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Special Edition: Tribute to the late Professor John Tiley

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Margaret McKerchar

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32 µ6HQG D VWURQJ PDQ WR (QJODQG ± capacity to put up a fight more important than intimate knowledge of income tax acts and practice¶ development of the dominion income tax relief system of 1920

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From 3rd June 1947 international juridical double taxation between the United Kingdom and Australia has been dealt with through a series of bi-lateral double taxation agreements.[2] Prior to the entry into the first of these agreements in 1946 the problem of double taxation of income by the United Kingdom was dealt with as part of a system

Income Tax Relief system operated from 1st July 1921 and 30th June 1947.

the 1919 conference between the Sub Committee of the United Kingdom Royal Commission on the Income Tax and representatives of the Dominions. Part 3 discusses

by Louis Botha (the Prime Minister of Transvaal) and Botha

Although the need for relief intensified when the United Kingdom raised its top marginal rate to 6/- in the (30%) no relief was enacted. The issue was considered again at the Imperial War Conference of 1918. There the then Chancellor of the Exchequer, Andrew Bonar Law, stated:

> It is certainly essential that this whole question be settled, and I think it should be settled immediately after the war. It is even in our interest that it should be done I mean the interest of the British Exchequer because it is quite obvious that with the income tax as high as it is likely to be after the war, unless adjustment of this kind is made, businesses which can be conducted in the Dominions without having an office in London will be transferred there and we shall lose the whol

[26] On Hughes recommendation George H Knibbs, the Commonwealth Statistician, was

One
income otherwise subject to double taxation and that the other country should surrender

Imperial Exchequer in such serious reductions in revenue that it may be possibly be
[33]

Under this approach Ewing

letter set out, in some detail, how, in his view, relief should be provided under the second approach. First the amount of income actually taxed in both countries would need to be ascertained. Then the highest amount of tax payable on that income in any part of the Empire would
to the several taxes assessed on the income, between the parts of the Empire in which it
[34] What Ewing envisaged is clear from an example that he provided in subsequent correspondence. On an income of £1000 the United Kingdom tax was £150 (representing a 15% rate) while the Australian tax was £45/14/1 (representing

United Kingdom tax of £150 which would be apportioned between the United Kingdom and Australia in the same proportions as the tax that each jurisdiction would otherwise levy bore to the sum of the taxes that would otherwise be levied by those jurisdictions. The total tax that would otherwise be levied was £195/14/1. The United Kingdom tax that would otherwise be levied of £150 represented 76.65% of the total tax that would otherwise be levied. This same percentage would then be applied to the £150 that the United Kingdom levied wh

would be 23.35% being £35/0/7.[35]

Ewing suggested that the income doubly taxed in more than one part of the Empire

relief and to provide all necessary particulars to show the manner and extent to which [36]

Ewing also recognised that there would probably be a few cases in which there would be double taxation between Australia and parts of the Empire other than the United Kingdom but considered that those cases would not present any features not found in the United Kingdom

CLR 568 as authority that in the case of a business which conducts some operations in Australia profits from sales outside Australia arise, at least in part, from sales within Australia.[53]

decision were to

[54] Here it appears that Ewing was envisaging a conflict of source rules and, on the basis of the third

hich are
received by British purchasers of Australian goods. [58]

On the question of whether his draft agreement of 22nd
approval Ewing pointed out that the draft merely expressed the policy of the United Kingdom Excess Profits Tax and the Australian War Time Profits Tax and, as no question of policy was involved in the draft agreement, the matter was entirely different from double income taxation within the Empire.[59]

Ewing closed by noting that he was attaching a copy of a memorandum on the causes of double taxation that he had provided to Knibbs prior to his departure and by

received from the Treasury in connection with the present consideration of double taxation within the Empire and that he had not possession of reports of Colonial conferences which Collins had sent to Knibbs.[60]

Collins then sent a Minute Paper to Ewing asking him to draft a cable containing a concise reply to the questions raised by Knibbs in his letter of 7th August. Collins pointed out that Knibbs was due to arrive in London in a few days and that the conference would meet on 23rd September.[61] In reply Ewing prote
position of this question renders it impossible for me to prepare a draft cable to Mr Knibbs effectively replying to his queries of 7th August regarding double income tax.
Ewing then referred back to the points he had made in his l

residence has already made it proper sacrifice in any reciprocal arrangement for eliminating Double Income Tax.[67]

> The contention, without qualification, that a primary right to tax income is possessed by the country whence the income is derived to the exclusion of the right to tax it in the country of residence violates the principle that each country has complete freedom to choose its own measure of liability in imposing taxation, and its difficult to justify on theoretical principles. If this contention were admitted, the United Kingdom would be called upon to sur(et)-ae admid0 1 dadmto tdeBTch in-41(dh0 1 3(i4BTxi)1 0 0 1(t)6(hat)h)]7(ca)1(devt)6e

disclosed by him it is not possible to further advise him as to what may be done by him
88

cable of 12th November 1919.

In the meantime Knibbs sent a further cable to the Australian Prime Minister as follows:

> Believe representations to sub-committee Double Income Tax will completely fail.
>
> If you think it desirable I should discuss matter unofficially with high members commission itself, please advise. Probably this best done through meeting them socially, in which case liberal allowances are absolutely necessary.
>
> Please telegraph early reply.[89]

The Australian Treasurer, W. A Watt, replied by cable on 18th November 1919 that there was no objection to Knibbs discussing problems with high members of the Commission but that the scale of allowances for Knibb
90

nd November 1919 advised:

> Double Income Tax Committee rejects both our proposals, but favours mutual sacrifice. Scheme on existing Fede

Scheme proposed Inland Revenue Officer here somewhat similar principle

3 KEY FEATURES OF UNITED KINGDOM ROYAL COMMISSION'S SCHEME FOR DOMINION INCOME TAX RELIEF

Notwithstanding lack of agreement from Australia the United Kingdom Royal Commission accepted the recommendations by the Sub Committee in full. The United

have regard to the following principles:

a) that where Income Tax is charged on the same income in both the United Kingdom and a Dominion the total relief to be given should

be met by the elimination of excessive taxation by remitting an amount equal to the lower of the taxes imposed by the two States. The Sub Committee also adopted what would nowadays be described as a principle of capital export neutrality by noting that an Empire citizen should not be penalised for investing in a part of the Empire outside his State of residence.[110] Moreover, the Sub Committee had regarded double income taxation as a hindrance to Imperial trade and the free circulation of capital within the Empire.[111]

Remitting the lower of the taxes imposed by the two States could be achieved by several different means. The Sub Committee had considered two alternatives: (a) the collection of the higher tax and its subsequent apportionment between the two States concerned in an agreed ratio; or (b) by each State remitting a portion of its tax so that the aggregate remission would be equal to the amount of the lower tax. Note that both of these alternatives involved a sharing of the burden of relief between the residence and source jurisdiction. By contrast, both of the alternatives apparently proposed by Knibbs

Harrison proposal would have involved rebates being given by the Dominions in some

only.[120] The rate of United Kingdom tax was to be calculated by reference to the

Commission observed that calculating the appropriate United Kingdom rate by reference to the gross amount was necessary if relief were to be granted consistently with the principle that only the higher tax should ultimately be paid on the same source of income.[121]

An important feature of the proposal was the treatment given to dividends. The Sub Committee proposed that there would be an adjustment at the United Kingdom resident company level by reference to the rates charged to the company by the United Kingdom and by the Dominion respectively and that a subsequent adjustment of United Kingdom rates could be made by reference to the total income of individual shareholders. This amounted to giving individual shareholders a credit for underlying Dominion corporate tax irrespective of their level of shareholding.[122] Where the Dominion provided further relief by reference to the total income of the shareholder any additional relief for the shareholder beyond that offered by the United Kingdom within the limit of one half of the appropriate United Kingdom rate would be borne by the Dominion. Where the Dominion did not provide further relief the Sub Committee stated that the tax ultimately borne by the shareholder would be: (1) the United Kingdom tax at the rate determined

borne by the paying company. The Sub Committee noted that under current rates in most cases the total relief necessary for a complete adjustment could be granted by the United Kingdom.[123]

The Sub Committee regarded one advantage of the proposal as being that it had an element of permanency as it allowed each State to alter its tax rates without reviving the issue of the division of relief. The Sub Committee considered that the proposal the part

complete reciprocal action by the Dominions. The majority of the Sub Committee thought that relief by the United Kingdom should not be conditional upon reciprocal action by Dominions. Some of the Sub Committee members, however, considered that the United Kingdom should reserve the right to apply the scheme only where the Dominion had taken the necessary steps to allow the individual taxpayer the balance of relief necessary to represent total taxation at the higher of the two rates.[124]

The United Kingdom Royal Commission also considered that if the recommendation were adopted the United Kingdom Government would have acted generously and that the Governments of the various Dominions would provide taxpayers with the balance of total relief necessary to ensure that the total tax payable did not exceed the higher of the two rates.[125]

Both the Sub Committee and the United Kingdom Royal Commission contented themselves with stating broad principles as to how the scheme would operate, although

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[120] United Kingdom, *supra* note 18 at p 172, paragraphs 28 and 29.
[121] United Kingdom, *supra* note 18 at p16, paragraph 71.
[122] The current practice of many countries today is to limit the availability of credits for foreign underlying tax to shar nte 1

taxation between the States and the Commonwealth would continue.[135]
then indicates that he was attaching 8 schedules illustrating the operation of the Royal Commission scheme in a variety of hypothetical circumstances. Unfortunately, copies of these schedules are not currently contained in the relevant Australian Taxation Office file located in the National Archives of Australia. Ewing anticipated that, for the Board of Inland Revenue, in particular, but also to some extent for the Dominions, significant complexities would be involved in the application of the scheme to companies. Ewing anticipated that further complications might arise in the case of companies due to:

> the differences between the bases of assessment in the United Kingdom and Australia. The United Kingdom taxes on profits which means net gain and involves deduction of many items which are not deductible in Australia. This feature will be the main difficulty to be overcome in isolating the actual

Winston Churchill, as Secretary of State for the Colonies, sent a despatch to the Australian Governor General on 30th June 1921 enclosing a draft clause that the United

to reciprocal relief from international double taxation of income. Churchill also sent the memorandum referred to above on Dominion Income Tax Relief issued to the public by the Board of Inland Revenue.[144] as the United Kingdom system was based on a comparison of the rates of United Kingdom tax and Dominion taxes and not on the amounts it was desirable that the rates of United Kingdom and Dominion taxes should be determined in the same way for the purposes y were determined for the purposes of relief in the United

of United Kingdom relief the method for determining the rate of United Kingdom tax differed from the method applied for determining the rate of Dominion tax. The calculation of the United Kingdom rate was determined by dividing tax payable by the

determined by dividing the amount t
allowing for any abatement. The rate of United Kingdom Super Tax payable was taken into account in determining the appropriate rate of United Kingdom tax and was determined by dividing the amount of Super Tax payable by the income which was subject to Super Tax. The despatch also indicated that to avoid complications that

Kingdom revenue authorities would issue certificates in the attached form indicating what the appropriate rate of United Kingdom tax was. The despatch went on to point out that, as the principle underpinning the system was that the lower of the two rates of tax should be eliminated, it followed that in assessing United Kingdom or Dominion tax as the case may be no deduction should be allowed for the other tax. In modern parlance

domestic tax payable. The despatch concluded by advising that certificates as to the

General by cable on 15th October 1921.[147] The cable noted that the Board of Inland Revenue regarded United Kingdom law relating to Double Income Tax as very
th September
1921 regarding the method for determining the rate of United Kingdom tax and Dominion tax and made the following suggestions on administrative procedures:

> It will be necessary also before or as soon as Commonwealth provisions operate to make arrangements as regards certificate of United Kingdom rate(s) of relief to be furnished to taxpayer claiming complementary relief in Commonwealth also Commonwealth and United Kingdom taxation years corresponding for purpose of relief. Board feel that in intricate matter mutual co-operation from the first would minimise administrative difficulties and friction with taxpayers. Suggest that Board should be supplied in advance with proposed Commonwealth provisions or if there is representative of Commonwealth Government in this country conversant with question he should discuss with Board in order that liaison should exist from the first. Should be glad to know whether Ministers agree.[148]

st
October 1921.[149] Ewing did not reply until 22nd November after the release of the first report (discussed below) of the Warren Kerr Commission. As will be seen a majority of the Warren Kerr Commission recommended that both the Commonwealth and the States grant reciprocal relief as part of the Dominion Income Tax Relief system. The
th September 1921 would indicate,
however, that a decision to grant reciprocal relief had been made at the Commonwealth Government level prior release of the first 1Qe1U0

-Australian incomes.[152] After noting the loss of revenue to Australia that would result for adopting the proposal, the Warren Kerr Commission stressed that several witnesses had testified to it that double income taxation acted as a distinct deterrent upon the investment of British capital in Australia.[153] The Warren Kerr Commission also regarded the concession which the proposal asked Australia to make as one which could rightly be regarded as a practical expression of the spirit of reciprocity which, as far as possible, should govern inter Empire transactions.[154] The Warren Kerr Commission pointed out that the theory of the British arrangements was that:

> the Empire should for certain important purposes be regarded as a unit, and that while each self-governing portion retains its full right of imposing taxation at its own rates and within the limits which itself fixes, from the point of view of membership of such an Empire no taxpayer can consider himself aggrieved if his total taxation, where he is taxed by more than one authority, does not exceed the higher of the two taxes.[155]

Although they each imposed income taxes in this period, the Governments of the individual Australian States had not been represented at the 1919 London meetings with the Sub-

> deduction made in Great Britain is not sufficient to provide complete relief against Double Taxation.[158]

The Warren Kerr Commission endorsed the views of the United Kingdom Royal Commission at paragraph 69 of its report (quoted above) and went on to recommend:

> 1. That in respect of incomes taxed both in the United Kingdom and the Commonwealth, in all cases where the deduction at present allowed from the United Kingdom tax is not in itself sufficient to insure the payment only of an amount equivalent to the higher of the two taxes, the Commonwealth Government should grant such further relief to the taxpayer as will effect that end.
>
> 2. That consequent upon the adoption of this recommendation, the Commonwealth and State Governments should mutually agree on the question of proportional deductions from their respective taxes in all cases where complete relief from Double Taxation is not entirely secured by the deductions under the British law.[159]

The Australian Government accepted this recommendation but the means for implementing it were left for the Federal Commissioner of Taxation to determine. The

1922.[164] After noting that no State Government had yet indicated its intention to be a party to the arrangement the letter indicated that the intent of the Australian legislation was to eliminate double taxation as between the United Kingdom and the Commonwealth of Australia to the extent that would be required if the States were parties to an arrangement for the elimination of treble income tax as recommended by the Warren Kerr Commission. Under s12A, where only Australian Commonwealth tax and United Kingdom tax was payable, Australia granted a rebate of tax where the Australian rate was greater than one half of the British rate. The amount of the rebate varied according to whether or not the Australian rate was greater than the British rate. Where the Australian rate was greater than the British rate then the Australian rebate was one half of the British rate. Where the Australian rate was not greater than the British rate the Australian rebate was the excess of the Australian rate over one half of the British rate. The Australian legislation would apply from the financial year commencing on 1 July 1921. As was standard Australian practice at the time assessments for that year would be based on income derived in the year ending 30 June 1921.

The letter envisaged several possible problems that might arise in the application of the system. First, although tax years between the Commonwealth and the Australian States were the same the United Kingdom applied a different tax year. Here, the letter indicated, the Australian Taxation Office would require the taxpayer to demonstrate that the amount of income included in the United Kingdom assessment was also included in the Australian Commonwealth assessment. Secondly, great administrative difficulties were envisaged in dealing with the United Kingdom system of averaging of incomes in determining taxable income for a year. On this question the Australian Taxation Office would assume, at least for the present, that the actual amount of Australian income taken into account by the United Kingdom authorities in determining the average income to be taxed for that year was the income that would otherwise be doubly or trebly taxed that year even though the United Kingdom averaging system might increase or decrease the actual amount. Thirdly the letter noted that the business income tax bases in the United Kingdom and Australia differed because the United Kingdom taxed net profits of the business whereas in Australia taxable income was determined by deducting from assessable income only such deductions as the *Income Tax Assessment Act 1915-1918 (Cth)* allowed (a point that Ewing had made to Collins in his letter of 21st January 1920

the United Kingdom and Commonwealth Taxing Authorities to require the taxpayer concerned to produce evidence to each authority from the other authority showing certain definite particulars as to income which has been assessed by the authority in a

The letter pointed out that differences in the progressive rate scales adopted by the two countries should not produce difficulties as the rate used for calculating the rebate in both countries would be the average rate determined by dividing the tax payable by the income on which tax was charged. No difficulties were anticipated in dealing expeditiously with claims for rebates by companies given that Australia taxed companies at a flat rate on their undistributed profits and at a lower flat rate on payments

[164] Governor General Commonwealth of Australia to Secretary of State for the Colonies, 2nd May 1922.

26th April 1922 and 22nd April 1922 are contained in Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

to absentees (non-residents in modern parlance) while the United Kingdom taxed companies at a flat rate. It was anticipated that difficulties might arise in the case of businesses owned by individuals or partnerships as the applicable rates would vary according to the amounts of taxable income assessed to the individual owner or the respective members of the partnership.

The letter set out in some detail the procedures that the Australian Taxation Office would follow in implementing the system in the case of an Australian branch of a United Kingdom business. These envisaged an itemised dissection of the income of the taxpayer showing the income that had been subject to Australian or United Kingdom taxation and the income that had been exempt from Australian tax with certification of these amounts by the Australian and United Kingdom taxation authorities at differing stages of the rebate process.

The procedure set out in the letter was bound to be cumbersome and clearly took a more detailed itemised approach to differing tax years and differences in tax bases than the approach that was proposed to be used in the United Kingdom. Correspondence between the revenue authorities in the two countries continued but, as is discussed in more detail below, despite this the two countries took significantly different approaches in operationalizing Dominion Income Tax Relief.

5 THE SUBSEQUENT OPERATION OF THE DOMINION INCOME TAX RELIEF SYSTEM BETWEEN THE UNITED KINGDOM AND AUSTRALIA; ASSESSMENT OF THE EFFECTIVENESS OF THE AUSTRALIAN REPRESENTATIVE AT THE 1919 – 1920 CONFERENCE

As between the United Kingdom and Australia, the Dominion Income Tax Relief system continued to operate in this form until the entry into force of the Australia United Kingdom Double Taxation Agreement in 1947.

not relevant. It is possible though that, if Ewing had been present at the meetings of the Sub-Committee of the United Kingdom Royal Commission, he may have been persuaded of the virtues of a notional as distinct from a measured approach to relief.[170]

considerable balance of tax (due to the application of its progressive rate scale to worldwide incomes), in fact, Australia by the 1930s regarded the system as working well.[171] By contrast in the 1930s the United Kingdom made intermittent efforts to reform the system as its high rates of taxation and a credit limit being one half of its applicable rate meant that it was bearing the major portion of relief that was granted. United Kingdom efforts in 1930 to amend the system so that the Dominions exempted some classes income (principally, fixed interest securities) from taxation on a source basis while the United Kingdom and the Dominions bore equal shares of relief on the remaining classes of income[172] received a frosty reception from the Dominions with Australia again leading the dissent.[173] Neville Chamberlain as United Kingdom Chancellor of the Exchequer subsequently made desultory efforts to revive the 1930 proposal[174] but when he failed to follow up on a request for a response to his proposal Australia simply decided not to reply at a300489.W*nBT/FJest4(h)11(e)-22(sy)9(st)4(em)15( )-21(so)

system meant that the Dominions wanted it to continue but the United Kingdom wanted it modified.[176]

deduction system in favour of an imputation system in 1923, notwithstanding the prior discussion in the report of the Sub-Committee of the United Kingdom Royal Commission, difficulties were experienced in determining whether the company or the shareholder was entitled to the relevant rebate under Dominion Income Tax Relief. The Commissioner of Taxation received correspondence from tax practitioners and businesses on this issue and the Australian Taxation Office view was that Australian shareholders were entitled to any Australian rebate but was unwilling to rule on whether the shareholder or the company should make the application to the United Kingdom for any applicable rebate of United Kingdom tax. In the case of non-resident shareholders the Australian Taxation Office view was that where the shareholder was separately assessed on the dividend the shareholder should apply for any Australian rebate but where this was not the case (that is where the company elected to withhold tax at source) the company should be the applicant.[177]

Prior to 1923 the Australian system principally provided relief from economic double taxation of dividends by relief at the company level. The system was that the company

practical difficulties were associated with collecting surtax from non-residents. The availability of various reliefs to residents could mean that, in some circumstances, a natural person resident shareholder could be entitled to a refund of tax in respect of dividends received. In effect resident shareholders were being given credit for United Kingdom corporate tax paid.[179]

Difficulties associated with the interaction of the two systems of corporate-shareholder taxation within the system of Dominion Income Tax Relief appear to have subsided when Australia in 1923, for reasons associated with Federal State co-operation in income tax collection, abandoned its dividend deduction system for an imputation system in which shareholders received rebates (which eventually were to be non-refundable), the effect of which in most cases was that no tax on dividends was payable at the shareholder level.[180] As mentioned above, throughout the 1930s successive Australian governments viewed the system as working well.

Dominion Income Tax Relief survived Aust
1930. After its adoption of a global system in 1930 Australia exempted foreign source income that had been subject any foreign income tax so the change to a nominal global system did not have a substantive effect on the Australian tax effects of most outbound investments. Exempting most foreign source income meant that Australia did not have to develop a credit based mirror image of the United Kingdom system of Dominion Income Tax Relief in the manner that had be

Kingdom parent companies on dividends paid by wholly owned Australian subsidiaries approached 67.5%. [183]

While Dominion Income Tax Relief was operating within the British Empire, the League of Nations was working on the problem of international juridical double taxation. At the same time the United States was refining the foreign tax credit system that it had introduced in 1918. Moreover, Double Tax Agreements that can be seen as the progenitors of the current OECD Model Double Taxation Convention had been entered into by some States. Importantly these included agreements between States, such as Sweden, with a schedular system of taxation and States, most notably the United States, which used a global system. Each of these developments have been the subject of detailed discussion elsewhere.[184] For the purposes of this paper three important points can be noted from these developments.

First, none of the reports of the League of Nations committees regarded the system of Dominion Income Tax Relief as optimal largely because of the administrative difficulties associated with it but also because it was not suited to eliminating international double taxation where one State was using a schedular system while the other was using a global system. Secondly, a consensus developed through actual treaties and the work of the League of Nations committees that involved a different approach to sharing the burden of relieving international juridical double taxation to that taken in the Dominion Income Tax Relief system. The international consensus came to be that source countries would reduce their taxes on investment income (such as interest, dividends and royalties) and that the residence country would have the primary right to tax this income subject to giving relief through a foreign tax credit. In the case of business profits the consensus that developed was that the source country would have the primary right to tax with the residence country having a residual right to tax provided it granted a foreign tax credit. The consensus was based on paradigms, adopting different treatments for different categories of income and treating the corporate tax as distinct from the shareholder tax, which reflected in different ways, paradigms of the schedular and classical tax systems of the countries that dominated the League of Nations committees and early treaty negotiations. Thirdly, in this period, the United States developed the practice of only limiting its foreign tax credit by reference to the United States tax otherwise payable on the relevant foreign source income. Tax planning subsequently led the United States to develop other limitations but none of the limitations prevented a foreign jurisdiction from increasing its tax rates to the level of United States rates to take advantage of the United States foreign tax credit. The end result of these developments was that by the end of World War II international practice, and particularly United States practice, had begun to settle on limiting the source

tax business profits and requiring the residence country to relieve double taxation by

[183] For a detailed discussion of the approaches of both Australia and the United Kingdom to dividends

Taylor, Negotiation And Drafting 1946 Treaty, *supra* note 178, pp. 205 to 206 and Taylor, Dreary Subject, *supra* note 178, pp. 218 to 220..

[184] See S Picciotto, *International Business Taxation*, Weidenfeld and Nicholson, London, 1992 at pp 12 to *Duke*

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concluded since 1939, compared with the pre- *Cahiers De Droit Fiscal International* pp 1

Cahiers De Droit Fiscal International pp 25 to 78.