




ATO Interpretative Decision

ATO ID 2009/21

Income Tax

Whether a United States head lessor of substantial equipment carries on business in Australia through a deemed permanent establishment under the United States Convention

FOI status: may be released

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Issue

Does Australia have a right to tax a United States head lessor under Article 7(1) of Schedule 2 of the *International Agreements Act 1953* (Agreements Act) where they lease equipment to an Australian resident company who subleases the equipment to third parties in Australia?

Decision

No. Australia does not have a right to tax a United States head lessor under Article 7(1) of Schedule 2 of the Agreements Act where they lease equipment to an Australian resident company who subleases the equipment to third parties in Australia.

Facts

The taxpayer is a United States resident for the purposes of the US Convention.

The taxpayer is carrying on the business of leasing substantial equipment.

The taxpayer leases substantial equipment to an Australian resident entity who subleases the equipment to third parties. The third parties operate the equipment within Australia for more than 12 months.

The taxpayer receives lease payments from the Australia resident entity in accordance with the lease agreement.

The lease agreement is not a hire-purchase agreement for the purposes of the US Convention.

The taxpayer entered into the lease agreement with the Australian resident entity in May 1993 outside Australia. However, the equipment that is the subject of the lease was previously leased by the taxpayer to the Australian resident entity under an earlier lease agreement which terminated upon the entering into of the new lease in May 1993.

The negotiations for the new lease took place predominantly outside Australia during the period from December 1989 to May 1993. However, only the drafting of the lease was carried out in Australia.

Up until the commencement of the new lease in May 1993, the equipment remained in the possession of the Australian resident entity and was located in Australia during this time.

There is no requirement in the lease for the equipment to be physically located or used in Australia by the Australian resident entity.

At the end of the lease period, the lease agreement requires that the Australian resident entity return the equipment to the taxpayer at an address in the United States.

The taxpayer does not lease the equipment through an office, dependent agent or any other fixed place of business in Australia.

The taxpayer does not undertake any maintenance or inspection activities for the equipment while it is used in Australia, as this is the responsibility of the Australian resident entity under the lease agreement.

Reasons for Decision

Schedule 2 to the Agreements Act contains the tax treaty between Australia and the United States (the US Convention). Article 7(1) of the US Convention allocates Australia a right to tax profits of an enterprise of the United States (US) where that enterprise carries on business in Australia through a

permanent establishment in Australia.

Article 5 of the US Convention

Article 5(4)(b) of the US Convention deems a US enterprise to have a permanent establishment in Australia where:

it maintains substantial equipment for rental or other purposes within that other State (excluding equipment let under a hire-purchase agreement) for a period of more than 12 months.

Based on the ordinary meaning of the terms within the expression 'maintains ... for rental or other purposes ... within Australia' and the context in which the expression is used in Article 5(4)(b) of the US Convention, the Commissioner considers the expression applies to situations where the actions of a US lessor enterprise are directed toward keeping its substantial equipment present within Australia for leasing purposes. Accordingly, a US lessor enterprise will be considered to maintain substantial equipment within Australia where the lessor:

- (a)** directs or otherwise requires that the equipment be used by the lessee within Australia, or
- (b)** already has equipment located within Australia which is available for lease in Australia, and the equipment is used within Australia.

For the purposes of paragraph (a) above, a US lessor enterprise is considered to direct or otherwise require that the equipment be used by the lessee within Australia if there is a requirement in the lease that they be physically located or used within Australia. However, a lessor would not be considered to direct or otherwise require that the equipment be used by the lessee within Australia where the equipment is of a general nature such that it can be used in most locations, the lessor has no requirement as to where the lessee ultimately uses the equipment, and it simply eventuates that the lessee brings the equipment to Australia and uses it in Australia.

The same principles apply whether the US lessor enterprise is a head lessor or sublessor in a chain of leases over the equipment. Where the US lessor enterprise is a head lessor, the Commissioner considers the actions of the US lessor alone (that is as distinct from those of the lessee or any sublessees) to determine whether the US lessor is maintaining the equipment for rental or other purposes within Australia.

In situations where the leased equipment is:

- already located in Australia

- made available for lease in Australia, and
- actually used in Australia.

The Commissioner considers that the actions of the US lessor enterprise are directed towards keeping the equipment in Australia. This will be the case regardless of whether the US lessor enterprise brought the equipment to Australia to make them available for leasing, had the equipment constructed in Australia, or simply allowed them to remain in Australia for the purpose of leasing following the expiry of a previous lease contract. This will also be the case regardless of whether the lease agreement requires the leased equipment be used in Australia during the lease, or whether the US lessor enterprise makes the equipment available for lease worldwide and they are then used by the lessee in Australia.

Accordingly, the actions of the taxpayer are considered to be directed towards keeping the equipment in Australia because:

- the equipment was already located in Australia before the new lease was entered into on 21 May 1993
- the equipment was made available by the taxpayer for lease in Australia, and
- the equipment is actually used by the Australian resident entity in Australia for a period of more than 12 months.

Therefore, the taxpayer is considered to be maintaining substantial equipment for rental purposes within Australia for a period of more than 12 months. Accordingly, the taxpayer is deemed to have a permanent establishment in Australia under Article 5(4)(b) of the US Convention in relation this equipment leasing activity.

Article 7 of the US Convention

However, Australia will only have a taxing right under Article 7(1) of the US Convention over the leasing profits attributable to this deemed permanent establishment where the taxpayer is considered to be carrying on its leasing business in Australia through its deemed permanent establishment.

Maintaining leased equipment in Australia that gives rise to a deemed permanent establishment (for example, because the lessor directs that it be used by the lessee within Australia) does not necessarily mean, of itself, that the US lessor enterprise is carrying on its business in Australia through that permanent establishment. Whilst the deemed permanent establishment is the 'activity' of maintaining the equipment for rental or other purposes within Australia (as opposed to being 'a fixed place of business' permanent establishment under Article 5(1) of the US Convention) it is a consideration of the

entirety of activities undertaken in Australia by the lessor that determines whether the lessor is carrying on business in Australia.

Accordingly, where the lease contracts are entered into outside Australia and the activities of the lessor in Australia only consist of the drafting of the lease but not the receipt of lease rentals, the Commissioner considers that this mere leasing of equipment by the US lessor enterprise in Australia will not, of itself, constitute the carrying on of business in Australia through the deemed permanent establishment. The Commissioner considers that for business to be carried on in Australia through the deemed permanent establishment, a US lessor enterprise would need to be undertaking more of the activities constituting its leasing business within Australia, for example, undertaking inspection or maintenance checks on the equipment in Australia, or conducting lease negotiations in Australia.

The taxpayer does not carry on any of its leasing business activities through its deemed permanent establishment in Australia other than the activity of maintaining the equipment within Australia for rental purposes. Accordingly, the taxpayer is not considered to be carrying on business through its deemed permanent establishment in Australia. Therefore, Australia does not have a taxing right over the taxpayer's leasing profits under Article 7(1) of the US Convention.

Date of decision: 18 January 2008

Year of income: Year ended 30 June 2004

Year ended 30 June 2005

Year ended 30 June 2006

Year ended 30 June 2007

Year ended 30 June 2008

Year ended 30 June 2009

Year ended 30 June 2010

Legislative References:

International Agreements Act 1953

Schedule 2 Article 5(4)(b)

Schedule 2 Article 7(1)

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