FEDERAL COURT OF AUSTRALIA

Burton v Commissioner of Taxation [2019] FCAFC 141

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| Appeal from: | *Burton v Commissioner of Taxation* [2018] FCA 1857  |
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| File number: | WAD 600 of 2018 |
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| Judges: | **LOGAN, STEWARD AND JACKSON JJ** |
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| Date of judgment: | 22 August 2019 |
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| Catchwords: | **TAXATION** – foreign income tax offset – s 770-10 of the *Income Tax Assessment Act 1997* (Cth) – where taxpayer paid tax in the United States on gains made from the sale of certain assets in that country – where gains were also taxable in Australia – where gains were derived on capital account for Australian tax purposes – where 50% capital gains tax discount applied – where Commissioner denied the taxpayer a foreign income tax offset against his tax liability in Australia on the gains to the extent of half of the tax paid in the United States – whether the capital gains before the application of capital losses and the capital gains tax discount were “included in” the taxpayer’s assessable income for the purposes of s 770-10 – whether the full tax paid in the United States on the gains was paid “in respect of” the Australian net capital gain for the purposes of s 770‑10 **TAXATION** – treaty interpretation – Art 22(2) of the double tax convention between Australia and the United States – where Art 22(2) of the double tax convention between Australia and the United States requires Australia to allow as a credit against Australian tax the US tax paid “in respect of income derived from sources in the United States” – whether the gain constitutes “income derived from sources in the United States” – whether the gain “in respect of” which tax is paid refers to the whole of the gain taxed in the United States or the discounted gain taxed in Australia – where the double tax convention was incorporated into Australian law pursuant to s 5 of the *International Tax Agreements Act 1953* (Cth) – whether there is an inconsistency between Art 22(2) and s 770-10 of the *Income Tax Assessment Act 1997* (Cth)  |
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| Legislation: | *Income Tax Assessment Act 1936* (Cth) ss 95, 97, 121EG, 160AF (repealed)*Income Tax Assessment Act 1997* (Cth) Divs 6, 770, ss 2‑35, 2‑45, 4-10, 4-15, 6-5, 6-10, 6-15, 13-1, 102-5, 104‑10, 110-25, 115-10, 115-25, 115-100, 115-215, 116‑20, 770-1, 770-5, 770-10, 770-65, 770-70, 950-100, 950-150, 995-1*Income Tax (International Agreements) Act* *1968* (Cth)*International Tax Agreements Act 1953* (Cth) ss 3, 4, 5, 14 (repealed), 15 (repealed), 16*Taxation Laws Amendment (Foreign Tax Credits) Act 1986*(Cth)Explanatory Memorandum, *Income Tax (International Agreements) Bill 1968* (Cth)Explanatory Memorandum, *Tax Laws Amendment (2007 Measures No. 4) Bill 2007* (Cth)*Agreement between Australia and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, and Protocol*, signed on 17 March 1976, [1976] ATS 24 (entered into force on 27 September 1976)*Agreement between the Government of Australia and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, signed on 25 July 1991, [1991] ATS 49 (entered into force on 30 December 1991)*Agreement between the Government of the Commonwealth 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 Capital Gains*, signed on 7 December 1967, [1968] ATS 9 (terminated on 17 December 2003)*Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, signed on 6 August 1982, [1983] ATS 16 (entered into force on 31 October 1983) as amended, Arts 2, 3, 6, 7, 8, 10, 11, 12, 13, 14, 15, 17, 18, 19, 20, 21, 22*Vienna Convention on the Law of Treaties*, opened for signature on 23 May 1969, [1974] ATS 2 (entered into force on 27 January 1980), Art 31  |
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| Cases cited: | *Anson v Commissioners for Her Majesty’s Revenue and Customs* [2015] UKSC 44; 4 All ER 288*Carr v Western Australia* (2007) 232 CLR 138*Certain Lloyd's Underwriters Subscribing to Contract No IH00AAQS v Cross* (2012) 248 CLR 378*Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation (No 4)* [2015] FCA 1092; (2015) 102 ATR 13*Commissioner of Inland Revenue v Lin* [2018] NZCA 38*Commissioner of Taxation v Lamesa Holdings BV* (1997) 77 FCR 597*ConnectEast Management Ltd v Federal Commissioner of Taxation* (2009) 175 FCR 110*Duckering (Inspector of Taxes) v Gollan* [1965] 2 All ER 115*Esso Australia Resources Ltd v Federal Commissioner of Taxation* (1998) 83 FCR 511*Federal Commissioner of Taxation v Greenhatch* (2012) 203 FCR 134*Jeffrey James Prebble Pty Ltd v Commissioner of Taxation* (2003) 131 FCR 130*McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation* (2005) 142 FCR 134*Mutual Life and Citizens’ Assurance Co Ltd v Commissioner of Taxation* (1959) 100 CLR 537*Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355*Satyam Computer Services Limited v Commissioner of Taxation* [2018] FCAFC 172; (2018) 362 ALR 589*Stevens v Kabushiki Kaisha Sony Computer Entertainment* (2005) 224 CLR 193*Thiel v Commissioner of Taxation* (1990) 171 CLR 338*Woodside Energy Ltd v Commissioner of Taxation (No 2)* [2007] FCA 1961; (2007) 69 ATR 465  |
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| Date of hearing: | 21 May 2019 |
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| Date of last submissions on behalf of the Appellant: | 5 June 2019 |
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| Date of last submissions on behalf of the Respondent: | 19 June 2019 |
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| Registry: | Western Australia |
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| Division: | General Division |
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| National Practice Area: | Taxation |
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| Category: | Catchwords |
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ORDERS

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|  | WAD 600 of 2018 |
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| BETWEEN: | CRAIG IAN BURTONAppellant |
| AND: | COMMISSIONER OF TAXATIONRespondent |

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| JUDGES: | LOGAN, STEWARD AND JACKSON JJ |
| DATE OF ORDER: | 22 AUGUST 2019 |

THE COURT ORDERS THAT:

1. The appeal be dismissed.
2. The appellant pay the respondent’s costs of and incidental to the appeal, to be taxed if not agreed.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

LOGAN J:

1. Mr Craig Burton is an Australian tax resident. In the 2011 and 2012 income years, he derived capital gains from investments which he had made in the United States of America (**US**). Those gains were taxed at source under US revenue law. Mr Burton paid the applicable US tax.
2. By virtue of Mr Burton’s residence, the gains were also taxable in Australia, albeit in a different way. In his Australian tax returns for the income years in question, Mr Burton claimed the benefit of the US tax which he had paid, either as a foreign tax credit pursuant to Article 22(2) of the***Convention*** *between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* ([1983] ATS 16), signed in Sydney on 6 August 1982, as incorporated into Australian law pursuant to s 5 of the *International Tax Agreements Act 1953* (Cth), (**International Tax Agreements Act**) or as a foreign income tax offset (**FITO**) under s 770-10 of the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**).
3. The learned primary judge accurately summarised the effect of the differing taxation regimes as between the US and Australia in respect of the gains. Under US law, Mr Burton was entitled in the relevant years to concessional treatment of capital gains on assets held for more than a year, achieved by taxing them at a rate which was less than half the ordinary income tax rate. In Australia, those gains were also taxable as capital gains on assets held for more than a year. The concessional treatment provided under Australian law in those circumstances was to apply a 50% discount to the capital gain as part of the formula by which a net amount was included in assessable income.
4. The Commissioner did not allow in full either the tax offset or credit which Mr Burton claimed against his Australian tax liability. Instead, in making amended assessments of Mr Burton’s taxable income, he allowed a tax offset of half of the US tax which he had paid. The Commissioner also concluded that no different position was dictated by Art 22(2) of the Convention. In each instance, the Commissioner’s view was that, on the true construction of each of s 770-10 of the 1997 Act and Art 22(2) of the Convention, the purpose of avoidance of double taxation was achieved by the allowance of a tax offset (or credit) of 50% of US tax paid, because under Australian income tax law, only 50% of the gain formed part of the net amount included in Mr Burton’s assessable income. The Commissioner termed this the “apportionment approach”.
5. Mr Burton objected against the amended assessments. His grounds were that he ought to have been allowed a tax offset (or credit) for the full amount of the US tax which he had paid. In his objection decision, the Commissioner adhered to his earlier position. Mr Burton then appealed against that objection decision to this Court in the exercise of the original jurisdiction conferred on it by s 14ZZ of the *Taxation Administration Act 1953* (Cth). In the result, the learned primary judge concluded that the construction adopted by the Commissioner of both s 770-10 and Art 22(2) was correct and dismissed Mr Burton’s taxation appeal.
6. Mr Burton has appealed against the dismissal of his taxation appeal. The issues in the appeal are as they have always been. Mr Burton contends that under either or each of s 770-10 of the 1997 Act or Art 22(2) of the Convention, he is entitled to a tax offset (or credit) of the whole of the US tax which he has paid, whereas the Commissioner contends that he is entitled to a tax offset (or credit) of 50% of that amount. More particularly, the grounds of appeal are:

1. The primary judge erred in finding at [77]-[78] that the three capital gains in question, before application of capital losses and discount, were not “included in” the appellant’s assessable income for the purposes of s 770-10(1) of the ITAA 1997.

2. It should have been held that the appellant’s capital gains on the three assets in issue, before application of capital losses and discount, were “included in” the appellant’s assessable income for the purposes of s 770-10(1) of the ITAA 1997.

3. The primary judge erred in finding at [113] that the full United States tax on the three gains was not paid “in respect of” the Australian net capital gain for the purposes of s 770-10(1) of the ITAA 1997.

4. It should have been held, in the alternative to Ground 2 above, that the full United States tax on each gain was paid “in respect of” the corresponding Australian net capital gain for the purposes of s 770-10(1) of the ITAA 1997.

5. The primary judge erred in finding at [126] that Article 22(2) of the Double Tax Convention between Australia and the United States does not require Australia to allow as a credit against the relevant Australian tax the full United States tax paid in respect of the three gains.

6. It should have been held, in the alternative to Grounds 2 and 4 above, that Article 22(2) of the Double Tax Convention between Australia and the United States requires Australia to allow as a credit against the relevant Australian tax the full United States tax paid in respect of the three gains.

1. There was no evidentiary controversy before the primary judge. I therefore gratefully adopt the comprehensive summary offered by his Honour of the background facts and related tax treatment by the US Internal Revenue Service or, as the case may be, the Commissioner.
2. In the 2011 and 2012 income years, Mr Burton was the trustee of an Australian discretionary trust: the CI Burton Family **Trust**. He was also a member of the class of objects of the Trust at the relevant times. Three gains derived by Mr Burton as trustee of the Trust are relevant:
	1. the gain on the disposal of what is described below as the NEPA Investment;
	2. the gain on the disposal of what is described below as the Strega 1 Investment; and
	3. the gain on the disposal of what is described below as the Strega 2 Investment.
3. Mr Burton held each of these investments for more than 12 months and on capital account for Australian tax purposes.

## NEPA Investment

1. On or around 18 November 2004, Mr Burton as trustee acquired certain rights in respect of oil and gas wells in Pennsylvania, US, which on 18 September 2010 he then sold to Chesapeake Energy Corporation. Those rights were a 1.75% option to participate in certain wells and an interest in other wells in respect of which Mr Burton as trustee had previously exercised an option (**Nepa Investment**).
2. The Nepa Investment arose under a Participation Agreement dated 18 November 2004 between Mr Burton as trustee, Tioga Oil & Gas Inc and Seaspin Pty Ltd as trustee of the Aphrodite Trust, under which the Nepa Investment and the other rights were acquired. The quantum of the option to participate was initially 6%.
3. On a number of occasions, the Participation Agreement was amended by further agreement. Amongst other things, the quantum of the option to participate varied. Immediately before 1 March 2010, this was at approximately 3.375%. On that date Mr Burton as trustee sold to Chesapeake 1.625% of his then 3.375% option. That transaction did not give rise to gains which are in issue in this proceeding.
4. Mr Burton as trustee in respect of the Nepa Investment paid costs totalling $1,864,355 in the calendar years 2009 and 2010.
5. There was a further sale by Mr Burton as trustee on 18 September 2010 to Chesapeake. This sale concerned the remaining 1.75% option to participate and his interest in other wells in respect of which he had previously exercised an option, that is, the NEPA Investment. The consideration was US$25,434,715. That consideration was paid to Mr Burton in five instalments of:
* US$2,712,480 on or around 13 October 2010;
* US$8,137,440 on or around 30 November 2010;
* US$8,137,440 on or around 28 January 2011;
* US$5,459,635 on or around 29 April 2011; and
* US$987,720 on or around 8 June 2011.
1. A resolution was made by Mr Burton in his capacity as trustee on 30 June 2011 to distribute all discount capital gains arising from the sale of assets other than shares (including the gains arising from the disposal of the NEPA Investment) to himself, in his capacity as an object of the Trust.
2. This gave rise to certain US tax treatment of Mr Burton’s disposal of the NEPA Investment. Although he was not a resident of the US for tax purposes, Mr Burton was taxable on the sale of the NEPA Investment under US law because it represented a gain on a US ‘real property interest’, which is treated as ‘income effectively connected with a United States trade or business’ (**ECI**). ECI is earned by a non-resident alien when it qualifies as a long-term capital gain by virtue of it being held for more than one year. Such ECI was taxed at 15% at the relevant time. This is in contrast to ordinary income in respect of which the tax rate was 35%.
3. Mr Burton was liable in his personal capacity to pay US tax on the long-term capital gain from the disposal of the NEPA Investment, as US law regarded the Trust of which Mr Burton was trustee as a ‘grantor trust’, the income of which is attributed to the ‘owner’ of such a trust (for present purposes being Mr Burton in his personal capacity).
4. As a consequence, for the US tax year ended 31 December 2010, Mr Burton returned and paid US tax at 15% on the long-term capital gain from the disposal of the NEPA Investment of US$8,985,565 (being the two instalments received in the 2010 calendar year totalling US$10,849,920, less the cost of US$1,864,355). The US tax paid was US$1,347,834.
5. Secondly, for the US tax year ended 31 December 2011, Mr Burton returned and paid US tax at 15% on the long-term capital gain from the disposal of the NEPA Investment of US$14,584,795 (being the three instalments received in the 2011 calendar year). The US tax paid was US$2,187,720.
6. Across these two US tax years the total long-term capital gain from the disposal of the NEPA Investment was US$23,570,360 and the total US tax paid by Mr Burton on this gain was US$3,535,554.

## Australian tax on the NEPA Investment

1. The consideration for the disposal of the NEPA Investment in respect of all five instalments was received in the year ended 30 June 2011.
2. It is common ground that, for Australian tax purposes, the gain on the sale of the NEPA Investment was a CGT event A1 within the meaning of s 104-10 of the 1997 Act. As such, it gave rise to foreign capital gains of the Trust in that financial year by means of this computation:
* The capital proceeds under s 116-20 of the 1997 Act from the disposal of the NEPA Investment were $25,322,008, being the then equivalent of US$25,434,715;
* The cost base, under s 110-25 of the 1997 Act for the NEPA Investment was $2,567,687, being the then equivalent of US$1,864,355;
* Under s 104-10 of the 1997 Act, subtracting the cost base from the capital proceeds derived from disposal (i.e. (b) from (a)) results in the capital gain on the disposal of the NEPA Investment, $22,754,321; and
* After application of the 50% CGT discount provided for in s 115-25 of the 1997 Act the amount of $11,366,161 was included in the net capital gain (**NCG**) of the Trust under s 102-5(1).
1. Mr Burton was personally liable for the tax on this capital gain because he was an object of the Trust and presently entitled to the capital gain on disposal of the NEPA Investment. Through the application of s 115-215, he had a capital gain of $22,754,321 (being part of the capital gain in his tax return of $24,013,666 covering both the NEPA Investment and the Strega 1 Investment referred to below). After application of the 50% discount in s 102-5(1) and s 115-25, an NCG of $11,366,161 was included in his assessable income in respect of the disposal of the NEPA Investment (being part of the NCG of $12,006,833 that covered both the NEPA Investment and the Strega 1 Investment).
2. The Australian income tax payable by Mr Burton in his personal capacity on the NCG on the disposal of the NEPA Investment was $5,114,772 (being the NCG included in Mr Burton’s assessable income in respect of the disposal of the NEPA Investment multiplied by his marginal tax rate).
3. In Mr Burton’s tax return for the year ended 30 June 2011 in respect of the gain on the NEPA Investment he claimed a FITO of $3,414,207, representing the US$3,535,554 paid in US tax referred to above (being part of the total FITO of $3,875,952 claimed in respect of both the NEPA Investment and the Strega 1 Investment).

## Strega 1 Investment

1. By agreement dated 5 March 2008, Mr Burton as trustee relevantly acquired a right to payment if the counterparty did not drill certain wells in Pennsylvania (**Strega 1 Investment**).
2. Mr Burton as trustee received US$1,260,000 in January 2011 by way of satisfaction of the Strega 1 Investment.
3. On 30 June 2011, Mr Burton as trustee resolved to distribute all discount capital gains arising from the sale of assets other than shares (including the gains arising from the disposal of the Strega 1 Investment) to himself in his capacity as an object of the Trust.

## US tax on the Strega 1 Investment

1. In the US, the gain on the disposal of the Strega 1 Investment was taxed as ECI in the form of a royalty at the ordinary income rate of 35% in the year ended 31 December 2011. The US tax paid by Mr Burton in respect of the disposal of the Strega 1 Investment was US$481,000.

## Australian tax on the Strega 1 Investment

1. The consideration for the disposal of the Strega 1 Investment was received by Mr Burton in the year ended 30 June 2011. The NCG for Australian tax purposes as computed the same way described in [25] above with capital proceeds being $1,264,284 and the cost base $4,939 resulting in a capital gain of $1,259,345 and a discount capital gain of $629,673.
2. It followed that the Australian income tax payable by Mr Burton in his personal capacity on the NCG on the disposal of the Strega 1 Investment was $283,353. In his income tax return for 30 June 2011 Mr Burton claimed a FITO of $461,745 in respect of the gain on the Strega 1 Investment, representing the US$481,000 paid in US tax (being part of the total FITO of $3,875,952 claimed in respect of both the NEPA Investment and the Strega 1 Investment).

## Strega 2 Investment

1. Under the same 5 March 2008 agreement, Mr Burton as trustee retained participation rights in future wells via a nominee entity (**Strega 2 Investment**). In May 2011, Mr Burton as trustee became entitled to proceeds of disposal of the Strega 2 Investment pursuant to an agreement dated September 2010.
2. As trustee, Mr Burton received a total of US$9,068,426 over the period 1 July 2011 to 30 June 2012 for the disposal of the Strega 2 Investment. Pursuant to a trust resolution dated 28 June 2012 Mr Burton as trustee resolved to distribute discount capital gains (including the gains arising from the disposal of the Strega 2 Investment) to himself in his capacity as an object of the Trust.

## US tax on the Strega 2 Investment

1. The gain on this disposal was taxed in the US as long-term capital gain ECI at the rate of 15% for the years ended 31 December 2011 and 31 December 2012. The gains for these years were US$7,035,454 and US$2,032,972 respectively, totalling US$9,068,426.
2. The US tax was withheld from the proceeds due to Mr Burton and remitted to the US Internal Revenue Service in four tax payments totalling US$1,536,836, against which the US dollar equivalent of $291,470 was refunded (the net payment was the US dollar equivalent of $1,119,885).

## Australian tax on the Strega 2 Investment

1. The consideration for the disposal of the Strega 2 Investment was received by Mr Burton in the year ended 30 June 2012. The NCG for Australian tax purposes was calculated in the same manner described in [25] above (before the capital losses subtraction, described below), with the capital proceeds being $8,944,014. There was no cost base.
2. In the year ended 30 June 2012, Mr Burton had discount capital losses of $1,199,755 from separate transactions. These were subtracted from the $8,944,014 capital gain derived from the Strega 2 Investment in accordance with ‘Step 1’ of the method statement in s 102-5(1), resulting in $7,744,259. Under ‘Step 3’ of s 102-5(1), the 50% discount was applied to that net figure, resulting in a NCG of $3,872,129.
3. The Australian income tax payable by Mr Burton in his personal capacity on the NCG on the disposal of the Strega 2 Investment was therefore $1,742,458.
4. In his Australian tax return for the year ended 30 June 2012, Mr Burton claimed a FITO of $1,119,886 in respect of the gain on the Strega 2 Investment, representing the US tax referred to above.

## Comparative tax concessions on capital gains on long term investments

1. In summary, the US, like Australia, allows concessions on capital gains made on long-term investments. The nature of the concessions differs as between the two countries. In the US, Mr Burton, for the most part, paid US tax at a discount rate of 15% on the whole of those gains; in relation to some (identified above) he paid at a rate of 35%. In Australia only 50% of the gain is included in the calculation of the net amount included in assessable income, but one pays one’s normal marginal rate on the overall taxable income.

## Legislative and Treaty Provisions

1. Section 5(1) of the International Tax Agreements Act provides that, “Subject to this Act, on and after the date of entry into force of a provision of [an international agreement], the provision has the force of law according to its tenor”. The Convention is one such international agreement.
2. Subject to a presently immaterial exception, a provision in an international agreement thus given the force of domestic law prevails over a provision in an Assessment Act or a law imposing taxation, to the extent of any inconsistency. This paramountcy is the result of s 4 of the International Tax Agreements Act, which provides:

**Incorporation of Assessment Act**

1. Subject to subsection (2), the Assessment Act is incorporated and shall be read as one with this Act.

Note: An effect of this provision is that people who acquire information under this Act are subject to the confidentiality obligations and exceptions in Division 355 in Schedule 1 to the *Taxation Administration Act 1953*.

(2) The provisions of this Act have effect notwithstanding anything inconsistent with those provisions contained in the Assessment Act (other than Part IVA of the *Income Tax Assessment Act 1936*) or in an Act imposing Australian tax.

By s 3 of the International Tax Agreements Act, “Assessment Act” is defined to mean the *Income Tax Assessment Act 1936* (Cth) (**1936 Act**) or the 1997 Act.

1. Article 22 of the Convention provides:

Relief from double taxation

1. Subject to paragraph (4) and in accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), in the case of the United States, double taxation shall be avoided as follows:

(a) the United States shall allow to a resident or citizen of the United States as a credit against United States tax the appropriate amount of income tax paid to Australia; and

(b) in the case of a United States corporation owning at least 10 percent of the voting stock of a company which is a resident of Australia from which it receives dividends in any taxable year, the United States shall also allow as a credit against United States tax the appropriate amount of income tax paid to Australia by that company with respect to the profits out of which such dividends are paid.

Such appropriate amount shall be based upon the amount of income tax paid to Australia. For purposes of applying the United States credit in relation to income tax paid to Australia the taxes referred to in sub-paragraph (1)(b) and paragraph (2) of Article 2 (Taxes Covered) shall be considered to be income taxes. No provision of this Convention relating to source of income shall apply in determining credits against the United States tax for foreign taxes other than those referred to in sub-paragraph (1)(b) and paragraph (2) of Article 2 (Taxes Covered).

1. Subject to paragraph (4), **United States tax paid** under the law of the United States and in accordance with this Convention, other than United States tax imposed in accordance with paragraph (3) of Article 1 (Personal Scope) solely by reason of citizenship or by reason of an election by an individual under United States domestic law to be taxed as a resident of the United States, **in respect of income derived from sources in the United States by a person who, under Australian law relating to Australian tax, is a** **resident of Australia** **shall be allowed as a credit against Australian tax payable in respect of the income**. **The credit shall not exceed the amount of Australian tax payable on** **the** **income** or any class thereof or on income from sources outside Australia. Subject to these general principles, the credit shall be in accordance with the provisions and subject to the limitations of the law of Australia as that law may be in force from time to time.
2. An Australian corporation that owns at least 10 percent of the voting power in a United States corporation is, in accordance with the law of Australia as in force at the date of signature of this Convention, entitled to a rebate in its assessment, at the average rate of tax payable by it, in respect of dividends paid by the United States corporation that are included in the taxable income of the Australian corporation. However, should the law as so enforce be amended so that the rebate in relation to the dividends ceases to be allowable under that law, Australia shall allow credit under paragraph (2) for the United States tax paid on the profits out of which the dividends are paid as well as for the United States tax paid on the dividends.
3. For the purposes of computing United States tax, where a United States citizen is a resident of Australia, the United States shall allow as a credit against United States tax the income tax paid to Australia after the credit referred to in paragraph (2). The credit so allowed against United States tax shall not reduce that portion of the United States tax that is creditable against Australian tax in accordance with paragraph (2).

[Emphasis added]

1. Section 102-5 of the 1997 Act sets out the steps entailed in determining how much of what is termed a “net capital gain” is included in assessable income:

**102-5 Assessable income includes net capital gain**

(1) Your assessable income includes your net capital gain (if any) for the income year. You work out your ***net capital gain*** in this way:

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| *Working out your net capital gain*Step 1. Reduce the \*capital gains you made during the income year by the \*capital losses (if any) you made during the income year.Note 1: You choose the order in which you reduce your capital gains. You have a net capital loss for the income year if your capital losses exceed your capital gains: see section 102-10.Note 2: Some provisions of this Act (such as Divisions 104 and 118) permit or require you to disregard certain capital gains or losses when working out your net capital gain. Subdivision 152-B permits you, in some circumstances, to disregard a capital gain on an asset you held for at least 15 years.Step 2. Apply any previously unapplied \*net capital losses from earlier income years to reduce the amounts (if any) remaining after the reduction of \*capital gains under step 1 (including any capital gains not reduced under that step because the \*capital losses were less than the total of your capital gains).Note 1: Section 102-15 explains how to apply net capital losses.Note 2: You choose the order in which you reduce the amounts.Step 3. Reduce by the \*discount percentage each amount of a \*discount capital gain remaining after step 2 (if any).Note: Only some entities can have discount capital gains, and only if they have capital gains from CGT assets acquired at least a year before making the gains. See Division 115.Step 4. If any of your \*capital gains (whether or not they are \*discount capital gains) qualify for any of the small business concessions in Subdivisions 152-C, 152-D and 152-E, apply those concessions to each capital gain as provided for in those Subdivisions.Note 1: The basic conditions for getting these concessions are in Subdivision 152-A.Note 2: Subdivision 152-C does not apply to CGT events J2, J5 and J6. In addition, Subdivision 152-E does not apply to CGT events J5 and J6.Step 5. Add up the amounts of \*capital gains (if any) remaining after step 4. The sum is your ***net capital gain*** for the income year. |

Note: For exceptions and modifications to these rules: see section 102-30.

(2) However, if during the income year:

(a) you became bankrupt; or

(b) you were released from debts under a law relating to bankruptcy;

any \*net capital loss you made for an earlier income year must be disregarded in working out whether you made a \*net capital gain for the income year or a later one.

(3) Subsection (2) applies even though your bankruptcy is annulled if:

(a) the annulment happens under section 74 of the *Bankruptcy Act 1966*; and

(b) under the composition or scheme of arrangement concerned, you were, will be or may be released from debts from which you would have been released if instead you had been discharged from the bankruptcy.

1. Division 770 of the 1997 Act contains Australia’s own tax offset regime in relation to foreign tax. By virtue of s 4-10(3) of the 1997 Act, a tax offset reduces the amount of income tax payable by a taxpayer in respect of a year of income. During the relevant income years, the material provisions provided:

**Guide to Division 770**

**770-1 What this Division is about**

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| You may get a non-refundable tax offset for foreign income tax paid on your assessable income.There is a limit on the amount of the tax offset.A resident of a foreign country does not get the offset for some foreign income taxes.You may also get the offset for foreign income tax paid on some amounts that are not taxed in Australia. |

**770-5 Object**

(1) The object of this Division is to relieve double taxation where:

(a) **you have paid foreign income tax on amounts included in your assessable income**; and

(b) **you would, apart from this Division, pay Australian income tax on the same amounts**.

(2) To achieve this object, this Division gives you a tax offset to reduce or eliminate Australian income tax otherwise payable on those amounts.

Note 1: This Division applies in relation to Medicare levy and Medicare levy (fringe benefits) surcharge in the same way as it applies to Australian income tax. See section 90-1 in Schedule 1 to the *Taxation Administration Act 1953*.

Note 2: The tax offset under this Division can be applied against your Medicare levy and Medicare levy (fringe benefits) surcharge liability for the year, if an amount of it remains after you apply it against your basic income tax liability. See item 22 of the table in subsection 63-10(1).

**Subdivision 770-A—Entitlement rules for foreign income tax offsets**

**Table of sections**

**Basic entitlement rule for foreign income tax offset**

770-10 Entitlement to foreign income tax offset

770-15 Meaning of ***foreign income tax***, ***credit absorption tax*** and ***unitary tax***

**Basic entitlement rule for foreign income tax offset**

**770-10 Entitlement to foreign income tax offset**

(1) You are entitled to a \*tax offset for an income year for \*foreign income tax. **An amount of foreign income tax counts towards the tax offset for the year if you paid it in respect of an amount that is all or part of an amount included in your assessable income for the year**.

Note 1: The offset is for the income year in which your assessable income included an amount in respect of which you paid foreign income tax—even if you paid the foreign income tax in another income year.

Note 2: If the foreign income tax has been paid on an amount that is part non-assessable non-exempt income and part assessable income for you for the income year, only a proportionate share of the foreign income tax (the share that corresponds to the part that is assessable income) will count towards the tax offset (excluding the operation of subsection (2)).

Note 3: For offshore banking units, the amount of foreign income tax paid in respect of offshore banking income is reduced: see subsection 121EG(3A) of the *Income Tax Assessment Act 1936*.

 [Emphasis added]

## The Meaning and Effect of the Convention

1. The learned primary judge gave more detailed attention to the meaning and effect of s 770-10 within Div 770 of the 1997 Act than to the meaning and effect of Art 22(2) of the Convention. The meaning and effect of the latter derived by his Honour was said to follow from the same process of reasoning already adopted in relation to s 770-10. As was confirmed by the parties on the hearing of the present appeal, this approach was responsive to the way in which both Mr Burton’s and the Commissioner’s submissions had been presented to his Honour on the hearing of the taxation appeal. As will be seen, that presentation may well have led his Honour into error.
2. My preference is first to consider the meaning and effect of Art 22(2) of the Convention. That is for two reasons. First, the effect of s 4(2) of the International Tax Agreements Act is, as already noted, that that provision confers paramountcy. If Mr Burton were entitled to foreign tax credits by virtue of Art 22(2) as so applied, it would matter not whether he was or was not likewise entitled to tax offsets in the same amounts by virtue of s 770-10 (which is not to say that, to do justice to the parties to the appeal, it would then be rendered unnecessary to consider that subject). Secondly, the risk in first considering s 770-10 is that a process of reasoning informed or influenced by the text of that section in the context in which it appears in the 1997 Act and by the application of principles for the construction of a domestic statute may colour one’s approach to the construction of the different text of a provision in the different context of an international agreement, according to principles applicable when such a provision is incorporated into domestic law. Grounds 5 and 6 of Mr Burton’s notice of appeal allege error on the part of the primary judge in failing to uphold in full his claim for foreign tax credits under Art 22(2).
3. In ***Thiel*** *v Commissioner of Taxation* (1990) 171 CLR 338, at 344 contextual difference as between an expression found in an international tax agreement and in the 1936 Act was one of the factors which Mason CJ, Brennan and Gaudron JJ identified as making it “safer to look to the context of the Agreement itself”.
4. As was the case in relation to the State Parties to the bilateral international tax agreement considered in *Thiel*, Australia but not the other State Party, Switzerland in that case the US in the present, is a party to the *Vienna Convention on the Law of Treaties* *done at* *Vienna, 23 May 1969, entered into force 27 January 1980* (**Vienna Convention**)*.* The US has signed but has never ratified the Vienna Convention: see United Nations Treaty Collection, Chapter XXIII, Law of Treaties. That the US is not a party to the Vienna Convention does not mean that the requirement found in Article 31 of the Vienna Convention that a treaty is to be interpreted in accordance with the ordinary meaning to be given to its terms “in their context and in the light of its object and purpose” is thereby rendered irrelevant. Nevertheless, as McHugh J, Mason CJ, Brennan and Gaudron JJ agreeing, explained in *Thiel*, at 356, “because the interpretation provisions of the Vienna Convention reflect the customary rules for the interpretation of treaties, it is proper to have regard to the terms of the Convention in interpreting the Agreement, even though [the other State Party] is not a party to that Convention”.
5. One of the expressed purposes of the Convention is the avoidance of double taxation, another is the prevention of fiscal evasion, each with respect to taxes on income. It necessarily follows from the permission found in Art 13(1) of the Convention that, “Income or gains derived by a resident of one of the Contracting States from the alienation or disposition of real property situated in the other Contracting State may be taxed in that other State” that “income” where it appears in, materially, Art 22(2) includes “gains”. The agreement between the parties to this effect was not misconceived.
6. To identify one purpose of the Convention as avoiding double taxation with respect to taxes on income leaves unanswered “What taxes and on what income?” The answer is supplied by Art 22(2). Omitting presently immaterial words, the taxes and income are, respectively, “United States tax paid under the law of the United States … in respect of income derived from sources in the United States” and “Australian tax payable in respect of the income”. As a matter of construction flowing from the use of the definite article, “the” preceding “income” and context, “the income” must be one and the same as the “income derived from sources in the United States”. More particularly, given that the Convention includes as income a “gain”, the answer becomes, “United States tax paid under the law of the United States … in respect of [a gain] derived from sources in the United States” and “Australian tax payable in respect of the [gain]”. The “gain” is always the same. It is, at all times, the “gain derived from sources in the US”.
7. Again as a matter of construction, the “gain derived from sources in the US” is not defined by US law for the purposes of the Convention. Neither is it defined by Australian law. The Convention looks to the result of the operation of the law of the US and the payment of the resultant US tax on the one hand and the operation of the law of Australia on the other to ascertain, respectively, the amount of US tax payable and paid and the amount of the Australian tax payable. For present purposes, it is otherwise concerned with US law only to the extent of whether that law can be said to be “in respect of” a gain derived from sources in the US. The Convention is likewise concerned with the taxation law of Australia only to the extent of whether that law can be characterised as a law by which tax is payable “in respect of” that gain, i.e. the gain derived from sources in the US.
8. The double taxation sought to be avoided by the allowance of a credit in respect of US tax so paid is that US tax and the Australian tax so payable, each “in respect of” the gain as so construed, derived from the sources in the US.
9. More particularly, Mr Burton did not, in terms of the Convention, derive what the 1997 Act terms a “discount capital gain” from sources in the US. He derived what the Convention terms a gain and thus income. The amount of that gain was not one and the same as the “discount capital gain”. It was much more than that, as his taxation return disclosed. The Convention requires that there be a gain derived from sources in the US. Whether that “gain” is taxable under US law and, if so, whether the US tax has been paid are consequential questions. In the same way, whether that gain is taxable under Australian law is a further, consequential question. For the purposes of Art 22(2), neither US nor Australian revenue law defines whether or not a gain from sources in the US has been made, only whether such a gain is taxable in the respective jurisdictions.
10. What, as used in Art 22(2), does “in respect of” mean?
11. As a matter of ordinary English, “in respect of” means regarding, relating or referring to: *Oxford English Dictionary*, Online Edition, meaning P2a(b) of “respect”, as used in the phrase, “in respect of”. It connotes a relevant connection but not necessarily absolute precision in application or association.
12. It was in this sense and in a materially similar context that the meaning of the phrase was understood in ***Duckering v Gollan***,both by the Court of Appeal [1964] 1 WLR 1178 and, on further appeal, by the House of Lords [1965] 1 WLR 680. In the Court of Appeal, Lord Denning MR, with whom Danckwerts and Diplock LJJ agreed, with reference to an analogue of Art 22(2) in the then United Kingdom-New Zealand Double Taxation Agreement, observed at 1184:

It seems to me that [the article in the agreement] is dealing with the chargeable income, that is, the income assessable in respect of any year. It is not referring to the measure by which it is computed.

The point was even more explicitly made by Lord Donovan (with whom the other members of the House sitting agreed) in relation to the meaning of “in respect of” on the dismissal of the appeal to the House of Lords. His Lordship stated at 690-691:

As regards the “natural meaning” of the expression now under construction I would not dispute that the man in the street may regard himself as paying income tax “in respect of” his income of the previous year; but this is hardly an interpretation which can be preferred to that which is already well established in law, namely, that one pays income tax “in respect of” the income of the year of assessment for which the tax was granted by Parliament. As regards the assertion that anomalies will follow from acceptance of the respondent's interpretation, I think one must remember that any scheme designed to give relief in one country from income tax suffered in another on the same income for the same or a corresponding period is productive of many difficulties, not all of which can be perceived and provided against in advance. The disputes which have come before the court in this connection amply bear this out. In these circumstances, anomalies cannot be treated as a satisfactory guide in matters of construction, though no doubt there are cases where they may turn the scale. The present is not such a case, and the courts can here do no more than look at the language used and give it a fair and reasonable construction.

1. *Duckering v Gollan* was one of the cases relied upon by Mr Burton in support of his submission that both US and Australian tax were payable “in respect of” the same gain. As a matter of construction, he submitted that each tax was payable “in respect of” the whole of each gain. In amplification of that submission, Mr Burton put that there was an analogy to be drawn with these observations made by Fullagar J (with whom Dixon CJ agreed) in ***Mutual Life*** *and Citizens’ Assurance Co Ltd v Commissioner of Taxation* (1959) 100 CLR 537, at 550 and 554:

at 550 -

If you impose a tax on 𝑎/𝑏 of *x*, you are taxing *x*, and, if *x* includes *y*, you are taxing *y*. In other words, as my brother *Menzies* put it during argument, if you impose a tax on 10 per cent of an amount which includes several items, then you are imposing a tax on every item which is included in that amount.

at 554 -

… no income can be regarded as exempt from income tax either if it is required to enter into the calculation directly as itself a part of the assessable income, or even if, though it is excluded from the actual calculation of assessable income, the rate of tax is increased by reference to its existence.

1. The point presently of interest is not precisely the same as the example mentioned in *Mutual Life* by Fullagar J. Here, *x*, each “gain”, included *y*, the discount capital gain, the latter a construct solely for the purposes of Australian taxation law. Under Australian taxation law, the *measure* or *mechanism* by which Australian tax payable was computed included a 50% discount but that does not detract from a conclusion that the Australian tax was nonetheless payable “in respect of” *x,* the gain as a whole. That, in my view, is the point made as to “in respect of” in *Duckering v Gollan*.
2. In *Commissioner of Inland Revenue v* ***Lin*** [2018] NZCA 38 (leave to appeal subsequently refused, qv *Lin v Commissioner of Inland Revenue* [2018] NZSC 54), a case to which attention was directed in the course of submissions, New Zealand’s Court of Appeal, in construing an analogue of Art 22 found in the then New Zealand – China Double Taxation Agreement, made, at [29] – [30], these observations in relation to the meaning of “in respect of” in the article concerned:

The phrase “in respect of” is amorphous and can lead to linguistic uncertainty and confusion. It is often used where one word would more accurately convey its meaning and purpose. The phrase is used in three separate places in [the article concerned]. Mr Clews [counsel for the taxpayer, Lin] accepts the logic of consistency, of giving the same phrase the same meaning wherever it is used in the same provision. He accepts also that where the phrase “in respect of” is used in the second place (“tax paid in respect of the profits”) and the third place (“tax payable in respect of that income”) its meaning is synonymous with “on”. The phrase refers to tax paid *on* profits out of which a dividend is paid to the New Zealand resident; and to tax payable by the New Zealand resident *on* that income — that is, the “income derived by [a New Zealand resident”] from sources in ... China”.

We are satisfied that the phrase “in respect of” is used synonymously with “on” in all three places in [the article concerned]. Its meaning should be consistent throughout.

[Emphasis in original]

1. It is not apparent either from the judgment of the Court of Appeal, or on the subsequent, unsuccessful, leave application in the Supreme Court, that either court’s attention was drawn to *Duckering v Gollan*. However that may be, “in respect of” is used but twice in Art 22(2) of the Convention, in each instance in the first sentence. In contrast, it is the word “on” which is used in the second sentence of Art 22(2), “The credit shall not exceed the amount of Australian tax payable *on* the income or any class thereof or *on* income from sources outside Australia” (emphasis added). So the meaning, “on” discerned in *Lin* for “in respect of” does have some contextual support in Art 22(2). It does appear that “in respect of” and “on” are being used synonymously in Art 22(2). The order of use in Art 22(2) rather suggests that “in respect of” is predominant, with “on” carrying the ordinary meaning of “in respect of”, set out above and as adopted in *Duckering v Gollan*. But even if this is not so, it does not strain language to regard Australian tax as payable “on” the “gain”. Further and in any event, the second sentence is prescriptive of the maximum amount of the credit, not what it is payable “in respect of”. That is set out in the first sentence of Art 22(2) of the Convention, which describes the general intention of the State Parties. So an alternative and synonymous way to construe “on” in the second sentence of Art 22(2) is that it means “in respect of”. I do not regard *Lin* as an authority fatal to Mr Burton’s submission as to the meaning to give “in respect of”.
2. What is clear, in my view, is that neither “in respect of” nor “on” carries the meaning, “to the extent to which”. Yet that is the meaning adopted by the Commissioner is his “apportionment” approach.
3. Another case relied upon by Mr Burton is *Revenue and Customs Commissioners v* ***Anson*** [2015] 4 All ER 288. Mr Burton cited *Anson* for the following observation made by Lord Reed SCJ (with whom Lord Neuberger P and Lords Clarke, Sumption and Carnworth SCJJ agreed) at [114]:

The words ‘the same’ are ordinary English words. It should however be borne in mind that a degree of pragmatism in their application may be necessary in some circumstances if the object of the Convention is to be achieved, for example where differences between UK and foreign accounting and tax rules prevent a precise matching of the income by reference to which tax is computed in the two jurisdictions. It appears that some potential difficulties of this kind are in practice avoided by the Commissioners’ accepting that the profits on which foreign tax is computed and in respect of which relief can be claimed are not confined to those arising under UK tax principles in individual UK chargeable periods: see *Munro, UK Tax Treaties* (2013), para 4.26.

1. That observation was made in relation to another analogue of the present Art 22(2), Art 23(2)(a) of the double taxation agreement between the US and the United Kingdom. As is apparent even from Lord Reed’s observation, the treaty article under consideration in *Anson* explicitly used the words, “the same”. Article 22(2) does not explicitly do that. But that is the sense and effect of the use of the definite article, “the” in Art 22(2) to govern “income”. So, the reliance by Mr Burton on the quoted observation was not, in my view, misplaced. Lord Reed’s counselling in *Anson* of a “degree of pragmatism in their application” is akin, in my respectful view, to what Lord Donovan had earlier counselled in the House of Lords in *Duckering v Gollan* namely, the affording of “a fair and reasonable construction” to an instrument intended to afford relief from double taxation. *Duckering v Gollan* and *Anson* each offer illustrations of how to resolve a case where the State Parties to a double taxation agreement have reached common ground as evidenced by a provision akin to Art 22(2) of the Convention for providing relief from double taxation and the allowance of foreign tax credits in circumstances where each State Party has a different measure of taxation. That is this case. A conclusion that, in each jurisdiction and for the purposes of Art 22(2) of the Convention, tax is payable “in respect of” the whole of the gain better accords with the counselling as to their resolution evident in these cases than the Commissioner’s “apportionment” approach. As with Her Majesty’s Revenue and Customs Commissioners in *Anson*, the Commissioner has succumbed to vice of viewing the construction and application of an international agreement approved by State Parties through the false prism of language in legislation approved by the parliament of but one of those State Parties.
2. *Anson* has other relevance in the resolution of the present appeal, in my view. It is also noteworthy for the affirmation by Lord Reed, at [110] – [111] of the approach in the United Kingdom to the construction of double taxation agreements:

Article 31(1) of the Vienna Convention requires a treaty to be interpreted ‘in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose’. It is accordingly the ordinary (contextual) meaning which is relevant. As Robert Walker J observed at first instance in *Memec* [1996] STC 1336 at 1349, 71 TC 77 at 93, a treaty should be construed in a manner which is ‘international, not exclusively English’.

That approach reflects the fact that a treaty is a text agreed upon by negotiation between the contracting governments. The terms of the 1975 Convention reflect the intentions of the US as much as those of the UK. They are intended to impose reciprocal obligations, as the background to the UK/US agreements from 1945 onwards makes clear. The terms of art 23(2), in particular, broadly reciprocate those of art 23(1), and are important to businesses in the US as well as to the UK investors who may receive dividends or other income from them. In that context, one would be predisposed to favour an interpretation which reflected the ordinary meaning of the words used and the object of the Convention. This is indeed a point which has been repeatedly made, in other cases concerned with the construction of the UK/US double taxation conventions, in the face of narrow and technical constructions: see, for example, *Lord Strathalmond v IRC* [1972] 3 AII ER 715 at 721, (1972) 48 TC 537 at 544-545, and *IRC v Commerzbank AG*, *IRC v Banco do Brasil SA* [1990] STC 285 at 303, 63 TC 218 at 242.

The approach described by Lord Reed is completely congruent with the observations made in *Thiel*. In particular, “narrow and technical constructions” are to be deprecated. Mr Burton’s contended construction of the meaning to give “in respect of” is neither “narrow” nor “technical”.

1. *Anson* has yet further utility for present purposes, in my view. As with the double taxation agreement considered in that case, the Convention, in Art 3(2), provides:
2. As regards the application of this Convention by one of the Contracting States, any term not defined herein shall, unless the context otherwise requires, have the meaning which it has under the laws of that State relating to the taxes to which this Convention applies.

In *Anson*, the equivalent article was said by the Commissioners to mean that it was necessary to determine the source of the income taxed in each jurisdiction in accordance with UK tax law. That submission was rejected (at [98]) on the basis that it was inconsistent with the context in which the word “sources” was used in the equivalent of Art 22 of the Convention. By parity of reasoning, the meaning of “income” (for which, read “gain”) referred to in Art 22(2) cannot, in context, be dictated for the purposes of the Convention by Australian taxation law, any more than it can be dictated by US taxation law. Regard to Art 13(1) of the Convention discloses that income or gains, “derived by a resident of one of the Contracting States from the alienation or disposition of real property situated in the other Contracting State may be taxed in that other State”. In turn, Art 13(2) supplies definitions of “real property” and “real property situated in the other Contracting State”. Thus, the Convention does not leave to domestic law what constitutes a gain from the alienation of real property. “Gain” just has the meaning as the word is ordinarily understood. Materially, the domestic taxation law of each State Party becomes relevant only in the determination of whether, under that law, tax is payable “in respect of” such a “gain”.

1. Such a construction of Art 22(2) is, as Mr Burton submitted, supported by the understanding of the Organisation for Economic Co-operation and Development (**OECD**) as to what constitutes “double taxation” - “the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter”: OECD, Model Tax Convention on Income and on Capital (OECD, Paris, 2017), Introduction, 9, [1] (unaltered since before Protocol to the Australia-US Convention was agreed in 2001, see e.g. 1995 Model Tax Convention). The Convention closely follows the OECD model of the day. *Thiel* exemplifies the appropriateness of reference to an OECD commentary for assistance in the construction of a double taxation agreement. The assistance which I derive is confirmatory of a construction which does not delimit “gain” by the taxation mechanism of either Australia or the US. It is both necessary and sufficient if the subject matter, a gain as ordinarily understood has been derived from a source in the US.
2. This same understanding is evident in a pithy statement made by Professor Rebecca Kysar of Fordham Law School in her recent, illuminating, article “Double taxation occurs when more than one country lays claim to taxing an item of income”: Rebecca M Kysar, *Unraveling the Tax Treaty*, 104 Minnesota Law Review (forthcoming, 2020). A preliminary draft of this paper was the subject of a presentation by Professor Kysar at New York University’s Law School Tax Policy Colloquium, Vanderbilt Hall, 29 January 2019, and is cited by me with the author’s permission. The sentence quoted appears at 6 of that draft (I refer hereafter to the paper as “Kysar”).
3. What Professor Kysar terms “item of income” the OECD terms the “same subject matter”. In neither, in my view, is the level of abstraction of understanding delineated by domestic revenue law. The “laying claim” is so delineated but that is for the different purpose of ascertaining whether tax is payable “in respect of” that subject matter or item, here the gain derived from a source in the US.
4. Professor Kysar comprehensively and persuasively argues that the merits of adherence to a double taxation agreement regime as exemplified by the Convention may be moot from a tax policy perspective in the 21st century by comparison with their rationale as postulated almost a century ago in economists’ views which informed initial League of Nations’ drafted model double taxation agreements. These models continue to inform the contents of double taxation agreements such as the Convention. But this case is concerned not with the fiscal merits of high tax policy and probably also foreign relations and trade choices by State Parties but rather with the meaning and effect of a particular policy choice by Australia and the United States as found in the Convention and implemented into Australian domestic law by the International Tax Agreements Act. In relation to the exercise of Australian judicial power in the determination of Mr Burton’s challenge to the amended assessments, it is nothing to the point that the Convention might perhaps be thought by some to be disadvantageous to Australia in relation to a gain derived by an Australian resident from a source in the US, because of the differing ways in which US and Australian taxation laws bring to tax such a gain. If, on the true construction of the Convention, Australia is obliged to allow a credit of the full amount of US tax paid by Mr Burton and that result is considered by Australia to be overly generous, then it is for the Australian Executive to endeavour to renegotiate or withdraw from the Convention and to persuade the Australian Parliament to amend the International Tax Agreements Act. It is not for the Australian judiciary to adopt a meaning of, materially, Art 22(2) which it cannot bear on the basis of some apprehended Australian fiscal disadvantage.
5. For completeness and in fairness, I should record that Professor Kysar also opines at 13:

Treaties also do not resolve conflicts of characterization, again leaving a significant amount of double taxation in place. This is because the treaties defer to the domestic rules to assign character of income.

[Footnote reference omitted]

Insofar as judicial authority is directly cited for this proposition, reference (Kysar, 13, fn 57) is made to the US Tax Court case, *Boulez v. Commissioner* 83 T.C. 584 (1984). With respect, on my reading of that case, while the court did refer to US authority in relation to the ownership of property generating royalty income, the court also stated at 593, “the treaty embodies the same fundamental concept of ownership”. US domestic tax law was used not to the exclusion of the treaty’s meaning but rather as a convenient way of explaining a concept expressed in no different way by the treaty. The last sentence of Art 22(2), “Subject to these general principles, the credit shall be in accordance with the provisions and subject to the limitations of the law of Australia as that law may be in force from time to time” does defer to Australian taxation law in relation to the calculation and allowance of the foreign tax credit, but that is subject of the general principles found in the preceding part of Art 22(2). It is not a means by which, contrary to the general principles in Art 22(2) already discussed, an “apportionment” approach may permissibly be adopted by the Commissioner so as but partially to allow a foreign tax credit.

1. The foregoing takes up and expands upon Mr Burton’s submissions. It follows that I respectfully disagree with the following conclusion of the learned primary judge at [126]:

Under Australian law, the only income forming part of the assessable income is 50% of the capital gain on which tax is paid in the US. Where Art 22(2) refers to Australian tax payable in respect of income, the income is only 50% of the capital gain.

1. This approach, which reflects the Commissioner’s position, impermissibly conflates, in my view, the mechanism for the computation of Australian taxation with the more general question of whether such taxation is “in respect of” “the gain”.
2. I also respectfully disagree with his Honour’s further observation (at [127]) that, “The Article does not suggest that a credit is allowed against Australian tax payable for the whole amount of the US tax paid.” What Art 22(2) states is that a credit is to be allowed for “United States tax paid under the law of the United States … in respect of income [a “gain”] derived from sources in the United States”. For the reasons given above, Mr Burton paid the whole of the US tax “in respect of” the gains. That is the amount of the foreign tax credit. An error in his Honour’s statement is in the understanding of the effect in context of “in respect of”. A further error is that, in effect, such a construction rewrites Art 22(2) so that it obliges the allowance of a credit only of so much of the gain as constitutes a discount capital gain for Australian taxation law purposes. That construction is more than the text, read in context, can bear.
3. Necessarily, this means that Mr Burton’s appeal ought to be allowed.
4. This result must follow, irrespective of whether Mr Burton is also entitled to an equivalent foreign tax offset pursuant to Div 770 of the 1997 Act. That is because the International Agreements Act makes the convention prevail to the extent of any inconsistency.
5. After the close of oral submissions, it was thought appropriate by the Court to extend to the parties an opportunity to make supplementary written submissions directed to the contingency that Mr Burton might succeed under Art 22(2), as applied by the International Tax Agreements Act but fail under Div 770 with the question then being as to how, lawfully, the resultant foreign tax credits were to be allowed and accounted for under Australian revenue law. Each of the parties availed themselves of that opportunity. The following reflects the result of my consideration of their supplementary submissions.
6. As noted above, the paramountcy afforded Art 22(2) and the other articles in the Convention is only to the extent of inconsistency with the provisions contained in the 1997 Act or the 1936 Act (other than Part IVA of the 1936 Act). As with the meaning to give to “in respect of”, the approach to be adopted in relation to the allowing of the credit dictated by Art 22(2) must be informed by the same approach as that counselled by Lord Donovan in *Duckering v Gollan* in the passage excerpted above so as to prefer constructions which avoid, to the extent to which language of provisions reasonably admits, inevitable anomalies and difficulties. Mr Burton cannot receive both the full credit under Art 22(2) *and* the foreign income tax offset to which the Commissioner accepts he is entitled under Div 770 of the 1997 Act. The paramountcy afforded to the credit which must be allowed by virtue of Art 22(2) is only to the extent of inconsistency. It is the excess above the conceded foreign income tax credit which he must be allowed (but not so as to exceed the amount of Australian tax payable on the gain). So I accept the Commissioner’s submission that, if Mr Burton succeeds on his Art 22(2)-based grounds, it would be necessary to account for any foreign income tax offset otherwise supplied by s 770-10 of the 1997 Act. I also accept the Commissioner’s submission that s 16 of the International Tax Agreements Act does not provide for a rebate in circumstances such as the present.
7. By virtue of the International Tax Agreements Act, the effect of Article 22(2) is to require that Mr Burton be allowed the tax credit “in accordance with the provisions and subject to the limitations of the law of Australia as that law may be in force from time to time”. For present purposes, that means that the consequence of the allowing of his appeal and the consequential setting aside of the objection decision must be given effect by the Commissioner in the usual way by his making the requisite amended assessments so as to give effect to the basis upon which the appeal has been allowed.
8. I turn then to consider the meaning and effect of Div 770 of the 1997 Act.

## Division 770 of the 1997 Act

1. It does not at all follow that the conclusions reached in relation to Art 22(2) of the Convention dictate that Mr Burton is also entitled to a tax offset for the whole of the US tax which he has paid. The text of the entitlement provision in the 1997 Act, s 770-10, is different. So, too, is the context in which that text appears. It is that statutory text, read in that statutory context and with regard to the evident purpose of that statutory provision, not that of the Convention, which is determinative of entitlement. This approach is dictated by *Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503 at 519, [39]. *Thiel* is not a relevant authority for the purposes of the construction of s 770-10.
2. Further, the construction of the text of s 770-10 ought not to be approached with any *a priori* assumption as to its meaning derived from the Convention, any other double taxation agreement or any OECD commentary in relation to any model double taxation agreement.
3. Yet further, while at a general level of abstraction, it may readily be accepted, as Mr Burton submitted, that the purpose of Div 770 is to offer relief from double taxation, that Division’s object section, s 770-5 specifies the circumstances “where” it is intended to grant that relief.
4. Read in context, the text of s 770-10 is, in my view, fatal to the success of the alternative foundation of Mr Burton’s appeal, grounds 1 to 4 of which challenge the correctness of the conclusion adverse to him reached by the learned primary judge in relation to the allowance of foreign tax offsets under s 770-10 of the 1997 Act. An amount of foreign tax paid only counts towards a tax offset if it was paid “in respect of an amount that is all or part of an amount included in your assessable income for the year”.
5. Mr Burton submitted, relying upon *Duckering v Gollan* and *Anson*, that the meaning to afford to “in respect of” was the same as that discerned above in relation to its use in Art 22(2) of the Convention by reference to its ordinary meaning and such authorities. Reading it in context, I accept that the use of that phrase in s 770-10 is sufficiently similar to its use in a double taxation provision such as Art 22(2) of the Convention to make relevant by analogy that understanding as to its meaning found. So all that is needed is a relevant connection. But the connection must be with “an amount that is all or part of an amount included in your assessable income for the year”, not with ‘all or part of an amount that is all or part of an amount included in your assessable income for the year’.
6. Section 770-10 looks to “an amount that is all or part of an amount included in your assessable income for the year”. The term “assessable income” is defined in s 995-1 of the 1997 Act, which is not the same as “income” as understood for the purposes of the Convention. As defined in the 1997 Act, assessable income includes “ordinary income” (s 6-5) and, materially, what is termed “statutory income” (s 6-10). One form of statutory income included in assessable income is a net capital gain included pursuant to s 102-5(1) of the 1997 Act. As a matter of ordinary language flowing from the text of s 770-10 and, in turn, s 102-5(1), it is only the net capital gain which is, in each instance, included in Mr Burton’s assessable income. Regard to ss 6-5, 6-10 and 102-5 highlights that the phraseology “included in your assessable income” is pervasive in the 1997 Act. There is no contextual warrant for construing “included in” as extending to an amount which is used for computation of an amount that is included in assessable income. The learned primary judge (at [113] – [114]) reached just such a conclusion. That conclusion was correct, for the reasons given by his Honour.
7. Contrary to Mr Burton’s submission but adopting a submission made by the Commissioner, as a matter of ordinary language, all that s 770-10 “counts towards” the tax offset is, in the circumstances of this case, the amount of US tax paid by Mr Burton in this instance “in respect of” the net capital gain as calculated in accordance with the 1997 Act. Again as a matter of language, flowing from the text of s 770-10, the relevant connection, is with, materially, each net capital gain, as it is that amount which is included in Mr Burton’s assessable income, not with the integers which the 1997 Act prescribes for the calculation of that net capital gain. True it is that the capital gain is one such integer but that is not the connecting point.
8. That is not to say that the gains derived from sources in the US are not “brought to tax in Australia”. Mr Burton’s submission that they are is correct. That is why his Convention-based grounds have merit. Australian tax is indeed payable “in respect of” those “gains”. But the text employed in s 770-10 is “all or part of an amount included in your assessable income for the year”, not “brought to tax in Australia”. That text is not happenstance. It is congruent with other provisions in the 1997 Act; notably for present purposes, the definition of “assessable income” in the 1997 Act, ss 6-10 and 102-5(1). The Commissioner’s submission that s 770-10 should be construed accordingly is correct.
9. The statement in the “Guide”, found in s 770-1, “You may get a non‑refundable tax offset for foreign income tax paid on your assessable income” offers only limited assistance, in my view. In the 1997 Act, a “Guide” forms part of that Act but not an operative part, although s 950-150(2) of that Act permits it to be consulted for the purpose of construing an operative provision. As to the word “on”, the above discussion of the New Zealand case, *Lin*, is pertinent. The better view is that, in s 770-1, it means “in respect of”. Read literally, s 770-1 evidences a confusion of concepts in that foreign income tax is never paid on “assessable income”, the latter being an Australian, not a foreign, taxation law concept. But it is evidently cast at a high level of generality. When this and the meaning of “on” are appreciated, the use of the term “assessable income” looks to be a shorthand way of describing all amounts included in assessable income. So read, the Guide rather tends to confirm the construction of s 770-10 for which the Commissioner contended and which the learned primary judge adopted.
10. Within the statutory object provision, s 770-5, the text of s 770-5(1)(a) is much closer than that in s 770-1 to s 770-10. Again, the word “on” in both s 770-5(1)(a) and s 770-5(1)(b) looks to mean “in respect of”. Once again, the phraseology “amounts included in your assessable income”, found in s 770-5(1)(a) is not happenstance. The “same amounts” in s 770-5(1)(b) is, necessarily, a reference to the “amounts included in your assessable income” and, in context, means the net capital gain which is included, nothing more. It is true, as Mr Burton submitted, that s 770-5(1)(b) uses “the same”, whereas s 770-10 does not. But that is the sense in which the clause, “that is all or part of an amount included in your assessable income for the year”. governing “an amount” in the second sentence of s 770-10(1) is employed. The amount in respect of which foreign tax is paid has to be the same as all or part of an “amount included in your assessable income”. The object section is, in my view, congruent with s 770-10 but regard to it does not otherwise assist in the construction of s 770-10.
11. Mr Burton submitted that the construction of s 770-10 adopted by the primary judge, which I regard as correct, cannot be made to work sensibly in relation to capital losses. In support of this Mr Burton referred to the position, itself incontrovertible, that “Step 2” in the calculation of net capital gain ordained by s 102-5 of the 1997 Act requires that prior year capital losses be subtracted. This, he submitted, was incongruous, given that ordinary income and other forms of statutory income are just included in assessable income without deduction at that stage of prior year losses. But that, as the Commissioner submitted (correctly in my view), is just the result of the way in which the Australian Parliament has chosen to permit a dedication of prior year capital losses in a process that leads ultimately to an assessment of taxable income. It is to be remembered that the expressed object of Div 770 is not to relieve from double taxation in the abstract but rather “where” the circumstances stated in s 770-5 exist. According to that object, there is nothing about the construction of s 770-10 adopted by the primary judge which does not work sensibly. The inadequacy in Div 770 may well be in its object, especially when one has regard to broader statements such as that of the OECD as to the object of providing relief from double taxation. Viewed by reference to those broader objectives, it does seem incongruous that a prior year’s losses might reduce or even eliminate for foreign tax offset purposes any amount on (“in respect of”) which foreign tax has been paid. But the removal of any such incongruity is a matter for Parliament. As it happens, in the circumstances of the present case, prior year losses have no effect on the allowance of foreign tax credits, via Art 22(2) of the Convention, so the asserted incongruity is, in any event, academic.
12. Mr Burton also reiterated a submission made before but rejected by the primary judge that there was a tension between the construction of s 770-10 ultimately adopted by his Honour and s 121EG(3A) of the 1936 Act, which provides:

(3A) Subject to section 121EH, this Act applies to an OBU as if only the eligible fraction of each amount of foreign income tax (within the meaning of the *Income Tax Assessment Act 1997* ) the OBU paid in respect of an amount of assessable OB income had been paid in respect of that income.

1. “OBU” is a reference to Offshore Banking Unit. This particular provision would, so the submission went, be redundant if his Honour’s construction of s 770-10 were correct. The answer to this is that given by his Honour (at [86] and [87]). Division 9A of Part III of the 1936 Act is a discrete code directed to Offshore Banking Units as defined and of different origins to Div 770 of the 1997 Act. Such resultant redundancy, if any, as there may be to s 121EG(3A) of the 1936 Act is no reason at all not to afford the text of s 770-10 a meaning which, in my view, is plain.
2. For completeness, I add the following. Although notes to sections in the 1997 Act do not have operative effect, the construction of s 770-10 promoted by the Commissioner and adopted by the primary judge is consistent with Note 2 to that section. That does provide additional support for why that construction is correct. Though I have consulted the same, I have not found the Explanatory Memorandum to be of any particular assistance.

## Summary and Disposition

1. For the above reasons, Mr Burton has succeeded in demonstrating error on the part of the learned primary judge insofar as he has relied upon Art 22(2) of the Convention, as applied by the International Agreements Act. He has failed insofar as he further or alternatively alleged error in the construction and application of s 770-10 of the 1997 Act. The orders should therefore be as indicated by me at the conclusion of discussing the case based on Art 22(2).

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| --- |
| I certify that the preceding ninety-five (95) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Logan. |

Associate:

Dated: 22 August 2019

REASONS FOR JUDGMENT

STEWARD J:

1. In this appeal, Mr Burton (the “taxpayer”), a resident of Australia, has claimed the benefit of a foreign income tax offset (“FITO”) in respect of all of the income tax paid in the United States on the proceeds of the sale of certain assets in that country. In general terms, a FITO is a tax offset that reduces the amount of income tax that is payable in Australia (s 4-10(3) of the *Income Tax Assessment Act 1997* (Cth) (the “1997 Act”)). It was not disputed that the assets here were held on capital account for Australian income tax purposes and that CGT event A1 (s 104-10 of the 1997 Act) occurred when they were sold. Because the taxpayer is an individual, the gains made received concessional treatment; only 50% of the gain formed part of the calculation of the taxpayer’s net capital gain for the purposes of ss 102-5 and 115-215 of Pt 3‑1 of the 1997 Act. Mr Burton’s assessable income included that net capital gain.
2. The respondent (the “Commissioner”) contends that the taxpayer is not entitled to claim a FITO in respect of *all* the tax paid in the United States; he contends that the taxpayer is only entitled to a FITO in respect of that part of the United States tax paid (“US tax paid”) on the gain which was brought to account as assessable income by s 102-5 (that is, 50% of the net gain). The taxpayer disagrees. He submits that he is *also* entitled to a FITO for the US tax paid on that part of the gain which is not taxed in Australia.

## Background

1. The facts were not in dispute. They are set out more fulsomely in the reasons of the learned primary judge which I gratefully adopt. Mr Burton was the trustee of an Australian discretionary trust. He was also a beneficiary of that trust. In the years of income in dispute (the years ended 30 June 2011 and 30 June 2012), he was presently entitled to all of the discount gains arising from the sale of the applicable assets for the purposes of s 97 of the *Income Tax Assessment Act 1936* (Cth) (the “1936 Act”). Subject to the operation of s 115-215 of the 1997 Act (explained below), he was thus initially required to include in his assessable income that share of the net income of the trust as calculated in accordance with s 95 of the 1936 Act.
2. It is only necessary to describe one of the transactions which is the subject of this appeal because it sufficiently raises the issues for determination. In 2010, Mr Burton, in his capacity as trustee, held certain interests in respect of oil and gas wells in Pennsylvania (the “Nepa Investment”). These were sold on 18 September 2010 to Chesapeake Energy Corporation. The consideration, payable in five instalments, was US$25,434,715. For the purposes of the United States Internal Revenue Code the taxpayer was liable to pay, and did pay, tax at the rate of 15% (instead of the usual rate of 35%) on the long-term capital gain he had made. For the year ended 31 December 2010, in respect of the instalments paid in that year that gain was calculated to be US$8,985,565. The US tax paid was US$1,347,834. For the year ended 31 December 2011, the gain was calculated to be US$14,584,795. The US tax paid was US$2,187,720. The total US tax paid over the period was US$3,535,554.
3. For Australian tax purposes, it was not disputed that CGT event A1 (s 104-10 of the 1997 Act) occurred when the Nepa Investment was sold. For the year ended 30 June 2011, the capital proceeds from the sale of the Nepa Investment was calculated to be A$25,322,008 (the Australian dollar equivalent of US$25,434,715). The cost base was calculated to be A$2,567,687. The resulting capital gain was A$22,754,321. However, this gain was required to be reduced by 50% by s 115-25 of the 1997 Act. This left A$11,366,161. Mr Burton paid Australian tax on that amount of A$5,114,772. He claimed a FITO for the full amount of tax paid in the United States of US$3,535,554 (being A$3,414,207), and in this way reduced his tax liability by this sum.
4. The Commissioner contends that only 50% of the amount of US tax paid should count towards a FITO because only 50% of the net gain was included in the assessable income of the taxpayer in Australia.
5. It should be noted that at the time the assets were disposed of here, there were and remain complex provisions contained in Pt 3-1 of the 1997 Act that deemed the beneficiary of a trust, in certain circumstances, to be the taxpayer that made the capital gain instead of the trust estate: s 115‑215. The operation of similar predecessor provisions was explained by the Full Federal Court in *Federal Commissioner of Taxation v Greenhatch* (2012) 203 FCR 134. The parties agreed that those provisions applied to the taxpayer, and that we should proceed on the basis that it was the taxpayer, and not the trust estate, that incurred the various instances of CGT event A1. In other words, the 1997 Act treated Mr Burton as if he, in his personal capacity, sold the Nepa Investment (and the other assets sold). Accordingly, what was ultimately included in his assessable income was not his share of the net income of the trust attributable to that gain pursuant to s 97 of the 1936 Act, but rather, a net capital gain pursuant to s 102-5 of the 1997 Act. The taxpayer did not rely upon this statutory fiction in any way as a reason for contending that he was entitled to the FITO he claimed.

## The Legislation

1. The domestic rules governing the availability of a FITO are found in Div 770 of the 1997 Act. Section 770-1 describes the content of that Division as follows:

**What this Division is about**

You may get a non-refundable tax offset for foreign income tax paid on your assessable income.

There is a limit on the amount of the tax offset.

A resident of a foreign country does not get the offset for some foreign income taxes.

You may also get the offset for foreign income tax paid on some amounts that are not taxed in Australia.

Section 770-5 describes the object of the Division as follows:

**Object**

(1) The object of this Division is to relieve double taxation where:

(a) you have paid foreign income tax on amounts included in your assessable income; and

(b) you would, apart from this Division, pay Australian income tax on the same amounts.

(2) To achieve this object, this Division gives you a tax offset to reduce or eliminate Australian income tax otherwise payable on those amounts.

(Notes omitted.)

As will be seen, this appeal concerns what it means to give relief against “double taxation”.

1. The operative provision is found in s 770-10, which is in the following terms (including the notes):

**Entitlement to foreign income tax offset**

(1) You are entitled to a \*tax offset for an income year for \*foreign income tax. An amount of foreign income tax counts towards the tax offset for the year if you paid it in respect of an amount that is all or part of an amount included in your assessable income for the year.

Note 1: The offset is for the income year in which your assessable income included an amount in respect of which you paid foreign income tax—even if you paid the foreign income tax in another income year.

Note 2: If the foreign income tax has been paid on an amount that is part non‑assessable non-exempt income and part assessable income for you for the income year, only a proportionate share of the foreign income tax (the share that corresponds to the part that is assessable income) will count towards the tax offset (excluding the operation of subsection (2)).

Note 3: For offshore banking units, the amount of foreign income tax paid in respect of offshore banking income is reduced: see subsection 121EG(3A) of the Income Tax Assessment Act 1936 .

…

The notes form part of the 1997 Act: ss 2-45 and 950-100 of the 1997 Act. They may be used to identify accurately and quickly the relevant provisions and “to help” a taxpayer “to understand” those provisions: s 2-35 of the 1997 Act.

1. Subdivision 770-B sets out the rules for determining the amount of the FITO that may be used to reduce income tax otherwise payable. Section 770-65 describes the content of this subdivision as follows:

**What this Subdivision is about**

The amount of your tax offset is based on the amount of foreign income tax you have paid.

However, there is a limit on the maximum amount of your offset. The limit is the greater of $1,000 and an amount worked out under this Subdivision. This amount is based on a comparison between your tax liability and the tax liability you would have if certain foreign-taxed and foreign-sourced income and related deductions were disregarded.

You may choose to use the limit of $1,000 and not work out this amount.

There is an increase in the limit to ensure foreign income tax paid on some amounts that are not taxed always forms part of the offset.

1. Section 770-70 provides that the “amount of your tax offset for the year is the sum of the foreign income tax paid that counts towards the offset for the year.”
2. Section 770-75 sets out the limits on the amount of the offset that may be applied. It was not in issue and need not be reproduced.
3. Division 770 was introduced into the 1997 Act in 2007 replacing the former foreign tax credit rules contained in Div 18 of Part III of the 1936 Act. As originally enacted by *Taxation Laws Amendment (Foreign Tax Credits) Act 1986* (Cth), former s 160AF(1) provided:

Where —

(a) the assessable income of a year of income of a resident taxpayer includes foreign income; and

(b) the taxpayer has paid foreign tax in respect of the foreign income, being tax for which the taxpayer was personally liable,

the taxpayer is, subject to this Act, entitled to a credit of —

(c) the amount of that foreign tax, reduced in accordance with any relief available to the taxpayer under the law relating to that tax; or

(d) the amount of Australian tax payable in respect of the foreign income,

whichever is the less.

1. Something should next be said about the operation of Pt 3-1 of the 1997 Act, which is headed “Capital Gains and Losses: General Topics”. Australia does not separately tax capital gains made from the sale of a capital asset. Rather, it includes in the assessable income of a taxpayer, as an item of statutory income, a net figure, being a net capital gain, which is the product of a calculation mandated by s 102-5 of Pt 3-1. That provision is relevantly in the following terms:

**Assessable income includes net capital gain**

(1) Your *assessable income includes your net capital gain (if any) for the income year*. You work out your ***net capital gain*** in this way:

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| *Working out your net capital gain* Step 1. Reduce the \*capital gains you made during the income year by the \*capital losses (if any) you made during the income year. Note 1: You choose the order in which you reduce your capital gains. You have a net capital loss for the income year if your capital losses exceed your capital gains: see section 102-10. Note 2: Some provisions of this Act (such as Divisions 104 and 118) permit or require you to disregard certain capital gains or losses when working out your net capital gain. Subdivision 152-B permits you, in some circumstances, to disregard a capital gain on an asset you held for at least 15 years.Step 2. Apply any previously unapplied \*net capital losses from earlier income years to reduce the amounts (if any) remaining after the reduction of \*capital gains under step 1 (including any capital gains not reduced under that step because the \*capital losses were less than the total of your capital gains). Note 1: Section 102-15 explains how to apply net capital losses. Note 2: You choose the order in which you reduce the amounts. Step 3. Reduce by the \*discount percentage each amount of a \*discount capital gain remaining after step 2 (if any). Note: Only some entities can have discount capital gains, and only if they have capital gains from CGT assets acquired at least a year before making the gains. See Division 115. Step 4. If any of your \*capital gains (whether or not they are \*discount capital gains) qualify for any of the small business concessions in Subdivisions 152-C, 152‑D and 152-E, apply those concessions to each capital gain as provided for in those Subdivisions. Note 1: The basic conditions for getting these concessions are in Subdivision 152-A. Note 2: Subdivision 152-C does not apply to CGT events J2, J5 and J6. In addition, Subdivision 152-E does not apply to CGT events J5 and J6. Step 5. Add up the amounts of \*capital gains (if any) remaining after step 4. The sum is your ***net capital gain*** for the income year. |

(Emphasis added.)

Step 3 is in issue in this proceeding. When it applies it reduces the “amount” of a discount capital gain before that gain is included in the assessable income of a taxpayer. Subdivision 115-A sets out rules for the determination of what is a discount capital gain. Relevantly, a discount capital gain is one made by an individual (s 115-10). Subdivision 115‑B contains rules for determining the discount percentage. Relevantly, where the discount capital gain is made by an individual, the discount percentage is 50% (s 115-100).

1. In my view, the effect of applying the discount percentage to an amount of a capital gain, is to exclude an amount of that gain from inclusion in a taxpayer’s assessable income. The concept of what is included in a taxpayer’s assessable income is a critical feature of the 1997 and 1936 Acts. It forms a vital part of the formula for determining the taxable income upon which tax is payable. Section 4-15(1) of the 1997 Act provides:

Work out your ***taxable income*** for the income year like this:

Taxable income = Assessable income – Deductions

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| --- |
| *Method statement*Step 1. Add up all assessable income for the income year.To find out about your assessable income, see Division 6.Step 2. Add up your deductions for the income year.To find out what you can deduct, see Division 8.Step 3. Subtract your deductions from your assessable income (unless they exceed it). The result is your taxable income. (If the deductions equal or exceed the assessable income, you don’t have a taxable income.) |

Note: If the deductions exceed the assessable income, you may have a tax loss which you may be able to utilise in that or a later income year: see Division 36.

1. Division 6 of the 1997 Act sets out rules for determining a taxpayer’s assessable income. The language used is that of inclusion; the Division specifies what is in and what is out. Assessable income “includes” ordinary income (s 6-5) and statutory income (s 6-10). Pursuant to s 6‑15(1), if an amount is not ordinary income, and is not statutory income, it is not assessable income. Pursuant to s 6-15(2), exempt income (as defined) is not assessable income. Pursuant to s 6‑15(3), non-assessable non-exempt income (as defined) is not assessable income. As we shall see, s 770‑10 (the operative provision in Div 770) also adopts this nomenclature. It refers to an amount “included” in assessable income.
2. Here, it was not suggested that the amount of the net proceeds of sale excluded by step 3 of s 102-5 was non-assessable non-exempt income or exempt income. However, it was also not said to be ordinary income and it was not statutory income. As such it was not assessable income. In contrast, all of the net proceeds of sale were taxed in the US (albeit at, in some cases, at a concessional rate).

## The Convention

1. The taxpayer claimed an entitlement to a FITO pursuant to s 770-10. But he also relied, in the alternative, upon Art 22(2) of the *Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, signed on 6 August 1982, [1983] ATS 16 (entered into force on 31 October 1983) as amended (the “Treaty”). The Treaty has the force of domestic law by reason of s 5 of the *International Tax Agreements Act 1953* (Cth) (the “Agreements Act”). As such, it may possibly be invoked in certain cases by a taxpayer as, what is sometimes called, a “shield” when tax is imposed inconsistently with Australia’s obligations under the Treaty. The “shield” arises from the fact that the Treaty allocates taxing powers between nations and then from the enactment of that allocation into domestic law. As the Full Court of this Court observed in *Commissioner of Taxation v Lamesa Holdings BV* (1997) 77 FCR 597 at 600-601 in relation to the *Agreement between Australia and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, and Protocol,* signed on 17 March 1976, [1976] ATS 24 (entered into force on 27 September 1976):

The Agreement is an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. Although, therefore, the Agreement has this dual object, the Agreement substantially concerns allocation of taxing power.

Thus, as will be seen, the agreement allocates to the State, where business is carried on or through a permanent establishment, the right to tax business profits of that State (Art 7). It allocates to the country of residence the power to tax aircraft and ship profits (Art 8). Sometimes, as with Arts 7 and 8, the power allocated to the jurisdiction named is exclusive. Sometimes, as is the case with interest, both jurisdictions may tax but with a nominated limit of 10 per cent in one (Art 11). The allocation is of the right to tax. There is nothing in the Agreement which compels a jurisdiction to exercise that right. Australia, for example, does not tax “exempt income”, although such income could fall within the business profits Article.

1. Article 22 of the Treaty is headed “Relief from double taxation”. It is not concerned with the allocation of taxing power. Rather, at least in the case of Art 22(2), it operates on the assumption that *each* sovereign nation has validly imposed tax on the same amount, thus giving rise to the need for relief. Article 22(2) provides as follows:

Subject to paragraph (4), United States tax paid under the law of the United States and in accordance with this Convention, other than United States tax imposed in accordance with paragraph (3) of Article 1 (Personal Scope) solely by reason of citizenship or by reason of an election by an individual under United States domestic law to be taxed as a resident of the United States, in respect of income derived from sources in the United States by a person who, under Australian law relating to Australian tax, is a resident of Australia shall be allowed as a credit against Australian tax payable in respect of the income. The credit shall not exceed the amount of Australian tax payable on the income or any class thereof or on income from sources outside Australia. Subject to these general principles, the credit shall be in accordance with the provisions and subject to the limitations of the law of Australia as that law may be in force from time to time.

Article 22(1) imposes on the United States a reciprocal obligation to allow in respect of a taxpayer in the United States, a credit for income tax paid to Australia. Article 22(3) deals with rebates on dividends paid by a United States corporation and is not in issue. Article 22(4) is also not in issue and need not be reproduced.

1. I make the following observations about the operation of Art 22(2).
2. First, the Article contains three elements. The first is an expression of a general principle about relief from double taxation (the “First General Principle”). The language used to express that principle is generic in nature, consistently with the primary function of a double tax treaty which is to allocate taxing powers and responsibilities between two sovereign powers. For that purpose, the language deployed invokes commonly held concepts to enable the allocation of taxing power to work in the context of what might be very different domestic laws relating to the taxation of income. The second is another expression of general principle, namely that there is to be a limitation on the credit to be allowed: it must not exceed the amount of Australian tax payable on the income “or any class thereof or on income from sources outside Australia” (the “Second General Principle”). The third is not an expression of general principle. It allocates to Australia a measure of freedom to determine domestically what sort of rules it may enact to allow, or not allow, foreign tax credits. That freedom or capacity is limited to the enactment of rules which are subject to, or consistent with, the First and Second General Principles.
3. That Art 22(2) expresses principles in only a generalised way is consistent with the language of Art 22(1). Article 22(1)(a) relevantly states:

(a) the United States shall allow to a resident or citizen of the United States as a credit against United States tax the appropriate amount of income tax paid to Australia; and

…

Such appropriate amount shall be based upon the amount of income tax paid to Australia …

1. Secondly, what is the content of the First General Principle? In my view, the answer to that question will be dispositive of this part of the appeal. The taxpayer submitted that the word “income” as it first appears is to a gain made, namely here the gain made from the sale of the assets in the United States (it was not in dispute that the United States had the right to tax that gain by reason of Art 13 of the Treaty which deals with “income or gains” from a disposition of “real property situated” in that country). On this basis, it was said, the word “income” when used a second time in the phrase “Australian tax payable in respect of the income” needed to be read as Australian tax payable in respect of that same gain made in the United States. That is because it refers to “*the* income”. The “general principle” thus said to be expressed by Art 22(2) was that Australia must allow a credit for all of the US tax paid on a gain when calculating the Australian tax payable on that same underlying transaction. Focusing on the subject matter of the underlying transaction, it was contended, enabled the Treaty to apply in circumstances where Australia and the United States taxed the same gain very differently. Inferentially, and for that purpose, the “gain” is a singular indivisible amount of income. Thus, here, because the taxpayer paid US tax of US$3,535,554 on the sale of the Nepa Investment it was submitted that he was entitled to a credit of this amount for Australian tax payable in respect of that sale.
2. I respectfully disagree with that statement of the First General Principle. The contention that the word “income” refers to an underlying gain is perhaps too imprecise. Moreover, there is no reason to read the word “income” as referring to one indivisible gain which is the subject matter against which competing sovereign states seek to impose tax. Nor is the reference to “income” a reference to “assessable income”, as contended for by the Commissioner. Rather, “income” should be read as a concept which is independent of, but not divorced from, the domestic income tax regimes of each sovereign power (respectively income tax imposed by the Internal Revenue Code (US) and income tax imposed under the federal law of Australia: Art 2(1)). In that respect, the very subject matter and purpose of the Treaty concerns taxes on “income”. Whilst that term is not defined, we can observe generic species of income addressed throughout the Treaty. It deals with business profits (Art 7); “income” from real property (Art 6); “profits” from shipping and air transport (Art 8); dividends (Art 10); interest (Art 11); royalties (Art 12); “income or gains” from the disposal of real property (Art 13); income from independent personal services (Art 14); income from dependent personal services (Art 15); income derived by entertainers (Art 17); pensions, annuities, alimony and child support (Art 18); wages, salaries and similar remuneration paid to an employee of a state (Art 19); and payments made to a student (Art 20). Each of these is an item of income for the purposes of the Treaty. We know this because this is what the Treaty says they are. Article 21(1) provides:

*Items of income* of a resident of one of the Contracting States, wherever arising, *not dealt with in the foregoing Articles* of this Convention shall be taxable only in that State.

(Emphasis added.)

The word “income”, where it appears in Art 22(2), should thus be read as a reference to those items of income covered by the Treaty, including those addressed in Art 21. Context does not otherwise permit giving the word “income” its meaning under domestic Australian law: cf Art 3(2).

1. Thirdly, the language of Art 22(2), is not confined to a simple comparison of the tax paid in different countries on the same underlying transaction. In each case, the word “income” must bear a nexus, expressed by the words “in respect of”, with US “tax paid” and “Australian tax payable”. That directs attention to how each taxing regime taxes that income. The mistake which the taxpayer makes here is to commence its consideration of Art 22(2) with the identification of all of the US tax paid on the underlying gain. But because the purpose of Art 22(2) is the allowance by Australia of a credit against tax payable, in my view, the starting point must be the identification of what income Australia taxes. Because of the operation of the CGT 50% discount for individuals, Australia does not tax all of the gain made here; it taxes 50% of it (leaving aside the effect of any offsetting capital losses). That is the income, for Art 22(2) purposes, in respect of which Australian tax is payable. The question which then must be answered is what was the US “tax paid … in respect of” that income. In my view, only half of the US tax paid can be said to be in respect of the income taxed in Australia. In other words, the applicable general principle expressed in the first element of Art 22(2) is that US tax paid on income the subject of Australian tax shall be allowable as a credit against the Australian tax paid on that income.
2. Fourthly, expressing the principle in this way is a precise expression of the relief which should be given where a taxpayer has been subject to double tax. It ensures that Mr Burton does not pay double tax on the same amount of income he has earned. In contrast, if the taxpayer’s interpretation were to prevail, the taxpayer would get more protection or relief than he truly needs. Here, it would permit Mr Burton to claim as a credit against Australian tax payable, US tax paid on income (50% of the net proceeds) never brought to tax in Australia. I do not think that this was the intended outcome. In my view, “double taxation” takes place in the context of Art 22(2) when the same amount is taxed by different countries twice. However, it is not double taxation if one jurisdiction seeks to tax more aspects of a singular transaction than the other; it is only double taxation when they both seek to tax the same thing – that is, the same business profits, the same “income” from property, the same “profits” from shipping and air transport, the same dividend, the same interest, the same royalty, the same “income or gains” from the disposal of real property, the same income from independent personal services, and so on. As Viscount Dilhorne observed of the equivalent article in the then Double Taxation Relief (Taxes on Income) (New Zealand) Order, 1947 (S.R. & O. 1947, No. 1776), in *Duckering (Inspector of Taxes) v Gollan* [1965] 2 All ER 115 at 116:

The object of [the article] is clearly to secure that credit shall be given for New Zealand income tax paid in a particular year against United Kingdom tax payable in the same year *in respect of the same income*.

(Emphasis added.)

1. Fifthly, the parties were in agreement that in construing Art 22(2) regard should be had to the *Vienna Convention on the Law of Treaties*, opened for signature on 23 May 1969, [1974] ATS 2 (entered into force on 27 January 1980) (the “Vienna Convention”) and in particular Art 31 of that Convention. In *McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation* (2005) 142 FCR 134, the Full Court of this Court summarised the applicable principles arising from that Convention at 143 [38] as follows:

The application of the Convention has been discussed by McHugh J in *Applicant A v Minister for Immigration and Ethnic Affairs* (1997) 190 CLR 225 and in *Thiel v Commissioner of Taxation* (1990) 171 CLR 338, the latter case being concerned with the interpretation of the double taxation agreement between Australia and Switzerland. The leading authority in this Court on interpretation of double taxation agreements is *Lamesa*. It is unnecessary here, to set out again what is there said. The following principles can be said to be applicable:

* Regard should be had to the “four corners of the actual text”. The text must be given primacy in the interpretation process. The ordinary meaning of the words used are presumed to be “the authentic representation of the parties’ intentions”: *Applicant A* at 252-253.
* The courts must, however, in addition to having regard to the text, have regard as well to the context, object and purpose of the treaty provisions. The approach to interpretation involves a holistic approach.
* International agreements should be interpreted “liberally”.
* Treaties often fail to demonstrate the precision of domestic legislation and should thus not be applied with “taut logical precision”.

In my view, the interpretation I have reached is consistent with the foregoing principles of construction. It considers the meaning of the words of Art 22(2) in the context of the entire Treaty.

1. Sixthly, for the reasons that follow, there is no disconformity between Div 770 and the general principles established by Art 22(2). Division 770 is authorised by that Article.
2. Seventhly, it was a fundamental plank of the taxpayer’s case, both in reliance upon Art 22(2) and s 770-10, that the Commissioner was wrong to contend that double taxation only arises where foreign tax and Australian tax are imposed on “exactly the same amount”. It was said that double taxation arises where foreign tax and Australian tax are imposed on the same “subject matter”; namely, here, the same underlying gain. With great respect, I do not agree with this submission. The taxpayer’s inspiration for this expression of the test is found in some words contained in the introduction to the OECD’s *Model Tax Convention on Income and Capital* (and which language first appeared in 1995). The words were as follows:

International juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods.

Consideration of the OECD Model Convention and the commentary to it is well established, and I will assume that this includes the introduction to the Model itself: *Thiel v Federal Commissioner of Taxation* (1990) 171 CLR 338. However, putting aside the fact that these words were written some 12 years after the Treaty here was signed, it appeared to be accepted that the Treaty was based not *only* on the OECD Model. It was also based on the United States Model Income Tax Convention for the avoidance of double taxation and the prevention of tax evasion with respect to taxes on income. In that respect, it was not established that the two Models were materially and relevantly the same. In any event, and for my part, I was not assisted by the generalised words relied upon. They do not specifically address the issue before the Court. In my view, care should be taken before relying upon highly generalised statements in a bi-lateral document, the wording of which is likely to have been the product of competing sovereign interests and then the reaching of a compromise. Such statements are usually of very limited use: *Stevens v Kabushiki Kaisha Sony Computer Entertainment* (2005) 224 CLR 193 at 231 [126] per McHugh J. The safer course is to construe the words of the Treaty itself in their context and in accordance with the Vienna Convention.

1. Eighthly, I do not think that my approach lacks that “degree of pragmatism” which Lord Reed recently relied upon for the construction of the equivalent article in the United Kingdom‑United States double tax treaty: *Anson v Commissioners for Her Majesty’s Revenue and Customs* [2015] UKSC 44; 4 All ER 288 at [114]. I do not think it pragmatic to award a taxpayer a credit for foreign tax paid on income not included in assessable income in Australia.
2. Finally, the taxpayer contended that if the Commissioner’s approach were to be adopted there would be an anomalous outcome concerning the treatment of capital losses and revenue deductions. Because step 1 of s 102-5 requires the capital gain to be reduced by reference to other capital losses incurred during the income year, step 2 then requires the capital gain to be further reduced by any previously unapplied net capital losses from earlier income years, and steps 3 and 4 then require the application of available discount percentages, the FITO is limited to the resulting net capital gain. In contrast, it was said, the position was different for revenue gains. It was said that in such a case any deductions from ordinary income do not “burn” the amount of FITO that can be applied. It was then said that this differing treatment was anomalous, and was unlikely to be what Parliament intended. However, the reason for the difference, if there be a difference, arises from the treatment of capital gains and losses giving rise to a net capital gain which is only then included in assessable income. It does not arise, it seems to me, from adoption of the Commissioner’s construction of Art 22(2) or s 770-10 as against that favoured by the taxpayer. As for the availability of the CGT 50% discount, no anomaly arises from the inability to apply a FITO against amounts which are never included in assessable income. In these circumstances, the observation of Black CJ and Sundberg J in *Esso Australia Resources Ltd v Federal Commissioner of Taxation* (1998) 83 FCR 511 would appear to be apt. At 519 their Honours said:

Especially when different views can be held about whether the consequence is anomalous on the one hand or acceptable or understandable on the other, the Court should be particularly careful that arguments based on anomaly or incongruity are not allowed to obscure the real intention, and choice, of the Parliament.

See also *ConnectEast Management Ltd v Federal Commissioner of Taxation* (2009) 175 FCR 110 at 119 [41].

1. For these reasons, I do not think that Art 22(2) supports the taxpayer’s case. The learned primary judge reached the same conclusion below. His Honour said at [126]‑[127]:

In my view, the same process of reasoning should apply. Under Australian law, the only income forming part of the assessable income is 50% of the capital gain on which tax is paid in the US. Where Art 22(2) refers to Australian tax payable in respect of income, the income is only 50% of the capital gain.

Secondly, the word ‘all’ does not appear before the words ‘United States tax paid’ in the first line of Art 22(2). The Article does not suggest that a credit is allowed against Australian tax payable for the whole amount of the US tax paid. The general principle is that one is allowed a credit. It simply says a credit against US tax paid. It does not prescribe how much is to be allowed as a credit. The credit is subject to the provisions and limitations of Australian law. Division 770 serves to determine the credit allowable and importantly nothing in the Art 22 is inconsistent with the construction of s 770-10 advanced by the Commissioner.

I respectfully agree with and adopt these reasons of his Honour.

1. I should finally record that neither party addressed the Court as to what would happen if the Court were to decide that no offset was available under Div 770 but nonetheless was of the view that the taxpayer’s construction of the Treaty was correct. The parties were invited to make submissions in writing about this after the hearing.
2. The taxpayer submitted that s 16 of the Agreements Act provided the “mechanism” whereby the Commissioner could grant a credit for the US tax paid in conformity with Art 22(2). His argument, however, well illustrates the danger of a literal reading of the text of legislation without regard to statutory history. The relevance of that history can sometimes play a decisive role: cf *Woodside Energy Ltd v Commissioner of Taxation (No 2)* [2007] FCA 1961; (2007) 69 ATR 465. In some cases it does not: cf *Jeffrey James Prebble Pty Ltd v Commissioner of Taxation* (2003) 131 FCR 130. In this case it does.
3. Section 16 of the Agreements Act provides:

**Rebates of excess tax on income included in assessable income**

(1) This section applies in relation to each relevant part of a taxpayer’s income of the year of income that consists of income in respect of which a provision of an agreement limits the amount of Australian tax payable.

(2) The taxpayer is entitled, in respect of each relevant part of the taxpayer’s income of the year of income to which this section applies, to a rebate of the amount (if any) by which the amount ascertained in accordance with the last preceding section as the amount of Australian tax payable in respect of that part exceeds the limit applicable under the provisions of the agreement in relation to that part.

(3) The rebate to which a taxpayer is entitled under this section in respect of a relevant part of the taxpayer’s income shall be allowed in the taxpayer’s assessment in respect of income of the year of income in the assessable income of which that part is included.

(4) A rebate, or the sum of the rebates, a taxpayer is entitled to under subsection (2), in respect of income of a year of income, must not exceed the amount of Australian tax payable in respect of the taxpayer’s taxable income of that year after all other rebates of, and deductions from, that tax have been taken into account.

1. The taxpayer submitted:

Article 22(2) of the Australia-US Convention limits the amount of Australian tax payable, in terms of s 16(1). It does so by requiring, in the present circumstances, that a credit for the full amount of the US tax on the three gains in issue “shall be allowed” against Australian tax.

Under s 16(2), the appellant is entitled, in respect of his income for the 2011 and 2012 years of income, to a rebate of the amount by which the amount ascertained under the former s 15 of the Agreements Act exceeds the limit applicable under Article 22(2). Section 15 was repealed in 1986, but this does not deny s 16 effect, and the relevant part of s 16(2) should be construed as referring to the amount of tax otherwise payable but for the limit in the agreement: *Satyam Computer Services Ltd v Commissioner of Taxation* (2018) 362 ALR 589; [2018] FCAFC 172 at [27]. In the event that the Court agrees with the Commissioner’s construction of s 770-10(1), this is the Australian tax in respect of the three gains before the Article 22(2) credit. The limit applicable under Article 22(2) is the Australian tax payable after a credit has been allowed for the full amount of US tax. The rebate under s 16(2) is the difference, that is, the full amount of the US tax.

I respectfully disagree.

1. Section 16, in its current form, was introduced into the Agreements Act by the *Income Tax (International Agreements) Act* *1968* (Cth). This Act gave domestic force to a new double tax treaty that had been entered into between the governments of the Commonwealth of Australia and that of the United Kingdom in 1967. That amending Act also repealed and substituted s 14 of the Agreements Act (reproduced below). As will become clear, s 14 was the “mechanism” whereby Australia’s obligations concerning double taxation were at that time to be enforced by the giving of a credit for foreign tax paid. In contrast, s 16 was not that mechanism. Section 14 was then repealed by the *Taxation Laws Amendment (Foreign Tax Credits) Act* *1986* (Cth) when general rules for the allowance of a credit for foreign tax paid were introduced into the 1936 Act (Div 18 of Pt III). Section 14 provided:

Provisions relating to credits for foreign tax.

(1) This section has effect for the purpose of the determination of the credit or credits allowable, under an agreement, for foreign tax paid or payable by a person in respect of any income.

(2) Where the income of the person of the year of income includes only one amount of income in respect of which a credit is allowable under the agreement, a credit is allowable in respect of that amount of income.

(3) Where the income of the person of the year of income includes two or more amounts of income in respect of which credits are allowable under the agreement—

(a) if those amounts of income comprise one class of income only — one credit is allowable in respect of the total of those amounts; or

(b) if those amounts of income comprise two or more classes of income — a separate credit is allowable in respect of the total f those amounts included in each class of income.

(4) The amount of the credit allowable in respect of any income shall not exceed the amount of Australian tax payable in respect of that income.

1. The Explanatory Memorandum which accompanied the *Income Tax (International Agreements) Bill 1968* (Cth), relevantly said of s 14:

***Provisions relating to credits for foreign tax***

The main purpose of the new section 14, as of the section 14 being repealed, is to provide that where credit for foreign tax in respect of any income is allowable under the provisions of an agreement, the amount of that credit is not to exceed the amount of Australian tax payable in respect of the income.

Because of the exemption under section 23(q) of the Assessment Act, credits were, in practice, previously allowable only in the case of dividends and the existing section 14 requires the calculation of a separate credit in respect of each dividend derived from each country with which Australia has a double taxation agreement.

Following the new United Kingdom agreement credits will now be available also in respect of United Kingdom interest and royalties. With this extension of the area in which credits are allowable it is proposed to keep to a minimum the number of credit calculations required.

The proposed section 14 will apply on the basis of a separate credit for all income of a particular class that is derived from any one country with which Australia has a double taxation agreement. The limitation on the amount of credit will, therefore, be applied separately to each class of income derived from each such country.

…

1. In contrast, s 16 is not concerned with the provision of a “credit” but with the conferral of a “rebate” in defined circumstances. As the Explanatory Memorandum makes clear, s 16 is concerned with the payment of dividends, royalties and interest to non-residents in circumstances in which a double tax treaty has limited Australia’s taxing rights. For example, in 1968 the then *Agreement between the Government of the Commonwealth 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 Capital Gains*, signed on 7 December 1967, [1968] ATS 9 (terminated on 17 December 2003) limited Australia’s right to tax royalties paid to a resident of the United Kingdom to 10% of the amount paid. The Explanatory Memorandum thus stated about s 16:

This clause proposes the repeal of section 17 of the Principal Act and its replacement by a modified section – section 16.

The existing section 17 provides for the allowance of a rebate to give effect to provisions in Australia’s double taxation agreements limiting the amount of Australian tax payable by assessment processes in respect of dividends flowing to countries with which Australia has double taxation agreements. Where the amount of Australian tax on the dividend, as ascertained in accordance with the present section 16, exceeds the amount to which the Australian tax is limited, a rebate is to be allowed in the shareholder’s assessment.

It is necessary to extend the provisions now contained in section 17 because the new United Kingdom agreement, in addition to limiting the amount of Australian tax payable on dividends derived by United Kingdom residents, also provides for limitations on the Australian tax on interest and royalties paid to United Kingdom residents. The new section 16 will operate for these purposes.

The section will not apply in relation to income that is subject to withholding tax. Where United States, Canadian and New Zealand taxpayers derive dividends in respect of which the Australian tax is limited to 15%, the dividends will in general be subject to withholding tax and section 16 will accordingly not be applicable. Except in isolated cases, therefore, section 16 will in practice apply only in relation to United Kingdom residents.

1. With the repeal of s 14 of the Agreements Act and then Div 18 of the 1936 Act, in my view, the only “mechanism” left for the enforcement of Australia’s obligations in relation to double taxation is Div 770. Section 16 is not another form of this “mechanism”. It simply does not deal with the subject of double taxation. Read in the context of s 14 and the explanation of it found in the Explanatory Memorandum, it cannot, with respect, do the work contended for by the taxpayer.
2. Moreover, and in any event, s 16 cannot be given any sensible operation. Subsection (2) provides that the rebate is to be calculated as the amount by which the Australian tax payable “in accordance with the last preceding section” exceeds the limit applicable in a double tax agreement. That “preceding section” (s 15) set out a series of rules for the calculation of the “Australian tax” payable. However, s 15 was also repealed in 1986. Without those rules, s 16 cannot be made to work. Of course, the Court must “strive” to give meaning to every word of a provision, such as s 16: *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355. But no amount of striving can supply legitimate meaning and operation to a provision which is dependent upon another section which Parliament has seen fit to repeal.
3. The taxpayer also relied upon a decision of the Full Court of this Court in *Satyam Computer Services Limited v Commissioner of Taxation* [2018] FCAFC 172; (2018) 362 ALR 589 which concerned Art 23 of the *Agreement between the Government of Australia and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, signed on 25 July 1991, [1991] ATS 49 (entered into force on 30 December 1991). At [27] the Full Court said:

If, and to the extent that, s 16 of the Agreements Act has any bearing upon the proper construction of the statutory scheme, the repeal of the former s 15 should not be treated as denying s 16 any effect and it should be construed as referring to the amount of tax otherwise payable but for the limit in the agreement: *Project Blue Sky* at [71].

I do not think that this passage has any bearing on the proper outcome here. The Court in *Satyam* was dealing with a different issue, namely the correct interpretation of Art 23 of the India-Australia double tax treaty.

1. It was next submitted that the 1997 Act supplied the “machinery” to enable the credit arising under Art 22(2) to be enforced. It was said that the definition of “tax offset” in the method statement found in Step 3 of s 4-10(3) of the 1997 Act would include the “credit” conferred by Art 22(2). Section 4-10(3) provides:

*Method statement*

Step 1. Work out your taxable income for the income year.

To do this, see section 4-15.

Step 2. Work out your basic income tax liability on your taxable income using:

(a) the income tax rate or rates that apply to you for the income year; and

(b) any special provisions that apply to working out that liability.

See the *Income Tax Rates Act 1986* and section 4-25.

Step 3. Work out your tax offsets for the income year. A tax offset reduces the amount of income tax you have to pay.

For the list of tax offsets, see section 13-1.

Step 4. Subtract your tax offsets from your basic income tax liability. The result is how much income tax you owe for the financial year.

1. It was submitted that the credit referred to in Art 22(2) answers the description of an amount that “reduces the amount of income tax you have to pay”. It was said that the Commissioner’s “own practice recognises this”. I respectfully disagree. The offsets referred to in Step 3 are those provided by the 1936 and 1997 Acts, such as those found in Div 770. They are the ones listed in s 13-1 of the 1997 Act. That is why the provision directs the reader to that provision where there is found an applicable “list of tax offsets”. Whilst the provision is a “Guide” (see s 950-150 of the 1997 Act for the use to be made of a Guide), there is nothing to suggest, as submitted by the taxpayer, that it is not “exhaustive”. In my view, the list can be considered to confirm the meaning of Step 3 (s 950-150(2)(b)). It can be used to affirm that the offsets referred to in Step 3 are those supplied by the 1936 and 1997 Acts. The Commissioner’s practice cannot alter that conclusion.
2. It was then said, in the alternative, that Step 2(b) in s 4-10(3) supplied the necessary “machinery”. This was on the basis that “Article 22(2), as incorporated and given priority by ss 5 and 4(2) of the Agreements Act, is a ‘special provision’”. Again, I respectfully disagree. Step 2 is directed at the identification of the rate of tax which is payable on taxable income ascertained by Step 1. It does not deal with offsets or credits. They are addressed by Step 3. The offset can only have work to do once the quantum of tax has first been ascertained by Steps 1 and 2.
3. Finally, and in the alternative, ss 4(2) and 5 of the Agreements Act were relied upon. Those provisions are relevantly as follows:

**4 Incorporation of Assessment Act**

…

(2) The provisions of this Act have effect notwithstanding anything inconsistent with those provisions contained in the [1936 Act or 1997 Act] (other than Part IVA of the [1936 Act]) or in an Act imposing Australian tax.

…

**5 Current agreements have the force of law**

(1) Subject to this Act, on and after the date of entry into force of a provision of an agreement mentioned below, the provision has the force of law according to its tenor.

…

1. It is said that because of these provisions, Art 22(2) has the force of law with domestic application independent of Div 770. The taxpayer relies on an income tax ruling (TR 2000/16) for that purpose. The Commissioner generally supported this view of the application of Art 22(2) but observed that “there may well be scope for unforeseen anomalies, or practical difficulties, in computing credit by force of the article directly”.
2. Again, I respectfully disagree. As already mentioned, ordinarily, whilst it has the force of domestic law, the provisions of the Treaty serve to allocate taxing powers between nations; they do not operate to assess and then impose any tax. They are not a source of power to tax: *Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation (No 4)* [2015] FCA 1092; (2015) 102 ATR 13 at [61]; but note the exceptional circumstances in *Satyam*. As a result, as this Court observed in *Lamesa Holdings*, the business profits article in a double tax treaty does not authorise the Commissioner to impose tax on income which is treated by the 1936 and 1997 Acts as being exempt. For one thing, the language used often lacks the specificity required to impose tax (or to give a credit).
3. However, as the taxpayer points out here, the language of Art 22(2) is stronger. The critical phrase is “shall be allowed as a credit”. This was said to impose a domestically enforceable obligation to give a credit for foreign tax in the circumstances mandated by that article. But upon whom is the obligation imposed and what is its content? Three observations may be made:
	1. No obligation is imposed by Art 22(2) on the Commissioner. Rather, it is imposed on “Australia”. That term is relevantly defined in Art 3(1)(k) as the “Commonwealth of Australia” and, when used in a geographical sense, includes certain geographic areas, such as Norfolk Island. That term does not include the Commissioner. Various articles in the Treaty impose obligations and duties on the “competent authority” of each Contracting State. That term is defined in Art 3(1)(e)(ii) as meaning “the Commissioner of Taxation or his authorized representative”. Art 22(2) does refer to the competent authority of either Contracting State;
	2. Article 22(2), as already mentioned, expressly contemplates that the means of conferring a “credit” will be the enactment of separate domestic law. The credit which is allowable “shall be *in accordance with* the provisions and subject to the limitations of the law of Australia” (emphasis added); and
	3. Article 22(2) does not allocate taxing power (unlike, for example, Art 7). It thus cannot be invoked as a “shield”.
4. In my view, imposing the obligation on “Australia” and not on the Commissioner as a competent authority, strongly suggests that the intention here was to impose obligations at the level of two sovereign states. The obligation relevantly owed is to the Republic of the United States as a sovereign nation by the Commonwealth of Australia. That conclusion is consistent with the second observation I have made. The obligation is to be discharged by the enactment of domestic legislation. Here that is Div 770. This conclusion does not foreclose the availability of relief were Australia to be in breach of its obligation in Art 22(2). It may, for example, be open to a citizen of Australia to seek declaratory relief in this Court to determine whether Australia had complied with Art 22(2). But that citizen could not, in such proceedings, seek a credit outside the terms of Div 770. The Commissioner thus has no lawful authority, absent Div 770, to grant the FITO sought and the Treaty is no other source of power to do so. What he has said in TR 2000/16 makes no difference to that outcome.

## Division 770

1. The learned primary judge decided that s 770-10 allowed a FITO equal to only 50% of the US tax paid on the sale of the assets in the United States. Much of that conclusion turned upon the meaning to be attributed to the words “in respect of” and “included in assessable income” in that provision. His Honour concluded at [113]:

The words ‘in respect of’ require connection to, and they take their meaning from, their content and the purpose of the provision in context. The intent of the provision is that where only part of an amount in respect of which foreign income tax was paid equates to assessable income under Australian tax law, it is that portion to which the words are directed. The analysis set out above in relation to ‘included in’ applies also in relation to this debate. Assessable income is the limiting factor. In Australia, s 102-5 of the 1997 Act dictates that 50% of the capital gain is not assessable income.

For the reasons that follow I respectfully agree with his Honour’s conclusion.

1. Before addressing the taxpayer’s submissions on appeal, I should explain why I agree with the learned primary judge. In my view the conclusion his Honour reached accords with:
2. the ordinary and natural meaning of the words used in s 770-10. The provision is concerned with two amounts. The first is an “amount” of foreign income tax which has been paid. The second is an “amount” included in the assessable income of the taxpayer. If the first amount was paid “in respect of” the second, a FITO arises. Here, US$3,535,554 was not paid “in respect of” the amount of the Nepa Investment gain that comprised the net capital gain included in the assessable income of the taxpayer. That US tax was payable and paid in respect of a different amount: double the amount included as assessable income under Australian tax law. In other words, only half of the US tax paid was “in respect of” an amount included in assessable income. In that respect, it may be inapt to describe that as a “proportionate” approach. It would be more accurate to say that the provision requires the identification of the amount of foreign tax paid on income which has also been taxed in Australia. Like Art 22(2), one must first identify what has been included in assessable income, and then what foreign tax has been paid on that sum.
3. the object and purpose of Div 770. Section 770-1 expresses the function of Div 770 as being the provision of a FITO “for foreign income tax paid on your assessable income”. Here, only 50% of US tax was paid “on” the assessable income of the taxpayer. Section 770-5 expresses the object of Div 770. It states that relief is given where you paid foreign tax “on amounts included in your assessable income” and Australian tax would be paid “on the same amounts”, but for Div 770. I note here that the taxpayer urged upon the Court a construction of s 770-10 which did not limit the availability of a FITO to tax paid twice “on the same amounts”; the provision should be read, it was said, as being engaged where tax was paid twice on the *same subject matter*. That construction is not supported by the language of s 770-10 and is squarely inconsistent with the clear words of s 770-5. If it be the case that s 770‑10 uses language which permits constructional choices, for example by the use of words of nexus such as “in respect of”, s 770-5 would mandate a constructional choice here in favour of the Commissioner and against the taxpayer.
4. the “notes” to s 770-10. Note 2 expressly addresses a case where one amount is treated partly as assessable income and partly not (because it is treated as non-assessable non‑exempt income). It states that in such a case “only a proportionate share of the foreign income tax (the share that corresponds to the part that is assessable income) will count towards the tax offset”. In my view, this note may be used to help “understand” the reach of s 770-10. It is also not limited to a case of non‑assessable non-exempt income. As a matter of logic, the approach it mandates would apply whenever an amount is only partly included in assessable income. It would extend to an amount which is in part exempt income. It would extend to an amount which, as here, requires the exclusion of part of it in a determination of a net capital gain.
5. the Explanatory Memorandum which accompanied the introduction of the *Tax Laws Amendment (2007 Measures No.4) Bill 2007* (Cth) (the “2007 Explanatory Memorandum”). Paragraph 1.40 of that document states:

Entitlement to the tax offset will only arise when, and to the extent that, the foreign income tax has been *paid* on an amount included in assessable income [*Schedule 1, item 1, subsection 770-10(1)*]. Foreign income tax paid on non‑assessable non-exempt amounts (except for section 23AI and 23AK amounts) is disregarded. Only where the taxpayer has paid foreign income tax on an amount included in assessable income will double taxation, and consequently relief from double taxation, arise. *If only part of an amount on which an amount of foreign income tax has been paid is included in assessable income (eg, foreign income tax paid on the foreign branch income of an Australian company), only the same fraction of the foreign income tax counts towards the tax offset [Schedule 1, item 1, note 2 in subsection 770-10(1)]*.

(Emphasis added.)

1. the conclusions I have reached concerning Art 22(2) and the concept of double taxation more generally. The taxpayer does not need a FITO for US tax paid in respect of income which is not brought to account in Australia.
2. The taxpayer advanced a number of contentions to show appealable error. The contentions reflect the complex nature of the issues before the Court – they were, with the greatest of respect, well argued. However, I find myself unable to agree with them. The submissions were as follows.
3. First, it was contended that the entire net gain made from the sale of the assets was “included” in the assessable income of the taxpayer. It formed part of the calculation of the net capital gain. When the assets were sold CGT event A1 occurred. A capital gain was made in each case equal to the extent to which the capital proceeds exceeded each asset’s cost base. The whole gain was thus the subject of income taxation. Those gains were then included in Step 1 of s 102-5. At this point they had not been reduced by 50%. That only took place at Step 3. Australia’s choice to make that reduction, it was said, should not deny to Mr Burton his right to a credit for all the tax he had paid in the United States. Reliance was placed upon the observations of Fullagar J in *Mutual Life and Citizens’ Assurance Co Ltd v Commissioner of Taxation* (1959) 100 CLR 537. At 550, his Honour said:

If you impose tax on a proportion of *x*, you are taxing *x*, and, if *x* includes *y*, you are taxing *y*.

At 553-554, his Honour then said:

The general scheme of the Commonwealth legislation is not to impose tax by reference to specific categories of income. It contains, of course, many special provisions as to what does and does not constitute income, but its general plan is to treat as “assessable income” – gross income – whatever is income within the general conception of that term, and to require the “taxable income” to be ascertained by subtracting from assessable income what are called “allowable deductions”. Consistently with this general plan *no income can be regarded as exempt from income tax either if it is required to enter into the calculation directly as itself a part of the assessable income, or even if, though it is excluded from the actual calculation of assessable income, the rate of tax is increased by reference to its existence.*

(Emphasis added.)

1. I respectfully disagree with this submission. The language of s 770-10 relevantly directs attention to an amount that is “included in … assessable income”. In my view, that is a reference to what is included within the assessable income of a taxpayer by reason of Div 6 of the 1997 Act, and which then forms part of the formula for the determination of “taxable income” for the purposes of s 4-15 of the 1997 Act. Here, the amount that is included in the assessable income of the taxpayer is the net capital gain, being an item of “statutory income” and calculated in accordance with s 102-5, and no more. That is made clear by the opening words of that provision: “[y]our assessable income includes your net capital gain”. By choosing the words “included in … assessable income” in s 770-10, Parliament intended to refer to this method of assessment, and not to any broader concept. In particular, I note that s 770-10 does not refer to amounts that may form part of the computation of an item of assessable income, but which nonetheless, ultimately does not form part of the assessable income of the taxpayer. It is not concerned with whether an amount more broadly can be said to have been taxed or is exempt. In that respect, I can accept, that colloquially speaking, it can be said that the 1997 Act taxes the entire gain in the sense that the whole amount is brought to account by CGT event A1. But s 770-10 is not concerned with that more general enquiry. It is concerned with those amounts actually included in assessable income; for the reasons already given, 50% of the capital gain is not so included. Indeed, the taxpayer never suggested that it had been for the purposes of s 4-15.
2. Secondly, the taxpayer pointed out that s 770-10 does not refer to double taxation in respect of the “same amounts”. This, it was said, was deliberate. It was intended to enable Div 770 to apply to cases where foreign tax may not have been paid on the same amount, but on the same subject matter. In that respect, the significance of the phrase “same amounts” in s 770-5 was said to be of no moment; that is because ss 770-1 and 770-5 are not operative provisions, and describe the function and purpose of Div 770 at a high level of generality.
3. I am afraid that I disagree with this submission. I accept that Div 770 must be made to operate in circumstances where a foreign tax regime may tax a gain or a receipt or an earning in a different way. But what will be taxed will nonetheless comprise a quantified gain, profit, receipt or earning. Where that “amount” is included in a taxpayer’s assessable income, in the sense I have described above, s 770-10 will be engaged. Where only part of that “amount” is included in assessable income, to that extent, s 770-10 will also be engaged. It is precisely for that reason that s 770-5 refers expressly to the payment of Australian tax on the “same amounts”.
4. Thirdly, the taxpayer relied upon s 121EG(3A) of the 1936 Act which was introduced at the same time as Div 770. This provision is contained within Div 9A of Pt III of the 1936 Act which contains rules for the concessional taxing of Offshore Banking Units (“OBU”). Generally speaking, the company tax rate is applied to only a fraction of the OBU’s income (10%). A specific provision was introduced to deal with the calculation of the amount of foreign income tax paid by an OBU. It makes clear that only the same fraction of foreign income tax is taken to have been paid. Section 121EG(3A) provides:

Subject to section 121EH, this Act applies to an OBU as if only the eligible fraction of each amount of foreign income tax (within the meaning of the I*ncome Tax Assessment Act 1997*) the OBU paid in respect of an amount of assessable OB income had been paid in respect of that income.

It was submitted that the Commissioner’s construction of s 770-10 should not be accepted because it would render this provision otiose: see *Project Blue Sky* at 382 [71].

1. Once again, I regret that I cannot accept this submission. The learned primary judge said of it at [87]:

However, this provision is targeted at a discrete issue, namely, the treatment of assessable income of OBUs (or offshore banking units). It also forms part of a different division in a different Act, albeit that it was introduced at the same time as Div 770. Further, and unlike Note 2, it is not an example but an operative provision which operates on its own terms. Indeed it has its own discrete genesis as explained in its Explanatory Memorandum (particularly [1.90]-[1.93] and [1.306]-[1.308]), which describes the reasons why the provision was introduced. The reason was the fact that, at the time of the Explanatory Memorandum, foreign tax paid on assessable offshore banking income was quarantined from that paid on other assessable foreign income. The provision was to ensure that any excess foreign tax in respect of assessable offshore banking income could not be used to shelter other low foreign-taxed income earned by the offshore banking unit from Australian tax. It is a different regime with a discrete purpose which operates on its own terms.

I respectfully agree with and adopt his Honour’s reasons. The 2007 Explanatory Memorandum describes the function and purpose of s 121EG(3A) in language that does not support the taxpayer’s case. Paragraphs 1.90 to 1.93 state:

1.90 Foreign income tax paid on assessable offshore banking income of an offshore banking unit will be adjusted by the (offshore banking) eligible fraction.

1.91 Entitlement to an offset for foreign income tax paid on assessable offshore banking income will therefore only arise for a fraction (currently one-third) of the amount of foreign income tax paid. *This is consistent with the treatment afforded to assessable offshore banking income as well as the allowable offshore banking deductions*. [*Schedule 1, item 1, subsection 770-10(1) and items 55 to 61, paragraph 121B(3)(d), subsection 121EG(3A ) and paragraph 121EH(e), subsection 121EJ(1) of the ITAA 1936*]

1.92 The reduction of foreign income tax recognises that two-thirds of foreign income tax paid in respect of offshore banking income relates to offshore banking income that is non-assessable non-exempt income. *Double tax does not arise to the extent that the foreign income tax paid relates to non‑assessable non-exempt income*.

1.93 Although this treatment is not currently applied to foreign tax paid on assessable offshore banking income, the consequences are less prevalent. This is because the foreign tax currently paid on assessable offshore income is quarantined from that paid on all other assessable foreign income. Moreover, an offshore banking unit would seldom have an opportunity to utilise the additional foreign income tax. With the removal of foreign tax credit quarantining, the offshore banking unit could use this additional foreign tax to shelter other types of low-taxed foreign source income, which is not the desired outcome.

(Emphasis added.)

1. The statements that s 121EG(3A) is “consistent with the treatment afforded” under s 770-10 and that double tax does not arise to the extent that foreign tax is paid on non-assessable non‑exempt income, support the conclusion reached by the learned primary judge. Section 121EG(3A) is a provision dealing with double taxation in a very specific instance in a way that is entirely consistent with the construction of s 770-10 favoured by his Honour.
2. Fourthly, the taxpayer made the same point about capital losses reducing the amount of FITO that might be available. I have addressed that point already.
3. Fifthly, it was submitted that the full amount of US tax was, in any event, paid “in respect of” the net capital gain included in the taxpayer’s assessable income. It was contended that, in contrast to the decision of the Court of Appeal of New Zealand in *Commissioner of Inland Revenue v Lin* [2018] NZCA 38, the phrase “in respect of” in s 770-10 did not mean “on” (the same phrase appears in the clause dealing with double taxation in the New Zealand-China double tax agreement which was considered in *Lin*). Rather, we were urged to read the phase as “capable of breadth and flexibility” and as “referring to matters of substance”, namely the taxation of the same economic gain by two sovereign nations. Div 770 was concerned, it was said, with this substance because foreign tax is never paid *on* amounts of assessable income. By reason of the payment of US tax on the gains made here, the full amount of that tax should, it was submitted, count towards a tax offset; the full amount of foreign tax paid was relevantly “in respect of” the net capital gain included in the taxpayer’s assessable income.
4. Again, I do not agree with this submission. It assumes that the “substance” of double taxation is the taxation of the same substance or subject matter. For the reasons I have already given, that is not a correct statement. In my view, the words of nexus deployed within s 770-10, namely the phrase “in respect of”, probably does mean “on”. In that respect, *Lin* is instructive. It was concerned with Art 23(2) of the double tax agreement between New Zealand and China which was relevantly in the following terms:

(a) Subject to any provisions of the laws of New Zealand which may from time to time be in force and which relate to the allowance of a credit against New Zealand tax of tax paid in a country outside New Zealand (which shall not affect the general principle hereof), Chinese tax paid under the laws of the People’s Republic of China and consistently with this Agreement, whether directly or by deduction, in respect of income derived by a resident of New Zealand from sources in the People’s Republic of China (excluding, in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid) shall be allowed as a credit against New Zealand tax payable in respect of that income;

…

1. Harrison, Cooper and Asher JJ said at [29]-[30]:

… The phrase “in respect of” is amorphous and can lead to linguistic uncertainty and confusion. It is often used where one word would more accurately convey its meaning and purpose. The phrase is used in three separate places in art 23(2)(a). Mr Clews accepts the logic of consistency, of giving the same phrase the same meaning wherever it is used in the same provision. He accepts also that where the phrase “in respect of” is used in the second place (“tax paid in respect of the profits”) and the third place (“tax payable in respect of that income”) its meaning is synonymous with “on”. The phrase refers to tax paid on profits out of which a dividend is paid to the New Zealand resident; and to tax payable by the New Zealand resident on that income – that is, the “income derived by [a New Zealand resident”] from sources in ... China”.

We are satisfied that the phrase “in respect of” is used synonymously with “on” in all three places in art 23(2)(a).

1. In the context of Div 770, I also think that the phrase “in respect of” in s 770-10 probably means “on”. The phrase links two amounts: an amount of foreign income tax and an amount included in assessable income. In my view, s 770-1 informs the nature of that link when it states that a taxpayer may get an offset “for foreign tax paid *on* your assessable income”. The same word, “on” is used again in s 770-5 to describe the type of nexus Parliament had in mind: it refers to a taxpayer having “paid foreign income tax *on* amounts included in your assessable income”. There are no grounds for ignoring this immediate statutory context, and these manifest descriptions of what Parliament intended. For this reason I reject the taxpayer’s final submission.
2. The appeal should be dismissed with costs.

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| I certify that the preceding sixty-six (66) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Steward. |

Associate:

Dated: 22 August 2019

REASONS FOR JUDGMENT

JACKSON J:

1. I respectfully agree with Logan J and Steward J, for the reasons they each give, that grounds of appeal 1 to 4, concerning Div 770 of the *Income Tax Assessment Act 1997* (Cth) (***ITAA 1997***) should not be upheld.
2. I respectfully agree with Steward J that grounds of appeal 5 and 6, concerning Art 22 of the *Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, signed on 6 August 1982, [1983] ATS 16 (the **Treaty**) should not be upheld. I agree generally with his Honour's reasons, but I prefer to express my own reasons in relation to the key question of the proper construction of Art 22(2) of the Treaty. I gratefully adopt Logan J's and Steward J's respective expositions of the issues and the relevant legal principles, which permit me to be brief.
3. Stripped of matters that are presently not relevant, Art 22(2) of the Treaty reads as follows:

… United States tax paid under the law of the United States and in accordance with this Convention … in respect of income derived from sources in the United States by a person who, under Australian law relating to Australian tax, is a resident of Australia shall be allowed as a credit against Australian tax payable in respect of the income. The credit shall not exceed the amount of Australian tax payable on the income or any class thereof or on income from sources outside Australia. Subject to these general principles, the credit shall be in accordance with the provisions and subject to the limitations of the law of Australia as that law may be in force from time to time.

1. It is important to appreciate that the first sentence of Art 22(2) expresses a general principle. That is how the third sentence of the article refers to it. And reading it that way is consistent with the approach to the construction of international tax treaties which Logan J and Steward J have summarised. Insofar as s 5 of the *International Tax Agreements Act 1953* (Cth) gives the article the force of domestic law, it is necessary to take the same approach. Section 5 gives the Treaty the force of Australian law 'according to its tenor'.
2. The general principle expressed in the first sentence of Art 22(2) is that if a person who is an Australian resident for the purposes of Australian taxation law pays United States tax in respect of income (including a gain) derived from sources in the United States, the Australian government must allow a credit against Australian tax payable in respect of that income. That does not purport to define exactly what double taxation is, and what it is not. It does not say how much of the amount of United States tax paid must be allowed as a credit. It says nothing about whether the Australian tax against which a credit is to be allowed must be treated as having been payable in respect of all of the income from any given transaction in respect of which United States tax has been paid.
3. A few relevant matters must be established in order to conclude that there has been compliance with the general principle in the first sentence of Art 22(2). There must be United States tax paid under the law of the United States. It must be paid in respect of an amount of income (a gain) that is derived from sources in the United States. Such tax must be allowed as a credit against Australian tax. And the Australian tax against which the credit is to be allowed must be tax payable in respect of the amount of income that was derived from sources in the United States.
4. The requirement that the amount of income be the same in the case of each of the United States tax paid and the Australian tax payable emerges from the syntax of Art 22(2). But it does not follow that this amount of income must be *all* the income derived from a given source in the United States that is also subject to taxation in Australia. The term that is used to indicate a connection between the relevant amount of income, whatever that may be, and each of the United States tax and the Australian tax is 'in respect of'. That is indeterminate. No doubt, in each case the connection cannot be a distant, arbitrary or illogical one. But to the extent that it is necessary to identify the connection more precisely, that must be done in accordance with the provisions of the law of Australia. That is what the third sentence of Art 22(2) requires.
5. In considering the present case, it does not stretch the language of the article to read 'Australian tax payable in respect of the income' as referring to capital gains tax payable in Australia on assessable income being an amount equal to only 50% of the gain. So reading 'the income' as referring to 50% of the gain derived in the United States is consistent with the general principle in the first sentence of Art 22(2) (acknowledging there will also be differences, such as treatment of capital losses, in the way the laws of different countries calculate the gain).
6. Division 770 of *ITAA 1997* is, likewise, consistent with the general principle. It satisfies the requirements that I have identified above. Under s 770-10, the entitlement to a tax offset arises where 'foreign income tax' has been paid. That term is relevantly defined as tax that is imposed by a law other than an Australian law on profits or gains, whether of an income or capital nature: s 770‑15(1). Applying that here, it captures United States tax payable under the law of the United States on income (gains) derived from sources in the United States.
7. Section 770-10 grants an entitlement to a 'tax offset', which is defined in s 995-1, by reference to s 4-10, as something that reduces the amount of income tax, necessarily Australian income tax, that the taxpayer has to pay. That allows a credit against Australian tax, to use the terminology of Art 22(2).
8. Finally, when Div 770 is applied here, the Australian tax against which the credit is allowed is payable in respect of an amount of income that is the same as an amount of income derived from sources in the United States and in respect of which United States tax has been paid. That is the amount included in the taxpayer's 'assessable income' for the purposes of Australian tax. The fact that United States tax has also been paid on an amount of income not included in 'assessable income' does not change that. Nor is it to the point that the law of the United States treats the total of both amounts as a single indivisible item on which tax is paid (if that is indeed what United States law does). Article 22(2) requires that the credit be in accordance with the provisions of the law of Australia, not the law of the United States.
9. Since Div 770 is consistent with the general principles expressed in Art 22(2), the Commissioner was correct to allow the tax offset to the extent that he did. The Treaty requires no different result. It is therefore not necessary for me to express any views as to the basis on which the Treaty, read together with Australian legislation, may have authorised and required the Commissioner to give a credit for United States tax greater than the tax offset required under Div 770.
10. The appeal should be dismissed with costs.

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| I certify that the preceding thirteen (13) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Jackson. |

Associate:

Dated: 22 August 2019