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# The Income Tax Implications of a Foreign Individual Contracting to do Business in Australia, with Particular Reference to the Concepts of 'Residence' and 'Source'

## **Abstract**

[extract] In order to counteract the burgeoning tax burden that may be imposed in an era of increasing international trade and travel, many countries have subsequently utilised the terms of the Model Convention as a basis for the negotiation of double taxation treaties with their trading partners. While a DTA can go a long way to ensuring that a resident of one country will not be taxed twice if he contracts to do business in a trading partner country, one must bear in mind that these treaties are of bilateral and not international application. Where an individual contracts to do business in a non-treaty partner country, he will be at the mercy of that country's domestic tax legislation.

As Australia levies taxes on the basis of residence and source, I propose to examine Australia's domestic residence and source rules applicable to foreign individuals in terms of the common law and income tax legislation, and then to review the requisite residence and source aspects of double taxation treaties.

## **Keywords**

contract law, international contracts, income tax, double taxation agreements, foreign contractors

THE INCOME TAX IMPLICATIONS OF A FOREIGN INDIVIDUAL  
CONTRACTING TO DO BUSINESS IN AUSTRALIA, WITH PARTICULAR  
REFERENCE TO THE CONCEPTS OF 'RESIDENCE' AND 'SOURCE'

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[T]here is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right. Nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions!<sup>1</sup>

Parliament having prescribed the circumstances which will attract tax, or provide occasion for its reduction or elimination, the citizen has every right to mould the transaction into which he is about to enter into a form which satisfies the requirements of the statute. It is nothing to the point that he might have obtained the same or similar result as that achieved by the transaction into which he in fact entered by some other transaction, which, if he had entered into it, would or might have involved him in a liability to tax, or to more tax than that attracted by the transaction into which he in fact entered... The freedom to choose the form of transaction into which he shall enter is basic to the maintenance of a free society.<sup>2</sup>

## Introduction

In recent years there has been increasing international co-operation in the realm of contract law. A growing realisation of the benefits of applying uniform rules to international contracts has resulted in the ratification of the United Nations Convention on Contracts for the Sale of Goods (the Vienna Convention) by many countries, including Australia.<sup>3</sup> Global acceptance of international laws which regulate international transactions in the realm of commerce, under the aegis of such international and supranational bodies as GATT (General Agreement on Tariffs and Trade), the Group of Seven, the European Commission, the International Monetary Fund and regional trading blocs has, however, 'not

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1 Judge Learned Hand, quoted by Marshall J Langer in the title pages of *International Tax Planning* (European Edition) 1987, occasion of quote not given.

2 Waincymer J *Australian Income Tax - Principles and Policy* 2nd ed. 1993 p21.

3 The Convention entered into force in Australia on 1 April 1989.

(1997) 9 BOND LR

brought with it a weakening of nationalism with regard to the international community of taxpayers which has appeared.<sup>4</sup>

Nations are, in fact, still '...regarded as fiscally sovereign, with power to impose tax within their self-defined jurisdictional reach virtually unfettered by principles of international law.'<sup>5</sup> Consequently, in the light of the worldwide trend towards broadening national tax bases, any person contracting to do business in a foreign jurisdiction will inevitably fall under the scrutiny of both his local and the foreign tax authorities. The income generated by such business may as a result be subject to tax in both states, with the effect that tax would be paid twice on the same transaction, unless concessions were granted to alleviate this so-called 'double taxation'.

The reason for the incidence of double taxation is that different states may tax income according to different bases. Most countries levy taxes on the basis of the residence of the taxpayer and by reason of the location of the source of income. Residents are usually taxed not only on their domestic but also on their foreign-sourced income. The more onerous taxation of residents, as opposed to non-residents, is rationalised on the basis that a person benefiting from the infrastructure, privileges and protection offered by the government of the country sheltering him owes that government a certain fiscal allegiance as a *quid pro quo*. On the other hand, the rationale for taxing income according to its 'source' is that:

a country that produces wealth by reason of its natural resources or the activities of its inhabitants is entitled to a share of that wealth, wherever the recipient may reside.<sup>6</sup>

Countries may also levy taxes on the basis of domicile or of citizenship, or on a combination of bases.<sup>7</sup>

In the postwar period, the International Chamber of Commerce (ICC), acting as a representative of the international business lobby, encouraged the idea of a multilateral double tax convention to facilitate international investment. This resulted in the publication of a draft Double Taxation Convention on Income and Capital by the Organisation for Economic Co-operation and Development (OECD) in 1963.<sup>8</sup> This Model Income Tax Convention has been revised in 1977 and 1992, and forms the foundation for the bilateral negotiation of double taxation

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4 Glautier M W E and Bassinger F W A Reference Guide to International Taxation 1987 p 174.

5 Hamilton R and Deutsch R L Understanding Australian International Taxation 2nd ed. 1988 par. 217.

6 De Koker and Urquhart *Income Tax In South Africa* 1989 Vol 1 par. 8.1.

7 There are countries which levy tax according to the source principle alone, as many African countries do, while others may tax on a combination of residence and source (eg. Canada), residence and domicile (eg. Barbados), domicile and source (eg. El Salvador), residence, domicile and source (eg Republic of Ireland), or even a combination of citizenship, residence and source (eg. United States).

8 Piciotto S *International Business Taxation* 1992 p 52.

agreements (DTAs).<sup>9</sup>

In order to counteract the burgeoning tax burden that may be imposed in an era of increasing international trade and travel, many countries have subsequently utilised the terms of the Model Convention as a basis for the negotiation of double taxation treaties with their trading partners. While a DTA can go a long way to ensuring that a resident of one country will not be taxed twice if he contracts to do business in a trading partner country, one must bear in mind that these treaties are of bilateral and not international application. Where an individual contracts to do business in a non-treaty partner country, he will be at the mercy of that country's domestic tax legislation.

As Australia levies taxes on the basis of residence and source, I propose to examine Australia's domestic residence and source rules applicable to foreign individuals in terms of the common law and income tax legislation, and then to review the requisite residence and source aspects of double taxation treaties. The aim of this examination is to gain insight into the principles which will facilitate the drafting of tax-efficient contracts for foreign individuals contracting to do business in Australia. In this discussion the concern will be solely with the taxation of income arising out of a contract for services to be performed by a foreign individual, either arising out of a contract of employment, for example where an executive is seconded by his overseas head office to conduct business in the Australian subsidiary, or where a foreign entity utilises the services of the foreign person as an independent contractor.

## **Residence Rules For Individuals**

### **obtaining admission into Australia**

A foreigner who contracts to do business in Australia must bear in mind Australia's policy of meeting its labour requirements from its own workforce, allowing for temporary supplementation by foreigners with specialist skills. This being the case, he must obtain an appropriate visa prior to his departure. The visa will confer legality on the foreign individual's presence in Australia, but will not per se confer Australian residence.

The type of visa granted will depend on the type of services he will undertake, and the proposed length of his stay. A Business visa would allow an individual to be admitted to Australia for six months, and the holder may give lectures, attend conferences or work in a negotiating or advisory capacity. Under a Top Management visa an initial stay of up to four years may be permitted.

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<sup>9</sup> Some members of the OECD have developed their own models for negotiation, though these models are themselves based largely on the 1977 OECD Model. Examples of these are the United States Treasury Model of 1981 and the Netherlands Model of 1988. The United Nations also used the OECD 1963 and 1977 Draft in its preparation of the UN Model Double Taxation Convention between Developed and Developing Countries of 1980.

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### background to residence rules

The taxation laws of most countries require a certain degree of nexus, connection or relationship between the individual to be taxed and the territory concerned. The term 'residence' in itself implies a certain measure of permanence to an individual's presence in a particular place, although at common law it is a less ultimate concept than domicile.

In Australia, residence is one of the twin bases which bring an individual within the jurisdictional ambit of the government for fiscal purposes. In fact, the Commonwealth government may impose Australian revenue laws onto income derived under a contract entered into and carried out in another country, provided that the individual concerned is an Australian resident. In other words, residence is a test of extra-territorial jurisdiction.<sup>10</sup> Consequently, the question of whether or not a foreign individual who is under contract to do business in Australia will be considered to be a resident for Australian tax purposes will dramatically affect the amount of tax levied on his income generated by the transaction. An Australian resident is liable to tax on his worldwide income, while a non-resident is only liable to tax on his Australian-sourced income.<sup>11</sup> On the other hand, only Australian residents are entitled to certain statutory rebates and concessions.<sup>12</sup>

It should be noted that a foreigner may acquire Australian 'resident' status for income tax purposes without forfeiting, or in any way affecting, his resident status in his home country, thereby placing himself in the position where he could be liable for double taxation on the same transaction.<sup>13</sup> As mentioned above, this situation may be alleviated if his home country has a DTA with Australia. However, these agreements cannot be regarded as a universal panacea, as there are of course many countries which do not have such an agreement with Australia. Where no such DTA exists, a taxpayer would have to rely on any unilateral relief provided by the fiscal laws of his home country, or, failing this, assume the double tax burden. To complicate matters further, the issue of 'residence' is decided on a yearly basis, and the fact that a taxpayer is deemed to be a resident in any one year does not necessarily mean that he would be regarded as a resident for fiscal purposes in any other year.<sup>14</sup> As it is possible, under certain circumstances, for a foreigner to be deemed to be an Australian resident, with all the ensuing tax consequences that pertain to residence, from the moment of his arrival in Australia, he should acquaint himself with the statutory definitions of the term 'resident'.

### the statutory definitions of 'resident'

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<sup>10</sup> Rigney H R *Australian Business Taxation* 1990 p 3.

<sup>11</sup> Section 25(1) of the Act.

<sup>12</sup> For example, only a resident will be entitled to a zero threshold which frees the first slice of his income from tax, and to certain rebates, for example the medical expenses rebate.

<sup>13</sup> *Gregory v FCT* (1937) 1 AITR 201 is the authority for the view that a person may reside in more than one country at any one time. This was upheld in *FCT v Jenkins* (1982) 12 ATR 745.

<sup>14</sup> Per Northrop J in *FCT v Applegate* (1979) 9 ATR 899: 'Each year of income must be looked at separately'.

Section 995-1 of the Income Tax Assessment Act 1997 (hereinafter referred to as the 'ITAA 1997') defines an 'Australian resident' to mean: 'a person who is a resident of Australia for the purposes of the *Income Tax Assessment Act 1936*.' The definitions given to the term 'resident' or 'resident of Australia' in section 6(1)(a) of the Income Tax Assessment Act 1936, (hereinafter referred to as the 'ITAA 1936') set out the various circumstances under which individuals will be held to be residents of Australia for income tax purposes. These definitions have been generally accepted as being condensed into four tests - the fulfilment of any one of which will be sufficient to designate the person as a 'resident'.

The tests may be described as: (i) The 'Ordinary Concepts' Rule; (ii) The 'Domicile Rule'; (iii) The '183 Days' Rule; and (iv) The 'Commonwealth Superannuation Fund' Rule.

The 'Domicile Rule' applies particularly to persons domiciled in Australia who have been transferred abroad<sup>15</sup>, and the 'Commonwealth Superannuation Fund' Rule is designed to make sure that Australian diplomats and other Commonwealth government officials holding Australian posts abroad are considered to be residents for Australian fiscal purposes. As the subject matter under consideration is the income tax implications of residence and source rules relating specifically to foreign individuals contracting to do business in Australia, these tests will not be discussed.

### **the 'ordinary concepts' rule**

A resident, according to the 'ordinary concepts' rule embodied in section 6(1)(a) of the ITAA 1936 means:

...a person, other than a company, who resides in Australia...

This rather circuitous test is also referred to as the 'common law' test, as the use of the term 'resides' has been taken to refer to the common law notion of residence, as developed by the Commonwealth courts over a number of years. The common law test of residence is often described in the cases as being a matter of 'fact and degree', i.e. all pertinent factors should be taken into account.<sup>16</sup> Flowing from the case law, it is evident that a plethora of factors must be taken into account in the determination of residence, although no one factor has been held to be decisive. These factors include the individual's actual presence in Australia during the year of income<sup>17</sup>, the purpose, frequency and duration of his visits to Australia<sup>18</sup>, his family, business and social ties<sup>19</sup>, the nationality of the individual, the maintenance of a home in Australia which is available for use by the individual and statements or acts of intent by the individual which

15 See, for example, *FCT v Jenkins* (supra) and *FCT v Applegate* (supra).

16 Rigney H R *Australian Business Taxation* 1990 p 3.

17 Residence is often defined as the place where a person 'eats and sleeps', per Huddleston B in *Cesena Sulphur Co. Ltd v Nicholson* (1876) LR 1 Ex D 428 at 452.

18 *Levene v IRC* (1928) 13 TC 486; *Lysaght v IRC* (1928) 13 TC 511.

19 *Ibid.*

(1997) 9 BOND LR

demonstrate his intention to acquire Australian residence. While factors such as nationality are rarely taken into account, issues such as the nature of a person's family, business and social ties have proven to be most decisive.

The principal difficulty in applying the ordinary concepts rule lies in coupling exterior facts - those of physical presence - with the centrally important inner fact of intention. Intention cannot be apprehended directly, but can only be inferred from external indications such as the factors mentioned above. The determination of fiscal residence has evolved into a weighing of various elements of an individual's behaviour against an idealised notion of the conduct of a resident. As a result, a checklist of indicia of residence has been developed and is set on the scales in each case.<sup>20</sup>

While it is to be expected that 'different eyes will view the relative weight of the various factors differently'<sup>21</sup>, the inconsistency in the importance attached to these various factors by different judges has led to some arbitrary results in the case law. For example, a person is generally regarded as a resident if he has been present in a country for some time (183 days is often used as a benchmark). However, in *Case G43*<sup>22</sup> the taxpayer was an accountant domiciled and resident in Australia where he maintained a domestic establishment. For six years he spent four to five weeks per annum in New Guinea conducting audits for a group of companies. During his visits he moved between three towns, staying at hotels or quarters arranged by the companies. His formal reports were completed in Australia. Nevertheless it was held that these annual trips were part of the regular course of his professional practice, and that:

...the taxpayer from year to year regularly lives and works in New Guinea and has a present intention and requirement of continuing to do so indefinitely.<sup>23</sup>

Although 4 - 5 weeks is significantly shorter than 183 days, it was taken as representing an 'appreciable portion' of the time available to a professional man, and was sufficient to make him a resident of the Territory for fiscal purposes. The case was distinguished from *Case B131*, where the taxpayer was a barrister who was engaged for one specific task, to be performed in New Guinea. Even though the task took ten weeks to complete:

...there was not the remotest suggestion that the engagement would be a recurring one, either from year to year or even at irregular intervals. It was a definite mission carried out in one short visit.....<sup>24</sup>

### the '183 days' rule

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20 Isenbergh *J International Taxation: US Taxation of Foreign Taxpayers and Foreign Income* 1990 Vol 1 p50.

21 Hamilton R and Deutsch R L *op. cit.* p34.

22 (1956) TBRD 248 [Bd of Rev].

23 *Ibid* p254 per F C Bock (Member).

24 2 TBRD 681 [Bd of Rev].

***Section 6(1)(a)(ii) of ITAA 1936 designates as a resident a person:***

...who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that his usual place of abode is outside Australia and that he does not intend to take up residence in Australia;

This rule was designed to encompass foreign individuals present in Australia, albeit on a temporary basis. Although the section refers to 'one-half of the year of income', in doubtful cases the actual hours spent in Australia will be totalled to see whether this requirement has been fulfilled.<sup>25</sup> If it has, the person will be regarded as a resident, and will be assessable in regard to all foreign-sourced income. It would also appear that if this requirement has been satisfied (and the exceptions do not apply) a person will be treated as a resident for the entire year of income.<sup>26</sup> The 'year of income' refers to the fiscal year,<sup>27</sup> but there are no clear guidelines as to what will constitute a 'usual place of abode'.

In *FCT v Pechey* it was held that:

...before a person can be said to have been a resident at a particular place it must be possible to say that he had a settled or usual abode there or lived there for a considerable time.<sup>28</sup>

Unfortunately, there would appear to be no objective definition of what would constitute a 'settled' or 'usual' abode, or even as to what would be regarded as a 'considerable time'.

The 183 days rule again refers to the invisible element of 'intention'. This emphasis on intention in the Australian tax legislation can be contrasted with the 183 days test in the United States, where no regard is given to any other facts. This has the effect of foreign nationals inadvertently becoming US residents by virtue of a simple miscalculation, a missed plane, or even the serving of a jail sentence, since the section makes no reference to the presence being voluntary.<sup>29</sup> This is a situation which the Australian government obviously wishes to avoid, and thus the concept of 'intention' is an important component in the determination of residence.

The question of the intention of the taxpayer was raised in *FCT v Applegate*<sup>30</sup>, where the issue under consideration was whether an Australian taxpayer living abroad had ceased to be an Australian resident for tax purposes.

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25 *Wilkie v I.R. Commrs.* (1953) 32 TC 495.

26 11 CTBR Case 78; *Case Q51* (1965) TBRD.

27 *Isenbergh J op. cit.* p170.

28 75 ATC 4083 at 4086.

29 See section 7701(b) of the United States Internal Revenue Code, *Isenbaugh J op. cit.* p57.

30 *Op. cit.* at p909.

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Fisher J remarked:

Intention to return to Australia is a crucial feature in considering whether the taxpayer has retained an Australian domicile. Intention to make his home for the time being in his place of abode outside Australia is an important element in characterising that place of abode as his 'permanent' place of abode.<sup>31</sup>

One may discern from this case the corollary that in order to avoid being regarded as having an intention to take up residence *in* Australia, the foreign individual should not, in any way seek to establish, or indeed, even *form the intention of establishing*, a home which can be regarded as a 'permanent' place of abode in Australia.

Exactly how the subjective intention of the taxpayer will be objectively discerned by the courts is not clear.

#### **residence under the double taxation agreements**

The definitions of residence under Australia's domestic income tax legislation, as outlined above, must be viewed in the light of the residence provisions contained in Australia's DTAs, which are recorded in the Australian International Tax Agreements Act 1953. It should be mentioned at the outset that these DTAs have 'paramourcy' over the Income Tax Assessment Act, i.e. in any cases of inconsistency the provisions of these agreements will prevail over those contained in the Act.<sup>32</sup>

The form of Australia's DTAs (of which there are more than 30) is based on the Revised Model Double Taxation Convention on Income and Capital drafted by the OECD in 1977. Although the DTAs are not identical, (as the OECD provisions are modified in each case to suit the particular requirements of the countries concerned), they do follow a set pattern.

Residence is perhaps one of the most crucial and decisive factors in double taxation treaties. The benefits of a treaty will generally only apply to the residents of the treaty countries. In fact as far as income tax treaties are concerned, residence is a more important factor than citizenship, as most treaties grant concessions only to residents of the two countries involved.

As one of the main aims of entering into such an agreement is the avoidance of double taxation (the other is the prevention of fiscal evasion), the treaty is in essence:

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<sup>31</sup> *Ibid.*

<sup>32</sup> Section 4(2) (*Income and Fringe Benefits Tax International Agreements Act* 1953 provides that the provisions of that Act override any inconsistent provisions of the ITAA, except for Part IVA and the ITAA statutory limit on foreign tax credits.

...an agreement to limit the exercise of the taxing jurisdiction of each state. The restrictions on exercising tax jurisdiction are, therefore, seen as a form of bargain, based upon the reciprocal flows of investment and return on investment between the two states. The conclusion of the treaty is part of an overall policy of each state to encourage foreign investment or to assist the state's investors to participate in overseas trade and development.<sup>33</sup>

In practice, this co-operation involves countries reserving the right to tax their own residents in full, but relinquishing their claim to the income of the residents of the other treaty country in certain circumstances. This is achieved by assigning sole residence in a treaty partner country to an individual who is potentially resident in both countries.

Article 4.1 of the 1977 OECD Draft Convention defines the term 'resident of a Contracting State' to mean any person who is liable to tax in that State by reason of his domicile, residence, place of management or any other criterion of a similar nature. Where the individual is a resident of both States under these provisions, a series of 'tie-breaker' rules are applied in terms of Article 4.2 as follows:

- (i) The individual is deemed to be a resident of the State where he has a permanent home. If he has such a home in both States, he shall be deemed to be a resident of the State where his personal and economic relations are closer, i.e. where the centre of his vital interests lies.
- (ii) Failing this, he shall be deemed to be a resident of the State in which he has an habitual abode.
- (iii) If he does not have an habitual abode in either State, he shall be deemed to be a resident of the State of which he is a national.
- (iv) If he is a national of both States or of neither of them, the competent authorities
- (v) of the Contracting States shall settle the question by mutual agreement.

**the rules are applied in this order.**

As far as the DTA concept of 'permanent home' is concerned, the OECD Commentary on the Provisions of the Article makes it clear that although any form of home may be taken into account, (ranging from a house to a rented furnished room), the *permanence* of the home is essential.<sup>34</sup> The home must *always* be available to the individual, not just occasionally for a short visit, eg. for purposes of pleasure, business travel, educational travel, attending a course at a school etc. In looking at his centre of vital interests (where the individual has a home in both States), regard will be had to his family and social relations, his occupations, his political, cultural or other activities, his place of business, the place from which he administers his property etc.

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<sup>33</sup> Baker P *Double Taxation Agreements and International Tax Law: A Manual* 1991 p5.

<sup>34</sup> Par 1 Sect 13.

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The Australian DTA residence rules do not necessarily follow the OECD format - for example, the DTA between Australia and France utilises only the first step outlined above, whilst the Australia/India agreement utilises the first three steps but does not provide for a mutual agreement procedure. The specific terms of the agreement between the two countries must be looked at in each case.

## Source Rules For Individuals

As stated above, Australia levies tax on the basis of the geographic source of a particular transaction, as well as on the basis of the fiscal residence of the individual carrying out the transaction. The rules for the determination of the source of a given event are complex. This is especially the case where the activity giving rise to taxable income crosses the boundaries of more than one country, as is frequently the case with income generated by contractual obligations.

Australia's domestic tax laws can be described as a 'mixture of statutory source rules and rules established by tax common law.'<sup>35</sup>) These laws provide that all income which has an Australian source is liable to Australian taxation, regardless of the residence of the taxpayer.

***Section 6-5(2) of the ITAA 1997 states, in relation to the assessable income of residents that:***

If you are an Australian resident, your assessable income includes the ordinary income you derived directly or indirectly from all sources, whether in or out of Australia, during the income year.

***By contrast, section 6-5(3) declares, in relation to the assessable income of non-residents, that:***

If you are *not* an Australian resident, your assessable income includes:

- (a) the ordinary income you derived directly or indirectly from all Australian sources during the income year; and
- (b) other ordinary income that a provision includes in your assessable income for the income year on some basis other than having an Australian source.<sup>36</sup>

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35 Hamilton R 'International Aspects of Australian Income Taxation', in *Australian Taxation: Principles and Practice* 1987 p276.

36 Section 6-5(3)(b) of the ITAA 1997 appears rather confusing at first glance, as it has been stated earlier that the bases of taxation in Australia are the twin pillars of residence and source, and this section appears to tax income on an additional basis. However, this is explained in the ATO's 1997 publication *A Guide To The Rewritten Tax Law* in Session 2 Pg 13, where it is acknowledged that most ordinary and statutory income

***Section 995-1 of the ITAA 1997 defines an 'Australian source' as follows:***

ordinary income or statutory income has an Australian source if, and only if, it is derived from a source in Australia for the purposes of the *Income Tax Assessment Act 1936*.

The identification of the circumstances under which the income of a non-resident will be regarded as being derived from an Australian source is complicated by the fact that the ITAA 1936 provides no statutory definition of the term 'source'. Guidance as to the implications of the term must therefore come from the courts. A further hurdle to be overcome is the fact that different source rules are applied to different types of transactions, and thus the economic activity under investigation must first be classified into a particular category, for example: royalties, dividends, interest or service income.

Despite a statement from the Australian Treasurer in September 1985 that rules for determining source are being developed, no rules of general application have yet emerged. Much reliance must therefore be placed upon principles developed in general tax law in deciding what the real source of income is.<sup>37</sup>

**the concept of 'source' in the leading cases relating to service contracts**

As Australian fiscal source rules have been described as 'judge-made law',<sup>38</sup> it is necessary to examine the leading cases relating to the source of service contracts in order to gain insight into the guidelines that can be used in drafting tax-efficient service contracts.

In light of its frequency of citation, it is almost obligatory, in a discussion of the meaning of the source of income, to use as a point of departure the following passage by Isaacs J in *Nathan v FCT*:

The legislature in using the word 'source' meant, not a legal concept, but something which a practical man would regard as a real source of income. Legal concepts must, of course, enter into the question when we have to consider to whom a given source belongs. But the ascertainment of the actual source of a given income is a practical, hard matter of fact.<sup>39</sup>

Taking this quote at face value, one might happily assume that a 'practical',

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from foreign sources is not assessable to foreign residents. This paragraph refers to those limited situations where an amount is assessed on a specifically expressed basis. The example provided refers to the capital gain and loss provisions which bring to account gains and losses on the disposal of a taxable Australian asset rather than on Australian-sourced capital gains and losses.

37 Hamilton R and Deutsch R L *op. cit.* para 221. A statutory code of source rules can however be found in section 861 et seq of the United States Internal Revenue Code 1986.

38 Woellner, Vella and Burns *Australian Income Tax Law* 4th ed 1993 par 22-100.

39 1918 25 CLR 183 at 189-90. This passage was approved of in *Liquidator Rhodesia Metals Ltd v Commissioner of Taxes* (1940) AC 744 AT 789.

(1997) 9 BOND LR

common-sense and non-legalistic approach towards determining the source of income would lead to a single incontrovertible conclusion in each case. Unfortunately, the ensuing case law totally refutes this assumption. As Taylor FC remarked in relation to this famous quote in *FCT v French*<sup>40</sup>:

Perhaps it is fair comment to say that these observations throw little light on the immediate problem of selecting one factor rather than another as indicative of the source of an employee's wages or salary.

It was also cautiously admitted in *Esquire Nominees Ltd. v FCT*<sup>41</sup> that:

...to say that questions of source depend upon practical matters of fact will not necessarily assist in determining which of a range of possible meanings of source is meant.

The criticism has in fact been levelled that far from adopting a 'hard, practical matter of fact' approach, the courts have adopted what might be termed a 'form over substance' approach whereby they have focussed on the formalities of the transaction concerned, rather than on where the economic activity which gave rise to the income occurred.<sup>42</sup> A 'practical' person seeking to shield income flowing from a contract to perform services in Australia from being classified as Australian-sourced income for fiscal purposes would be dismayed to discover that it is quite possible for a single transaction to have a multiplicity of sources. If no one source is found to be 'dominant', an apportionment of the income generated might be called for.

This was the case in *Commissioner of Taxation v Cam and Sons Ltd*<sup>43</sup> where fishermen were employed on trawlers sailing both inside and out of the territorial waters of New South Wales, although they received payment for their work in Australia. Jordan CJ here expressed the matter succinctly:

Now a source may, and commonly does, consist of several factors. The character of the source may depend upon which of the factors is dominant...Where income is derived from salary or wages,... the source has several factors. Personal exertion may be involved in negotiating and obtaining the contract of employment, in performing the stipulated services, and in obtaining payment for them. In the present instance, for example, in the case of all the men involved, in a very real sense it may be said that the source of their wages consisted of the three elements of getting the job, doing it, and getting paid for it. Which of these factors is the most important element of the source in any given case depends on the facts of that case.<sup>44</sup>

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40 (1957) 98 CLR 398.

41 (1973) 47 ALJR 489 at 497.

42 Asprey report, par 17.69.

43 (1936) 36 SR (NSW) 544.

44 *Ibid* at pp 547-8.

In relation to the income arising out of a contract to perform services, he went on to say:

...if the source of income consists substantially in the making of contracts, the place where the contracts are made may be regarded as the only significant factor. If it consists in first making contracts and then carrying them into effect in circumstances such that both elements are substantial factors in the source, an apportionment must be made:...If the making of the contract is an insignificant factor, and the only substantial element is its performance, the place of performance is the only relevant locus of the source...<sup>45</sup>

The learned judge held that on the facts in this case, the only substantial source of the wages was the work by means of which the wages were earned. In reaching this conclusion, he took into consideration a number of English cases which had held that the source of a contract was the place of remuneration<sup>46</sup>, but distinguished these on the basis of the different source rules applicable under the United Kingdom taxation laws. It was finally decided that an apportionment should be made in proportion to a fisherman's working time in and out of New South Wales territorial waters respectively.

Although *FCT v United Aircraft Corporation*<sup>47</sup> dealt with the concept of source in relation to a contract entered into by a company, and not by an individual, the dicta of the court may be considered to be relevant in an investigation into the source of contracts concluded by individuals. In this case it was held that income from the use of know how in Australia was sourced in the United States, as the contract to supply the know how was entered into there. Rich J also sanctioned the 'case-by-case' approach, and took exception to the approach of concentrating on legal formalities:

...every case must be decided on its own circumstances...Screens, pretexts, devices and other unrealities, however fair may be the legal appearance which on first sight they bear, are not to stand in the way of the court charged with the duty of answering those questions...As the question to be determined in this case is a question of fact a decision on one set of facts is not binding and is often of little help on another set of facts. In *Premier Automatic Ticket Issuers Ltd v Federal Commissioner of Taxation* (7)[(1933) 50 CLR 268] and *Tariff Reinsurances Ltd v Commissioner of Taxes* (Vic.)(8)[(1938) 59 CLR 194] - cases which may, perhaps, be regarded as borderline cases - the court considered that, on the facts in each case, the contract should be regarded as the sole source of income and that therefore the locus of the contract was the locus of the source. But it does not follow that, in every case where a contract is one of the sources,

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45 *Ibid* at p 549.

46 The case of *Foulsham v Pickles* [1925] AC 548 received special note.

47 (1943) 68 CLR 525 at 538.

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the contract should be regarded as the sole source...<sup>48</sup>

The case of *FCT v French*<sup>49</sup> has proven to be highly controversial in the search for guidelines relating to the source of contracts of service. The case was decided by the High Court of Australia, with five judges presiding.

French was an engineer resident in New South Wales. He was employed under an oral contract by a company incorporated in New South Wales, for which he received monthly payments of salary into his Sydney bank account. During 1950 he spent 3 weeks in New Zealand working for his employer, and argued that the income relating to this period was exempt from income tax in Australia, it being sourced in New Zealand.<sup>50</sup>

Dixon CJ began his judgment by distinguishing the case of someone occupying an 'office', as, for example, a director might do, from an 'ordinary artisan', who earns his salary on a monthly basis by carrying out his work, and by stating that the respondent's case should be adjudged according to the latter case. (Unfortunately, he did not enlighten the court as to the basis on which someone bearing an office might be remunerated.) He went on to state that as such, the case was 'entirely different' from that in *Robertson v Federal Commissioner of Taxation*<sup>51</sup> which involved a governing director, and that the difference was 'even greater' in *Watson v Commissioner of Taxation*<sup>52</sup>, where:

...the remuneration was earned by procuring a specified result which an accountant carrying on business in a specified jurisdiction was commissioned to bring about. Because he journeyed into another jurisdiction in the course of his exertions to do so it did not follow that any part of the source of the remuneration was there located.<sup>53</sup>

Dixon CJ thus based his judgment on the fact that the respondent was an engineer, and not the holder of an office or a professional person, such as an accountant. Therefore the source of his income was the place where the work was carried out, this being the dominant source under these particular circumstances. It should perhaps be pointed out that an engineer is generally regarded as a professional person,<sup>54</sup> but Dixon CJ appears not to have subscribed to this view.

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48 *Ibid.*

49 (1957) 98 CLR 398.

50 Although an Australian resident is now taxed on his worldwide income, up until 1 July 1987 an exemption could be obtained under sec 23(q). This section, which has subsequently been repealed, provided an exemption in respect of income derived by an Australian resident from sources out of Australia and Papua New Guinea, where such income was not exempt from tax in the country from which it was derived.

51 (1937) 57 CLR 147.

52 (1930) 44 CLR 94

53 *FCT v French op cit* at p406.

54 See, for example, the definition of 'professional services' in Article 14 of the *Model Double Taxation Convention on Income and Capital* (Paris: OECD 1977), which specifically includes the independent activities of engineers.

McTiernan J offered a dissenting opinion based on the English cases which asserted that regard should be had to the locality of the contract (i.e. where it is entered into) and where payment is to be made, rather than to the place of the performance of the services.

Williams J went further than Dixon CJ and attempted to draw rather tenuous parallels between 'income derived from property', whose source is the place where the property is situated, and income from 'personal exertion', whose source, he argued, must therefore be the place where such personal exertion took place.

Kitto J held that there was not enough material relating to the terms of the contract in order for the court to determine the source. He submitted that although the place of performance of services is relevant and may even be decisive, he could not subscribe to the :

...sweeping proposition that in every case of employment the source of the wages or salary paid in respect of a particular period is to be found in work done by the employee in that period. I think it must depend on the circumstances, and most of all on the terms of the employment.<sup>55</sup>

He went on to point out that the terms of a contract may make the remuneration payable independent of the actual performance of services, such as in the case of public holidays, annual leave or long-service leave, or in the case of sick leave provided for in industrial awards or public service regulations.

Finally, Taylor J expressed the view that if he was compelled to select as the source of an employee's remuneration either the locus of the contract, or the place of payment, or the place where the services are performed which give rise to the right to remuneration, in the absence of any special circumstances he would choose the third element.<sup>56</sup>

Thus the ultimate outcome of the case was that Dixon CJ, Williams and Taylor JJ held that the sum paid to French in respect of the period of service in New Zealand was income derived by him from a source outside of Australia, while McTiernan J held that it was not income so derived. Kitto J held that the court had before it insufficient facts to enable the question to be decided.

If nothing more, *French's* case aptly demonstrates the lack of consensus on what should constitute the source of a service contract, given a specific set of facts. Even in the same case, the respective judges held divergent views, and these have proven to be a bone of contention in subsequent source cases dealing with these issues.

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55 *FCT v French* *op cit* at p417.

56 *Ibid* at p422.

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The facts in *FCT v Mitchum*<sup>57</sup> were that the actor, Robert Mitchum, entered into a contract with a Swiss company, in terms of which he was to undertake an advisory, consulting and acting role in two motion pictures, as directed by the company, at such studios and places and on such locations as the company from time to time designated. He also agreed to restrict his service activities in a number of directions; for example, he agreed to give his entire time and attention and devote his best talents and abilities to the company. He was not entitled to any damages for the failure of the Swiss company to utilise his services, but if he fully performed all the terms and conditions which fell to him to perform, he would be paid the salary agreed upon. His services were required for a period of 12 weeks plus 2 weeks free. In the event, the Swiss company lent him to Warner Brothers, who were making a film in Australia. Mr Mitchum came to Australia for 11 weeks, during which time he acted in the film and carried out some consulting services. He received payment for his services in the United States.

The Commissioner here based his case on the view that a rule of law had been established in *French's* case, to the effect that the source of remuneration for services rendered was the place at which the services were carried out, unless 'special circumstances' prevailed.

However, in his judgment, Barwick CJ, with whom Menzies and Owen JJ concurred, referred to the 'hard practical matter of fact' approach that was advocated in *Nathan's* case<sup>58</sup>, and pointedly stated that:

It would therefore be unlikely that there should be some rule of law which would compel the adoption of a particular conclusion where the facts themselves leave room for more than one view.<sup>59</sup>

He then referred to the fact that the Commissioner had not treated the agreement between the Swiss company and Mitchum as providing a global sum for his willingness to perform a variety of services, for the giving of several undertakings which restricted his freedom of action, and for the performance of those services if required to do so. He had, on the contrary, treated it as a weekly salary for services rendered. The source of such a weekly salary, in the Commissioner's view, would have to be Australia.

Barwick CJ rejected this submission as 'unacceptable':

The conclusion as to the source of income for the purposes of the Act is a conclusion of fact. There is no statutory definition of 'source' to be applied, the matter being judged as one of practical reality. In each case, the relative weight to be given to the various factors which can be taken into consideration is to be determined by the tribunal entitled to draw the ultimate conclusion as to source.

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57 (1965) 39 ALJR 23.

58 *Op cit* at p189-190.

59 *FCT v Mitchum op. cit.* at p25.

In my opinion, there are no presumptions and no rules of law which require that that question be resolved in any particular sense.<sup>60</sup>

He went on to quash any reliance that the Commissioner might place on *French's* case by expressly declaring that:

It is sufficient for present purposes to say that neither *French's* case nor any other of which I am aware lays it down that for the purposes of the Act the source of wages, salary or remuneration for services performed is necessarily, in default of special circumstances, in the place where the work is done or the services performed.<sup>61</sup>

All the afore-mentioned cases were referred to in *FCT v Efstathakis*<sup>62</sup>. Here a Greek national came to Australia in 1968 to take up a position as a permanent employee of the Greek ministry of foreign affairs. She was appointed as an assistant typist in the Greek Press and Information Service in Sydney by ministerial decision in Greece on 12 December 1969. As a permanent employee, she was required to join the Greek government superannuation scheme and to pay income tax on her salary in Greece, where, according to Greek law, she was domiciled. After such deductions were made her salary was paid to her in Australia. Under the terms of her appointment, she was subject to immediate transfer anywhere in the world on her government's decision. Her husband was a Greek national who was granted Australian citizenship in 1970, and they had purchased a home and had a child in Australia. The taxpayer argued that the source of her income was Greece, and therefore it was exempt from tax in Australia.<sup>63</sup>

In reaching his conclusion, Bowen CJ made reference to the fact that in *Mitchum's* case the contract contained provisions by which the taxpayer agreed to restrict his activities. Mr Mitchum was entitled to be paid the salary even if the Swiss company failed to utilise his services, provided he performed the other terms and conditions. However, this was not the case with Mrs Efstathakis. No evidence was led to the effect that she had any restrictions upon her obtaining concurrent employment, and her remuneration was linked to her services as a typist being performed. His opinion was that:

In the present case, the answer is not to be found in the cases, but in the weighing of the relative importance of the various factors which the cases have shown to be relevant.<sup>64</sup>

The court held that although some relevant factors occurred outside

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60 *Ibid* at p26.

61 *Ibid*.

62 (1979) 9 ATR 867.

63 Although the taxpayer was an Australian resident, the provisions of sec 23(q), mentioned above in relation to *French's* case, were still in operation at this time.

64 *Ibid* at p870.

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Australia, these did not outweigh the importance of factors which took place in Australia. These included the residence of the taxpayer and the fact that the services were performed and remunerated in Australia. The fact that Australia was the place of employment was held to be not merely incidental but central to the earning of the income, to the personal circumstances of the taxpayer and to the nature of the employment. The respondent was therefore liable to pay income tax in Australia.

The ultimate result of this case was that the taxpayer became liable to pay income tax on her salary in both Australia and Greece. There would be no relief for her under the double taxation agreement between Australia and Greece, as this provides only for income derived from international air transport. She would not be granted any unilateral tax relief in Australia on the tax paid in Greece, and her situation could only be ameliorated if unilateral relief was available under the Greek taxation laws.

### **The Source Of Services Under The DTAs**

Having examined the criteria applicable to a determination of the source of a contract from the viewpoint of the Australian domestic tax legislation and case law, it is appropriate to turn to the Australian International Agreements Act 1953.

Australia's DTAs contain rules relating specifically to the source of service-related income. In contrast to the source rules laid down in domestic common and statute law, these rules utilise fairly rigid and objective criteria, with detailed guidelines as to their application being provided by the OECD Commentary to the Model Convention.<sup>65</sup>

#### **the source of independent personal services**

Article 14 of the OECD Draft Convention provides that income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State unless he has a fixed base regularly available in the other State for the purpose of performing his activities.

The term 'professional services' includes, inter alia, independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants. These services must be 'independent' in nature. This means that professional services performed in employment are excluded, (for example a physician serving as a medical officer in a factory would not qualify). The Internal Revenue Service of the United States has ruled that:

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<sup>65</sup> Hamilton R and Deutsch R L *op cit* par 607.

the principal consideration in determining whether an individual is an employee or an independent contractor is whether or not services performed by an individual are for his own account, whether he receives the income and bears the losses arising for such services.<sup>66</sup>

A 'fixed base' is not defined, but, according to the OECD Commentary,<sup>67</sup> it would cover a physician's consulting room or the office of an architect or a lawyer. The idea of a 'fixed base' apparently carries with it the implication of a workshop, or at least of a business environment, as opposed to a dwelling place. The Bundesfinanzhof has held that a house in Germany which was made available to a Swiss independent technical adviser for his accommodation did not constitute a fixed base. The court found that the house in question would only be considered to be a fixed base if he conducted his advisory work there. As this was not the case, merely thinking about his advisory work while in the house, or travelling to work from there, did not render the house a fixed base.<sup>68</sup>

'Residence' is again a feature of this Article, as income derived by a resident in respect of independent personal services may only be taxed in the state of residence, unless he has a fixed base that is regularly available in that other state. If the individual has no such fixed base, he is exempt from tax in the country of source. It should be noted that although the other state has the right to tax any income attributable to the fixed base, this is not an exclusive right.<sup>69</sup>

#### **the source of dependent personal services**

Article 15.2 of the OECD Model Convention provides that in the event of a resident of a Contracting State deriving remuneration in the form of a salary or wage in respect of employment exercised in the other Contracting State, such remuneration will be taxed only in the taxpayer's State of residence if:

- (i) the individual is present in the other State for less than 183 days in the fiscal year concerned; and
- (ii) the remuneration is paid by or on behalf of an employer who is not a resident of the other State; and
- (iii) the remuneration is not borne by a permanent establishment or fixed base of the employer in the other State.

These provisions may again be modified in the treaties, for example the DTA between Australia and Indonesia provides that the individual must be present in the other State for a period not exceeding 120 days in any period of 12 months, and adds a further proviso that the remuneration must be subject to tax in the firstmentioned State, (i.e. if the income is exempt in that state the provisions of the Article will not apply).

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66 Baker *P op cit* p223.

67 Commentary on Article 14 Concerning the Taxation of Independent Personal Services, sec 4.

68 Baker *P op cit* p224.

69 *Ibid* at p222.

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Although the Article appears to set out precise rules for classifying the source of dependent personal services, problems have arisen due to the absence of definitions for the various terms used here. For example, the Model Convention does not define 'employment', or the method for determining the place where employment is exercised. In practice, it has been assumed that if an individual is present in a country for work purposes, then he is exercising his employment there. However, the view has also been put forward that presence in a country for visits of short duration does not constitute an exercising of employment. This view was upheld in a decision of the Administrative Tribunal of Paris concerning a Paris-based American journalist who made numerous trips to other countries in the course of his employment. It was held that the employment was exercised solely in France.<sup>70</sup>

Problems have also arisen in quantifying 183 days. The Lower Court of Amsterdam has held that the 183 days only includes days actually spent working, and not free days and holidays between bouts of working. This is not the viewpoint generally taken - German authorities consider that a person is present in a country for a day if they stay there overnight, while the Internal Revenue service of the United States has ruled that a day means a day during any part of which the employee is present in the United States.<sup>71</sup>

### **Using a Contract of Service as a Tax Planning Tool, where Foreign Individuals Contract to do Business in Australia**

Having examined Australia's domestic residence and source rules relating to a foreign individual contracting to do business here, and the relevant residence and source rules as embodied in Australia's DTAs, it is clear that the local and international (or transnational) rules stand in sharp contrast to one another. The DTAs have been fairly successful in their endeavours to impose uniform rules of residence and source, perhaps because these agreements are drafted by diplomats, rather than by tax lawyers.<sup>72</sup>

While these rules will greatly assist foreigners residing in countries which have entered into such agreements with Australia, one must bear in mind that to date Australia has not entered into DTAs with any African, Middle-Eastern or South American countries. Individuals residing in these countries have to look to Australia's domestic legislation for guidance.

Having noted the disparity between local and international rules, I intend to outline firstly the types of clauses which would be useful to a foreign individual who has contracted to do business in Australia, but who is a resident of a country which has not entered into a DTA with Australia, i.e. to a person who will be dealt

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<sup>70</sup> *Ibid* at p230.

<sup>71</sup> *Ibid* at p232.

<sup>72</sup> Lehman G and Coleman C *Taxation Law in Australia* 3rd ed 1994 par 10.1.

with by the Australian tax authorities in terms of the domestic tax legislation. I then intend to deal with clauses suitable for a foreign individual living in a treaty-partner country.

**factors to consider when drafting service contracts for - individuals residing in non-treaty partner countries**

Australia's domestic residence and source rules cannot be utilised with the same degree of confidence as the DTA rules. Although statutory rules have been laid down, these are open to a wide degree of interpretation by the courts.

In spite of the above caveat, one can still extract guidelines from these rules for the tax-efficient drafting of service contracts.

**the issue of residence**

A foreign businessman who has contracted to do business in Australia will wish to avoid being classified as an Australian resident, as this will result in his being taxed in Australia on his worldwide income. He should therefore plan strategically to use his service contract as a tax planning tool to avoid falling within the statutory definition of resident. He should do this by including clauses in his service contract to demonstrate that he does not reside in Australia, he does not intend to take up residence in Australia, and that his usual place of abode is outside Australia.

***The contract should thus provide as many of the following terms as possible:***

- (i) that the foreign businessman's stay in Australia will be limited to a specific duration (preferably less than 183 days in the fiscal year of Australia);
- (ii) that his visit is for a set business purpose, the perimeters of which are clearly set out in the document;
- (iii) that the service to be provided is a once-off transaction, and that it is not foreseen that a follow-up visit to Australia will be required;
- (iv) that, as the individual does not own or lease a home in Australia, accommodation will be provided at a hotel, or at some company property maintained solely for the purpose of housing visiting executives;
- (v) that this accommodation will only be made available to the person for the limited duration of his stay, and that accommodation will be provided for the businessman alone, and not for his family;
- (vi) that the contract was entered into in the foreigner's home country;
- (vii) that all correspondence should be addressed to the individual at an address in his home country, at his usual place of abode.

Although such clauses will go a long way towards negating any suggestion that the individual resides in Australia, one must not overlook the

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elusive idea of 'intention'. The person contracting to perform a service in Australia should additionally refrain from in any way expressing an intention to reside in Australia. A lesson can be learnt from the United States experience:

In this weighing of factors, taxpayers (and especially the better advised among them) held many of the important indicia of residence within their control and, therefore, often had the upper hand on questions of residence. An individual willing to lead a life of some apparent impermanence could spend substantial time in the United States without acquiring US residence. This relative advantage enjoyed by taxpayers was eroded, however, when the sheer length of an individual's stay foreclosed scrutiny of his intentions, when the individual became too visible or notorious, or when an individual's situation (often an immigration status) required expressions of intention that could not be belied by actions.<sup>73</sup>

### **the issue of source**

It must be stated at the outset that Australian domestic source rules provide no definite, incontrovertible rules which govern the incidence of source in relation to service contracts. It should also be borne in mind that:

...it is not possible for parties to determine by contract that the source of given income will be any place other than where relevant events and transactions occur. But, the formation of a contract may itself be a relevant event, or the terms of the contract may constitute a relevant transaction. That is, the determination of the geographical source of income may require that a pertinent contract be examined in order to assess its impact.<sup>74</sup>

The terms of a person's service contract would thus certainly influence whether or not it would be deemed to be sourced in Australia. One must not at this point lose sight of the fact that the ultimate goal of a businessman is to lighten his overall tax burden. To this end, he must evaluate whether or not it would be more beneficial for him to have his income sourced, and therefore taxed, in Australia, as opposed to in another jurisdiction. The rates of tax in Australia must thus be weighed against those applied in any other country in which the contract could, within the terms of the agreement, be sourced. Should he then discover that it would best serve his purposes if the services were not subject to Australian income tax, the service contract should be drafted accordingly.

***In order to try to avoid a service contract being judged as being sourced in Australia, the agreement should provide:***

- (i) that the contract was entered into in a foreign country, and that remuneration is to be paid in that country in the applicable foreign currency;

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<sup>73</sup> Isenbergh J *op cit* p51.

<sup>74</sup> Rigney H R *op cit* p57.

- (ii) that the individual performing the service is a professional person, who has a wide latitude in exercising his judgment in his advisory or consulting capacity, i.e. that he is acting in an independent manner as he sees fit;
- (iii) that the individual will channel all his abilities to fulfil the task in hand;
- (iv) that he is restrained from consulting with, or performing services for other clients during the period of the transaction;
- (v) that a global sum is to be paid for all the services to be provided and for the accompanying restrictions on services to others, i.e. the sum is payable in respect of the entire project.

Although these factors may carry some weight in an evaluation of whether or not the service income under consideration has an Australian source or not, one must not lose sight of the difficulty involved in identifying and classifying source in relation to taxation law. In the words of Burchell J:

...the word 'source', in this context, has no precise or technical reference. It expresses only a general conception of origin, leading the mind broadly, by analogy. The true meaning of the word evokes springs in grottos at Delphi, sooner than the instance of taxes. So the exactness which the lawyer is prone to seek must be consciously set aside; indeed, with respect to a choice between various contributing factors, it cannot be attained.<sup>75</sup>

#### **factors to consider when drafting service contracts for individuals residing in treaty partner countries**

Under DTAs, the factors to consider involve an understanding of which country will have the right to tax the income flowing from the service contract. Care should therefore be taken to ensure that the service income potentially exposed to double taxation is clearly associated with a particular country. I am assuming that the provisions of Articles 14 and 15 of the OECD Draft Convention are present in these treaties. In each case, the specific terms of the agreement should be examined.

#### **the issue of residence**

DTAs assume that an individual is a resident of one country. A series of tie-breaker rules attempt to discover where that place of residence is.

In seeking to establish that the foreign individual doing business in Australia is not resident here for DTA purposes, but is resident in his home country, his service contract should indicate:

- (i) that the person's permanent home, to which all correspondence

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<sup>75</sup> *Thorpe Nominees Pty Ltd v FCT* 88 ATC 4886 at 4896-7.

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should be addressed, is in his home country;<sup>76</sup>

- (ii) that the individual will be staying in a hotel, or in accommodation made available to him for the limited duration of his stay by the company utilising his services.

If the person is not in a position to include these two clauses in his contract, he will have to prove that his centre of vital interests or his habitual abode lies in his home country. These factors are more difficult to prove (and to include in a contract) than the factor of a 'permanent home'. If he cannot establish himself as a resident in his home country under the above tests, he may have to state in his service contract that he is a national of his home country.

### **the issue of source**

#### ***the source of independent personal services***

If a businessman can establish that in terms of the DTA between his home country and Australia he would be classified as a resident of that home country, he will not be liable to Australian income tax on those services. This exemption will only apply if he does not have a fixed base in Australia.

#### ***His contract to do business in Australia should provide:***

- (i) that no office, workshop or consulting rooms will be made available to the person during his stay in Australia;
- (ii) that the person will not acquire, and has not previously acquired, a fixed base in Australia.

### **the source of dependent personal services**

In terms of Article 15 of the OECD Model Convention, the foreign individual's service contract should provide:

- (i) that the individual will be present in Australia for less than 183 days in Australia's fiscal year. (The contract should state the duration of his presence here as running between two specified dates);
- (ii) that the remuneration to be paid to the individual will be paid by or on behalf of an employer who is not a resident of Australia;
- (iii) that the remuneration is not borne by a permanent establishment or fixed base of the employer in Australia.

## **Conclusion**

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<sup>76</sup> Note: it has been asserted, in relation to the question of a permanent home under DTAs, that: 'Someone who owns a dwelling in one country and always stays in hotels (or similarly transient quarters) in other countries can assert exclusive residence in the country of the permanent dwelling.' Isenbergh *J op. cit.* p336.

The postwar period can be characterised as an era in which both developed and developing countries have realised the necessity of promoting the unification and harmonisation of international commercial law, in order to break down trade barriers and facilitate the flow of international investment.

While it has been acknowledged that it is in the interest of nations to develop policies which will result in increased investment, the criticism has been levelled that:

...the scope for the imposition of taxation on persons and income items beyond the borders of a state seems only to be limited by some vaguely defined rule against arbitrariness.<sup>77</sup>

This arbitrariness stands in direct opposition to the needs of the international business community, which requires certainty in regard to the taxation implications of its business contracts which span national borders:

We live at a time when rapid and unpredictable change is the order of the day. But business likes stability. Political stability, especially when achieved by working democratic institutions is, of course, desirable, but what is really required to attract investment are *stable fiscal, monetary and tax policies*....Not only should policies be stable, but the rules and regulations in which they are embodied must be clear and transparent.<sup>78</sup>

The Australian domestic common and statute law rules of residence and source applicable to a foreign individual contracting to do business in Australia cannot be described as 'stable, clear and transparent.' Even the double taxation treaties are not above criticism, due to the lack of precise definitions given to certain terms. It has been stated, in relation to Australian tax law that:

It builds on language which has inherent ambiguities. Many of the core concepts are not defined and have been left for the courts to develop. Some are virtually indeterminate. Many have no justification in policy terms. There are numerous disputes.<sup>79</sup>

At a time when it appears that 'the wealth of a nation will be in direct proportion to the nation's international attractiveness',<sup>80</sup> it is imperative that the need for clear, transparent and stable tax rules in relation to Australian residence and source be addressed.

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77 Hamilton R and Deutsch R *L op. cit.* par 217.

78 Wendt H *Global Embrace* 1993 p235.

79 Waincymer J *op. cit.* p89.

80 Wendt H *op. cit.* p270.

(1997) 9 BOND LR