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Tax insights
New Australian tax treaty with Germany

Snapshot

On 12 November 2015, Australia and Germany signed a "new 21st Century tax treaty, which will reduce tax impediments to increased bilateral trade and investment and improve the integrity of the tax system". The treaty replaces one of Australia's oldest treaties, signed in 1972.

The Australia / Germany treaty (the New treaty) is the first treaty concluded by Australia since the OECD reports were released on 5 October 2015. The New treaty adopts most of the OECD's recommended treaty changes, in particular in respect of:

- Action 2: fiscally transparent entities
- Action 6: treaty abuse
- Action 7: artificial avoidance of permanent establishment status and
- Action 14: dispute resolution

The New treaty will come into effect after all domestic ratification requirements are completed by both countries. If ratification is completed in the first half of 2016, the New treaty would apply from 1 July 2016 for Australian income tax purposes and from 1 January 2017 for Australian withholding tax purposes. These dates would be delayed by one year if ratification is not completed until the second half of 2016.

Australian and German cross border investors should review existing structures and income flows to identify the potential risks and benefits under the New treaty.

Detailed comments

Withholding tax rates

The New treaty provides for maximum source country taxation as follows:

	Rate	Conditions include
Dividends	Nil	Company listed on recognised stock exchange (or company owned by one or more listed companies) holds directly at least 80% of the voting power for at least 12 months
	5%	Company holds directly at least 10% of the voting power for at least 6 months
	15%	Otherwise
Interest	10%	- generally; or
	Nil	- where paid to a Government, a body exercising governmental functions, a central bank or an unrelated financial institution
Royalties	5%	

Treaty Abuse

The New treaty is largely consistent with the BEPS Action 6 measures in respect of treaty abuse. The minimum standard has been reflected in:

- a new title and preamble: making it clear that the treaty is not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the Agreement for the indirect benefit of residents in third States)
- the adoption of the principal purpose test (PPT) which will deny treaty benefits in respect of an item of income where one of the principal purposes of a transaction or arrangement is to obtain treaty benefits, unless it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty

In addition, a number of specific anti-treaty abuse measures are included in the New treaty.

Permanent establishment

The New treaty is consistent with the BEPS Action 7 measures in respect of the new permanent establishment standard. Significantly, the New treaty:

- will deem a PE where a person (other than an independent agent) acting in a contracting state on behalf of an enterprise "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise"
- ensures that persons who act exclusively or almost exclusively for a closely related enterprise do not qualify as independent agents
- narrows the specific activity exceptions by making each of them subject to the condition that the relevant activity is preparatory or auxiliary for the enterprise
- introduces an anti-fragmentation rule to limit the specific activity exceptions where related activities are split between different legal entities or different places

In addition, in accordance with modern Australian treaty practice, the New treaty will deem a PE to arise if an enterprise of one of the contracting states:

- carries on supervisory or consultancy activities in the other state for more than nine months in connection with a building site, or a construction or installation project
- carries on activities (including the operation of substantial equipment) in the other state in the exploration for or exploitation of natural resources for a period or periods exceeding in the aggregate 90 days in any 12 month period or
- operates substantial equipment in the other state for a period or periods exceeding in the aggregate 183 days in any 12 month period

The time thresholds are subject to an aggregation rule to deal with contract-splitting between closely related enterprises. These deemed PE provisions significantly expand the PE concept compared with the existing treaty and will need to be carefully considered, for example, by German engineering and construction groups who perform projects in Australia.

German groups that sells goods or services directly to Australian customers should also evaluate the potential impact of Australia's new multinational anti-avoidance law (MAAL). This is effectively a unilateral expansion of the PE concept and is discussed further below.

Land rich entities

Once the New treaty is in force, German investors will no longer be entitled to treaty protection from Australian tax on gains from the disposal of shares in companies, the underlying assets of which are principally (>50%) Australian real property.

Claiming treaty benefits

In an uncommon article (Art 28), in respect of taxation by withholding at source (e.g. for dividends, interest and royalties), "the right to initially collect the withholding tax at a higher rate provided for under the domestic law … is not affected by the [treaty]". In order to claim the benefits of the treaty, the recipient is required to seek a refund and may be requested to provide a certificate of residence. The treaty allows for the taxation authorities to agree on the implementation of this article and it is to be hoped that the administration of this Article does not result in unnecessary compliance for taxpayers.

Other matters

Other key aspects of the New treaty include the following:

- the New treaty expressly deals with income derived through fiscally transparent entities or arrangements
- treaty benefits should generally be available for Australian managed investment trusts
- a ten year time limit will generally apply for making transfer pricing adjustments
- under the mutual agreement procedures, unresolved disputes may be submitted to binding arbitration after two years and
- the German and Australian tax authorities are required to assist each other in the collection of their respective revenue claims

Whilst the MAAL is similar in some respects to the UK diverted profits tax (DPT), the MAAL is likely to be more severe in its scope and impact, noting that the MAAL can potentially create a significant royalty withholding tax liability (potentially a 30% tax on gross royalties) and the ATO can impose 100% penalties

BEPS implementation in Australia

In addition to the New treaty, German multinationals should be aware of other significant Australian tax developments in connection with the OECD BEPS project.

Multinational anti-avoidance law (MAAL) – unilateral expansion of PE concept

Australia is moving unilaterally to broaden the PE concept via the multinational anti-avoidance law or MAAL (expected to be effective from 1 January 2016 and applicable to groups with global turnover of more than AUD 1 billion (approx. EUR 680 million)). The MAAL may apply where there is no PE under an applicable treaty. It allows the Australian taxation authorities (ATO) to deem sales of goods or services by a foreign supplier to Australian customers to be made through an Australian PE if an associated or commercially dependent entity performs activities in Australia in connection with those sales.

Whilst the MAAL is similar in some respects to the UK diverted profits tax (DPT), the MAAL is likely to be more severe in its scope and impact, noting that the MAAL can potentially create a significant royalty withholding tax liability (potentially a 30% tax on gross royalties) and the ATO can impose 100% penalties. German groups selling goods or services into Australia where the seller entity is a non-Australian entity and an associated or commercially dependent entity undertakes related activities in Australia (e.g. sales and marketing support services) need to address the potential impact of the MAAL. The MAAL can apply across a wide range of industries including engineering, contracting and technology groups. The ATO is expecting that affected taxpayers will pro-actively engage with the ATO and contemplate changes to the Australian business model or tax model.

Whilst it is expected that the wider scope of PE under the new OECD standards will take effect over time via a multilateral instrument or new bilateral treaties, such as this new Germany-Australia treaty, the Australian MAAL effectively brings the start date for a wider scope PE to 1 January 2016.

Hybrid financing

In respect of OECD BEPS Action 2 (hybrid financing), the Australian Government has announced its intention to move promptly and has referred the matter to the Board of Tax, asking it to report by early 2016. The changes could, for example, neutralise limited partnership and redeemable preference share arrangements that have been used by multinationals to finance Australian operations.

Country-by country reporting

Australia is in the process of finalising legislation to give effect to OECD proposals for country by country reporting, master file and local file documentation. In Australia, this will apply for years commencing on or after 1 January 2016 and is applicable to groups with global turnover of more than AUD 1 billion (approx. EUR 680 million).

Tax transparency disclosures

Australian companies with a turnover of at least AUD 100 million will have their annual total income, taxable income and tax paid published by the ATO. This is due to commence in December 2015.

Contacts

For more information, please contact

Vik Khanna
Partner
+61 (3) 9671 6666
vkhanna@deloitte.com.au

David Watkins
Partner
+61 (2) 9322 7251
dwatkins@deloitte.com.au

Claudio Cimetta
Partner
+61 (3) 9671 7601
ccimetta@deloitte.com.au

Mark Hadassin
Partner
+61 (2) 9322 5807
mhadassin@deloitte.com.au

For further information, visit our website at www.deloitte.com