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EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

This Explanatory Memorandum uses the following abbreviations and acronyms.

Abbreviation	Definition
Agreements Act	<i>International Tax Agreements Act 1953</i>
Assessment Acts	The ITAA 1936 and ITAA 1997
BEPS	Base Erosion and Profit Shifting
Convention	<i>Convention between Australia and Iceland for the Elimination of Double Taxation with respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance</i>
FBT Act	<i>Fringe Benefits Tax Assessment Act 1986</i>
G20	<i>Group of 20</i>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
OECD	Organisation for Economic Cooperation and Development
OECD Model	OECD Model Tax Convention on Income and on Capital
OECD Model Commentary	OECD Model Convention Commentaries (contained in the OECD Model Tax Convention on Income and Capital Full Version (as it read on 21 November 2017))

Chapter 1:

The Australia-Iceland Convention

Outline of chapter

- 1.1 Schedule 1 amends the Agreements Act to give force of law to the Convention.

Context of amendments

- 1.2 The Convention was signed in Reykjavik, Iceland, on 12 October 2022. It improves bilateral tax arrangements between Australia and Iceland by alleviating double taxation of income. It also enables greater administrative cooperation in tax matters, including through information exchange, to help reduce tax evasion and avoidance.
- 1.3 Countries commonly seek to eliminate double taxation and, particularly since the Final Reports of the OECD/G20 Base Erosion and Profit Shifting Project in 2015, mitigate tax evasion and avoidance through tax treaties. In 2022, Australia had bilateral tax treaties in place with 45 jurisdictions.
- 1.4 The Convention broadly follows the OECD Model. OECD members and many other countries use the OECD Model as the basis of bilateral conventions to eliminate double taxation. This helps to ensure a uniform approach to resolving the most common problems that arise in international taxation.

Double taxation

- 1.5 A key objective of the Convention is to alleviate the double taxation that results from the interaction of the Australian and Icelandic tax systems. The OECD defines double taxation as the imposition of comparable taxes in two (or more) countries on the same taxpayer in respect of the same taxable income or capital.
- 1.6 Australia and Iceland, like most countries, tax income on both a ‘source’ and ‘residence’ basis. For example, Australia usually taxes Australian residents on income from both domestic and foreign sources, and taxes non-residents on income from Australian sources.
- 1.7 Double taxation can occur when there is an overlap of source and/or residence taxing rights, such as when a person who is resident in one country derives income from another.

1.8 Under the Convention, Australia and Iceland agree to restrict their respective taxing rights to alleviate double taxation. The Convention allocates taxing rights between Australia and Iceland over different categories of income including business profits, dividends, interest, royalties, and pensions. The Convention also provides for relief from double taxation where both countries have a right to tax the same income, and for the resolution of disputes where the two countries attempt to tax the same income.

Tax evasion and avoidance

1.9 Another key objective of the Convention is to prevent tax evasion and avoidance. This is made clear in the title and the preamble of the Convention which clarify that Australia and Iceland do not intend the provisions of the Convention to create opportunities for tax evasion and avoidance.

1.10 As members of the Inclusive Framework on BEPS, Australia and Iceland are committed to the implementation of the OECD/G20 BEPS Project. That project provides governments with solutions, designed to be implemented domestically and through treaty provisions, for closing the gaps in existing international tax rules that allow corporate profits to disappear or be artificially shifted to low/no tax environments. These solutions are outlined in the Base Erosion and Profit Shifting 2015 Final Reports.

1.11 The Convention adopts a range of the integrity and tax certainty provisions recommended by the BEPS Project. These are outlined in the table below.

<i>Australia-Iceland Convention provisions</i>	<i>BEPS Project 2015 Final Reports</i>
Title	Action 6
Preamble	Action 6
Article 1 (Persons covered), paragraph 2	Actions 2 and 6
Article 1 (Persons covered), paragraph 3	Action 6
Article 4 (Residency), paragraph 3	Action 2
Article 5 (Permanent establishment), paragraphs 5, 6, 7, 9, 11 and subparagraph 8(a)	Action 7
Article 7 (Business profits), paragraph 8	Action 14
Article 9 (Associated enterprises), paragraphs 2 and 3	Action 14
Article 10 (Dividends), paragraph 3 and subparagraph 2(a)	Action 6
Article 13 (Alienation of property), paragraph 4	Action 6
Article 23 (Mutual agreement procedures), paragraphs 1, 2,3, 5 and 6	Action 14

Article 27 (Entitlement to Benefits), paragraphs, 1 and 2

Action 6

Summary of new law

- 1.12 Schedule 1 amends the Agreements Act to give the Convention force of law in Australia.
- 1.13 Key features of the Convention include:
- reduced withholding tax rates to create a more favourable bilateral investment environment and also make it cheaper for Australian business to access foreign capital and technology;
 - rules to reduce potential double taxation, which can deter investment; and
 - providing greater tax certainty to taxpayers in both jurisdictions.
- 1.14 Importantly, the Convention also includes OECD/G20 BEPS treaty-related recommendations, in line with Australia’s ongoing commitment to tackling international tax avoidance practices.

Detailed explanation of new law

- 1.15 These amendments list the Icelandic Convention as a current agreement that is given the force of law by the Agreements Act. [*Schedule 1, item 2, subsection 5(1) of the Agreements Act*]
- 1.16 The effect of this listing is that the provisions of the Convention are prioritised over the provisions of the Assessment Acts (other than Part IVA of the ITAA 1936), the FBT Act, and any imposition Acts to the extent of any inconsistency (see sections 4 and 4AA of the Agreements Act).
- 1.17 The amendments define the Icelandic Convention as the Convention, and its protocol, entered into between Australia and Iceland on 12 October 2022 in Reykjavik. [*Schedule 1, item 1, subsection 3AAA(1) of the Agreements Act*]
- 1.18 The Convention is based on the OECD Model. Consistent with the way that Australia negotiates its tax treaties, the OECD Model Commentary is directly relevant to the interpretation of the equivalent provisions of the Convention.¹

¹ The OECD Model and the OECD Model Commentary can be accessed online at: <https://www.oecd.org/tax/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm>; and

- 1.19 The following section provides an overview of the provisions of the Convention. As the OECD Model Commentary explains the provisions of the Convention that are identical to the equivalent provision in the OECD Model, the overview focusses on the departures from the OECD Model that were agreed to by Australia and Iceland.
- 1.20 Where particular provisions of the Convention are not explained in the following section, it is because those provisions are aligned with the equivalent provision in the OECD Model and their operation is explained by the OECD Model Commentary.

The Australia-Iceland Convention

Title and preamble

- 1.21 The title and the preamble are a general statement of the object and purpose of the Convention. The title and preamble provide that the Convention is for: the elimination of double taxation concerning taxes on income; and, the prevention of tax evasion and avoidance, including through the provisions of the treaty.
- 1.22 As the title and preamble form part of the context of the Convention, they serve an important role in interpreting the provisions of the Convention. This is consistent with the general rule of treaty interpretation in Article 31(1) of the Vienna Convention on the Law of Treaties, which provides that a ‘treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.’

Article 1 – Persons covered

- 1.23 Article 1 establishes that the Convention applies to all ‘persons’ who are residents of one or both of Australia and Iceland. ‘Person’ is defined in Article 3 (see below). [**Article 1, paragraph 1**]
- 1.24 Article 1 helps to ensure that the benefits of the Convention for income derived by or through entities that are wholly or partly fiscally transparent (for example, certain partnerships and trusts) are granted in appropriate cases, but only to the extent that the income is treated as the income of a resident of Australia or Iceland under their respective domestic laws. [**Article 1, paragraph 2**]
- 1.25 In the case of Australia, entities that are treated as wholly or partly fiscally transparent for Australian tax purposes include partnerships and trusts. Such

entities include partnerships that are subject to Division 5 of Part III of the ITAA 1936 (but not corporate limited partnerships that are subject to Division 5A of Part III). They also include trusts that are subject to Division 6 of Part III of the ITAA 1936 where the beneficiary of the trust is presently entitled or specifically entitled to the income and/or gains of the trust, as well as trusts that are subject to Division 276 of the ITAA 1997 (but not a public trading trust subject to Division 6C of Part III).

- 1.26 The reference to ‘income’ in this Article has a wide meaning and is to be read as including ‘profits and gains’. [*Protocol, paragraph 2*]
- 1.27 Using the term ‘income’ in this way is intended to put beyond doubt that the various forms of income that may be taxable in Australia are within scope of this Article.
- 1.28 Paragraph 3 confirms the general principle that the Convention does not restrict in any way Australia or Iceland’s right to tax their own residents, except where this is intended. [*Article 1, paragraph 3*]
- 1.29 The paragraph lists the Articles of the Convention that affect the taxation of a resident of Iceland or Australia. To the extent that there are any differences between the Articles listed in this paragraph and the corresponding paragraph in the OECD Model it is because the Article in the Convention does not affect the taxation of a resident. There are also additional Articles listed in the Convention compared to the OECD Model as there are additional paragraphs affecting taxation of residents in the Convention, compared to the OECD Model (for example, paragraph 4 of Article 17 (Pensions) and paragraph 6 of Article 13 (Alienation of property) are departures from the OECD Model).

Article 2 – Taxes covered

- 1.30 Article 2 specifies that taxes on income are covered by the Convention. Article 2 also specifies the existing taxes to which the Convention particularly applies to. [*Article 2*]
- 1.31 In Australia, these taxes are the income tax, resource rent taxes and the fringe benefits tax. [*Article 2, subparagraph 3(a)*]
- 1.32 In Iceland, these taxes are the income taxes to the state and the income tax to the municipalities. [*Article 2, subparagraph 3(b)*]
- 1.33 The Convention also applies to any identical or substantially similar taxes that Australia or Iceland may implement domestically in the future. The competent authorities of Australia and Iceland (the Australian and Icelandic tax authorities) are required to notify each other of any significant changes to their taxation laws. [*Article 2, paragraph 4*]
- 1.34 Article 2 departs slightly from the OECD Model to reflect that in Australia taxes on income are collected at the federal level and not by political

subdivisions or local authorities. In Iceland, taxes on income may be collected by political subdivisions or local authorities. **[Article 2, paragraph 1]**

Article 3 – General definitions

- 1.35 Article 3 provides definitions of and rules of interpretation for basic terms and key concepts that are used throughout the Convention that apply for all purposes. Certain other terms are defined in other articles of the Convention, such as ‘resident of a Contracting State’ (Article 4) and ‘Permanent Establishment’ (Article 5).
- 1.36 The definition of ‘Australia’ in the Convention follows the model set out in Australia’s other modern tax treaties. The definition excludes all external territories but adds back certain external territories by further exception. The definition includes areas adjacent to Australia (and the relevant Territories) which are subject to a domestic law dealing with the exploration for and exploitation of natural resources of the exclusive economic zone, or the seabed and subsoil of the continental shelf. **[Article 3, subparagraph 1(a)]**
- 1.37 The term ‘Iceland’ means Iceland, inclusive of its territorial sea and any area beyond the territorial seas within which Iceland exercises jurisdiction or sovereign rights with respect to the sea bed, its subsoil and its superjacent waters, and their natural resources. **[Article 3, subparagraph 1(b)]**
- 1.38 The term ‘enterprise’ applies to the carrying on of any business. **[Article 3, subparagraph 1(f)]**
- 1.39 The term ‘business’ includes the performance of professional services and of other activities of an independent character. **[Article 3, subparagraph 1(c)]**
- 1.40 Consistent with the OECD Model, these definitions read together clarify that, under the Convention, business activities are considered to constitute an enterprise, regardless of the meaning of that term under domestic law.
- 1.41 The terms ‘enterprise of a Contracting State’ and ‘enterprise of the other Contracting State’ mean an enterprise carried on by a resident of Australia and Iceland and are used interchangeably to refer to Australia and Iceland, as the context requires. **[Article 3, subparagraph 1(g)]**
- 1.42 The definition of ‘company’ in the Convention means any body corporate or any entity which is treated as a company or a body corporate for tax purposes. **[Article 3, subparagraph 1(d)]**
- 1.43 This definition is broadly consistent with the definition in the OECD Model, which refers to any entity that is treated as a body corporate for tax purposes. The definition is adapted to reflect that Australia’s income tax laws do not use the expression ‘body corporate’.

- 1.44 The term ‘competent authority’ means the Commissioner of Taxation for Australia and the Minister of Finance for Iceland, or their authorised representatives. **[Article 3, subparagraph 1(e)]**
- 1.45 The term ‘international traffic’ means any transport by a ship or aircraft, except when that transport is solely between places in a Contracting State, and the enterprise that operates the ship or aircraft is not an enterprise of that State. **[Article 3, subparagraph 1(h)]**
- 1.46 This definition is used to preserve the right of a Contracting State to tax transportation that occurs domestically, even when it is carried out by an enterprise of the other State. The definition follows the alternative formulation to the standard OECD Model that is provided for in paragraph 6.3 of the 2017 OECD Model Commentary on the definition.
- 1.47 The term ‘national’ means any individual possessing the nationality or citizenship of a Contracting State, and any legal person, company, partnership or association deriving its status as a national in accordance with a Contracting State’s domestic laws. **[Article 3, subparagraph 1(i)]**
- 1.48 The terms ‘person’ includes an individual, a company and any other body of persons. **[Article 3, subparagraph 1(j)]**
- 1.49 The term ‘tax’ means Australian tax or Icelandic tax as the context requires, but excludes any penalty or interest imposed under Australia and Iceland’s domestic laws. **[Article 3, subparagraph 1(k)]**
- 1.50 The taxes covered by the Convention are stipulated in Article 2 (Taxes Covered). The specific exclusion for penalties and interest is not contained in the OECD Model but is a standard feature of Australia’s tax treaties. The exclusion reflects that penalties and interest are not treated as a tax under Australia’s income tax laws. As such, the Convention does not restrict the Commissioner of Taxation’s ability to levy penalties or interest, and Australia is not required to provide relief under the Convention for penalty or interest charges.
- 1.51 The term ‘recognised pension fund’ of a Contracting State extends the OECD Model definition to ensure that it applies appropriately to Australian superannuation funds. The extension also ensures that the definition applies to an Icelandic pension fund according to the income tax law of Iceland. **[Article 3, subparagraph 1(l)]**
- 1.52 The changes ensure that Australian superannuation funds and Icelandic pension funds are covered by the definition, irrespective of the requirement that an entity or arrangement of a State be treated as a separate legal entity under the taxation laws of the State. This addition resolves the issue identified in paragraph 10.6 of the OECD Model Commentary on the definition, which recognises that in some States, a pension fund might not constitute a separate legal person.

- 1.53 The definition of recognised pension fund in the Convention also expands on the condition in subparagraph 1(l)(ii), which covers entities or arrangements that are established and operated exclusively to invest funds for entities or arrangements that provide retirement benefits. The extension covers the investment of a life insurance company's funds, to the extent those funds support retirement income products provided by the life insurance company. This extension reflects the fact that Australia's superannuation system also extends to life insurance companies.
- 1.54 The term 'recognised stock exchange' means the Australian Securities Exchange and any other Australian stock exchange recognised as such under Australian law, and the Nasdaq Iceland and any other Icelandic stock exchange recognised as such under Icelandic law. The competent authorities may agree on other stock exchanges that should be considered to be a 'recognised stock exchange'. **[Article 3, subparagraph 1(m)]**
- 1.55 A term not defined in the Convention has the same meaning that it has under the domestic law of the Contracting State applying the Convention. The definition of a relevant term under a Contracting State's taxation law has precedence over its meaning under other domestic laws. **[Article 3, paragraph 2]**

Article 4 – Resident

- 1.56 The Article provides a basic rule that defines the term 'resident' for the purposes of the Convention as any person who is liable to tax as a resident of Australia or Iceland. This language deviates from the OECD Model, which refers to a person being liable to tax by reason of their 'domicile, residence, place of management or any other criterion of a similar nature'. The broader language covers the OECD criteria as well as additional criteria for residency under Australia's domestic laws. For example, under Australia's domestic laws, for the residency of a company, voting power is a relevant factor. **[Article 4, paragraph 1]**
- 1.57 The Convention generally applies on the basis that a person is a resident of either Australia or Iceland.
- 1.58 Article 4 contains a series of tie-breaker rules for determining the country of residence for an individual who is a resident of both Australia and of Iceland under the basic residence rule. **[Article 4, paragraph 2]**
- 1.59 The tie-breaker rules are based on the equivalent provision in the OECD Model. Consistent with the OECD Model, the rules apply hierarchically (for example, the second tie-breaker rule only applies if an individual's residence cannot be determined under the first rule). The final tie-breaker rule provides that the competent authorities of Australia and Iceland shall endeavour to resolve the individual's residence by mutual agreement. **[Article 4, subparagraph 2(d)]**

- 1.60 The requirement to endeavour to determine an individual's residence by mutual agreement is a departure from the equivalent provision in the OECD model, which obliges the competent authorities to settle the question of residency.
- 1.61 Article 4 also contains a tie-breaker rule for persons other than individuals that are residents of both Australia and Iceland under the basic residence rule. This rule provides that the competent authorities of Australia and Iceland shall seek to determine by mutual agreement, which country the dual-resident is a resident of for the purposes of the Convention. In reaching such agreement, the competent authorities must consider the dual-resident's place of effective management, place of incorporation or constitution, and any other relevant factors. **[Article 4, paragraph 3]**
- 1.62 Factors relevant to tie-breaker determinations may vary over time but are likely to include considerations such as:
- where the meetings of the entity's board of directors or equivalent body are usually held;
 - where the chief executive officer and other senior executives usually carry on their activities;
 - where the senior day-to-day management of the entity is carried on;
 - where the entity's headquarters are located;
 - which jurisdiction's laws govern the legal status of the entity;
 - where its accounting records are kept; and
 - whether determining that the entity is a resident of one jurisdiction but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention.
- 1.63 If the competent authorities cannot agree on a dual-resident's residence status, Article 4(3) will treat the dual-resident as neither a resident of Australia nor Iceland for the purposes of the Convention. As a result, such persons (other than individuals) will not be able to enjoy the benefits under the Convention available to residents. **[Article 4, paragraph 3]**
- 1.64 This tie-breaker rule is based on the equivalent provision in the OECD Model. However, in contrast to the OECD Model, the competent authorities are not authorised to agree to extend the benefits of the Convention to a person where they cannot agree on a person's residence status. This departure is aligned with Australia's position in respect of Article 4 of the *Multilateral Convention to Implement Tax Treaty Measures to Prevent Base Erosion and Profit Shifting*.
- 1.65 Although the Convention may deem certain dual-residents to not be Australian residents for the purposes of enjoying benefits under the Convention (either because they are treated as a resident of Iceland, or residents of neither Australia nor Iceland), such persons remain a resident for the purposes of

Australian domestic tax law. This is because the residence rule in the Convention does not affect the characterisation of a person's residence under Australia's domestic law. Accordingly, such a person remains liable for taxation in Australia as a resident, insofar as is permitted under the Convention.

Collective Investment Vehicles

- 1.66 Article 4 allows a 'collective investment vehicle' (see below) to be treated as a resident individual for treaty purposes, and therefore receive treaty benefits, provided certain criteria are met. This allows a collective investment vehicle to claim treaty benefits for its investors for administrative simplicity, such that each individual investor does not need to claim treaty benefits. This overcomes the practical difficulties often faced for the many investors in widely held collective investment vehicles in individually claiming treaty benefits in the source country. *[Article 4, paragraph 4]*
- 1.67 This treatment only applies to the extent the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established. However, the collective investment vehicle is treated as an individual who is a resident of the Contracting State in which it is established and as the beneficial owner of all the income it receives if it meets certain criteria. That is, if the principal class of relevant interests in the collective investment vehicle is listed and is regularly traded on a recognised stock exchange, or at least 80 per cent of the value of beneficial interests in the vehicle is owned by investors who are residents of the Contracting State in which the vehicle is established, or at least 90 per cent of the value of the beneficial interests in the vehicle is owned by investors who are 'equivalent beneficiaries' (see below). *[Article 4, paragraph 4]*
- 1.68 Under Article 4, the collective investment vehicle shall only be treated as an individual who is a resident of the Contracting State in which it is established and the beneficial owner of income it receives, if an individual receiving that income in the same circumstances would have been considered the beneficial owner of the income (that individual being a resident of the State in which the vehicle is established). *[Article 4, paragraph 4]*
- 1.69 For such purposes, 'collective investment vehicle' means a vehicle that is widely-held, holds a diversified portfolio of securities or invests directly or indirectly in immovable property for the main purpose of deriving rent, and is subject to investor-protection regulation in the State in which it is established. In the case of Australia, it must also be a managed investment trust for the purposes Australian tax. In the case of Iceland, it must also be a mutual fund for the purposes of Icelandic law or an alternative investment fund for the purposes of Icelandic law. *[Article 4, subparagraph 5(a)]*

- 1.70 Australia and Iceland may agree in an Exchange of Notes to include other investment funds or vehicles established in either Contracting State as collective investment vehicles for these purposes. **[Article 4, subsubparagraph 5(a)(iii)]**
- 1.71 For the purposes of paragraph 4 of Article 4, the term ‘equivalent beneficiary’ means a resident of the Contracting State in which the collective investment vehicle is established and a non-resident beneficiary who would have been subject to the same or lower rate of tax if they were investing through a third country and there is an effective and comprehensive information exchange provision between that third country and the source jurisdiction. **[Article 4, subparagraph 5(b)]**

Article 5 – Permanent establishment

- 1.72 Article 5 introduces the concept of ‘permanent establishment’, which is used to determine the rights of a Contracting State to tax the profits of an enterprise of the other Contracting State. This concept is central to the operation of Articles 7 (Business profits), 10 (Dividends), 11 (Interest), 12 (Royalties), 13 (Alienation of property), 14 (Income from employment), 20 (Other income) and 22 (Non-discrimination).
- 1.73 Article 5 applies the primary definition of ‘permanent establishment’ in the OECD Model. The definition applies for the purposes of the Convention and provides that a ‘permanent establishment’ is a fixed place of business through which an enterprise conducts its business. **[Article 5, paragraph 1]**
- 1.74 Article 5 also includes a non-exhaustive list of examples of places of business that constitute permanent establishments under paragraph 1. This list is based on the OECD Model but contains one variation. **[Article 5, paragraph 2]**
- 1.75 Similar to the majority of Australia’s other modern tax treaties, it is recognised that the primary definition of ‘permanent establishment’ includes business conducted on agricultural or forestry property. **[Article 5, subparagraph 2(g)]**
- 1.76 This reflects Australia’s policy to retain taxing rights over the use of Australian land for primary production activities.
- 1.77 Consistent with the OECD Model, Article 5 further holds that a building site or a construction or installation project constitutes a permanent establishment. However, the Convention reduces the OECD Model’s 12-month threshold for a site or project to be considered a permanent establishment to six months. **[Article 5, paragraph 3]**
- 1.78 The truncation of the 12-month threshold to six months further bolsters Australia’s source-based taxation rights concerning its natural resources.
- 1.79 Article 5 deems three additional activities as permanent establishments, in line with Australia’s reservations on Article 5 of the OECD Model Commentary. **[Article 5, paragraph 4]**

- 1.80 First, consistent with Australia’s reservation to Article 5, set out in paragraph 202 of the OECD Model Commentary, Article 5 deems supervisory or consultancy activities connected to a building site or construction or installation project (exceeding 183 days in any 12-month period) carried on by an enterprise of a Contracting State in the other State to be a permanent establishment. **[Article 5, subparagraph 4(a)]**
- 1.81 This reservation reflects Australia’s concerns that Article 5 of the OECD Model may not be broad enough to cover supervisory activities and consultancy activities which are not supervisory but of a similar character.
- 1.82 Second, Article 5 deems natural resource activities exceeding 90 days in any 12-month period to be a permanent establishment. In other words, a permanent establishment is deemed to exist where an enterprise of one country carries on natural resource exploration or exploitation activities (including operating substantial equipment) in the other country for a period or periods exceeding, in the aggregate, 90 days in any 12-month period. **[Article 5, subparagraph 4(b)]**
- 1.83 This provision preserves Australia’s ability to tax profits from activities concerning Australian natural resources. This provision is consistent with Australia’s reservation to paragraph 1 of Article 5 of the OECD Model, as noted in paragraph 188 of the OECD Model Commentary. **[Article 5, subparagraph 4(b)]**
- 1.84 Further, the provision establishes a duration test expressed as a period or periods exceeding, in aggregate, 90 days in any 12-month period. This lower duration test is consistent with international practice established in offshore activities articles. **[Article 5, subparagraph 4(b)]**
- 1.85 Finally, Article 5 provides that a permanent establishment is deemed to exist where an enterprise operates substantial equipment in a country for one or more periods which exceed, in aggregate, 183 days in any 12-month period. **[Article 5, subparagraph 4(c)]**
- 1.86 The meaning of the term ‘substantial’, in the context of the phrase, ‘substantial equipment’, is determined on the relevant facts and circumstances of each individual case. **[Article 5, subparagraph 4(c)]**
- 1.87 Factors such as size, quantity or value of the equipment, or the role of the equipment in income producing activities are relevant considerations. Examples of substantial equipment include:
- industrial earthmoving equipment used in road or dam building;
 - manufacturing or processing equipment used in a factory; or
 - oil or drilling rigs, or platforms and other structures used in the petroleum, gas or mining industries.
- 1.88 The inclusion of the operation of substantial equipment in subparagraphs 4(b) and 4(c) of Article 5 reflects Australia’s concerns that such operations may

otherwise not meet the requirements of the concept of a ‘fixed place of business’ in accordance with the OECD Model definition of permanent establishment. *[Article 5, paragraph 1]*

- 1.89 Australia’s experience is that the definition of permanent establishment in paragraph 1 of Article 5 of the OECD Model may be inadequate to deal with high-value mobile activities, in particular those involving the use of substantial equipment.
- 1.90 For example, the inclusion of the operation of substantial equipment as a permanent establishment ensures the definition of permanent establishment covers activities such as where vessels are used as platforms for offshore oil and gas activities. Such activities are places of business through which an enterprise carries on a business in Australia. However, the mobile nature of a vessel platform means they may not satisfy the requirements in the OECD Model for a place of business to be fixed. The inclusion of these provisions makes clear that such activities shall be deemed to be carried on through a permanent establishment of the enterprise situated in that other State under the Convention. *[Article 5, subparagraphs 4(b) and 4(c)]*
- 1.91 The reference to ‘operation’ and ‘operates’ in subparagraphs 4(b) and 4(c) ensure that only the active use of substantial equipment is covered by Article 5. *[Article 5, subparagraphs 4(b) and 4(c)]*
- 1.92 This means that 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 permanent establishment in that country under these provisions.
- 1.93 For example, if an Icelandic enterprise itself operates a mobile crane at an Australian port for more than 183 days in a 12-month period, the enterprise would be deemed to have a permanent establishment in Australia under subparagraph 4(c) of this Article. If that Icelandic enterprise merely leases the mobile crane to another person and that other person operates the crane at an Australian port for its own purposes, the Icelandic enterprise would not be deemed to have a permanent establishment in Australia under subparagraph 4(c) of this Article. However, if that other person operates the crane for or on behalf of the Icelandic enterprise in Australia, the Icelandic enterprise would be considered to operate the crane in Australia.
- 1.94 Article 5 further sets out rules for aggregating the time spent on particular projects by closely related enterprises for the purpose of paragraphs 3 and 4. *[Article 5, paragraph 5]*
- 1.95 These provisions prevent enterprises from circumventing the permanent establishment time thresholds by splitting up activities. They are consistent with paragraph 52 of the OECD Model Commentary for Article 5, which notes that the time threshold has been the subject of some abuse, and that although contract splitting activities may fall within the scope of anti-avoidance rules, “...some States may nevertheless wish to deal expressly with such abuses”.

- 1.96 Article 5 also contains a list of preparatory or auxiliary activities that are exceptions to the general definition of permanent establishment in paragraph 1 of Article 5, consistent with the equivalent provision in the OECD Model. These exceptions are subject to an anti-fragmentation rule that applies where business operations are split between locations. **[Article 5, paragraphs 6 and 7]**
- 1.97 Article 5 also deems a permanent establishment to exist where a person, other than an independent agent, acts on behalf of an enterprise, even though the enterprise may not have a fixed place of business (within the meaning of paragraphs 1 and 2) in a Contracting State, under stipulated conditions. **[Article 5, paragraphs 8 and 9]**
- 1.98 The conditions set out in the Convention are consistent with those of the OECD Model, with the exception of subparagraph 8(b) which extends the Article to cover situations where a person acts on behalf of another in the manufacturing or processing of goods or merchandise. **[Article 5, subparagraph 8(b)]**
- 1.99 This variation prevents an enterprise that undertakes manufacturing or processing activities in a country through an intermediary from avoiding tax in that country. Its inclusion reflects Australia's reservation to Article 5 of the OECD Model outlined at paragraph 188 of the OECD Model Commentary on Article 5. This reflects Australia's policy to retain taxing rights over profits from manufacturing or processing activities conducted in Australia on behalf of an enterprise of the other Contracting State, particularly in relation to mineral resources.
- 1.100 Paragraph 12 is an Australian specialty and there is no equivalent in the OECD Model. It provides that the principles set out in Article 5 apply when determining whether a permanent establishment exists in a third country, or a third country enterprise has a permanent establishment in Australia or Iceland. This is particularly the case when applying the source rules in Articles 11(7) (Interest) and 12(5) (Royalties). **[Article 5, paragraph 12]**

Article 6 – Income from immovable property

- 1.101 Consistent with the OECD Model, Article 6 states that 'immovable property' is defined in accordance with the laws of the country in which it is located. Immovable property includes, for example, leases and other interests in or over land, livestock and equipment used in agriculture and forestry. The Convention adds to this definition to clarify that the right to explore or mine for mineral, oil or gas deposits or other natural resources are also immovable property, and that these rights and interests are located in the country where the exploration or mining may take place. **[Article 6, paragraphs 2 and 3]**
- 1.102 These provisions enhance Australia's ability to tax income generated by Icelandic residents from mining interests and rights located in Australia.

- 1.103 Article 6 further establishes that income generated by a resident of one state from immovable property located in the other state may be taxed in that other state. *[Article 6, paragraph 1]*
- 1.104 This includes income from the direct use, leasing of, or use in any other form, of immovable property, as well as income from the immovable property of an enterprise. *[Article 6, paragraph 4 and 5]*
- 1.105 Some of Australia’s tax treaties exclude profits of an enterprise from agriculture or forestry from the operation of this Article. Such profits are generally dealt with under Article 7 (Business Profits) of Australia’s tax treaties. Under this Convention, the allocation of taxing rights over such profits is determined by Article 6. This is reflected in the phrase ‘including income from agriculture or forestry’ in paragraph 1 of the Article. Accordingly, profits from the relevant activities may be taxed in Australia where the immovable property is situated in Australia, irrespective of whether the enterprise has a permanent establishment in Australia.
- 1.106 In the case of agriculture and forestry activities, an enterprise would in any event generally have a permanent establishment in the country in which the property is situated.

Article 7 – Business profits

- 1.107 Article 7 provides for the taxation of business profits. The Article is based on the OECD Model text of Article 7 and its Commentary as they read before 22 July 2010. This approach is consistent with Australia’s reservation to Article 7 of the OECD Model outlined in paragraph 99 of the OECD Commentary on Article 7.
- 1.108 The Article provides that the business profits of a resident of one country may only be taxed in the other country if those profits are attributable to the carrying on of a business through a permanent establishment, as defined in Article 5 (Permanent Establishment), in that other country. *[Article 7, paragraph 1]*
- 1.109 The profits of a permanent establishment are to be determined for the purposes of this Article on the basis of arm’s length dealings. *[Article 7, paragraph 2 and 3]*
- 1.110 The Convention modifies a number of the standard OECD Model provisions to clarify the way the arm’s length principle is to be applied. These provisions are consistent with corresponding provisions in Australia’s other tax treaties, and with internationally accepted concepts more generally.
- 1.111 The Convention supplements the standard OECD Model reference in paragraph 2 of Article 7 to a permanent establishment ‘dealing wholly independently with the enterprise of which it is a permanent establishment’, so that it also includes a reference to ‘other enterprises with which it deals’. *[Article 7, paragraph 2]*

- 1.112 This addition recognises that the permanent establishment of an enterprise also has dealings with other enterprises and ensures that in working out the profits that are attributable to the permanent establishment, those dealings must also be on an arm's length basis.
- 1.113 The Convention also supplements the standard reference in paragraph 3 of Article 7 to the expenses of an enterprise that must be allowed as deductions. In addition to being expenses incurred for the purposes of the permanent establishment, the expenses must be ones that would be deductible if the permanent establishment were an independent entity which paid those deductions. [*Article 7, paragraph 3*]
- 1.114 The Protocol to the Convention also clarifies that the reference to 'income' in the Convention (including the reference in paragraph 5 of Article 7) has a wide meaning and includes profits and gains. [*Protocol, paragraph 2*]
- 1.115 Paragraph 4 of Article 7 is concerned with a permanent establishment which, although carrying on certain business activities in its own right, also undertakes purchasing of goods or merchandise for its head office. Paragraph 4 is designed to clarify that the profits of the permanent establishment derived from the business activities carried on in its own right will not be increased by adding to them any amount in respect of profits attributable to the purchasing activities undertaken for the head office. It follows, that any expenses incurred by the permanent establishment in respect of those purchasing activities will not be deductible in determining the taxable profits of the permanent establishment. [*Article 7, paragraph 4*]
- 1.116 Article 7 also contains a provision that excludes profits from any form of an insurance business from the application of Article 7. [*Article 7, paragraph 6*]
- 1.117 This exclusion means that Australia and Iceland retain the right to tax the income of non-resident insurers and re-insurers under their respective domestic laws. The provision is consistent with Australia's reservation to Article 7 of the OECD Model and preserves the application of Division 15 of Part III of the ITAA 1936 (Insurance with non-residents).
- 1.118 Article 7 contains a further rule to ensure that the Article applies appropriately to business profits that a resident of Australia or Iceland derives through one or more interposed trust estates. This rule specifies that such a resident is deemed to have carried on the business of the trust through a permanent establishment located in the other country. [*Article 7, paragraph 7*]
- 1.119 This provision is consistent with Australia's reservation to Article 7 of the OECD Model and ensures that Article 7 does not prevent Australia from taxing the beneficiary of a trust estate on the basis that the trustee, rather than the beneficiary, is the entity that has a permanent establishment in Australia.
- 1.120 Article 7 also provides a general seven-year limit on the time that Australia and Iceland can adjust the profits that are attributable to a permanent establishment. The seven-year limit applies from the end of the taxable period in which the

profits would have been attributable to the permanent establishment. The limit does not apply on a finding of fraud, gross negligence or wilful default, or where an audit has commenced in relation to the profits of the enterprise within a period of 7 years from the end of the taxable year in which the profits would have been attributable to the permanent establishment. **[Article 7, paragraph 8]**

- 1.121 This provision is based on the wording included as an option in the OECD Model Commentary on Article 7 of the OECD Model which limits the length of time during which an adjustment can be made to the profits attributable to a permanent establishment as a matter of practical administration. Under Subdivision 815-C of the ITAA 1997, there is a seven-year time limit from the date the assessment was made for transfer pricing adjustments in respect of permanent establishments.

Article 8 – Shipping and air transport

- 1.122 Article 8 provides that profits from international shipping or air transport are taxable only in the country of residence of the operator. **[Article 8, paragraph 1]**
- 1.123 Notwithstanding the general rule in paragraph 1, Article 8 also provides that profits derived by an enterprise of one country from the carriage by ships or aircraft of passengers, livestock, mail, goods or merchandise that are shipped and discharged in the other country, may be taxed in the other country. This also applies to profits derived from leasing a ship or aircraft. **[Article 8, paragraph 2]**
- 1.124 This approach to the coverage of the profits from domestic sea and air transportation, which gives effect to source-country taxing rights over internal traffic, is consistent with Australia’s reservation to Article 8 of the OECD Model, outlined in paragraph 38 of the OECD Commentary on Article 8. The provisions of Article 8 also apply to profits from the participation in a pool, a joint business or an international operating agency. **[Article 8, paragraph 3]**
- 1.125 Profits from international shipping or air transport also include profits from containers used in such activities. **[Article 8, paragraph 4]**

Article 9 – Associated enterprises

- 1.126 Article 9 deals with adjustments to profits that may be made for tax purposes where transactions have been entered into between associated enterprises (parent and subsidiary companies under common control) on other than arm’s length terms.
- 1.127 This Article would not generally authorise the rewriting of accounts of associated enterprises where it can be satisfactorily demonstrated that the transactions between such enterprises have taken place on normal, open market commercial terms.

- 1.128 Paragraphs 1 and 2 of the Convention’s Article 9 are paragraphs 1 and 2 respectively of the OECD Model. Amendments to the wording reflect Australia’s consistent treaty practice. **[Article 9, paragraphs 1 and 2]**
- 1.129 The term ‘might be expected to’ in paragraph 1 is included to broadly conform to Australia’s treaty practice and allows adjustments where it is not possible to determine the conditions that ‘would’ have been made between the associated enterprises. **[Article 9, paragraph 1]**
- 1.130 The words ‘dealing wholly independently with one another’ address Australia’s concerns that the appropriate benchmark for determining whether the conditions made or imposed, between associated enterprises, differ from those which might be expected to be made between independent enterprises, should involve consideration of whether those dealings between the enterprises occurred on a truly independent basis. **[Article 9, paragraph 1]**
- 1.131 The term ‘made or imposed’ in paragraph 1 is to be interpreted broadly and includes any conditions that operate between those enterprises. **[Protocol, paragraph 3]**
- 1.132 Article 9 also provides a general seven-year limit on the time that Australia and Iceland can initiate transfer pricing adjustments in respect of separate legal entities. The seven-year limit applies from the end of the taxable period to which the adjustment relates. The limit does not apply on a finding of fraud, gross negligence or wilful default, or where an audit has commenced in relation to the profits of the enterprise within a period of 7 years from the end of the taxable year in which the profits would have accrued to the enterprise. **[Article 9, paragraph 3]**
- 1.133 This provision is based on the wording included as an option in the OECD Model Commentary on Article 9 of the OECD Model which limits the length of time during which adjustments to transfer pricing can be made in respect of separate legal entities. Under Subdivision 815-B of the ITAA 1997, there is a seven-year time limit from the date the assessment was made that applies for transfer pricing adjustments in respect of separate legal entities.

Article 10 – Dividends

- 1.134 Article 10 allocates taxing rights over dividends paid between Australia and Iceland.
- 1.135 The Article follows the standard OECD Model approach of generally permitting source-based taxation of dividends paid by a company which is a resident of one country to a resident of the other country. **[Article 10, paragraphs 1 and 2]**
- 1.136 The Article also provides that:
- certain cross-border intercorporate dividends are subject to a maximum 5 per cent rate of tax in the source country, while all other dividends

are subject to a maximum of 15 per cent rate of tax in the source country;

- dividends paid to companies that hold at least 80 per cent of the paying company are not taxable in the source country;
- in certain circumstances, dividends beneficially owned by a Government or a recognised pension fund are not taxable in the source country;
- dividends paid in respect of a holding which is effectively connected with a permanent establishment are to be dealt with under Article 7 (Business Profits); and
- the extraterritorial application by either country of taxing rights over dividend income is not permitted. [*Article 10, paragraphs 2, 3, 4, 6 and 7*]

Definition of ‘dividend’

1.137 The term ‘dividend’ is defined in the Article as:

- income from shares or other rights, not being debt-claims, participating in profits; and
- other amounts which are subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident for the purposes of its tax. [*Article 10, paragraph 5*]

1.138 This definition is based on the equivalent provision in the OECD Model but contains three key variations.

1.139 First, the definition does not refer to ‘jouissance’ shares or rights, mining shares, and founders’ shares, as these shares are not used in Australia’s domestic tax laws.

1.140 Second, the definition uses the term ‘other amounts’ instead of ‘income from other corporate rights’. This removes any doubt as to whether the definition can be applied to certain deemed dividends that might not be characterised as ‘income’ (such as bonus shares and certain capital distributions), as well as to distributions from certain non-corporate entities (such as deemed dividends received from trusts).

1.141 Finally, the reference to ‘for the purposes of its tax’ in respect of the residence of the company making a distribution is intended to ensure that the domestic law characterisation of a company as a resident of a country is retained, even where the general residence tie-breaker rule would ordinarily prevent the company from being the resident of that country for the purposes of the treaty. This rule ensures that the correct tax laws are used to define the meaning of

‘dividend’ when applying the dual-resident company rule in paragraph 8 of Article 10.

Maximum rates of withholding tax

- 1.142 The Article sets the standard maximum rates of taxation for the country in which a dividend is sourced. These rates are 5 per cent for certain intercorporate dividends, and 15 per cent for all other dividends, and are based on the standard approach in the OECD Model. [*Article 10, paragraph 2*]
- 1.143 For the 5 per cent rate for intercorporate dividends to apply, the beneficial owner of the dividends must be a company that directly holds at least 10 per cent of the voting power in the company paying the dividends throughout a 365-day period that includes the day that the dividends are paid. [*Article 10, subparagraph 2(a)*]
- 1.144 This holding period requirement differs from the holding period requirements that are included in some of Australia’s existing tax treaties, which generally require the holding period to be satisfied at the time the dividend is declared. In contrast, the holding period in Article 10 of the Convention can be for any 365-day period that includes the day of the payment of the dividends. Thus, under paragraph (2)(a) of Article 10, the holding period may straddle the dividend payment date. This approach is consistent with the approach in the OECD Model.
- 1.145 However, in contrast to the OECD Model, Article 10 of the Convention uses a minimum of 10 per cent voting power in a company (instead of 25 per cent of the capital) as the threshold for determining when the intercorporate dividend rate applies. The focus on voting power is Australia’s consistent treaty practice and has previously been endorsed by the OECD (see, for example, paragraph 15 of the Commentary to Article 10 of the 2008 OECD Model).
- 1.146 Consistent with Australia’s reservation to paragraph 2 of Article 10 of the OECD Model, the Convention does not contain a provision authorising the competent authorities of Australia or Iceland to settle, by mutual agreement, the mode of application of the limits in paragraph 2.

Exemption for certain cross-border intercorporate dividends

- 1.147 No tax will be payable in the source country on intercorporate dividends paid to a company that is the beneficial owner of those dividends and is a resident of the other country where the recipient company:
- directly or indirectly holds shares representing 80 per cent or more of the voting power of the company paying the dividends; and
 - has held those shares throughout a 365-day period that includes the day of the payment of the dividend. [*Article 10, paragraph 3*]
- 1.148 For the purpose of computing the 365-day period, no account shall be taken of changes of ownership that would directly result from a corporate

reorganisation, such as a merger or divisive reorganisation, of the company that directly or indirectly holds the shares or that pays the dividend.

[Article 10, paragraph 3]

1.149 To qualify for the exemption, the company that is the beneficial owner of the dividends must either be:

- a company that has its principal class of shares;
 - listed on any of the recognised stock exchanges defined under Article 3 (General Definitions). That is, the Australian Securities Exchange and any other Australian stock exchange recognised as such under Australian law, or the Nasdaq Iceland and any other Icelandic stock exchange recognised as such under Icelandic law; and
 - regularly traded on one or more of such recognised stock exchanges.
- a company that is owned directly or indirectly by one or more companies that meets the above listing and trading requirements (provided that where a company is owned indirectly, each intermediate company is a resident of either Australia or Iceland or is a resident of a third country that would be entitled to equivalent treaty benefits);
- a company that is owned directly or indirectly by one or more third country resident companies, which if it directly held the shares in respect of which the dividends are paid, would be entitled to equivalent treaty benefits (that is, an exemption from source country taxation), provided that where a company is owned indirectly, each intermediate company is a resident of either Australia or Iceland or is a resident of a third country that would be entitled to equivalent treaty benefits; or
- a company that does not meet the above requirements but which is nevertheless granted benefits with respect to those dividends by the competent authority of the country in which the dividends arose.

[Article 10, subparagraphs 3(a) to (c)]

1.150 Competent authorities may reach agreement that other stock exchanges constitute a recognised stock exchange for the purpose of the Convention.

[Article 3, subparagraph 1(m)(iii)]

Equivalent benefits

1.151 Under subparagraph 3(b) of this Article, an exemption applies to dividends:

- paid by a company in a country (the paying company) to a company in the other country (the receiving company); and
- where the receiving company is itself wholly-owned by one or more companies (the owning companies) that are either themselves listed on a recognised stock exchange specified in subparagraphs 1(m)(i) or

(ii) of Article 3 (General Definitions) and regularly traded on one or more recognised stock exchanges, or would be entitled to equivalent benefits under another treaty between the country of which the owning company or companies are a resident and the country of which the paying company is a resident had the owning companies owned the holding in the paying company directly.

- 1.152 Subparagraph 3(b) of this Article expressly clarifies that for the owning companies to satisfy the wholly-owned requirement, each intermediate company in the chain of ownership must be a resident of either Australia or Iceland or be entitled to equivalent benefits under another treaty between the country of which the owning company or companies are a resident and the country of which the paying company is a resident had the owning companies owned the holding in the paying company directly. This means that the ownership chain cannot include a company resident in a third country that would not be entitled to equivalent benefits under another treaty between that third country and the country of which the paying company is a resident had the company resident in the third country owned the holding in the paying company directly.
- 1.153 The exemption would apply to dividends paid by an Australian company to an Icelandic company that is itself owned by one or more companies entitled to equivalent benefits under another tax treaty between the country of which that company (or those companies) were a resident and Australia. Similarly, dividends paid by an Icelandic company to an Australian company that is itself owned by one or more companies entitled to equivalent benefits under another tax treaty between the country of which that company (or those companies) were a resident and Iceland, would also be exempt.

Competent authority determination

- 1.154 Dividends which are beneficially owned by a company that does not meet the conditions in subparagraphs 3(a) or (b) of this Article will also be exempt from tax in the source country if the competent authority of that country determines that the conditions for denying a benefit under the Convention in paragraph 1 of Article 27 do not exist. That is, the competent authority determines that obtaining the exemption was not one of the principal purposes of the arrangement or transaction that would result in that dividend exemption and obtaining the exemption would not be contrary to the object and purpose of the provisions of the Convention. Before refusing to grant benefits to a company under subparagraph 3(c) of this Article, the competent authority is required to consult with the competent authority of that company's country of residence.
- [Article 10, subparagraph 3(c)]***

Exemption for Governments and recognised pension funds

- 1.155 Article 10 of the Convention also provides an exemption from source country taxation for certain dividends that are beneficially owned by a government, or recognised pension funds, of Australia or Iceland.
- 1.156 Dividends which are beneficially owned by Australia or Iceland, or one of their political subdivisions or local authorities (including a government investment fund), are not taxable in the source country if they directly hold no more than 10 per cent of the voting power in the company paying the dividends.
[Article 10, subparagraph 4(a)]
- 1.157 The 10 per cent threshold ensures that the exemption only applies where the beneficial owner of the dividends holds a portfolio interest in the company paying the dividends and is consistent with Australia’s long-standing practice in respect of sovereign immunity.
- 1.158 The exemption also applies to the central banks of Australia and Iceland (the Reserve Bank of Australia and the Central Bank of Iceland, respectively), and to the recognised pension funds of Australia and Iceland. *[Article 10, subparagraphs 4(b) to (d)]*
- 1.159 The Protocol to the Convention also clarifies that the term ‘government investment fund’ means an entity that satisfies certain conditions. That is, the entity must be wholly owned by a Contracting State, or political subdivision or a local authority thereof, be funded solely by public monies and all returns on the entity’s investments must be public monies. In addition, the term does not include certain entities which are described in the Protocol, such as partnerships, or entities with principal activity related to non-financial goods or services. The definition is based on concepts in Australia’s sovereign immunity rules (refer Division 880 of the ITAA 1997) and is intended to ensure that the exemption is only available where the government entity is performing governmental functions (as opposed to engaging in commercial activities).
[Protocol, paragraph 4]
- 1.160 The requirement that all the returns on the entity’s investments are public monies ensures that the benefits of the exemption do not flow to individuals acting in a private capacity.
- 1.161 The exemption for recognised pension funds of Iceland applies to a fund of Iceland whose income is exempt from tax in Iceland. *[Article 10, subparagraph 4(d)]*
- 1.162 The exemption for recognised pension funds of Australia applies where the fund derives dividends from the carrying on of complying superannuation activities. The exemption also applies to other residents of Australia that carry on such activities. This extension recognises that Australia’s superannuation system extends to other entities, such as life insurance companies. *[Article 10, subparagraph 4(c)]*

1.163 The exemption for dividends beneficially owned by Australian pension funds does not require the dividends to be exempt from tax in Australia. This approach reflects that Australian superannuation funds have concessional tax arrangements (which can include tax exemptions), but not full tax exemptions in all cases.

Dividends effectively treated as business profits

1.164 Paragraphs 1, 2, 3 and 4 of Article 10 do not apply to dividends that are effectively connected with a permanent establishment of the beneficial owner of the dividends that is located in the country where the dividends are sourced. The taxation of such dividends is instead dealt with by Article 7 (Business Profits). [*Article 10, paragraph 6*]

1.165 This exception is based on the OECD Model.

Extra-territorial taxation precluded

1.166 Article 10 limits the extra-territorial application, by either Australia or Iceland, of taxing rights over dividend income. Broadly, a country is precluded from taxing dividends paid by a company that is a resident solely of the other country, unless:

- The person that derives the dividends is a resident of the first country; or
- The shareholding that gives rise to the dividends is effectively connected with a permanent establishment in the first country. [*Article 10, paragraph 7*]

1.167 This provision ensures that source country taxation does not extend to the distribution of profits, which may already be taxed in accordance with the provisions of the Convention, to the company's shareholders that are unconnected to the source country. The provision is based on the OECD Model but contains a deviation.

1.168 The reference to dividends being 'beneficially owned' by a resident replaces the standard OECD approach that requires the dividends to be 'paid' to a resident. This approach ensures that the limitation applies appropriately where the recipient of the dividend payments is not the beneficial owner.

Dual resident company rule

1.169 The limitation on extra-territorial taxation does not apply to dividends that are paid by a dual-resident company that is deemed to be a resident only of Australia or Iceland because of the residency tie-breaker rule in Article 4 (Resident). Where such dividends are beneficially owned by a resident of the country to which the dual-resident company's residency was allocated under

the treaty, Article 10 applies as though the dual-resident company was a resident of the other country. *[Article 10, paragraph 8]*

- 1.170 The effect of this rule is that the country of source can continue to tax dividends paid by a dual-resident company whose residency is allocated to the other country, provided that the dividends are paid out of profits arising in the source country. Australia's consistent treaty practice is to include this provision to prevent dual-resident companies being established in Australia to allow untaxed Australian profits to be paid to shareholders resident in a treaty partner country or a third country, without any Australian tax at either the company or shareholder level.

Article 11 – Interest

- 1.171 Article 11 allocates taxing rights over interest paid between Australia and Iceland.
- 1.172 The Article generally permits source-based taxation of interest paid to residents of each country. However, the maximum rate of withholding tax for the source country is 10 per cent of the gross amount of interest. There are also a range of exemptions from source-based taxation that apply in certain circumstances for interest derived by Governments, financial institutions or recognised pension funds. *[Article 11, paragraphs 2, 3 and 4]*
- 1.173 The Article also provides that:
- interest that is effectively connected with a permanent establishment of the beneficial owner are to be dealt with under Article 7 (Business Profits);
 - interest shall be deemed to arise in the payer's country of residence according to domestic law; and
 - the concessional arrangements for interest only apply to the amount that might have been expected to be paid or credited under arm's length dealing between independent parties. *[Article 11, paragraphs 6, 7 and 8]*

Definition of 'interest'

- 1.174 The term 'interest' is defined in the Article as:
- income from debt-claims of every kind (whether or not secured by a mortgage and whether or not carrying a right to participate in the debtor's profits);
 - income from government securities;
 - income from bonds and debentures; and

- income which is subjected to the same taxation treatment as income from money lent by the law of the source country. [*Article 11, paragraph 5*]

1.175 This definition is based on the equivalent provision in the OECD Model but extends that definition to include income that is subjected to the ‘same taxation treatment as income from money lent’ by the law of the source country. This extension ensures that income that is effectively treated as interest under a State’s domestic law is dealt with by Article 11 and is consistent with Australia’s reservation to Article 11 of the OECD Model outlined in paragraph 45 of the OECD Model Commentary on Article 11.

Maximum rate of withholding tax

1.176 The Article sets the maximum rate of taxation for the country in which interest arises. This rate is 10 per cent of the gross amount of interest. [*Article 11, paragraph 2*]

Exemptions for Governments

1.177 Article 11 of the Convention also provides an exemption for interest that arises in either Australia or in Iceland, and that is derived and beneficially owned by the other country or one of their political subdivisions or a local authority (including a government investment fund). [*Article 11, subparagraph 3(a)*]

1.178 The Protocol to the Convention clarifies that the term ‘government investment fund’ means an entity that satisfies certain conditions. That is, the entity must be wholly owned by a Contracting State, or political subdivision or a local authority thereof, be funded solely by public monies and all returns on the entity’s investments must be public monies. In addition, the term does not include certain entities which are described in the Protocol, such as partnerships, or entities with principal activity related to non-financial goods or services. The definition is based on concepts in Australia’s sovereign immunity rules (refer Division 880 of the ITAA 1997) and is intended to ensure that the exemption is only available where the government entity is performing governmental functions (as opposed to engaging in commercial activities). [*Protocol, paragraph 4*]

1.179 The requirement that all the returns on the entity’s investments are public monies ensures that the benefits of the exemption do not flow to individuals acting in a private capacity.

1.180 The exemption also applies to interest that is beneficially owned by the central banks of Australia and Iceland (the Reserve Bank of Australia and the Central Bank of Iceland, respectively). [*Article 11, subparagraph 3(b)*]

1.181 The exemption from source-based taxation does not apply where the beneficial owner of the interest is able to directly or indirectly determine the identity of one or more persons who make the decisions that comprise the control and

direction of the operations of the issuer of the debt-claim. *[Article 11, subparagraph 4(a)]*

- 1.182 This restriction is consistent with the scope of Australia's domestic sovereign immunity rules, which are limited to passive investments.
- 1.183 Where the exemption does not apply, the general 10 per cent rate limit applies.

Exemption for recognised pension funds

- 1.184 Article 11 also provides an exemption for interest that arises in Iceland that is derived and beneficially owned by a recognised pension fund of Australia or a resident of Australia deriving such interest from the carrying on of complying superannuation activities. This extension recognises that Australia's superannuation system extends to other entities, such as life insurance companies. *[Article 11, subparagraph 3(c)]*
- 1.185 Consistent with the exemption from dividend withholding tax in Article 10 (Dividends), Article 11 provides an exemption for interest that arises in Australia that is derived and beneficially owned by a recognised pension fund of Iceland whose income is exempt from tax in Iceland. *[Article 11, subparagraph 3(d)]*
- 1.186 The exemption from source-based taxation does not apply to a recognised pension fund, or to another entity that can access the exemption, where the beneficial owner of the interest is able to directly or indirectly determine the identity of one or more persons who make the decisions that comprise the control and direction of the operations of the issuer of the debt-claim. *[Article 11, subparagraph 4(a)]*
- 1.187 This restriction ensures that the exemption is only applicable where the beneficial owner of the interest is an arm's length lender who does not play an active role in the management or operation of the entity paying the interest. This reflects that the exemption is intended to apply to 'passive' investments by the lender, which exclude debt arrangements that convey special rights or obligations, or that are entered into where the lender plays an active role in the other entity because of some other arrangement (such as a substantial shareholding).
- 1.188 Where the exemption does not apply, the general 10 per cent rate limit applies.

Exemption for financial institutions

- 1.189 Article 11 of the Convention also provides an exemption for interest that arises in Australia, and that is derived by a financial institution which is unrelated to and dealing wholly independently with the payer, provided the financial institution is a resident of Iceland and is the beneficial owner of the interest. Similarly, if a financial institution resident in Australia is able to satisfy the same conditions, the exemption applies to the interest that arises in Iceland and is derived by that financial institution. *[Article 11, subparagraph 3(e)]*

- 1.190 The exemption for interest paid to financial institutions recognises that the general 10 per cent source country tax rate on gross interest can be excessive given the cost of their funds.
- 1.191 For the purposes of this Article, the term ‘financial institution’ means a bank or other enterprise substantially deriving its profits by raising debt finance in the financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance. [*Article 10, subparagraph 3(e)*]
- 1.192 The exemption for financial institutions is not available for interest paid as part of an arrangement involving back-to-back loans, or arrangements that are economically equivalent and intended to have a similar effect. [*Article 11, subparagraph 4(b)*]
- 1.193 The denial of the exemption for such arrangements is directed at preventing related party and other debt from being structured through financial institutions to gain access to the exemption under the Convention. The restriction applies to any interest paid on the component of a loan that is considered to be back-to-back. In such cases, the general 10 per cent rate limit applies.
- 1.194 An example of a back-to-back arrangement is a transaction or series of transactions structured in such a way that:
- an Icelandic financial institution receives or is credited with an item of interest arising in Australia; and
 - the financial institution pays or credits, directly or indirectly, all or substantially all of that interest (at any time or in any form, including commensurate benefits) to another person who, if it received the interest directly from Australia, would not be entitled to similar benefits with respect to that interest.
- 1.195 However, a back-to-back arrangement would generally not include a loan guarantee provided by a related party to a financial institution.

Interest effectively treated as business profits

- 1.196 Paragraphs 1, 2, subparagraph (e) of paragraph 3, and paragraph 4 of Article 11 do not apply to interest that is effectively connected with a permanent establishment of the beneficial owner of the interest that is located in the country where the interest arises. The taxation of such interest is instead dealt with by Article 7 (Business Profits). [*Article 11, paragraph 6*]
- 1.197 This exception is consistent with the OECD Model.

Deemed source of interest

- 1.198 Article 11 contains a rule that generally deems interest to arise in the country in which the payer is a resident for the purposes of its tax. This deeming rule is broadly based on the equivalent provision in the OECD Model, although the

Convention also includes the phrase ‘for the purposes of its tax’. This refers to the case where a person is a resident of a country under its domestic tax law, even if the person is deemed to be a resident only of the other country for the purposes of the Convention by virtue of paragraphs 2 or 3 of Article 4 (Resident). This wording operates to allow Australia to tax interest paid by a resident of Australia to a resident of Iceland who is the beneficial owner of that interest. *[Article 11, paragraph 7]*

- 1.199 This deemed source rule does not apply to interest payments that are an expense of a person that is incurred in carrying on a business through a permanent establishment. In such cases, the interest is deemed to arise in the country in which the permanent establishment is situated. *[Article 11, paragraph 7]*
- 1.200 This provision is based on the equivalent provision in the OECD Model. However, in contrast to the OECD Model, the provision in the Convention is not limited to permanent establishments that are located in the Contracting States (that is, Australia or Iceland). As such, interest can be deemed to arise in a third country where it is connected to a permanent establishment of the payer in such a country.

Related persons

- 1.201 Article 11 contains a general safeguard against payments of excessive interest where a special relationship exists between the parties to a loan transaction (or between those parties and some other person). In such cases, the beneficial treatment provided by Article 11 is limited to the amount of interest that would have been expected to have been agreed to if the parties to the loan arrangements were dealing at arm’s length. Any excess part of the interest continues to be taxable according to the domestic laws of Australia and Iceland and the other provisions of the Convention. *[Article 11, paragraph 8]*
- 1.202 This provision is based on the equivalent provision in the OECD Model. The provision contains a minor departure, referring to ‘the amount which might have been expected to’, rather than ‘the amount which would have been agreed’. This allows adjustments where it is not possible to determine the amount that ‘would’ have been agreed between the related parties due to an absence of independent comparisons.

Article 12 – Royalties

- 1.203 Article 12 allocates taxing rights over royalties paid or credited between Australia and Iceland.
- 1.204 In contrast to the OECD Model, which allocates taxing rights over royalties on an exclusive residency basis, Article 12 of the Convention also permits source-based taxation of royalties that arise in Australia or in Iceland. *[Article 12, paragraphs 1 and 2]*

1.205 The Article provides that:

- royalties that arise in Australia or Iceland and that are beneficially owned by a resident of the other country may be subject to a maximum 10 per cent rate of tax in the country in which they arise;
- royalties that are effectively connected with a permanent establishment of the beneficial owner are to be dealt with under Article 7 (Business Profits);
- royalties are generally deemed to arise in the payer's country of residence according to domestic law; and
- the concessional arrangements for royalties only apply to the amount that might have been expected to be paid or credited under arm's length dealing between independent parties.

Definition of 'royalty'

1.206 The definition of 'royalty' in the Article expands on the equivalent definition in the OECD Model.

1.207 These extensions generally ensure that the definition in the Convention is aligned with the definition in Australia's domestic income tax law. As a result of these changes, the definition in Article 12 to the Convention is structured differently to that in the OECD Model.

1.208 In contrast to the OECD Model, which refers to payments that are received as consideration, the definition in the Convention expands on the reference to payments so that the definition applies to 'payments or credits, whether periodical or not, and however described or computed, to the extent to which they are made as consideration'. [*Article 12, paragraph 3*]

1.209 The definition of royalty in the Convention includes payments or credits made as consideration for:

- the use of, or right to use, intellectual property, as well as the supply of any assistance that is ancillary and subsidiary to such use;
- the supply of scientific, technical, industrial or commercial knowledge or information, as well as the supply of any assistance that is ancillary and subsidiary to the use of such knowledge or information;
- the use of, or right to use, motion picture films, or any tapes or discs, or any other means of reproduction or transmission;
- the use of, or right to use, radiofrequency spectrum; or
- not supplying or granting another person any property or right that is covered by the definition. [*Article 12, paragraph 3*]

- 1.210 In contrast to the part of the definition in the OECD Model that refers to ‘information concerning industrial, commercial or scientific experience’, the definition of royalty in the Convention refers to the supply of such information or knowledge. *[Article 12, subparagraph 3(b)]*
- 1.211 This expanded reference ensures that the definition covers the full range of technical know-how that may be supplied as a royalty.
- 1.212 In contrast to the part of the definition in OECD Model that includes a general reference to ‘artistic work... including cinematograph films’, the definition in the Convention refers specifically to ‘motion picture films and films or audio or video tapes or disks, or other means of image or sound reproduction or transmission for use in connection with television, radio or other broadcasting’. *[Article 12, subparagraph 3(d)]*
- 1.213 This expanded reference is included to ensure that this part of the definition is capable of being applied in the context of modern technological developments. This approach reflects Australia’s consistent treaty practice. However, in practical terms, the general reference to ‘artistic work’ in the OECD Model is likely to include each of the specific extensions in this part of the definition.
- 1.214 The definition of royalty in the Convention also applies to payments or credits made for the use of, or right to use, the radio frequency spectrum specified in a spectrum licence. *[Article 12, subparagraph 3(e)]*
- 1.215 This provision is not included in the OECD Model. The provision is commonly included in Australia’s tax treaties and is aimed at preserving Australia’s ability to tax payments (or credits) that arise in Australia for the use in Australia of any part of the radio frequency spectrum specified in an Australian spectrum licence. The extension also ensures that the definition of royalty in the Convention is aligned with Australia’s domestic law definition.
- 1.216 Article 12 also treats as a royalty, amounts paid or credited in respect of forbearance to grant to third persons rights to use property covered by this Article. *[Article 12, subparagraph 3(f)]*
- 1.217 This provision is not included in the OECD Model and ensures that such payments are subject to tax as a royalty payment under the terms of this Article.

Royalties effectively treated as business profits

- 1.218 Article 12 does not apply to a royalty that is effectively connected with a permanent establishment of the beneficial owner of the royalty that is located in the country in which the royalty arises. The taxation of such royalties is instead dealt with by Article 7 (Business Profits). *[Article 12, paragraph 4]*
- 1.219 This exception is consistent with the OECD Model but adapted to reflect that the definition of ‘royalty’ in the Convention also includes amounts that are ‘credited’.

Deemed source of royalties

- 1.220 Article 12 contains a rule that generally deems royalties to arise in the country in which the payer is a resident for the purposes of its tax. This paragraph allows Australia to tax royalties paid by a resident of Australia to a resident of Iceland who is the beneficial owner of those royalties. [**Article 12, paragraph 5**]
- 1.221 While there is no equivalent provision in Article 12 of the OECD Model, this deeming rule follows the provision that is included in Article 11 (Interest) of the Convention, which is broadly based on the deeming rule for Article 11 (Interest) of the OECD Model.
- 1.222 This deemed source rule does not apply to royalty payments that are an expense of a person that is incurred in carrying on a business through a permanent establishment. In such cases, the royalty is deemed to arise in the country in which the permanent establishment is situated. [**Article 12, paragraph 5**]
- 1.223 As with the deeming rule for interest in Article 11 (Interest), royalties can be deemed to arise in a third country where they are connected to a permanent establishment of the payer in such a country.

Related persons

- 1.224 Article 12 contains a general safeguard against payments or credits of excessive royalties where a special relationship exists between the parties to a transaction (or between those parties and some other person). In such cases, the beneficial treatment provided by Article 12 is limited to the amount of royalties that would have been expected to have been agreed to if the parties to the arrangements were dealing at arm's length. Any excess part of the royalty continues to be taxable according to the domestic laws of Australia and Iceland and the other provisions of the Convention. [**Article 12, paragraph 6**]
- 1.225 This provision is based on the equivalent provision in the OECD Model. The provision contains minor departures, referring to 'the amount which might have been expected to' rather than 'the amount which would have been agreed'. The provision is also modified to reflect that the definition of royalty in the Convention extends to amounts that are credited.

Article 13 – Alienation of property

- 1.226 Article 13 allocates taxing rights over income arising from the alienation of immovable property and movable property. Paragraphs 1 to 4 of Article 13 align with the equivalent provisions in the OECD Model.
- 1.227 The reference to 'income' in this Article has a wide meaning and is to be read as including 'profits and gains'. [**Protocol, paragraph 2**]

- 1.228 Using the term in this way is intended to put beyond doubt that a gain from the alienation of property, which in Australia may be income or a profit under ordinary concepts, is to be taxed in accordance with this Article.
- 1.229 Article 13 permits source-based taxation of income from the alienation of immovable property by the country in which the property is situated. **[Article 13, paragraph 1]**
- 1.230 Article 13 permits source country taxation by a country of income from the alienation of movable property that forms part of the business property of a permanent establishment located in that country. **[Article 13, paragraph 2]**
- 1.231 The term ‘movable property’ means property that is not immovable property. **[Protocol, paragraph 5]**
- 1.232 The Article also assigns exclusive residence-based taxation for income that an enterprise that operates ships or aircraft in international traffic derives from the alienation of such ships or aircraft, or from movable property related to their operation. **[Article 13, paragraph 3]**
- 1.233 This provision aligns with the equivalent provision in the OECD Model. However, as noted above in respect of Article 3 (General Definitions), the definition of ‘international traffic’ used in this Convention is based on the alternative formulation provided in the OECD Model Commentary.
- 1.234 The Article also permits the source country to tax income derived from the alienation of any shares or comparable interests (for example, in a partnership or trust) by a resident of the other country where, at any time during the 365 days preceding the alienation, more than half of the value of such interests related to immovable property located in that country. **[Article 13, paragraph 4]**
- 1.235 This rule is designed to deal with arrangements involving the effective alienation of incorporated immovable property, or like arrangements. It ensures that capital or revenue gains on disposal of a foreign resident’s interests in certain assets are taxable by Australia. Such treatment applies whether the immovable property is held directly or indirectly through a chain of interposed entities. The rule refers to ‘any shares’, whereas the OECD Model simply refers to ‘shares’. This expanded reference is intended to make it clear that the provision has the broadest possible application.
- 1.236 Article 13 contains a ‘sweep up’ rule that generally assigns exclusive taxing rights over gains of a capital nature from the alienation of property that is not otherwise dealt with in the Article to the country of residence. **[Article 13, paragraph 5]**
- 1.237 This aspect of the sweep-up rule is based on the equivalent provision in the OECD Model. However, in contrast to the other provisions in Article 13 of the Convention, the sweep-up rule refers specifically to ‘gains of a capital nature’. This means that the broad reference to ‘income’ in Article 13 is not relevant to the sweep-up rule, which applies to a more limited class of ‘gains’. As such,

any income or profits that are not also gains are dealt with as business profits under Article 7 (Business Profits), or as ‘other income’ under Article 20 (Other Income).

- 1.238 The sweep-up rule in the Convention also contains an exception that applies where the alienator of the property is not the beneficial owner of the gains. In such cases, the gains from the alienation of property may also be taxed in the country in which the property is situated. [*Article 13, paragraph 5*]
- 1.239 This exception is not contained in the OECD Model. It ensures that source country taxation can apply to gains that are made by a fiscally transparent entity such as a trust.
- 1.240 Article 13 provides that where an individual ceases to be a resident of a Contracting State and continues to be treated under the taxation law of that State as having alienated any property and is therefore taxed within that State, the individual may choose to be treated for the purposes of taxation in the other Contracting State as if the individual had, immediately before ceasing to be a resident of the first-mentioned State, alienated and reacquired the property for an amount equal to its market value at that time. [*Article 13, paragraph 6*]
- 1.241 The purpose of this departure from the OECD Model is to prevent double taxation of capital gains of departing residents. Under Australia’s domestic law, a person who ceases to be a resident of Australia will generally trigger a tax liability on unrealised gains from assets held, other than ‘taxable Australian property’ (within the meaning of the ITAA 1997). A departing Australian resident individual may elect to either pay the Australian tax at the time of departure or to defer tax on the unrealised gain until the actual disposal of the asset.
- 1.242 Paragraph 6 of Article 13 allows a former Australian resident individual who has been taxed on the unrealised gains upon departure from Australia, and who becomes an Icelandic resident, to elect to be treated for Icelandic taxation purposes as having, immediately before ceasing to be a resident of Australia, alienated and reacquired the property for an amount equal to its market value at that time. This means that if subsequently, the individual (now a resident of Iceland), alienates the property, Iceland is precluded from taxing the individual on the gain that accrued during the period of their residence in Australia.
- 1.243 Iceland would still be able to tax any gains accrued during the period after the individual’s change in residence.
- 1.244 Where instead, the departing Australian individual elects to defer their capital gains tax liability on foreign assets until actual disposal of those assets, paragraph 5 of Article 13 will generally allocate exclusive taxing rights over the whole gain to the new country of residence, Iceland, however this is subject to paragraph 7 of article 13.
- 1.245 Article 13 does not affect Australia or Iceland’s right to tax income from the alienation of property derived by a person who ceases to be a resident of their

country in certain circumstances. This rule applies to a person that was a resident at any time during the year of income in which the property was alienated or had been a resident at any times during the six preceding years.

[Article 13, paragraph 7]

- 1.246 This provision preserves the operation of ‘exit taxes’ that are applied to a person who ceases to be a resident of Australia or Iceland. However, the six-year limit means that any exit taxes that apply after a person ceases to be a resident (for example, because they have deferred effect) cannot be applied after the time limit expires. In such cases, any income from the alienation of an asset that would otherwise be subject to an exit tax in the former country of residency is taxable in the new country of residency (subject to the other provisions of the Article).

Article 14 – Income from employment

- 1.247 Article 14 provides that income from employment (that is, salaries, wages and similar remuneration) earned by an individual shall only be taxable in their state of residence. **[Article 14, paragraph 1]**
- 1.248 However, if the individual’s employment occurs in the other state, then their salary, wages or similar remuneration may be taxed in that state, subject to certain conditions being met and the exceptions in the Article not being applicable (for example in respect of short-term visits, employment on a ship or aircraft). **[Article 14, paragraphs 1 to 3]**
- 1.249 Article 14 additionally allocates taxing rights over fringe benefits. The effect is that fringe benefits can only be taxed in the state that has been allocated the sole or primary taxing right under the Convention, in respect to salary, wages or other similar remuneration from the employment to which the fringe benefit relates. **[Article 14, paragraph 4]**
- 1.250 Article 14 expressly defers to the provisions of Articles 15 (Directors’ Fees), 17 (Pensions) and 18 (Government Service) that also concern salaries, wages and similar remuneration. **[Article 14, paragraph 1]**

Article 15 – Directors’ fees

- 1.251 Article 15 provides that directors’ fees and other similar payments earned by a resident of one state may be taxed in the country of residence of the company receiving the directorship services. **[Article 15]**

Article 16 – Entertainers and sportspersons

- 1.252 Article 16 provides that income earned by a resident of one state as an entertainer or sportsperson in the other state, may be taxed in that other state. **[Article 16, paragraph 1]**

- 1.253 If income from an entertainer or sportsperson's personal activities accrues to another person, it may be taxed in the state where the activities take place, notwithstanding Article 14 (Income from Employment).
[Article 16, paragraph 2]

Article 17 – Pensions

- 1.254 Article 17 provides that pensions and other similar remuneration shall only be taxed in the recipient's country of residence, subject to the provisions of Article 18 (Government Service). *[Article 17, paragraph 1]*
- 1.255 However, Article 17 provides a dual taxing right for pensions and similar remuneration paid under the social security legislation of the source country, or under any public scheme organised by the source country for social welfare purposes. This dual taxing right only applies where the payments are to an individual who is a national of the source country. *[Article 17, paragraph 2]*
- 1.256 Article 17 also provides dual taxing rights for certain lump sum pension payments and other similar remuneration that arise in the source state and are paid to a resident of the other state. Source state taxation only applies where the payment is made from a recognised pension fund, under a retirement benefit scheme, or in consequence of retirement, invalidity, disability or death, or by way of compensation for injuries. *[Article 17, paragraph 3]*
- 1.257 The Protocol to the Convention explains that the term 'retirement benefit scheme' means an arrangement that an individual participates in, in order to secure retirement benefits. The Protocol also provides examples of such schemes in Australia, all of which are effectively treated as part of Australia's superannuation. *[Protocol, paragraph 6]*
- 1.258 Article 17 allocates sole taxing rights to the source country for alimony or other maintenance payments made to a resident of the other country.
[Article 17, paragraph 4]

Article 18 – Government service

- 1.259 Article 18 provides that income (that is, salaries, wages and other similar remuneration) paid to an individual by a Contracting State or one of its political subdivisions or local authorities for the individual's government service are only taxable in that State. However, such income is taxable only in the other State, if the individual who earns the income is a resident of that State, provided they did not become a resident solely to render the services, or they are a national of that country. *[Article 18, paragraph 1]*
- 1.260 Government pensions are taxable only in the source country unless the person is both a resident and a national of the other country, in which case the pension is taxable only in the residence country. *[Article 18, paragraph 2]*

- 1.261 Paragraphs 1 and 2 do not apply where the relevant services are performed in connection with a business carried on by the State, or one of its political subdivisions or local authorities. In such cases, Articles 14 (Income from Employment), 15 (Directors' Fees), 16 (Entertainers and Sportspersons) and 17 (Pensions) shall apply. **[Article 18, paragraph 3]**

Article 19 – Students

- 1.262 Article 19 provides that where payments received by visiting students and business apprentices are made for the purposes of their maintenance, education or training then these payments will not be taxed by the country in which the student is undertaking their education or training, provided those payments are from sources outside that State. The student or business apprentice must be temporarily present in the country solely for the purpose of the individual's education or training. **[Article 19]**
- 1.263 Payments received by visiting students or business apprentices from employment are covered by other Articles.

Article 20 – Other income

- 1.264 Article 20 provides for the taxation of any form of income that is not dealt with by the earlier Articles of the Convention.
- 1.265 Any such income of a resident of Australia or Iceland, wherever arising, is taxable only in the country of residence. **[Article 20, paragraph 1]**
- 1.266 Article 20 also provides an exemption to the general rule for income from a right or property, other than immovable property as defined in paragraph 2 of Article 6, that is effectively connected to a permanent establishment. In such cases, Article 7 applies to allocate the taxing right of that other income to the country in which the permanent establishment is situated. **[Article 20, paragraph 2]**
- 1.267 Notwithstanding paragraphs 1 and 2, where the income of a resident of Australia or Iceland arises in the other State, it may also be taxed in the other State. **[Article 20, paragraph 3]**
- 1.268 This approach differs from that provided in the OECD Model, which allocates exclusive taxing rights on the basis of residency. The departure is consistent with Australia's reservation to the OECD Model.
- 1.269 Where income may be taxed in both countries in accordance with this Article, the country of residence of the person deriving the income is obliged by Article 21 (Relief from Double Taxation) to provide double taxation relief.

Article 21 – Relief from double taxation

- 1.270 Article 21 provides the rules to reduce double taxation. Under the Convention, Australia and Iceland agree to restrict their respective taxing rights to avoid double taxation. The Convention broadly follows the OECD Model for the alleviation of double taxation with the Convention adopting the credit method of relief from double taxation. Under this method the residence country is required to give credit against its tax for the tax paid in the source country.
- 1.271 Australia provides for relief from double taxation by allowing a credit against its own tax for Icelandic tax paid under the laws of Iceland and in accordance with the Convention on income derived by a resident of Australia from sources in Iceland. **[Article 21, subparagraph 1(a)]**
- 1.272 This is primarily achieved through Australia’s domestic tax provisions that provide for tax credits, such as the foreign income tax offset rules in Division 770 of the ITAA 1997. Australia also provides exemption for certain amounts of income (for example, certain branch profits are exempt under section 23AH of the ITAA 1936 and certain non-portfolio dividend distributions are exempt under Subdivision 768-A of the ITAA 1997). There is no Australian tax, against which, a credit could be applied for such exempt income.
- 1.273 Iceland provides for relief from double taxation by allowing a deduction against its own tax for Australian tax paid under the law of Australia and in accordance with the Convention on income derived by a resident of Iceland from sources in Australia. The deduction from Icelandic tax payable shall not exceed the Australian tax paid on the related income. **[Article 21, paragraph 2]**
- 1.274 Iceland may take into account income that is exempt from tax in Iceland in accordance with the Convention when calculating the amount of tax on the remaining income derived by a resident of Iceland. **[Article 23, subparagraph 2(b)]**

Article 22 – Non-discrimination

- 1.275 Article 22 provides the rules to prevent tax discrimination. Article 22 implements the provisions of the OECD Model with some departures.

Discrimination based on nationality

- 1.276 Under the Convention, Australia and Iceland agree that nationals of one country shall not be treated less favourably than nationals of the other country in the same circumstances. That is, the treatment in respect of taxation or any connected requirement cannot be other or more burdensome than for a national of the other country. This principle applies to both the taxation itself and any requirement connected with such taxation. **[Article 22, paragraph 1]**

Non-discrimination and permanent establishments

1.277 Paragraph 2 forbids a country from levying tax less favourably on permanent establishments of the other country than on the country's own enterprises carrying on the same activities. This applies to all residents of a treaty country, irrespective of their nationality, who have a permanent establishment in the other country. This should not be construed as obliging a country to provide residents of the other country any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents. *[Article 22, paragraph 2]*

Deductions for payments to foreign residents

1.278 The two countries must allow the same deductions for interest, royalties and other disbursements paid to residents of the other country as they do for payments to their own residents. However, the two countries are allowed to reallocate profits between associated enterprises on an arm's-length basis in accordance with paragraph 1 of Article 9 (Associated Enterprises), and to limit deductions in accordance with paragraph 8 of Article 11 (Interest) and paragraph 6 of Article 12 (Royalties). *[Article 22, paragraph 3]*

Enterprises owned or controlled abroad

1.279 Paragraph 4 forbids a country from giving less favourable treatment to an enterprise, the capital of which is owned or controlled, wholly or partly, directly or indirectly by one or more residents of the other country. That is, Australian companies owned or controlled by Icelandic residents may not be given other or more burdensome treatment than similar locally owned or controlled Australian companies. *[Article 22, paragraph 4]*

When this Article applies

1.280 Article 22 does not apply to a law of Australia relating to a rate of taxation in respect of an individual who is a working holiday maker under Australian law. *[Article 22, paragraph 5]*

1.281 Paragraph 6 departs from the OECD Model so that instead of applying to taxes of every kind and description, the Article applies only to those taxes covered by Article 2 (Taxes Covered) of the Convention. See explanation of Article 2 above. *[Article 22, paragraph 6]*

Article 23 – Mutual agreement procedure

1.282 Article 23 provides for a procedure for resolving difficulties and disputes arising from the application of the Convention. It provides for the consultation between the competent authorities of the two countries with a view to reaching a solution in cases where a person is able to demonstrate actual or potential imposition of taxation contrary to the provisions of the Convention. *[Article 23, paragraphs 1 and 2]*

- 1.283 Article 23 also obliges the competent authorities of the two countries to endeavour to resolve by mutual agreement any difficulties or doubts that arise regarding the interpretation or application of the treaty. The competent authorities may also consult together for the elimination of double taxation in cases not provided for in the Convention. *[Article 23, paragraph 3]*
- 1.284 The competent authorities are permitted to communicate directly with each other without having to go through diplomatic channels. This may be done by electronic means (for example, email or web conferencing), letter, telephone, direct meetings or any other convenient means. *[Article 23, paragraph 4]*

Arbitration

- 1.285 In some instances, the competent authorities may not reach agreement on a solution to a particular case. Paragraph 5 of this Article provides for arbitration to be used to assist in resolving those cases.
- 1.286 Only those cases presented under paragraph 1 of this Article (that is, where a person contends that the actions of either Australia or Iceland, or both, will result in taxation not in accordance with the Convention) are eligible for arbitration. Cases which arise under paragraph 3 of this Article, for example a case involving a general difficulty in interpreting or applying the agreement, are not eligible to be resolved through this arbitration mechanism.
- 1.287 Cases arising under paragraph 1 of this Article can only access the arbitration mechanism if the competent authorities are unable to reach agreement within two years from when all information required by the competent authorities to address the case has been provided to both competent authorities. If the case remains unresolved after that time, the person may request that the arbitration mechanism be used. Access to arbitration in such cases is automatic; it is not subject to the specific agreement of the competent authorities.
- 1.288 It is not intended that the arbitration mechanism be used as an alternative to the mutual agreement procedure. Where the competent authorities have reached an agreement that does not leave any issues unresolved in the case, that case is not eligible for arbitration even if the taxpayer does not agree with the solution reached. However, if any issue remains outstanding so that taxation contrary to the Convention remains, the competent authorities cannot consider (either alone or together) the case resolved and refuse the person access to the arbitration mechanism.
- 1.289 Unlike the mutual agreement procedure, which may be invoked where a taxpayer considers that taxation not in accordance with the treaty has resulted or will result, the arbitration mechanism is only available in respect of actual taxation contrary to the Convention which has resulted from the actions of Australia or Iceland, or both. This would include instances where an assessment or determination of tax has been made or otherwise where the taxpayer has been officially notified by the revenue authorities of Australia or

- Iceland that they will be taxed on an item of income and has resulted for the person in taxation not in accordance with the provisions of the Convention.
- 1.290 Further, unresolved issues cannot be submitted for arbitration if a decision on those issues has already been rendered by a court or administrative tribunal of either Australia or Iceland. This means where a court or administrative tribunal of one of the two countries has already rendered a decision that deals with those issues and applies to that person.
- 1.291 Paragraph 5 of this Article provides that unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision that decision is binding on both Australia and Iceland. Further, the two countries are obliged to implement the decision notwithstanding any time limits contained in their respective domestic laws. **[Article 23, paragraph 5]**
- 1.292 In the case of Australia, paragraph 5 of Article 23 shall not apply to an unresolved issue to the extent it involves the application of Part IVA of the ITAA 1936 or section 67 of the *Fringe Benefits Tax Assessment Act 1986*. **[Article 23, paragraph 5 and Protocol, paragraph 7]**
- 1.293 The operational rules and procedures of the arbitration mechanism will be mutually agreed by the competent authorities of Australia and Iceland. **[Article 23, paragraph 5]**
- 1.294** Paragraph 6 of this Article authorises Australia and Iceland to release any information to the arbitration board that is necessary for carrying out the arbitration procedure. The confidentiality rules contained in Article 24 (Exchange of information) will apply to that information and to the arbitration board. **[Article 23, paragraph 6]**
- 1.295 The competent authorities of each State are required to ensure that the taxpayer and their advisors enter into confidentiality agreements before the arbitration proceedings begin. The mutual agreement procedure and arbitration proceedings terminate if the taxpayer or their advisors materially breach the confidentiality agreement. The drafting of the second part of paragraph 6 is based on the drafting of paragraph 5 of Article 23 of the Multilateral Convention to implement tax treaty related measures to prevent base erosion and profit shifting. The inclusion of this paragraph in the Convention with Iceland reflects the importance Australia places on the confidentiality of taxpayer information. **[Article 23, paragraph 6]**

General Agreement on Trade in Services dispute resolution process

- 1.296 This Article also deals with disputes that may be brought before the World Trade Organisation Council for Trade in Services under the dispute resolution processes of the General Agreement on Trade in Services (GATS). **[Article 23, paragraph 7]**
- 1.297 Australia and Iceland are both parties to the GATS. Article XVII (National Treatment) of the GATS requires a party to accord the same treatment to

services and service suppliers of other parties as it accords to its own like services and service suppliers.

- 1.298 Articles XXII (Consultation) and XXIII (Dispute Settlement and Enforcement) of the GATS provide for discussion and resolution of disputes. Where a measure of another party falls within the scope of a tax treaty, paragraph 3 of Article XXII (Consultation) provides that the other party to the tax treaty may not invoke Article XVIII (National Treatment). However, if there is a dispute as to whether a measure actually falls within the scope of a tax treaty, either country may take the matter to the Council on Trade in Services for referral to binding arbitration – subject to the exception that if the dispute relates to a tax treaty which existed at the time the GATS entered into force, the matter may not be brought to the Council on Trade in Services unless both parties agree.
- 1.299 Paragraph 7 of this Article provides for the purposes of paragraph 3 of Article XXII (Consultation) of the GATS that notwithstanding that paragraph 3, any dispute between them as to whether a measure falls within the scope of the Convention may only be brought before the Council on Trade in Services with the consent of both Australia and Iceland. Paragraph 7 is based, in all essential respects, on the recommendation in paragraph 93 of the Commentary on Article 25 (Mutual Agreement Procedure) of the OECD Model and is common in recent international tax treaty practice.
- 1.300 Any doubt as to the interpretation of paragraph 7 of this Article shall be resolved under paragraph 3 of this Article or, failing agreement under that procedure, pursuant to any other procedure agreed to by the two countries.

Article 24 – Exchange of information

- 1.301 Article 24 obliges the competent authorities to exchange information as is foreseeably relevant for carrying out the provisions of the Convention or to the administration or enforcement of domestic laws concerning the taxes of every kind and description imposed on behalf of the Contracting States. The information is not restricted to persons or taxes covered under the treaty and may therefore cover persons who are not residents of either Australia or Iceland and taxes outside of those covered in Article 2. [**Article 24, paragraph 1**]
- 1.302 Article 24 provides the purposes for which the exchanged information may be used and the persons to whom it may be disclosed, and limitations on the exchange of information, in a manner which is consistent with the approach taken in the OECD Model. [**Article 24, paragraphs 2 and 3**]
- 1.303 When requested, a country is required to obtain and supply information using its domestic information gathering powers even though the country may not require the information for its own tax purposes. Australia would recognise this obligation to obtain relevant information for treaty partner countries, even in the absence of an explicit provision to this effect. [**Article 24, paragraph 4**]

- 1.304 Paragraph 5 ensures that the limitations to information exchange contained in paragraph 3 cannot be used to prevent the supply of information solely because the information is held by a bank, other financial institution, a nominee or a person acting in an agency or a fiduciary capacity, or because it relates to ownership interests in a person. *[Article 24, paragraph 5]*

Article 25 – Assistance in the collection of taxes

- 1.305 Australia and Iceland are authorised and required to provide assistance to each other in the collection of revenue claims. This assistance is not to be restricted by the terms of Article 1 (Persons Covered) or Article 2 (Taxes Covered) of the Convention. Assistance must therefore be provided as regards a revenue claim owed to either country by any person, whether or not a resident of Australia or Iceland. The competent authorities may mutually agree on the mode of application of this Article. *[Article 25, paragraph 1]*
- 1.306 The form of the assistance is set out in paragraphs 3 and 4 of this Article.

Definition of revenue claim

- 1.307 The term revenue claim is defined for the purposes of this Article to mean an amount owed in respect of taxes of every kind and description imposed by Australia or Iceland, or by Iceland's political subdivisions or local authorities, but only insofar as the imposition of such taxes is not contrary to the Convention or any other instrument in force between Australia and Iceland. It also applies to interest, administrative penalties and costs of collection or conservancy related to such amount. *[Article 25, paragraph 2]*
- 1.308 It is intended that the Article extend to any identical or substantially similar taxes which are subsequently imposed by either country in addition to, or in place of, these taxes. *[Article 2, paragraph 4]*

Enforceable revenue claims

- 1.309 Assistance in collection will only be provided by Australia in relation to a revenue claim that is enforceable in Iceland. Similarly, Iceland is not required to provide assistance in collection in respect of an Australian revenue claim that is not enforceable in Australia. A revenue claim will be enforceable where the requesting country has the right, under its domestic law, to collect the revenue claim. Further, the revenue claim must be owed by a person who, at that time, under the law of that country, has no administrative or judicial rights to prevent its collection.
- 1.310 Paragraph 3 of this Article regulates the way in which the revenue claim of the requesting country is to be collected by the requested country. Other than in relation to time limits and priority the requested country is required to collect the revenue claim in accordance with its own laws as though it were its own revenue claim. This obligation applies even if, at that time, the requested

country has no need to undertake collection actions related to that taxpayer for its own tax purposes. **[Article 25, paragraph 3]**

- 1.311 Where Iceland makes a revenue claim, the Australian Commissioner of Taxation will apply the provisions of Division 263 (Mutual assistance in collection of foreign tax debts) in Schedule 1 to the *Taxation Administration Act 1953* for the administration and collection of that claim.

Measures of conservancy

- 1.312 Australia or Iceland may request the other country to take measures of conservancy even where it cannot yet ask for assistance in collection, such as where the revenue claim is not yet enforceable or when the debtor still has the right to prevent its collection. Measures of conservancy are aimed at preventing a person from disposing of the person's assets in a way that is harmful to the person's creditors' interests. An example of a conservancy measure is the seizure or the freezing of assets before final judgment to guarantee that the assets will still be available when collection can subsequently take place.
- 1.313 If requested to do so by Iceland, Australia is required to take measures of conservancy in respect of the revenue claim in accordance with the provisions of Australian law as if the revenue claim were an Australian revenue claim. Although Australia does not have specific conservancy measures, the Commissioner of Taxation may apply for a Mareva injunction, which would prevent the taxpayer and the taxpayer's associates from dealing with certain assets. **[Article 25, paragraph 4]**

Time limits

- 1.314 The requested country's domestic law time limitations beyond which a revenue claim cannot be enforced or collected do not apply to a revenue claim in respect of which the other country has made a request for assistance in collection. Rather, the time limits of the requesting country apply. **[Article 25, paragraph 5]**
- 1.315 This paragraph follows paragraph 5 of Article 27 (Assistance in the Collection of Taxes) of the OECD Model but has no practical effect in Australia as there is currently no time limit imposed in Australia on the collection of a revenue claim.

Priority of claims

- 1.316 Any rules of Australia and Iceland which give priority to tax debts over the claims of other creditors do not apply to a revenue claim of the other country. This restriction applies regardless of the fact that the requested country must generally treat the claim as its own revenue claim.

- 1.317 The words ‘by reason of its nature as such’ in paragraph 5 of this Article indicate that any time limits and priority rules to which the paragraph applies are only those that are specific to unpaid taxes. Consequently, paragraph 5 of this Article does not prevent the application of general rules concerning time limits or priority which would apply to all debts, such as rules giving priority to a claim by reason of that claim having arisen or having been registered before another one. *[Article 25, paragraph 5]*

Restriction on judicial and administrative proceedings

- 1.318 Any legal or administrative objection concerning the existence, validity or the amount of a revenue claim of the requesting country is to be exclusively dealt with in that country. For example, no legal or administrative proceedings, such as a request for judicial review, may be initiated in Australia with respect to the existence, validity or amount of an Icelandic revenue claim. *[Article 25, paragraph 6]*

Change in circumstances

- 1.319 Where the relevant conditions in paragraph 3 or 4 of this Article are no longer satisfied after a request for assistance has been made, but before the revenue claim has been collected and remitted by the requested country, the competent authority of the requesting country is required to promptly notify the competent authority of the other country of that fact.
- 1.320 An example is where a request for assistance in collection has been made by Iceland, but the revenue claim ceases to be enforceable in Iceland prior to its collection by Australia.
- 1.321 Following such notification, the requested country has the option to ask the requesting country to either suspend or withdraw its request for assistance. If the request is suspended, the suspension applies until such time as the requesting country informs the other country that the conditions necessary for making a request as regards the revenue claim are again satisfied or that it withdraws its request. *[Article 25, paragraph 7]*

Limitations

- 1.322 The requested country is permitted to refuse the request for assistance in certain circumstances.
- 1.323 The first limitation on the obligations of the country receiving the request is that it is not required to exceed the bounds of its own domestic laws and administrative practice or those of the other country in fulfilling its obligations under this Article. *[Article 25, subparagraph 8(a)]*
- 1.324 However, this does not prevent Australia from applying administrative measures to collect an Icelandic revenue claim, even though invoked solely to provide assistance in the collection of Icelandic taxes.

- 1.325 The second limitation provides that the requested country is not required to satisfy a request where it would require the carrying out of measures that are contrary to public policy, such as where providing assistance may affect the vital interests of the requested country itself. **[Article 25, subparagraph 8(b)]**
- 1.326 The third limitation provides that the requested country is not obliged to satisfy a request for assistance if the other country has not pursued all reasonable measures of collection or conservancy that are available under its own laws or administrative practice. **[Article 25, subparagraph 8(c)]**
- 1.327 Additionally, the requested country may reject a request for assistance on the basis of practical administrative considerations such as when the costs of recovering a revenue claim would exceed the amount of the revenue claim itself. **[Article 25, subparagraph 8(d)]**
- 1.328 The final limitation allows the requested country to refuse to provide assistance if it considers that the taxes with respect to which assistance is requested are imposed contrary to generally accepted taxation principles. **[Article 25, subparagraph 8(e)]**

Article 26 – Members of diplomatic missions and consular posts

- 1.329 Article 26 ensures that the provisions of the Convention do not result in members of diplomatic missions and consular posts receiving less favourable treatment than that to which they are entitled to in accordance with the general rules of international law or under the provisions of special agreements. **[Article 26]**
- 1.330 Such persons are entitled, for example, to certain fiscal privileges under the *Diplomatic Privileges and Immunities Act 1967* and the *Consular Privileges and Immunities Act 1972* which reflect Australia's international diplomatic and consular obligations.

Article 27 – Entitlement to Benefits

- 1.331 Article 27 seeks to address potential treaty abuse. It provides that treaty benefits under the Convention are not to be granted for an item of income, if it can be reasonably concluded that the obtaining of the benefit was one of the principal purposes of any arrangement or transaction that resulted in that benefit, unless it is established that the granting of that benefit is in accordance with the object and purpose of the relevant provisions of the Convention. **[Article 27, paragraph 1]**
- 1.332 This paragraph adopts the wording of the Principal Purpose Test in the OECD Model and is intended to ensure that the Convention should apply in accordance with the purposes for which it was entered into, i.e. to provide benefits in respect of bona fide exchanges of goods and services and

- movements of capital and persons, as opposed to arrangements where one of the principal purposes is to secure a more favourable tax treatment.
- 1.333 Article 27 also adopts the optional OECD paragraph referred to in the OECD Commentary on this Article, which supplements the Principal Purpose Test. This addition provides that the competent authority can provide treaty benefits despite the application of the Principal Purpose Test where the competent authority considers that such benefits would have been granted without the arrangement that attracted the application of the Principal Purpose Test. The competent authority must consider the relevant facts and circumstances before reaching a decision and must consult the competent authority of the other Contracting State before rejecting a request to grant benefits if that request was made by a resident of that other State. *[Article 27, paragraph 2]*
- 1.334 Article 27 provides that where income is exempt from tax in a Contracting State only because of the status of that individual as temporary resident under the applicable laws of that State, then that individual cannot obtain treaty benefits in the other Contracting State in respect of that item of income. *[Article 27, paragraph 3]*
- 1.335 In Australia, temporary residents are not assessable on foreign-sourced income, subject to certain exceptions such as income that is remuneration for employment. The inclusion of paragraph 3 of Article 27 ensures that this tax treatment, when interacting with the operation of the treaty, does not create the potential for double non-taxation.
- 1.336 Article 27 preserves the application of domestic anti-abuse laws. This ensures that the Convention does not prevent the application of domestic laws that are designed to prevent the evasion or avoidance of taxes. Where such anti-abuse laws result in double taxation, the competent authorities are to consult in accordance with the mutual agreement procedure outlined in paragraph 3 of Article 23 of the Convention. *[Article 27, paragraph 4]*
- 1.337 The Protocol describes a range of laws that are understood to be domestic anti-abuse rules for the purposes of this paragraph of Article 27. This clarifies the scope of the provision on an inclusive basis, as paragraph 4 of Article 27 is not limited to the listed examples, applying to anti-avoidance laws more generally. *[Protocol, paragraph 1]*
- 1.338 The types of laws that are listed in the Protocol include:
- Australia and Iceland’s general anti-avoidance rules;
 - thin capitalisation and dividend stripping rules;
 - transfer pricing rules;
 - controlled foreign company and transferor trust rules; and
 - measures designed to ensure that taxes can be effectively collected and recovered, including conservancy measures.

Article 28 – Protocol

- 1.339 Article 28 provides that the Protocol to the Convention is an integral part of the Convention. [*Article 28*]
- 1.340 This Article incorporates the provisions of the Protocol into the Convention. The Protocol sets out a number of positions that were agreed to in the course of negotiations. Particular provisions of the Protocol are referenced throughout this explanatory memorandum where those provisions are relevant to a specific Article.

Article 29 – Entry into force

- 1.341 Article 29 provides for the entry into force of the Convention. Australia and Iceland shall notify each other in writing, through the diplomatic channels, that the country has completed their domestic requirements for the entry into force of the Convention. The Convention enters into force on the date of the last notification. [*Article 29*]
- 1.342 In Australia, enactment of the legislation giving the force of law in Australia to the Convention, is the necessary prerequisite to the exchange of diplomatic notes taking place.

Date of application for Australian taxes

Withholding tax

- 1.343 The provisions of the Convention apply in Australia in respect of withholding tax on income that is derived by a non-resident, in relation to income derived on or after 1 January next following the date on which the Convention enters into force. [*Article 29, subparagraph a(i)*]

Fringe benefits tax

- 1.344 The Convention applies in Australia in respect of fringe benefits tax in relation to fringe benefits provided on or after 1 April next following the date on which the Convention enters into force. [*Article 29, subparagraph a(ii)*]

Other Australian taxes

- 1.345 The Convention applies to other Australian taxes in relation to income of any year of income beginning on or after 1 July next following the date on which the Convention enters into force. [*Article 29, subparagraph a(iii)*]

Date of application of Icelandic taxes

Withholding tax

- 1.346 The Convention applies in Iceland to taxes withheld at source concerning income derived on or after 1 January next following the date on which the Convention enters into force. *[Article 29, subparagraph b(i)]*

Other Icelandic taxes

- 1.347 The Convention applies to other Icelandic taxes on income, chargeable for any tax year beginning on or after 1 January next following the date on which the Convention enters into force. *[Article 29, subparagraph b(ii)]*

Article 30 – Termination

- 1.348 Article 30 provides that the Convention continues in effect indefinitely. However, either country may terminate the Convention by giving notice of termination at least six months before the end of any calendar year beginning after the expiration of five years from the date of the Convention's entry into force. Termination is by written notice through the diplomatic channels. *[Article 30]*

Cessation date for Australian taxes

Withholding tax

- 1.349 In the event of termination, the Convention will cease to apply in Australia in respect of withholding tax in relation to income that is derived by a non-resident on or after 1 January next following the date on which the notice of termination is given. *[Article 30, subparagraph (a)(i)]*

Fringe benefits tax

- 1.350 In the event of termination, the Convention will cease to apply in Australia in respect of fringe benefits tax in relation to fringe benefits provided on or after 1 April next following the date on which the notice of termination is given. *[Article 30, subparagraph (a)(ii)]*

Other Australian taxes

- 1.351 In the event of termination, the Convention will cease to apply to other Australian taxes in relation to income of any year of income beginning on or after 1 July next following the date on which the notice of termination is given. *[Article 30, subparagraph (a)(iii)]*

Cessation date for Icelandic taxes

Withholding tax

- 1.352 In the event of termination, the Convention will cease to apply to tax withheld at source on income derived on or after 1 January next following the date on which the notice of termination is given. [*Article 30, subparagraph (b)(i)*]

Other Icelandic taxes

- 1.353 In the event of termination, the Convention will cease to apply to other Icelandic taxes on income, for taxes chargeable for any tax year beginning on or after 1 January next following the date on which the notice of termination is given. [*Article 30, subparagraph b(ii)*]

Consequential amendments

- 1.354 The amendments update various notes in the Agreements Act which set out where the text of various treaty agreements and protocols may be accessed. The text of any treaty in force for Australia is published in the Australian Treaty Series, accessible from the Australian Treaties Database on the Department of Foreign Affairs and Trade website (www.dfat.gov.au) or through the Australian Treaties Library on the AustLII website (www.austlii.edu.au). [*Schedule 1, items 4, 5, 6, 7, 9 and 11, notes to subsection 3AAA(1) of the Agreements Act*]
- 1.355 The amendments also update various notes in the Agreements Act to reflect that the information in each note is current as of 2022. The notes relate to where the text of a treaty or other agreement is located, which has not changed since the last time each note was amended. [*Schedule 1, items 3, 8 and 10, notes to subsections 3(1) and 3AAA(1) of the Agreements Act*]

Commencement, application, and transitional provisions

- 1.356 The amendments commence on the day after they receive the Royal Assent. However, the Convention itself must first enter into force before it can take effect. For entry into force, Australia and Iceland must exchange instruments of ratification on the completion of their domestic implementation procedures.
