a manner consistent with the OECD views on attributing profits to a permanent establishment.

This approach would provide greater certainty in determining the extent to which the U.S. can seek to impose profits in the case of a permanent establishment in the U.S. By contrast, the existing Australia / U.S. treaty does not incorporate this OECD approach to profit attribution.

5. Substantial Equipment Deemed PE (Article 5)

Under the current U.S. treaty, an enterprise of one State shall be deemed to have a permanent establishment (PE) in the other State if it "maintains" substantial equipment for rental or other purposes within that other State (excluding equipment let under a hire-purchase agreement) for a period of more than 12 months.

Revisions to the Australia / U.S. double tax treaty should replace the "maintains" test with the "operates" test, as used under Australia's most recent tax treaties (Finland, Japan, New Zealand, Switzerland). This term "operation" (or "operates") has the benefit of clarifying that only active use of substantial equipment assets are captured under this Article. Thus, an enterprise that merely leases substantial equipment to another person for that other person's own use in a country would not be deemed to have a PE in that country.

There is no substantial equipment clause in the 2006 U.S. model, but it is not unreasonable to expect that the "operates" test would be acceptable to the U.S.

6. Dividends - Pension Fund / Superannuation Fund (Article 10)

The U.S. model provides that a pension fund resident in the other State shall not be taxed on dividends paid from the source State, provided that there is no trade or business carried on in the source State.

As noted, Australia already unilaterally grants such an exemption for non-Australian pension funds. However, Australian superannuation funds could be exposed to U.S. tax on dividends paid from the U.S.

The recent Australia / Switzerland treaty has provided for an exemption from source State tax on dividends paid to a pension fund / superannuation fund in the other State. This exemption is limited to holdings of no more than 10%.

This exemption from source State tax on dividends paid to a pension fund / superannuation fund in the other State could be expanded to the U.S. / Australia treaty. We would endorse this approach in any revisions to the Australia / U.S. double tax treaty.

7. Dividends - Government Investment Funds (Article 10)

The recent Australia / Switzerland treaty has also made clear that "Government investment funds" including the Australian Future Fund will be exempt from source State tax on dividends (on holdings of no more than 10%). This same approach is also adopted by Australia in the Australia / New Zealand treaty.

Whilst the U.S. has a form of sovereign immunity via Section 892 and Australia recognizes the principle of sovereign immunity, we expect that such an exemption in the treaty would be simpler.

We would endorse this approach in any revisions to the Australia / U.S. double tax treaty.

8. Interest (Article 11)

The U.S. model adopts the position that interest income is taxable only in the country of residence. That is not consistent with Australian treaty practice, and it is considered unlikely that Australia would agree to such a position.

Rather, Australian treaty practice is to permit source country taxation of interest, subject to certain exceptions. The current U.S. treaty already has a number of such exceptions (e.g. governments and financial institutions).

Similar to the comments above in respect of dividends, the exceptions from source country tax on interest should be extended to pension funds / superannuation funds and Government investment funds, such as the Australian Future Fund.

9. Gains / Alienation of Property (Article 13)

The current U.S. treaty adopts a "2001 Australian style" sweep up clause that provides that capital gains not otherwise covered by the specific preceding paragraphs of Article 13 may be taxed in accordance with the provisions of domestic law. This leaves a residual power to tax capital gains in the source country.

The 2006 U.S. model by contrast has a sweep up clause that provides that gains not otherwise covered by the specific preceding paragraphs of Article 13 may be taxed only in the State of residence.

This approach is consistent with current Australian treaty practice.

We would endorse the 2006 U.S. model approach in any revisions to the Australia / U.S. double tax treaty.

10. Managed Investment Trusts (MITs)

The recent Australia/New Zealand treaty has included specific rules to provide treaty benefits to income derived through MITs (refer to Article 4.7).

A similar article should be adopted in any revisions to the Australia / U.S. double tax treaty.

This matter is not dealt with by the 2006 U.S. model as MITs are specific to Australia. However, it should be noted that the current U.S. model already has language that is specific to Australia, in that it deals with "listed Australian property trusts".

11. Pension Article

As a general principle the Pension Article within a particular treaty seeks to ensure that the recipient is only subject to tax in the country in which they are a resident. However, typically the term "pension" is not defined, and many amounts paid in respect of superannuation benefits may not fall within the concept of a "pension".

The scope of the term "pension" for these purposes should be expanded (consistent with current superannuation practices) and clarified.

In conclusion, AmCham deeply appreciates U.S. Treasury's openness to considering our views on these issues. As noted above, AmCham looks forward to discussing these proposals with your colleagues in June.

Yours sincerely,

R. Niels Marquardt
United States Ambassador (ret.)
CEO
American Chamber of Commerce in Australia

Encl. U.S. Model Income Tax Convention (2006), Article 18 Pension Funds

CC:

U.S. Ambassador to Australia, The Hon. John Berry

Australian Ambassador to the U.S.A., The Hon. Kim Beazley