# Decision impact statement

## Burton v Commissioner of Taxation

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| **Court citation(s):** | [2019] FCAFC 141 |
| **Venue:** | Full Federal Court<br>High Court (special leave application) |
| **Venue reference no:** | Full Federal Court – reference no. WAD 600 of 2018<br>High Court (special leave application) – reference no. P44 of 2019 |
| **Judges:** | Full Federal Court – Justices Logan, Steward and Jackson |
| **Judgment date:** | Full Federal Court – 22 August 2019<br>High Court – refusal of special leave – 13 February 2020 |
| **Appeals on foot:** | No |
| **Decision outcome:** | Favourable to the Commissioner |

## Impacted advice

The ATO has reviewed the impact of this decision on related advice and guidance products.

## Précis

This Decision impact statement outlines the ATO's response to this case which concerns entitlement to foreign income tax offsets (FITOs) under subsection 770-10(1) of the *Income Tax Assessment Act 1997*[1] where an Australian resident pays tax in the United States of America (US) on a capital gain that is only partly assessable in Australia.

## Brief summary of facts

The taxpayer was an Australian resident for income tax purposes. As the beneficiary of a trust estate, section 115–215 treated him as a taxpayer who had derived capital gains made on the disposal of rights that had been held by the trust for more than 12 months.

The taxpayer paid the income tax assessed by the US on the whole of those gains, but at a discounted rate compared to that payable on ordinary income subject to US income tax.

[1] All legislative references in this Decision impact statement are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

Pursuant to the ITAA 1997, only part of the US capital gains was included in his Australian assessable income. This was because in one of the relevant years of income he had unrecouped capital losses which, pursuant to the method statement contained in subsection 102-5(1), reduced his assessable capital gain by the amount of those losses. His US capital gains were also further reduced, pursuant to that subsection, by the 50% discount applicable to capital gains resulting from the disposal of assets held for more than 12 months.

The taxpayer claimed FITOs in his Australian tax returns in respect of the US-sourced gains that were equal to the whole of the assessed US income tax that he had paid. The Commissioner issued amended income tax assessments to the taxpayer that reduced those FITOs to amounts equal to the US income tax paid in respect of the amount of the gains which were included in the taxpayer's assessable income in Australia. This is consistent with the Commissioner's view as expressed in ATO Interpretative Decision ATO ID 2010/175 *Foreign income tax offset: entitlement where foreign capital gain is only partly assessable in Australia*.

The taxpayer's objections to these amended assessments were disallowed. An appeal to the Federal Court (McKerracher J) against that decision was dismissed. A further appeal to the Full Federal Court (Logan, Steward and Jackson JJ) was also dismissed (by a majority – Logan J dissenting). A subsequent application to the High Court of Australia for special leave to appeal the Full Federal Court's decision was refused.

## Issues decided by the Court

Per Steward, Jackson J agreeing, Logan J dissenting - the reference in Article 22(2) of the tax treaty between the Australia and the US[2] to '*the income'* (that is, in respect of which Australian tax was payable by an Australian resident on income derived from sources in the US') should be read as a concept independent of, but not divorced from, the domestic income tax regimes of each sovereign power. There was no reason to read that expression, as contended by the taxpayer, as referring to one indivisible gain that was the subject matter against which the competing States sought to impose tax. Because the purpose of Article 22(2) was the allowance by Australia of a credit against tax payable, the starting point was the identification of what Australia taxed. Due to the operation of subsection 102-5(1), Australia did not tax all of the gain; it taxed 50% of it (or less if capital losses were offset). That was *'the income'* for the purposes of Article 22(2), in respect of which Australian tax was payable. For that reason only half (or less if capital losses were offset) of the US tax paid could be said to be in respect of income taxed in Australia.

Per the whole Court – the reference in subsection 770–10(1) to foreign tax paid *'in respect of … an amount included in your assessable income'* was a reference only to the proportion of the foreign tax paid on the net capital gain that was included in assessable income, as determined by subsection 102-5(1).

Per Steward, Jackson J agreeing, Logan J dissenting – even if the Court were to accept the taxpayer's interpretation of Article 22(2), but not his interpretation of subsection 770–10(1), Article 22(2) did not, of its own force, oblige the Commissioner to allow a credit but instead only imposed an obligation on the Commonwealth of Australia as a sovereign state to enact suitable legislation to give effect to the Article. In addition, there was no legislative mechanism, despite the existence of sections 4,

[2] *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 (the Treaty).

5, and 16 of the *International Tax Agreements Act 1953* and section 4–10 of the ITAA 1997, by which such a credit could be allowed.

## ATO view of decision

The decision of the majority of the Full Federal Court reflects the Commissioner's view of the law and has no impact for the ATO.

The Court's interpretation of subsection 770–10(1) confirms the correctness of the Commissioner's view expressed in ATO ID 2010/175 – that is, that where a resident of Australia pays foreign income tax on the whole of a foreign capital gain which is only partly assessable in Australia, only a proportionate share of the foreign income tax counts towards the foreign income tax offset under subsection 770–10(1).

It also reflects the Commissioner's view that subsection 770–10(1) is not inconsistent with Article 22(2) of the Treaty and that in any event Article 22(2) does not directly, of its own force, create an entitlement for a taxpayer to a credit for foreign income tax paid.

## Implications for impacted advice or guidance

The decision confirms the correctness of the Commissioner's view expressed in ATO ID 2010/175

## Comments

We invite you to advise us if you feel this decision has consequences we have not identified. Please forward your comments to the contact officer.

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| **Date issued:** | 22 April 2020 |
| **Due date:** | 5 June 2020 |
| **Contact officer:** | Contact officer details have been removed as the comments period has expired. |

### Legislative references

*Income Tax Assessment Act 1997*
4-10
102-5(1)
115-215
770-10(1)

*International Tax Agreements Act 1953*
4
5
16

*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, Article 22(2)

*Vienna Convention on the Law of Treaties* [1974] ATS 2, Art 31

**Case references**

*Anson v Commissioners for Her Majesty's Revenue and Customs* [2015] UKSC 44

*Carr v The State of Western Australia* [2007] HCA 47; 232 CLR 288; 82 ALJR 1; 239 ALR 415

*Certain Lloyd's Underwriters Subscribing to Contract No IH00AAQS v Cross* [2012] HCA 56; 248 CLR 378; 87 ALJR 131; 293 ALR 412

*Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation (No 4)* [2015] FCA 1092; 102 ATR 13; 2015 ATC 20-535

*Commissioner of Inland Revenue v Lin* [2018] NZCA 38

*Commissioner of Taxation v Lamesa Holdings BV* [1997] FCA 7; 77 FCR 597; 36 ATR 589; 97 ATC 4752

*ConnectEast Management Ltd v Commissioner of Taxation* [2009] FCAFC 22; 175 FCR 110;; 75 ATR 101; 2009 ATC 20-095;

*Duckering (Inspector of Taxes) v Gollan* [1965] 2 All ER 115

*Esso Australia Resources Ltd v The Commissioner of Taxation of the Commonwealth of Australia* [1998] FCA 1655; 83 FCR 511; (1998) 40 ATR 512

*Commissioner of Taxation v Greenhatch* [2012] FCAFC 84; 203 FCR 134; 2012 ATC 20-322; 88 ATR 560

*Prebble v Commissioner of Taxation* [2003] FCAFC 165; 131 FCR 130; 53 ATR 513; 2003 ATC 4770

*McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation* [2005] FCAFC 67; 142 FCR 134; [2005 ATC 4398; 59 ATR 358

*Mutual Life & Citizen's Assurance Co Ltd v Commissioner of Taxation (Cth)* [1959] HCA 21; 100 CLR 537; 33 ALJR 54; [1959] ALR 733

*Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28; 194 CLR 355; 72 ALJR 312; 153 ALR 490

*Satyam Computer Services Ltd v Commissioner of Taxation* [2018] FCAFC 172; 266 FCR 502; 2018 ATC 20-671; (2018) 108 ATR 822

*Stevens v Kabushiki Kaisha Sony Computer Entertainment* [2005] HCA 58; 224 CLR 193; 79 ALJR 1850; 221 ALR 448

*Thiel v Commissioner of Taxation* [1990] HCA 37; 171 CLR 338; 21 ATR 531; 90 ATC 4717

*Woodside Energy Ltd (ABN 63 005 482 986) v Commissioner of Taxation (No.2)* [2007] FCA 1961; 69 ATR 465