Taxation of the Passive Income of Foreign Governments and Sovereign Wealth Funds in Selected Foreign Countries

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Poland • Switzerland • United Kingdom

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TAXATION OF THE PASSIVE INCOME OF FOREIGN GOVERNMENTS AND SOVEREIGN WEALTH FUNDS IN SELECTED FOREIGN COUNTRIES

COMPARATIVE SUMMARY

Executive Summary

On the basis of the principle of sovereign immunity, Australia, Canada, Japan, and the United Kingdom exempt foreign governments and their instrumentalities from taxation of their source country passive investments through administrative acts or practices, and to a limited extent, sovereign wealth funds may also benefit from these regimes. Germany, Norway, Poland, and Switzerland do not apply the doctrine of sovereign immunity to grant foreign governments general exemptions from taxation on their source country income. However, the Norway-Russia double taxation treaty exempts interest earned by the other government and its central bank while the Kuwait-Poland treaty exempts source dividends earned by the other county's governments and their funds. Germany appears to have no such exemptions in its double taxation treaties, while the Swiss double taxation treaties allow for much discretion and flexibility on the basis of informal agreements between the Contracting States.

In their domestic legislation, Canada, Germany, Norway, and the United Kingdom do not tax source country interest of non-residents, whereas Australia, Japan, Poland, and Switzerland withhold tax on such interest at varying rates. Source country dividends are exempted for non-residents in the United Kingdom, and for corporate non-residents they are totally exempted in Norway and 95 percent exempted in Germany. Australia taxes only the dividends from untaxed corporate profits, whereas Canada, Japan, Poland, and Switzerland withhold taxes on source country dividends at varying rates.

I. Scope of the Project

This report consists of individual reports for Australia, Canada, Germany, Japan, Norway, Poland, Switzerland, and the United Kingdom. All these countries are members of the Model Tax Convention of the Organization for Economic Co-operation and Development [OECD Model Tax Convention][1] and for each of these countries the report surveys the country's domestic legislation, policy, or practice on the taxation of passive income (interest, dividends, and capital gains) earned by foreign governments or their instrumentalities and by foreign sovereign wealth funds. To assess the significance of any tax exemptions for foreign governments and their funds, this report also reviews the domestic laws on taxing source country income from interest, dividends, and capital gains that is earned by non-resident corporations in general. In addition, to provide a sampling of the applicable double taxation treaties, each country report examines at least one double taxation treaty with another country that has a prominent sovereign wealth fund.

[1] Organization for Economic Co-operation and Development, Model Tax Convention on Income and on Capital, Electronic Version, Feb. 1, 2005, available by subscription from the official Web-site http://www.oecd.org/document/17/0,3343,es_2649_33747_35035793_1_1_1_1,00.html.

II. Taxation of Foreign Governments

In comparing the domestic laws and policies on the taxation of foreign governments and their entities, a difference between Japan and the Commonwealth countries of Australia, Canada, and the United Kingdom on the one hand and Continental Europe on the other becomes apparent. Whereas Japan and the surveyed Commonwealth countries base their practice of exempting foreign governments and their agencies from taxation of their passive source income on the international law concept of sovereign immunity, this theory is not used to generally exempt governments from taxation in continental Europe.[2] In the domestic laws of Germany, Norway, Poland, and Switzerland, foreign governments are deemed to be treated like other foreign entities, and if exemptions are made, they are most likely to be found in double taxation treaties or the practice resulting from them.

Australia and Canada exempt foreign governments from taxation on their passive source income; they implement this principle through individual administrative acts.

- In Australia, a foreign government or its agency may obtain an exemption for funds that will remain governmental by applying for a private binding ruling that usually will be granted for portfolio investments, with 10 percent equity or less being the guidepost for defining a non-commercial activity.
- In Canada, the government or a central bank of a foreign country may obtain an exemption from withholding taxes for Canadian source portfolio investments that serve a truly governmental function and not a commercial activity, provided that there is reciprocity.

Japan and the United Kingdom exempt foreign governments from taxation on their passive source income through their administrative practice, which in the case of Japan has found expression in the exemption of the foreign governments from having to report source income to the authorities, on the grounds that it would not be taxed in any event.

In addition to these unilateral or reciprocity-based practices, these above described countries may allow for further exceptions on the basis of their double taxation treaties.

Among the surveyed continental European countries that do not subscribe to the sovereign immunity concept for the taxation of foreign government's passive investments, Germany stands out by adhering to the principle of taxing foreign governments like any other foreign company, not only in its domestic legislation but also in its treaty practice. The German double taxation treaties follow the spirit of article 4, paragraph 1 of the OECD Model Tax Convention by treating the governments of the treaty states as residents, and therefore as taxpayers, and by not making exceptions from this principle.

Norway and Poland, while adhering to the principle that foreign governments should be taxpayers, nevertheless make some treaty exceptions to this principle. The double taxation treaty between Norway and Russia, for instance, exempts passive income from taxation at the source if it is beneficially owned by the other Contracting State or its subdivisions or instrumentalities, central banks, certain named financial institutions for foreign trade, and similar institutions designated by mutual agreement.

Poland has double taxation treaties with China, Kuwait, Russia, and Singapore. Of these, the only exemption from the taxation of a foreign government is found in the treaty with Kuwait. It provides that dividends earned in the source country by the government of the other state are exempt from taxation.

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[2] All the surveyed countries are members of the Convention on Diplomatic Relations, Apr. 18, 1961, 23 UST 3227; TIAS 7502; 500 UNTS 95 and of the Convention on Consular Relations, Apr. 24, 1963, 21 UST 77; 596 UNTS 261, and it can be safely assumed that they observe these conventions by exempting diplomatic and consular staff from taxation, as well as exempting foreign governments for mission-related purposes. These Conventions are not further discussed in this report.

Switzerland has no domestic legislation exempting foreign governments from taxation of their passive Swiss-source income. It also appears that the double taxation treaties do not specify such exemptions. The actual practice, however, cannot be deduced from a reading of the relevant double taxation treaties, because they contain many discretionary clauses that should allow the contracting states to make exceptions from the otherwise governing regimes for dividends and interest. This, at least, was found in the double taxation treaties with Norway and Kuwait.

III. Taxation of Sovereign Wealth Funds

In exempting foreign governments from taxation of their passive source income, Australia, Canada, and the United Kingdom may extend this principle to sovereign wealth funds on the basis of individual decisions that examine the governmental nature and purpose of the fund.

- In Australia, a sovereign wealth fund may be exempted from the dividend or interest withholding tax, if the fund establishes that the generated passive investment income results from the performance of a governmental function within Australia.
- In Canada, the scrutiny of the sovereign wealth fund appears to focus on the public/humanitarian or commercial purpose of the fund: Chinese banks have been denied exempt status, whereas the New Zealand Earthquake Relief Fund qualified.
- In the United Kingdom, a sovereign wealth fund will be exempted from passive investment income if it is an integral part of the government of a foreign sovereign state, but the exemption will be denied if the fund is an entity that is separate from the government, even though the government may own its shares.

Germany, Japan, Norway, Poland, and Switzerland have no unilateral or reciprocity-based rules on exempting sovereign wealth funds, thus allowing only for treaty provisions to exempt sovereign wealth funds from the taxation of their passive source-country income. German treaties appear to contain no such provisions, whereas the flexibility found in the Swiss double taxation treaties is not helpful in revealing the actual practice.

The treaty between Japan and Singapore exempts the taxation of interest earned not only by the Contracting State's governments, their local authorities, and central banks, but also of any institution wholly owned by that government. The Canada-Norway double taxation treaty contains a similar provision, thus exempting Canadian and Norwegian sovereign wealth funds from taxation of dividend and interest income in the other country. The treaty between Poland and Kuwait exempts dividend income earned by a company owned by the government of the other country.

IV. Domestic Tax Rates for Passive Investment Income Earned by Foreign Corporations

Interest

Canada, Germany, Norway and the United Kingdom exempt interest from taxation to a considerable extent, if the interest is earned by a non-resident portfolio investor. In Germany, the only types of interest that are taxable for non-residents are mortgage interest and interest derived from certain hybrid debt instruments that are similar to shares. Interest from German bank accounts is not taxed if earned by a foreign resident. In Canada, interest is exempt if earned by a foreign resident through an arm's length transaction, and in the United Kingdom, interest earned from bank accounts is exempt for foreign residents. Norway generally exempts interest earned by non-residents.

Australia, Japan, Poland, and Switzerland tax non-residents on source country interest, usually by applying the general withholding tax from which relief can only be obtained through an applicable double taxation treaty. Australia taxes interest at the general rate of 10 percent; the Japanese tax rate for interest earned by passive investments is 15 percent; Poland taxes non-resident corporations on their Polish-

source interest at the flat corporate rate of 19 percent; and Switzerland generally withholds at the rate of 35 percent, with certain exceptions applying to affiliated enterprises within the European Union.

Dividends

Norway exempts foreign corporations from being taxed on their source country dividends on the theory that this avoids inter-corporate taxation. Norway, however, taxes non-resident portfolio dividends of non-residents from outside the European Economic Area and also dividends earned by residents of tax havens. Such dividends are taxed at the generally applicable rate of 25 percent.

The German provisions and their underlying philosophies are similar, yet Germany exempts from taxation only 95 percent of the dividends earned by resident and non-resident corporations. The remaining 5 percent, as well as dividends earned by individual non-resident shareholders, are taxed at the rate of 26.38 percent. The United Kingdom, on the other hand, generally exempts from taxation the dividends earned by non-residents.

Australia, Canada, Japan, Poland, and Switzerland tax non-residents on their source country dividends, usually at the rates that also apply to residents. Australia, however, distinguishes between franked and unfranked dividends and imposes the 30 percent tax rate only on dividends from profits for which the corporation has not been taxed.

Canada generally withholds at the rate of 25 percent, aside from various exceptions; the Japanese withholding rate for passive income dividends earned by non-residents is 20 percent; Poland withholds dividends earned by non-resident business entities at the flat corporate rate of 19 percent; and Switzerland applies the withholding rate of 35 percent to portfolio holdings while granting a participation exemption to substantial holdings by Swiss and European investors.

Capital gains

Capital gains from passive investments of non-residents are not taxed in Japan and the United Kingdom. Norway exempts capital gains from the sale of stock if earned by a non-resident corporation under the principles that are applied to dividend income. In Germany, non-resident corporate entities pay capital gains tax at the rate of 26.38 percent on only 5 percent of the gain from on the sale of substantial participations (one percent of shares held during five years).

Capital gains from passive investments that are earned by non-residents are generally taxed in Australia, Canada, Poland, and Switzerland. Australia applies the marginal tax rate, Canada withholds at 25 percent, Poland applies the 19 percent corporate tax rate to business entities, and Switzerland applies the federal income tax rate of 8.5 percent.

IV. Tax Rates in Sample Double Taxation Treaties

In this very limited sampling of double taxation treaties,[3] the bilateral treaties between Norway on the one hand and Australia, Canada, Germany, Japan, and Switzerland, on the other, have been reviewed because the Norwegian Pension Fund is one of the oldest and most prominent sovereign wealth funds.[4]

Of these, the treaty with Canada exempts dividends and interest earned by the governments of the contracting states. The treaty with Switzerland exempts the Swiss dividends earned by the Norwegian Government, Central Bank, and Oil Fund, and no corresponding provision for interest is needed because

[3] For a more comprehensive treatment of several double taxation treaties between Australia and countries that have sovereign wealth funds, see the country report on Australia.

[4] For more information, see the country report on Norway.

it is generally not taxed at the source. The treaty with Poland exempts dividends earned by the Kuwaiti government or a company owned by it, but does not provide a corresponding provision for interest? Does this last sentence refer to a Norwegian treaty?

The treaties with Australia, Germany, and Japan contain no specific exemption of Norway's government or its funds.

The treaty with Australia taxes source country interest at a rate of up to 15 percent, portfolio dividends at up to 15 percent, and dividends from participations at 0 to 5 percent. The treaty with Germany taxes source country interest with a rate of 0 percent, portfolio dividends at up to 15 percent, and dividends from participations at up to 5 percent. The treaty with Japan does not tax Japanese interest and dividends earned by Norwegian residents.

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TAXTION OF THE PASSIVE INCOME EARNED BY FOREIGN GOVERNMENTS AND SOVEREIGN WEALTH FUNDS

AUSTRALIA

Australia does not grant a complete immunity from Australian taxation to foreign sovereigns. Rather Australia distinguishes between commercial and non-commercial investments and permits non-commercial passive investments to apply for and be granted an exemption from taxation on the basis of sovereign immunity. Australia's foreign policy and domestic legislation permits commercial investments by foreign sovereigns to be taxed.

Australia has signed a number of taxation agreements that may reduce the rate of Australian taxation payable by any foreign resident. In some recent taxation agreements the term resident is defined to include the governments of the contracting parties.

Introduction

Within Australia taxation is primarily levied in accordance with the Income Tax Assessment Act 1936 (Cth) and the Income Tax Assessment Act 1997 (Cth). Rulings and interpretations on application of income tax law may be made by the Australian Taxation Office.[1]

International tax agreements are governed by the text of the relevant treaty and the International Tax Agreements Act 1953 (Cth). Direct foreign investment is regulated via the Foreign Acquisitions and Takeovers Act 1975 (Cth) and overseen by the Foreign Investment Review Board.[2]

Immunities granted to foreign states are governed by the Foreign States Immunities Act 1985 (Cth) and the public international law doctrine of sovereign immunity.

I. Tax Status of Foreign Governments

General Position

Generally, a non-resident is liable for Australian taxation on income that is sourced in Australia and is not liable for Australian taxation on foreign sourced income.[3] In accordance with the International

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[1] See the Australian Taxation Office Web site at: http://www.ato.gov.au/default.asp?menu=4244 (last visited May 2, 2008). Income Tax Assessment Act 19997 (Cth) §§ 6-5(3), 6-10(5), available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au.

[2] See the Foreign Investment Review Board's website at http://www.firb.gov.au/content/default.asp (last visited May 2, 2008). Legislation available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au.

[3] *Income Tax Assessment Act 1997* (Cth) §§ 6-5(3), 6-10(5), available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au.

Tax Agreements Act 1953 (Cth) and taxation treaties, rates of taxation for some situations are agreed and recorded within the relevant treaty. These treaties become schedules to the International Tax Agreements Act 1953 (Cth).

Australia's policy on commercial investments by foreign governments is, as articulated by the Foreign Investment Review Board, to require "...commercial investments by foreign governments or their agencies to be structured in a manner that enables all normal taxes and charges to be levied, and avoids questions of sovereign immunity arising".[4]

Further § 20 of the Foreign States Immunities Act 1985 (Cth) provides that:

> A foreign State is not immune in a proceeding in so far as the proceeding concerns an obligation imposed on it by or under a provision of a law of Australia with respect to taxation, being a provision that is prescribed,[5] or is included in a class of provisions that is prescribed, for the purposes of this section.

Exemption for Foreign Governments

In general foreign governments (and their agencies) that hold "passive investments" may be exempt from withholding tax on interest or dividends provided they meet the following conditions:

- the investment is made by a foreign government (or agency of a foreign government);
- the funds invested are and will remain government funds; and
- the income is derived from a "non-commercial activity."[6]

An exemption may be obtained by the foreign government seeking a binding private ruling from the Australian Taxation Office (ATO). In general a holding of 10 percent or less equity in a company (i.e. a portfolio holding) will be considered "non-commercial activity.[7]

The basis for this exemption is the doctrine of sovereign immunity, and while there is no legislation establishing this exemption, it is a long-standing practice and has been detailed in an Australian Taxation Office interpretive decision.[8]

On November 4, 2005, the then Australian Treasurer announced that new legislation would be introduced to clarify and codify the existing practice,[9] however, to date such legislation has not been

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[4] *See also* Foreign Investment Review Board, ANNUAL REPORT 2005-2006: CHAPTER 3 OVERVIEW OF THE *FOREIGN ACQUISITIONS AND TAKEOVERS ACT 1975, available at* http://www.firb.gov.au/content/Publications/AnnualReports/2005-2006/Chapter3.asp.

[5] By virtue of regulation 3 and the schedule to the Foreign States Immunities Regulations 1987 (Cth), prescribed legislation includes the Income Tax Assessment Act 1936 (Cth) and the *I*nternational Tax Agreements Act 1953 (Cth). All legislation available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au

[6] Australian Taxation Office Interpretative Decision, ATO ID 2002/45, available from the Australian Taxation Office Web site, http://law.ato.gov.au/atolaw/view.htm?dbwidetocone=05%3AATO%20Interpretative%20Decisions%3ABy%20Year%3A2002%3A1-99%3A%230045%23ATO%20ID%202002%2F45%20-%20Sovereign%20Immunity%3B (official source, last visited May 2, 2008).

[7] *Id.*

[8] ATO ID 2002/45, *id.*

[9] Press Release, Australian Government, 094/2005: Clarifying The Taxation Of Foreign Government Investments (Nov. 4, 2005), *available at* http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2005/094.htm&pageID=&min=phc&Year=2005&DocType=0.

introduced.

II. Tax Status of Sovereign Wealth Funds

Unless an exemption applies, dividends, interest, and royalties derived by sovereign wealth funds are subject to a final withholding tax at the time of payment.[10] Currently the general rates of taxation are:[11]

- unfranked dividends[12] – 30 percent;
- interest – 10 percent; and
- royalties – 30 percent.

These rates may be reduced due to the operation of a tax treaty or agreement (also known as double taxation avoidance agreements) between foreign governments and Australia.[13] For example, an agreement between Australia and China prescribes the following rates for tax on income: 15 percent for unfranked dividends; 10 percent for interest; and 10 percent for royalties.[14]

Sovereign wealth funds that are beneficiaries of Australian trusts (including beneficiaries that are trustees) are taxed upon distribution.[15] Where the sovereign wealth fund is a beneficiary of an Australian managed investment trust, the fund is taxed via a non-final withholding tax rate of 30 percent[16] (this rate may be reduced as the result of a tax treaty).

Where a sovereign wealth fund has direct ownership of real property, any associated rental income will be taxed at the general tax rate, and, the property may be subject to capital gains tax on disposal.[17]

Similar to a foreign government, where a sovereign wealth fund establishes that income generated results from the performance of a governmental function within Australia and that the income is from a

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[10] Income Tax Assessment Act 1936 (Cth) §§ 128B(1), (2) and (2B), available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au.

[11] Current rates of tax are available from the Australian Taxation Office Web site at http://www.ato.gov.au/. (last visited April 10, 2008).

[12] Unfranked dividends are dividends paid from profits on which Australian tax has not been paid. Franked dividends do not attract dividend withholding tax.

[13] Australia has entered into tax agreements with over 40 countries. *See* Australian Taxation Office Web site, PAYG *Withholding From Interest, Dividends And Royalties To Non-Residents*, AUSTRALIAN TAX AGREEMENTS, http://www.ato.gov. au businesses/content.asp?doc=/Content/50240.htm&page=15&H15 (last visited April 10, 2008). Details of each agreement, and the domestic legislation implementing each agreement, are available from the Australian Government, Treasury Web site at http://www.treasury.gov.au/documents/625/XLS/Australian_Tax_Treaty_Table_April_2008.xls (last visited April 10, 2008).

[14] Agreement between the Government of Australia and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion [1990] ATS 45, arts. 10-12, [1990] Australian Treaty Series (ATS) 45 (official source). A copy of the treaty is available from the AustLII Australian Treaty Series Web site, http://www.austlii.edu.au/au/other/dfat/treaties/1990/45.html (unofficial source, last visited May 2, 2008).

[15] The trustee of the Australian trust is assessed on behalf of the Sovereign Wealth Fund.

[16] Taxation Administration Act 1953 (Cth), Schedule 1, Division 12, §§ 12-375 – 12-40, available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au. *Also see* Australian Taxation Office, WITHHOLDING ARRANGEMENTS FOR MANAGED FUND DISTRIBUTIONS TO FOREIGN RESIDENTS, http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/78088.htm&pc=001/005/054/002/014&mnu=24612&mfp=001&st=&cy=1 (last visited Apr. 10, 2008). The current company tax rate is available from the Australian Taxation Office Web site at: http://www.ato.gov.au/businesses/content.asp?doc=/content/44266.htm (last visited Apr. 10, 2008).

[17] Advice from the Australian Embassy, Washington DC, to author, dated April 10, 2008.

"passive investment," the fund may be exempted from dividend or interest withholding tax.[18]

However, where a sovereign wealth fund carries on a business in Australia, either through a resident subsidiary or a branch, the fund will be taxed on the same basis as an Australian resident company and generally will not be able to claim any sovereign immunity exemption for any subsequent passive income through that entity.[19]

III. Domestic Law

Section 995-1 of the Income Tax Assessment Act 1997 (Cth) defines a foreign resident as "a person who is not a resident of Australia for the purposes of the Income Tax Assessment Act 1936" (person is defined to include a company).

Section 44(1)(b) of the Income Tax Assessment Act 1936 (Cth) provides that the assessable income of a foreign resident shareholder in a company (whether the company is resident in Australia or not) includes:

> (i) dividends (other than non-share dividends) paid to the shareholder by the company to the extent to which they are paid out of profits derived by it from sources in Australia; and
> (ii) non-share dividends paid to the shareholder by the company to the extent to which they are derived from sources in Australia; and
> (c) if the shareholder is a non-resident carrying on business in Australia at or through a permanent establishment of the shareholder in Australia, and the company is a resident:
> (i) dividends (other than non-share dividends) that are paid to the shareholder by the company and are attributable to the permanent establishment, to the extent to which they are paid out of profits derived by the company from sources outside Australia; and
> (ii) non-share dividends that are paid to the shareholder by the company and are attributable to the permanent establishment, to the extent to which they are derived from sources outside Australia.

Section 855 of the Income Tax Assessment Act 1997 (Cth) provides that a foreign resident is subject to capital gains tax where a capital gains tax event[20] occurs in relation to specified assets.

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[18] In accordance with ATO ID 2002/45, *supra* note 6.

[19] *Id.*

[20] Section 104-5 of the Income Tax Assessment Act 1997 (Cth) describes a capital gains tax event as: "Disposal of a capital gains tax asset; Use and enjoyment before title passes; Loss or destruction of a capital gains tax asset; Cancellation, surrender and similar endings; End of option to acquire shares etc; Creating contractual or other rights; Granting an option; Granting a right to income from mining; Entering into a conservation covenant; Creating a trust over a capital gains tax asset; Transferring a capital gains tax asset to a trust; Converting a trust to a unit trust; Capital payment for trust interest; Beneficiary becoming entitled to a trust asset; Disposal to beneficiary to end income right; Disposal to beneficiary to end capital interest; Disposal by beneficiary of capital interest; Creating a trust over future property; Granting a lease; Granting a long term lease; Lessor pays lessee to get lease changed; Lessee receives payment for changing lease; Lessor receives payment for changing lease; Capital payment for shares; Liquidator or administrator declares shares or financial instruments worthless; Forfeiture of a deposit; Receipt for event relating to a capital gains tax asset; Individual or company stops being an Australian resident; Trust stops being a resident trust; Company stops being member of wholly-owned group after roll-over less that market value; Change in relation to replacement asset or improved asset after a roll-over under Subdivision 152-E; Trust fails to cease to exist after a roll-over under Subdivision 124-N; Failure to acquire replacement asset and to incur fourth element expenditure after a roll-over under Subdivision 152-E; Cost of acquisition of replacement asset or amount of fourth element expenditure, or both, not sufficient to cover disregarded capital gain; Bankrupt pays amount in relation to debt; Asset passing to tax-advantaged entity; capital gains tax asset starts being trading stock; Special capital loss from collectable that has fallen in market value; Pre- capital gains tax shares or trust interest; Balancing adjustment occurs for a depreciating asset that you used for purposes other than taxable purposes; Direct value shifts affecting your equity or loan interests in a company or trust; Entitlement to receive payment of a carried interest; You make a FOREX realisation gain covered by item 1 of the table in subsection 775-70(1); You make a FOREX realisation loss covered by item 1 of the table in subsection 775-75(1); Foreign hybrid loss exposure adjustment section 705-57 in tax cost setting amount of assets of entity becoming subsidiary member of consolidated group or MEC group; Amount

In relation to capital gains tax events occurring on or after December 12, 2006, the specified assets are taxable Australian property (i.e. direct or indirect interests in Australian real property and an Australian permanent establishment's business assets (other than real property)) (§ 855-20).[21]

On the basis of Australia law (and in the absence of a relevant double taxation treaty or Sovereign exemption from taxation ruling)[22] a non-resident corporations is subject to a final withholding tax at the time of payment[23] and is subject to capital gains tax.

Currently the general rates of taxation are:[24]

- unfranked dividends[25] – 30 percent;
- interest – 10 percent; and
- royalties – 30 percent.

Capital gains are taxed at the gain at marginal tax rate[26] (capital losses may be carried forward).

Australia considers Australian real property owned by non-residents (whether owned directly or via an entity) as eligible for taxation and that income (or gains) from the alienation of property may also

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remaining after step 3A etc. of joining allocable cost amount is negative; Tax cost setting amounts for retained cost base assets exceed joining allocable cost amount; No reset cost base assets against which to apply excess of net allocable cost amount on joining; Amount remaining after step 4 of leaving allocable cost amount is negative; Error in calculation of tax cost setting amount for joining entity's assets; Discharged amount of liability differs from amount for allocable cost amount purposes; and Reduction in tax cost setting amount for reset cost base assets on joining cannot be allocated." Available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au.

[21] AUSTRALIAN MASTER TAX GUIDE, 2007 ¶ 13-720 (41st ed, CCH, Sydney, 2007). There are three methods that may be used to establish the capital gains tax payable. *See*: The Australian Tax Office, CALCULATORS – CAPITAL GAINS – THREE METHODS OF CALCULATING CAPITAL GAINS, Sept. 2007, *available at* http://www.ato.gov.au/businesses/content.asp?doc=/content/33748.htm&pc=001/003/019/002/007&mnu=601&mfp=001/003&st=&cy=1.

[22] Details of reduce taxation rates resulting from taxation agreements may be viewed on the Australian Taxation Office website at http://www.ato.gov.au/businesses/content.asp?doc=/Content/50240.htm&page=15&H15 (last visited May 2, 2008).

[23] Income Tax Assessment Act 1936 (Cth) §§ 128B(1), (2) and (2B), available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au.

[24] Current rates of tax are available from the Australian Taxation Office Web site at http://www.ato.gov.au/ (last visited Apr. 10, 2008).

[25] Unfranked dividends are dividends paid from profits on which Australian tax has not been paid. Franked dividends do not attract dividend withholding tax.

[26] Non-resident individual tax rates for 2007-2008 are:

Taxable income	Tax on this income
$0 – $30,000	29c for each $1
$30,001 – $75,000	$8,700 plus 30c for each $1 over $30,000
$75,001 – $150,000	$22,200 plus 40c for each $1 over $75,000
$150,001 and over	$52,200 plus 45c for each $1 over $150,000

Non-resident companies are taxed at the same marginal rate as Australian companies. The current income tax rate for companies is 30% (with some superannuation and non-profit companies being eligible for a 15% tax rate). *See* Australian Tax Office, COMPANY TAX RATES, TAX RATES 2006-2007, Jan. 2008, available at http://www.ato.gov.au/businesses/content.asp?doc=/content/44266.htm&pc=001/003/019/001/006&mnu=601&mfp=001/003&st=&cy=1.

be taxed.[27]

IV. Treaties on Double Taxation

Australia has double taxation agreements with several nations that have significant Sovereign wealth funds, including China; Norway, Russia, and Singapore. The taxation rates set in those agreements are:

Country	Withholding taxes (% rate limits)[28]			
	Dividends	**Interest**	**Royalties**	**Application dates**
China[29]	15	10	10	July 1, 1991
Norway[30] (1983 and 2006 Convention)	0/5/15	0/15	5/10	July 1, 1983 and January 1, 2008 (respectively)
Russia[31]	5/15/30	10	10/30	July 1, 2003
Singapore[32]	0/15	10	10	July 1, 1969

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[27] AUSTRALIA MASTER TAX GUIDE, *supra* note 21, at 1204.

[28] *See* Australian Government, Treasury Web site, http://www.treasury.gov.au/documents/625/XLS/Australian_Tax_Treaty_Table_April_2008.xls (last visited May 2, 2008) and *PAYG Withholding From Interest, Dividends And Royalties To Non-Residents*, *supra* note 13.

[29] Agreement between the Government of Australia and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 1990 ATS 45 (official source). A copy of the treaty is available from the AustLII Australian Treaty Series Web site, http://www.austlii.edu.au/au/other/dfat/treaties/1990/45.html (unofficial source, last visited May 6, 2008).

[30] Convention with the Kingdom of Norway for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion, 2007 ATS 32 (official source); Convention between Australia and the Kingdom of Norway for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, and Protocol, 1983 ATS 19 (official source). Copies of the treaties are available from the AustLII Australian Treaty Series Web site, http://www.austlii.edu.au/au/other/dfat/treaties/2007/32.html & http://www.austlii.edu.au/ au/other/dfat/treaties/1983/19.html, respectively (unofficial source, last visited May 6, 2008).

[31] These rates do not apply where the "dividend, royalty or interest income is preferentially taxed and information related to that dividend, royalty or interest income is given confidential treatment," *see* P*AYG Withholding From Interest, Dividends And Royalties To Non-Residents*, *supra* note 13. Thus the effect of Article 23 of the treaty (Limitation of Benefits) is to deny treaty benefits for highly mobile income where the income is preferentially taxed and information concerning that income is not readily exchanged between the two countries, meaning that dividends, interest, and royalties falling into this category are subject to withholding tax at the Australian domestic law rates. For this reason there are three possible withholding tax rates for Russian-bound dividends (5%, 15% and 30%) and two royalty withholding tax rates (10% and 30%).

[32] Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 1969 ATS 14 (official source); Protocol amending the Agreement with the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 1990 ATS 3 (official source). Copies of the treaty and protocol are available from the AustLII Australian Treaty Series Web site, http://www.austlii.edu.au/au/other/dfat/ treaties/1969/14.html and http://www.austlii.edu.au/au/other/dfat/treaties/1990/3.html, respectively (unofficial source, last visited May 6, 2008).

Capital Gains Tax Provisions

Australia introduced a capital gains tax regime in 1985 and has several "pre-capital gains tax" treaties, some of which have been amended by subsequent protocols or re-negotiations to include provisions dealing comprehensively with capital gains (eg. Malaysia (1999),[33] New Zealand (1995), [34] and Singapore (1989)[35]).

However, it should be noted that Australia's Commissioner of Taxation has released a public ruling that "Australia's right to tax gains taxable in Australia exclusively under the capital gains tax regime … is not limited by pre-CGT treaties.. because: (a) from Australia's perspective these treaties do not distribute taxing rights over capital gains; and (b) …Australia's tax on capital gains is not a tax to which pre-CGT treaties apply."[36]

Australia's treaty provisions in relation to pre and post introduction of capital gains tax may be represented as:[37]

	Pre-Capital Gains Tax	**Post-Capital Gains Tax**
Heading	Alienation of Property	Alienation of Property
Activities	No article in pre-OECD treaties (ie. negotiated before Australia's membership of the OECD) and later pre-capital gains tax treaties did not deal with alienation of property comprehensively, thus often only real property alienations is addressed.	Comprehensively deals with capital gains.

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[33] Agreement between the Government of Australia and the Government of Malaysia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (Canberra, 20 August 1980) [1981] ATS 15 (official source), amended by Protocol Amending the Agreement between the Government of Australia and the Government of Malaysia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income of 20 August 1980 (Sydney, 2 August 1999), [2000] ATS 25 (official source) & by Second Protocol And Exchange Of Letters, Amending The Agreement Between The Government Of Australia And The Government Of Malaysia For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income Of 20 August 1980, a amended by the First Protocol of 2 August 1999, (Genting Highlands, 28 July 2002), [2004] ATS 1 (official source).

[34] Agreement between the Government of Australia and the Government of New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Melbourne, 27 January 1995) [1997] ATS 23 (official source), amended by Protocol Amending the Agreement between the Government of Australia and the Government of New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Melbourne, 15 November 2005, [2007] ATS 5 (official source).

[35] Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Canberra, 11 February 1969) [1969] ATS 14 (official source), amended by Protocol amending the Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income of 11 February 1969 (Canberra, 16 October 1989) [1990] ATS 3 (official source).

[36] Australian Tax Office, TAXATION RULING TR 2001/12 available at the ATO Web site, http://law.ato.gov.au/atolaw/print.htm?DocNum=0000540667&Life=20011219000001-99991231235959&DB=full&printTitle=Rulings~Taxation~TR%202001%2F12~Income%20tax%20and%20capital%20gains%20tax%3A%20capital%20gains%20in%20pre-CGT%20tax%20treaties%20-%20Overview%20(As%20at%2019%20December%202001) (official source, last visited Apr. 30, 2008).

[37] Table abbreviated version of that found in Australian Tax Office, *id*.

	Pre-Capital Gains Tax	**Post-Capital Gains Tax**
Characterization	Generally expressed to deal only with income from alienation of property.	Income, profits, and gains.
Source Rules	Income	Income, profits, and gains.
Entry into force provisions in treaties address	Income	Income, profits, and gains.
Force of law provisions	Give treaty force of law in relation to 'income'	General formula introduced: provisions of the treaty have force of law 'according to their tenor' (i.e., dealing with income, profits, or gains).

Capital gains tax provisions are addressed in the treaties between Australia and China, Norway, Russia and Singapore and in recent agreements between Australia and Canada[38] and Australia and Finland.[39] The intention of the Australian government is to more closely align the treaty provisions addressing capital gains tax to those in the model OECD treaty.[40]

Status of Contracting States' Governments

The 2006 Convention with Norway[41] specifically includes the government of the contracting states within the resident provision (art. 4, para. 1): "The Government of a Contracting State or a political subdivision or local authority of that State is also a resident of that State for the purposes of the Convention."

Agreements with China, Singapore and Russia do not include this provision; however, it is included in the agreements with the United Kingdom,[42] Japan (not yet in force),[43] and South Africa (not

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[38] Protocol Amending the Convention between Australia and Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Canberra, 23 January 2002, [2002] ATS 26 (official source). Available from the Australian Treaty Database on Austlii, http://www.austlii.edu.au/cgi-bin/sinodisp/au/other/dfat/treaties/2002/26.html?&nocontext=1 (unofficial source, last visited May 1, 2008).

[39] Agreement between the Government of Australia and the Government of Finland for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion, Melbourne, 20 November 2006, [2007] ATS 36 (official source). Available from the Australian Treaty Database on Austlii, http://www.austlii.edu.au/cgi-bin/sinodisp/au/other/dfat/treaties/2007/36.html?&nocontext=1 (unofficial source, last visited May 1, 2008).

[40] *See* Hon. Peter Costello, Press Release, New Australia-Finland Taxation Treaty Signed, No. 126 (Nov. 2006), *available at* http://www.treasurer.gov.au/DisplayDocs.aspx?pageID=&doc=pressreleases/2006/126.htm&min=phc.

[41] Convention Between Australia and the Kingdom of Norway for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion, Canberra, 8 August 2006, [2007] ATS 32 (official source). Available form the Australian Treaty Database on Austlii, http://www.austlii.edu.au/cgi-bin/sinodisp/au/other/dfat/treaties/2007/32.html?&nocontext=1 (unofficial source, last visited May 1, 2008).

[42] Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, Canberra, 21 August 2003, 2003 ATS 22 (in force) (official source). Available from the Australian Treaty Database on Austlii, http://www.austlii.edu.au/cgi-bin/sinodisp/au/other/dfat/treaties/2003/22. html?&nocontext=1 (unofficial source, last visited May 1, 2008).

[43] Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Protocol, and Exchange of Notes,Tokyo, January 31, 2008, [2008] AUSTRALIAN TREATIES NOT IN FORCE, (ATNIF) 1 (not yet in force) (official source). Available from the Australian Treaty Database on Austlii, http://www.austlii.edu.au/au/other/dfat/treaties/notinforce/2008/1.html (unofficial source, last visited May 6, 2008).

yet in force).[44]

Sample text from some of Australia's taxation treaties addressing the definition of resident and the implementation of capital gains tax is detailed in Annex A.

V. Foreign Investment Approval

All direct investments by foreign governments (or their agencies) are subject to the Foreign Acquisitions and Takeovers Act 1975 (Cth)[45] and the Australian Government's foreign investment policy; as such, direct investments require prior notification to, and prior approval from, the Australian government.

Direct investment includes investments made via an entity that is 15 percent or more owned by a foreign government.[46] However, these are distinguished from non-controlling investments where the investing party is not in a position to determine the policy of the business.[47] In accordance with the Foreign Acquisitions and Takeovers Act 1975 (Cth) and the Government's foreign investment policy, the Australian government may block proposals (subject to the Act) where it determines that the proposal is contrary to Australia's national interest.[48]

In determining "national interest," the Australian Government will have regard to the six issues[49] including "whether the investment may impact on Australian Government revenue or other policies." Thus "investments by foreign government entities must be taxed on the same basis as operations by other commercial entities."[50]

VI. Australia's Sovereign Funds

Australia has two sovereign wealth funds. The Australian Future Fund (derived from privatization of national government assets (eg. Telstra), budget contributions and taxation revenue) is intended to fund public sector superannuation payments.[51] The Australian Future Fund is established

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[44] Protocol Amending the Agreement between the Government of Australia and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income of 1999, Pretoria, 31 March 2008 [2008] ATNIF 2 (not yet in force) (official soruce). Available from the Australian Treaty Database on Austlii, http://www.austlii.edu.au/cgi-bin/sinodisp/au/other/dfat/treaties/notinforce/2008/2.html?&nocontext=1 (unofficial source, last visited May 1, 2008).

[45] Foreign Acquisitions and Takeovers Act 1975 (Cth), available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au.

[46] *Id.*, § 17F.

[47] *Id.*, § 19(7), *id*.

[48] *Id.,* § 17F. *Also see* Australian government, the Treasury, *Summary of Australia's Foreign Investment Policy,* Mar. 2008, available at http://www.firb.gov.au/content/_downloads/General_Policy_Summary%20march%202008%20-%20including%20guidelines%20and%20electronic%20lodgement.rtf.

[49] The other five issues are: 1. Whether an investor's operations are independent from the relevant foreign government. 2. Whether an investor is subject to and adheres to the law and observes common standards of business behavior. 3. Whether an investment may hinder competition or lead to undue concentration or control in the industry or sectors concerned. 4. Whether an investment may impact on Australia's national security. 5. Whether an investment may impact on the operations and directions of an Australian business, as well as its contribution to the Australian economy and broader community.

[50] *See* Attachment A: The Treasury, *Summary of Australia's Foreign Investment Policy*, *supra* note 48.

[51] Australian Government Future Fund Web site, http://www.futurefund.gov.au/ (last visited April 9, 2008).

under the Future Fund Act 2006 (Cth)[52] and operates separately and independently from the Australian government.

The Higher Education Endowment Fund (established via the Higher Education Endowment Fund Act 2007 (Cth))[53] is managed by the Future Fund Board of Guardians under a specific investment mandate. The Higher Education Endowment Fund provides funding for education sector capital works and research projects (as decided by the Minister for Education, Employment and Workplace Relations and the Minister for Industry, Innovation, Science and Research).[54]

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[52] Available from the official Web site of the Australian government, Attorney-General's Department, http://www.comlaw.gov.au.

[53] *Id.*

[54] For further information on the Higher Education Endowment Fund, see Australian government, Department Education, Employment and Workplace Relations' website at: http://www.heef.dest.gov.au/default.htm (last visited May 6, 2008).

I. Annex A

Country[55]	**Capital Gains Tax**
China Agreement between the Government of Australia and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income 1990 ATS 45	Article 4 Resident 1. For the purpose of this Agreement, the term "resident", in relation to a Contracting State, means 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. 2. A person is not a resident of a Contracting State for the purposes of this Agreement if the person is liable to tax in that State in respect only of income from sources in that State. 3. Where by reason of the preceding provisions of this Article a person, being an individual, is a resident of both Contracting States, then the status of the person shall be determined in accordance with the following rules: (a) the person shall be deemed to be a resident solely of the Contracting State in which a permanent home is available to the person; (b) if a permanent home is available to the person in both Contracting States, or in neither of them, the person shall be deemed to be a resident solely of the Contracting State with which the person's economic and personal relations are the closer. 4. Where by reason of the provisions of paragraph (1) a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident solely of the Contracting State in which its place of effective management or head office is situated. However, where such a person has its place of effective management in a Contracting State and its head office in the other Contracting State, the person shall be deemed to be a resident solely of that other State. 5. If a company has become a resident of a Contracting State for the principal purpose of enjoying benefits under this Agreement, that company shall not be entitled to any of the benefits of Articles 10, 11 and 12.

[55] See Australian government, Treasury Web site at, http://www.treasury.gov.au/documents/625/XLS/Australian_Tax_Treaty_Table_April_2008.xls (last visited Apr. 30, 2008) for links to the Australian Treaty Database on Austlii. A copy of the treaty is available from the Austlii Australian Treaty Serie, http://www.austlii.edu.au/cgi-bin/sinodisp/au/other/dfat/treaties/2007/36.html?&nocontext=1(last visited May 1, 2008).

Country[55]	**Capital Gains Tax**
	6. Where by reason of the provisions of paragraph (1) a company is a resident of Australia and, under a tax agreement between China and a third country, is also a resident of that third country, the company shall not be considered to be a resident of Australia for the purposes of enjoying benefits under this Agreement. Article 13 Alienation of property 1. Income or gains derived by a resident of a Contracting State from the alienation of real property referred to in Article 6 and, as provided in that Article, situated in the other Contracting State may be taxed in that other State. 2. Income or gains from the alienation of property, other than real property referred to in Article 6, that forms part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or pertains to a fixed base available to a resident of the first-mentioned State in that other State for the purpose of performing independent personal services, including income or gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such a fixed base, may be taxed in that other State. 3. Income or gains from the alienation of ships or aircraft operated in international traffic, or of property other than real property referred to in Article 6 pertaining to the operation of those ships or aircraft, shall be taxable only in the Contracting State of which the enterprise which operated those ships or aircraft is a resident. 4. Income or gains derived by a resident of a Contracting State from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property in the other Contracting State of a kind referred to in Article 6, may be taxed in that other State. 5. Nothing in this Agreement affects the application of a law of a Contracting State relating to the taxation of gains of a capital nature derived from the alienation of property other than that to which any of paragraphs (1), (2), (3) and (4) apply.

Country[55]	**Capital Gains Tax**
Singapore Protocol amending the Agreement with the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income 1990 ATS 3.	Article 10A (1) Income or gains derived by a resident of one of the Contracting States from the alienation of real property referred to in Article 4A and, as provided in that Article, situated in the other Contracting State may be taxed in that other State. (2) Income or gains from the alienation of property, other than real property referred to in Article 4A, that forms part of the business property of a permanent establishment which an enterprise of one of the Contracting States has in the other Contracting State or pertains to a fixed base available to a resident of the first-mentioned State in that other State for the purpose of performing independent personal services, including income or gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such a fixed base, may be taxed in that other State. (3) Income or gains from the alienation of ships or aircraft operated in international traffic, or of property (other than real property referred to in Article 4A) pertaining to the operation of those ships or aircraft, shall be taxable only in the Contracting State of which the enterprise which operated those ships or aircraft is a resident. (4) Income or gains derived by a resident of one of the Contracting States from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property in the other Contracting State of a kind referred to in Article 4A and, as provided in that Article, situated in that other State, may be taxed in that other State. (5) Nothing in this Agreement affects the application of a law of a Contracting State relating to the taxation of gains of a capital nature derived from the alienation of property other than that to which any of paragraphs (1), (2), (3) and (4) apply.".
Russia Agreement between the Government of Australia and the Government of the Russian Federation for the avoidance of Double Taxation and	Article 4 Residence 1 For the purposes of this Agreement, a person is a resident of a Contracting State if the person is a resident of that State under the law of that State relating to its tax. 2 A person is not a resident of a Contracting State for the purposes of this Agreement if the person is liable to tax in that State in respect only of income

Country[55]	**Capital Gains Tax**
the prevention of Fiscal Evasion with respect to Taxes on income, and Protocol 2003 ATS 23	from sources in that State. 3 Where by reason of the preceding provisions of this Article a person, being an individual, is a resident of both Contracting States, then the person shall be deemed to be a resident solely of the Contracting State in which a permanent home is available to the person, or if a permanent home is available to the person in both Contracting States, or in neither of them, the person shall be deemed to be a resident solely of the Contracting State with which the person's personal and economic relations are closer. For the purpose of this paragraph, an individual's citizenship of one of the Contracting States shall be a factor in determining the degree of the individual's personal and economic relations with that Contracting State. 4 Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident solely of the State in which its place of effective management is situated. Article 13 Income from alienation of property 1 Income or profits derived by a resident of a Contracting State from the alienation of real property situated in the other Contracting State may be taxed in that other State. The meaning of the term "real property", and its situation, shall be determined in accordance with Article 6. 2 Income or profits from the alienation of property, other than real property, that forms part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or pertains to a fixed base available in that other State to a resident of the first mentioned State for the purpose of performing independent personal services, including income or profits from the alienation of that permanent establishment (alone or with the whole enterprise) or of that fixed base, may be taxed in that other State. 3 Income or profits from the alienation of ships or aircraft operated by an enterprise of a Contracting State in international traffic, or of property (other than real property) pertaining to the operation of those ships or aircraft, shall be taxable only in that State. 4 Income or profits derived by a resident of a Contracting State from the

Country[55]	**Capital Gains Tax**
	alienation of any shares or other interests in a company, or of an interest of any kind in a partnership, trust or other entity, where the value of the assets of such entity, whether they are held directly or indirectly (including through one or more interposed entities, such as, for example, through a chain of companies), is principally attributable to real property, situated in the other Contracting State, may be taxed in that other State. 5 Nothing in this Agreement affects the application of a law of a Contracting State relating to the taxation of capital gains derived from the alienation of any property other than that to which any of the preceding paragraphs of this Article apply.
Norway Convention Between Australia and the Kingdom of Norway for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion 2007 ATS 32 (2006 Convention)	Article 4 Residence 1 For the purposes of this Convention, the term "resident of a Contracting State " means: (a) in the case of Australia , a person who is a resident of Australia for the purposes of Australian tax; and (b) in the case of Norway, a person who is liable to tax therein by reason of domicile, residence, place of management or any other criterion of a similar nature. The Government of a Contracting State or a political subdivision or local authority of that State is also a resident of that State for the purposes of the Convention. 2 A person is not a resident of a Contracting State for the purposes of this Convention if the person is liable to tax in that State in respect only of income from sources in that State. 3 Where by reason of the preceding provisions of this Article a person, being an individual, is a resident of both Contracting States, then the person's status shall be determined as follows: (a) the individual shall be deemed to be a resident only of the State in which a permanent home is available to that individual; but if a permanent home is available in both States, or in neither of them, that individual shall be deemed to be a resident only of the State with which the individual's personal and

Country[55]	**Capital Gains Tax**
	economic relations are closer (centre of vital interests); (b) if the State in which the centre of vital interests is situated cannot be determined, the individual shall be deemed to be a resident only of the State of which that individual is a national; (c) if the individual is a national of both States or of neither of them, the competent authorities of the Contracting States shall endeavour to resolve the question by mutual agreement. 4 Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated. 5 Where under this Convention any income, profits or gains are relieved from tax in a Contracting State and, under the law in force in the other Contracting State, an individual in respect of that income or those profits or gains is exempt from tax by virtue of being a temporary resident of the other State within the meaning of the applicable tax laws of that other State, then the relief to be allowed under this Convention in the first-mentioned State shall not apply to the extent that that income or those profits or gains are exempt from tax in the other State. Article 13 Alienation of Property 1 Income, profits or gains derived by a resident of a Contracting State from the alienation of real property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State. 2 Income, profits or gains from the alienation of property, other than real property, that forms part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including income, profits or gains from the alienation of that permanent establishment (alone or with the whole enterprise), may be taxed in that other State. 3 Income, profits or gains of an enterprise of a Contracting State from the

Country[55]	**Capital Gains Tax**
	alienation of ships or aircraft operated by that enterprise in international traffic, or of property (other than real property) pertaining to the operation of those ships or aircraft, shall be taxable only in that State. 4 Income, profits or gains derived by a resident of a Contracting State from the alienation of any shares or comparable interests deriving more than 50 per cent of their value directly or indirectly from real property situated in the other Contracting State, may be taxed in that other State. 5 Gains of a capital nature from the alienation of any property, other than that referred to in the preceding paragraphs shall be taxable only in the Contracting State of which the alienator is a resident.
Norway Convention between Australia and the Kingdom of Norway for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, and Protocol 1983 ATS 19 (1983 Convention)	Article 4 Residence (1) For the purposes of this Convention, a person is a resident of one of the Contracting States- (a) in the case of Australia, subject to the provisions of paragraph (2), if the person is a resident of Australia for the purposes of Australia tax; and (b) in the case of Norway, if the person is liable to tax therein by reason of his domicile, residence, place of incorporation or any other criterion of a similar nature but not if he is liable to tax in Norway in respect only of income from sources therein. (2) In relation to income from sources in Norway, a person who is subject to Australian tax on income which is from sources in Australia shall not be treated as a resident of Australia unless the income from sources in Norway is subject to Australian tax or, if that income is exempt from Australian tax, it is so exempt solely because it is subject to Norwegian tax. (3) Where by reason of the preceding provisions of this Article an individual is a resident of both Contracting States, then his status shall be determined in accordance with the following rules: (a) he shall be deemed to be a resident solely of the Contracting State in which he has a permanent home available to him; (b) if he has a permanent home available to him in both Contracting States, or

Country[55]	**Capital Gains Tax**
	if he does not have a permanent home available to him in either of them, he shall be deemed to be a resident solely of the Contracting State with which his personal and economic relations are the closer. (4) For the purposes of the last preceding paragraph, an individual's citizenship or nationality of a Contracting State as well as his habitual abode shall be factors in determining the degree of his personal and economic relations with that Contracting State. (5) Where by reason of the provisions of paragraph (1), a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident solely of the Contracting State in which its place of effective management is situated. Article 13 Alienation of property (1) Income or gains from the alienation of real property or of an interest in or over land or of a right to exploit, or to explore for, a natural resource may be taxed in the Contracting State in which the real property, the land or the natural resource is situated. (2) For the purposes of this Article, shares or comparable interests in a company, the assets of which consist wholly or principally of real property or of interests in or over land in one of the Contracting States or of rights to exploit, or to explore for, natural resources in one of the Contracting States, shall be deemed to be real property situated in the Contracting State in which the land or the natural resources are situated or in which the exploration may take place. (3) Subject to the provisions of paragraph (1), income from the alienation of capital assets of an enterprise of one of the Contracting States or of capital assets available to a resident of one of the Contracting States for the purpose of performing professional services or other independent activities shall be taxable only in that State, but, where those assets form part of the business property of a permanent establishment or fixed based situated in the other Contracting State, such income may be taxed in that other State. (4) Gains from the alienation of shares in a company the capital of which is wholly or partly divided into shares and which is a resident of Norway for the purposes of Norwegian tax, derived by an individual who is a resident of

Country[55]	**Capital Gains Tax**
	Australia, may be taxed in Norway. (5) Gains from the alienation of ships or aircraft operated in international traffic, or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.

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TAXATION OF PASSIVE INCOME EARNED BY FOREIGN GOVERNMENTS AND SOVEREIGN WEALTH FUNDS

CANADA

Executive Summary

Canada does not have a specific law on the subject, but it does have a written departmental policy of granting qualified sovereign immunity to the passive income earned by foreign governments or their agencies through non-commercial activities. Applications for exemptions are filed with the Revenue Canada Agency. Canada also has provisions exempting certain types of income earned by foreign governments in its many tax treaties. These provisions vary from country to country.

I. Tax Status of Foreign Governments

Are they exempt from taxation on their passive income (interest, dividends, capital gains) on the basis of legislation?

Canada's Income Tax Act[1] and its supporting regulations do not contain a provision specifically exempting passive income earned by foreign governments or their agencies from taxation.

Is there a practice of exempting them?

Canada recognizes a qualified principle of sovereign immunity to exempt most income earned by foreign governments and their agencies from Canadian income tax. The Revenue Canada agency has published an Information Circular in which it outlines this principle in the following terms:

> Sovereign Immunity
>
> 50. Under the Doctrine of Sovereign Immunity, the Government of Canada may grant exemption from tax on certain Canadian-source investment income paid or credited to the government or central bank of a foreign country. Written authorization not to withhold tax is given to the Canadian resident payer upon request after substantiation that such investment income (other than that already exempt under the Act and Regulations) is the property of the government or central bank of a foreign country. The written authorization will have an expiry date at which time the Canadian payer would be required to re-apply for further authorization not to withhold. A request for authorization not to withhold should be forwarded to: Revenue Canada, Taxation 875 Heron Road Ottawa, Ontario K1A 0L8 Attention: Provincial and International Relations Division Investment income of a foreign government or its agency is exempt only if (a) the other country would provide a reciprocal exemption to the Canadian Government or its agencies; (b) the income is derived by the foreign government or agency in the course of exercising a function of a governmental nature and is not income arising in the course of an industrial or commercial activity carried on by the foreign authority; and (c) it is interest on an arm's length debt or portfolio dividends on listed company shares. Income such as rentals, royalties or direct dividends from a

[1] R.S.C. c. 1 (5th Supp. 1989), as amended, (official source), also *available at* http://lois.justice.gc.ca/ en/showtdm/cs/I-3.3?noCookie (unofficial source, last visited May 2, 2008).

company in which the foreign government has a substantial or controlling equity interest does not qualify for exemption.[2]

The above paragraph does not specifically mention capital gains. However, it appears that Revenue Canada would apply the same basic rules in deciding whether the capital gain was taxable as a commercial activity or would be exempt under the principle of sovereign immunity.[3]

Is that practice based on the country's understanding of international customary law?

Revenue Canada officials believe that the principle of sovereign immunity has been recognized for many years and may well be based upon Canada's understanding of international customary law. However, there are no legislative provisions in which sovereign immunity is specifically recognized, even though observation of it has long been the practice of Canadian tax authorities. Therefore, there is no supporting legislative history or commentary.[4]

If there is no legislation or practice, does that mean that they are taxed as ordinary foreign taxpayers?

Canada does recognize sovereign immunity and has included relevant and supporting provisions in most of its tax treaties. It should be noted that foreign governments are non-residents and thus the immunity they generally enjoy is from withholding taxes, rather than from the income taxes paid by Canadian residents. The general rate of withholding tax on dividends and capital gains is 25 percent, but this is usually reduced or eliminated by tax treaties. Canada has recently exempted interest income earned at arm's length by non-residents from withholding tax.[5]

Is their tax treatment brought about by treaties?

Canada has over eighty tax treaties. Many of these treaties contain provisions exempting interest income earned by foreign governments. Such a provision is contained in article 11(3) of the Canada-United States Income Tax Convention of 1980.[6] There are no comparable provisions for dividends or capital gains in the treaty with the United States, but as has already been pointed out, applications for the exemption of these types of passive income may be filed with the Revenue Canada Agency.

II. Tax Status of Sovereign Wealth Funds

Revenue Canada authorities indicate that Canada does not have any special rules for sovereign wealth funds. Interest earned by these funds would generally be exempt from Canadian withholding tax under the Income Tax Act and under Canada's tax treaties. Applications for sovereign immunity for dividends and capital gains would have to be filed with Revenue Canada. Passive income from commercial activities would normally be taxable. Revenue Canada authorities cited Chinese banks as an example of government-owned enterprises that had been denied sovereign immunity. Investments by New Zealand's Earthquake Commission were cited as an example of a foreign government agency that

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[2] Revenue Canada Agency, IC77-16R4, s. 50, http://www.cra-arc.gc.ca/E/pub/tp/ic77-16r4/ic77-16r4-e.html (last visited May 3, 2008).

[3] *Id.*

[4] Information obtained by telephone from the Revenue Canada Agency on May 2, 2008.

[5] 2007 S.C. c. 35, § 59 (official source).

[6] 1984 S.C. c. 20, Part I (official source), also *available at* http://www.lexum.umontreal.ca/ca_us/cgi-bin/disp.pl/en/cts.1984.15.1.en.html?query=%22tax%22&langue=en&selection=&database=en&method=all&retour=/ca_us/cgi-bin/srch.pl?numhits=25~~language=en~~method=all~~query=tax~~database=en (unofficial source).

had been granted sovereign immunity and is not taxed on its Canadian earnings.[7]

III. Domestic Law

Non-resident interest paid at arm's length is currently not taxable in Canada. Interest that is not paid at arm's length is taxed at the 25 percent withholding rate. Dividends and capital gains are also generally subject to the 25 percent withholding rate, although there are a number of complicated exceptions.[8]

IV. Treaties on Double Taxation

Canada has a tax treaty with the Kingdom of Norway. Like the Canada-United States Tax Treaty, this treaty exempts interest income earned in one country and paid to the government or a political subdivision of the other from tax in the country in which it is earned. However, unlike the Canada-United States Tax Treaty, the Canada-Norway treaty contains a virtually identical provision respecting dividends. Thus, dividends earned by Norway's SWF or the Province of Alberta's Heritage Fund are not taxable in the country in which they are earned. This means that Norway's SWF does not have to apply for sovereign immunity, as a SWF founded in a country that does not have a similar provision in its tax treaty with Canada would.

Under the Canada-Norway tax treaty, dividends may be taxed in the country in which they are earned at the rate of 5 percent, if the recipient holds at least 10 percent of the voting power of the payer, and 15 percent in other cases. The treaty also provides that capital gains from transactions involving real property are subject to withholding tax.[9]

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May 2008

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[7] Information obtained by telephone from the Revenue Canada Agency on May 6, 2008.

[8] C.C.H. Canada, CANADIAN TAX REPORTER, para. 26,105 (2008).

[9] Canada-Norway Income Tax Convention 2002, 2002 S.C. c. 24. (official source), also *available at* C.C.H. Canada, *id.,* para 31,903.

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TAXATION OF PASSIVE INCOME EARNED BY FOREIGN GOVERNMENTS AND SOVEREIGN WEALTH FUNDS

GERMANY

Executive Summary

Germany taxes foreign governments and sovereign wealth funds on their passive investments in the same manner as any other foreign corporate entity. There is no exemption on the basis of statutory law or deemed customary international law or practice, nor do German double taxation treaties exempt foreign governments or their entities.

Nevertheless, the tax burden of foreign governmental entities on their passive income from German sources is light, because domestic law generally exempts from taxation most German-source interest that is earned by foreign residents, and it also exempts from taxation 95 percent of the dividends from German corporations that are earned by foreign corporate entities. Capital gains are not taxed at all, unless they amount to a participation, in which case they also enjoy the 95 percent corporate exemption.

I. Tax Status of Foreign Governments

Germany does not exempt foreign governments from taxation on their passive German-source income.[1] Instead, foreign governments are deemed to be foreign corporate entities that are taxed on their passive German source income.[2] Although section 5 of the German Corporation Tax Code[3] exempts certain specifically named German governmental units from taxation, there are no corresponding provisions for foreign governments, and consequently, the general provision of section 2 of the Corporation Tax Code applies to them. It provides that foreign entities are subjected to limited tax liability, which means that they are taxed on their German-source income as provided by law.[4]

German authorities are not under the impression that foreign governments should be exempted from taxation by virtue of international customary law.[5] Instead, exemptions of governmental institutions are provided only on the basis of bilateral and multilateral treaties, for the specific purposes listed in these treaties,[6] and these treaties do not include any general immunity of foreign governments, central banks, or

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[1] This information has been obtained from officials of the German Federal Ministry of Finance.

[2] D. Gosch, Körperschaftsteuergesetz 111 (München, 2005).

[3] Körperschaftsteuergesetz [KStG], repromulgated Oct. 15, 2002, BUNDESGESETZBLATT [BGBl, official law gazette of the Federal Republic of Germany] I at 4210, as amended.

[4] KStG, § 2 subjects foreign entities to "limited tax liability"; Einkommensteuergesetz [EStG], repromulgated Oct. 19, 2002, BGBl I at 4210, as amended; § 49 lists the taxes that are imposed on limited taxpayers.

[5] Information obtained from officials of the German Federal Ministry of Finance.

[6] The Ministry of Finance periodically publishes a list of tax-exempting treaties for the benefit of the decentralized tax authorities. The latest of this list is Bundesministerium der Finanzen, Vorschrift VV DEU BMF 2007-08-20 IV B 3 –S 1311/07/0039, Aug. 20, 2007, *available at* the official Web-site http://www.bundesfinanzministerium.de/nn_58004/DE/BMF__Startseite/Aktuelles/BMF__Schreiben/Veroffentlichungen__zu__Steuerarten/einkommensteuer/055.html. The listings contained therein are limited to multilateral treaties such as the Vienna Conventions and very specific bilateral treaties exempting specifically named governmental institutions in the host country, such as, for instance, cultural institutions.

sovereign wealth funds. Moreover, the German philosophy is strongly influenced by article 4, paragraph 1 of the OECD Model Treaty,[7] according to which a foreign government and its subdivisions are residents (and therefore taxpayers) in the other treaty country.

Despite this seemingly categorical approach to taxing foreign governments, the tax burden imposed on their passive investments in Germany is light due to a tax policy that aims to attract foreign investments (see below, section III).[8]

II. Tax Status of Sovereign Wealth Funds

Germany taxes sovereign wealth funds like any other foreign corporate taxpayer.[9] Since, as explained above, Germany does not exempt foreign governments from taxation on their passive income, there is no occasion in German law to distinguish between types of sovereign wealth funds according to their degree of governmental management or purpose. Yet, as is explained below (section III), the tax burden on these funds is light.

III. Domestic Law on the Taxation of Passive Income Earned by Foreign Residents

Interest

Aside from a few exceptions, Germany does not tax foreign taxpayers on their German interest earnings. This is provided in section 49 of the Income Tax Code.[10] This provision contains a complete listing of the circumstances under which foreign individuals or corporations are taxed on their German source income.[11] The only types of interest that are listed in this section as taxable to non-residents are interest derived from loans secured by mortgages and interest derived from convertible bonds, non-voting preferred stock, and profit-sharing bonds. For a non-resident, the interest on these specified types of debt instruments is withheld at the rate of 25 percent. [12]

Dividends

Ninety-five percent of the dividends from German corporate entities are exempted from taxation if they are earned by a corporate shareholder. This is provided in section 8b, paragraph 1 of the Corporation Tax Act, and this rule applies to domestic corporations and foreign corporations alike.[13] This exemption of corporate dividend income became applicable in 2003 and is the result of a reform of the German corporation tax that was designed to avoid inter-corporate double taxation. Under this system, the domestic dividend-distributing corporation is taxed at a 25 percent tax rate on its earned income (whether distributed or not), and ultimately the domestic private shareholder is taxed on his dividend

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[7] Organization for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital,* version of January 2003, promulgated in German translation in the official administrative gazette BUNDESSTEUERBLATT 2007 I at 656.

[8] GERMAN TAX AND BUSINESS LAW GUIDE ¶ 131,000 (Sweet & Maxwell, London, 2002-).

[9] This information has been obtained from officials of the German Federal Finance Ministry.

[10] EStG, *supra* note 3.

[11] W. Bächle & T. Rupp, Internationales Steuerrecht 461 (Stuttgart, 2002).

[12] EStG § 43 20 1 and EStG § 43 a ¶ 1. Added to this withholding is a 5.5% surcharge [Solidaritätszuschlaggesetz, repromulgated Oct. 15, 2002, BGBl I at 4130, as amended], thus amounting to 26.38%.

[13] Gosch, *supra* note 2, at 802.

income.[14] In between these two stages, dividends are generally not taxed. Foreign corporations are included in this exemption from taxation, in order to grant them equal treatment.[15]

There are some exceptions from this principle that make dividends taxable if the shares are owned by banks, life insurers, or pension funds. These exceptions, however, only affect corporate shareholders who reside in Germany, in the member states of the European Union (EU), or in Switzerland[16] and do not apply to residents of other countries.[17]

The actual exemption of only 95 percent of dividend income results from section 8 b, paragraph 5, which provides for the taxation of 5 percent of the dividend income on the grounds that this percentage is deemed to be attributed to expenses related to this income that the corporation may be able to deduct in its general income computation. The result of this complex rule is a definitive limitation of the tax exemption of dividends to 95 percent.[18]

Capital Gains

Capital gains realized by a non-resident corporate entity from the sale of shares in German companies are taxed only if they amount to the sale of a participation,[19] which is defined as the ownership of at least 1 percent of the shares of the company over the five years preceding the sale.[20] Capital gains of such substantial participations are taxed according to the same principles as dividends from foreign companies:[21] section 8 b, paragraphs 2 and 3 of the Corporation Tax Act exempt 95 percent of the capital gains from a participation in a German corporation if the gains are realized by a foreign or domestic corporation. The remaining 5 percent of the gains are taxed.[22]

IV. Treaties on Double Taxation

In General

German double taxation treaties are to a large extent irrelevant for the taxation of passive German-source income earned by foreign residents because, aside from certain exceptions, the exemption of 95 percent of corporate dividends and of capital gains from participations also applies to foreign corporations residing in countries that have a double taxation treaty with Germany.[23] In addition, it appears that the non-taxability of German-source interest for foreign residents also should override any less favorable treaty provisions, because there is no tax liability generated for such income to which a

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[14] Individual taxpayers, both foreign and domestic, who have portfolio holdings of shares in German companies are subject to a withholding tax of 25%, [EStG § 20 ¶ 1, in conjunction with EStG § 43, 43 a, and § 49 ¶ 5 (a)], plus a 5.5% surcharge [Solidaritätszuschlaggesetz, repromulgated Oct. 15, 2002, BGBl I at 4130, as amended], thus amounting to 26.38%.

[15] Gosch, *supra* note 2, at 791.

[16] KStG, § 8b ¶ 7 & 8.

[17] Gosch, *supra* note 2, at 894

[18] *Id.,* at 874.

[19] Gains derived from the sale of substantial participations, German permanent establishment, and ships or real property are the only types of gains that are listed in ESTG § 49 as creating a tax liability for taxpayers with a limited tax liability.

[20] As defined by EStG § 17.

[21] Bächle, *supra* note 11 at 469; C. Bourseaux, *Germany* in TAXATION OF COMPANIES IN EUROPE at 8.4.2.3 (Amsterdam, 2004).

[22] KStG § 2 no. 1, in conjunction with EStG § 49 ¶ 1 no. 2 (e).

[23] Gosch *supra* note 2, at 790 & 823.

treaty could apply. These features of German law may also reduce scope of application of the EU Parent-Subsidiary Directive[24] and the EU Savings Directive.[25]

Generally, the newer German double taxation treaties follow the Model Tax Convention of the Organization for Economic cooperation and Development [OECD][26] by considering the governments of the treaty states as residents and therefore taxpayers.

The OECD Model Convention's philosophy of limiting the source country taxation of interest, dividends, and capital gains from passive investment is also observed in these treaties.[27] It is often stated that the focus on taxing passive source income less at the source and more in the country of residence of the transnational taxpayer favors the European countries when they export capital.[28] On the other hand, this distribution of the taxes on passive income may benefit the European member states of the OECD by allowing them to compete for investments through lower source-country tax rates.[29]

Kuwait

The double taxation treaty between Germany and Kuwait[30] defines the governments of the treaty states and their governmental institutions as residents, which appears to imply that they are deemed to be taxpayers.

Interest is not taxed in the source country, and portfolio dividends may be taxed in the source country with a rate of up to 15 percent while dividends of substantial holdings (at least 10 percent of the share capital) may be taxed in the source country with a rate of up to 5 percent. Capital gains from passive investments are not taxed at all in the source country.

Norway

The double taxation treaty between Germany and Norway[31] contains no provisions on the taxation of each other's governments or their agencies or funds, other than the confirmation of diplomatic immunities as provided by treaty or customary international law.

According to this agreement, source country interest earned by residents of the other country is not taxed in the source country; source country dividends earned from portfolio investments of a resident of the other country may be taxed by the source country with a rate of up to 15 percent, while dividends earned from a substantial participation (of at least 25 percent of the shares) in a source country corporation may not be taxed at all by the source country. Capital gains from the sale of shares or

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[24] Council Directive 90/435/EEC of 23 July 1990, on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states, 1990 OFFICIAL JOURNAL OF THE EUROPEAN COMMUNITIES [O. J., official source] (L225) 6.

[25] Council Directive 2003/48/ECof 3 June 2003, on taxation of savings income in the form of interest payments, 2003 O. J. (L 157) 38.

[26] *Model Tax Convention on Income and on Capital, supra* note 7, at 656.

[27] K. VOGEL, DOPPELBESTEUERUNGSABKOMMEN 772, 962, & 1087 (München, 1986).

[28] OBERSON & H. Hull, Switzerland in International Tax Law 77 (Amsterdam, 2006).

[29] W. SCHÖN, TAX COMPETITION IN EUROPE 3 (Amsterdam, 2003).

[30] Abkommen zwischen der Bundesrepublik Deutschland und dem Staat Kuwait zur Vermeidung der Doppelbesteuerung auf dem Gebiet der Steuern vom Einkommen und vom Vermögen und zur Belebung der wirtschaftlichen Beziehung, May 18, 1999, BGBl 2000 II at 390.

[31] Abkommen zwischen der Bundesrepublik Deutschland und dem Königreich Norwegen zur Vermeidung der Doppelbesteuerung und über gegenseitige Amtshilfe auf dem Gebiet der Steuern vom Einkommen und vom Vermögen, Oct. 4, 1991, BGBl 1993 II at 969.

participations in a source country company are not taxable in the source country, if the seller of the shares or participations is a corporation that resides in the other country.

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JAPAN

TAXATION OF PASSIVE INCOME EARNED BY FOREIGN GOVERNMENTS AND SOVEREIGN WEALTH FUNDS

Executive Summary

Though there is no explicit provision to exempt foreign governments from tax on passive income, they are, in fact, exempted from tax on interests on deposits and dividends. There is no provision for taxation on sovereign wealth funds either. They are taxed the same way as other funds. The Japan-Singapore Tax Treaty and the Japan-Norway Tax Convention have provisions to exempt the Singapore government and Singapore's sovereign wealth fund from taxation on interest.

I. Tax Status of Foreign Governments

Though the Corporation Tax Law and the Income Tax Law do not have provisions to exempt the foreign government from taxation, passive income earned in Japan by foreign governments are exempted from taxation.

By reading the Corporation Tax Law,[1] it appears that foreign governments are liable to pay tax on domestic source income. Under the definitions of the Corporation Tax Law, a foreign government is classified as a foreign corporation. A foreign corporation must pay corporation tax if it has domestic source income unless it is a public corporation. A foreign government is not a public corporation because foreign governments are not listed as public corporations in the Schedule No. 1 of the Corporation Tax Law. In comparison, local governments are listed in the Schedule though they are domestic corporations.

> Article 2
>
> (iii) Domestic corporation: a corporation maintaining its head office or main office within the country.
>
> (iv) Foreign corporation: a corporation other than domestic corporations.
>
> (v) Public corporation: the corporations listed in Schedule No. 1.[2]
>
> Article 4
>
> (2) Foreign corporations shall be liable to pay corporation tax pursuant to this Act in cases where they have domestic source income defined in Article 138 (Domestic source income) (with respect to public interest corporations, etc. or non-juridical organizations, etc. that are foreign corporations, they are liable to

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[1] Hōjinzei hō [Corporation Tax Law], Law No. 34 of 1965, *as amended by* Law No. 100 of 2007, *available at* http://law.e-gov.go.jp/htmldata/S40/S40HO034.html (a government Web site, unofficial source).

[2] Translation from YUJI GOMI and TASUKU HONJO, WA-EI TAIYAKU HŌJINZEI HŌ [CORPORATION TAX ACT OF JAPAN], 2 (2007) (unofficial translation).

> pay corporation tax only if they have such domestic source income derived from profit-making activities), where they undertake a corporate taxation trust, or where they carry out operations for retirement fund, etc. defined in Article 145-3 (Computation of amount of retirement pension fund as to foreign corporations).
>
> (3) Notwithstanding the preceding two paragraphs, public corporations shall not be liable to pay corporation tax.[3]

Domestic source income includes interests on national government bonds or municipal bonds or certain credits issued by domestic corporations and interest on deposits and savings in Japan.[4] Also included in domestic source income are: dividends of surplus or profits, distribution of surplus or funds from a domestic corporation, or distribution of profits of investment trusts (excluding bond investment trusts and investment trusts on employment of publicly issued bonds) or specified beneficiary certificate issuance trusts that have been entrusted to business places in Japan.[5]

In addition to the Corporation Tax Law, the Income Tax Law states that foreign corporations are obligated to pay income tax when they receive payment that is classified as "foreign corporation taxable income" or that derives from certain trustee activities.[6] "Foreign corporation taxable income" includes interests and dividends.[7]

Based on these provisions, it looks foreign governments must pay tax on interests on bonds and savings, and dividends of profit. However, interests accrued in bank deposits in Japan for a foreign government are not taxed in Japan.[8] It is explained that such treatment is an international custom based on international law of sovereign immunity.[9] This treatment is not based on explicit provisions of laws in Japan. For tax on dividends, it appears foreign governments are also exempted from them though documents that directly so state were not located. Corporations have to submit notices before they receive interests or dividends to the payer of those under article 224 of the Income Tax Law.[10] Foreign

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[3] *Id.* at 51.

[4] Corporation Tax Law, Law No. 34 of 1965, *as amended by* Law No. 100 of 2007, art. 138, item 4.

[5] *Id.* art. 138, item 5.

[6] Income Tax Law, Law No. 33 of 1965, *as amended by* Law No. 100 of 2007, art. 5, para. 4, *available at* http://law.e-gov.go.jp/htmldata/S40/S40HO033.html (a government Web site, unofficial source).

[7] "Foreign corporation taxable income" means incomes prescribed in article 161, item 1-2 through item 7 and item 9 through item 12 of the Income Tax Law. *Id.* art. 5, para. 2. Article 61, items 4 and 5 of the Income Tax Law lists interests and dividends.

[8] Yasunori Chikaishi , *Gaikoku seifu · gaikoku taishikan tō no gensen chōshū gimu oyobi nōzei gimu [Obligation of foreign governments and foreign embassies to withhold and pay tax],* ZEIDAI RONSHU 45, 79, 104-5 (2004), *available at* http://www.nta.go.jp/ntc/kenkyu/ronsou/45/chikaishi/ronsou.pdf; and KONOSUKE KIMURA, KOKUSAI ZEIHŌ [INTERNATIONAL TAX LAW], 151 (2000).

[9] Chikaishi, *supra* note 8 at 104-105; and KIMURA, *supra* note 8, at 151.

[10] Article 224 of the Income Tax Law, Law No. 30 of 1965, *as amended by* Law No. 100 of 2007.

> A person (excluding corporations mentioned in the Attached List No. 1 (Table of public corporations) of the Corporation Tax Law and others prescribed by Cabinet Order; …) who in this country receives payment of interest, etc. or dividend, etc. (excluding interest of ordinary deposits and others prescribed by Cabinet Order; …) provided for in Article 23 paragraph 1 (Interest Income) or Article 24 paragraph 1 (Dividend income) shall, as prescribed by Cabinet Order, not later than the date such payment becomes definite, give notice of his name or title and address (…) to a person (…) who makes payment of that interest, etc. or dividend, etc. …. (translated by author.)

governments, however, are exempted from this notice requirement. It is explained that there is little reason to get notices from corporations that do not have to pay these tax.[11] Therefore, it is assumed that foreign governments are not paying tax on dividends. Presumably, this exemption was also based on sovereign immunity though no documents stated so.

Capital gains on stocks are not listed as taxable income of foreign corporations in the Corporation Tax Law and the Income Tax Law.

II. Tax Status of Sovereign Wealth Funds

Sovereign Wealth Funds are not treated differently from other funds.[12] They are taxed in accordance with Japanese tax law and tax treaties.

In a case of Singapore's fund, a Sovereign Wealth Fund is exempted from tax in Japan based on the Agreement between the Government of the Republic of Singapore and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.[13] Article 11, paragraph 3 of the Agreement reads:

> 3. Notwithstanding the provisions of paragraph 2, interest arising in a Contracting State and derived by the Government of the other Contracting State, a local authority there of, the central bank of that other Contracting State or any institution wholly owned by that Government, or by any resident of the other Contracting State with respect to debt-claims guaranteed, insured or indirectly financed by the Government of that other Contracting State, a local authority thereof, the central bank of that other Contracting State or any institution wholly owned by that Government shall be exempt from tax in the first-mentioned Contracting State.

The Japan-Norway Tax Convention also has a similar provision.[14]

III. Domestic Law

Tax rates for foreign corporations on domestic source interests and dividends depend on their size, business, or other factors. Also, temporary treatment to reduce such tax would be applied. There may be exceptions to the general rule on specific items. The following are the general rules. The general tax rate for a foreign corporation is thirty percent of income as of 2008.[15]

Article 355, paragraph 2 of the Income Tax Law Enforcement Order lists foreign governments and foreign local governments as "others" who are excluded from the notice requirement of the Income Tax Law Article 224, paragraph 1.

[11] Masasuke Takeda, DHC konmentaru shotokuzei hō [DHC Income Tax Law Commentary], 8895 (1983), *cited by* Chikaishi, *supra* note 8, at 150.

[12] Confirmed by an e-mail from a National Tax Agency official, to Sayuri Umeda, Senior Foreign Law Specialist, Law Library of Congress (Apr. 3, 2008) (on file with the author).

[13] Agreement between the Government of the Republic of Singapore and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Treaty No. 8 of 1995, *available at* http://www.iras.gov.sg/ESVPortal/resources/singaporejapandta.pdf (unofficial source).

[14] Convention between Japan and The Kingdom of Norway for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Treaty No. 8 of 1992, art. 11, para. 3. Ministry of Foreign Affairs, Nikokukan jōyaku shū [Treaties between two countries] 1992, 1857 (1994) (unofficial source).

[15] Corporation Tax Law, Law No. 34 of 1965, *as amended by* Law No. 100 of 2007, art. 143, para. 1.

Interest

In general, fifteen percent of interest is withheld at the source.[16] If a foreign corporation has a permanent establishment in Japan, interest income should be included in taxable income when it pays tax by self assessment.[17] The amount of tax withheld is credited to the corporation tax to be paid.

Dividends

In general, twenty percent of dividend is withheld at the source.[18] If a foreign corporation has a permanent establishment in Japan, dividend income should be included in taxable income when it pays tax by self assessment.[19] The amount of tax withheld is credited to the corporation tax to be paid.

Capital Gain from Shares

As stated in section I, a foreign company's capital gain from shares is generally not taxed in Japan.

IV. Treaties on Double Taxation

Japan has treaties on double taxation with fifty-five countries, including China, Singapore, and Sweden, but not Kuwait.[20] In the Japan–Singapore Tax Agreement,[21] there is no provision on whether governments and their subdivisions are considered taxpayers or not. Though there are more details, the general rules of taxation and rates on interest, dividends, and capital gains in Japan for a Singapore resident are as follows.

Interest

It is not taxed (taxed in Singapore).[22] The beneficial owner of the interest is taxed up to ten percent of the gross amount of interest.[23]

Dividends

They are not taxed (taxed in Singapore).[24] The beneficial owner of the dividends is taxed fifteen percent of the gross amount of the interest.[25] The tax rate is five percent if the beneficial owner is a

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[16] Income Tax Law, Law No. 33 of 1965, *as amended by* Law No. 100 of 2007, art. 179, item 3 and art. 212, para. 1.

[17] Corporation Tax Law, Law No. 34 of 1965, *as amended by* Law No. 100 of 2007, art. 141, item 1.

[18] Income Tax Law, Law No. 33 of 1965, *as amended by* Law No. 100 of 2007, art. 179, item 1 and art. 212, para. 1.

[19] Corporation Tax Law, Law No. 34 of 1965, *as amended by* Law No. 100 of 2007, art. 141, item 1.

[20] KAZUO KINOSHITA AND HIROSHI KANEKO EDS., KOKUSAI KAZEI NO RIRON TO KADAI [THEORIES AND TASKS OF INTERNATIONAL TAXATION], 36-7 (2005).

[21] Agreement between the Government of the Republic of Singapore and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Treaty No. 8 of 1995.

[22] *Id*. art. 11, para. 1.

[23] *Id*. art. 11, para. 2.

[24] *Id*. art. 10, para. 1.

[25] *Id*. art. 10, para. 2 (b).

company which owns twenty five percent or more of the voting shares of the company in Japan for six months.[26]

Capital Gains

A nonresident's capital gains from shares are basically not taxed in Japan. They may be taxed in the following cases:

> (a) gains from the alienation of shares of a company not traded regularly at a recognized stock exchange, or of an interest in a partnership, a trust or an estate, the property of which consists principally of immovable property situated in a Contracting State, may be taxed in that Contracting State.
>
> (b) gains derived by a resident of a Contracting State from the alienation of shares of a company being a resident of the other Contracting State may be taxed in that other Contracting State, if:
>
> (ⅰ) shares held or owned by the alienator (together with such shares held or owned by any other related persons as may be aggregated therewith) amount to at least 25 per cent of the entire share capital of such company at any time during the taxable year or the basis period for the year of assessment; and
>
> (ⅱ) the total of the shares alienated by the alienator and such related persons during that taxable year or the basis period for that year of assessment amounts to at least 5 per cent of the entire share capital of such company.[27]

In the Japan-Norway Tax Convention, there are almost identical provisions concerning interest and dividends.[28] There is, however, no provision similar to the above paragraph in the Convention.[29] Nonresident's capital gains from shares are basically not taxed in Japan.

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April 2008

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[26] *Id*. art. 10, para. 2 (a). More specifically, six months period should be "immediately before the end of the accounting period for which the distribution of profits takes place."

[27] *Id*. art 13, paragraph 4.

[28] Convention between Japan and The Kingdom of Norway for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Treaty No. 8 of 1992, arts. 10 and 11.

[29] *Id*. art. 13.

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TAXATION OF PASSIVE INCOME EARNED BY FOREIGN GOVERNMENTS AND SOVEREIGN WEALTH FUNDS

NORWAY

Executive Summary

Norway has ratified the Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations, which govern the status of foreign government personnel in Norway. Norway applies a tax exemption on companies' income from shares. This exemption applies to both private and state-owned companies, as well as to foreign companies within the European Economic Area. No provisions specifically concerning the taxation of sovereign wealth funds in Norway were located. Norway has a large sovereign wealth fund called the Government Pension Fund which manages Norway's substantial petroleum revenues to meet the needs of the increasing public pension expenditures.

I. Tax Status of Foreign Governments

Chapter 2 of the Norwegian Tax Act contains provisions regarding limitations on taxation and tax exemptions for certain persons and organizations.[1] According to the Tax Act, the Norwegian state is exempt from paying taxes, which includes government institutions, government establishments, and government funds.[2] No similar provisions have been found for foreign states.

The status of foreign government agencies and personnel, consular officers, and representatives of international organizations in Norway is governed by the provisions of the Vienna Convention on Diplomatic Relations (1961),[3] and the Vienna Convention on Consular Relations (1963).[4] Foreign government personnel are exempt from municipal wealth and income taxes.[5]

II. Tax Status of Sovereign Wealth Funds

No information was found with regards to the taxation of foreign sovereign wealth funds in Norway during the preparation of this report. As discussed under section III below, Norway applies a tax exemption on companies' incomes from shares. The tax exemption also applies to state-owned foreign companies within the European Economic Area (EEA), but not to companies outside the EEA (which are still taxed at a rate of 25 percent).

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[1] Skatteloven (Act No. 14, Mar.28, 1999) [in Norwegian], *available at* http://www.lovdata.no/all/hl-19990326-014.html (official source).

[2] *Id.,* ch. 2 § 30.

[3] Vienna Convention on Diplomatic Relations, Apr.18, 1961, 500 UNITED NATIONS TREATY SERIES (UNTS, official source) 95, *available at* http://untreaty.un.org/ilc/texts/instruments/english/ conventions/9_1_1961.pdf.

[4] Vienna Convention on Consular Relations, Apr. 24, 1963, 596 UNTS 261, *available at* http://untreaty.un.org/ilc/texts/instruments/english/conventions/9_2_1963.pdf.

[5] Ministry of Foreign Affairs, *Diplomat in Norway*, June 21, 2006, *available at* http://www.regjeringen.no/en/dep/ud/Documents/veiledninger/2006/Diplomat-in-Norway.html?id=419528 (offficial Web site of the Norwegian Ministry of Foreign Affairs).

III. Domestic Law

Interest

Interest earned directly by non-residents from Norwegian sources is not taxable in Norway.[6]

Capital Gains

In the information available from the Norwegian government, share income constitutes both dividends and capital gains. Please see text below under "Dividends."[7]

Dividends

Since 2004, Norway has granted a tax exemption on companies' income from shares. The tax exemption model was adopted to avoid chain taxation when shares are owned by companies in multi-tier corporate structures. The tax exemption applies to Norwegian private and public limited companies and other companies of the same standing for tax purposes. It also applies to associations, institutions, Norwegian stock investment funds, estates in bankruptcy, and municipal and state-owned companies. The tax exemption model also applies to foreign companies and entities within the EEA that correspond to the Norwegian companies.[8] According to the Ministry of Finance, the tax exemption generally applies to domestic and cross-border income on shares.[9] In order to prevent tax avoidance, the tax exemption is not applicable to investments in foreign countries outside the EEA with low corporate taxation or to portfolio investments outside the EEA.[10]

The withholding tax regime on dividends from Norwegian companies to corporate shareholders outside the EEA has not changed. These corporate shareholders are still subject to a withholding tax of 25 percent or a reduced rate if there is an applicable double tax convention.[11]

IV. Treaties on Double Taxation

On the Norwegian Government's official Web site, a list of the countries with which Norway has double-taxation treaties, with links to the relevant treaties, is available.[12] As an example, Norway and Russia entered into a double taxation treaty in 1996, which came into force in 2002. The treaty applies to persons who are residents in either Norway or Russia, or both.[13] The term "persons" means individuals,

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[6] *Norway,* THE TAXATION OF PATENT ROYALTIES, DIVIDENDS, INTEREST IN EUROPE 11 (IBFD Amsterdam, 2002-).

[7] Ministry of Finance, *The Corporate Tax System and Taxation of Capital Income,* http://www.regjeringen.no/nb/dep/fin/tema/Norsk_okonomi/topics/The-corporate-tax-system-and-taxation-of-capital-income.html?id=418058 (official Web site of the Norwegian Ministry of Finance, last visited May 5, 2008).

[8] *Id.*

[9] *Id.*.

[10] *Id.*, & Elisabeth A. Landmark, *Kildeskatt på Aksjeutbytte til Utenlandske Aksjonærer – Fritaksmetoden,* SKATTEDIREKTORATET, Mar. 2, 2005, *available at* http://www.nordea.no/sitemod/upload/root/www_nordea_no/Text/Corporate/issuer_services_05-05457_informasjon_kildeskatt-fritaksmetodenb-020305-el.pdf.

[11] Landmark, *id.*

[12] Ministry of Finance, *General Tax Conventions between Norway and Other States*, Oct. 9, 2007, *available at* http://www.regjeringen.no/en/dep/fin/Selected-topics/Taxes-and-Duties/skatteavtaler/tax-treaties-between-norway-and-other-st-2.html?id=450647.

[13] Convention between The Kingdom of Norway and The Russian Federation for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes and Income on Capital, art. 1, Ministry of Finance Web site, May 17,

companies, or other bodies of persons.[14] According to article 4 of the OECD model tax convention, the term "resident" includes States, political subdivisions, and local authorities thereof.[15] Article 4 of the tax treaty between Norway and Russia, which also defines the term "resident," does not include States. The first paragraph of this article states:

> For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of registration, place of management or any other criterion of a similar nature. But this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

With regard to dividends, article 10, first paragraph, of the tax treaty between Norway and Russia follows the OECD model convention, stating: "Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State." [16]

The second paragraph differs from the OECD Model Convention and states that dividends may also be taxed in the Contracting State where the company paying the dividends is a resident, according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax shall not exceed 10 percent of the gross amount of the dividends.[17]

Interest arising in a Contracting State that is paid to a resident of the other State may be taxed in that other State.[18] This is the same rule as in the OECD Model Convention. The second paragraph of article 11 differs, and in the Norway-Russia tax treaty it states:

> However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed 10 per cent of the gross amount of the interest.

The third paragraph of article 11 contains a provision which exempts interest from tax in cases where the interest is beneficially owned by the Norwegian or Russian state, a regional or local authority thereof, or by an instrumentality of Norway or Russia which is not subject to tax within the state. The paragraph states:

> Notwithstanding the provisions of paragraph 2, interest shall be exempt from tax in the Contracting State in which it arises if:
> a) the interest is beneficially owned by a Contracting State, a regional or local authority thereof or by an instrumentality of that State which is not subject to tax therein;
> b) the interest is beneficially owned by: the Central Bank of Norway, the Norwegian Guarantee Institute for Export Credits, A/S Eksportfinans; the Central Bank of Russia, Foreign Trade Bank of Russia; or any other institution similar to the above-mentioned institutions, as may be agreed from time to time between the competent authorities of the Contracting States;

2001, *available at* http://www.regjeringen.no/en/dep/fin/Selected-topics/Taxes-and-Duties/skatteavtaler/Skatteatale-Norge-Russland-vedlegg2.html?id=107028.

[14] *Id.*, art. 3, point d.

[15] Articles of the Model Convention with Respect to Taxes on Income and on Captial, OECD, July 15, 2005, *available at* http://www.oecd.org/dataoecd/50/49/35363840.pdf.

[16] Convention between The Kingdom of Norway and The Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes and Income on Capital, art. 10, Ministry of Finance Web site, May 17, 2001, *available at* http://www.regjeringen.no/en/dep/fin/Selected-topics/Taxes-and-Duties/skatteavtaler/Skatteatale-Norge-Russland-vedlegg2.html?id=107028.

[17] *Id.*

[18] *Id.*, art. 11.

> c) the interest is paid by a purchaser to a seller in connection with a commercial credit resulting from deferred payments for goods, merchandise, equipment or services. [19]

The general rule for capital gains is the same in the tax treaty between Norway and Russia as in the OECD model convention and states that "gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State."[20] Paragraph 5 of article 13 of the tax treaty between Norway and Russia differs from the OECD Model Convention and regulates gains derived from the alienation of shares and other corporate rights. It states:

> Gains derived by an individual of a Contracting State from the alienation of shares or the other corporate rights in an entity which is a resident of the other Contracting State, and gains from the alienation of any other security which are subjected in that other State to the same taxation treatment as gains from the alienation of such shares or other rights may be taxed in that other Contracting State, but only if:
> a) the alienator has been a resident of that other Contracting State at any time during the five years immediately preceding the alienation of the shares, rights or security; and
> b) the alienator was the beneficial owner of the abovementioned shares or rights while a resident of that other State.[21]

V. Other Information

Norway is unique among the Nordic countries because of its substantial oil revenues. The Government Pension Fund was established in 2006 and consists of two funds: the "Government Pension Fund – Global," which was formerly called the Government Petroleum Fund, and the "Government Pension Fund – Norway," which was formerly the National Insurance Scheme Fund.[22]

The Government Petroleum Fund was established in 1990 as a fiscal tool to manage national petroleum revenues. The Fund was renamed in 2006 as part of a broader national pension reform, designed to facilitate government savings to meet the rapidly raising needs of public pension expenditure.[23] In 2007, the size of the Government Pension Fund – Global was about US$373 billion.[24] The Norwegian Ministry of Finance is responsible for the management of the Government Pension Fund. It is the Norwegian Central Bank, Norges Bank, that invests the Government Pension Fund – Global's capital abroad in bonds and equities, in accordance with guidelines issued by the Norwegian Ministry of Finance.[25]

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[19] *Id.*

[20] *Id.,* art. 13.

[21] *Id.*

[22] Ministry of Finance, *The Government Pension Fund,* http://www.regjeringen.no/en/dep/fin/The-Ministry/Underliggende-etater/The-Government-Pension-Fund-.html?id=270410 (last visited May 5, 2008). For information on the Government Pension Fund, please visit the Norwegian Ministry of Finance official Web site at http://www.regjeringen.no/en/dep/fin/Selected-topics/The-Government-Pension-Fund.html?id=1441.

[23] Ministry of Finance, *The Government Pension Fund –Global, Fact Sheet,* Apr. 2008, *available at* http://www.regjeringen.no/upload/FIN/Statens%20pensjonsfond/summary-apr08.pdf (official Web site of the Ministry of Finance).

[24] *Id.*

[25] *The Government Pension Fund, supra* note 22.

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POLAND

TAXATION OF PASSIVE INCOME EARNED BY FOREIGN GOVERNMENTS AND SOVEREIGN WEALTH FUNDS

Executive Summary

Polish tax legislation is based on principles of limited and unlimited tax liability and does not exempt entities established and/or owned by foreign governments from taxation. There is no special tax regime for foreign direct investments either. All income originated in Poland is subject to a flat-rate 19 percent corporate income tax. Taxation of dividends may vary depending on provisions of a bilateral tax treaty.

I. Tax Status of Foreign Governments

Legislation of Poland does not provide for a special tax regime in regard to foreign direct investments, including those conducted by a foreign government. Mechanisms of investment, the status of investors, and guarantees provided to investors by the Government of Poland are established by a number of legislative acts, including the Law on Investment Funds[1] and the Law on Securities.[2] These documents emphasize the equality of all forms of investment in Poland and expand the domestic regime to all foreign investors, including foreign governments. No special permits are required to conduct investment activities in Poland, except in a few special sectors. Rules on minimum capital contributions by foreign investors and minimum share requirements, which were previously in force, were abolished by present legislation. The repatriation or reinvestment of dividends received from investment activities in Poland can be conducted without restrictions regardless of the source of the company's revenue or its origin, and is subject to regular taxation. There is no controlled foreign corporation legislation in Poland as well as other laws that would address foreign government investment entities. Dividends received by foreign governments can be taxed under domestic law, and according to the provisions established by bilateral treaties. Depending on the terms of a treaty, Polish law expands the definition of foreign government institutions to Central banks, public state organizations, municipal authorities, certain government agencies, pension funds, and investment funds.

II. Tax Status of Sovereign Wealth Funds

Basic principles of the taxation legislation are determined by the Tax Ordinance Act, which entered into force on July 1, 2007.[3] Provisions of the Act regarding the equal status of all taxpayers in the country (art.3) and principles of limited and unlimited tax liability were confirmed and explained by the Minister of Finance in his letter of April 12, 2005.[4] The letter established that all companies with their seats or management on the territory of Poland are liable for tax on the whole of their income regardless of the location of its sources. Taxpayers with no seat or management in the territory of Poland are liable for tax on income earned only in the territory of Poland. There is no special tax regime regarding Sovereign Wealth Funds, and therefore there is no provision in Polish tax legislation that would grant tax exemption to them. The existing legislation exempts from taxation foreign investment companies, which operate in

[1] DZIENNIK USTAW RZECZYPOSPOLITEJ POLSKIEJ (Journal of Laws of the Republic of Poland (official gazette), hereinafter DZ. U.) 2004, No. 146, Item 1546.
[2] Dz.U.2002, No. 41, Item 363.
[3] Dz.U.2005, No. 8, Item 60.
[4] Dz.U.2005, No. 36, Item 1521.

special economic zones, and this exemption applies to all types of investment funds. The Income Tax Treaty concluded between the United States and Poland on October 8, 1974,[5] is also based on the principle that a resident of one state may be taxed by another state on any income from sources within this state. It appears that the only exemptions provided are for foreign shareholders from the European Union Member States in regard to taxation of dividends paid by Polish companies.

III. Domestic law

The Polish law provides for a flat-rate 19 percent corporate income tax, which is applicable to all resident and non-resident business income except exempt income or where different tax rates apply. Capital gains, interest, royalties, and other forms of income are included in the taxable income base. Dividends are subject to withholding 19 percent tax, which may be reduced by relevant provisions of a tax treaty if the recipient is a non-resident.

IV. Treaties on Double Taxation

Within the scope of this request, Poland has concluded treaties on avoidance of double taxation with China, Kuwait, Russia, and Singapore. All of them establish special rates for taxing dividends paid to a foreign company by a Polish resident company. In regard to the withholding tax rates that are applicable to dividends paid to non-residents under the tax treaties, these rates are 10 percent for China, Russia, and Singapore, and 5 percent for non-government Kuwaiti companies. Kuwait is the only country in this group whose government is exempt from withholding tax on dividends. The Treaty, which entered into force in 1996 states (art.8) that no tax shall be paid if a dividend is paid to a company that belongs to the government of the other state or a company in which at least 25 percent of the capital is owned by the government.

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[5] IBFD Tax Treaty Database at http://ip-online.ibfd.org/treaty/.

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TAXATION OF PASSIVE INCOME EARNED BY FOREIGN GOVERNMENTS AND SOVEREIGN WEALTH FUNDS

SWITZERLAND

Executive Summary

Swiss domestic law does not exempt foreign governments or foreign sovereign wealth funds from taxation on passive income earned from Swiss sources.

Such exemptions may occur as the result of tax treaties or of the practice arising from these. The Swiss-Norwegian treaty on double taxation specifically exempts Norway's government, central bank, and oil fund from taxation on dividends earned from Swiss companies, and this treaty exempts all Norwegian taxpayers from taxation on interest earned from Swiss sources.

Swiss domestic law imposes a 35 percent withholding tax on Swiss source interest and dividends, but substantial shareholders enjoy participation exemptions on their dividend income. Swiss domestic law imposes a federal gains tax of 8.5 percent on capital gains of portfolio shareholders while exempting substantial shareholders.

I. Tax Status of Foreign Governments

Swiss domestic law does not exempt foreign governments from taxation on their passive income earned in Switzerland.[1] Therefore, it appears Swiss domestic law should operate to the effect that foreign governments and their entities are, as a rule, taxed by Switzerland on their Swiss source income from interest, dividends, and capital gains like other foreign corporate taxpayers. There is only one statutory exemption, and it provides that foreign governments are not taxed on their real estate that is used for diplomatic and consular purposes.[2]

In the absence of statutory unilateral exceptions, foreign governments may nevertheless be exempted from taxation of their passive Swiss-source income by treaty or by the practice resulting from a treaty. Whereas the Vienna Conventions on Diplomatic Relations[3] and Consular Relations[4] exempt foreign governments from taxation only for the narrow, mission-related purposes stated therein,[5] bilateral double taxation treaties may exempt governmental entities from taxation on various categories of passive income.[6] There is, however, much variance in the respective treaty provisions, as is explained below (*see* section on Double Taxation Treaties).

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[1] Information obtained from Mr. Dieter Leutwyler, Press Speaker of the Swiss Federal Finance Ministry.

[2] Bundesgesetz über die direkte Bundessteuer [DBG], Dec. 14, 1990, as amended, SYSTEMATISCHE SAMMLUNG DES BUNDESRECHTS [SR] no. 642.11, art. 56 (i) (official source).

[3] Convention on Diplomatic Relations, Apr. 18, 1961, 23 UST 3227; TIAS 7502; 500 UNTS 95 (official source).

[4] Convention on Consular Relations, Apr. 24, 1963, 21 UST 77; 596 UNTS 261 (official source).

[5] One Swiss authority views these conventions as replacing former international customary law on governmental immunity from taxation. *See* E. BLUMENSTEIN & P. LOCHER, SYSTEM DES SCHWEIZERISCHEN STEUERRECHTS 69 (Zürich, 2002).

[6] *Id.*

II. Tax Status of Sovereign Wealth Funds

There is no domestic statutory rule exempting foreign sovereign wealth funds from taxation on their passive income in Switzerland. It appears, therefore, that in the absence of a tax treaty providing otherwise, these funds should be taxed in Switzerland. If a treaty exempts certain governmental entities from taxation, sovereign wealth funds may qualify for an exemption to the extent that they live up to the treaty criteria in terms of the nature of the fund and its relationship to government by virtue of ownership, management, purpose, and control.[7]

III. Domestic Law

In General

Switzerland has a high level of cantonal taxation and a great degree of variance among the cantonal taxes.[8] Switzerland also has federal taxes, and of these, the federal withholding tax[9] is the most relevant for passive income. It is imposed on dividend and interest income, and the revenue is shared with the cantons. The federal income tax,[10] on the other hand, is imposed on certain capital gains. There are many cantonal income taxes, some of which may also tax capital gains, but these are not discussed in this report.

Interest

Non-resident taxpayers are subjected to a withholding tax of thirty-five percent on interest received from Swiss obligations or customer accounts of Swiss banks.[11] The withholding may be adjusted accordingly if interest is taxed at a lower rate under an applicable double taxation treaty (*see below*, section on Double Taxation Treaties). Corporate taxpayers from member countries of the European Union (EU) are not taxed by Switzerland on interest earned from an affiliated Swiss company. This is provided in the Swiss–EU agreement adopting the EU Savings Directive.[12]

Dividends

Non-resident taxpayers are subjected to a thirty-five percent withholding tax on dividends received from a resident Swiss corporation.[13] There are, however, the following exceptions from this tax rate or liability:

- Double taxation treaties usually provide lower rates for portfolio dividends and even lesser rates or total exemptions for substantial holdings.[14]

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[7] Information obtained from Mr. Dieter Leutwyler, Press Speaker of the Swiss Federal Finance Ministry.

[8] X. OBERSON & H. HULL, SWITZERLAND IN INTERNATIONAL TAX LAW (Amsterdam, 2006).

[9] Bundesgesetz über die Verrechnungssteuer [VStG], Oct. 13, 1965, as amended, SR no. 642.21, *available at* the official Web site http://www.admin.ch/ch/d/sr/c642_21.html.

[10] DBG.

[11] VStG, art. 4 par. 1 & art. 13.

[12] Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/ECof 3 June 2003, on taxation of savings income in the form of interest payments, Oct. 26, 2004, effective July 1, 2005, SR 0641.926.81, art. 15; Oberson, *supra* note 8, at 303.

[13] VStG, art. 4.

[14] R. Wüthrich, *Switzerland, in* International Bureau of Fiscal Documentation, 2 THE TAXATION OF COMPANIES IN EUROPE 8.5.2. 1 (Amsterdam, 2007-).

- According to the EU Parent-Subsidiary Directive,[15] foreign corporations from European Union countries who own at least twenty-five percent of the stock of a Swiss company are not taxed on their dividend income.

- The Swiss participation relief applies to holdings of at least twenty percent of the Swiss stock-distributing company.[16] Technically, this privilege is not an exemption, but it has the same effect as an exemption.[17]

Capital gains

Foreign entities must pay federal gains tax on their capital gains realized from shares in Swiss corporations.[18] The rate of the federal gains tax is 8.5 percent of the net profit,[19] yet the participation exemption applies to substantial holdings.[20] The taxable gain of all profits realized in Switzerland is determined according to Swiss principles of income taxation.[21]

IV. Treaties on Double Taxation

In general

Switzerland has bilateral double taxation treaties for income with more than eighty countries,[22] so that, in effect, the treaties are more indicative of the actual practice than the unilateral provision of Swiss domestic law. Although many of the newer treaties follow the OECD model treaty,[23] they nevertheless vary significantly on the treatment of foreign governments and their entities and on the taxation of interest, dividends, and capital gains received by foreign creditor or shareholders from Swiss sources. Moreover, the wording of the treaties cannot always be regarded as conclusive for determining the actual practice, because the contracting states may interpret the treaty according to their mutual intentions.[24]

Norway

The double taxation treaty with Norway exempts each other's governments from the taxation of source country dividends and extends that privilege also to the Swiss Central Bank, the Norwegian Central Bank, the Norwegian Oil Fund, and any other governmentally owned entity that is designated by

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[15] Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states, 1990 OFFICIAL JOURNAL OF THE EUROPEAN COMMUNITIES (L225) 6, applicable between Switzerland and the EU member states on the basis of Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/ECof 3 June 2003 on taxation of savings income in the form of interest payments, Oct. 26, 2004, effective July 1, 2005, SR no. 0641.926.81, art. 15.

[16] DBG, art. 69.

[17] Wüthrich, *supra* note 14, at 7.1.3.1.

[18] DBG, art. 51, in conjunction with DBG, art. 49, par. 3; Wüthrich, *supra* note 14, at 4; 8.4.2.3 and 7.1.6.

[19] DBG, art. 68.

[20] DBG, art. 69.

[21] DBG, arts. 58 – 67.

[22] Wüthrich, *supra* note 14, at 8.5.2.

[23] Organization for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (electronic version), Feb. 1, 2005, *available* by subscription from the official Web-site http://www.oecd.org/document/17/0,3343,es_2649_33747_35035793_1_1_1_1,00.html;Oberson, *supra* note 8, at 77.

[24] Oberson, *supra* note 8, at 89.

agreement of the authorities of in both countries.[25] No corresponding provision exists for exempting interest earned by the other government and its entities, because article 11 of the treaty provides that interest is not taxed by the source country.

The general rate of the taxation of dividends in the source country is up to fifteen percent, but substantial holdings in a source country company are exempt from dividend taxation. The only capital gains from dividends that are taxed in the source country are substantial holdings owned by individual taxpayers.

Kuwait

The double taxation treaty with Kuwait[26] specifies in its article 4, paragraph 2 that the government of a treaty state and its subdivisions qualify as residents of the respective treaty country and that the same status applies to governmental institutions that have been created by a government to exercise public functions and that are recognized as such by mutual agreement of the competent authorities. The Protocol to the treaty specifies several Kuwaiti entities as falling within the scope of article 4, paragraph 2. Listed are:

- the Central Bank of Kuwait;
- Public Institution for Social Security;
- governmental corporations;
- government offices;
- government agencies;
- foundations; and
- the Development Fund.

According to article 11 of the treaty, the source country may tax interest of a creditor who resides in the other treaty country with a maximum rate of ten percent, and creditors who are foreign governments, their subdivisions, and agencies are tax residents within the meaning of this provision. Nevertheless, the actual treaty practice cannot be deduced from the treaty itself, due to discretionary clauses contained therein that allow for mutual understandings by the treaty countries.

Source country dividends are taxable with a maximum of fifteen percent, but substantial holdings enjoy the participation exemption. Due to discretionary clauses that allow for mutually agreeable interpretations, the actual practice of dividend taxation cannot be cannot be ascertained from the treaty provisions.

According to article 13 of the treaty, capital gains from the sale of stock are not taxed in the source country.

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May 2008

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[25] Abkommen zwischen der schweizerischen Eidgenossenschaft und dem Königreich Norwegen zur Vermeidung der Doppelbesteuerung auf dem Gebiet der Steuern vom Einkommen und vom Vermögen, as amended, SR no. 0.672.959.811, art. 10 (official source).

[26] Abkommen zwischen der schweizerischen Eidgenossenschaft und dem Staat Kuwait zur Vermeidung der Doppelbesteuerung auf dem Gebiet der Steuern vom Einkommen und vom Vermögen, Feb. 16, 1999, with Protocol, SR no. 0.672.947.61 (official source).

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TAXATION OF PASSIVE INCOME EARNED BY FOREIGN GOVERNMENTS AND SOVEREIGN WEALTH FUNDS

UNITED KINGDOM

Foreign governments are not typically taxed in the UK, based upon the principle of sovereign immunity. The UK government has specifically noted that sovereign wealth funds are excluded from taxation on the basis of this principle.

I. Tax Status of Foreign Governments

Foreign states are typically exempt from taxation in the UK under the longstanding principle of sovereign immunity, provided for by customary international law. The UK has a practice of exempting foreign governments from taxation on passive income based on the above principle of customary international law.[1]

II. Tax Status of Sovereign Wealth Funds

Investment in the United Kingdom through sovereign wealth funds has been actively encouraged, and UK Trade and Investment notes that the high profile recently garnered by these funds generates opportunities for inward investment.[2]

The investments of foreign states recognized by the United Kingdom are typically exempt from tax under the longstanding principle of sovereign immunity provided for by customary international law. Her Majesty's Revenue and Customs has stated that "Income and gains arising to, and in the sole direct beneficial ownership of: the Head (for example a reigning Monarch or a President) of a foreign Sovereign independent State; the Spouse of such a Head of State; a foreign independent Sovereign Government, are … normally immune from taxation."[3] This immunity only extends to income and gains that are beneficially owned by the foreign state and not to entities that are separate from the government, even though these may be wholly owned through shares by the government.[4] The government has recently stated in Parliament that:

> Where a sovereign wealth fund is an integral part of the government of a foreign sovereign state it will benefit from immunity from UK tax. As a result of this immunity no taxation will have been received from sovereign wealth funds. The United Kingdom recognises the principle of international law known as sovereign immunity whereby one sovereign state does not seek to apply its domestic laws to another sovereign state. In accordance with this principle, current UK practice is to regard as immune from direct taxes all income and gains which are beneficially owned by the head of state and the government of a foreign sovereign state recognised by the UK.[5]

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[1] UK Trade and Investment, *UK to Attract Sovereign Wealth Funds*, Apr. 11, 2008, *available at* http://www.ukinvest.gov.uk/OurWorld/4019411/en-GB.html

[2] *Id.*

[3] HM Revenue and Customs, *INTM155010 - Sovereign and Crown Immunity,* http://www.hmrc.gov.uk/manuals/intmanual/INTM155010.htm (last visited Apr. 17, 2008).

[4] *Id.*

[5] 28 Apr. PARL. DEB., H.C. (6th ser.) (2008) 144W.

III. Domestic Law

Interest

The domestic rate of taxation on the payment of interest to non-residents is the savings income tax rate of twenty per cent, unless these are quoted Eurobonds or short interest.[6] Interest from bank deposits may be paid without this tax if a declaration of non-residence is filed with the bank.[7]

Dividends

There is no tax on dividends that are paid in the UK to a non-resident.[8]

Capital Gains

Non-resident companies are liable to UK corporate tax on any capital gains that are attributable to a UK permanent establishment, notably those that arise

> on the disposal of assets situated in the United Kingdom while the UK trade is being carried on and use or acquired for use in the trade carried on through the permanent establishment (s. 11(2)(b) ICTA[9] and s 10(3) TCGA;[10] [and] any unrealized capital gains on assets situated in the UK and used for the purpose of the trade if the business in the UK increases or the assets are removed from the UK (s. 25(3) The CGA).[11]

The current rate was reduced from thirty percent to twenty-eight percent in April 2008.[12]

IV. Double Tax Treaties

The UK has concluded over 100 tax treaties on the avoidance of double taxation, and claims to have the largest network of treaties on this subject.[13] The UK currently uses the OECD Model Convention for its tax treaties.[14]

An example of the tax treatment of foreign governments is present in the double taxation treaty of the UK and Singapore.[15] In this treaty, the government exempts interest arising in each of its states from

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[6] II THE TAXATION OF COMPANIES IN EUROPE, ¶ 8.5.1.2 (1972-).

[7] *Id.*

[8] THE TAXATION OF COMPANIES IN EUROPE, *supra* note 6, at II, ¶ 8.5.1.1.; HM Revenue and Customs, *IR20 - Residents and Non-Residents: Liability to Tax in the United Kingdom*, 1999, *available at* http://www.hmrc.gov.uk/pdfs/ ir20.htm.

[9] Income and Corporation Taxes Act 1988, c. 1, *available at* http://www.opsi.gov.uk/acts/acts1988/Ukpga_1988 0001_en_1 (official source).

[10] Taxation of Chargeable Gains Act 1992 c. 12, *available at* http://www.opsi.gov.uk/acts/acts1992/Ukpga_1992 0012_en_1 (official source).

[11] THE TAXATION OF COMPANIES IN EUROPE, *supra* note 6, at ¶ 8.4.2.1.

[12] Finance Act 2007, c. 11, § 2, *available at* http://www.opsi.gov.uk/acts/acts2007/pdf/ukpga_20070011_en.pdf (official source).

[13] UK Trade and Investment, *Tax in the UK*, Dec. 2007, *available at* http://www.ukinvest.gov.uk/United-Kingdom/4016067/en-GB.html.

[14] THE TAXATION OF COMPANIES IN EUROPE, *supra* note 6, at II, ¶ 8.6.1.

[15] Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, Feb. 12, 1997, Gr. Brit.-Singapore, Gr. Brit. T.S. No. 41 (2000), (Cm. 4683), *available at* http://www.hmrc.gov.uk/international/singapore-dtc.pdf (unofficial source).

tax. The term "government" in this treaty is extended, in the case of Singapore, by the government of Singapore, to include:

> the Monetary Authority of Singapore and the Board of Commissioners of Currency; the Government of Singapore Investment Corporation Pte Ltd; a statutory body; and any institution wholly or mainly owned by the Government of Singapore as may be agreed from time to time between the competent authorities of the Contracting States.[16]

For the UK, the term "government" in the treaty covers the Government of the United Kingdom of Great Britain and Northern Ireland and includes:

> the Bank of England; the United Kingdom Export Credits Guarantee Department; the Commonwealth Development Corporation; and any institution wholly or mainly owned by the Government of the United Kingdom as may be agreed from time to time between the competent authorities of the Contracting States.[17]

Under the terms of this Treaty, non-residents may be charged up to fifteen percent in taxes for dividends and interest in the source country.

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[16] *Id.,* art. 11(4).

[17] *Id.*