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Tax Treaties Unit
International Tax and Treaties Division
The Treasury
Langton Crescent
Parkes ACT 2600

By e-mail: treaties@treasury.gov.au

Dear Sir/Madam

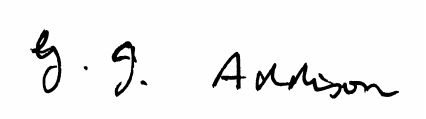
Submission on the Revision of the Australia-Switzerland Tax Treaty

CPA Australia welcomes the opportunity to comment on the revision of the Australia/Switzerland tax treaty. We have limited our comments to the identification of specific issues rather than making a submission on all aspects of the Australia/Switzerland tax treaty. We understand that the key focus of the negotiations will be updating the exchange of information provisions, addressing the most favoured nation obligations in the existing treaty and updating the treaty in line with Australia's recent treaty practice.

The points we would like to be considered by Treasury in renegotiating Australia's existing tax treaty with Switzerland are contained in Appendix 1 and Appendix 2, attached to this letter. Appendix 2 looks at a specific issue in relation to the operation of the "aggregation" provision which has been in a number of Australia's recent treaties, in connection with permanent establishments. We would appreciate any comments you have and would welcome the opportunity to discuss this issue at our next Tax Treaties Advisory Panel meeting.

If you have any questions, please do not hesitate to contact me on 03 9606 9771, Theo Sakell of Pitcher Partners on 03 8610 5503, or Isabelle Mac Innes of Deloitte on 02 9322 7457.

Yours faithfully,



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Appendix 1

Our comments for your consideration in relation to the revision of the Australia-Switzerland Tax Treaty are as follows:

1. The definition of "person" in Article 3(1) should also specifically include partnerships and trusts.

2. The definitions in Article 3(1) should also include a definition for a "fiscally transparent entity" adopting the same words used in the new New Zealand Treaty in Article 1(2). Further, such a definition should specifically include partnerships that are not taxed as companies in either jurisdiction and should also specifically cover trusts, whether fixed or non-fixed.

3. The personal resident definition changes incorporated in Article 4 of the new New Zealand tax treaty should also be adopted with the new Switzerland tax treaty.

   Australia should preserve the tax benefits it offers to temporary residents of Australia under the tax treaty in the same manner as it has done with the new New Zealand tax treaty.

4. The "dual listed company arrangements" and "managed investment trusts" features of the new New Zealand tax treaty should also be adopted.

5. The definition of "permanent establishment" in Article 5 should be expanded to cover the operation of substantial equipment for more than 183 days in any twelve month period.

6. Please refer to Appendix 2 which looks at a specific issue in relation to the operation of the "aggregation" provision which has been in a number of Australia's recent treaties, in connection with permanent establishments.

7. In relation to the Business Profits Article, a statute of limitations period should be inserted in the same manner as per Article 7(8) of the new New Zealand tax treaty, with the exception that the time period should be four years consistent with our domestic legislation (but subject to what is the Switzerland statute of limitations period under their domestic tax law).

8. The statute of limitations period for transfer pricing adjustments under Article 9 – (Associated Enterprises) should be inserted in the same manner as per the new New Zealand tax treaty Article 9(4).

9. The more favourable dividend withholding tax rate changes as per the new New Zealand tax treaty should be adopted particularly including the nil % rate per Article 10(3) of the new New Zealand tax treaty as well as Article 10(4).

10. A 0% interest withholding tax rate should be inserted in Article 11 in relation to interest derived by an unrelated financial institution.

11. The royalty withholding tax rate under Article 12 should be reduced from a maximum of 10% to not exceed 5%.

12. The definition of royalties should specifically exclude equipment given the suggested inclusion of substantial equipment.

13. Article 13(4) in relation to the alienation of interests in land rich entities should be amended in the same manner as per Article 13(4) of the new New Zealand tax treaty. That is, the relevant threshold should be more than 50% of the value attributed to real property in the relevant entities.

14. A Most Favoured Nations clause should be inserted in the new tax treaty similar to the one adopted in Article 29(2) of the new New Zealand tax treaty.

Appendix 2

Permanent Establishment (PE) Article and the "aggregation" provision

We have set out below the issue in relation to the operation of the "aggregation" provision which has been in a number of Australia's recent treaties, in connection with PEs.

In the Australia/New Zealand tax treaty (the New Zealand tax treaty), the provision is found at Article 5(6), which relevantly states:

6. *a)* The duration of activities under paragraphs 3 and 4 will be determined by aggregating the periods during which activities are carried on in a Contracting State by associated enterprises provided that the activities of the enterprise in that State are connected with the activities carried on in that State by its associate.

b) …..

c) Under this Article, an enterprise shall be deemed to be associated with another enterprise if:

(i) one is controlled directly or indirectly by the other; or

(ii) both are controlled directly or indirectly by the same person or persons.

The issue we have been considering is whether in aggregating activities of associated enterprises, one looks only to activities of foreign associates or whether one also looks to activities of Australian associates.

We have set out below four scenarios to illustrate whether the "aggregation" provision is intended to have operation in respect of each of these scenarios:

Scenario 1:

- NZCo1, a New Zealand resident company, is involved in the exploration for natural resources (refer to Article 5(4)(b) of the New Zealand tax treaty) for say 60 days in Australia, (exploration activity #1)
- NZCo2 , a New Zealand resident company, also undertakes exploration for natural resources for say 60 days in Australia (exploration activity #2)
- There is no overlap in the two separate 60 day periods and it is accepted that the two separate activities are "connected" in the context of Article 5(6)(a)
- NZCo1 and NZCo2 are associates

Scenario 2:

- The facts are as per scenario 1 above, except that NZCo1 has no involvement
- Instead AusCo, an Australian resident company, undertakes exploration activity #1
- NZCo2 and AusCo are associates

Scenario 3:

- The facts are as per scenario 2 above, except that exploration activity #1 undertaken by AusCo lasts say 3 years, and
- The role of NZCo2 is limited to say 60 days
- NZCo2 and AusCo are associates

Scenario 4:

- The facts are as per scenario 3 above, except that NZCo2 and AusCo are not associates

It is submitted that the "aggregation" provision is intended to have operation in respect of scenario 1 but is not intended to have operation in respect of scenarios 2 and 3. The "aggregation" provision has no operation in scenario 4 as the parties are not associates.

However, given the breadth of the words used, the "aggregation" provision could be read more widely so as to have operation in respect of scenarios 2 and 3. It is essentially this issue we would like to discuss.

We have set out some of our observations on the aggregation provisions below:

1) It is noted and acknowledged that there is no geographic limitation in the definition of associate.

2) However, in context, Article 5 is directed at determining whether the activities of a non-resident (relevantly, a resident of New Zealand) has a PE in Australia so as to be exposed to Australian tax (refer to Article 7 of the New Zealand Tax Treaty). Thus, it is considered that Article 5, including Article 5(6) is directed at an examination of the activities of two or more non-residents.

3) It is noted that the examples in the Explanatory Memorandum (EM) for each of Australia's most recent tax treaties deal only with activities of non-residents:

    - Example 1.6 in the EM for the Australia/Japan tax treaty,
    - Example 1.1 in the EM for the Australia/South Africa tax treaty,
    - Example 1.1 in the EM for the Australia/Chile tax treaty, or
    - Example 1.1 in the EM for the Australia/Turkey tax treaty

4) The EM for each of Australia's most recent tax treaties, all state these aggregation provisions are aimed at counteracting contract splitting for the purposes of avoiding the application of the PE rules. For instance, paragraph 1.69 of the EM for the Australia/Japan tax treaty states that :

    "This provision is an anti-avoidance measure aimed at counteracting contract splitting for the purposes of avoiding the application of the permanent establishment rules"

5) In context, we read the OECD Commentary and the comments in the EM as addressing a situation of "contract splitting" as between two or more non-residents with the objective of preventing any one or other of the non-residents having a PE in Australia. In a situation where the non-residents collectively have such a presence in Australia, the aggregate activities of the non-residents are such that the non-residents collectively exceed any PE threshold or safe harbour and are treated as each having a PE.

6) This is practically and commercially a different scenario to where an Australian resident which is wholly within the Australian tax net, seeks the assistance of an associated non-resident. The activities of the Australian resident are ongoing and so clearly exceed any PE threshold or

safe harbour – noting that of course one would not normally be seeking to apply any PE threshold or safe harbour test to an Australian resident.

7) If the associated non-resident provides assistance in relation to "connected" activities, it is submitted that the PE threshold or safe harbour (in the example, 90 days) should be applied to the associated non-resident on its own account **and the activities of the associated non-resident should not be aggregated with the Australian resident**.

8) If (contrary to our submission) the activities of the Australian resident are aggregated with the associated non-resident, this would mean that the 90 days threshold would be irrelevant in any situation similar to scenario 3.

9) It is considered that taxation or non-taxation based on the PE concept in such that minor activity in Australia (e.g. total activity in Australia by non-resident(s) of less than 90 days) should not result in having a PE in Australia. This principle should not change simply because a non-resident has an Australian associate.

10) It is submitted that the economic presence in Australia of NZCo2 is the same under scenarios 3 and 4, and in neither case should NZCo2 have a PE in Australia. It is clear that NZCo2 should not have a PE in Australia in scenario 4. NZCo2, in scenario 3, should not have a PE in Australia when it undertakes the same activities as NZCo2 in scenario 4.

11) The ATO's a recent Interpretative Decision (ATO ID 2010/190) which concludes that the activities of foreign associates and Australian associates should be aggregated is contrary to our submission (the ATO's case is similar to our case scenario 3 above).

12) In our view, including time limits under the PE Article provides practical guidance to non-resident businesses conducting a specific operation in Australia. The inclusion of time limits in the PE Article should create greater certainty and reduce compliance costs, not the reverse.