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Abstract

As a tax treaty between a developing and a developed country, the Sino-Australian Income Tax Agreement contains important aspects of the model treaties and bears some resemblance to the Sino-American Tax Treaty. The Agreement also contains clauses reflecting the unique positions of each contrasting party.

Keywords

tax treaty, China, Australia, income tax

A COMPARATIVE ANALYSIS OF THE SINO-AUSTRALIAN INCOME TAX AGREEMENT

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As a tax treaty between a developing and a developed country, the Sino-Australian Income Tax Agreement contains important aspects of the model treaties and bears some resemblance to the Sino-American Tax Treaty. The Agreement also contains clauses reflecting the unique positions of each contrasting party.

Introduction

In November 1988 Australia and the People's Republic of China concluded the Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income ("the Agreement") at Canberra.¹

In May 1989 the Income Tax Amendment Bill 1989 was introduced into the Commonwealth Parliament to enact the Agreement. The Bill was passed by the House of Representatives without amendment. However, the Agreement has not been ratified by the Senate at the result of the tragic events in Beijing on 4 June 1989.

Since adoption of the open-door policy to the outside world, China has now concluded 22 tax treaties, of which 18 have become effective. Although there will doubtless be more treaties, China's tax treaty program seems largely complete and its network now covers nearly all of China's main trading partners and investors.

The Agreement embodies important aspects of the model tax treaty drafted by the Organization for Economic Cooperation and Development

¹ "Agreement between Australia and the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income" reprinted in *Butterworths Australian Income Tax* (1989), 9003-9018.

("the OECD Model"),² the United Nations Model Double Taxation Convention between Developed and Developing Countries ("the UN Model")³ and bears some resemblance to the Sino-American Income Tax Treaty ("the US Treaty") which took effect in 1987.⁴ This comment attempts to provide a comparative analysis of the provisions of the Agreement and the model treaties and the US Treaty, with emphasis directed towards the provisions of the Agreement which illustrate developing country provisions.

Based on model tax treaties

The OECD Model

Tax treaties are bilateral conventions negotiated between countries for the primary purpose of resolving double taxation problems which arise from the assertion by more than one country, through their domestic laws, of jurisdiction to tax the same item of income. Such overlapping or double taxation arises quite often from the fact that most countries exercise jurisdiction to tax income on two bases, one derived from the source of the item of income, the other from the residence of the recipient of that item of income. Under these circumstances, double taxation is likely to exist when trade, investment, or other income-producing activities involve more than one country. Many countries, through their domestic laws, have tried to deal with the problem of double taxation. However, as the volume of the international trade and investment has grown tremendously since the end of World War II, the need for model tax treaties to provide a more coherent and complete resolution of double taxation problems has become indispensable.

The end of World War II saw serious attempts at formulating methods of eliminating double taxation and tax evasion. In 1963 the Organization for Economic Cooperation and Development ("the OECD") issued the first major model income tax treaty, along with a recommendation that OECD member countries conform to the terms of the convention in their bilateral negotiations. In 1977 OECD revised its model treaty — the present OECD Model.

The OECD Model adopts the position that the country of residence should bear the burden of eliminating double taxation of income via the foreign tax credit mechanism or the total exemption of resident country

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- 2 "Organization for Economic Cooperation and Development, Model Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital" reprinted in *Australian International Tax Agreements* (1983) 1-501 CCH Australia Ltd.
 - 3 "UN Model Double Taxation Convention between Developed and Developing Countries" in UN Department of International Economic and Social Affairs, UN Doc ST/ESA/102, UN Sales No E 80 XVI 1.3 (1980). For a detailed analysis of the UN Model, see Surrey "United Nations Group of Experts and the Guidelines for Tax Treaties between Developed and Developing Countries" (1978) 19 *Harvard International Law Journal* 2.
 - 4 *Agreement between the Government of the United States of America and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income* reprinted in *International Tax Treaties of All Nations* (1985) v 17 Series B 411-447 Oceana Publications Inc.

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taxation of foreign source income.⁵ In addition, the OECD Model limits the extent of foreign source jurisdiction to tax and reduces the tax rate where imposed.⁶ The OECD Model is intended for use between OECD member countries, ie, almost exclusively industrial nations.

The Agreement is based substantially on the OECD Model, although many different provisions remain. China's acceptance in the Agreement of the basic principles of the OECD Model suggests that its tax system is very much within the mainstream of international tax systems.

The UN model

While the OECD Model was drafted to provide a uniform approach to effectuate the objectives of bilateral tax treaties between developed countries, the objectives and needs of developing countries are divergent from those of developed countries. To provide a uniform approach to accommodate the particular objectives of developing countries, in the late sixties, the Economic and Social Council of the United Nations set up the United Nations Group of Experts on Tax Treaties Between Developed and Developing Countries ("the Group"). The Group started working in 1968 and held eight meetings altogether. At its eighth meeting in December 1979 the Group concluded its work on a United Nations Model Double Taxation Convention between Developed and Developing Countries, the UN Model in its present form.⁷

The OECD and UN Models are similar in many respects. The principal difference between the two is that the UN Model is directed specifically at treaties between a developed country and a developing country. As developing countries are basically recipients of capital and investment, the UN Model provides an expanded source-based jurisdiction to tax income which arises in-country. Developing countries seek less drastic reductions of withholding rates of passive investment income and seek lower threshold definitions of the term "permanent establishment" which defines the requisite degree of in-country business presence necessary to subject an enterprise to taxation.

The Agreement embodies important aspects of the UN Model and reflects China's general tax treaty policy toward a developed country. The importance of the Agreement is heightened by the emergence of significant trade, capital formation, and technology transfer between the two countries in recent years.

Special concerns of the developing countries

As a common goal, the purposes of bilateral tax treaties are to avoid international double taxation, to prevent tax avoidance and evasion, and to

5 See Whittaker, "An Examination of the OECD and UN Model Tax Treaties: History, Provisions, and Application to US Foreign Policy" (1982) 8 North Carolina Journal of International Law and Commerce Regulation 39, 45.

6 Ibid.

7 See Surrey, *United Nations Model Convention for Tax Treaties Between Developed and Developing Countries: a Description and Analysis* (1980) 3.

reduce the barriers to trade and investment posed by the administrative burdens of complying with two tax systems. While these are the principal tax policy concerns of all tax treaties, they do not include those special concerns of the developing countries. In the negotiation of tax treaties developing countries, as a group, share two major objectives somewhat at odds with those of the developed countries. The objectives are to maximize the public capture of the revenue from foreign investment activities by expanding source-based jurisdiction and to encourage foreign investment by seeking treaty terms, which in effect, provide subsidies to investors at the expense of developed country treaty partners.⁸

These objectives, however, conflict directly with the desire of the developed countries. Most industrialized countries stress greater residence-state jurisdiction, and strive to limit the taxation of income in source states.⁹ Such restrictions, though formally reciprocal, only produce equitable revenue effects when investment flows between treaty partners are relatively equal.¹⁰ When investment flows primarily in one direction, as it generally does from developed to developing countries, the seemingly reciprocal source-based restrictions produce revenue sacrifices by the investment receiving states, namely, the developing countries.

China, like other developing countries, is interested in obtaining tax revenues from foreign investors. Again like developing nations, in negotiating tax treaties, China tries very hard to put in an effective clause to subsidize investors in terms of tax benefits in order to attract them.¹¹

However, the relationship between China and Australia is not a typical one between a developing country and a developed country as far as trade and investment are concerned. For example, over the last ten years, Australian companies have established more than 30 joint ventures in China with the total value of investment in excess of A\$250 million. At the same time, Chinese investment in Australia, including major investments in the Channar Iron Ore Mine in Western Australia and the Portland Aluminium Smelter, totals between A\$350 to A\$400 million and is continuing to increase in spite of the recent strain between the two countries.¹² The Agreement, to a certain extent, reflects this unique relationship.

8 "Tax sparing" is one such potential measure. See below **Miscellaneous Provisions**.

9 See Brockway, "The US Tax Treaty Program: Major Issues and Options" (1980) 11 Tax Notes 907, 909.

10 See Roberbloom and Langbein, "United States Tax Treaty Policy: An Overview" (1981) 19 Columbia Journal of Transnational Law 359, 374.

11 See eg "Agreement between the Government of the People's Republic of China and the Government of Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income" reprinted in *International Tax Treaties of All Nations* (1988) vol 20 Series B art 21 Oceana Publications Inc. See generally below **Elimination of Double Taxation**.

12 Speech made by Mr Robin Duffer Hyams, Senior Trade Commissioner and Minister, Commercial Australian Trade Commission, Australian Embassy to Beijing, at Australia-China Business Cooperative committee, the Seventh China-Australia Senior Executive Forum, 28-29 May 1990, Shanghai, 1-2.

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Scope and definitions

"Resident" defined

Bilateral tax treaties are designed to benefit "persons" who are "residents" or dual residents of the signatory states. The threshold determination of residence as a premise to the application of tax treaty benefits is used by both the UN Model and the US Treaty. Article 1 of the Agreement states that the "[a]greement shall apply to persons who are residents of one or both of the Contracting States".¹³ The application of the Agreement is wholly dependent upon the determination of residence. The article 1 standard of residence is in complete accord with the UN Model and the US Treaty.¹⁴

The term "person" is defined in article 3 of the Agreement to include an individual, a company and any other body of persons.¹⁵ The term "resident" is defined in article 4 of the Agreement as "a person who is fully liable to tax therein by reason of being a resident of that State under the tax law of that State".¹⁶ The provision adopted is that of the UN Model.¹⁷ This definition is also identical with that contained in the US Treaty.¹⁸

Persons who are defined as residents of both Contracting States are dual residents. In such instances, the model treaties have developed the "tie breaker" rules to determine a deemed residence for treaty purposes. The UN Model "tie breaker" rules deem the residence of dual residence individuals as follows:

- he shall be deemed to be resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests);
- if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has a habitual abode;
- if he has a habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State in which he is a national;
- if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

13 Agreement, above n 1 art 1.

14 UN Model, above n 3; US Treaty, above n 4 art 1.

15 Agreement, above n 1 art 3(d).

16 Ibid art 4(1).

17 UN Model, above n 3 art 4(1).

18 US Treaty, above n 4 art 4(1).

The Agreement contains similar provisions¹⁹ and therefore provides sufficient guidance to assist planners in predicting the residence of dual resident individuals.

The Agreement also applies the UN Model's provisions to the determination of a dual resident company.²⁰ The UN Model, as well as the OECD Model, deem the place of "effective management" as the residence of dual resident companies.²¹ The provision of the Agreement in this regard seems very different from that contained in the US Treaty.²²

Article 4(5) of the Agreement was drafted as the primary anti-treaty shopping provision,²³ designed to deny Agreement benefits to third country investors. Article 4(5) provides that the Contracting Parties may deny the benefits of the reduced withholding rates of article 10 (dividends), article 11 (interest), and article 12 (royalties) to any company if such company has become a resident of a Contracting State for the principal purpose of enjoying its benefits available under the Agreement.²⁴ This provision is very identical to that contained in Protocol paragraph 7 of the US Treaty.²⁵

It is important to note the status of Hong Kong if the Agreement were ratified and effective. In 1984, China and the United Kingdom signed a treaty ("the Hong Kong Treaty") which returns the sovereign control of Hong Kong to China in the year 1997.²⁶ It is not clear from the Agreement itself whether the territory of Hong Kong will be within the Agreement definition of China as "all the territory of the People's Republic of China, including its territorial sea, in which the laws relating to Chinese tax apply."²⁷ The Hong Kong Treaty establishes the Hong Kong Special Administrative Region. The Hong Kong Special Administrative Region will clearly cease to be a British colony; however, the present Hong Kong legislative process and judicial system will remain in force for 50 years. The Hong Kong Region will retain the current monetary system and system of taxation for 50 years. It is argued that Hong Kong is not within the definition of China as defined in China's tax treaties with other countries, because

19 Agreement, above n 1 art 4(3).

20 Ibid art 4(4).

21 UN Model, above n 3 art 4(3); OECD Model, above n 2 art 4(3).

22 According to art 4(3) of the US Treaty, where a company is a resident of both Contracting Parties, then the competent authorities of the Contracting States shall determine through consultations the contracting state of which the company shall be deemed to be a resident for the purpose of this Agreement, and if they are unable to determine, the company concerned shall not be considered to be a resident of either country for purposes of enjoying tax benefits.

23 The term "treaty shopping" typically refers to the practice of establishing resident status in a country having favourable treaty provisions. See generally Freud, "Treaty Shopping and the 1981 United States Treasury Draft Model Income Tax" (1983) 6 Hastings International and Comparative Law Review 627; Rosenbloom, "Tax Treaty Abuse: Policies and Issues" (1983) 15 Law and Policy International Business 763.

24 Agreement, above n 1 art 4(5).

25 US Treaty, above n 4 Protocol para 7.

26 *The Agreement between the Government of the United Kingdom of Great Britain and the Government of the People's Republic of China on the Future of Hong Kong*, 19 December 1984, United Kingdom-People's Republic of China, 1984 Great Britain TS No 20 (Cmd 9352), 23 ILM, 1366.

27 Agreement, above n 1 art 3(1)(b).

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Chinese taxes will not be in force in Hong Kong for 50 years.²⁸ The argument that Hong Kong will not be within the definition of China is reasonable and persuasive. The issue is of major importance due to significant potential for treaty abuse by third country residents who establish residence in Hong Kong to derive Agreement benefits.

Permanent establishment

The principal purpose of bilateral tax treaties is to eliminate or reduce the incidence of double taxation. The concept of the "permanent establishment" is a fundamental aspect of tax treaty policy because the existence or non-existence of a permanent establishment is determinative of whether the business profits of a resident enterprise of the other contracting state are subject to in-country taxation or exempt from such taxation under the treaty. In the absence of a tax treaty, all business profits are generally subject to taxation. The definition of "permanent establishment" sets a standard to determine the desired degree of business activity or fixed business presence required to subject such enterprises to in-country taxation.

Tax treaties between developed countries reduce the incidence of double taxation by using a permanent establishment definition, the threshold of which requires a higher presence to subject an enterprise to in-country taxation. The rationale is that the flow of capital and investment between countries are relatively equal in amount; therefore, exemption at source is an efficient means to eliminate double taxation without the loss of tax revenue for each one.²⁹ By contrast, the UN Model takes a different approach³⁰ as it is drafted principally for treaty negotiations between developed and developing countries. In such cases, the flow of capital and investment is primarily supplied by the developed country. The developing countries desire a low definitional threshold of the permanent establishment status so as to expand the jurisdictional tax base. Developing countries also seek to attract foreign investment. Negotiators representing developing countries strive to draft a definitional standard of permanent establishment which balances these interests.

The Agreement's definition of "permanent establishment" is actually a blend of the OECD Model and the UN Model. The Agreement defines "permanent establishment" as a fixed place of business through which the business of an enterprise is wholly or partly carried on.³¹ Article 5(2) of the Agreement provides that the term "permanent establishment" specifically includes the following:

- a place of management;
- a branch;
- an office;
- a factory;

28 Easson and Li, "Foreign Tax Update" (1990) Tax Bulletin 27.

29 OECD Model, above n 2 art 5.

30 UN Model, above n 3 art 5.

31 Agreement, above n 1 art 5(1).

- a workshop;
- a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
- a farm or forest.

The above specifically-mentioned terms are merely intended to cite examples of a fixed place of business and are not exclusive. The Agreement's general concept of a permanent establishment is typical of existing treaties.

The Agreement, however, adopts the UN Model approach relating to permanent establishment status concerning building sites, construction, assembly or installation projects which continue for a period in excess of six months.³² The OECD Model and the tax treaty policy of the developed countries typically provide that construction projects completed within a twelve month period are not permanent establishments.³³ Furthermore, the Agreement adopts the UN Model provision that supervisory activities in connection with construction related to projects elevates a foreign presence to permanent establishment status where such activities are in excess of six months.³⁴

Australian residents engaged in construction projects or providing supervisory services related to construction projects for a period in excess of six months per project maintain a permanent establishment under the Agreement and are subject to taxation within China even though no fixed place of business exists.

The Agreement also provides that permanent establishment status attaches to structures, installations, drilling rigs, ships or other equipment used in the exploration of natural resources for a period in excess of three months.³⁵ This provision is not within the model treaties. The reduced exemption period is probably due to the existence of vast opportunities within, and offshore from, both Contracting Parties concerning natural resource exploration and each party's desire to expand its taxable base. It is interesting to note that as China has invested substantially in natural resources area in Australia, such a provision will affect Chinese investment in Australia much more than it does to Australian investment in China when the Agreement enters into force.³⁶

The furnishing of services, including consulting services, by enterprises attains permanent establishment status when such services continue, concerning the same project, for a period aggregating more than six months within any 12-month period.³⁷ An Australian firm which provides services within China, yet maintains no office within China, will be subject to tax in

32 Ibid art 5(3).

33 See OECD Model, above n 2 art 5(3).

34 Agreement, above n 1 art 5(3)(a); UN Model, above n 3 art 5(3)(a).

35 Agreement, above n 1 art 5(3)(c).

36 Above n 12.

37 Agreement, above n 1 art 5(3)(b).

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China where such services concerning the same project are provided for an aggregate period in excess of six months within a twelve month period. The Agreement provision is adopted from the UN Model.³⁸ Activities of Australian service enterprises such as law firms or accounting firms may inadvertently maintain permanent establishments under the Agreement.

The Agreement excludes from permanent establishment status facilities used solely for storage display or delivery of goods or merchandise belonging to the enterprise.³⁹ Additionally, the term "permanent establishment" does not include a facility used solely to purchase goods or to collect information. An Australian firm which merely maintains an inventory within China or maintains a facility within China to purchase or deliver goods will not be subject to taxation within China if such activities are the sole in-country ones. Exemption will arise in situations where an Australian firm maintains an inventory within China solely under consignment arrangements with independent agents. However, the Agreement provides that if the activities of such an agent are devoted wholly or almost wholly on behalf of that firm, the firm shall be deemed to have a permanent establishment.⁴⁰ This is very similar to those provided in the US Treaty.⁴¹

Taxes covered

(i) Australian taxes

Article 2(1)(a) defines the scope of Australian taxes subject to the Agreement as being federal income taxes and the resource rent tax in respect of offshore projects imposed by the federal government.

(ii) PRC taxes

Article 2(1)(b) defines the scope of PRC taxes covered by the Agreement. The objective of this analysis is to examine the Agreement's impact upon PRC taxation of Australian residents. Thus a brief summary of the PRC taxes, which are subject to the Agreement, is provided at this juncture. However, a detailed analysis of the emerging system of PRC taxation is beyond the scope of this analysis.

The individual income tax law. The Individual Income Tax Law of the People's Republic of China (the "IIT Law")⁴² was enacted at the Third Session of the Fifth National People's Congress on 10 September 1980. Detailed Rules and Regulations for the Implementation of the Individual Income Tax Law of the People's Republic of China ("the IIT Regulations")⁴³ were promulgated by the Ministry of Finance on 14 December 1980. Liability for tax under the IIT Law is primarily borne by foreigners and

38 UN Model, above n 3 art 5(3)(b).

39 Agreement, above n 1 art 5(4)(a).

40 Ibid art 5(6).

41 US Treaty, above n 4 art 5(5)(6).

42 IIT Law. For the English translation, see *China Laws for Foreign Business* 30-500 CCH Australia Ltd (hereinafter called "*China Laws*").

43 IIT Regulations, approved by the State Council on 10 December 1980 and promulgated by the Ministry of Finance on 14 December 1980, *China Laws* 30-520.

relatively few Chinese such as artists and writers. The absence of greater IIT Law applicability is due to the statutory exemption of Renminbi 800.00 per month (about \$200).⁴⁴

The IIT Law is imposed on individuals, regardless of citizenship, according to their residence and source of their income. Non-residents and residents for less than one year are subject to the IIT Law for income gained within the PRC.⁴⁵ However, the IIT Regulations provide an exemption for individuals who reside in China for not more than ninety days within a calendar year provided that such compensation is paid by employer outside China.⁴⁶

Residents for a period in excess of one year but not exceeding five years shall pay tax only on that part of their income received outside China which is remitted to China.⁴⁷ Residents for a period more than five years are subject to tax on a worldwide basis.⁴⁸

The IIT Law has established six categories of income subject to tax.⁴⁹ The rate of tax for wages and salaries is progressive between five percent and 45 percent.⁵⁰ The standard exemption for Renminbi 800.00 is reflected in the rate schedule as a zero bracket amount. However, in accordance with the Provisional Regulations of the State Council Concerning the Reduction of the Individual Income Tax on Wages and Salaries of Foreign Nationals Working in China,⁵¹ income tax payable on wages and salaries of foreigners or overseas Chinese working in China will be reduced by 50 percent. The remaining categories of income such as non-employee personal service income, royalties, dividends, and rentals are taxed at a flat rate of 20 percent.⁵²

The joint venture income tax law. The Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment ("the JVIT Law")⁵³ was adopted by the Fifth National People's Congress on 10 September 1980. The Ministry of Finance issued the Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment ("the JVIT Regulations")⁵⁴ on 14 December 1980, which was effective as of the date of enactment. The JVIT Law is

44 IIT Law, above n 42 art 5.

45 Ibid art 1.

46 IIT Regulations, above n 43 art 5(1).

47 Ibid art 3.

48 Ibid.

49 They are (a) wages and salaries; (b) compensation for personal service; (c) royalties; (d) interest, dividends, and extra dividends; (e) other income specified as taxable by the Minister of Finance.

50 IIT Law, above n 42 art 3.

51 *Provisional Regulations of the State Council Concerning the Reduction of Individual Income on Wages and Salaries of Foreign Nationals Working in China*, promulgated by the State Council on 8 August 1987, *China Laws* 30-528.

52 IIT Law, above n 42 art 3(2).

53 JVIT Law, *China Laws* 33-500.

54 JVIT Regulations, *China Laws* 33-510.

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applicable to all joint ventures created under the Law of the People's Republic of China on Sino-foreign Joint Equity Enterprises ("the Joint Venture Law").⁵⁵

The JVIT Law imposes a 30 percent tax rate on joint ventures and provides a local surtax of 10 percent, on the tax paid, making the effective tax rate 33 percent.⁵⁶ An additional withholding tax of ten percent is levied upon any amount remitted out of China. Taxable income is defined as gross income gained from productions, business operations, and other sources⁵⁷ reduced by the costs, expenses, and losses incurred in that year.⁵⁸ Net operating losses may be carried forward for five years.⁵⁹ The JVIT Law does not include a capital gains structure. Such income is taxed as ordinary income.⁶⁰ Fixed assets are generally depreciated on a straight line basis.⁶¹ The Ministry of Finance may, upon application, approve other depreciation methods in circumstances owing to special reasons.⁶²

The JVIT Law contains a refund provision of 40 percent of the income tax paid where a foreigner reinvests for at least five years the profits from a joint venture.⁶³ Another tax incentive is provided via a tax holiday system whereby a joint venture scheduled to operate for ten or more years may be exempted from income tax liability in the first two profit making years and receive a 50 percent reduction of tax in the following three years.⁶⁴

The foreign enterprise income tax law. The Foreign Enterprise Income Tax Law of the People's Republic of China ("the FEIT Law")⁶⁵ was enacted by the Fourth Session of the Fifth National People's Congress on 13 December 1981. The Detailed Rules and Regulations for the Implementation of the Foreign Enterprise Income Tax Law of the People's Republic of China ("the FEIT Regulations")⁶⁶ were promulgated by the Ministry of Finance on 21 February 1982. The FEIT Law is applicable to foreigners doing business in China through investment vehicles other than equity joint ventures covered by the JVIT Law.

The FEIT Law incorporates a concept of establishment similar to that typically found in tax treaties.⁶⁷ The term "establishment" is defined as an office, site, or business agent engaged in production or business operations

55 Joint Venture Law, passed at the Second Session, the Fifth National People's Congress on 1 July 1979 and amended at the Third Session, Seventh National People's Congress on 4 April 1990, *China Laws* 6-500.

56 JVIT Law, above n 53 art 3.

57 Ibid art 1.

58 Ibid art 2.

59 JVIT Regulations, above n 54 art 7.

60 Ibid art 15.

61 Ibid art 12.

62 Ibid art 13.

63 Joint Venture Law, above n 55 art 7; JVIT Law, above n 53 art 5.

64 Joint Venture Law, above n 55 art 7; JVIT Law, above n 53 art 5.

65 FEIT Law, *China Laws* 32-500.

66 FEIT Regulations, *China Laws* 32-510.

67 See Note, "Permanent Establishment, under the Non-Discrimination Clause in Income Tax Treaties" (1978) 11 Cornell International Law Journal 51.

within China by a foreign enterprise.⁶⁸ The extent to which the activities of an agent will constitute an establishment seems unclear; however, agents who perform market research or promotional activities without authority to sign contracts have not satisfied the establishment test.

The FEIT Law asserts a tax on the taxable income of foreign enterprises who maintain establishments within China.⁶⁹ The tax rate is progressive. The FEIT Law also imposes a local surtax of ten percent of the taxable income subject to the national tax.⁷⁰ Foreign enterprises which do not maintain establishments, as defined, are taxed at a fixed rate of 20 percent on gross PRC source dividends, interest, rents, royalties, and other income.

The calculation of taxable income under the FEIT Law corresponds generally to the calculation of taxable income under the JVIT Law. The FEIT Law does not contain capital gain provisions.⁷¹ The FEIT Law depreciation and useful life provisions provide straight line depreciation in accord with the JVIT Law.⁷² The FEIT Regulations provide a deduction for interest on loans subject to local authority approval as to reasonableness.⁷³ Interest on capital, as under the JVIT Law, is a nondeductible item.⁷⁴

Inter-company administrative expenses and overhead expenses paid to a head office for services actually performed by such head office are deductible expenses; however, royalties paid to a head office are non-deductible items.⁷⁵

The FEIT Law provides a tax incentive structure more restrictive than the JVIT Law in that the exemption or reduction of income may be available only to foreign enterprises concerning farming, forestry, animal husbandry, or other low profit operations.⁷⁶ The apparent rationale for the more liberal coverage of the tax incentive structure under the JVIT Law is due to a strong desire by the PRC to attract high technology in joint equity projects.

In order to attract more investment, a new tax law entitled the Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment and Foreign Enterprises was drafted to replace the JVIT Law and FEIT Law and this law has been adopted at the Fourth Session of the Seventh National People's Congress in April 1991. This new tax law, which has 30 articles, has unified the different tax treatments under the JVIT Law and FEIT Law with the income tax ranging from 15 percent to 33 percent. The new tax law comes into force on 1 July 1991.

68 FEIT Regulations, above n 66 art 2.

69 FEIT Law, above n 65 art 2; FEIT Regulations, above n 66 art 4.

70 FEIT Law, above n 65 art 4.

71 FEIT Regulations, above n 66 art 20.

72 Ibid arts 15-18.

73 Ibid art 12.

74 Ibid art 10(3).

75 Ibid art.

76 FEIT Law, above n 65 art 5.

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Business profits

As in the Model treaties, the Agreement provides that the profits of a foreign enterprise are taxable if a permanent establishment exists.⁷⁷ Article 7 of the Agreement delineates the calculation of profits subject to taxation.

Business profits of a permanent establishment are calculated as if such establishment were a distinct and separate enterprise dealing wholly independently with the enterprise of which it is a permanent establishment.⁷⁸ This provision is accord with the UN Model and the US Treaty. General and administrative expenses of a permanent establishment are deductible whether incurred within the State of the permanent establishment or elsewhere, such as a head office.⁷⁹ This provision is also in accord with the UN Model and the US Treaty.⁸⁰ Under the Agreement, however, payments of royalties or interest on debts to the head office or related branch are deductible only to the extent of reimbursed actual costs.⁸¹ This provision is adopted from the UN Model.

The Agreement adopts the UN Model provision and the US Treaty provision that where profits include items of income which are treated separately within the Agreement, such as dividends (article 10), interest (article 11), and royalties (article 12), those items will not be included within the profits definition.⁸² The adoption of the UN standard operates to establish gross basis of business profits so as to provide greater source taxation within the home country.

Unlike the US Treaty, this article of the Agreement also provides that if the law of either Contracting State regarding tax imposed on profits from insurance with non-residents is affected because the change of law, both sides will consult with each other in order to amend this provision.⁸³

Investment income

Treaty provisions concerning the jurisdiction to tax investment income highlight the competing interests between developed and developing countries. Developed countries prefer the resident based jurisdiction with corresponding reductions or exemptions of source based withholding rates in other contracting states. Due to disparity in the flow of capital between developed and developing countries, a residence preference results in hardship to source-based developing countries. In this context, the negotiators of developing countries strive to adopt a rate of withholding which is lower than the normal rate of withholding so as to reduce taxation and attract investment, but which also preserves a satisfactory rate of withholding so as to generate revenues within the developing countries. The major differences among the OECD Model and the UN Model concern the

77 Agreement, above n 1 art 7.

78 Ibid art 7(2).

79 Ibid art 7.

80 UN Model, above n 3 art 7(3).

81 Agreement, above n 1 art 7 (3).

82 Ibid art 7(7).

83 Ibid art 7(8).

rate of withholding and the percentage of ownership which is deemed direct investment so as to provide certain additional withholding reduction. Under the Agreement, each country may tax investment income. Reduced rates of withholding tax, however, apply.

The IIT Law and FEIT Law impose a withholding tax of 20 percent on PRC investment source income.⁸⁴ The US Treaty generally adopts a reduced withholding rate of 10 percent concerning investment income paid to residents of a Contracting State.⁸⁵ The UN Model does not state a fixed rate of withholding so as to allow contracting parties to work out through negotiation the appropriate level of withholding. The Agreement provisions providing withholding of 15 percent for dividends and ten percent for both interest and royalties at source represent a position designed to expand source jurisdiction taxable base.⁸⁶

Dividends

The Agreement provisions concerning dividends are similar to the UN Model and the US Treaty provisions⁸⁷ although, the UN Model adopts a reduction in withholding tax on dividends paid to the investors.⁸⁸ The Agreement does not adopt the reduced withholding rates of the UN Model as to direct investors.⁸⁹ Agreement provisions concerning dividends have limited importance to Australian residents as China in practice limits foreign equity participation to statutory limited liability companies created under the Joint Venture Law.⁹⁰ As China expands its economic base, future foreign equity participation other than statutory joint ventures may be possible.

The term "dividend" is defined as income from shares or other rights participating in profits and are not debt related. Local law will determine whether a payment represents equity or debt participation.⁹¹ This provision is the same as provided in the US Treaty.⁹²

The reduced rate of withholding tax does not apply where the dividend recipient maintains a permanent establishment within the other Contracting State and the dividend is effectively connected with that permanent establishment or fixed base.⁹³ In these instances, the payments are taxed as business profits under article 7 if effectively connected to a permanent establishment or as independent service income under article 14 if effectively connected to a fixed base.⁹⁴ As mentioned before, the Agreement allows the source country to tax the dividend of a resident company of the other Contracting State at the rate of 15 percent of the gross amount whereas

84 IIT Law, above n 42 art 3(2).

85 US Treaty, above n 4 arts 9(2), 10(2), 11(2).

86 Agreement, above n 1 arts 10(2), 11(2), 12(2).

87 Agreement, above n 1 art 10; UN Model, above n 3 art 10; US Treaty, above n 4 art 9.

88 UN Model, above n 3 art 10.

89 Agreement, above n 1 art 10.

90 Joint Venture Law, above n 55.

91 Agreement, above n 1 art 10(3).

92 US Treaty, above n 4 art 9(3).

93 Agreement, above n 1 art 10(4).

94 Ibid.

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the US Treaty allows the source country to tax such dividends up to only ten percent. It is still considerably lower than that stipulated in both countries' domestic tax systems.

Interest

The Agreement defines the term "interest" as income from debt claims of every kind, whether or not secured and whether or not carrying a right to participate in profits.⁹⁵

The Agreement's interest withholding tax provision of ten percent at source is illustrative of the intent of China to expand its source-based jurisdiction.⁹⁶ Under the Agreement, interest is sourced to a Contracting State where interest expense is borne by the government, a resident, a permanent establishment, or a fixed base within that Contracting State.⁹⁷

Unlike the US Treaty, the Agreement does not provide an exemption of interest withholding tax concerning payments on claims financed by the government of a Contracting State or any financial institution owned by the government. This reflects the Australian position regarding the sovereign immunity in the context of Chinese government investment in Australia. Just as the Commissioner of Taxation, Mr. Boucher put it at a seminar held in Beijing in 1989:

Australia recognises the principle of sovereign immunity and extends its application to non-business activities of other governments. But we do not accept that the principle applies to ordinary commercial undertakings carried on by government. Accordingly, Chinese enterprises undertaking business or commercial activities in Australia can generally be expected to be subject to Australia's domestic taxation laws, and to be treated for the purpose of the tax treaty in the same way as any other foreign enterprises. . . .⁹⁸

It is interesting to note that the US Treaty does provide an exemption of interest withholding concerning payments on claims financed by the government of a Contracting State or any financial institution wholly owned by the government.⁹⁹ Such a provision could be an incentive to direct US government financing to China. However, as Chinese banking institutions are wholly owned by the government, their financing within the United States will be exempt from withholding tax under the US Treaty. This seems at odds with the American long-standing position on the issue of sovereign immunity in general.¹⁰⁰

The Agreement's interest provisions do not apply where the beneficial owner maintains a permanent establishment or fixed base within the source

⁹⁵ Ibid art 11(3).

⁹⁶ Ibid art 11(2).

⁹⁷ Ibid art 11(5).

⁹⁸ (1989) 18 Butterworths Weekly Tax Bulletin 271.

⁹⁹ US Treaty, above n 4 art 10(3).

¹⁰⁰ See the United States Foreign Sovereign Immunity Act 1976, Publication L No 94-583, 90 Stat 2891, codified at 28 USCA, ss 1330, 1332(a)(2), 1391(9) 144(d), 1602-1611. For more information regarding American and Chinese positions on sovereign immunity, see Theroux and Peele, "China and the Sovereign Immunity: the Huguang Railway Bond Case" (1982-1983) 2 China L Rep 129-152.

country.¹⁰¹ In such cases, interest income is treated as business profits (article 7) or income from the performance of independent personal services (article 14).

Royalties

The taxation of royalties is one of the principal areas in which developed and developing countries disagree. The OECD Model, for example, calls for no taxation at source on royalties.¹⁰² Exemption of royalties from taxation at source, however, is generally viewed by developing countries as inappropriate in a treaty between a developing and a developed country, because the income flow of such payments is likely to be very one-sided; residents of a developing country are much more likely to be the payers of royalties than the recipients. Accordingly, the UN Model provides for taxation of royalties at source, with the maximum rate of tax to be agreed in bilateral negotiations.¹⁰³

The Agreement provisions for royalties provide source-base taxation including typical payments in consideration of the use of copyright in artistic works including films, tapes used in radio or television broadcasting, patents, technical know-how, trademarks, designs, models, plans, secret formulae, or processes. The royalty provisions of the Agreement also include payments for the use of equipment rentals of industrial, commercial or scientific equipment and related information.¹⁰⁴ These provisions are adopted from the UN Model¹⁰⁵ and illustrate an effort to expand source-based jurisdiction. The Agreement's maximum rate of ten percent is similar to that contained in the US Treaty.¹⁰⁶ The Agreement does not include a reduced rental payment provision, as provided in the US Treaty,¹⁰⁷ concerning royalties paid for the rental of industrial, commercial or scientific equipment.

Like the US Treaty, the Agreement contains an interesting sourcing provision concerning royalty payments by a government or political subdivision. Article 12(5)¹⁰⁸ of the Agreement sources any royalty payment by a government or political subdivision to the Contracting State of the payer. The Chinese government incurs royalty liability, due to the use of Australian equipment and know-how, probably far in excess of that incurred by the Australian government. The source jurisdiction of China is thus expanded due to this source provision which deems a royalty as arising in the Contracting State of the government payer. The UN Model does not contain a similar provision.

Royalty payments are taxable under article 7 (business profits) or article 14 (independent personal services) where the royalty payment is effectively

101 Agreement, above note 1 art 11(4).

102 OECD Model, above note 2 art 12(2) and (3).

103 UN Model, above note 3 art 12(2) and (3).

104 Agreement, above note 1 art 12(3).

105 UN Model, above n 3 art 12(3).

106 US Treaty, above n 4 art 11(2).

107 Ibid, Protocol, para 6.

108 Agreement, above n 1 art 12(5).

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connected to a permanent establishment or fixed base.¹⁰⁹ The Agreement is in accordance with the UN Model and the US Treaty. Thus an Australian lessor of drilling rigs or shipping used for exploration of natural resources within China for a period in excess of three months maintains a permanent residence within China.¹¹⁰ The lessor must compute taxable income under article 7 as the payments are not royalties under the Agreement.¹¹¹

The Agreement also applies an "arm's-length" standard to royalty payment where special relationships indicate a royalty amount is in excess of a reasonably bargained amount.¹¹² In such cases, the excess amount will be treated under the other relevant Agreement provisions where applicable.

Income from real property

Article 6 of the Agreement adopts the UN Model position concerning income from real property. It is similar to the US Treaty.¹¹³ Article 6 concerns only the income arising from real property whereas article 13 governs income from the sale of such property.

The Agreement provides that income from real property may be taxed in the country where such property is located. Local law will determine whether property is defined as real property. In the case of Australia, the term specifically includes a lease of land and any other interest in or over land; a right to receive variable or fixed payments either as consideration for the exploitation of or the right to explore for or exploit, or in respect of the exploitation of, mineral deposits, oil or gas well, quarries or other places of extraction or exploitation of natural resources. And in the case of China, the term specifically includes property accessory to real property, livestock, equipment used in agriculture and payments as consideration for the working of, or the right to work mineral deposits and other natural resources.¹¹⁴ Article 6 also covers royalty payments relating to the exploration of the land such as oil royalties.¹¹⁵ Interest on loans which encumber real estate are governed by article 11.

Gains from alienation of property

Real property

The Agreement adopts the basic UN Model provisions concerning income and gains from the sale or exchange of real property.¹¹⁶ The definition of real property is that of article 6 relating to income from real property. Gains from the sale or exchange of real property may be taxed within the state of situs. The Agreement provides that the sale of capital stock of a company, whose principal property is real estate, is taxable within

109 Ibid art 12(4).

110 Ibid.

111 Ibid art 5(3)(c).

112 Ibid art 12(6).

113 US Treaty, above n 4 art 6.

114 Agreement, above n 1 art 6(2).

115 Ibid art 6.

116 Ibid art 13.

the Contracting State where such real property is located.¹¹⁷ The Agreement adopts a position not within the model treaties which provides source based taxation of gains from the sale or exchange of any other property not specifically mentioned.¹¹⁸ This catchall provision ensures that all gains from the sale of property interests are taxable within the state of situs even where such property is not specifically defined under art 13.

Personal property

The Agreement provides that income or gains from the sales or exchange of personal property consisting of movable business assets of a permanent establishment or fixed base for the purpose of performing independent personal services are subject to taxation in the state of situs.¹¹⁹ The Agreement provides jurisdiction to tax gains upon the sale or exchange of capital stock in a company, the assets of which consist principally or wholly of real property in the other Contracting State.¹²⁰ This Agreement provision is principally adopted from the UN Model.¹²¹

Elimination of double taxation

In general there are two basic methods of eliminating double taxation of income in treaty negotiations: the exemption method and the credit method.¹²² Under the exemption method, the country of residence excludes from income the amounts taxed in the source country. Under the credit method, each contracting state allows a credit against its taxes for certain taxes paid in the other contracting state. There are also two ways of applying the credit system: the country of residence may allow a "full credit" against its own tax for the amount of tax paid to the source nation, or it may allow an "ordinary credit" limited to the amount of its own tax, which is levied on the income taxed in the other state.¹²³

The Agreement adopts the credit method where, in case of China, the amount of credit given shall not exceed the total amount of the Chinese tax on that income, and in case of Australia, the credit is allowed against Australia tax payable as far as the law permits.¹²⁴

As one of the major differences from the US Treaty, the Agreement contains a tax sparing provision.¹²⁵ "Tax sparing" refers to an allowance by a country of a credit for taxes of another country which would normally have been imposed by the second country but were not imposed on a foreign-controlled enterprise because the second country wished to provide a tax

117 Ibid art 13(4).

118 Ibid art 13(5).

119 Ibid art 13(2).

120 Ibid art 13(4).

121 UN Model, above n 3 art 13(5).

122 OECD Model, above n 2 arts 23A and 23B.

123 Ibid art 23.

124 Agreement, above n 1 arts 23(1) and (2).

125 US Treaty, above n 4 art 22.

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holiday or other tax incentive in order to promote foreign investment from the first country.

The issue of tax sparing is probably better explained by the example of the US Treaty. In contrast to other developed countries, the United States has no treaties with developing countries containing a tax sparing provision, because the United States has a firm policy opposed to tax sparing credits.¹²⁶ On the other hand, developing countries like China, often have a firm policy that a tax sparing credit is an essential prerequisite to a treaty. They argue that by doing so they can provide an incentive for foreign investment and their incentive will be negated if the resident country, through decreased foreign tax credits, increases its own taxation of the income at issue. In negotiating the US Treaty, the United States rejected such an argument by pointing out that the interplay of deferral and the overall limitation on the US credit for foreign taxes often results in the investor, not the US Treasury, reaping the benefit of a tax holiday or other tax incentive, as intended by the foreign country.¹²⁷ Because of the strong objection of the United States, for the first time in tax treaties with developed countries, China failed to put in a tax sparing provision. By compromise, however, China incorporated a provision in the US Treaty to the effect that the US Treaty would be amended if the United States adopts a statutory framework for "tax sparing" in the future or provides such a provision in a tax treaty with any other country.¹²⁸

Under the Agreement, Australia will give credit to its residents if their income has been taxed in China.¹²⁹ This provision will apply to tax exemptions and deductions, allowed under the Chinese national tax laws and regional tax laws from China's special investment areas such as the Special Economic Zones (the "SEZs") or other development areas.¹³⁰ Suppose that an Australian resident invests in an Australian-Chinese equity joint venture located in Shenzhen SEZ and also suppose that the joint venture is a manufacturing one that is scheduled to operate for ten years. Under these circumstances, the income he generated from the joint venture would be taxed in Shenzhen. According to the JVIT Law, his income from the joint

126 For a detailed discussion of US negotiations with China regarding this provision of the US Treaty see Schreyer, "A Guide to the China-US Tax Treaty" (August 1984) East Asian Executive Report 10-14.

127 Ibid.

128 US Treaty, above n 4, Letter of Agreement dated 30 April 1984.

129 Agreement, above n 1 art 23(2).

130 In 1979 and 1980 China established SEZs in the municipalities of Shenzhen, Zhuhai and Shantou in Guangdong Province and Xiamen in Fujian Province in order to encourage foreign investment. Foreign investors and enterprises in these defined areas enjoy preferential treatment in the form of lower tax rates and less burdensome entry and exit procedures. Local government authorities in these designated zones possess greater economic decision-making power than is generally available to local governing bodies outside the SEZs. Other development areas include, among others, "14 Coastal Cities" designated by the central government as "open areas" to attract foreign investment. As with the SEZs, the 14 Coastal Cities offer a variety of investment incentives to foreign businesses, including preferential tax treatment. See Pow and Moser, "Law and Investment in China's Special Investment Areas" in *Foreign Trade, Investment, and the Law in the People's Republic of China* (1987 Moser ed) 199-269.

venture will be taxed at the rate of 30 percent. In addition, a 10 percent local surtax will be imposed on the tax paid, making the effective rate of 33 percent. When he remits parts of his income back to Australia, a further ten percent withholding tax will be levied on the remitted amount. As mentioned before, both JVIT Law and JVIT Regulations provide some tax benefits which allow such a joint venture a total tax exemption for the first two profit making years and a 50 percent deduction in the following three years. Since the joint venture is located in Shenzhen SEZ, he is entitled to further tax incentives provided under the Provisional Regulations on Reduction and Exemption of Enterprise Income Tax and Consolidated Industrial and Commercial Tax for the Fourteen Coastal Cities and the Special Economic Zones ("the SEZ Tax Regulations").¹³¹ Under the SEZ Tax Regulations, the joint venture is taxed at 15 percent instead of 33 percent. Further, the Australian investor can freely remit its profits back home without any liability to the ten percent withholding tax.

If the Agreement were ratified and effective, the Australian investor would receive foreign tax credit for taxes "spared" within China due to the above or future tax holidays or other tax incentive. In other words, Australia shall suppose that these tax exemptions or deductions have not been given and shall grant to him the deduction to the amount to be taxed at the tax ratio stipulated by the tax laws of China. Such a provision will no doubt help China to attract more investment from Australia. Moreover, the Agreement also provides that the tax sparing provisions will be viewed in a ten-year period. As the Australia Commissioner of Taxation noted that such a provision "represents a major shift on Australia's part from its previous agreements under which the less generous gross up and credit method and a five-year review period applied".¹³²

Miscellaneous provisions

Personal service income

The personal service income provisions of the Agreement are related to dependent personal service income,¹³³ employee wages, and independent personal service income.¹³⁴ Independent personal service income refers to professional service income of persons such as physicians, lawyers, engineers, architects, dentists and accountants. Such definitions are adopted from the UN Model.¹³⁵

The Agreement provides that a resident employee of the Contracting State is exempt from taxation concerning wages, salaries, or remuneration earned in the other Contracting State where:

131 SEZ Tax Regulations promulgated by the State Council on 15 November 1984, *China Laws* 70-845.

132 Butterworths Weekly Tax Bulletin, above n 98.

133 Agreement, above n 1 art 15.

134 Ibid art 14.

135 UN Model, above n 3 arts 14 and 15.

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- the employee is not present in the other Contracting State for an aggregate period of 183 days or six months in any consecutive period of 12 months;
- the remuneration is paid by or on behalf of an employer not resident within the other Contracting State; and
- the remuneration is not borne by a permanent establishment or fixed base the employer has in that other State.¹³⁶

Each of the above requirements must be satisfied in order to exempt wages from taxation. Consequently, an Australian employee within China in excess of 183 days in any consecutive period of 12 months, but not in any given year as stipulated in the US Treaty,¹³⁷ will be subject to the PRC income tax under the IIT Law on PRC source wages.¹³⁸ The IIT Law subjects worldwide income to taxation where the individual has been a resident of China in excess of five years.¹³⁹ The Agreement will subject an Australia employer to PRC tax if wages are paid by a resident employer of a PRC permanent establishment.¹⁴⁰

The Agreement subjects income earned in an independent capacity to tax where:

- a resident individual of a Contracting State is within the other Contracting State for an aggregate period in excess of 183 days within any consecutive period of 12 months; or
- a fixed base is available within the other Contracting State for the purpose of performing services.¹⁴¹

Thus an Australian resident lawyer will be subject to taxation under the IIT Law if such individual is present within the PRC for an aggregate period in excess of 183 days or if the individual or his firm maintains an office within the PRC. The income subject to taxation, however, is limited to PRC source income attributable to the period of presence or the fixed base.¹⁴²

Directors' fees or similar payments are subject to taxation where an individual acts in that capacity for a company resident in the other Contracting State.¹⁴³ An Australian resident acting as a director for a company resident in China will be subject to tax within China under the IIT Law.¹⁴⁴

The Agreement generally subjects resident athletes, musicians, or other entertainers to taxation concerning related earnings within the other Contracting State.¹⁴⁵ A resident of a Contracting State due to personal activities as an entertainer or athlete as part of an agreed cultural exchange

136 Agreement, above n 1 art 15(2).

137 US Treaty, above n 4 art 14(2).

138 Agreement, above n 1 art 15(1); IIT Law, above n 42.

139 IIT Law, above n 42 art 1; IIT Regulations, above n 43 art 3.

140 Agreement, above n 1 art 15(2)(b) and (c).

141 Ibid art 14(1).

142 Ibid art 14(2).

143 Ibid art 16.

144 IIT Law, above n 42.

145 Agreement, above n 1 art 17.

program is exempt from taxation in the other Contracting State.¹⁴⁶ Australian entertainers or athletes who receive PRC sources income due to personal efforts as part of an agreed cultural exchange program are not subject to PRC taxation under the IIT Law. The limited exemption is included in order to promote cultural exchange activities rather than professional performance. This is similar to those included in the US Treaty.¹⁴⁷

Resident individuals of a Contracting State temporarily within the other Contracting State, for the primary purpose of teaching courses or conducting research at educational institutions, or scientific research institutions, are exempt from taxation within the other Contracting State for a period not in excess of two years.¹⁴⁸ Australian resident individuals within China for a period not in excess of two years, for the purpose of teaching or conducting scientific research, are exempt from the PRC taxation under the IIT Law. The model treaties do not contain a similar provision. However, such an exemption does not apply to remuneration received by the researcher if the research is undertaken primarily for the private interests.¹⁴⁹

Resident students or trainees of a Contracting State who are temporarily present in the other Contracting State, solely for education or training, are exempt from taxation within the other Contracting State concerning education or training and maintenance payments from abroad.¹⁵⁰ In respect of grants or scholarships, these students or trainees shall be entitled to the same exemptions or deductions as local residents do.¹⁵¹ This provision does not seem as generous as the US Treaty provision.¹⁵²

Non-discrimination

Unlike the US Treaty, the Agreement does not adopt a non-discrimination provision.¹⁵³ Non-discrimination provisions are intended to preclude the imposition of additional or greater taxes on residents of the Contracting State than it would impose on its own residents. Non-inclusion of such a provision in the Agreement is believed to be restricted by the Australian domestic law.¹⁵⁴

Administrative provisions

Article 24 sets forth a mutual agreement provision whereby the competent authorities agree to resolve tax disputes of persons who believe a

146 Ibid.

147 US Treaty, above n 4 art 16.

148 Agreement, above n 1, art 20. The US Treaty, however, allows three years in this respect: US Treaty, above n 4 art 19.

149 Ibid.

150 Ibid art 21(1).

151 Ibid art 21(2).

152 US Treaty, above n 4 art 16. For example art 16 provides that personal service income of students or trainees not in excess of \$5,000 will be exempt from tax.

153 Ibid art 23.

154 See the Speech made by Niu Licheng, Deputy Director of the General Tax Bureau of China at the Symposium on Sino-Australian Investment Laws and Regulations held in China from 22 April 1989 to 2 May 1989, 2.

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tax not in accordance with the Agreement has been assessed.¹⁵⁵ Resident status determines to which competent authority such person shall present the case. Australian residents must present such a case to the Australian Taxation Office or authorized representatives; correspondingly, Chinese residents must present such a case to the Ministry of Finance or authorized representatives. The Agreement requires that a person must present the case to the appropriate competent authority within three years of notification of denial of the disputed benefit.¹⁵⁶ The status of limitation is within the OECD Model.¹⁵⁷ The competent authority will proceed to resolve tax disputes within the competent authority of the Contracting State if the claim appears justified.¹⁵⁸ Any determination regarding the merits of such case will not be denied due to domestic statute of limitation.¹⁵⁹

Article 25 provides for the exchange of information necessary to administer the Agreement. Article 25 is not restricted to persons as defined by the Agreement. Exchange of information regarding third country residents is permissible as the exchange of information is not limited to persons covered under the Agreement.¹⁶⁰

Conclusion

The Agreement adopts positions which will alleviate the incidence of double taxation, such as the reduced withholding tax provisions concerning investment income and the foreign tax credit provisions which ensure ultimate credibility of Agreement administrative cooperation to prevent the evasion of taxes. The overwhelming significance of the Agreement to residents of the Contracting States, should the Agreement be ratified, is the degree of certainty it provides regarding the tax consequences of activities by residents of one country within the other country. As to China, the certainty provided by the Agreement will encourage Australian investment to assist the process of China's modernization program.

On 26 February 1991 the Foreign Affairs Minister, Senator Gareth Evans, announced the removal of the remaining economic and political restrictions on Australia's relations with China which were applied following the tragic events in Beijing two years ago. Obviously, the decision by the Australian government to normalize relations with China has been made with an eye on bilateral trade and investment between the two countries and the need to restore confidence in Australia/China trade within the business community. That it is now "business as usual" with China will definitely put pressure on the Commonwealth Parliament to consider ratifying the Agreement, as the Agreement presents an opportunity for Australia to stimulate foreign trade with a major developing nation via tax policy; it also represents an opportunity to further non-tax foreign policy considerations with China, whose geopolitical importance is unparalleled.

155 Agreement, above n 1 art 24.

156 Ibid.

157 OECD Model, above n 2 art 25(1).

158 Agreement, above n 1 art 24(2).

159 Ibid.

160 Ibid art 25(1).

Postscript

Since this article was set up in print, a new tax law entitled the Income Tax Law of the People's Republic of China Concerning Foreign Investment Enterprises and Foreign Enterprises was enacted by the National People's Congress to replace the JVIT Law and FEIT Law with a flat 30 percent national tax and a flat 3 percent local tax applicable to all foreign investment enterprises and establishments of foreign companies in China, subject to any available tax incentives. The new tax law took effect on 1 July 1991.