TD 2007/31 - Income tax: is a non-resident enterprise that under a hire-purchase agreement hires out substantial equipment to another entity that uses the equipment in Australia deemed to have a permanent establishment in Australia under Article 4(3)(b) of the tax treaty between Australia and Singapore or equivalent provisions in other Australian tax treaties?

This cover sheet is provided for information only. It does not form part of *TD 2007/31 - Income tax: is a non-resident enterprise that under a hire-purchase agreement hires out substantial equipment to another entity that uses the equipment in Australia deemed to have a permanent establishment in Australia under Article 4(3)(b) of the tax treaty between Australia and Singapore or equivalent provisions in other Australian tax treaties?*

This determination contains references to repealed provisions, some of which may have been re-enacted or remade. The determination has effect in relation to the re-enacted or remade provisions. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten.
Australia's tax treaties and other agreements except for the Taipei Agreement are set out in the Australian Treaty Series. The citation for each is in a note to the applicable defined term in sections 3AAA or 3AAB of the International Tax Agreements Act 1953.

Taxation Determination

Income tax: is a non-resident enterprise that under a hire-purchase agreement hires out substantial equipment to another entity that uses the equipment in Australia deemed to have a permanent establishment in Australia under Article 4(3)(b) of the tax treaty between Australia and Singapore or equivalent provisions in other Australian tax treaties?

This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Ruling

1. No. A non-resident enterprise is not deemed to have a permanent establishment in Australia under Article 4(3)(b) of the tax treaty between Australia and Singapore[1] (the Singapore Agreement) or equivalent provisions in other Australian tax treaties if it hires out substantial equipment under a hire-purchase agreement to an entity that uses the equipment in Australia.

2. This view applies in respect of other tax treaties with Australia as specified in paragraph 17 of this Determination.

3. For the purposes of this Determination, the term 'hire-purchase agreement' has the same meaning as in Taxation Ruling TR 2007/10.[2]

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[1] See Schedule 5 to the *International Tax Agreements Act 1953*.
[2] See paragraph 32 of Taxation Ruling TR 2007/10 – Income tax: the treatment of shipping and aircraft leasing profits of United States and United Kingdom enterprises under the deemed substantial equipment permanent establishment provisions of the respective Taxation Conventions.

Date of effect

4. This Determination applies to income years commencing both before and after its date of issue. However, the Determination does not apply to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
19 December 2007

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Explanation

5. Whilst the following explanation discusses Article 4(3)(b) of the Singapore Agreement, the reasoning applies equally to all other tax treaties containing an equivalent provision. These tax treaties are listed at paragraph 17 of this Determination.

6. Article 4(3)(b) of the Singapore Agreement provides that a Singapore enterprise is deemed to have a permanent establishment in Australia, and to carry on trade or business through that permanent establishment, if substantial equipment is being used in Australia by, for or under contract with the enterprise.

7. The Full Federal Court in *McDermott Industries (Aust) Pty Ltd v. Federal Commissioner of Taxation*[3] (*McDermott*) held that a Singapore bareboat lessor of substantial equipment had a deemed permanent establishment in Australia under Article 4(3)(b) of the Singapore Agreement on the basis that the equipment was, by virtue of that lease, being used in Australia either by, or under contract with, the Singapore lessor.[4]

8. It has been suggested that there is no relevant distinction between a bareboat lease and a hire-purchase agreement, so the Court's reasoning in *McDermott* would apply equally to substantial equipment that is in Australia under a hire-purchase agreement with a Singapore enterprise.

9. Whether the elements of Article 4(3)(b) of the Singapore Agreement are satisfied in the case of a hire-purchase agreement is to be determined in accordance with the broad principles of treaty interpretation[5]. In taking a liberal approach where the rules of construction are not as precise as for domestic provisions, gaps and ambiguities in applying the provisions of a treaty are to some extent to be accommodated in a way that addresses the context of the provision and meets the object and purpose of the tax treaty.[6]

10. The Singapore Agreement does not have any direct references to hire-purchase agreements, nor does the relevant extrinsic material provide any insight into the interpretation to be given to Article 4(3)(b), particularly for instances involving hire-purchase agreements, both in respect of Article 4(3)(b) itself and in the context of the Singapore Agreement as a whole.

11. There is no change in legal ownership under a hire-purchase agreement until the option to purchase is exercised. The Court in *McDermott* took a broad view of the scope of the expression 'used … by, for or under contract with'. On the face of it, a hire-purchase agreement could be seen as a type of contract under which equipment is 'used' by its owner in the sense contemplated by the Court. However, the Commissioner considers that, on balance, a number of factors weigh against this conclusion.

12. Firstly, nothing in the decision in *McDermott* suggests that the Court had considered the issue in relation to hire-purchase agreements either directly or indirectly.

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[3] [2005] FCAFC 67.
[4] Paragraph 71 of the Court's reasons for decision.
[5] See Taxation Ruling TR 2001/13 Income tax: interpreting Australia's Double Tax Agreements.
[6] See paragraphs 93 and 94 of TR 2001/13 and see further *McDermott* [2005] FCAFC 67 at paragraph 38.

13. Secondly, a relevant consideration is the treatment of hire-purchase agreements in paragraph 9 of the Commentary on Article 12 of the *1977 OECD Model Double Taxation Convention on Income and on Capital*. Although Article 12 dealt with a different subject matter, namely the taxation of equipment leasing under the royalties definition in the Model Convention, the context is relevant in that the Commentary outlines a distinction for treaty purposes between sale and hire that is not solely dependent on the legal form of a transaction. A hire-purchase agreement is given as a specific example of a transaction that should be treated as a sale for the purposes of the Royalties Article. In the absence of any contrary factors, this approach is also relevant when determining the treatment to be provided for Article 4(3)(b) of the Singapore Agreement purposes.

14. Thirdly, in a number of contexts Australian domestic law expressly treats a hire-purchase agreement as though it were an initial sale of the equipment together with a loan arrangement. See section 128AC of the *Income Tax Assessment Act 1936* and Divisions 40 and 240 of the *Income Tax Assessment Act 1997*. This of course does not compel a similar conclusion in the treaty context in the absence of an equivalent deeming provision but, other things being equal, it would be broadly desirable, so far as the respective texts allow, to interpret Article 4(3)(b) of the Singapore Agreement in a manner that gives consideration to the approach taken under domestic law.

15. Therefore, given that there is no express guidance in the treaty itself and based on the abovementioned contextual considerations, the Commissioner considers that when applying Article 4(3)(b) of the Singapore Agreement to a hire-purchase agreement involving substantial equipment, the agreement should be treated as, in effect, an initial sale of the equipment together with a loan arrangement. This approach is considered to resolve ambiguity in applying the tax treaty provision in a way that is consistent with the context in which the provision exists and the underlying object and purpose of the tax treaty.

16. As the substantial equipment is treated as if it has initially been disposed of by the Singapore enterprise for the purposes of Article 4(3)(b) of the Singapore Agreement, it is not used in Australia, by, for or under contract with the Singapore enterprise and the enterprise is not deemed to have a permanent establishment in Australia.

17. This approach is not limited to Article 4(3)(b) of the Singapore Agreement but also applies in respect of the tax treaties specified below:

Tax Treaty	Schedule No. to Agreements Act
Canada	3
New Zealand	4
Netherlands	10
French	11
Belgian	13
Philippine	14
Swiss	15
Malaysian	16
Swedish	17
Danish	18

Irish	20
Italian	21
Korean	22
1982 Norwegian	23
Maltese	24
1984 Finnish	25
Chinese[7]	28
Papua New Guinea	29
Thai	30
Sri Lankan	31
Fijian	32
Hungarian	33
Kiribati	34
Indian	35
Polish	36
Vietnamese	38
Spanish[8]	39
Czech[9]	40
Taipei	41
South African	42
Slovak	43
Argentine	44
Romanian	45
Russian[10]	46
Mexican[11]	47

[7] The Chinese Agreement specifies that a permanent establishment will be deemed where: 'a structure, installation, drilling rig, ship or other equipment used for the exploration for, or exploitation of, natural resources, or in activities connected with that exploration or exploitation, but only if so used continuously, or those activities continue, for a period of more that three months.'

[8] The Spanish Agreement specifies that a permanent establishment will be deemed where: 'A structure, installation, drilling rig, ship or other like substantial equipment is used for the exploration for, or exploitation of, natural resources or in activities connected with that exploration or exploitation, in either case if used continuously or those activities continue for a period of more than twelve months.'

[9] Applies to heavy equipment not substantial equipment.

[10] Applies to heavy industrial equipment not substantial equipment.

[11] Applies to heavy equipment not substantial equipment.

References

Previous draft:

TD 2007/D11

Related Rulings/Determinations:

TR 2001/13; TR 2006/10; TR 2007/10

Subject references:

- hire-purchase agreements
- permanent establishment
- Singapore tax treaty
- substantial equipment
- tax treaties

Legislative references:

- International Tax Agreements Act 1953 Sch 3
- International Tax Agreements Act 1953 Sch 4
- International Tax Agreements Act 1953 Sch 5
- International Tax Agreements Act 1953 Sch 5 Article 4
- International Tax Agreements Act 1953 Sch 10
- International Tax Agreements Act 1953 Sch 11
- International Tax Agreements Act 1953 Sch 13
- International Tax Agreements Act 1953 Sch 14
- International Tax Agreements Act 1953 Sch 15
- International Tax Agreements Act 1953 Sch 16
- International Tax Agreements Act 1953 Sch 17
- International Tax Agreements Act 1953 Sch 18
- International Tax Agreements Act 1953 Sch 20
- International Tax Agreements Act 1953 Sch 21
- International Tax Agreements Act 1953 Sch 22
- International Tax Agreements Act 1953 Sch 23
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- International Tax Agreements Act 1953 Sch 30
- International Tax Agreements Act 1953 Sch 31
- International Tax Agreements Act 1953 Sch 32
- International Tax Agreements Act 1953 Sch 33
- International Tax Agreements Act 1953 Sch 34
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- International Tax Agreements Act 1953 Sch 36
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- International Tax Agreements Act 1953 Sch 45
- International Tax Agreements Act 1953 Sch 46
- International Tax Agreements Act 1953 Sch 47
- ITAA 1936 128AC
- ITAA 1997 Div 40
- ITAA 1997 Div 240
- TAA 1953

Case references:

- McDermott Industries (Aust) Pty Ltd v. Federal Commissioner of Taxation [2005] FCAFC 67; (2005) 142 FCR 134; (2005) 219 ALR 346; [2005] ALMD 7876; 2005 ATC 4398; (2005) 59 ATR 358

Other references:

- OECD Committee on Fiscal Affairs for the Organisation for Economic Co-operation and Development, Model Tax Convention on Income and Capital, Paris, 1977 published version

ATO references

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