FEDERAL COURT OF AUSTRALIA

Satyam Computer Services Limited v Commissioner of Taxation [2018] FCAFC 172

File number:	NSD 1648 of 2017 NSD 1649 of 2017 NSD 1650 of 2017
Judge:	**ROBERTSON, DAVIES AND WIGNEY JJ**
Date of judgment:	11 October 2018
Catchwords:	**TAXATION** – international taxation – double taxation agreement between Australia and the Republic of India (the Indian agreement) – interpretation of double taxation agreements - interaction between domestic tax law and double taxation agreements - where company resident in India for tax purposes – whether payments to the company that are royalties for the purposes of the Indian Agreement but are not otherwise royalties under Australian tax law are deemed to be Australian source income by reason of Article 23 of the Indian Agreement and ss 4 and 5 of the *International Tax Agreements Act 1953* (Cth) and therefore included in the company's assessable income for Australian tax purposes
Legislation:	*Federal Court of Australia Act 1976* (Cth) *International Tax Agreements Act 1953* (Cth) *International Tax Agreements Amendment Act (No 1) 2011* (Cth) *Income Tax Assessment Act 1936* (Cth) *Income Tax Assessment Act 1997* (Cth) *Income Tax (International Agreements) Amendment Act (No. 2) 1991* (Cth)
Cases cited:	*Bywater Investments v Federal Commissioner of Taxation* (2016) 260 CLR 169 *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4)* (2015) 102 ATR 13; [2015] FCA 1092 *CIT v P.V.A.L. Kulandagan Chettiar* (2004) 267 ITR 654 (SC) *CIT v R.M. Muthiah* (1993) 202 ITR 508

Federal Commissioner of Taxation v Lamesa Holdings BV (1997) 77 FCR 597

GE Capital Finance Pty Ltd v Federal Commissioner of Taxation (2007) 159 FCR 473

Project Blue Sky Inc v Australian Broadcasting Authority (1998) 194 CLR 355

Task Technology Pty Ltd v Federal Commissioner of Taxation (2014) 224 FCR 355

Tech Mahindra Limited v Federal Commissioner of Taxation (2015) 101 ATR 755; [2015] FCA 1082

Tech Mahindra Limited v Federal Commissioner of Taxation (2016) 250 FCR 287

Union of India v Azadi Bachao Andolan (2003) 263 ITR 706 (SC)

Verizon Communications Singapore Pte Ltd v The Income Tax Officer (2014) 361 ITR 575 (Mad)

Wipro Ltd v DCIT (2016) 382 ITR 179 (Karn)

Date of hearing:	14 August 2018
Registry:	New South Wales
Division:	General Division
National Practice Area:	Taxation
Category:	Catchwords
Number of paragraphs:	29
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Solicitor for the Respondent:	Australian Government Solicitor

ORDERS

NSD 1648 of 2017
NSD 1649 of 2017
NSD 1650 of 2017

BETWEEN:	**SATYAM COMPUTER SERVICES LIMITED (NOW AN AMALGAMATED ENTITY NAMED TECH MAHINDRA LIMITED)** Applicant
AND:	**COMMISSIONER OF TAXATION** Respondent
JUDGES:	**ROBERTSON, DAVIES AND WIGNEY JJ**
DATE OF ORDER:	**11 OCTOBER 2018**

THE COURT ORDERS THAT:

1. The question set out in the special case dated 2 May 2018 pursuant to s 25(6) of the *Federal Court of Australia Act 1976* (Cth) and r 38.01 of the *Federal Court Rules 2011* (Cth) be determined as follows in each case:

   Question

   Are payments received by the applicant from its Australian clients that are royalties for the purposes of Article 12 of the Indian Agreement (but are not otherwise royalties as defined by s 6(1) of the *Income Tax Assessment Act 1936* [(Cth)] taken to have an Australian source for the purposes of s 6-5 of the *Income Tax Assessment Act 1997* [(Cth)] by reason of Article 23 of that Agreement and the *International Tax Agreements Act 1953* [(Cth)] and therefore assessable income for the purposes of the *Income Tax Assessment Act 1936* (Cth) and *Income Tax Assessment Act 1997* (Cth)?

   Answer

   Yes.

2. The applicant pay the Commissioner's costs, as agreed or assessed.

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

REASONS FOR JUDGMENT

THE COURT:

1 Pursuant to s 25(6) of the *Federal Court of Australia Act 1976* (Cth) and r 38.02 of the *Federal Court Rules 2011* (Cth), the following question of law was reserved for determination by the Full Court on the basis of facts agreed in the special case:

> Are payments received by the applicant from its Australian clients that are royalties for the purposes of Article 12 of the Indian Agreement (but are not otherwise royalties as defined by s 6(1) of the *Income Tax Assessment Act 1936* [(Cth)] taken to have an Australian source for the purposes of s 6-5 of the *Income Tax Assessment Act 1997* [(Cth)] by reason of Article 23 of that Agreement and the *International Tax Agreements Act 1953* [(Cth)] and therefore assessable income for the purposes of the *Income Tax Assessment Act 1936* (Cth) and the *Income Tax Assessment Act 1997* (Cth)?

2 The "Indian Agreement" is a reference to 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* [1991] ATS 49 (entered into force on 30 December 1991).

3 The applicant is a resident of India for tax purposes and carries on a business providing computer technology services to customers. In the income years ended 30 June 2009, 30 June 2010 and 30 June 2011, the applicant had offices in Sydney and Melbourne through which it provided software products and information technology services to entities in Australia. The services provided by the applicant to entities in Australia were performed partly by employees located in Australia and partly by employees located in India. In *Tech Mahindra Limited v Federal Commissioner of Taxation* (2015) 101 ATR 755; [2015] FCA 1082 (***"Tech Mahindra"***), Perry J held that the payments received by the applicant for the services provided by the employees located in India (**"the Indian services"**) were "royalties" as defined in Article 12(3)(g) of the Indian Agreement and Australia was given the right to tax those payments under Article 12(2) of the Indian Agreement. That decision was upheld on appeal: *Tech Mahindra Limited v Federal Commissioner of Taxation* (2016) 250 FCR 287. An application for special leave to appeal was refused by the High Court: Transcript of Proceedings, *Tech Mahindra Limited v Commissioner of Taxation* [2017] HCATrans 58 (10 March 2017).

4 Justice Perry also held that the payments were deemed to have an Australian source by virtue of Article 23 and s 4(2) of the *International Tax Agreements Act 1953* (Cth) (**"Agreements**

Act") and were therefore taxable as Australian source income under s 6-5(3)(a) of the *Income Tax Assessment Act 1997* (Cth) (**"ITAA 1997"**). That conclusion was not challenged on appeal or considered by the Full Court in *Tech Mahindra Limited v Federal Commissioner of Taxation* (2016) 250 FCR 287. In this special case, the applicant challenges that conclusion.

5 Article 23 of the Indian Agreement provides as follows:

> **Source of income**
>
> (1) Income, profits or gains derived by a resident of one of the Contracting States which, under any one or more of Articles 6 to 8, Articles 10 to 20 and Article 22 may be taxed in the other Contracting State, shall for the purposes of the law of that other State relating to its tax be deemed to be income from sources in that other State.
>
> (2) Income, profits or gains derived by a resident of one of the Contracting States which, under any one or more of Articles 6 to 8, Articles 10 to 20 and Article 22 may be taxed in the other Contracting State, shall for the purposes of Article 24 and of the law of the first mentioned State relating to its tax be deemed to be income from sources in that other State.

6 In issue is whether, where Article 23 applies to an item of income, the item of income is deemed to have an Australian source for the purposes of the law of Australia "relating to its tax".

7 The Indian Agreement is a schedule to the Agreements Act. Until 27 June 2011, s 11Z of the Agreements Act provided:

> Subject to this Act, on and after the date of entry into force of the Indian Agreement, the provisions of the agreement, so far as those provisions affect Australian tax, have the force of law according to their tenor.

8 Section 11Z was repealed by the *International Tax Agreements Amendment Act (No 1) 2011* (Cth) and replaced by s 5 which provides in similar terms that the Indian Agreement "has the force of law according to its tenor".

9 Section 4 of the Agreements Act provides as follows:

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

10 Pursuant to s 3(1), the "Assessment Act" is defined to include the *Income Tax Assessment Act 1936* (Cth) (**"ITAA 1936"**) and the ITAA 1997 and, by the operation of s 4(1), the provisions of the ITAA 1936 and the ITAA 1997 are incorporated into the Agreements Act subject to s

4(2): *GE Capital Finance Pty Ltd v Federal Commissioner of Taxation* (2007) 159 FCR 473 (***"GE Capital"***) at [40].

11 The applicant did not dispute that the income from the Indian services (which Australia may tax as royalties under Article 12) is ordinary income of the applicant for the purposes of Australian tax law. However, the applicant contends that Article 23 of the Indian Agreement and the Agreements Act do not have the effect of deeming the amounts paid to it for the provision of the Indian services to be income from sources in Australia for the purposes of s 6-5 of the ITAA 1997 and do not result in those amounts being included in its assessable income for Australian tax purposes.

12 Section 6-5(3) relevantly provides:

> If you are a foreign resident, your assessable income includes:
>
> (a) the ordinary income you derived directly or indirectly from all Australian sources during the income year; and
>
> (b) other ordinary income that a provision incudes in your assessable income for the income year on some basis other than having an Australian source.

13 Section 995-1 of the ITAA 1997 defines "Australian source" as follows:

> Ordinary income or statutory income has an Australian source if, and only if, it is derived from a source in Australia for the purposes of the [Income Tax Assessment Acts].

14 The applicant argued that whilst Australia is allocated the right to tax the "royalties" by the Indian Agreement, it can only exercise that right if it has the right to impose tax on those amounts under Australia's domestic law and Australia's domestic law does not give Australia that right. It was submitted that whilst s 4(1) of the Agreements Act operates to incorporate the provisions of the Assessment Acts into that Act, the reverse is not true and the Assessment Acts retain their own identity and are not amended by the Agreements Act. It was argued that the purpose of Article 23 is not to create a tax liability in circumstances where there is no liability under the domestic law of the Contracting State that has the right to tax. Rather, it was said, Article 23 is a corollary to the grant of the right to tax provided for in the Indian Agreement by recognising the right of the Contracting States to enact domestic tax law deeming the source of the income to enable the exercise of the taxing rights allocated by the Indian Agreement. Support for this proposition was said to be found in the Explanatory Memorandum to the *Income Tax (International Agreements) Amendment Act (No. 2) 1991* (Cth) giving force to the Indian Agreement. It was submitted that there is nothing in that

Explanatory Memorandum that evidences the intent that, by reason of the entry into the Indian Agreement, Australia sought to impose tax on the residents of India in respect of amounts that were not otherwise liable to Australian tax.

15 We do not agree that Article 23 is merely enabling. In our view, the language of Article 23 should be given effect according to its terms and the context, object and purpose of the Indian Agreement does not warrant a different construction being given to the meaning of Article 23 which otherwise is sufficiently clear in its terms: *Task Technology Pty Ltd v Federal Commissioner of Taxation* (2014) 224 FCR 355 at [12]. The language used in Article 23(1) is "shall for the purposes of the law of that other State relating to its tax be deemed to be income from sources in that other State". As a matter of language, the Article operates to deem an item of income which one of the Contracting States has the right to tax to be from sources in that Contracting State "for the purposes of" the law of that State "relating to its tax". Section 6-5(3)(a) of the ITAA 1997 is part of the law of Australia "relating to its tax". The effect of Article 23 therefore is that the payments in question are deemed to have an Australian source for the purposes of s 6-5(3)(a).

16 We also do not agree that Article 23 is not given effect for the purposes of Australian tax law by the provisions of the Agreements Act. The effect of s 5 of the Agreements Act giving the Indian Agreement the force of law "according to its tenor" for Australian tax law purposes is to enact the Indian Agreement into Australian law (*Bywater Investments v Federal Commissioner of Taxation* (2016) 260 CLR 169 (**"Bywater Investments"**) at [147]), with the result that the deeming of source effected by Article 23 is given the force of law for Australian tax law purposes. The effect of s 4(1) of the Agreements Act is that both that Act and the Assessment Acts are to be interpreted and read as one. Whilst the Assessment Acts still retain their own identity (*GE Capital* at [40]), to the extent of any inconsistency between the provisions of the Agreements Act and the provisions of the Assessment Acts (other than Part IVA, which is not relevant here) the provisions of the Agreements Act have effect and override the provisions of the Assessment Acts. As Middleton J observed in *GE Capital* at [44] the "obvious purpose of s 4(2) is to ensure that the Agreements Act is to prevail, but only in respect of its field of operation and according to its provisions". Accordingly, because of the combined operation of ss 4 and 5 of the Agreements Act, it is not to the point that the Agreements Act is not incorporated into the Assessment Acts.

17 The question is whether there is any inconsistency between Article 23, which is enacted into Australian domestic tax law, and provisions of the Assessment Act with the result that to the extent of that inconsistency Article 23 prevails. Relevantly in the present case, an inconsistency arises because of the definition of "Australian source" in s 995-1 of the ITAA 1997, with the result that the payments in question have an Australian source for the purposes of s 6-5(3)(a) notwithstanding the definition of "Australian source" in s 995-1 of the ITAA 1997.

18 This effect is recognised and affirmed by s 3AA(2) of the Agreements Act. By s 3AA(2), for certain classes of income that are not presently relevant, provisions of double tax agreements in the terms of Article 23 (which the legislation refers to as "source of income provisions") do not apply in working out for the purposes of the Assessments Acts whether that income is attributable to sources in Australia.

19 Nor does this construction involve any notion of the Indian Agreement "amending" the definition of "Australian source" in s 995-1 of the ITAA 1997. The effect of s 4(2) of the Agreements Act is that the provisions of Article 23 are the "leading" provisions and the definition of "Australian source" in s 995-1 of the ITAA 1997 is the "subordinate provision" which "must give way" to the former: *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 (***"Project Blue Sky"***) at [70]. No question of amendment of the ITAA 1997 arises (or for that matter of the ITAA 1936 as it was in 1991 at the time that the Indian Treaty was given the force of law).

20 Thus, we do not accept the submission that there is no Australian taxing law that imposes tax on the income from the Indian services. That income is included in the applicant's assessable income under s 6-5(3)(a) of the ITAA 1997 because it is income from an Australian source by reason of the combined operation of Article 23 of the Indian Agreement, ss 4 and 5 of the Agreements Act and s 6-5(3)(a) of the ITAA 1997. As the amounts form part of the applicant's assessable income, such amounts are an integer in the calculation of the applicant's taxable income under s 4-15(1) of the ITAA 1997 and therefore part of the amount on which income tax must be paid by reason of s 4-10 of the ITAA 1997 and s 5 of the *Income Tax Act 1986* (Cth).

21 It was submitted that the Commissioner's position was contrary to the approach adopted in India, where the courts have recognised that a provision of a double tax agreement cannot fasten a tax liability where the liability is not otherwise imposed by a local Act: *CIT v R.M.*

Muthiah (1993) 202 ITR 508 at 512-3; *Union of India v Azadi Bachao Andolan* (2003) 263 ITR 706 at 724 (SC); *CIT v P.V.A.L. Kulandagan Chettiar* (2004) 267 ITR 654 at 659 (SC); *Verizon Communications Singapore Pte Ltd v The Income Tax Officer* (2014) 361 ITR 575 (Mad) at 594, [23]; *Wipro Ltd v DCIT* (2016) 382 ITR 179 at 205, [36] (Karn). However, the Commissioner did not argue that the Indian Agreement operated to impose a liability separate and independent from the operation of Australia's domestic law. The construction urged by the Commissioner, which the Court accepts, does not give rise to an inconsistent interpretation of the provisions of the Indian Agreement. This is because it is not the interpretation of the Indian Agreement which would produce that inconsistency, if there be one, but the effect of Australia's domestic law in ss 4 and 5 of the Agreements Act which would produce that result: cf *Bywater Investments* at [148].

22 Nor, contrary to the applicant's submissions, does the Commissioner's construction give rise to the prospect of double taxation. That is because of Article 23(2) which relevantly provides that income derived by a resident of one of the Contracting States which may be taxed in the other Contracting State under Article 12 "shall for the purposes of Article 24 and of the law of the firstmentioned State relating to its tax be deemed to be income from sources in that other State". Article 24(4) relevantly provides:

> **Methods of elimination of double taxation**
>
> (4) In the case of India, double taxation shall be avoided as follows:
>
> (a) the amount of Australian tax paid under the laws of Australia and in accordance with the provisions of this Agreement, whether directly or by deduction, by a resident of India in respect of income from sources within Australia which has been subjected to tax both in India and Australia shall be allowed as a credit against the Indian tax payable in respect of such income but in an amount not exceeding that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax; and
>
> (b) for the purposes of the credit referred to in subparagraph (a) above, where the resident of India is a company by which surtax is payable, the credit to be allowed against Indian tax shall be allowed in the first instance against the income tax payable by the company in India and, as to the balance, if any, against the surtax payable by it in India.

23 By Article 23(2), the reference to "income from sources within Australia" in Article 24(4)(a) encompasses the income deemed to be income from sources in Australia by the operation of Article 23(1).

24 The history of the source of income provisions (as they are referred to in s 3AA(2) of the Agreements Act) in Australia's tax treaties does not advance the applicant's case. The parties gave a different account of the history but in the light of the text of Article 23(1) the purpose of that Article is clear. It is to perfect the taxing rights to which the treaty refers by providing that, for the purposes of, relevantly, Australian tax law, such income has a source in Australia. Contrary to the applicant's submission, the Explanatory Memorandum to the *Income Tax (International Agreements) Amendment Act (No. 2) 1991* (Cth) giving force to the Indian Agreement supports this construction. In relation to Article 23 the Explanatory Memorandum states (at pp. 30-31):

> Article 23 effectively deems income, profits or gains derived by a resident of one country which, under the agreement, may be taxed in the other country, to be income from sources in the latter country for the purposes of the domestic laws of both counties and Article 24 (Methods of Elimination of Double Taxation) of the agreement. It thus ensures the jurisdictional (source) right of each country to exercise the taxing rights allocated to it by the agreement over residents of the other country.
>
> The article is also designed to ensure that where an item of income, profits or gains is taxable under the agreement by both countries, double taxation relief will be given by the country of residence of the recipient of the income, profits or gains (pursuant to Article 24) in respect of tax levied by the other country in accordance with the taxing rights allocated to it under the agreement. To this end, the article effectively provides for income, profits or gains derived by a resident of Australia which is taxable by India under the agreement to be treated as foreign income for the purposes of the foreign tax credit provisions of the ITAA.

25 Insofar as the source of income provisions are about the provision of credit relief in the resident state for tax paid in the source state, as the applicant submitted, that is the purpose of Article 23(2). As Perry J stated in *Tech Mahindra* at [37], it is Article 23(2), not Article 23(1), which operates for the purposes of Article 24 of the Indian Agreement and for the purposes of the law of the resident state.

26 The applicant also placed store on the generalised principle that tax treaties are, and can only be, exclusively relieving: that is, they are only ever "shields not swords" and not the grant of a standalone taxing power and independent imposition of taxation. The Commissioner did not cavil with the proposition that tax treaties do not grant a standalone taxing power or the independent imposition of taxation (see *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4)* (2015) 102 ATR 13; [2015] FCA 1092 and the cases cited at [50]–[52]) or that the allocation of the tax rights they effect is permissive. They do not oblige the contracting states to tax: *Federal Commissioner of Taxation v Lamesa Holdings BV* (1997) 77 FCR 597

(***"Lamesa"***) at 600-601; *GE Capital* at [36]. However none of these generalisations establish the proposition that Article 23 does not operate according to its terms.

27 Finally, we reject the submission that the conclusion in *Tech Mahindra* at [36]–[37] involves "a substantial reconstruction of the statutory scheme that assesses and imposes taxation in Australia". That assertion was said to arise by reason of the limitation of the rates at which income within the definition of "royalty" in the Indian Agreement can be assessed by reason of Article 12(2). This was also said to create two classes of taxable income: those subject to the caps in Article 12(2) and those not so subject which, it was submitted, "tells against" the conclusion in *Tech Mahindra* at [36]–[37]. This submission is rejected. Article 12(2) and the legislation giving effect to it simply operate in accordance with their terms and do so harmoniously with the other provisions to achieve the legislative intention, namely to include income of the kind now in dispute in assessable income but subject to the limitation in Article 12(2). 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].

28 In summary, the text of Article 23(1) of the Indian Agreement is not ambiguous. Its "effect" is given paramountcy by s 4(2) of the Agreements Act and that effect is recognised and affirmed by s 3AA(2) of the Agreements Act. There is nothing in the context, object or purpose of the Indian Agreement or the Agreements Act which permits it to be read down to conform with a generalised assertion about the "effect" of tax treaties drawn from outside the text of the Indian Agreement.

29 The question reserved for determination by the Court should be answered "yes" in each case. The applicant is to pay the Commissioner's costs, as agreed or assessed.

I certify that the preceding twenty-nine (29) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justices Robertson, Davies and Wigneyj.

Associate:

Dated: 11 October 2018