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Non- discrimination: The backpacker and the shareholder

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Thursday, November 14th, 2019

Equality is one of the core values of modern democratic societies. It is no accident that equality featured in opening preamble to the United States Declaration of Independence in 1776 and the first article of both the French Declaration of the Rights of Man in 1789 and the United Nations Universal Declaration of Human Rights in 1948. Tax treaties however, only provide limited access to equal treatment in the host state.

Backpacker tax

Australia, like many other countries, has special visa arrangements to allow young people to make extended working holidays in the country. https://en.wikipedia.org/wiki/Working_holiday_visa These arrangements give opportunities for deeper exploration of other cultures and societies without the need for extensive financial resources.

In *Addy v Commissioner of Taxation* [2019] FCA 1768, Catherine Addy, a British citizen, travelled to Australia and stayed there under a working holiday visa. Most of her time there was spent living with others in a house share in Sydney. She had also worked and lived on a horse farm in Western Australia from April to June 2016. And made several visits to other parts of Australia and also toured through several countries in South-East Asia. Ms Addy worked as a waitress during some of her time in Australia at two different hotels.

Working holiday visa

Along with the working holiday visa, Australia imposed a special income tax regime on the employment income of the holders of such visas which became known as the "backpacker tax". The lowest rate of backpacker tax was 15% for taxable income up to A$37,000. For Australian residents the lowest rate of tax was 32.5% for income up to A$87,000. Australian residents qualified for a nil rate for income up to A$18,200 which did not apply to taxpayers subject to the backpacker tax.

Art 25(1) of the Australia-United Kingdom Tax Treaty (in line with Art 24(1) of the OECD Model) specifies that:

Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected.

The Federal Court of Australia observed that the definition of "working holiday maker" in necessarily extends only to particular individuals who are not nationals of Australia (as an Australian national cannot hold such a visa). The discrimination was disguised by the reference to "working holiday maker" but plainly what it disguises is nationality. A resident national of Australia undertaking the same work as did Ms Addy, in other words "in the same circumstances", would not be taxed by reference to the backpacker rates and would benefit from the tax-free threshold.

The Court rejected the ATO argument that art 25(1), requires comparison with a notional Australian who holds a working holiday visa and has earned working holiday taxable income which mean there was no comparator. A national of Australia could not hold such a visa or have that kind of income which was the difference in treatment.

More burdensome taxation

Taxation must be more burdensome than that imposed on a local national to be discriminatory. Ms Addy's taxable income was A$20,686.00. It is plain that her inability to qualify for the tax-exempt threshold made her income tax liability more burdensome than an Australian national earning the same income. Although not discussed in the judgement, they may be certain circumstances in which the effective rate of tax might be lower under the backpacker tax than for an ordinary Australian resident. This does not itself negate the discrimination where the tax is higher.

Most-favoured nation treatment

Most-favoured nation treatment confers a different form of equal treatment. Such treatment must not be less favourable than treatment extend by the granting state to a third state. In *ABC Proprietary Limited v Commissioner for The South African Revenue Services* TC – IT 14287 – 12 June 2019, the South African Tax Court considered whether MFN treatment was engaged by a protocol to the Netherlands- South Africa Tax Treaty concluded in 2008 that introduced such a provision into the dividend article 10. At issue was whether dividends paid by a South African resident company to its parent company should be subject to withholding tax at the rate of 5% as provided by article 10 (2)(a) or to a zero rate by operation of a most-favoured-nation provision in article 10 (1)). The analysis turned on the interaction between that protocol, a 2010 protocol to the South Africa-Sweden Tax Treaty which also provided for a 5% rate of withholding tax on dividends paid to a corporate shareholder with a substantial participation, subject to most-favoured-nation treatment if a treaty was concluded with a third state that provided for a lower rate of withholding tax. A zero rate of withholding tax was agreed in the Kuwait-South Africa Tax Treaty concluded in 2004.

Multi-treaty engagement

There was no dispute that the zero rate would apply if the most-favoured-nation provision in the Netherlands-South Africa tax treaty was applicable. The most-favoured-nation provision only applied if more favourable treatment was agreed with a third state subsequently to the 2008 protocol. The most-favoured-nation treatment in the South Africa- Sweden treaty agreed in 2010 was not limited to subsequent agreements. The Tax Court concluded that most-favoured-nation treatment applied to dividends paid in 2012 in these circumstances. I will return to some of the treaty interpretation issues in this case in a subsequent blog.

Around the time of the South African Tax Court decision, Chilean tax administration announced

the activation of most-favoured-nation treatment in treaties concluded with Argentina, France and Sweden Circular No. 27/2019 28of June, 2019, http://www.sii.cl/normativa_legislacion/circulares/2019/circu27.pdf as a result of the entry into force of an agreement between Chile and Japan. The Circular noted that the equivalent provisions in the Chile-Uruguay Tax Treaty were not engaged because that treaty was concluded after that with Japan.

The South African decision and the Chilean announcement both reveal how widespread the use of most-favoured-nation treatment is. Treaty provisions giving effect to this or non-standard and the necessity for a careful reading are indicated by both.

I have to disclose an interest in the *Addy* case, having assisted Ms Addy's counsel, John Hyde Page with the foreign authorities and sources and formulation of submissions.

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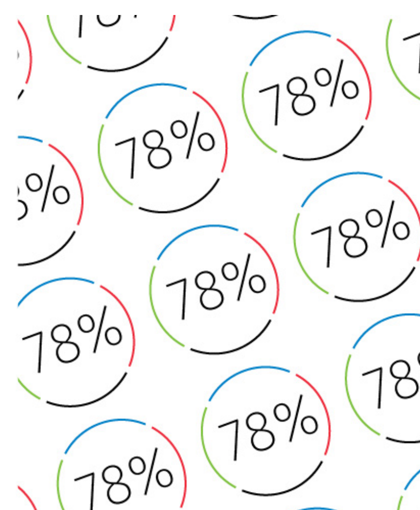

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