tax notes international
Volume 64, Number 11 ■ December 12, 2011

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Eligibility for Treaty Benefits Under The Australia-U.S. Income Tax Treaty

by Jason Connery, Douglas Poms, and
Jennifer Blasdel-Marinescu

Reprinted from *Tax Notes Int'l*, December 12, 2011, p. 843

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SPECIAL REPORTS

Eligibility for Treaty Benefits Under the Australia-U.S. Income Tax Treaty

by Jason Connery, Douglas Poms, and Jennifer Blasdel-Marinescu

Jason Connery is a principal, Douglas Poms is a principal, and Jennifer Blasdel-Marinescu is a manager in the International Corporate Services group of KPMG LLP's Washington National Tax practice.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only and does not necessarily represent the views or professional advice of KPMG LLP.

To be entitled to benefits under income tax treaties, companies must satisfy eligibility requirements. This article includes flowcharts to help practitioners navigate the eligibility requirements of the Australia-U.S. income tax treaty applicable to Australian companies.[1]

Income tax treaties may exempt business income from source country income taxes and eliminate or reduce domestic withholding taxes on payments between residents of countries that are parties to an income tax treaty. To be entitled to benefits under U.S. income tax treaties, a company must not only be a resident of the tax treaty partner's country, but must also satisfy at least one of the tests in the treaty's limitation on benefits provision, if applicable.

The flowcharts in this article focus on the eligibility of Australian companies claiming benefits on income that would otherwise be subject to U.S. taxation. This article does not address the eligibility for treaty benefits of entities that are partnerships or are otherwise transparent for U.S. or Australian tax purposes. This article is based on the treaty, the protocol to the treaty signed on September 27, 2001, and the U.S. Treasury technical explanation to the protocol.

This article is the 10th in a series[2] that provides flowcharts to assist practitioners in determining a company's eligibility for tax treaty benefits under the LOB

[1]Convention Between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, August 6, 1982, as amended by a protocol signed on September 27, 2001.

[2]*See* Jason Connery, Douglas Poms, and Jennifer Blasdel, ''Eligibility for Treaty Benefits Under the Switzerland-U.S. Income Tax Treaty,'' *Tax Notes Int'l*, May 9, 2011, p. 505, *Doc 2011-6410*, or *2011 WTD 89-21*; Connery, Poms, and Blasdel, ''Eligibility for Treaty Benefits Under the Japan-U.S. Income Tax Treaty,'' *Tax Notes Int'l*, Sept. 6, 2010, p. 789, *Doc 2010-18355*, or *2010 WTD 172-12*; Connery, Poms, and Blasdel, ''Eligibility for Treaty Benefits Under the 2009 Protocol to the France-U.S. Income Tax Treaty,'' *Tax Notes Int'l*, Apr. 12, 2010, p. 149, *Doc 2010-5809*, or *2010 WTD 69-14*; John Venuti, Connery, Poms, and Blasdel, ''Eligibility for Treaty Benefits Under the Netherlands-U.S. Income Tax Treaty,'' *Tax Notes Int'l*, Nov. 23, 2009, p. 601, *Doc 2009-24084*, or *2009 WTD 223-11*; Venuti, Connery, Poms, and Alexey Manasuev, ''Eligibility for Treaty Benefits Under the Canada-U.S. Income Tax Treaty,'' *Tax Notes Int'l*, June 15, 2009, p. 967, *Doc 2009-11815*, or *2009 WTD 113-15*; Venuti, Ron Dabrowski, Poms, and Manasuev, ''Eligibility for Treaty Benefits Under U.K.-U.S. Income Tax Treaty,'' *Tax Notes Int'l*, Mar. 23, 2009, p. 1095, *Doc 2009-4590*, or *2009 WTD 56-9*; Venuti, Connery, Poms, and Manasuev, ''Eligibility for Treaty Benefits Under the Luxembourg-U.S. Income Tax Treaty,'' *Tax Notes Int'l*, July 21, 2008, p. 285, *Doc 2008-14359*, or *2008 WTD 142-8*; Venuti, Dabrowski, Poms, and Manasuev, ''Eligibility for Treaty Benefits Under the France-U.S.

(Footnote continued on next page.)

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provisions of specific U.S. income tax treaties and, when applicable, in determining eligibility for a 0 percent withholding tax rate on cross-border intercompany dividend payments to the company.

This article contains eight flowcharts. The first seven flowcharts analyze the LOB provision of the treaty as applied to Australian companies. The eighth flowchart analyzes the requirements that an Australian company must satisfy to qualify for a 0 percent withholding tax rate on cross-border intercompany dividend payments under article 10(3) of the treaty. Although the flowcharts provide a comprehensive review of applicable provisions under the treaty, taxpayers and their tax advisers should carefully evaluate each case and determine whether the requirements of the treaty are met based on all facts and circumstances. ◆

Income Tax Treaty,'' *Tax Notes Int'l*, Feb. 11, 2008, p. 523, *Doc 2008-773*, or *2008 WTD 33-10*; and Venuti and Manasuev, ''Eligibility for Zero Withholding on Dividends in the New Germany-U.S. Protocol,'' *Tax Notes Int'l*, Jan. 14, 2008, p. 181, *Doc 2007-27516*, or *2008 WTD 12-10*.

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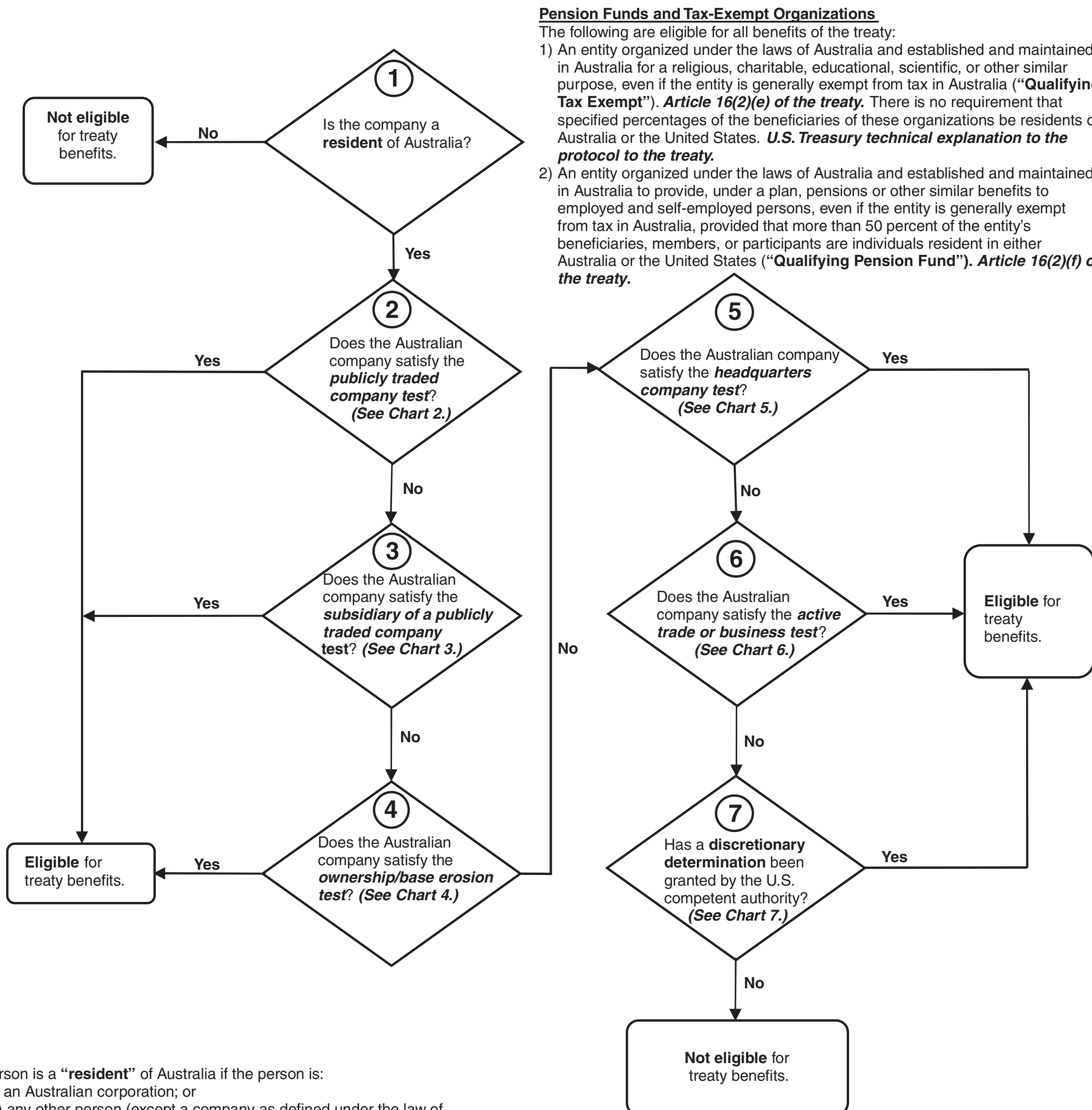
Chart 1. Eligibility for Treaty Benefits Under Article 16 (LOB) of the Australia-U.S. Tax Treaty



A person is a **"resident"** of Australia if the person is:

(i) an Australian corporation; or

(ii) any other person (except a company as defined under the law of Australia relating to Australian tax) who, under that law, is a resident of Australia,

provided that, in relation to any income, a person who is:

(iii) subject to Australian tax on income which is from sources in Australia; or

(iv) a partnership, an estate of a deceased individual, or a trust (other than a trust that is a provident, benefit, superannuation, or retirement fund, or that is established for public charitable purposes or for the purpose of enabling scientific research to be conducted by or in conjunction with a public university or public hospital, the income of which is exempt from tax under the law of Australia relating to Australian tax),

is not treated as a resident of Australia except to the extent that the income is subject to Australian tax as the income of a resident, either in the hands of that person or in the hands of a partner or beneficiary, or, if that income is exempt from Australian tax, is so exempt solely because it is subject to U.S. tax. ***Article 4(1)(a) of the treaty***.

A person is a **"resident"** of the United States if the person is:

(i) a U.S. corporation;

(ii) a U.S. citizen, other than a U.S. citizen who is a resident of a state other than Australia for the purposes of a double tax agreement between that state and Australia; or

(iii) any other person (except a corporation or unincorporated entity treated as a corporation for U.S. tax purposes) resident in the U.S. for purposes of its tax, provided that, in relation to any income derived by a partnership, an estate of a deceased individual, or a trust, such person is not treated as a resident of the United States except to the extent that the income is subject to U.S. tax as the income of a resident, either in its hands or in the hands of a partner or beneficiary, or, if that income is exempt from U.S. tax, is exempt other than because such person, partner, or beneficiary is not a U.S. person according to U.S. law related to U.S. tax.

Article 4(1)(b) of the treaty.

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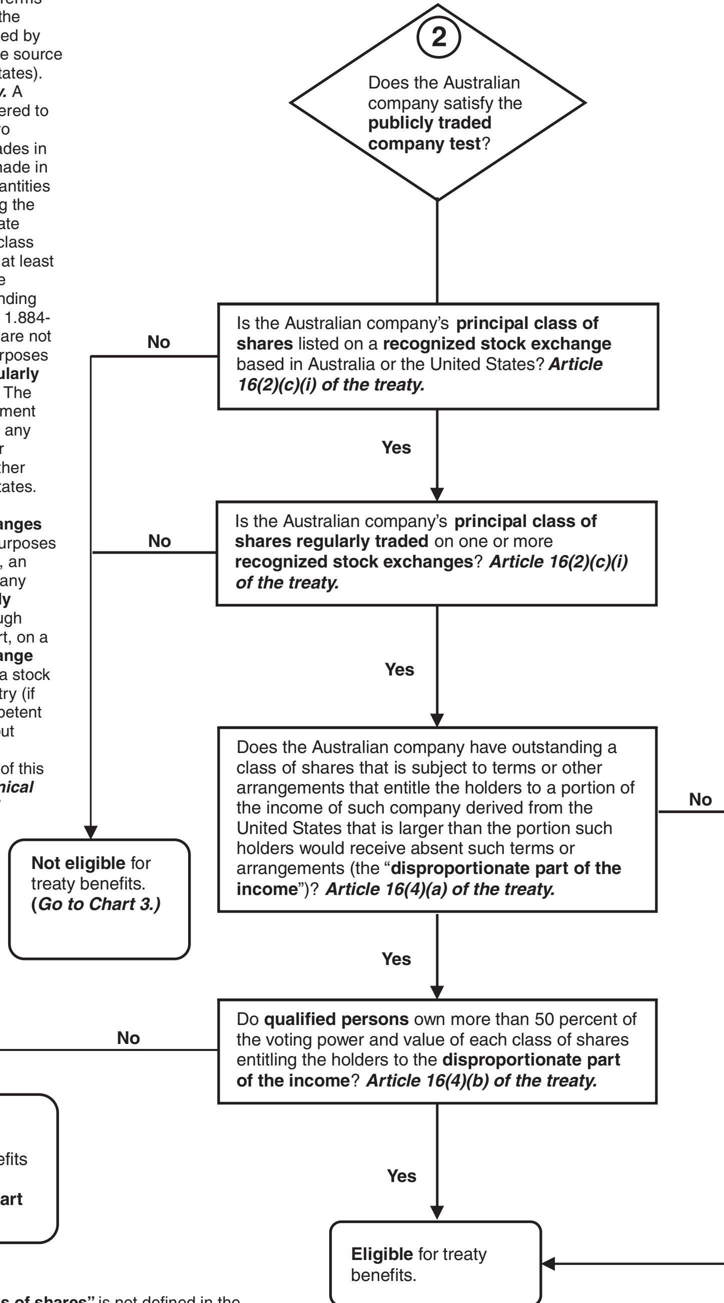
Chart 2. Publicly Traded Company Test Under Article 16(2)(c)(I) (LOB) of the Australia-U.S. Tax Treaty

The term "**regularly traded**" is not defined in the treaty. Terms not otherwise defined in the treaty generally are defined by reference to the law of the source state (here, the United States). ***Article 3(2) of the treaty.*** A class of shares is considered to be **regularly traded** if two requirements are met: trades in the class of shares are made in more than de minimis quantities on at least 60 days during the tax year, and the aggregate number of shares in the class traded during the year is at least 10 percent of the average number of shares outstanding during the year. Sections 1.884-5(d)(4)(i)(A), (ii), and (iii) are not taken into account for purposes of defining the term "**regularly traded**" under the treaty. The **regularly traded** requirement can be met by trading on any **recognized exchange** or **exchanges** located in either Australia or the United States. Trading on one or more **recognized stock exchanges** may be aggregated for purposes of this requirement. Thus, an Australian resident company could satisfy the **regularly traded** requirement through trading, in whole or in part, on a **recognized stock exchange** located in the U.S. or on a stock exchange in a third country (if agreed upon by the competent authorities). Authorized but unissued shares are not considered for purposes of this test. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***



The term "**principal class of shares**" is not defined in the treaty. Generally, the "**principal class of shares**" means the common shares of the company representing the majority of the aggregate voting power and value of the company. If the company does not have a class of ordinary or common shares representing the majority of the aggregate voting power and value of the company, then the **principal class of shares** is that class or any combination of classes of shares that represents, in the aggregate, a majority of the voting power and value of the company. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

"Recognized stock exchange" means:

(i) the NASDAQ system owned by the National Association of Securities Dealers, Inc., and any stock exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934;
(ii) the Australian Stock Exchange and any other Australian stock exchange recognized as such under Australian law; and
(iii) any other stock exchange agreed upon by the competent authorities.

Article 16(6) of the treaty.

A resident of Australia or the United States is a **qualified person** for a tax year if the resident:

(i) is an individual;
(ii) is Australia or the United States, any political subdivision or local authority thereof or any agency or instrumentality of Australia or the United States;
(iii) satisfies the **publicly traded company test**;
(iv) satisfies the **subsidiary of a publicly traded company test** ***(see Chart 3)***;
(v) is a person (other than an individual or a company) the principal class of units of which is listed or admitted to dealings on a **recognized stock exchange** based in Australia or the United States and is **regularly traded** on one or more of the **recognized stock exchanges** ***(see article 16(2)(d)(i) of the treaty)***;
(vi) is a person (other than an individual or company) in which the direct or indirect owners of at least 50 percent of the beneficial interests in such person are **qualified persons** by reason of (iii) or (v), above ***(see article 16(2)(d)(ii))***;
(vii) is a **Qualifying Tax Exempt** ***(see Chart 1 for definition)***;
(viii) is a **Qualifying Pension Fund** ***(see Chart 1 for definition)***;
(ix) satisfies the **ownership/base erosion test** ***(see Chart 4)***; or
(x) satisfies the **headquarters company test** ***(see Chart 5)***.

Article 16(2) of the treaty.

The **disproportionate part of the income** of an Australian resident company is the excess portion of such company's income from the United States to which the holders are entitled, above what they otherwise would be entitled to receive. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

An Australian resident, other than an individual or a company (e.g., a trust), is a **qualified person** if the principal class of units in that resident is listed or admitted to dealings on a **recognized stock exchange** based in Australia or the United States and is **regularly traded** on one or more of the **recognized stock exchanges**. ***Article 16(2)(d)(i) of the treaty.***

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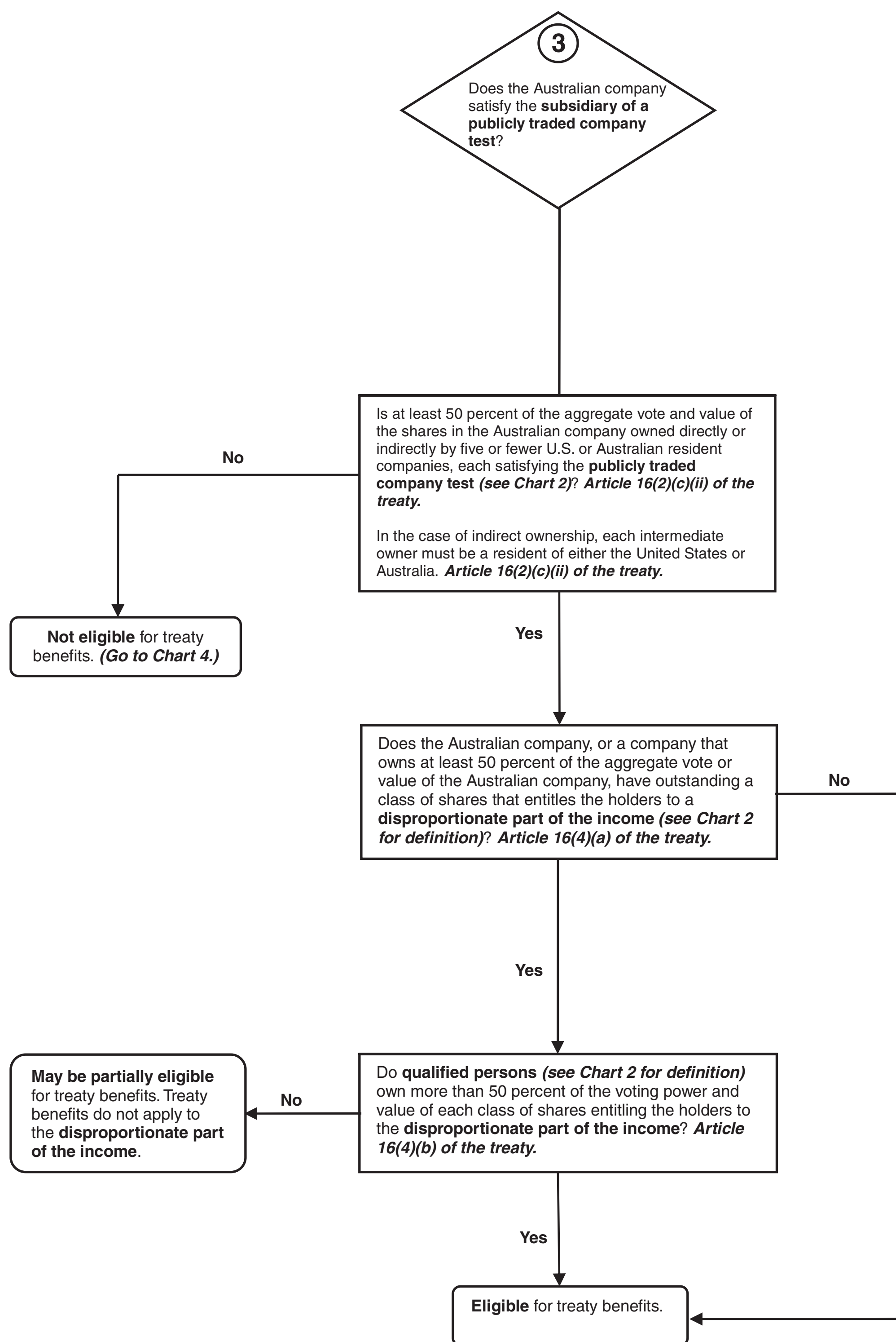
Chart 3. Subsidiary of a Publicly Traded Company Test Under Article 16(2)(c)(ii) (LOB) of the Australia-U.S. Tax Treaty



To determine whether the 50 percent ownership test is met, one must take into account the aggregate vote and value of each class of shares issued by the Australian company. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

An Australian resident entity, other than an individual or company (e.g., a trust), is a **qualified person** ***(see Chart 2 for definition)*** if the direct or indirect owners of at least 50 percent of the beneficial interests in such entity are entities that satisfy the **publicly traded company test** ***(see Chart 2)***, provided the other requirements described on this chart are satisfied. ***Article 16(2)(d)(ii) of the treaty.***

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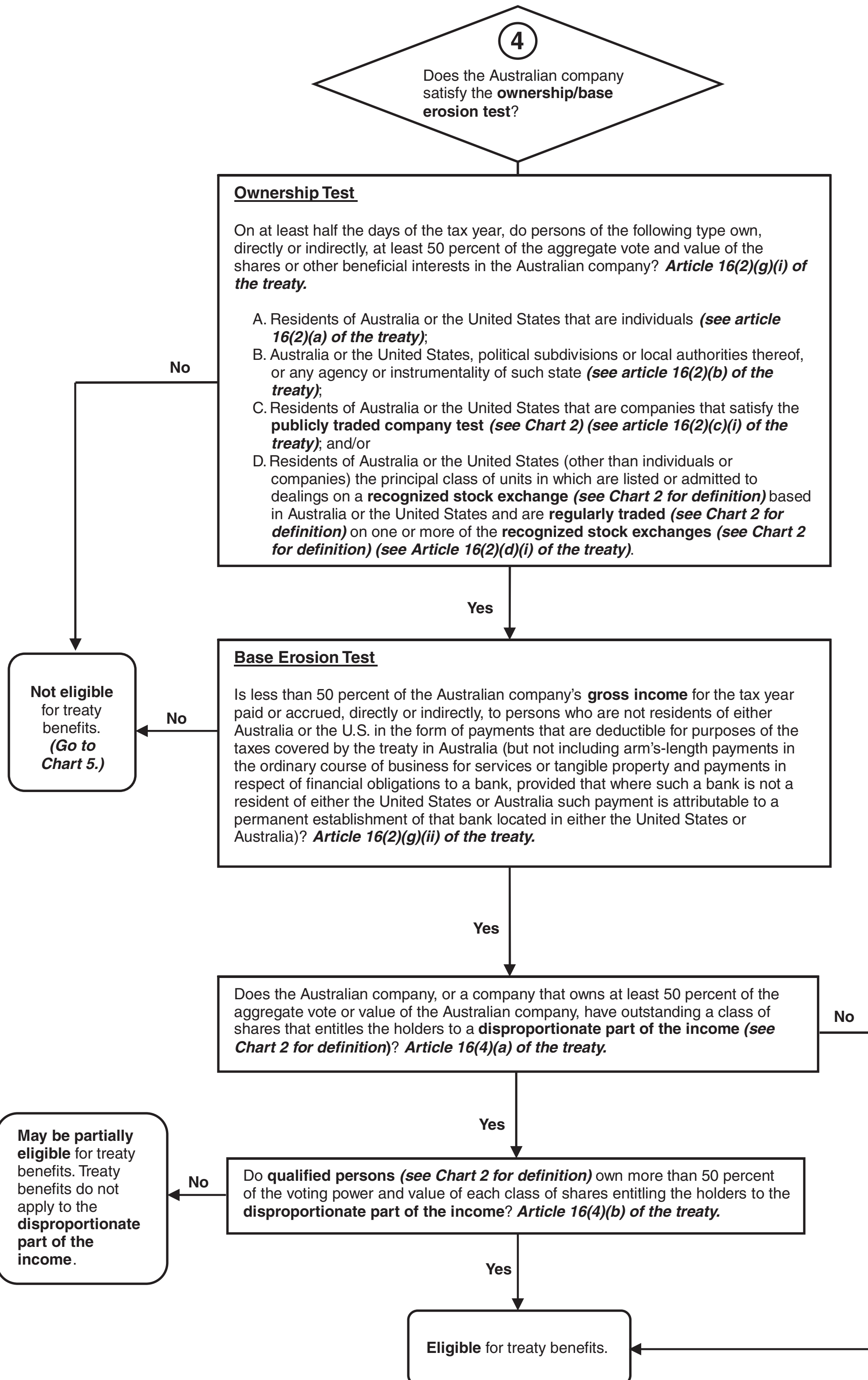
Chart 4. Ownership/Base Erosion Test Under Article 16(2)(g) (LOB) of the Australia-U.S. Tax Treaty



For purposes of D. of the **ownership test**, the beneficial interests in a trust will be considered to be owned by its beneficiaries in proportion to each beneficiary's actuarial interest in the trust. The interest of a remainder beneficiary will be equal to 100 percent less the aggregate percentages held by income beneficiaries. A beneficiary's interest in a trust will not be considered to be owned by a person entitled to benefits under the other provisions of paragraph 2 of the LOB provision if it is not possible to determine the beneficiary's actuarial interest. Consequently, if it is not possible to determine the actuarial interest of any beneficiaries in a trust, the **ownership test** cannot be satisfied, unless all possible beneficiaries are **qualified persons** ***(see Chart 2 for definition). U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

The term "**gross income**" is not defined in the treaty. In the case of the United States, the term "**gross income**" has the same meaning as such term in section 61 of the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

To the extent they are deductible from the taxable base, trust distributions are deductible payments. However, depreciation and amortization deductions, which do not represent payments or accruals to other persons, are disregarded for this purpose. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

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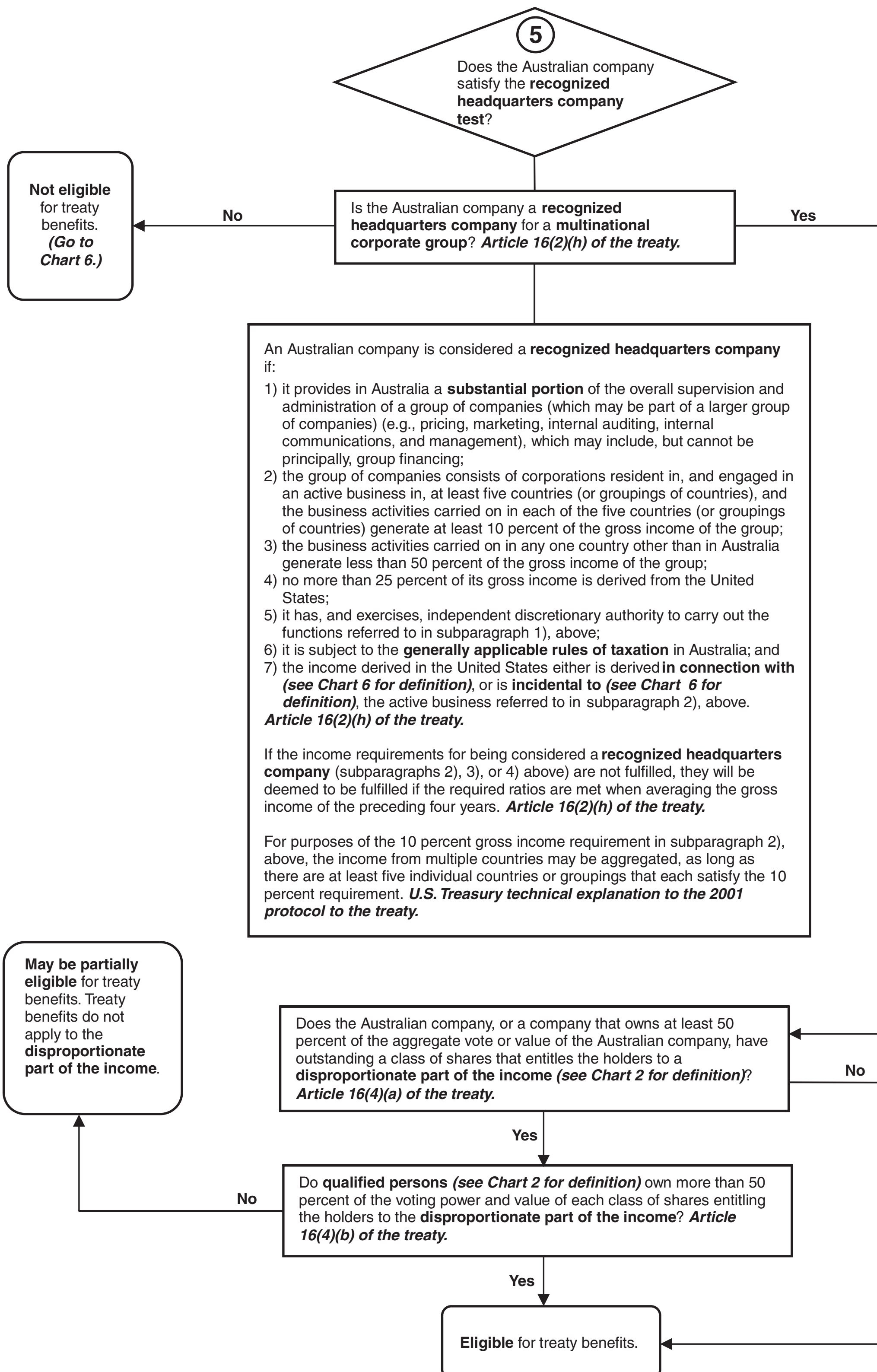
Chart 5. Headquarters Company Test Under Article 16(2)(h) (LOB) of the Australia-U.S. Tax Treaty



A **multinational corporate group** includes all corporations that the **headquarters company** supervises and excludes affiliated corporations not supervised by the **headquarters company**. The **headquarters company** does not have to own shares in the companies that it supervises. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

In determining whether a **"substantial portion"** of the overall supervision and the administration of the group is provided by the **headquarters company**, its headquarters-related activities must be substantial in relation to the same activities for the same group performed by the other entities. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

The reference to **"generally applicable rules of taxation"** should be understood to mean that the Australian company must be subject to the income taxation rules to which a company engaged in the active conduct of a trade or business would be subject. Thus, if Australia introduced special taxation legislation that would impose a lower rate of income tax on **headquarters companies** than was imposed on companies engaged in the active conduct of a trade or business, or would provide for an artificially low taxable base for such companies, a **headquarters company** subject to these rules would not be entitled to the benefits of the treaty under the **recognized headquarters company test**. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

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Chart 6. Active Trade or Business Test Under Article 16(3) (LOB) of the Australia-U.S. Tax Treaty

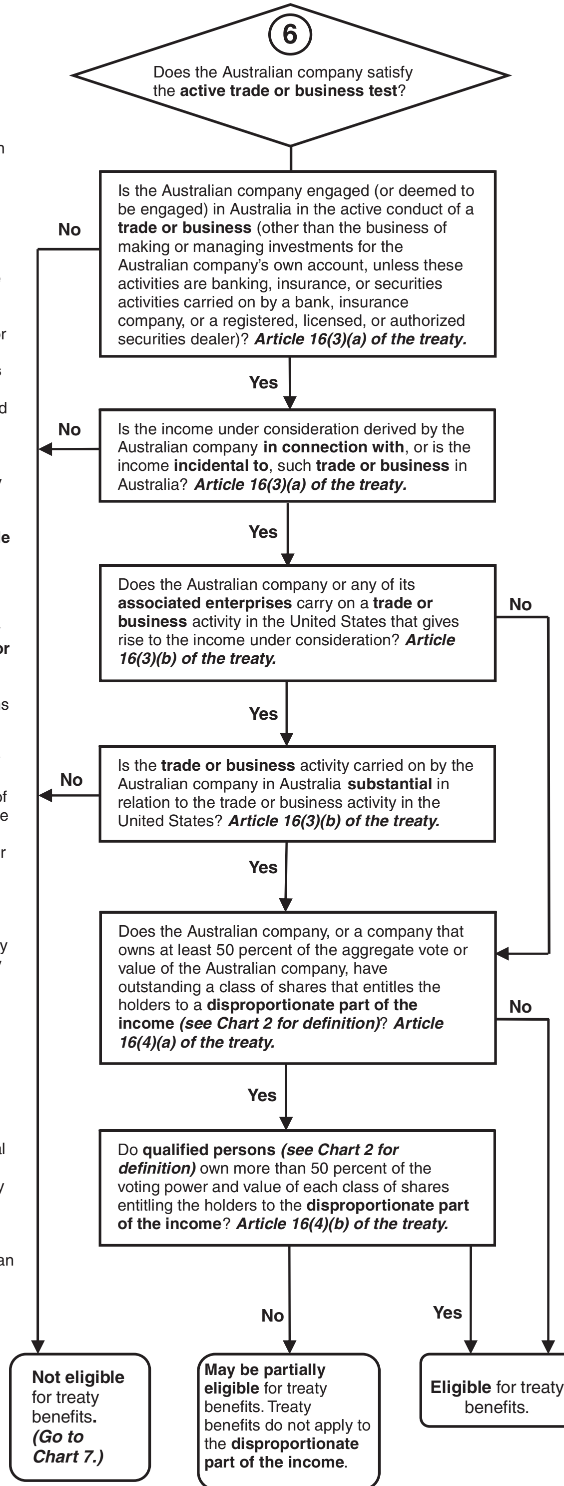
(Only applies if an item of income is derived in connection with or incidental to an active trade or business in Australia)

The term **"trade or business"** is not defined in the treaty. The U.S. Treasury technical explanation to the 2001 protocol to the treaty explains that the **U.S. competent authority** ***(see Chart 7 for definition)*** will refer to the regulations issued under section 367(a) for the definition of the term "**trade or business**." In general, therefore, a **trade or business** will be considered to be a specific unified group of activities that constitute or could constitute an independent economic enterprise carried on for profit. Furthermore, a corporation generally will be considered to carry on a **trade or business** only if the officers and employees of the corporation conduct substantial managerial and operational activities.

Because a headquarters operation is in the business of managing investments, a company that functions solely as a **headquarters company** ***(see Chart 5 for definition)*** will not be considered to be engaged in an **active trade or business** for purposes of article 16(3)(a). ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

In determining whether an Australian company is "engaged in the **active conduct of a trade or business**" in Australia, activities conducted by a partnership in which the Australian company is a partner and activities conducted by persons **"connected to"** the Australian company are deemed to be conducted by such Australian company. A person is **"connected to"** another (1) if one possesses at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or (2) if another person possesses, directly or indirectly, at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in each person. In any case, a person is considered **connected to** another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons. ***Article 16(3)(c) of the treaty.***

An Australian company is **associated** with an **enterprise** of the United States if: (1) the Australian company participates directly or indirectly in the management, control, or capital of an enterprise of the United States; (2) the U.S. enterprise participates directly or indirectly in the management, control, or capital of the Australian company; or (3) any third person(s) participates directly or indirectly in the management, control, or capital of the Australian company and the U.S. enterprise. ***Article 9(1)(a) and (b) of the treaty.***



Income is derived **in connection with** a trade or business if the income-producing activity in the state of source (here, the United States) is a line of business that forms a part of or is complementary to the trade or business conducted in the state of residence (here, Australia) by the income recipient. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

A business activity generally will be considered to "form a part of" a business activity conducted in the other state (here, the United States) if the two activities involve the design, manufacture, or sale of the same products or type of products, or the provision of similar services. The line of business in the state of residence (here, Australia) may be upstream, downstream, or parallel to the activity conducted in the state of source (here, the United States). Thus, the line of business may provide inputs for a manufacturing process that occurs in the state of source (here, the United States), may sell the output of that manufacturing process, or simply may sell the same sorts of products that are being sold by the trade or business carried on in the source state. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

For two activities to be considered to be "complementary," the activities need not relate to the same types of products or services, but they should be part of the same overall industry and be related in the sense that the success or failure of one activity will tend to result in the success or failure for the other. In cases in which more than one **trade or business** is conducted in the other state (here, the United States) and only one of the trades or businesses forms a part of or is complementary to a **trade or business** conducted in the state of residence (here, Australia), it is necessary to identify the **trade or business** to which an item of income is attributable. Royalties generally will be considered to be derived in connection with the **trade or business** to which the underlying intangible property is attributable. Dividends will be deemed to be derived first out of earnings and profits of the treaty-benefited **trade or business**, and then out of other earnings and profits. Interest income may be allocated under any reasonable method consistently applied. A method that conforms to U.S. principles for expense allocation will be considered a reasonable method. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

Income derived from the United States will be **"incidental to"** the **trade or business** conducted in Australia if production of such income facilitates the conduct of the **trade or business** in Australia. An example of incidental income is the temporary investment of working capital by an Australian company in securities issued by persons in the United States. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

Whether the Australian company's **trade or business** activity in Australia is **substantial** in relation to the **trade or business** activity in the United States will be determined based on all the facts and circumstances. ***Article 16(3)(b) of the treaty.*** Factors to be taken into account include: (1) the comparative sizes of the trades or businesses in both the United States and Australia (measured by reference to asset values, income, and payroll expenses); (2) the nature of the activities performed in the United States and Australia; and (3) the relative contributions made to that trade or business in the United States and Australia. In making each determination or comparison, due regard will be given to the relative sizes of the U.S. and Australian economies. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

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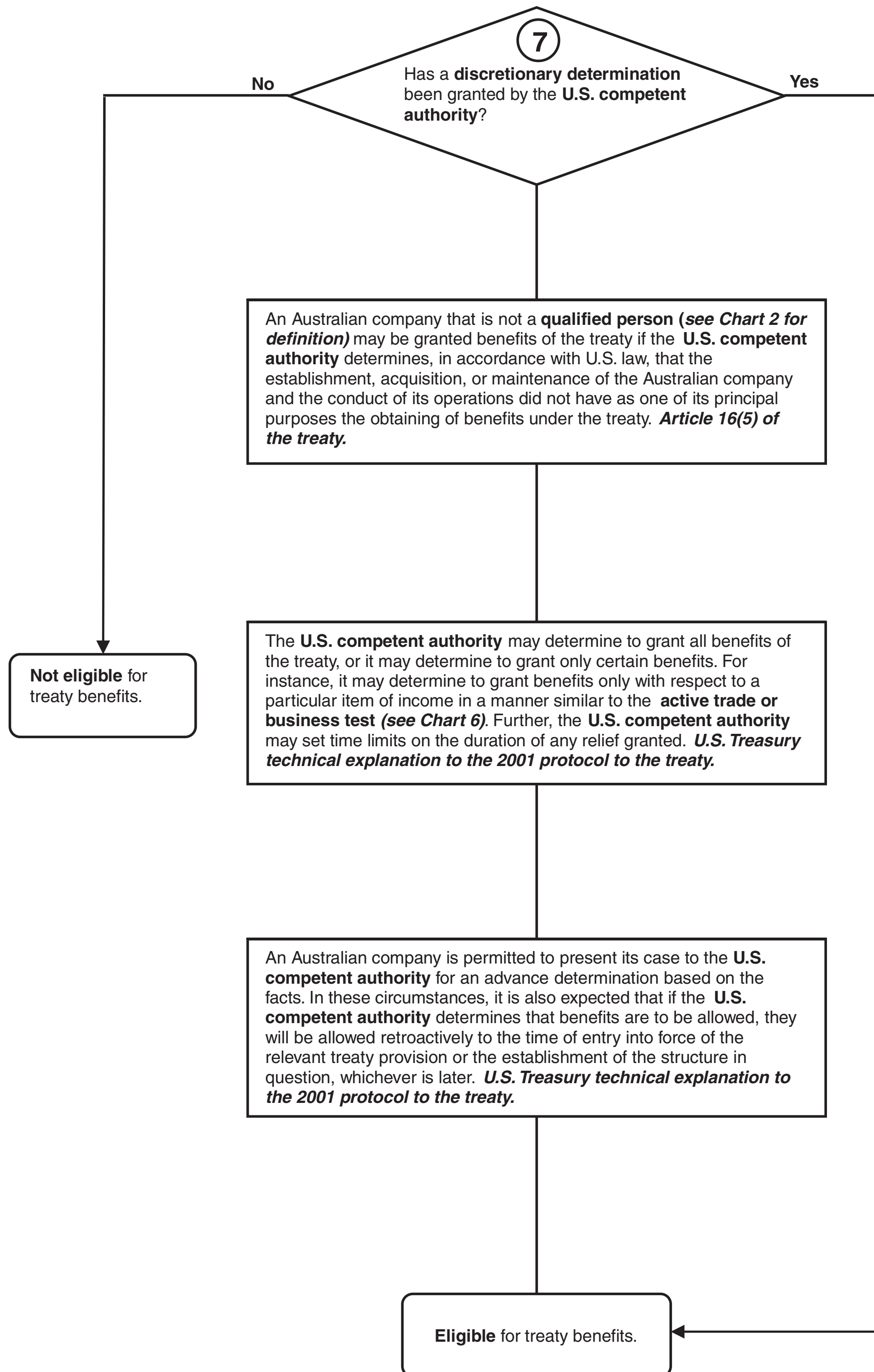
Chart 7. Discretionary Determination by U.S. Competent Authority Under Article 16(5) (LOB) of the Australia-U.S. Tax Treaty



The **"U.S. competent authority"** is the secretary of the Treasury or a delegate. ***Article 3(e)(i) of the treaty.***

Requesting competent authority assistance — A taxpayer may request the assistance of the **U.S. competent authority** under Rev. Proc. 2006-54. The **U.S. competent authority** may determine in its own discretion that the taxpayer qualifies for certain benefits under the LOB article of the treaty.

There is a US $15,000 user fee for requesting a **discretionary determination** under the LOB provision. If a request is submitted for more than one entity, a separate user fee is charged for each entity. ***Section 14.02 of Rev. Proc. 2006-54.***

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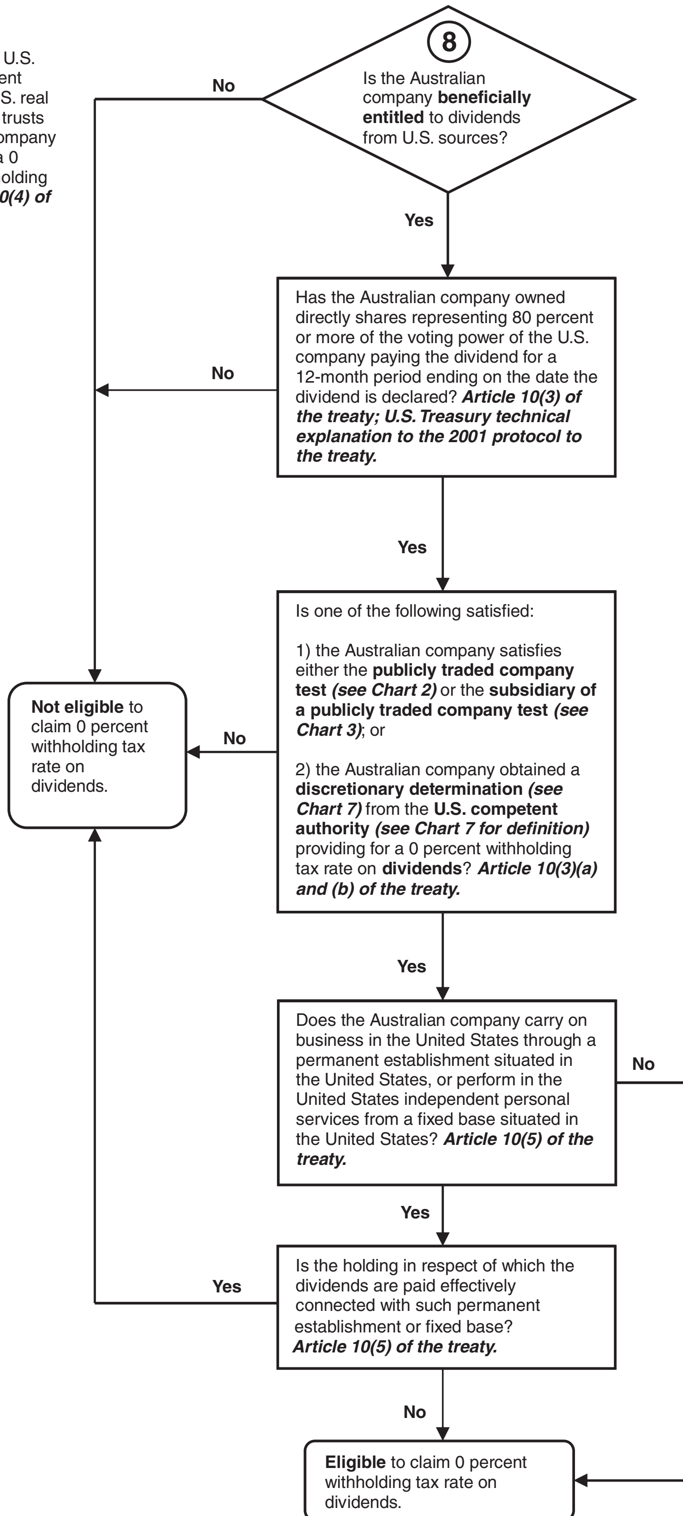
Chart 8. Eligibility for 0 Percent Withholding Tax Rate on Dividends Under Article 10(3) of the Australia-U.S. Tax Treaty



The term **"beneficially entitled"** is not defined in the treaty. A person **"beneficially entitled"** to a dividend is the "beneficial owner" of the dividend. Thus, the resident **beneficially entitled** to a dividend is the person to which the dividend income is attributable for tax purposes under the laws of the source state (here, the United States). Accordingly, if a dividend paid by a U.S. company is received by a nominee or agent that is a resident of Australia on behalf of a person that is not a resident of Australia, the dividend is not entitled to the zero rate of withholding on dividends. However, a dividend received by a nominee on behalf of a resident of Australia would be entitled to benefits if all other requirements are satisfied. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

"Dividends" means income from shares as well as other amounts which are subjected to the same taxation treatment as income from shares by the law of the state of which the company making the distribution is a resident for the purposes of its tax (here, the United States). ***Article 10(6) of the treaty.***

The term **"dividends"** is defined broadly and flexibly. The definition is intended to cover all arrangements that yield a return on an equity investment in a corporation as determined under the tax law of the state of source (here, the United States), as well as arrangements that might be developed in the future. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

The term **"dividends"** includes income from shares, or other corporate rights that are not treated as debt under the law of the source state (here, the United States), that participate in the profits of the company. The term also includes income that is subjected to the same tax treatment as income from shares by the law of the source state (here, the United States). Thus, under U.S. tax principles, a constructive dividend that results from a non-arm's-length transaction between a corporation and a related party is a dividend. Similarly, a payment denominated as interest that is made by a thinly capitalized corporation may be treated as a dividend to the extent that the debt is recharacterized as equity for U.S. tax purposes. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

In the case of the United States, the term **"dividends"** includes amounts treated as a dividend under U.S. law upon the sale or redemption of shares or upon a transfer of shares in a reorganization. *See, e.g.,* Rev. Rul. 92-85, 1992-2 C.B. 69 (sale of foreign subsidiary's stock to U.S. sister company is a deemed dividend to extent of subsidiary's and sister's earnings and profits). Further, a distribution from a U.S. publicly traded partnership, which is taxed as a corporation under U.S. law, is a dividend for purposes of article 10 (dividends). However, a distribution by a limited liability company is not characterized by the United States as a dividend and, therefore, is not a dividend for purposes of article 10, provided the limited liability company is not taxable as a corporation under U.S. law. ***U.S. Treasury technical explanation to the 2001 protocol to the treaty.***

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