TR 2001/13 - Income tax: Interpreting Australia's Double Tax Agreements

This cover sheet is provided for information only. It does not form part of *TR 2001/13 - Income tax: Interpreting Australia's Double Tax Agreements*

This ruling is being reviewed as a result of a recent court/tribunal decision. Refer to Decision Impact Statement: Virgin Holdings SA v Commissioner of Taxation; Undershaft (No. 1) Limited and Undershaft (No. 2) BV v Commissioner of Taxation (Published 29 July 2009).

This ruling contains references to repealed provisions, some of which may have been re-enacted or remade. The ruling has effect in relation to the re-enacted or remade provisions. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten.
Australia's tax treaties and other agreements except for the Taipei Agreement are set out in the Australian Treaty Series. The citation for each is in a note to the applicable defined term in sections 3AAA or 3AAB of the International Tax Agreements Act 1953.

This document has changed over time. This is a consolidated version of the ruling which was published on *19 December 2001*

Taxation Ruling
Income tax: Interpreting Australia's Double Tax Agreements

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Preamble

This document does not rule on the application of a 'tax law' (as defined) and is, therefore, not a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953****. The document is, however, administratively binding on the Commissioner of Taxation. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Ruling is about

1. This Ruling has been issued to guide ATO staff in interpreting Australia's double tax agreements (DTAs). The manner in which DTAs are interpreted is in some respects different from, and in some respects similar to, the way in which domestic tax legislation is interpreted. This Ruling aims to address some of those differences and similarities in a way that assists those who normally interpret domestic law statutes, in cases where they are dealing with DTAs.

2. The first half of the Ruling (comprising the What this Ruling is about section and Parts 1 and 2 of the Ruling and explanations section) discusses general treaty concepts affecting treaty interpretation. The second half (comprising Parts 3 and 4 of the Ruling and explanations section) explains specific interpretative rules and principles relevant to interpreting DTAs. Within this framework, the What this Ruling is about section provides an initial explanation of DTAs and how they are incorporated into Australian domestic law. Part 1 of the Ruling and explanations section addresses the methods utilised in DTAs to avoid double taxation, and how taxing rights are allocated between the two countries that have concluded a DTA.

3. Part 2 of the Ruling and explanations section then explains that while there are two major international 'Models' for DTAs, each DTA is a result of separate bilateral negotiations; consequently, each treaty has its differences. Having examined these broad concepts, Parts 3 and 4 of the same section identify specific interpretative rules which should be used.

4. Each of Australia's DTAs is a bilateral agreement between Australia and another country[1] under which Australia undertakes to

[1] The *Taipei Agreement* (Schedule 41 to the *International Tax Agreements Act 1953*) is a special case, and is differently framed, but the interpretative

apply its taxation laws in accordance with the terms of the agreement it has negotiated. Australia meets its obligations under its DTAs by incorporating them directly into our domestic law. Each Australian DTA is given the force of law domestically under the *International Tax Agreements Act 1953* (the 'Agreements Act') and is incorporated as a schedule to that Act. See, as an example, in relation to the *Vietnamese Agreement*, section 11ZC and Schedule 38[2].

5. As well as giving DTAs the force of law, the Agreements Act clarifies the status of DTAs with respect to the 'Assessment Act'[3] and the various income tax 'Rates Acts'. The effect of subsection 4(1) of the Agreements Act, in particular, is that the DTAs are to be interpreted and read as one with the Assessment Act. While each *DTA itself* is a treaty, and only the other country party to it can take action on it internationally, the provisions of the DTAs become part of Australian domestic law by legislative action, and are just as legally effective in domestic law as the provisions of the Assessment Act. The provisions of a DTA can therefore be relied on, in their implemented form, by individual taxpayers before Australian courts.

6. Subsection 4(2) of the Agreements Act deals with possible conflicts by effectively providing that the terms of the DTAs override those of the Assessment Act (except for Part IVA of the *Income Tax Assessment Act 1936*, which is a general anti-avoidance provision, and section 160AO of the same Act, dealing with maximum credits) and the Rates Acts, in the event of any inconsistency.

7. The above analysis reflects the fact that our DTAs have two parallel characters and operate simultaneously on two levels. They first of all represent obligations that Australia has undertaken at the international law level, and on which only the other country may directly rely. Once they are implemented by legislation they also, however, represent domestic law obligations, on which individual taxpayers may rely before Australian courts. While the issues considered by ATO officers will usually relate to the domestic law implementation of DTAs, those issues can only be properly analysed,

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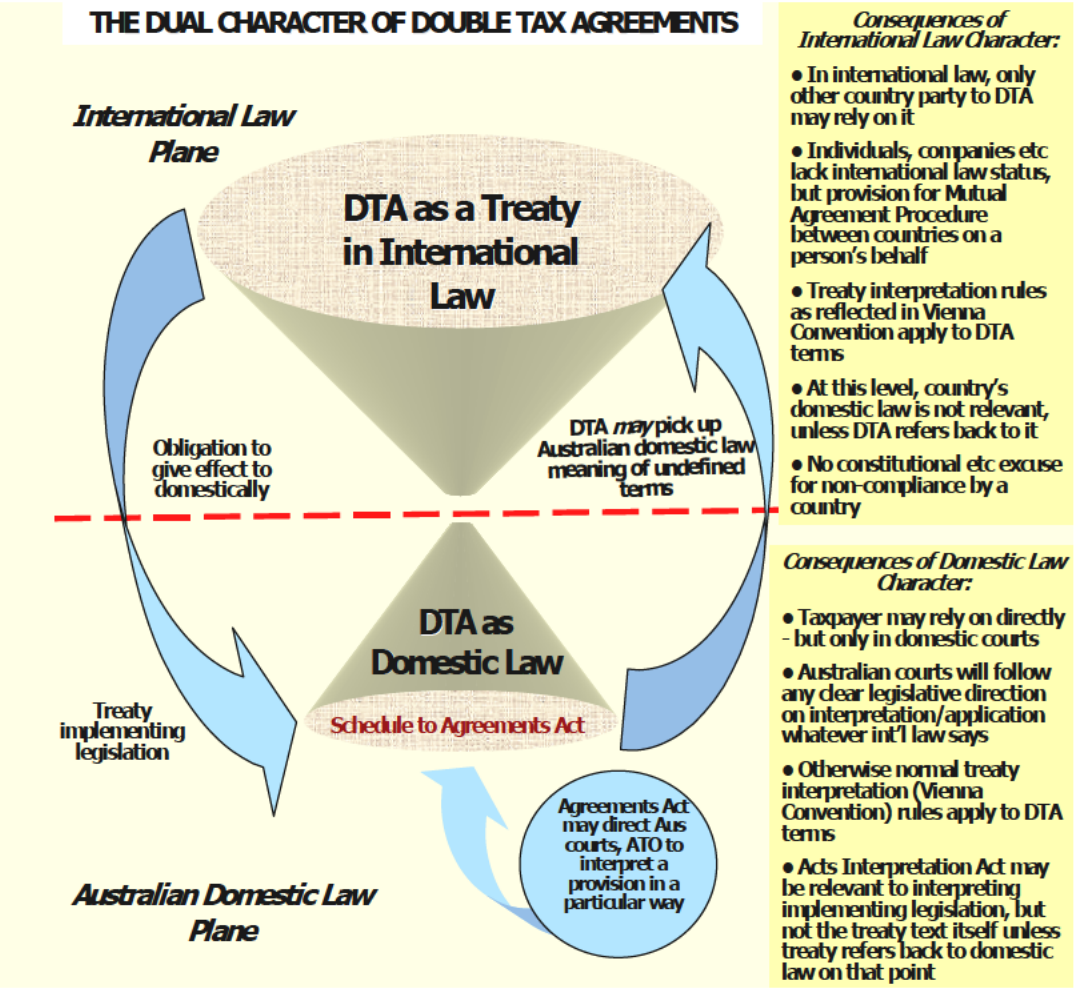
approaches discussed below would equally apply. Some DTAs are formally termed Double Taxation '*Conventions*', but that is a matter of form and does not denote any difference of substance.

[2] Note, as an exception, that the *Non-Discrimination* Article (Article 23) of the *United States Convention* (Schedule 2 to the Agreements Act) was not implemented in our domestic law, but operates only at the international level: subsection 6(1) of the Agreements Act. This operation at the government-to-government level only is also apparent from the terms of the Article: 'Each Contracting State in enacting tax measures shall ensure that: ...'. Article 23 therefore cannot give rise to legally enforceable rights for taxpayers and only the respective governments can take action on it internationally.

[3] The reference to the 'Assessment Act' is to the *Income Tax Assessment Act 1936* or the *Income Tax Assessment Act 1997*, as appropriate, as indicated by the definition at subsection 3(1) of the Agreements Act.

and their implications fully understood, when the 'parallel lives' of Australian DTAs are kept in mind. Some of the consequences flowing from this character are considered in more detail below, particularly at Parts 3 and 4 of this Ruling.

8. The dual character of DTAs may be diagrammatically expressed as follows:



Ruling and explanations

Part 1: How DTAs avoid double taxation

Introduction

9. The main structural mechanism by which a DTA avoids double taxation is to 'distribute' or 'allocate' taxing rights over 'income'[4] between those countries that are parties to the DTA and to

[4] The term 'income' is used in this Ruling in a broad sense, to cover all fiscal receipts the subject of a DTA, including, as an example, capital gains. Most of Australia's older DTAs do not, in the ATO's view, generally deal with

require the 'residence' country to relieve double taxation for any 'source' taxation levied in accordance with the treaty. By this means they essentially reconcile competing domestic law taxing claims based on the residence of the taxpayer and the source of the income concerned.

10. This Part discusses the different methods of 'allocating' these rights between the countries. It also addresses the issue of whether a DTA may create a taxing right where such right previously did not exist under a country's domestic law and, finally, it considers the consequences of a country not exercising a taxing right 'allocated' to it under the DTA's terms.

11. The basis for the 'allocation' of taxing rights varies for different categories of income. For some categories of income the taxation right is reserved solely to the country of 'residence' (for the purposes of the DTA) of the taxpayer. For other categories, the DTAs provide for both countries to tax the income (with in some cases the tax of the country of source being limited) with the country of residence providing relief for tax paid in the other country, thus avoiding double taxation. In some rare cases, the country in which the income is sourced may be given an exclusive taxing right.

Resolution of dual residence and dual source cases

12. Unrelieved double taxation can arise where, because of differing domestic law rules, two countries both claim to be the country of 'residence' of the taxpayer[5] and/or the country of 'source' of the income concerned. Moreover, as these are the basic criteria for the distribution or allocation of taxing rights under a DTA, it is important that they be clearly defined for the purposes of the DTA.

13. Accordingly, the DTAs contain 'tie-breaker' rules to ensure that a dual resident 'person' (whether an individual, company or other entity) is treated as a resident of only one of the countries for the purposes of the DTA[6]. Australia's DTAs also generally contain a

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Australian capital gains, but new DTAs negotiated since the introduction of an Australian capital gains tax do. See generally on this point the Taxation Ruling on pre-capital gains tax treaties: TR 2001/12.

[5] For example, the country of a company's incorporation (country A) may regard the company as resident there on that basis, according to its domestic law, while the other country (country B) may regard it as resident in country B on the basis of its central management and control being there, with that being a test of 'residence' under its domestic law.

[6] The *United States Convention* (Schedule 2 to the Agreements Act) is an exception in that it only has such 'tie-breaker rules' for individuals, not companies. This is because the terms 'United States corporation' and 'Australian corporation' are defined to effectively exclude the application of the Convention to dual resident companies. The tie-breaker rules do not of themselves directly affect whether the person is a resident of a country at domestic law – for such purposes the

Source of Income Article, or other provisions, to clarify the source of the various categories of income subject to the 'distributive' rules and other double tax relief provisions in the DTA[7]. In the case of some DTAs, those source provisions are to be found in the Agreements Act[8] and will govern the interpretation by the ATO and Australian courts of the DTA, for the reasons outlined below[9].

Residence country-only taxation

14. As noted above, DTAs provide that some types of income are to be taxed only by the country of residence of the recipient for the purposes of the DTA (the 'residence country'). A common example of a 'residence country-only' taxing right under a DTA is that provided for in relation to international shipping and airline profits[10], mainly because of the difficulties associated with determining the source of such profits. Most pensions are also taxable only in the country of residence of the pensioner under Australia's DTAs[11].

The case of 'business profits': Residence country-only taxation, or full taxation by both countries with residence country relief

15. The DTAs provide, as a more complex example, that a country may not tax 'business profits' (or 'industrial or commercial profits', in some older DTAs) derived by an enterprise of the other DTA party unless the profits are attributable to a permanent establishment ('PE')[12] situated in the first ('host') country, through which PE the

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'person' remains a domestic law resident of each of the countries. The DTA will override the general domestic law to the extent of the inconsistency, such as where it limits taxing rights over 'non-residents' under the treaty, but it will leave unaffected the person's ability to claim, for example, family allowances only available to residents under domestic law. In some cases a country's domestic law may make domestic law residence status or the operation of particular domestic tax rules depend on treaty residence status after application of the tie-breaker test. For example, in Australia this incorporation of treaty concepts of residence occurs in the definition of 'prescribed dual resident' at subsection 6(1) of the *Income Tax Assessment Act 1936* and of 'Part X Australian resident' at section 317 of the same Act.

7 See, for example, Article 22 of the *Vietnamese Agreement* (Schedule 38 to the Agreements Act).

8 Examples are subsection 11(3) of the Agreements Act, in relation to the *German Agreement* (Schedule 9 to the Agreements Act) and subsections 11ZF(2) and (3) of the Agreements Act, in relation to the *Taipei Agreement* (Schedule 41 to the Agreements Act).

9 See below, at paragraph 77ff.

10 Article 8 in most DTAs.

11 Article 18 in most DTAs. See the discussion at paragraph 21 below for an exception.

12 The term 'permanent establishment' is a key term that is defined in some detail in DTAs, usually at Article 5. As Paragraph 1 of the OECD Commentary to Article

enterprise carries on business in that country. Where there *is* such a PE, both the host country to the PE and the country of residence of the enterprise may tax income derived by it through that PE, with a credit or exemption being given by the second (residence) country for tax paid in the host country of the PE.

Full source country taxation – with residence country relief

16. For some other categories of income, DTAs also allow what can be termed for present purposes the country of 'source' of the income to fully tax, but again require the residence country to effectively reduce or eliminate its taxes so that there is no double levy of taxation.

17. An example is the *Alienation of Property* Article usually found at Article 13 of Australia's DTAs. It provides, amongst other things, that where real property situated in a country is disposed of by a resident of the other DTA country, the first country may tax the resulting profit. A credit or exemption must be given by the second (residence) country to relieve double taxation, in accordance with the *Methods of Elimination of Double Taxation* Article, which is at Article 23 in most of Australia's DTAs.

18. The *Alienation of Property* Article in Australian DTAs negotiated since the introduction of the general Australian 'capital gains tax' also incorporates a 'sweep-up' provision. This allows each country to apply its domestic law to tax gains of a capital nature derived from an alienation of property not otherwise dealt with by the Article, with the residence country providing the usual relief from double taxation under the *Methods of Elimination of Double Taxation* Article. This differs from the OECD Model, which provides a *residence* country-only sweep-up in these circumstances[13].

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5 of the OECD Model says: '[t]he main use of the concept of permanent establishment is to determine the right of a Contracting State to tax the profits of an enterprise of the other Contracting State'.

[13] Australia has made a 'Reservation' to the OECD Model expressing its different approach on this issue. As to Reservations, see below at paragraph 109ff. The standard Australian provision reflecting that Reservation is closely related to the alternative 'sweep-up' provision provided for in the United Nations Commentary on Article 13 of the UN Model Tax Convention: UN, UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES (1980) p 150. The UN Model was recently released in a 2001 edition, but in this respect it has not been relevantly amended.

Source country taxation limited by rate – with residence country relief

19. In other cases the source country may tax the income, but only to a specified extent. For example, dividends, interest and royalties may usually be taxed by both countries - with the source country tax rate being limited and with the residence country providing double tax relief. This may be dealt with in the DTA by requiring a DTA party to give a credit for foreign tax actually paid. The other major method for relieving double taxation is where the DTA requires a country to give an exemption for tax on the relevant income. Australia uses the credit method in its DTAs (with the DTA partners often providing for an exemption, on their part) though sometimes at domestic law Australia goes further than is required of it by the DTA and provides a full exemption[14]. The use of the domestic law exemption method of double tax relief, rather than the credit method specified by the DTA, is common internationally and is regarded by the ATO as fully consistent with Australia's treaty obligations.

20. The source country tax rate on interest or royalties is typically[15] limited to 10% of the gross amount of the interest or royalties. Dividend withholding tax rates are often limited to a maximum of 15%, but in Australia's more recent DTAs some categories of dividends (such as fully franked dividends flowing to a treaty partner resident company shareholder, directly holding at least 10% of the voting power in the Australian company paying the dividends) may be taxed at lower rates (such as 5%[16]) or may not be taxed at all by the source country[17]. Of DTAs currently in force in Australia, most of the earlier ones, such as the *Netherlands Agreement*, have a flat 15% maximum rate of source country taxation on all dividends[18].

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[14] Even when there is no DTA, double tax is often in practice avoided through a 'unilateral' foreign tax credit, or exemption system, under a country's domestic law (such as ss 23AH, 23AJ or 160AF of the *Income Tax Assessment Act 1936*, in Australia's case). A DTA may sometimes simply confirm that domestic law position in an instrument binding at international law.

[15] Though not always; the *Indian Agreement* (Schedule 35 to the Agreements Act) provides, for example, for a maximum interest withholding tax of 15% (Article 11) and differentiated rates of royalty withholding tax of up to 20% (Article 12).

[16] For example, the *Czech Agreement* (Schedule 40 to the Agreements Act). As in that Agreement, the criteria for the lower dividend withholding tax rate may be different for dividends paid by the treaty partner resident companies to Australian company shareholders.

[17] *Finnish Agreement* (Schedule 25 to the Agreements Act) Article 10; *South African Agreement* (Schedule 42 to the Agreements Act).

[18] Schedule 10 to the Agreements Act.

Exclusive source country taxation

21. As mentioned earlier, it is comparatively rare for a DTA to provide an exclusive taxing right to the 'source' country. However, the OECD Model Convention and some of Australia's DTAs provide for certain government service remuneration and pensions to be treated as taxable only in the source country. Article 19 of the *Spanish Agreement*[19] provides an example of this.

The words used to allocate taxing rights

22. It is important to note that the distributive rules in the DTAs allocate taxing rights on a 'shall be taxable only' or 'may be taxed' (by one of the countries) basis. As demonstrated by the decision in *Chong v FC of T*[20], the inclusion of the word 'only' in the former case denotes the allocation to one of the Contracting States of an *exclusive* taxing right over the category of income flow concerned. The latter formula ('may be taxed') does not itself affect the taxing right of the other Contracting State although, as noted already, the *Methods of Elimination of Double Taxation* Article may require the residence country to give relief by means of a credit or exemption.

23. A common mistake in the practical consideration of a DTA is to see the phrase 'may be taxed' as indicating that the country referred to (usually the source country) is the only one *entitled* to tax that category of income, but that it need not do so (because of the word 'may') while viewing the phrase 'shall be taxable only' as *requiring* the country mentioned (usually the residence country) to tax that income. In fact, a country is never *required* by a DTA to exercise a taxing right under that DTA if it does not wish to. What the phrase 'may be taxed' normally means is that the country mentioned (the source country) has a non-exclusive *entitlement* to tax the income. Under normal international tax principles, the other (residence) country may also continue to tax its residents (where its domestic law so provides) on the income, wherever sourced, unless the DTA explicitly prevents it from doing so.

24. Correspondingly, the phrase 'shall be taxable only' limits the exercise of a domestic law taxing power to the country concerned – that country has an exclusive taxing right. For the other country to exercise a domestic law taxing right would be contrary to the DTA, and that attempt would be ineffective at domestic law anyway, to the extent that the treaty as implemented takes precedence (in the country's domestic law) over other domestic law in the event of a conflict.

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[19] Schedule 39 to the Agreements Act.
[20] 2000 ATC 4315.

25. Where the DTA requires a credit to be given by the residence country, there are 'shared taxing rights' but the source country is said to have the 'primary taxation right' because the residence country must give relief for the tax paid to the source country and therefore only effectively receives tax equal to the difference between the tax payable in the source country and the tax payable in the residence country. That may be nothing if the residence country has lower rates than the source country. If the DTA requires the other country to give an exemption (as Austria is required to do in certain circumstances, under the *Austrian Agreement*[21], for example) there is, of course, effectively no 'secondary taxing right' given to the residence country. Even though the income cannot be taxed in the residence country in such cases, the DTA may provide for the exempted income to affect the tax levied on other income of its resident under the 'exemption with progression' system which a number of exemption countries apply[22].

26. It follows from the different types of 'distributive rules' in the DTAs, and the varying ways in which they allocate the taxing rights over income between countries, that it is essential to decide which DTA category the income falls within, because that will determine which country may or may not tax it.

Domestic law taxing rights not addressed by a DTA

27. Goldberg J noted in *Chong v. FC of T*[23] that:

> When one refers to an allocation of taxing power one is doing no more than saying that in an area where both contracting states have the right to impose taxation, and may have already imposed taxation, they have agreed that one contracting state, rather than the other or, as the case may be, both contracting states, shall have the right to impose taxation in that area. Whether one uses the language of allocation of power or the language of limitation of power, the result is the same: there is designated or agreed who shall have the right under the agreement to impose taxation in the particular area.

28. It appears to follow from his Honour's analysis that in an area where a DTA party exercises, or both parties exercise, a domestic law right to impose taxation, a DTA which does not allocate that area of taxation to either country will leave the domestic law exercise of taxing rights unaffected, rather than implicitly rendering them ineffective. This is the generally accepted view internationally, and it represents the ATO view.

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[21] Schedule 27 to the Agreements Act, Article 23(3)(a).
[22] As specifically provided for in the *Austrian Agreement,* Article 23(3)(c).
[23] 2000 ATC 4315 at 4322 (paragraph 26).

Are DTAs a 'shield' rather than a 'sword' for taxing rights?

29. As indicated above, DTAs are generally seen as intended to operate in a 'permissive' manner in relation to the domestic laws of the Contracting countries, not in an 'empowering' fashion so as to impose, through the words of the DTAs, a further liability to tax. It has often been said that they thus provide a 'shield' against double taxation but not a 'sword' for the respective revenue authorities to rely on.

30. It is true that a central purpose of DTAs is to reconcile competing claims to tax jurisdiction that might otherwise apply under the respective laws of the countries, and that whether and how practical effect is given to the distributive rules in a DTA remains for the most part governed by the ordinary domestic law rules. Nevertheless, the most accurate expression of the position is that countries could, if they wished, provide, through the clear words of a treaty, to expand the existing areas of domestic tax liability, and (once implemented in a way that alters the pre-existing domestic laws) this would expand the areas of domestic tax liability as compared to those existing before. This could only occur within constitutional limits, of course, and the constitutions of some countries may entirely prevent such an expansion of applicable domestic law.

31. While an examination of DTAs under the interpretative rules discussed in this ruling would usually show that such an intention (that is, an intention of expanding domestic taxing liability) did *not* objectively exist in the case of a particular DTA, there will be some examples where this can occur.

32. For example, Taxation Ruling TR 2001/11[24] notes the ATO view that, by reason of Australia's DTAs being given the force of law by the Agreements Act (including section 4 of that Act), the *Business Profits* Articles of Australia's DTAs 'are self-operating and take precedence to the extent that they are inconsistent with' the *Income Tax Assessment Act 1936*. Accordingly, the Ruling states that in the ATO's view this means that a determination under subsection 136AE(4) is not necessary where a DTA applies before issuing an amended assessment to bring profits of a PE into line with the separate enterprise and arm's length principle requirements of the Business Profits Article[25]. The Ruling notes, however, that a determination would usually be made in practice, in particular to address any argument that it is a case where the DTA permits recourse to domestic

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[24] On international transfer pricing - operation of Australia's permanent establishment attribution rules, paragraph 2.3.

[25] As to the derivation of income or incurring of expenditure attributable to a permanent establishment in Australia; these requirements are usually found at paragraphs 2 and 3 of Article 7 in Australia's DTAs.

law and that an amended assessment fails if not supported by a determination under Division 13 of our domestic law[26].

33. In the same way, the ATO considers that the DTA *Associated Enterprises* Article (Article 9 in most of Australia's DTAs) could similarly apply to adjust profits of separate but related enterprises in cases where Division 13 of our domestic law is *not* relied on.

Deemed source of income provisions

34. However one approaches the 'shield, but not a sword' issue discussed above, it needs to be borne in mind that Australia's recent DTAs may operate to have what amounts to some 'sword-like' effect in practice because of the inclusion in them of a *Source of Income* Article or the existence of corresponding provisions in the Agreements Act itself, of the type already noted[27].

35. These *Source of Income* Articles or legislative source provisions provide broadly that items of income that one of the Contracting States may tax under the DTA shall be treated as having a source there for the purposes of domestic law, as well as for relevant DTA purposes. One purpose of these rules is to ensure that each country is empowered in its domestic law to exercise the taxing rights allocated to it (in the DTA) over residents of the other country. Those DTA source rules thus prevent any argument that the income does not have, by domestic law rules, a source in the country that is, under the DTA rules, entitled to tax that income in the hands of a resident of the other country.

36. The other purpose is that (as intended by the *Methods of Elimination of Double Taxation* Article) double taxation relief will be given by the country of residence in respect of tax levied by the other country in accordance with the taxing rights allocated to it, through the income being treated as foreign income for credit or exemption purposes[28].

37. This is consistent with the approach of looking at the intent of the parties as manifest in the DTA's wording, since the *Source of Income* Article is designed on Australia's part (it is an Australian 'specialty' to seek this provision in our DTA negotiations) as an

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[26] At paragraph 3.14.

[27] At paragraph 13 above.

[28] It should be noted that this ensures consistency with the foreign tax credit provisions of section 160AF of the *Income Tax Assessment Act 1936* applying only in respect of foreign source income. It should also be noted that, under section 23AH of the *Income Tax Assessment Act 1936*, foreign branch income and foreign branch capital gains derived by an Australian company from a business carried on in a 'listed' country are usually exempt from Australian tax. The listing is done by regulation, and all DTA partners are currently listed.

add-on to domestic law to ensure that domestic law will fully implement the intent of the other, more substantive, articles of the DTA. That is not to say that domestic law may not have already given the same result, in a particular case, without these special provisions.

38. In the absence of the *Source of Income* Article or legislative source provisions mentioned above, the normal Australian source rules would be applied by the Courts to determine if the relevant income subject to the DTA distributive rule had an Australian or foreign source, as the case may be. Accordingly, because under the applicable common law rules a finding of source is essentially a practical matter of fact to be determined by the circumstances of each case[29], the Court's decision as to the source of income might sometimes give a result that would be contrary to the result which the DTA objectively indicates was intended by Australia and the DTA partner.

39. As an example of how these source provisions operate, it is usual in Australia's DTAs for the source country to have a non-exclusive taxing right over entertainment income derived in Australia by visiting entertainers (usually under Article 17) and the source rules thus avoid any disputes arising over the source of that income when that taxing right is being exercised through the domestic law (eg, pursuant to subsection 6-5(3) and section 6-10 of the *Income Tax Assessment Act 1997* ('ITAA 1997')).

Unexercised DTA taxing rights

40. As well as not dictating that the allocated taxing rights *must* be exercised by a country, DTAs also do not, except in certain respects to ensure their effectiveness,[30] dictate *how* they are to be exercised. Whether and how those rights are exercised is usually left to the respective ordinary domestic laws (that is, the domestic laws other than the DTA as domestically implemented). It is therefore possible, and unexceptional, to have a situation where there is a right under a treaty to impose a form of taxation, but where the legislature has not decided to impose (or has positively decided *not* to impose) such a tax liability under domestic law. A future legislature may pass legislation exercising the right, and that would be consistent with the treaty. When new legislation is being proposed, the consistency of such legislation with Australia's treaty obligations will sometimes be an issue for these reasons.

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[29] *Nathan v. FC of T* (1918) 25 CLR 183 at 189-190; *FC of T v. Mitchum* (1965) 113 CLR 401; 13 ATD 497.

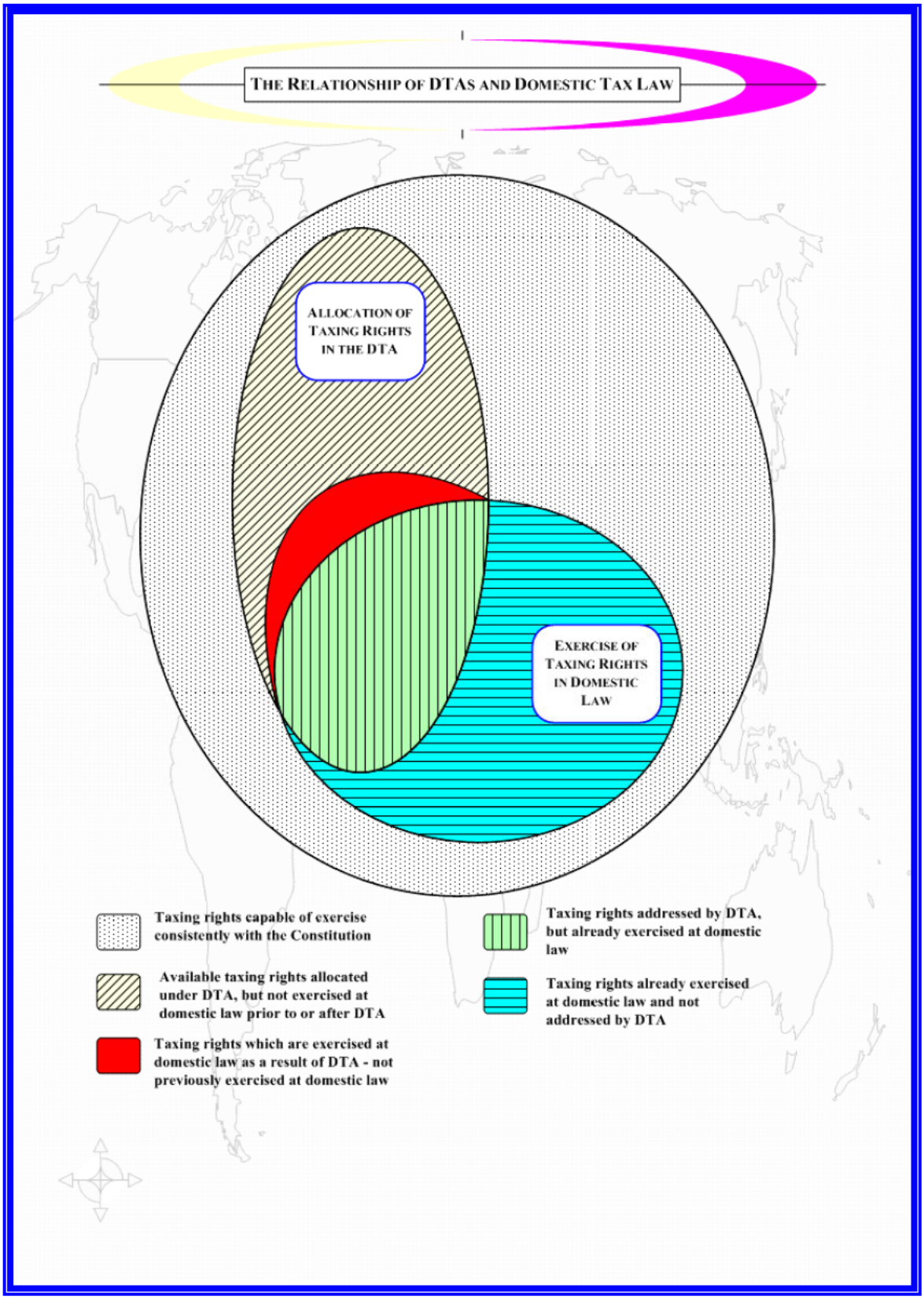
[30] Such as the application of the separate enterprise and arm's length principle requirements of the *Business Profits* Article.

41. As an example of the sharing of taxing rights under a DTA, but where the resulting allocated rights are not fully exercised in domestic law, Australia has the ability to impose withholding tax (at a maximum rate specified in the DTA) on dividends paid by an Australian resident company to a treaty partner resident shareholder. In the case of a United Kingdom resident shareholder, for example, the specified rate is 15% under Article 8(3) of the *United Kingdom Agreement*.[31] In fact, it will often be the case that no Australian tax is levied or payable because of the domestic law exemption from withholding tax of franked dividends paid by Australian resident companies to non-resident shareholders[32], regardless of whether Australia has concluded a DTA with the country of the shareholder's residence.

42. The following is a diagrammatic expression of how taxing powers under a DTA relate to domestic law and powers to tax. Note that the segments and relationships in this diagram are not drawn to scale:

[31] Schedule 1 to the Agreements Act (with a Protocol at Schedule 1A).

[32] Paragraph 128B(3)(ga) and Section 128D of the *Income Tax Assessment Act 1936*.


THE RELATIONSHIP OF DTAS AND DOMESTIC TAX LAW
ALLOCATION OF TAXING RIGHTS IN THE DTA
EXERCISE OF TAXING RIGHTS IN DOMESTIC LAW
Taxing rights capable of exercise consistently with the Constitution
Available taxing rights allocated under DTA, but not exercised at domestic law prior to or after DTA
Taxing rights which are exercised at domestic law as a result of DTA - not previously exercised at domestic law
Taxing rights addressed by DTA, but already exercised at domestic law
Taxing rights already exercised at domestic law and not addressed by DTA

Determining tax liability in a DTA case

43. The above explanations point to a general approach that could be taken when determining a taxpayer's liability for Australian income tax where a DTA may be applicable. This approach is as follows:

- first, determine whether any tax liability appears to arise on its face and, if so, the quantum of that liability, under the relevant Assessment Act and the Rates Acts;
- secondly, determine whether any Article of the DTA operates to preclude or limit the Assessment Act and Rates Acts liability, to 'pick up' domestic law concepts or to support the general domestic law provisions. It is just as significant to establish whether the relevant DTA leaves an issue unaddressed and dealt with by domestic law; and,
- thirdly, determine whether a provision of the DTA or of the Agreements Act dictates how the taxing right is to be exercised, or whether the *Source of Income* Article or a corresponding provision in the Agreements Act operates to require that the first step be revisited.

44. Sometimes it will be better to work back from step three to step one where, for example, the DTA makes clear that Australia has no taxing right, or where the question of general law domestic liability is a much more complex one than the operation of the DTA. However, as with all such treaty issues, it is not desirable to be overly 'linear' in analysing any DTA issue.

45. The general domestic law and the terms of the DTAs may at various stages inform the meaning and operation of each other, and the two must often be kept in mind simultaneously, in the sense of requiring 'parallel processing' and a disciplined approach to interpretation. On such an approach, many aspects of the problem are considered simultaneously (see, as an example, the approach taken in Taxation Ruling TR 2001/12 on pre-capital gains tax treaties[33]). The following sections of this ruling explore the nature and consequences of this approach in more detail.

Part 2: Variations between DTAs

46. It is important for interpretation purposes to remember that *each* DTA is the product of a separate bilateral negotiation process. While, therefore, there is a general template structure to Australia's DTAs, each contains variations in terms from other DTAs because

[33] At paragraph 17ff.

they are negotiated against the background of the particular languages, legal systems, tax rules, tax treaty and wider economic policies and expectations of the respective countries at the time, as well as some historical influences.

47. Those factors, and the fact that treaty negotiations are conducted against the general background of the OECD and United Nations Model Tax Conventions (which, being products of international compromise and consensus, are couched in comparatively broad terms) mean that the Australian negotiators, administrators and courts cannot expect the terms of the DTAs to be expressed with the same precision as our ordinary domestic tax legislation. Nor is it possible to always maintain consistency in how the terms of a particular Article are expressed in the various DTAs, because of the different 'mix' of the above factors in different negotiations and the 'give and take' that is a necessary incident of international negotiations.

48. This is an important point to bear in mind, because it means that the network of DTAs is not drafted in an absolutely uniform manner in relation to residents of all treaty partners, or in relation to similar activities or situations.

49. Differing wording in two DTAs may represent the same intended meaning (such as, in the ATO's view, the terms 'beneficial entitlement' in the *Dividends*, *Interest and Royalties* Articles of some DTAs and 'beneficial ownership' in the corresponding Articles in other DTAs). Often such differences exist because a country wants to avoid unintentionally 'picking up' a domestic law usage for an undefined term that may be different to the international tax meaning of the phrase more usually relied on. Alternatively, it may be because a country does not recognise a particular concept and regards the use of a term as potentially creating uncertainty before its courts and in the administration of the DTA[34].

50. In other cases, differences in wording may represent specific negotiating intentions (e.g., the reference simply to 'income' rather than 'income, profits or gains' in many of our pre-capital gains DTAs is, in the ATO's view, significant as is noted in Taxation Ruling TR 2001/12)[35].

51. It is sometimes possible that the same wording in different DTAs could present a different intended meaning. DTA negotiators will generally seek to identify the differences between a DTA under

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[34] Such as the concepts of 'citizenship' and 'nationality' – frequently only one or the other of these has a clear domestic law meaning for a DTA party, or the meaning may differ as between the Parties. Because of this, an Article such as the *Government Service* Article in the *Austrian Agreement* and some of Australia's other DTAs refers to 'a citizen or national' of a country.

[35] At paragraphs 56 and 59.

negotiation and their existing treaty network wording and as far as possible avoid the same wording having different usages, but that will not always be possible.

52. One practical example of the potential significance of different wording between DTAs is that, although the business profits/ permanent establishment ('PE') principle[36] is common to all the DTAs, the definition of a PE in one DTA may be substantively different to the definition in another DTA.

53. For example, the definition of a PE in the *United States Convention*[37] is wider than the definition in the *Japanese Agreement*[38]. Accordingly, Australia may have a taxing right under the *Business Profits* Article of the *United States Convention* in respect of certain profits of a United States enterprise but not under the *Business Profits* Article of the *Japanese Agreement* in respect of like profits of a comparable Japanese enterprise.

54. Similarly, although it is usual for Australian DTAs to provide an exemption from Australian tax for independent personal (including professional) services income derived by a treaty partner resident individual who makes a short-term visit to Australia, usually of no more than 6 months, the conditions under which that exemption applies can vary from DTA to DTA.

55. Take the case, for example, of an Australian resident company that engages two foreign engineering consultants, one being solely a resident of the United States and the other being solely a resident of Thailand. They are engaged to carry out a business study in Australia for a period not exceeding 183 days in a year of income. The company claims that the fees paid by it to the two foreign consultants are not taxable by Australia because of the *Independent Personal*

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[36] That is, the general principle noted above (at paragraph 15) that business profits sourced in a country may only be taxed by that country where there is a permanent establishment (as defined by the DTA) in that country.

[37] Schedule 2 to the Agreements Act, at Article 5. There are no changes to this Article under the proposed Protocol to the *United States Convention*. This was signed on 27 September 2001 and the text is available on the ATO website. The Amending Protocol will only come into force after necessary legislation is passed and the other internal procedures of both countries have been completed and each state has notified the other of this. Even then, it only has domestic effect, affecting taxpayers, from the dates specified for that purpose in Article 13 of the Protocol. This sequence of events is broadly in accord with the usual DTA sequence of events for a DTA: *signature* of an agreed text by Ministers or high-level officials such as Ambassadors, *entry into force* of a DTA or Protocol as a binding international law agreement following an exchange of notifications that internal procedures of each country have been met, and finally the giving of *domestic law effect* to its terms.

[38] Schedule 6 to the Agreements Act, at Article 3.

Services Articles found in the *United States Convention*[39] and the *Thai Agreement*[40] respectively.

56. In both cases, the 'short-term visit' provision in those Articles may operate to preclude Australia from taxing income derived by an individual who is a resident of the other country from the performance in Australia of independent personal services during a period not exceeding 183 days in a year of income, - see Article 14(a) of the *United States Convention* and Article 14(2)(a) of the *Thai Agreement.*

57. This is only one of the conditions that need to be satisfied before Australia is prevented from taxing the visiting individual, however, and it is necessary to refer to the other conditions in the relevant agreements on a case-by-case basis.

58. In the case of the visiting United States consultant, the only other condition to be satisfied is the absence of a fixed base in Australia regularly available to the consultant for the purpose of performing his or her activities - Article 14(b) of the *United States Convention*. A similar condition would apply in the case of the Thai consultant under Article 14(2)(b) of the *Thai Agreement.*

59. But the *Thai Agreement* contains an *extra* condition not found in the *United States Convention*, namely that the income is not deductible in determining taxable profits of an enterprise or a permanent establishment situated in Australia (Article 14(2)(c)). The rationale for that condition is that if the amount *paid* to the consultant is tax deductible (for Australian tax purposes) for the payer, Australia should not be obliged to then exempt from tax the corresponding income *earned* by the consultant in Australia.

60. If we assume that neither visitor has a fixed base in Australia, the result of applying the respective *Independent Personal Services* Articles would be that while the *United States Convention* would operate to preclude Australia from taxing the income derived by the visiting United States consultant, no such restriction would apply under the *Thai Agreement* in the case of the visiting Thai consultant where the fee paid to that consultant by the Australian resident company is a tax deductible item for it.

61. These examples demonstrate how important it is to pay close attention to the particular terms of the relevant DTAs when determining whether they operate to limit or preclude the ordinary domestic law tax liability in the case, or group of cases, under consideration.

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[39] Schedule 2 to the Agreements Act, at Article 14.
[40] Schedule 30 to the Agreements Act, at Article 14.

Part 3: DTAs as implemented legislation

Specific definitions and deeming provisions in Australia's DTAs

62. Just as for ordinary domestic law provisions, the starting point for the interpretation of a substantive treaty provision should be the definitions provided in the treaty itself, and any relevant deeming provisions. As a result of the 'parallel lives' of a DTA noted above[41], however, the definitions of terms and any specific directions about how a DTA should be interpreted, as it applies *in our domestic tax law*, may be found in:

- the particular Article concerned (e.g., the definitions of 'resident', 'permanent establishment' 'dividends', 'interest', 'royalties' and clarifications as to the source of income in the relevant specific Articles);
- the *General Definitions* Article (usually Article 3);
- a 'Miscellaneous' or 'Specific Provisions' Article (e.g., Article 27 of the *United States Convention*);
- a Protocol to the DTA. A Protocol may be concluded as part of the original DTA[42], such as the Protocol to the *German Agreement*[43] (an 'original protocol') or may be entered into later to amend the original DTA, in which case it is an 'amending protocol'[44]. As the Protocols make clear, they are to be read as integral parts of the DTAs (which means that they have equal international and domestic law force); or,
- a provision of the Agreements Act (e.g., subsections 3(7) to 3(11A) and sections 3A, 11ZF and 18) which indicates how the DTA should be interpreted in Australian domestic law. This does not *necessarily* mean that the provision will bear the same interpretation in the other country, although such implementing provisions, particularly when they are part of the original implementing legislation for the DTA, often reflect understandings explicitly reached during the negotiations.

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41 At paragraph 7.

42 Usually for presentational reasons, such as because it departs from the usual Model of one of the negotiating parties.

43 Schedule 9 to the Agreements Act.

44 See, for example, the Protocol to the *French Agreement* (at Schedule 11A to the Agreements Act).

'Undefined terms' in a DTA

63. One of the central practical issues in treaty interpretation is that of whether the treaty allows reference back to domestic law to determine what a term used in the treaty, but not defined there, means. A set of specific 'rules' for interpreting DTAs is set out in the *General Definitions* Article, which is present in all of Australia's DTAs.

64. Australia's older DTAs in all substantive respects use the wording of the 'undefined terms' provision that appeared in the then current *General Definitions* Article of the OECD Model Double Taxation Convention. The domestic law meaning for this purpose may, for Australia, be the statute-defined meaning, or where there is no relevant statutory definition, the 'common law' meaning of the term. For example, Article 3(2) of the *United States Convention* states:

> 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.

65. From approximately 1990 (beginning with the *Chinese Agreement*[45]) Australian DTAs have utilised a provision which clarifies that the domestic law to be looked at is not generally that existing at the time a treaty is entered into, where that has changed, but is rather the law as it stands when the DTA party applies that DTA. The usual formulation provides:

> In the application of this Agreement by a Contracting State, any term not defined in this Agreement shall, unless the context otherwise requires, have the meaning which it has under the laws of that State from time to time in force relating to the taxes to which this Agreement applies.

66. The OECD Model was similarly amended in 1995 to read as follows, with the immediately relevant changes from the previous (1977) OECD Model italicised:

> As regards the application of the Convention *at any time* by a Contracting State, any term not defined shall, unless the context otherwise requires, have the meaning that it has *at that time* under the law of that State for the purposes of the taxes to which the Convention applies, *any meaning under the applicable tax laws of that State prevailing over the meaning given to the term under other laws of that State.*

67. The OECD Model changes reflect the fact that the OECD Members, first of all, wished to clarify that the law to be looked at is

[45] Schedule 28 to the Agreements Act.

the law at the time of the DTA being applied to the relevant fact situation, not the historical meaning at the time of the DTA's conclusion. In this respect the provision adopts what is termed an 'ambulatory' approach.

68. Second, the OECD Members sought to clarify that where the context allows a specific domestic tax law meaning and a domestic non-tax law meaning, the former should prevail. While the first change now reflects Australian practice, both changes are regarded by the ATO, as a matter of practice, as only reflecting what is implicit in Australian DTAs anyway[46].

69. This recognises that a DTA is designed with a view to ensuring that it continues to meet its objects and purposes by adapting itself to a fast-changing area of domestic law, yet at the same time is not to be read so flexibly as to allow those objects and purposes to be subverted. When interpreted in this light, the DTA will therefore continue to live and as far as possible (consistent with the balance of the bargain that has been struck) keep up to date over the long period that it is likely to remain in force, without developing a 'life of its own'.

70. The OECD Commentaries support this general approach; they recognise that the 1995 amendments were intended to be *clarificatory* only, rather than changing the meaning. The Commentaries state:

> … the wording of paragraph 2 provides a satisfactory balance between, on the one hand, the need to ensure the permanency of commitments entered into by States when signing a

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[46] See the judgment of Mason J in *FC of T v Sherritt Gordon Mines Ltd* 77 ATC 4365 at 4370 where he stated that: 'Whether the reference to the 'the meaning which it has under the laws of the Contracting State' [in the 'undefined terms' provision] is ambulatory or static is a serious question. But it is a question which I am not disposed to answer . . .'. This was because it would not have affected the decision in that case. For a discussion ultimately favouring the ambulatory approach, see Avery Jones et al, 'The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model – Part I' 1984 British Tax Review, 14 at 24-28 and 40-48 ('Avery Jones et al Part I'). As noted by the same authors, even the earlier formulation's reference to tax laws does not prevent the reference to general law meanings, because the meaning in tax laws will often 'pick up' the general law meaning expressly or by implication: Edwardes-Ker, TAX TREATY INTERPRETATION, looseleaf, ('Edwardes-Ker') at p 22-23.
As a matter of practice, the ATO considers that the meaning of a DTA term may evolve, but only if and to the extent that there was 'intended' to be a built-in evolutionary capacity in the original treaty, with the question of whether both parties intended there to be such a capacity being determined on normal Vienna Convention on the Law of Treaties interpretational principles (as to which, see below, paragraph 95ff). This aligns with the approach which Edwardes-Ker favours. He terms it the 'evolutionary approach'. As he puts it: 'an original tax treaty meaning may evolve – but only to an extent consistent with the original intention of both treaty partner States' (paragraph 9.06).

> convention (since a State should not be allowed to make a convention partially inoperative by amending afterwards in its domestic law the scope of terms not defined in the Convention) and, on the other hand, the need to be able to apply the Convention in a convenient and practical way over time (the need to refer to outdated concepts should be avoided).[47]

71. In determining what constitutes a term's meaning under the applicable domestic rules relating to tax, the normal domestic rules of interpretation are applied to that domestic law. This could, in Australia's case, involve consideration of sections 15AA and 15AB of the *Acts Interpretation Act 1901* (Cth), which are addressed below[48].

Does the 'context' require a different meaning?

72. When a term in a DTA is not defined by the DTA, reference is therefore to be made to the meaning of the term for the purposes of the domestic tax laws of the country applying the DTA, but only, in accordance with the direction in the undefined terms provision of the *General Definitions* Article, 'unless the context otherwise requires'. This aspect of the *General Definitions* Article in Australia's DTAs is closely based on the corresponding OECD Model Convention provision. For the reasons dealt with below[49], it is therefore highly relevant to consider what the OECD Commentaries to that Model say about this provision.

73. Paragraph 12 of the OECD Commentary on the *General Definitions* Article further emphasises that the interpretation set out in the 'undefined terms' provision applies 'only if the context does not require an alternative interpretation', the point just made, and a proviso that is often overlooked or not given its full force. The paragraph then states:

> The context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based).

74. This contextual limitation on referring to the domestic law places a significant qualification on the use of this provision in practice, requiring a careful scrutiny of both the context and the domestic law. It follows that reliance cannot necessarily be placed on

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[47] Paragraph 13 of the OECD Commentary on the *General Definitions* Article (Article 3). Paragraph 13.1 notes that 'Paragraph 2 was amended in 1995 to conform its text more closely to the general and consistent understanding of Member states'.

[48] At paragraph 80ff.

[49] See below, paragraph 101ff.

an undefined term in a DTA being interpreted according to its domestic law meaning; the context of its use in the DTA may indicate that such a meaning is inappropriate, in that it would not be an accurate representation of the 'bargain' or '*consensus ad idem*' which objective evidence shows has been reached by the negotiating countries.

75. Although there is some debate concerning the meaning of 'context' when used in the 'undefined terms' provision at Article 3(2) or similar in our DTAs, the ATO view, like that of most commentators, is that it is in practice to be broadly interpreted and that it includes the full range of materials open to consideration under Articles 31 and 32 of the Vienna Convention on the Law of Treaties (considered below[50]) and not just those specifically referred to as the 'context' in Article 31 of that Convention[51]. This broad approach to 'context' is also consistent with the approach of Australian courts in domestic law cases[52].

76. The issue of the meaning of 'context' in the undefined terms provision of our DTAs is discussed at paragraphs 40 to 46 of Taxation Ruling TR 2001/12, which concludes, on this point:

> Accordingly, the ATO considers treaty context should be taken in its broadest sense to have regard to the full fabric of matters that may be considered, including the historical and political matrix and the matters referred to in the Avery Jones discussion. In particular the following discussion has regard to:

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[50] At paragraph 95ff.

[51] See on this point: Avery Jones et al, 'The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model – Part II' 1984 *British Tax Review*, 90 at 90-105 ('Avery Jones et al Part II'). See also, to similar effect, Edwardes-Ker, paragraphs 7.06 and 23.15, noting the wide meaning of the term 'context' implicit in paragraph 13 of the OECD Commentary on Article 3. The interpretative significance of the OECD Commentaries is addressed below.

[52] In *Chaudhri v. FC of T* [2001] FCA 54, the Full Federal Court (Hill, Drummond and Goldberg JJ) noted that:

> The guiding principle of statutory interpretation may be summed up as being the ascertaining of the meaning of the words which Parliament has used by reference to the context in which they appear, where "context" has the wide meaning which extends to the legislative history, the Parliamentary intention and the mischief to which a particular provision has been directed as well as the narrower meaning which would dictate reading the words to be construed by reference to the immediately surrounding or otherwise related provisions.

See also the joint judgment of Brennan CJ, Dawson, Toohey and Gummow JJ in *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 187 CLR 384 at 408, which was relied on in *Chaudhri*.

- the practices and policies of Australia and the treaty partners in negotiating treaties at that time and subsequently;
- given the usual treaty object of avoidance of double taxation, the domestic taxation environments of the two countries when the treaty was negotiated; and
- the political, economic and diplomatic background to the treaty.

Interpreting Australian legislation implementing DTAs

77. Brennan CJ noted in *Applicant A*[53] that:

> If a statute transposes the text of a treaty or a provision of a treaty into the statute so as to enact it as part of domestic law, the prima facie legislative intention is that the transposed text should bear the same meaning in the domestic statute as it bears in the treaty. To give it that meaning, the rules applicable to the interpretation of treaties must be applied to the transposed text and the rules generally applicable to the interpretation of domestic statutes give way.

78. DTAs are implemented in Australia as Schedules to the Agreements Act, and are implemented in accord with any sections of that Act bearing on the DTA specifically, or on it as one of many affected DTAs. The approach taken by his Honour in *Applicant A* therefore applies.

79. If DTA implementing *legislation* is clear, however, it must be applied and enforced whether or not the result might be regarded as in contravention of accepted principles of international law. Ultimately, the implementing legislation itself is the authentic expression of the Parliamentary intent in implementing the treaty and it cannot be impugned constitutionally on the basis that it is contrary to the international obligations in the DTA itself. Where there is any ambiguity or obscurity in the implementing legislation, however, a Court may look to the DTA itself to assist in determining what the legislature intended.[54]

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[53] *Applicant A v. Minister for Immigration and Ethnic Affairs* (1997) 190 CLR 225, at 230-231.

[54] *Polites v. The Commonwealth* (1945) 70 CLR 60, *Horta v. The Commonwealth* (1994) 181 CLR 183, *Kartinyeri v. The Commonwealth* (1998) 72 ALJR 722 at 745-746, 152 ALR 540 at 571-572, *AMS v. AIF and AIF v. AMS* [1999] HCA 26 (17 June 1999). The High Court said in *Horta* (at p 295):

> It was submitted on behalf of the plaintiffs that the enactment of the two Acts would be beyond the legislative power conferred by s.51(xxix) if the Treaty were void under international law either on the ground that it was contrary to international law or on the ground that Australia's entry into or

80. A Court will have regard to the Vienna Convention in examining the *text* of the DTA itself, as negotiated by the two DTA parties. It may have recourse to sections 15AA and 15AB of the *Acts Interpretation Act 1901*, which are similar to the Vienna Convention interpretation rules[55], in interpreting an implementing provision such as subsection 3(11) or section 3A of the Agreements Act (which prescribe how a particular DTA provision is to be interpreted and applied in domestic law in defined circumstances).[56]

81. The focus of the *Acts Interpretation Act 1901* is essentially on the presumed intention of Parliament when enacting, for example, treaty-implementing legislation, while the Vienna Convention rules basically focus on the presumed intention of the drafters of the actual treaty text. Quite apart from the similarity of the rules, there does not appear to be any scope for the two sets of interpretation rules to apply simultaneously on exactly the same point (because of the parallel, but distinct lives of a DTA already noted) so that the issue of conflict between the two sets of rules does not appear to arise.

82. The *Acts Interpretation Act 1901* provisions are also potentially relevant where the DTA *General Definitions* Article takes us back to an examination of a concept under Australian domestic law, because this will necessarily involve applying Australia's domestic law *interpretative* provisions, as noted above. In certain cases, it could take us back to specific definitions in the *Acts Interpretation Act 1901*.

> performance of it would be in breach of Australia's obligations under international law. There is, however, a short answer to that submission. That answer is that even if the Treaty were void or unlawful under international law or if Australia's entry into or performance of the Treaty involved a breach of Australia's obligations under international law, the Act and the Consequential Act would not thereby be deprived of their character as laws with respect to "External affairs" for the purposes of s.51(xxix). [……..] In particular, there is simply no basis either in s.51(xxix) or in any other provision of the Constitution for the plaintiffs' submission that the legislative power conferred by s.51(xxix) must be confined within the limits of "Australia's legislative competence as recognized by international law".

[55] See, for example, David H Bloom, 'Report on Australia', in CAHIERS DE DROIT FISCAL INTERNATIONAL: INTERPRETATION OF DOUBLE TAXATION CONVENTIONS', 1993 Vol 78a, International Fiscal Association, 179 at 183. The Vienna Convention rules were referred to in the Attorney-General's Department discussion paper which preceded the drafting of section 15AB of the *Acts Interpretation Act*: EXTRINSIC AIDS TO STATUTORY INTERPRETATION, AGPS 1982 at 9.

[56] Edwardes-Ker notes in this respect that 'a uniform domestic approach cannot be identical to any one particular State's approach to the interpretation of its purely domestic tax statutes – because such approaches do not take sufficient account of the fact that a bilateral tax treaty is a treaty which must be interpreted in accordance with the common understanding of *both* states': Edwardes-Ker, paragraph 1.05 and Chapter 5.

83. Section 15AA of the *Acts Interpretation Act 1901* reads as follows:

> **Regard to be had to purpose or object of Act**
>
> (1) In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object.

84. Section 15AB of the same Act reads as follows:

> **Use of extrinsic material in the interpretation of an Act**
>
> (1) Subject to subsection (3), in the interpretation of a provision of an Act, if any material not forming part of the Act is capable of assisting in the ascertainment of the meaning of the provision, consideration may be given to that material:
>
> (a) to confirm that the meaning of the provision is the ordinary meaning conveyed by the text of the provision taking into account its context in the Act and the purpose or object underlying the Act; or
>
> (b) to determine the meaning of the provision when:
>
> (i) the provision is ambiguous or obscure; or
>
> (ii) the ordinary meaning conveyed by the text of the provision taking into account its context in the Act and the purpose or object underlying the Act leads to a result that is manifestly absurd or is unreasonable.
>
> (2) Without limiting the generality of subsection (1), the material that may be considered in accordance with that subsection in the interpretation of a provision of an Act includes:
>
> (a) all matters not forming part of the Act that are set out in the document containing the text of the Act as printed by the Government Printer;
>
> (b) any relevant report of a Royal Commission, Law Reform Commission, committee of inquiry or other similar body that was laid before either House of the Parliament before the time when the provision was enacted;

(c) any relevant report of a committee of the Parliament or of either House of the Parliament that was made to the Parliament or that House of the Parliament before the time when the provision was enacted;

(d) any treaty or other international agreement that is referred to in the Act;

(e) any explanatory memorandum relating to the Bill containing the provision, or any other relevant document, that was laid before, or furnished to the members of, either House of the Parliament by a Minister before the time when the provision was enacted;

(f) the speech made to a House of the Parliament by a Minister on the occasion of the moving by that Minister of a motion that the Bill containing the provision be read a second time in that House;

(g) any document (whether or not a document to which a preceding paragraph applies) that is declared by the Act to be a relevant document for the purposes of this section; and

(h) any relevant material in the Journals of the Senate, in the Votes and Proceedings of the House of Representatives or in any official record of debates in the Parliament or either House of the Parliament.

(3) In determining whether consideration should be given to any material in accordance with subsection (1), or in considering the weight to be given to any such material, regard shall be had, in addition to any other relevant matters, to:

(a) the desirability of persons being able to rely on the ordinary meaning conveyed by the text of the provision taking into account its context in the Act and the purpose or object underlying the Act; and

(b) the need to avoid prolonging legal or other proceedings without compensating advantage.

Part 4: General treaty interpretation rules

Overview: characteristics of DTAs that may affect their interpretation

85. Some of the specific features of DTAs that in practice impact on their interpretation include:

- DTAs are written in very much more general terms than domestic law so that there is perhaps more room for courts to give an interpretation based on purpose, the consideration of 'substance over form', etc.;
- DTAs use an international tax terminology which may not exist in domestic law (or if it does was usually drawn from treaties so that the international treaty meaning applies; for example, see the consideration of the domestic tax law definition of 'royalties' (which was influenced by treaty meanings) in TR 98/21 on cross border leasing);
- there are internationally accepted OECD Commentaries on the meaning of tax treaties which need to be taken account of to fully understand the DTA and its international usages and context where the DTA reflects the OECD Model Commentaries[57]. As noted below, the same can apply for some UN Model materials[58];
- because of the common terms used internationally and the Commentaries, treaties are the subject of a much broader and internationally focused jurisprudence in cases, texts and administrative rulings than domestic tax law, and foreign case law may be particularly relevant; and
- tax treaties often have a life of 20 to 30 years and so have to be flexible enough to cope with many changes in domestic law, while remaining true to the negotiated bargain and the agreed balance of obligations and concessions between the two countries[59].

86. These characteristics necessitate a different conceptual approach to interpretation than is required in construing a statute. In

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[57] See below, paragraph 101ff.

[58] See below, paragraph 112.

[59] This is not to say that the bargain reached envisages that *every change in the law* will be brought within the scope of the treaty: see, once again, TR 2001/12, where the ATO indicates its view that an analysis of the pre-CGT Australian DTAs indicates that they are not designed in a way that would pick up the CGT regime that Australia later adopted.

an important article on the interpretation of tax treaties, a group of international DTA experts noted that '[a] point to be made at the outset is that treaty interpretation is a subject in itself and not merely an extension of statutory interpretation, as has sometimes been thought in common law countries where treaties normally take their effect by virtue of a statute.'[60] The authors' approach on this point is in accord with the approach taken by Australian courts in DTA and other treaty cases and represents ATO practice.

The approach of Australian courts

87. In *Shipping Corporation of India Limited v. Gamlen Chemical Company Australasia*[61], the High Court of Australia considered that, despite the fact that a treaty had been enacted as domestic law, it should be interpreted broadly in a way conducive to producing a uniform international interpretation. The Court said:

> It has been recognised that a national court, in the interests of uniformity should construe rules formulated by an international convention . . . 'in a normal manner appropriate for the interpretation of an international convention, unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptation', to repeat the words of Lord Wilberforce in *James Buchanan and Co Ltd v. Babco Forwarding and Shipping (UK) Ltd* [1978] AC 141, at p. 152.

88. The legislature, when legislating the DTA into domestic law, is therefore taken to expect that it be interpreted in the light of the normal rules for interpreting treaties. As noted above[62], Brennan CJ in *Applicant A* recognised the *prima facie* legislative intention that the *text of a treaty transposed* into an Act is to be read in accordance with normal treaty interpretation principles.

89. An 'exception' already noted[63] would be where the implementing legislation directs how a particular DTA provision is to be interpreted or applied (thus evincing a particular Parliamentary intent). Even that way of dealing with an issue has often been agreed by the negotiating countries as a way of addressing the issue without altering the DTA wording, particularly if it is only an issue for one of the negotiating countries and departs from the other country's usual treaty practice. A common instance, already noted, is where the implementing provisions of the Agreements Act, rather than the DTA provisions themselves, address source issues[64].

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[60] Avery Jones et al Part I, at 14.
[61] (1980) 147 CLR 142 at p 159.
[62] At paragraph 77.
[63] At paragraph 79ff.
[64] As noted above, paragraph 13.

90. In *Thiel v. FC of T*[65] the High Court endorsed reference to broader international law principles when interpreting tax treaties. McHugh J's judgment (with which the majority agreed in their joint judgment) outlines the applicable international law principles in interpreting DTAs[66]. His Honour's comments confirm that it is necessary as a matter of practice to apply international law principles when interpreting a DTA as incorporated in the Australian taxation law:

> The Agreement is a treaty and is to be interpreted in accordance with the rules of interpretation recognised by international lawyers: *Shipping Corporation of India Ltd v. Gamlen Chemical Co (A/Asia) Pty Ltd* (1980) 147 CLR 142 at p 159. Those rules have now been codified by the Vienna Convention on the Law of Treaties to which Australia, but not Switzerland, is a party. Nevertheless, 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 Switzerland is not a party to that Convention: *Fothergill v. Monarch Airlines Ltd* (1981) AC 251 at pp 276, 213-214.
>
> ... [because the term enterprise is ambiguous] it is proper to have regard to any 'supplementary means of interpretation' in interpreting the Agreement. In this case the supplementary means of interpretation are the 1977 OECD Model Convention for the avoidance of Double Taxation with respect to Taxes on Income and Capital, which was the model for the Agreement and Commentaries issued by the OECD in relation to that model convention.

91. The importance of examining DTAs as international law agreements to which the Vienna Convention on the Law of Treaties treaty interpretation rules apply has been emphasised also in the more recent Federal Court decisions on DTAs, *FC of T v. Lamesa*[67], and *Chong v FC of T*[68].

92. The following general principles can be drawn from the approach of Australian courts to the interpretation of treaties in these and other cases[69]:

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[65] 90 ATC 4717.

[66] At 4727. See also the similar comments of Dawson J at 4722.

[67] 97 ATC 4752.

[68] 2000 ATC 4315.

[69] This analysis is drawn primarily from the approach adopted by McHugh J in *Applicant A v. Minister for Immigration and Ethnic Affairs* (1997) 190 CLR 225 at 251-254, which was referred to with approval by the Full Court of the Federal Court in *FC of T v. Lamesa Holdings BV* 97 ATC 4752 at 4758-4759, in relation to DTAs. The first listed principle is drawn from *Thiel* and *Lamesa.*

- the Vienna Convention rules apply to tax treaties just as for other treaties;
- reflecting the need for negotiating compromises, treaties are usually less precise than domestic legislation. Consequently, treaty interpretation should be based on a view that treaties cannot be applied with the 'taut logical precision' that might be appropriate for statutes. International instruments should therefore be interpreted more 'liberally' than domestic legislation;
- Article 31 of the Vienna Convention requires a 'holistic'[70] approach to treaty interpretation - that is, a simultaneous examination of:
  - the 'ordinary meaning' of the relevant words;
  - their 'context'; and
  - the 'object and purpose' of the treaty they form part of;

  nevertheless, the text of the treaty is the starting point and has primacy in terms of the interpretative process. This means that the Vienna Convention rules do not look to the subjective intent of the negotiating parties as the primary inquiry – the rules therefore reject the 'subjective intention-based' approach to treaty interpretation in favour of an essentially 'textual' approach[71].

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[70] *FC of T v. Lamesa* 97 ATC 4752 at 4758 (Full Federal Court, citing McHugh J in *Applicant A v. Minister for Immigration and Ethnic Affairs* (1997) 190 CLR 225, at 251 ff).

[71] The 'textual' method looks to determine the intent of the negotiators primarily through analysing what they said in the text, which is presumed to be the final, authentic and most reliable expression of their intent. It only looks beyond the text in limited cases, such as where the text leaves the question unanswered. See, for example, McHugh J in *Applicant A* (at p 251): '... Art 31 does not justify, to adopt the words of the International Law Commission, "an investigation *ab initio* into the intentions of the parties" in order to achieve a result which is thought to further those intentions' [footnote omitted]. The Full Federal Court in *Lamesa*, citing McHugh J's judgment, accepted this principle (at 4759).
See also Sinclair, THE VIENNA CONVENTION AND THE LAW OF TREATIES (2nd ed, 1984), 115. Edwardes-Ker: notes that 'domestic courts which have hitherto stressed the "intentions" of the Contracting States will have to adopt a "textual approach" as the starting point of interpretation. This textual approach is endorsed by Article 31(1) of the Vienna Convention and is, effectively, already adopted in several common law states'; Edwardes-Ker, paragraph 1.06; see also paragraph 6.01.
Nor do the Vienna Convention rules look primarily to the general objects and purposes of the treaty and then interpret the treaty in that light (the 'teleological'

The requirement to interpret treaties 'liberally'

93. Some debate surrounds the requirement just noted that DTAs be interpreted 'liberally'. Some have interpreted this to mean that this requires the terms of DTAs to be read as *broadly* as possible. The ATO considers, however, that the requirement for a 'liberal' interpretation of a DTA is directed to the rules of construction to be adopted, rather than being directed at the width and ambit of the content of particular DTA provisions.

94. In other words, when the courts speak of DTAs being given a more 'liberal' interpretation than domestic legislation, in the ATO's view they mean that the rules of construction will not be as detailed and rigid as they might be if the courts were to interpret domestic legislation or domestic instruments[72], and gaps, imprecision and ambiguities should be accepted as sometimes inevitable in such a text, and to some extent accommodated or 'smoothed over' in a way that addresses the context and meets the object and purpose of the DTA.

The Vienna Convention on the Law of Treaties

95. The *Vienna Convention on the Law of Treaties* ('the Vienna Convention') entered into force internationally on 27 January 1980 and applies *as a treaty* to the interpretation of all treaties since concluded as between Australia and any other countries which are also parties to the Vienna Convention.

96. In any case, it is almost universally considered that the Vienna Convention's rules for treaty interpretation are declaratory of 'customary international law'[73], and that the rules therefore apply to

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approach to treaty interpretation). The Vienna Convention rules first of all look to the final text of a treaty as the latest and most definitive expression of the common intent of the parties but interpret it in a way that will sometimes pick up elements of the other ('subjective' or 'teleological') styles of treaty interpretation. The Vienna Convention rules do this by reflecting the objects and purposes stated as the DTA's intention, and allowing recourse to some materials outside that text to throw light on the common intention of the parties, in limited circumstances.

[72] But note that the Full Federal Court in *Lamesa* stated at 4759 'We should add that, while we pay heed to the admonition of McHugh J to adopt a 'liberal approach', cases such as *Cooper Brookes (Wollongong) Pty Ltd v. FC of T* (1981) 147 CLR 297, 81 ATC 4292 suggests that interpretation of municipal tax law should also not involve the application of narrow legalistic principles.'

[73] That is, the body of international law rules which have their source in the customary practice of countries, with a recognition by countries that these rules apply *as a matter of international law*. In other words, a country can be bound by these rules without having explicitly agreed to them in a treaty. Most customary rules of international law can be modified between countries by a differing treaty rule, however.

all countries, whether or not they are parties to the Convention itself and whether or not the treaty being examined was entered into before or after the Vienna Convention entered into force. The High Court, as already noted[74], recognised the former point in *Thiel*[75] where the rules were applied although Switzerland was not a party to the Vienna Convention. The latter point has also been recognised by our courts[76]. The Vienna Convention rules should therefore be applied when interpreting any of Australia's DTAs, as a matter of practice.

97. The relevant provisions of the Vienna Convention are Articles 31 and 32, which read as follows:

> **Article 31: General rule of interpretation**
>
> (1) A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to terms of the treaty in their context and in the light of its object and purpose;
>
> (2) The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
>
> (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
>
> (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
>
> (3) There shall be taken into account, together with the context:
>
> (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
>
> (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties relating to its interpretation;

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[74] At paragraph 90 above.

[75] 90 ATC 4717 at 4723 and 4727.

[76] See, for example, the discussion in the Judgment of Katz J, with whom the other members of the Federal Court agreed on this point, in *Minister for Immigration and Multicultural Affairs v. Savvin* (2000) 98 FCR 168 at 187-188, paragraphs 90-91. While the Vienna Convention does not apply *as a treaty* to the interpretation of treaties concluded by countries before the Vienna Convention entered into force for them (as provided by Article 4), the operation of the customary international law rules codified by it is not so limited.

(c) any relevant rules of international law applicable in the relations between the parties.

(4) A special meaning shall be given to a term if it is established that the parties so intended.

Article 32: Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable.

Treaties in more than one language

98. Article 33 of the Vienna Convention provides that the different language texts of a treaty authenticated in two languages are equally authoritative, unless the treaty provides to the contrary. Australia's DTAs with foreign language treaty partners are usually prepared in the required language of the other DTA party, as well as in English, and are carefully checked by language experts to ensure there are no discrepancies of meaning. Both texts are then signed, usually by Ministers or Ambassadors of the two countries.

99. Where DTAs are concluded in two languages, the very last line of the substantive treaty text (just before the signature block) usually provides that the two texts are both equally authentic. Although the English text is the only one attached to the Agreements Act, our courts have been willing to look to the foreign language text for clarification.

100. In *Thiel*[77], for example, the High Court was prepared to consider the German language version of the DTA when determining the DTA reference to an 'enterprise'. In *Lamesa*[78] and *Chong*[79], the Federal Court noted the equal authenticity of the foreign language text, although the point was not critical to the decisions. Sometimes a DTA provides that one text, usually the English language one, prevails

[77] 90 ATC 4717 at 4719ff. With no evidence led on the meaning of the German language text, and no agreement as to its interpretation, the court did not ultimately rely on the German language text, however.
[78] 97 ATC 4752 at 4755.
[79] 2000 ATC 4315 at 4326.

in the event of a conflict between the two texts in different languages[80].

The OECD Model Tax Convention & Commentaries: status and interpretative value

101. Recommendations of the OECD Council (which were adopted on 23 October 1997) request member countries to conform to the OECD Model when entering into new DTAs or renegotiating existing ones. While not binding (since they are not formal OECD 'Decisions', binding on OECD Members under the OECD Constitution), the OECD Model and Commentaries create a general or 'quasi-political', rather than 'legal', expectation that OECD Members will basically comply, subject to specific 'Observations' and 'Reservations' lodged with the OECD. Those Observations and Reservations place on record that the relevant DTA policies and practices of the countries concerned are based on a different approach than that indicated in the OECD Model or its Commentaries. Australia has lodged various Observations and Reservations to the OECD Model and Commentaries over time which (like Observations and Reservations lodged by other OECD Member countries) are reproduced in the OECD Commentaries. The status and interpretative relevance of Observations and Reservations is considered further below[81].

102. In *Thiel*, the High Court judges all accepted that the OECD Model Taxation Convention's official Commentaries may be relevant to the interpretation of DTAs based on the OECD Model. In *Thiel*, McHugh J (with whom the majority agreed in their joint judgment) approved recourse to the OECD Model and Commentaries under Article 32 of the Vienna Convention (that is, as supplementary means only available for consideration when there is ambiguity or the like, or to confirm a meaning reached by examining Article 31 materials).[82]

103. Dawson J also approved reference to the Model and Commentaries 'as a supplementary means of interpretation to which recourse may be had under Article 32 of the Vienna Convention'.[83] His Honour went further than the other judges, however, by expressing the view that the OECD Model and Commentaries were also relevant under Article 31 of the Vienna Convention, as primary materials to be considered even when there was no ambiguity or the like[84]. In so doing, Dawson J nevertheless acknowledged that 'some

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[80] See, for example, the *Indian Agreement* (Schedule 35 to the Agreements Act).
[81] At paragraph 109ff.
[82] *Thiel v. FC of T* (1990) 90 ATC 4717, at 4727 and 4720.
[83] *Ibid*, at 4723.
[84] Dawson J, in his discussion of Article 31 of the Vienna Convention at 4723, had stated:

doubts have been expressed about the applicability, as a matter of language, of Article 31 to the Commentaries in the case of a bilateral treaty such as a double taxation agreement'.[85]

104. The Commentaries, with the various Observations and Reservations of OECD Member countries which they reproduce (and which are further considered below[86]), therefore provide important guidance on interpretation and application of the OECD Model and as a matter of practice will often need to be considered in interpretation of DTAs, at least where the wording is ambiguous, which (as noted above[87]) is inherently more likely in treaties than in general domestic legislation.

105. In addition, the Commentaries, with the Observations and Reservations, do provide part of the historical context of the DTA negotiations. They also have a role in testing the interpretation reached by other means, although if they conflict with, rather than confirm, that interpretation there may be an issue of whether this would be admissible in a court, since the matter was left unresolved by the *Thiel* judgments.

Subsequent revisions to OECD Commentaries

106. There is some debate over whether subsequent changes to the OECD Commentaries should be used as an aid to interpretation of earlier DTAs. On one hand, there is the view that the OECD Commentaries are only relevant to those DTAs subsequently concluded. Einfeld J expressed this view in the Federal Court decision of the first instance in *Lamesa Holdings BV v. FC of T*. His Honour referred to the Full High Court decision in *Thiel* and to the comments made by Dawson J in that case:[88]

> Further extrinsic material, referred to in *Thiel* as permissible by Mason CJ, Brennan and Gaudron JJ, who agreed with McHugh J, is consideration of the 1977 OECD Model and Commentaries in construing a double tax agreement. Dawson J added an important caveat to this view, namely that the

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'For my part, I do not see why the OECD model convention and commentaries should not be regarded as having been made in connection with and accepted by the parties to a bilateral treaty *subsequently concluded* in accordance with the framework of the model'. (emphasis added).

85 *Thiel v. FC of T* (1990) 90 ATC 4717, at 4723. He cited, as to the doubts, Avery Jones et al Part II at 92. Edwardes-Ker similarly considers that the OECD Commentaries do not fall within the meaning of Article 31(2) of the Vienna Convention: paragraph 15.03.

86 Paragraph 109ff.

87 See Paragraph 94 above.

88 97 ATC 4229 at 4237.

> OECD model and commentaries are only applicable to those bilateral treaties subsequently concluded.

107. On the other hand, the Introduction to the OECD Commentaries now indicates more clearly that the later Commentaries are intended by OECD Member states to be used for interpretation and application of DTAs concluded before their adoption, except where the OECD Model has been changed in substance. The Year 2000 update to the OECD Model and Commentaries states:

> 35. Needless to say, amendments to the Articles of the Model Convention and changes to the Commentaries that are a direct result of these amendments are not relevant to the interpretation or application of previously concluded conventions where the provisions of those conventions are different in substance from the amended Articles. However, other changes or additions to the Commentaries are normally applicable to the interpretation and application of conventions concluded before their adoption, because they reflect the consensus of the OECD Member countries as to the proper interpretation of existing provisions and their application to specific situations.
>
> 36. Whilst the Committee considers that changes to the Commentaries should be relevant in interpreting and applying conventions concluded before the adoption of these changes, it disagrees with any form of *a contrario* interpretation that would necessarily infer from a change to an Article of the Model Convention or to the Commentaries that the previous wording resulted in consequences different from those of the modified wording. Many amendments are intended to simply clarify, not change, the meaning of the Articles or the Commentaries, and such *a contrario* interpretations would clearly be wrong in those cases.

108. These changes to the Commentaries reflect the fact that the Commentaries are usually expressed not as forming an agreement between countries as to a *new* meaning but as reflecting a common view as to what the meaning is *and always has* been. Accordingly, unless it is apparent that the substance of the OECD Model has itself changed since a DTA was negotiated or the treaty in question does not conform to the OECD Model, or unless the Commentaries make clear that a former interpretation has actually been substantively altered, rather than merely elaborated, the ATO considers it appropriate, as a matter of practice, to consider, at least, the most recently adopted/published OECD Commentaries (currently the Year 2000 Commentaries) as well as others which may have been available at the

time of negotiation.[89] Often, if a DTA provision is to be fully understood, the changes that have occurred to the relevant OECD Commentaries over time will need to be examined and considered[90].

Observations & Reservations

109. A further point which needs to be considered is the relevance for interpretation purposes of the previously mentioned Observations and Reservations of individual OECD Member countries to the OECD Model Tax Convention and its Commentaries, as Australia, like some of its DTA partners, sometimes depart significantly from the OECD Model. OECD Member Countries lodge *'Reservations'* when they do not agree with either the relevant text of an OECD Model Article or any variations in text permitted by the Commentaries (and where they therefore wish to put other countries on notice of their views and intentions in negotiating the terms of the DTA). Countries enter *'Observations'* if they do not object to the Model Article's text, but do not concur with the interpretation of that text set out in the Commentaries.

110. The theory behind the Observations and Reservations is most clearly stated in the Introduction to 'Non-Member Positions'[91] section in the OECD Model Convention Commentaries. The Introduction reads:

> 2. ... Recognising that non-Member countries could only be expected to associate themselves to the development of the Model Tax Convention if they could retain their freedom to disagree with its contents, the Committee also decided that these

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[89] This approach may also be justified in terms of Article 31(3) of the Vienna Convention, with the Commentaries representing either 'a subsequent agreement between the parties regarding the interpretation of the treaty' (Article 31(3)(a)) or 'any subsequent practice in the application of the treaty which establishes the agreement of the parties relating to its interpretation' (Article 31(3)(b)). In *Lamesa,* Einfeld J in fact referred to the 1977 OECD Commentaries when interpreting the 1976 *Netherlands Agreement* (Schedule 10 to the Agreements Act) on the basis that the relevant part was based on an OECD Report released in 1974 and widely available.

[90] An example is the amendment to paragraph 8 of the 1977 Model Commentaries on Article 5 (permanent establishments) by the 1992 Commentaries (in response to a 1983 Report). The amendments treated the leasing of industrial, scientific and commercial equipment as a matter for the Business Profits Article, rather than the Royalties Article. Australia and some other countries disagreed, and lodged a 'Reservation' (a concept discussed at paragraph 109ff) to the OECD Model *Royalties* Article, to this effect: see paragraph 39 of the OECD Model Commentary on Article 12. The history of the OECD Model and Commentaries is found in Volume 1 of the loose-leaf (and most authoritative) version of the OECD Model.

[91] The term 'positions' is used since countries that are not OECD Members cannot formally lodge Observations or Reservations to the OECD Model.

> countries should, like Member countries, have the possibility to identify the areas where they are unable to agree with the text of an Article or with an interpretation given in the Commentary. …
>
> 5. ... For each Article of the Model Tax Convention, the positions that are presented in this document indicate where a country disagrees with the text of the Article and where it disagrees with an interpretation given in the Commentary in relation to the Article.

111. Observations and Reservations may be of considerable relevance in explaining variations from the OECD Model, both when interpreting implementing legislation under section 15AA of the *Acts Interpretation Act 1901* and when applying Article 31 of the Vienna Convention. They may not ultimately be admissible in court except to confirm the interpretations otherwise reached under those provisions or when considering ambiguous provisions under Article 32 of the Vienna Convention or, possibly, under section 15AB of the *Acts Interpretation Act 1901*.

United Nations Model and Commentaries

112. Although not as well developed as the processes and procedures that surround the OECD Model Convention, the UN Model Convention and its Commentaries and materials that explain the provisions of that Model[92] may constitute a supplementary aid to interpretation where Australia's DTAs draw upon the UN Model. In a formal sense, the admissibility of this material is subject to the same general limitations as applies to the OECD Model and Commentaries, although as it forms the main basis of negotiations for fewer DTAs than does the OECD Model, more evidence may be required as to its relevance and its weight.

Colonial Model DTAs

113. Australia's current DTA with the United Kingdom was strongly influenced by the 'Colonial Model'[93] once widely used within the British Empire and Commonwealth. That DTA with the UK in turn influenced aspects of Australia's DTAs with Japan and Germany, and the special history of these three DTAs needs to be

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[92] Including the UNITED NATIONS MANUAL FOR THE NEGOTIATION OF BILATERAL TAX TREATIES BETWEEN DEVELOPED AND DEVELOPING COUNTRIES of 1979, which preceded the 1980 UN Model. A 2001 version of the UN Model and Commentaries has recently been published.

[93] The 'Colonial Model' was not published as such. The expression is used to refer to early UK treaty practice with colonies and other Commonwealth countries - see J Newman, UNITED KINGDOM DOUBLE TAX TREATIES (1979) 2.

borne in mind when interpreting those aspects which differ from our more usual DTA practice.

114. Features of the Colonial Model reflected in these DTAs include:

- it defined and used a concept of 'industrial and commercial profits' - the analogue to the OECD's undefined expression 'profits of an enterprise'. The definition generally excluded certain specific items which were often (but not always) expressly dealt with under other distributive rules; and
- items might be deleted from the distributive rules (and therefore not brought within the scope of the DTA) if source country taxing rights were to be retained over the item. For example, there is no OECD *Capital Gains* Article in the *United Kingdom* and *Japanese* Agreements - even though they were OECD members. Likewise, the *United Kingdom, Japanese and German* DTAs omitted the prevailing OECD *Immovable Property*, *Capital* and *Income Not Expressly Mentioned* Articles.

115. The drafting of the *Methods of Elimination of Double Taxation* Article in these DTAs also departs from OECD practice to ensure the residence country either credits or exempts source country tax on items not included in the distributive rules.

Explanatory Memoranda etc

116. The Explanatory Memoranda for the enabling Bills when Australia's DTAs are implemented domestically (and sometimes the Second Reading Speeches) can be particularly useful as evidencing the Australian negotiators' understanding of the DTA's terms, and Parliament's understanding and expectations when the legislation was passed.

117. While there are some issues about how a court would treat such material, to the extent that it bears upon *substantive* DTA provisions (that is, on matters other than the specific *implementing* provisions) the Explanatory Memoranda should, as a matter of practice, be examined in the ATO consideration of novel issues involving recent DTAs. They will often, for example, record Memoranda of Understanding which are not part of the DTA, but assist in understanding it[94]. An example is the Memorandum on the

[94] Edwardes-Ker notes that 'In many States, courts can consider a tax treaty's local domestic legislative history – which may be persuasive at a domestic (but not

scope of Argentine export legislation which is extracted in paragraph 4.63 of the Explanatory Memorandum for the DTA implementing legislation to the *Argentine Agreement*[95].

Other Instruments

118. Often the DTA provides for matters such as the updating of certain references under the DTA to be dealt with by an exchange of letters between relevant Ministers (such as under Article 23(5)(b) of the *Vietnamese Agreement*[96]) rather than amendment of the DTA[97].

Foreign court decisions

119. Since Australian courts have recognised that interpretation in a way conducive to producing a uniform international interpretation is an important goal in interpreting treaties[98], it follows that foreign court decisions on similar provisions may give valuable guidance about the meaning of a term. They need to be treated with some caution, since they may be founded on different interpretative principles or approaches. Some courts may, for example, less strictly follow the Vienna Convention rules, or may apply a domestic law meaning of a term when they should apply an accepted international tax meaning. A court may also, quite properly, apply a domestic law meaning to a term left undefined by the DTA, whereas the same approach before Australian courts may lead to a different domestic law meaning being 'picked up'.

120. Nevertheless, a foreign court's decisions, including on the foreign language text, may provide important insights. Some foreign courts have considerable experience and expertise in interpreting DTAs. In *Lamesa*, the Full Federal Court did not need to (or wish to)

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necessarily at a public international) level', and gives some examples of state practice: paragraph 25.02.

[95] Schedule 44 to the Agreements Act, implemented by Act No 149 of 1999. See also the list of examples in the Explanatory Memorandum for the *Indian Agreement* (Schedule 35 to the Agreements Act, implemented by Act No 214 of 1991) to explain which 'services' were intended by negotiators to be governed by the *Business Profits* Article, and which were to be dealt with under the *Royalties* Article.

[96] Dealing with 'tax sparing' whereby tax foregone by Vietnam to encourage investment in certain sectors is treated by Australia as actually paid, for the purposes of our foreign tax credit system. This means the Australian resident investing in Vietnam receives the full benefit of the special concession by Vietnam. Australia's policy is now generally against agreeing to 'tax sparing'.

[97] Section 4A of the Agreements Act provides for notification in the *Gazette* of certain 'events', such as an exchange of letters. In practice, the relevant Minister usually also notifies the event by means of a Media Release.

[98] See paragraph 87 above.

express a concluded view on the issue. The Court noted, however, that[99]:

> We would, however, express our agreement with the distinction drawn by Lindgren J in *Allstate Life Insurance Co v. Australia and New Zealand Banking Group Ltd (No 6)* (1996) 64 FCR 79 between the content of foreign law which is receivable in evidence and the application of that law to facts once its content has been ascertained which is not. However, where the construction of an international treaty arises, evidence as to the interpretation of that or subsequent treaties in one of the participating countries forms part of a matrix of material to which reference could properly be made in an appropriate case. As presently advised we would not wish it to be thought that a limited view of the material to which reference could be made in interpreting a double tax treaty should be taken. Had there been some decision of an appropriate Dutch court interpreting a treaty with identical or similar language, then, in our view, evidence of such a decision might well have been admissible.

121. There are also strong reasons to consider, as a matter of practice, the decisions of courts from countries other than the treaty partner (an issue not addressed by the *Lamesa* Court). Any such consideration would need to be consistent with the comments of the High Court in *Cook v. Cook*[100] that:

> Subject, perhaps, to the special position of decisions of the House of Lords given in the period in which appeals lay from this country to the Privy Council, the precedents of other legal systems are not binding and are useful only to the degree of the persuasiveness of their reasoning.

ATO materials

122. There are many Taxation Rulings dealing with specific DTA issues,[101] and it is likely that there will be increasing numbers of

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[99] 97 ATC 4229 at 4757.

[100] (1986) 162 CLR 376 at 390, Mason, Wilson, Deane and Dawson JJ.

[101] Such as IT 2047 on teachers and professors and Article 15 of the *New Zealand Agreement*, IT 2066 on the *French Agreement*, IT 2323 on United States entertainers and Article 17 of the *United States Convention*, IT 2324 on United States entertainer's support personnel and Article 15 of the *United States Convention,* IT 2445 on the foreign tax credit system (underlying tax credits), ITs 2527-2529 on the Foreign Tax Credit System, IT 2542 on the taxation position of United States non-government pensions under the *United States Convention*; IT 2554 on Italian pensions paid to Australian residents, IT 2568 on the tax treatment of United States sourced dividend, interest and royalty income derived by United States citizens resident in Australia, IT 2574 on the tax treatment of exchange teachers under the *United States Convention,* IT 2577 on the Japan Exchange and Teaching (JET) Program, IT 2619 on the treatment of

Taxation Determinations,[102] Rulings and ATO Interpretative Decisions on DTA issues in future. The significance of any such materials in a particular case will, of course, depend upon the inherent status of those materials and their relevance to the issue under consideration. As with all such material, it is important to ensure that the material is up to date, and that any relevant addenda have been taken into account.

123. Some early DTAs and some long-standing DTA issues can also be better understood with the assistance of relevant Canberra Income Tax Circular Memoranda.[103] Such material must be treated

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visiting professors and teachers under the *United Kingdom Agreement*, IT 2650 on residency - permanent place of abode outside Australia, IT 2660 on the definition of royalties, IT 2665 on Swedish, Danish, Finnish, Dutch and Malaysian government service pensions paid to Australian residents under the respective DTAs, TR 93/12 on computer software, TR 94/14 on application of Division 13 of Part III (international profit shifting) of the *Income Tax Assessment Act 1936*, TR 97/19 on whether there are any implications under the *Chinese Agreement* of resumption of Chinese sovereignty over Hong Kong, TR 97/20 on arm's length transfer pricing methodologies for international dealings, TR 98/17 on residency status of individuals entering Australia, TR 98/21 on the withholding tax implications of cross border leasing arrangements, TR 2000/16 on international transfer pricing and profit reallocation adjustments, relief from double taxation and the Mutual Agreement Procedure, TR 2001/11 on international transfer pricing - operation of Australia's permanent establishment attribution rules, and TR 2001/12 on capital gains in pre-CGT tax treaties.

[102] Such as TD 93/67 on Fringe Benefits Tax and DTAs, TD 93/89 on certain payments made by Australian residents to Italian shipping enterprises, TD 93/151 on whether periodic workers' compensation payments made by Comcare are 'pensions' for purposes of the pensions articles in Australia's DTAs, TD 93/218 on whether the definition of 'the Netherlands' in the *Netherlands Agreement* includes Aruba and the Netherlands Antilles, TD 93/219 on whether the definition of 'United Kingdom' in the *United Kingdom Agreement* includes British possessions, TD 93/220 on whether the definition of 'France' in the *French Agreement* includes the French Territories, TD 93/221 on whether the definition of 'United States' in the *United States Convention* includes United States possessions; TD 94/44 on the time threshold in the 'substantial equipment' provision of the *Permanent Establishment* Article of the *Spanish Agreement*, TD 95/50 on dividend withholding tax under the *Philippines Agreement*; TD 2000/9 on whether the Macau Special Administrative Region (SAR) is now covered by the *Chinese Agreement*; TD 2001/21 on whether salary paid to a French resident employed as an assistant teacher in an Australian school is exempt income under the terms of the *French Agreement*; TD 2001/22 on whether salary paid to a German resident employed as an assistant teacher in an Australian school is exempt income under the terms of the *German Agreement*; TD 2001/23 on whether salary paid to a Italian resident employed as an assistant teacher in an Australian school is exempt income under the terms of the *Italian Agreement*, and TD 2001/24 on whether salary paid to a Japanese resident employed as an assistant teacher in an Australian school is exempt income under the terms of the *Japanese Agreement*.

[103] Such as No 864 dealing with the 1967 *United Kingdom Agreement* (as it existed prior to the 1980 Amending Protocol), No 874, which gives details of the provisions in the *Japanese Agreement* and the *Singapore Agreement* (as the latter

with great caution, of course, and many of the DTAs referred to in CITCMs have been amended or replaced since the relevant CITCMs issued.

124. The Treaties Unit in National Office also has access to some of the materials relating to the actual negotiations of particular DTAs, including material produced by the ATO (such as notes of discussions) and material provided by the other negotiating country. Such materials are of varying quality and are not generally available because of the traditional confidentiality of bilateral treaty negotiations between countries. The Treaties Unit also holds correspondence relating to the subsequent operation of DTAs which may further illuminate the DTA's intended operation.

Other materials

125. Extrinsic materials of various types are extensively relied on by some countries. Some, such as the 'Technical Explanations' which are a feature of United States domestic procedures for consideration of a DTA, may help explain the views being put by the relevant DTA partner or a taxpayer. As the 'Technical Explanations' are, however, developed as part of the internal processes of the United States when implementing a DTA, they are of little or no usefulness in objectively *proving* the intent of both parties to a DTA. They are primarily designed to reflect the views of the United States negotiators, upon which there may not necessarily be a *consensus ad idem* ('meeting of minds'), but they may in some cases provide useful signposts to that *consensus*[104]. Even if they might not be admissible in court, or might be of little probative value, they may better inform an understanding of the DTA as a whole.

Date of effect

126. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute

existed prior to the 1989 Amending Protocol) and No 875 on royalties (much of which has since been updated in IT 2660). CITCM No 705 deals with the (since terminated) 1953 *Australia-United States Double Tax Convention* but is occasionally useful in understanding provisions of the current (1982) *United States Convention.*

[104] See on the use of United States materials and the different approaches taken to such materials by the courts of other countries, Edwardes-Ker at paragraph 25.04. Edwardes-Ker notes, importantly, that this does not supplant the rule that a treaty must be interpreted in accordance with the common intention of both States.

agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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Subject references:
- alienation of property
- arm's length principle
- business profits
- capital gains tax
- Colonial Model
- Credit article
- cross border dealings
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- double tax agreements
- foreign pension income
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- source rules/dual resident article
- tax treaties
- taxes covered
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- UN Model
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