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Special Edition: Tribute to the late Professor John Tiley

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‘Send a strong man to England - capacity to put up a fight more important than intimate knowledge of income tax acts and practice’: Australia and the development of the dominion income tax relief system of 1920

C John Taylor¹

Abstract

The system of Dominion Income Tax Relief, which operated between the United Kingdom and Australia between 1st July 1921 and 30th June 1946, offered a solution to the problem of international juridical double taxation which differed in significant respects from the solution subsequently developed in bi-lateral double taxation treaties. The system allowed a country taxing on the basis of residence (in this case the United Kingdom) to give a credit for underlying foreign tax paid on dividends irrespective of the nature and extent of the shareholding in the foreign company. More fundamentally the system required a sharing of the obligation to relieve international juridical double taxation between the residence and source country that did not depend on a differential treatment of particular categories of income.

Using the archival sources that have been available to the author this paper examines: (1) the views of the then Australian Commissioner of Taxation on the problem; (2) the effect that submissions by the Australian representative (the Commonwealth Statistician) at a conference of Dominion representatives with the Sub Committee of the United Kingdom Royal Commission had on the scheme of Dominion Income Tax; and (3) the reasons for the subsequent demise of the scheme.

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This paper is based in part on a paper presented at the 5th International Accounting History Conference, Banff, Canada, 9th to 11th August 2007. Since writing that paper the author was able to locate two Australian Taxation Office files relevant to the development of the system of Dominion Income Tax Relief and the paper has been substantially revised having regard to the content of those files. The paper was presented at the inaugural meeting of the Australasian Tax History Chapter of the Australasian Tax Teachers Association at QUT on 27th June 2013. The author spent two periods of sabbatical leave at the University of Cambridge in 2005 and 2008. The late Professor John Tiley provided friendship and support for the author on those visits during which much of the research that resulted in this paper was conducted.

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 known as ‘Dominion Income Tax Relief’. In the Australian context the Dominion Income Tax Relief system operated from 1st July 1921 and 30th June 1947.

The system of Dominion Income Tax Relief offered a solution to the problem of international juridical double taxation which differed in significant respects from the solution subsequently developed in bi-lateral double taxation treaties. The system allowed a country taxing on the basis of residence (in this case the United Kingdom) to give a credit for underlying foreign tax paid on dividends irrespective of the nature and extent of the shareholding in the foreign company. More fundamentally the system required a sharing of the obligation to relieve international juridical double taxation between the residence and source country that did not depend on a differential treatment of particular categories of income. The system was developed following a conference between a Sub Committee of the United Kingdom Royal Commission On The Income Tax appointed in 1919 and representatives of the Dominions.

Using the archival sources that have been available to the author³ this paper examines the effect that submissions by the Australian representative at the conference of Dominion representatives with the Sub Committee of the United Kingdom Royal Commission had on the scheme of Dominion Income Tax Relief as developed by the Sub Committee. The paper argues that those submissions resulted in a system that produced favourable revenue results for Australia for most of the years of its operation. Ironically this feature of the system meant that the United Kingdom was dissatisfied with it for much of the same period. When, following changes to the Australian corporate tax system in 1939, the Dominion Income Tax Relief system began producing adverse revenue consequences for both jurisdictions they both sought its replacement with a double taxation agreement of a type that was then becoming the international norm. The paper also suggests that administrative difficulties associated with the operation of the system as between the United Kingdom and Australia might have been lessened if an Australian technical expert had been attended the conference and been part of the detailed negotiations.

This paper is divided into five parts. Part 1 outlines the reliefs granted by the United Kingdom resulting from discussions with the Dominions prior to 1919. Part 2 discusses

² Australia – United Kingdom Double Taxation Agreement, signed 29th October 1946, entry into force 3rd June 1947; Australia – United Kingdom Double Taxation Agreement, signed 7th December 1967, entry into force 8th May 1968; Protocol to Australia – United Kingdom Double Taxation Agreement, signed 29th January 1980, entry into force 21st May 1980; Australia – United Kingdom Double Taxation Agreement, signed 21st August 2003, entry into force 17th December 2003.

³ Archival research has been confined to the National Archives of Australia in Canberra and the United Kingdom National Archives at Kew. To date the author has only been able to locate a limited number of files relevant to Dominion Income Tax relief at either archive. Unfortunately an important file in the National Archives of Australia Series A461/8, Control Symbol D344/3/3 Part 1 is incomplete and does not contain copies of several key documents referred to in correspondence within it. Originals and copies of some items of correspondence referred to in National Archives of Australia Series A461/8, Control Symbol D344/3/3 Part I are contained in National Archives of Australia Series A11804 Control Symbol 1926/317. Some documents referred to in National Archives of Australia Series A461/8, Control Symbol D344/3/3 Part I are contained in National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I. The relevant Australian Taxation Office files are National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I and Part II.

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 key features of the United Kingdom Royal Commission's scheme namely, Dominion Income Tax Relief. Part 4 discusses the implementation of the Dominion Income Tax Relief system in Australia in 1921. Part 5 briefly discusses the subsequent operation of the system of Dominion Income Tax Relief in relation to Australian sourced income and the reasons for its replacement by a double taxation agreement in 1947. In the process Part 5 reflects on the effect of the Australian representative at the 1919 conference on the development and subsequent history of the system of Dominion Income Tax Relief.

1 DISCUSSIONS AND RELIEFS GRANTED PRIOR TO 1919

The problem of double taxation within the British Empire became apparent as British colonies started levying income taxes in the 19th century. Beginning with the introduction of the Indian Income Tax in 1860 the various British colonies began to tax United Kingdom residents on a source basis on at least some income. The Australian colonies all introduced income taxes between 1884 and 1907. All of the income taxes of the Australian colonies in this period levied tax on income sourced within the colony irrespective of the residence of the taxpayer. Similarly, when Australia first introduced a federal income tax in 1915 it also was a wholly territorial tax which taxed income with an Australian source irrespective of the residence of the taxpayer deriving the income.⁴

From 1803 to 1914 the United Kingdom, by contrast, taxed both on a residence and source basis although foreign source income of United Kingdom residents was only subject to United Kingdom tax when it was remitted to the United Kingdom.⁵ From 1914 onwards, however, the United Kingdom by s5 of the *Finance Act 1914* subjected major types of foreign source income to United Kingdom tax irrespective of whether they were remitted to the United Kingdom or not.⁶

In 1896 the Royal Colonial Institute sent a memorial on double taxation within the British Empire to the United Kingdom Chancellor of the Exchequer. Discussion of the issue in the United Kingdom House of Commons followed but attempt to enact a provision requiring the United Kingdom to grant a foreign tax credit to income that had been subject to Colonial income taxes proved to be unsuccessful.⁷

The issue of double taxation of income within the British Empire was raised again at the Imperial Conference of 1907.⁸ Cape Colony, following the decision of the House of Lords in *De Beers Consolidated Mines v Howe* [1906] AC 455, sought 'the repeal of enactments imposing double income tax on British subjects by the laws of the separate States and Great Britain'. *De Beers Consolidated Mines Ltd*, although incorporated in and carrying on business in Cape Colony, had been found to be a resident of the United Kingdom on the basis that its central management and control was in the United Kingdom. As a United Kingdom resident De Beers was subject to United Kingdom tax on its worldwide income. Dr Jameson (the Prime Minister of Cape Colony) supported

⁴ *Income Tax Assessment Act 1915 (Cth)* s10(1).

⁵ See the discussion of the history of the jurisdictional scope of United Kingdom income tax laws in P A Harris, *Corporate/Shareholder Income Taxation And Allocating Taxing Rights Between Countries*, IBFD Publications, Amsterdam, 1996, at p287

⁶ See the discussion in Harris *supra* note 5 at p 294.

⁷ See the discussion in Harris, *supra* note 5 at p 294.

⁸ United Kingdom, *Minutes Of The Imperial Conference 1907* pp 183 to 189.

by Louis Botha (the Prime Minister of Transvaal) and Alfred Deakin (Prime Minister of Australia), argued that ‘to us Colonists, it appears that the most equitable arrangement is that it should be a tax on incomes earned in the country where the tax is in force’.⁹ H H Asquith, then the United Kingdom Chancellor of the Exchequer, rejected the request stating, ‘I cannot hold out any hope that the Imperial Parliament will effect any change in that principle of our law. To do so would deprive ourselves here of an amount which I should be very sorry offhand to calculate, and also it would fly entirely in the face of the principle of our income tax law which is that wherever a person, a natural person or an artificial person, chooses for purposes of his or their own, to domicile themselves in this country, to take advantage of our laws for the purposes of carrying on their trade, they are proper subjects of taxation, and we cannot discuss the question amongst whom in what part of the world the ultimate profits are divided.’¹⁰ A subsequent attempt to enact a provision exempting income that had been subject to Colonial income tax from United Kingdom income tax was unsuccessful.¹¹

The issue was raised again at the Imperial Conference of 1911. New Zealand proposed a resolution calling for Imperial legislation exempting United Kingdom residents from United Kingdom tax on income or profits which had already been subject to income or other tax in by a self-governing dependency. The Union of South Africa proposed that the United Kingdom grant a foreign tax credit in respect of tax paid to Colonies.¹² Lloyd George, then the United Kingdom Chancellor of the Exchequer, rejected the New Zealand proposal on the basis that it would be too costly to the United Kingdom revenue but considered that the South African suggestion merited further consideration.¹³ The extension of the United Kingdom income tax base by s5 of the *Finance Act 1914* to tax residents on major items of foreign source income irrespective of their remittance to the United Kingdom together with the increase in income tax rates both in the United Kingdom and in the Dominions to finance involvement in World War I intensified the need for double income tax relief. On 9th July 1914 a deputation from the Dominions met with Lloyd George, then Chancellor of the Exchequer, to object to the income of persons from the Dominions being subject to United Kingdom income tax. In response Sir John Simon and Lloyd George stated in the United Kingdom House of Commons that United Kingdom tax would only apply to foreign source income where the recipient of the income was domiciled in the United Kingdom.¹⁴

Some relief was given by the United Kingdom *Finance Act 1916* which provided in s43:

If any person who has paid, by deduction or otherwise, United Kingdom income-tax for the current income-tax year on any part of his income at the rate exceeding three shillings and sixpence¹⁵ proves to the satisfaction of the Special Commissioners that he has also paid Colonial income-tax in respect

⁹ United Kingdom, *supra* note 8 at p188.

¹⁰ United Kingdom, *supra* note 8 at p 186.

¹¹ See the discussion in Harris, *supra* note 5 at p294.

¹² United Kingdom, *Minutes Of The Imperial Conference 1911* p 358.

¹³ United Kingdom, *supra* note 11 at p362.

¹⁴ Extracts from report of the Australian Cabinet Sub-Committee (Messrs Glynn and Webster and Senator Russell) dated 10th February 1919, The members of the deputation were Sir George Reid, the Honourable G H Perley, and the Honourable T Mackenzie. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁵ Rates were expressed in terms of shillings and pence in the pound. A rate of 3/- 6d represents a rate of 17.5%.

of the same part of his income, he shall be entitled to repayment of a part of the United Kingdom income-tax paid by him equal to the difference between the amount so paid and the amount he would have paid if tax had been charged at the rate of three shillings and sixpence, or, if that difference exceeds the amount of tax on that part of his income at the rate of the Colonial income-tax equal to that amount.

In this section the expression ‘United Kingdom income tax’ means income-tax charged under the Income Tax Acts; and the expression ‘Colonial income-tax’ means income-tax charged under any law in force in any British possession or any tax so charged which appears to the Special Commissioners to correspond to United Kingdom income tax.

As Harris points out, for the purpose of this unilateral relief by the United Kingdom, both residence of the taxpayer and source of income were irrelevant. The sole criterion for relief was that income was taxed in both the United Kingdom and a Dominion.¹⁶ As an Australian Cabinet Sub-Committee noted in 1919 the relief offered by the *Finance Act 1916* only benefited persons on large incomes.¹⁷ Subsequently a Sub Committee of the United Kingdom Royal Commission On The Income Tax established in 1919 was to note that a further objection to this form of relief was that it was entirely borne by the United Kingdom Exchequer.¹⁸ Under the system the United Kingdom tax payable prior to relief was calculated by deducting the Dominion tax paid not by grossing up the income for the Dominion tax paid.¹⁹

The relief given by the *Finance Act 1916* was only ever intended to be a temporary measure. The issue of double income tax within the British Empire was considered again at the Imperial War Conference of 1917 which passed the following resolution:

That the present system of double income taxation within the Empire calls for review in relation:

1. to firms in the United Kingdom doing business with the Overseas Dominions, India and the Colonies;
2. to private individuals resident in the United Kingdom who have capital invested elsewhere in the Empire, or who depend on remittances from elsewhere within the Empire; and
3. to its influence on the investment of capital in the United Kingdom, the Dominions and India, and to the effect of any change on the position of British capital invested abroad.

The Conference, therefore, urges that this matter should be taken in hand immediately after the conclusion of the war, and that an amendment of the law should be made which will remedy the present unsatisfactory position.²⁰

¹⁶ Harris, *supra* note 5 at 295.

¹⁷ Extracts from report of the Australian Cabinet Sub-Committee, *supra* note 14.

¹⁸ United Kingdom, *Report Of The Royal Commission On The Income Tax*, London, 1920, Appendix 1, at p169 paragraph 12.

¹⁹ A point noted in United Kingdom, *supra* note 18 at p172 paragraph 32.

²⁰ Quoted in United Kingdom, *supra* note 18 at p169.

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 whole of the revenue. So that it is in our interest that there should be no delay in doing this. But I do not think it would be wise, nor do I think it would be right, to attempt to deal with more than we have done, during the war.²¹

2 THE 1919 CONFERENCE OF DOMINION REPRESENTATIVES WITH THE SUB COMMITTEE OF THE UNITED KINGDOM ROYAL COMMISSION ON THE INCOME TAX

On 26th March 1919 the United Kingdom Secretary of State for the Colonies, following discussions with the Chancellor of the Exchequer²², advised the Governors General of the various Dominions that a Royal Commission on the Income Tax was about to be appointed and proposed that Royal Commission would confer with financial representatives selected by the Dominion Governments on the question of double income tax.²³ Sir Robert Garran, the drafter of the Australian Federal *Income Tax Act* 1915 made contact with the Royal Commission and was advised that they were not yet ready for a conference on the issue. The Royal Commission proposed to appoint a Sub-Committee to examine the question of double income tax relief within the British Empire and to confer with Dominion representatives. The then Australian Prime Minister, W M Hughes, regarded the deliberations of the Sub-Committee as extremely important and, apparently, did not consider Garran, despite his technical knowledge of the statute, as someone who would be forceful enough in the committee's deliberations. Another logical choice might have been Robert Ewing²⁴, the Commissioner of Taxation, but it may be that Hughes and the Government were already aware of Ewing's views on relief from double taxation. Later correspondence indicates that the Australian Government rejected a scheme developed by Ewing as involving too great a loss of revenue notwithstanding what Ewing regarded as its arithmetical correctness.²⁵ Hughes suggested sending a 'strong man to England' arguing that the 'capacity to put up a fight

²¹ United Kingdom, *Minutes Of The Imperial Conference 1918*, 8th Day p 3. Amendments were made to the rules providing relief in 1918 but these were merely technical adjustments consequent on changes in United Kingdom domestic tax law.

²² United Kingdom, *supra* note 18 at 168.

²³ Secretary of State for the Colonies to Governor General of the Commonwealth of Australia dated 26th March 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

²⁴ Ewing was Commonwealth Commissioner of Taxation from 1917 to his retirement in 1939. He had previously briefly been acting Commissioner in 1917, Deputy Commissioner of Taxation in Victoria in 1916 and 1917 and had been secretary of the land tax branch of the Commonwealth Department of the Treasury from 1911 to 1916. See P D Groenewegen, 'Ewing, Robert' in Bede Nairn and Geoffrey Searle (general editors), *Australian Dictionary Of Biography*, Volume 8, pp 453 to 454.

²⁵ R Ewing, Commissioner of Taxation to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II at pp. 177 to 179 refers to the scheme he developed and notes that, 'while arithmetically correct', it was 'not acceptable to the Commonwealth Government because it involved too great a loss of revenue.'

more important than intimate knowledge of Income Tax Acts and practice'.²⁶ On Hughes recommendation George H Knibbs, the Commonwealth Statistician, was appointed as the Australian representative at the conference.²⁷

George Handley Knibbs' had been a licensed surveyor, had taught geodesy, astronomy, hydraulics and physics at the University of Sydney and had been New South Wales superintendent of technical education. He had been appointed first Commonwealth statistician in 1906 a position he was to hold until 1921 when he became director of the newly established Commonwealth Institute of Science and Industry. By 1919 Knibbs had represented Australia and many international statistical, scientific and insurance conferences, had been a member of several wartime committees and had chaired the Royal Commission into the taxation of Crown leaseholds in 1918-1919. One biographer summarised Knibbs' career and personality as follows:

With ability and confidence evident in all his work, Knibbs won considerable prestige for the office of Commonwealth statistician, confounding those who had criticised his appointment. His major interest was in vital statistics and it was here that he won his international reputation....His failure to concern himself with current economic questions, coupled with his self-assurance and didacticism bordering on pomposity, may eventually have rendered him unpopular. His written expression, however, may have belied his reputed charm of manner and unnerving kindness of heart. He talked quickly and quietly in a high-pitched voice about his extraordinarily wide interests; one interviewer observed that 'an hour's conversation with him is a paralysing revelation'.²⁸

The Royal Commission formally appointed the Sub-Committee on 3rd July 1919 to: 'consider what arrangements with the various Dominions are practicable in order to ensure that any existing hardship arising from the imposition of Double Income Tax within the Empire may be remedied'.²⁹

Knibbs was not able to leave Australia until 2nd August 1919.³⁰ Prior to Knibbs leaving Australia the Commonwealth Commissioner of Taxation (Robert Ewing) wrote to the Secretary of the Commonwealth Treasury (James R Collins³¹) examining two alternative approaches for dealing with the problems of double and treble taxation.³²

²⁶ Cable dated 4th July 1919 from W M Hughes, London, to Acting Prime Minister (Commonwealth of Australia). Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

²⁷ Australian Cabinet decision, 8th July 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

²⁸ Susan Bambrick, 'Knibbs, Sir George Handley' in Bede Nairn and Geoffrey Searle (general editors) *Australian Dictionary Of Biography*, Volume 9, Melbourne University Press, Carlton, Victoria, 1981. pp 620-621. Knibbs' contribution as Commonwealth statistician is discussed in more detail in Susan Bambrick, 'The First Commonwealth Statistician: Sir George Knibbs' (1969) 102 *Journal and Proceedings, Royal Society of New South Wales* pp 128 to 135.

²⁹ United Kingdom, *supra* note 18 at p 168.

³⁰ Letter Collins (Secretary, Department Of The Treasury, Commonwealth Of Australia) to The Secretary, Prime Minister's Department, 20th August 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

³¹ James Richard Collins was Secretary Commonwealth Department of the Treasury, 1916 to 1926. See K R Page, 'Collins, James Richard' in Bede Nairn and Geoffrey Searle (general editors), *Australian Dictionary Of Biography*, Volume 8, pp 77 to 78.

³² R. Ewing, Commissioner of Taxation to The Secretary of the Treasury (Collins), Melbourne, 17th July 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at pp 82 to 83.

One approach was that the ‘country of origin’ should have the exclusive right to tax income otherwise subject to double taxation and that the other country should surrender any claim to tax it. Ewing rightly surmised that this approach would ‘involve the Imperial Exchequer in such serious reductions in revenue that it may be possibly be found impractical for the Imperial Government to agree to it’.³³

The other approach was that a ‘broad Empire view should be taken on the question’. Under this approach Ewing envisaged that ‘a citizen of the Empire should pay one tax on incomeassessed in more than one part of the Empire’. Ewing considered that the tax payable should be the highest amount payable in any part of the Empire. Ewing’s 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 need to be determined and that tax would then be apportioned ‘pro rata to the several taxes assessed on the income, between the parts of the Empire in which it has been taxed’.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 approximately a 4.57% rate). Under Ewing’s scheme total tax borne would be the 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 which meant that the United Kingdom’s would be entitled to retain £114/19/5 of the £150 tax that it levied. Australia’s proportion of the £150 of tax would be 23.35% being £35/0/7.³⁵

Ewing suggested that the income doubly taxed in more than one part of the Empire could be ascertained on a time basis using the Imperial fiscal year and that the comparison of taxes should be made in respect of the income included in the taxpayer’s return to the Board of Inland Revenue which was also taxed in another part of the Empire. In making this suggestion Ewing was concerned with differences in tax bases between jurisdictions (for example Australia exempted income from Commonwealth War loans whereas the United Kingdom did not). Ewing’s object was to ascertain the ‘actual amount of income on which tax is being charged in the two countries’. Ewing realised that the procedure he suggested would involve the Board of Inland Revenue in considerable work in calculations and that other taxing authorities throughout the Empire would have similar difficulties. In Ewing’s view, however, the anticipated difficulties were ‘not likely to prove sufficiently formidable as to warrant much consideration’. Ewing considered that the onus should be on the taxpayer to apply for

³³ Ewing to Collins, 17th July 1919, *supra* note 31 at p82.

³⁴ Ewing to Collins, 17th July 1919, *supra* note 31, at pp82-83.

³⁵ Note ‘The Commr’ dated 28th November 1919 and accompanying schedules. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p147. This note appears to have been prepared by an Australian Taxation Office official and sent to the Commissioner of Taxation. The example in the text is based on Schedule ‘C’ to the note. The note states that ‘Schedule ‘C’ in accordance with your instructions now’.

relief and to provide all necessary particulars to show the manner and extent to which the taxpayer's income had been doubly taxed.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 – Australia case.³⁷

Ewing also prepared a memorandum summarising the cases where double and treble income tax could arise³⁸ and a memorandum on Australian War Time Profits Tax and United Kingdom Excess Profit Duty.³⁹ Ewing requested that his letter and memoranda be passed on to Knibbs and it is clear that this was done.⁴⁰

Evidently the views of the Australian government did not accord with Ewing's. While en route to London, Knibbs, in a letter to Ewing, referred to a 'long marconigram' and a 'long telegram' that he had received from Collins the Secretary of the Australian Treasury. Knibbs had replied to Collins but states that the government's directions 1,2 and 3 did not appear to him to be wholly unambiguous as they presupposed 'an elementary and clearly defined condition of things which in many cases does not exist'. Knibbs indicated that he would appreciate Ewing's views in writing and assumed that Ewing would be in conference with Collins and the Government on the whole matter.⁴¹

It appears likely that Ewing had not seen the marconigram and the telegram referred to in Knibbs letter to him.⁴² Collins wrote to Ewing on 20th August 1919 quoting the content of a 'wireless' advice to Knibbs dated 4th August.⁴³ The passage quoted (punctuation inserted) was:

Double income tax. One. Commonwealth Government thinks it should be recognised that each part of the Empire is entitled to collect tax on incomes earned within its borders and that the Mother Country should not tax incomes earned in Australia. Two. Commonwealth Government is not prepared to recommend to Parliament any plan which will divert to Mother Country or any other Dominion a portion of the proceeds of any Australian tax levied upon incomes earned in Australia. Three. If principle referred to in number one above cannot be conceded owing to necessities of Imperial Treasury Commonwealth Government's view is that maximum tax on incomes earned

³⁶ Ewing to Collins, 17th July 1919, *supra* note 32 at pp. 82-83.

³⁷ Ewing to Collins, 17th July 1919, *supra* note 32, at p83.

³⁸ 'Double Income Tax' R Ewing 31/7/1919 and 'Income Tax, Double taxation in England and Australia' R Ewing, 31/7/1919 National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I pp 90 and 91 and pp 98 to 103.

³⁹ 'Australian War Time Profits Tax And United Kingdom Excess Profits Duty' R Ewing, 31/7/1919 National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part 1 at pp 86 to 87.

⁴⁰ G H Knibbs, Commonwealth Statistician cable to Secretary, Department of the Treasury, Commonwealth of Australia, 7th August 1919 refers to Ewing's letter of 17th July. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p107.

⁴¹ G H Knibbs, to R W Ewing, 9 Aug 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p.104.

⁴² Ross for Secretary of the Treasury to Commissioner of Taxation 1st October 1919 National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part 1, p.153 enclosed a copy of the Government's proposals which had been included in the Marconigram sent to Knibbs. This appears to be the first time that the proposals had been sent to Ewing.

⁴³ Collins (Secretary of the Treasury) to Commissioner of Taxation (Ewing), 20th August 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p.108.

in Australia should be the rate which is imposed by British law the Australian Treasury getting the proceeds of the tax at its own rate and the British Treasury getting only the excess above that rate.⁴⁴

Collins' letter enclosed a letter from Knibbs to Collins dated 7th August 1919 which is clearly the letter that Knibbs referred to in his letter to Ewing dated 9th August 1919.⁴⁵ It is clear from the letter that Knibbs saw conflict between the directions that he had received from the Government and Ewing's letter to Collins and other documents prepared by Ewing which had been passed on to Knibbs.

Knibbs requested clarification of the application of jurisdictional concepts in actual cases. The first direction from the Government referring to 'income earned within its borders' was not unambiguous in Knibbs' view. For example, was interest received by a United Kingdom resident on a Commonwealth Loan earned within Australia's borders? Knibbs noted that Ewing's letter to Collins had referred to 'the country of origin of the income' and Knibbs requested that Ewing 'could probably indicate, from his experience, the bearing of the two definitions in respect of actual cases.'⁴⁶

Knibbs also questioned, in relation to both the second and third directions by the Government, whether the principles in Ewing's letter should be 'followed modified (sic) perhaps in the way implied?' Knibbs pointed out that in Australia's case, due to the presence of State income taxes, there was triple taxation and raised the issue of whether 'the double taxation within Australia could be used as an argument against the principle indicated in the Marconigram (by way of analogy of course).'⁴⁷

A clearly annoyed Ewing sent a lengthy reply to Collins on 1st September 1919. Although he does not explicitly state so at this point, it is clear from subsequent correspondence from Ewing to Collins that Ewing regarded the Australian Government as having rejected his scheme.⁴⁸ The second point in Collins' cable to Knibbs of 4th August could be seen as a rejection of schemes like the one developed by Ewing as being one which diverted a portion of tax, which Australia had collected on income sourced within Australia, to the United Kingdom or other Dominions. The three decisions of the Government communicated to Knibbs by wireless on 4th August, in Ewing's view involved 'many legal technicalities arising out of the interpretation of the terms "income earned in Australia" and "income earned in the United Kingdom"'.⁴⁹ Ewing considered that the Government's decision 'of course' implied that:

⁴⁴ Collins to Knibbs, 4th August 1919 as quoted in Collins to Ewing, 20th August 1919 *supra* note 42 at p.108.

⁴⁵ Collins to Ewing, 20th August 1919, *supra* note 43 at p.108. Collins letter to Ewing also quotes an extract from another letter from Knibbs to Collins. The extract quoted includes the following: 'the marconigram pre-supposes only an elementary case. The question will have to be treated in more detail.'

⁴⁶ G H Knibbs to Secretary, Department of the Treasury, Commonwealth of Australia, (J R Collins), 7th August 1919, copy in National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, at p.107.

⁴⁷ Knibbs to Collins, 7th August 1919, *supra* note 46, at p.107.

⁴⁸ Ewing to Collins, 17th March 1920, *supra* note 25, at pp. 177 to 179.

⁴⁹ R Ewing, Commissioner of Taxation to The Secretary to the Treasury (J R Collins), Melbourne, 1st September 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, pp. 109 to 112 at p112.

- (1) The United Kingdom should tax all profits and gains arising in the United Kingdom from sales of Australian goods contracted for within the United Kingdom.
- (2) That the United Kingdom will not divert to Australia any portion of the proceeds of the United Kingdom tax levied upon income earned in the United Kingdom.
- (3) Failing the acceptance of the principle mentioned in (1) above, the Imperial Government would be entitled to retain the maximum tax on income earned in the United Kingdom and also taxed in Australia, and the Australian Treasury would get only the excess (if any) above that rate.⁵⁰

Interestingly to a 21st century reader, Ewing is conceptualising the issues in terms of a claim to tax based not on formal characteristics such as the place of sale but on one which looks more to the extent to which value had been added in different jurisdictions. His own scheme outlined in his letter to Collins of 17th July 1919 and in his previous memorandum to Knibbs would, in these situations have involved a sharing of tax at the larger of the two rates in the same proportions as the rates in each of the countries represented of the combined rate.

Ewing's reply then summarised the jurisdictional base of the United Kingdom income tax and the jurisdictional base of the Australian income tax. In modern parlance the United Kingdom taxed residents on their worldwide income but also taxed non-residents on the annual profits or gains accruing from 'any property in the United Kingdom or (the following words were underlined in Ewing's reply) from any trade or profession, employment, or vocation exercised within the United Kingdom'. The Australian income tax, by contrast, only taxed taxable income derived directly or indirectly from sources within Australia.⁵¹

Ewing then proceeded to summarise what he understood to be relevant English case law. Although Ewing expressed all conflicts in terms of source rules his summary appears to be based in part on United Kingdom decisions concerning the residence of companies. Ewing summarised what he perceived to be relevant English case law as follows:

- (1) The owner of a business with its head office in the United Kingdom resides there; and
- (2) If the head office of a business is in the United Kingdom the business is being carried on in the United Kingdom and all its profits, wherever arising, are earned in the United Kingdom and are taxable there.
- (3) That a trade or business is being conducted in the United Kingdom when contracts are made in the United Kingdom for the sale or delivery of goods there.⁵²

Ewing then pointed out that Australian court decisions had 'supplemented' the decisions of the English courts and cited *Meeks v Commissioner of Taxation (NSW)* (1915) 19

⁵⁰ Ewing to Collins, 1st September 1919, *supra* note 49, pp. 109 to 112 at p112.

⁵¹ Ewing to Collins, 1st September 1919, *supra* note 49, at p111 and 112.

⁵² Ewing to Collins, 1st September 1919, *supra* note 49, at p111.

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

Assuming that any or all of the points in the Australian Government's decision were to be accepted, Ewing anticipated that 'great difficulty must be expected in determining whether the United Kingdom or Australia is to take the principal tax'.⁵⁴ Here it appears that Ewing was envisaging a conflict of source rules and, on the basis of the third implication that he drew from the Government's decision, considered that one jurisdiction would 'take the principal tax' and subject all the income to tax at its full rates while the tax collected by the other jurisdiction would be confined to the excess, if any, of tax on the income at its full rates over the primary tax. As the Australian income tax at the time was an entirely source based tax it appears that Ewing could see no conceptual basis on which the source rule of one country should be preferred over the source rule of the other country.

Ewing considered that it would be impractical to arrive at a satisfactory settlement of the issues 'along the lines laid down by the Government'.⁵⁵ The Government's first direction would necessitate an amendment to both British and Australian law to define what 'earned in Australia' or 'earned in the United Kingdom' would mean. The same issue would arise under the Government's third direction with the additional problems of determining which country should have the first claim on the income or, failing that, how taxes on the income should be apportioned between the two countries.⁵⁶ Ewing's view was that, while it was likely that the amount of tax involved was relatively small, it was probable that the loss of revenue to Australia would be greater under the Government's third proposal than it would be under the proposal that Ewing had previously made.⁵⁷

In response to Knibbs' more specific questions, Ewing indicated that the expressions, 'income earned within its borders' and 'the country of origin of the income', although apparently dissimilar, were capable of the same interpretation and considered that the court decisions previously summarised would apply in a similar way to the latter expression. Ewing's view was that the interest in the example referred to be Knibbs would (apparently on an application of the case law that he had previously summarised) have a United Kingdom source if the loans were floated there but noted that in both the United Kingdom and Australia specific provisions would deem the interest to be sourced within each country's jurisdiction.

Ewing stated that, prior to Knibbs' departure, he had discussed with him the possibility that double taxation within Australia might be used as an argument against the Commonwealth Government. Ewing pointed out that the difference between double taxation within Australia and double taxation within the Empire was that, within Australia, the Commonwealth Government taxed the whole of the income within Australia, whereas Britain did not tax the whole of the income within the Empire but discriminated and thus caused dissatisfaction. Nor was discrimination confined to the

⁵³ Ewing to Collins, 1st September 1919, *supra* note 49, at p111. Ewing's summary somewhat overstates the effect of the decision in *Meeks* which was concerned with determining source of income in a business with multi stage operations.

⁵⁴ Ewing to Collins, 1st September 1919, *supra* note 49, at p111.

⁵⁵ Ewing to Collins, 1st September 1919, *supra* note 49, at p111.

⁵⁶ Ewing to Collins, 1st September 1919, *supra* note 49, at p111.

⁵⁷ Ewing to Collins, 1st September 1919, *supra* note 49, at p110.

British Government as Australia taxed ‘considerable amounts of incomes which are received by British purchasers of Australian goods.’⁵⁸

On the question of whether his draft agreement of 22nd July had the Government’s 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 complaining that Collins’ letter under reply was the first communication that he had 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 protested that ‘the present 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 letter of 1st September to Collins referring particularly to: (a) the importance of interpreting the phrase ‘earned in the United Kingdom’ and ‘earned in Australia’ to the application of the three points in the Government’s decision; (b) the difficulties likely to arise in determining which country was to take the principal tax assuming that all three of the Government’s points were accepted; and (c) that in his opinion it would be impractical to arrive at a satisfactory settlement of the question along the lines laid down by the Government. Ewing then went on to point out that, in his view, the Government position would mean that Australia would be unable to collect any income tax from sales of Australian products in the United Kingdom as those profits would be treated as arising exclusively in the United Kingdom. Ewing considered that, if such an approach were applied generally to sales of Australian products in other parts of the world the prospect could not be viewed without serious concern.’⁶²

Having made his points and protest Ewing then, ‘so far as I can, in the circumstances’ suggested that the following cable be sent to Knibbs:

Double Income Tax you letter 7th August point one, phrase income earned within its borders and country of origin of the income have same meaning. Difficulty must be expected in determining whether Britain or Australia is to have principal tax on income assessed both countries. Point 2, treble taxation

⁵⁸ Ewing to Collins, 1st September 1919, *supra* note 49, at p 109 to 110.

⁵⁹ Ewing to Collins, 1st September 1919, *supra* note 49, at p109.

⁶⁰ Ewing to Collins, 1st September 1919, *supra* note 49, at p109.

⁶¹ J R Collins, Department Of The Treasury, Minute Paper, Subject: Double Income Tax – United Kingdom and Australia, undated. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, at p113.

⁶² R Ewing, Commissioner of Taxation to The Secretary to the Treasury (Collins), Melbourne, 3rd September 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, pp.114 to 115.

Britain, Commonwealth and States, difference between double taxation within Australia and within Empire is that Commonwealth taxes all income in Australia but Britain does not tax all Empire income, War-Profits Tax draft agreement by Ewing merely expresses policy set out in British and Commonwealth Acts. It expresses more clearly and effectually than British draft the means to give effect to both laws.⁶³

Collins and Ewing then discussed the issue⁶⁴ and Collins forwarded to Ewing a copy of a the following cable sent to Knibbs on 8th September:

Your letter 7th August. Following terms used by Treasury and Commissioner of Taxation respectively are to be regarded as having same meaning such terms being 'income earned within its borders' and 'country of origin of income'. Instructions in Treasury radiogram 5th August are basic and elementary only. Intention being that you should discuss with other members of Conference best method of deciding where income is in fact earned. Questions are most complicated and can only be determined with knowledge of taxation practice and technicalities in England as well as in Australia. Views expressed by you at Conference will not bind Commonwealth Government but of course your recommendations will receive serious consideration and you may indicate to Conference that your views are subject to consideration of Commonwealth Government. Part one Treasury radiogram 5th August refers both to Commonwealth and State income tax. The words Australian Treasury in part three should be read as including both Commonwealth and State. General principles indicated in Ewing's letter of 17th July should not be followed. War Profits Tax draft agreement by Ewing merely expresses policy set out in British and Commonwealth Acts. It expresses more clearly than British draft means to give effect to both laws.⁶⁵

The cablegram represents both a clear rejection of the approach Ewing had set out in his letter to Knibbs of 17th July and also a significant restriction on Knibbs' freedom to negotiate at the Conference. Knibbs could negotiate but could not bind the Australian Government. Technical issues would have to be sent back for further consideration. Knibbs had been sent for his skills in negotiation and argument not for his technical knowledge of taxation law and practice.

Knibbs arrived in London on 13th September 1919.⁶⁶

It is clear from the report of the Sub Committee that Knibbs led the argument of the Dominions seeking greater relief from double taxation. The report of the Sub-Committee records Knibbs as having put two propositions to it. First, that the State in which income arises has the primary right to tax it to the exclusion, if necessary, of the country where the income is received. Knibbs alternative contention was that if the place of residence was an equally significant factor in deciding whether liability to tax arises then any Dominion which abstains from basing a charge for Income Tax on

⁶³ Ewing to Collins, 3rd September 1919, *supra* note 62.

⁶⁴ J R Collins to R W Ewing Esq, Commissioner of Taxation, 8th September 1919. Ewing, to Collins, 3rd September 1919, *supra* note 61. Collins' letter encloses a copy of the cable and refers to 'our conversation of Friday last, on the subject of double income tax'.

⁶⁵ Cablegram 8th September 1919 to G H Knibbs, C/o High Commissioner of Australia, London. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p.126.

⁶⁶ United Kingdom, *supra* note 18 at p 168.

residence has already made it proper sacrifice in any reciprocal arrangement for eliminating Double Income Tax.⁶⁷ Knibbs' cables to the Australian Prime Minister's Department and Treasury make reference to the three principles which Treasury had instructed him to adhere to in negotiations. In a cable to the Australian Prime Minister's Department dated 30th September 1919 Knibbs states:

Harrison, Assistant Secretary, Inland Revenue, exhaustively analysed double tax question. Think acceptance of principle 1 wireless August 4th hopeless. Acceptance principle 2 likely. Acceptance last part principle 3 highly improbable, since notion here is that parties might share equally. Advise immediately if in argument I might concede more.⁶⁸

The Australian Treasury forwarded a copy of Knibbs' cable to Ewing on 1st October 1919 asking for Ewing's opinion in relation to it.⁶⁹ Ewing's reply was conveyed on his behalf by an Assistant Commissioner of Taxation. Ewing considered that Harrison's views represented 'an inescapable position on this question.' Ewing, however, did not agree with the view that 'parties might share equally' unless that phrase was interpreted to mean that the higher tax on the income common to both assessments should be divided between the two Governments proportionately to their separate taxes on that income. Ewing here was clearly seeing the phrase 'parties might share equally' as capable of being interpreted consistently with the approach that he had advocated in his letter to Collins of 17th July 1919. If the phrase meant that the tax should be divided so that Britain retained half and Australia retained half Ewing considered that the proposition should not be agreed to due to the differences in basis of assessment between the United Kingdom and Australia. Understandably Ewing considered that the only practical scheme to obviate double taxation within the Empire was the second scheme that he had advocated in his letter to Collins of 17th July. In Ewing's view it would be futile for Knibbs to continue to press the Government's proposals and that Knibbs should be advised to advocate the scheme that Ewing had proposed in his letter of 17th July.⁷⁰

Collins advised Knibbs by cable dated 10th October 1919 that he could not concede more but was at liberty to discuss the matter fully with representatives of the British Government and to indicate what his recommendations to the Australian Government would be subject to the proviso that those recommendations would not be binding unless the Australian Government agreed to them.⁷¹

The first principle in Knibbs' cable and in the Australian Government's directions to him amounted to an assertion of the primacy of the taxing rights of the State of source. Knibbs' position in relation to this principle was indeed hopeless. The Sub-Committee of the Royal Commission rejected Knibbs' contention comprehensively:

⁶⁷ United Kingdom, *supra* note 18 at p170, paragraph 21.

⁶⁸ Cable G H Knibbs to Secretary Prime Minister's Department 30th September 1919. The cable notes that a copy was sent to Treasury for urgent advice on 1st October 1919 (the date of receipt of the cable). Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

⁶⁹ Ross, for Secretary of the Treasury to Commissioner of Taxation, 1st October 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.130.

⁷⁰ A F Twine, Assistant Commissioner of Taxation to The Secretary of the Treasury, Melbourne, 3rd October 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I p.131.

⁷¹ Cable dated 10th October 1919 Collins (Secretary of Australian Treasury) to Australian Prime Minister's Department recommending that cable in terms set out be sent to Knibbs. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I

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 surrender a right which it has exercised ever since the imposition of its Income Tax, a right which is common to the systems of many foreign countries and some Dominions, and is based on an admitted canon of taxation, that of ability to pay. It cannot be conceded that any State which taxes the residents of another State should be entitled, because it has done so, to expect that the other State should surrender its right to tax those residents.⁷²

The Sub Committee further noted that acceptance of the Knibbs' contention would produce inequity between a United Kingdom resident who invested in the United Kingdom only and one who invested in a Dominion unless the rates in the United Kingdom and the Dominion happened to be the same.⁷³ In addition, giving a sole right to tax to the county of source would, the Sub-Committee noted, mean that the cost of solving the Double Income Tax problem would be thrown almost entirely on the United Kingdom Exchequer given the disproportion between the amount of United Kingdom capital invested in the Dominions and vice versa.⁷⁴ As he indicated in a letter to Collins dated 23rd October 1919, Knibbs' at this point was also satisfied that the principle of the primacy of source basis taxation could not be 'equitably urged.' Knibbs, in terms more consistent with a benefit theory of taxation, summarised one view on this issue in the Sub-Committee as:

The advantages to the U.K. of persons earning their money in Australia is (sic) fully understood, but the view is that if they elect to live in the U.K. they must take the place of ordinary citizens, subject however to a concession – made for Imperial reasons – in regard to total tax,⁷⁵

One implication of this passage seems to be that relief from international double taxation was a concession made for imperial reasons rather than one based on in principle objections to international double taxation.

It appears that the Sub-Committee regarded Knibbs' third point and the Australian Government's third direction to him as modification of his first point. The Sub-Committee noted an argument that the country of residence should only have a right to tax to the extent to which its own tax exceeds the tax imposed by the source country. The Sub-Committee characterised an argument to this effect as a modification of Knibbs' first contention but does not expressly attribute the modified argument to Knibbs.⁷⁶ An Australian Cabinet Sub-Committee had reported to the Australian Cabinet on the question of double income tax relief on 10th February 1919. That report

⁷² United Kingdom, *supra* note 18 at p171, paragraph 22.

⁷³ United Kingdom, *supra* note 18 at p171, paragraph 23.

⁷⁴ United Kingdom, *supra* note 18 at p 171 paragraph 23.

⁷⁵ G H Knibbs to The Secretary Department of the Treasury, Melbourne, 23rd October 1919, Ross, for Secretary of the Treasury to Commissioner of Taxation, 22nd November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part 1, p.153. It appears that this letter was not received in Australia until approximately 2nd December 1919 when the Department of the Treasury passed it on to Ewing.

⁷⁶ United Kingdom, *supra* note 18 at p171 paragraph 24.

included a recommendation that: 'Incomes of persons resident in on part of the British Empire should not be altogether exempt on the ground that they are derived from another part; Rebates, based upon a reasonable arrangement between the Government of the United Kingdom and the Dominions and not limited to [illegible] in receipt of large incomes should, however, be allowed in respect of total tax paid.'⁷⁷ It seems likely, therefore, that Knibbs would have put forward a rebate or foreign tax credit as a mechanism for achieving what the Sub-Committee describes as a modification of Knibbs' first contention. For a rebate or foreign tax credit to give full effect to the modified contention noted by the Sub-Committee the foreign tax credit would need to be unrestricted and fully refundable by the country of residence.⁷⁸ The Sub-Committee rejected the granting of an unrestricted foreign tax credit in these terms:

Unless it were practicable, as clearly it is not, to establish a ratio between the tax to be levied on the ground of origin, and that to be levied on the ground of residence, it would be possible for any State in which income arises to increase its rate of taxation, either generally or on incomes arising therein, or in particular on the incomes of non-residents, solely at the expense of the State of residence, whose tax would automatically be diminished by the amount by which the State of origin chose to increase its own tax.⁷⁹

Although this principle was rejected by the Sub-Committee its ultimate recommendation adopted a form of foreign tax credit with limits imposed which ensured that the United Kingdom would not, in effect, be refunding tax paid to Dominions. The ultimate result here might be thought to be consistent with Knibbs' second point being the second of the Australian Government's directions to him.

It appears that Knibbs' also argued that a Dominion which abstains from taxing its residents on their foreign source income has already made its proper sacrifice. This was not an argument that Knibbs had been directed to make by the Australian Government but it was consistent with the first of Australian Government's directions to him and can be regarded as a supporting argument for that viewpoint. The Sub-Committee rejected what it described as Knibbs' 'alternative contention' summarily:

it is obvious that it is open to a State on the accepted principle that every State has complete liberty to impose its own taxation in its own way, to enlarge the scope of its Income Tax so as to cover liability due to residence; and it cannot be argued that a State which abstains from charging such a tax (which in certain circumstances in certain States might be almost entirely non-productive) necessarily makes a tangible sacrifice.⁸⁰

Knibbs' comment, 'notion here is that parties might share equally', may also reveal something of the thinking behind the solution ultimately proposed by the Sub-Committee. E R Harrison an assistant secretary of the United Kingdom Board of Inland

⁷⁷ Extracts from report of the Australian Cabinet Sub-Committee, *supra* note 14.

⁷⁸ The United States had introduced an unrestricted foreign tax credit in 1918 the first of its kind in the world in relation to income tax. Limitations on the United States foreign tax credit were not introduced until 1921. See the discussion in M J Graetz and M M O'Hear, 'The 'Original Intent' Of U.S. International Taxation' (1997) 46 *Duke Law Journal* 1021. The United States was able to have an unrestricted foreign tax credit between 1918 and 1921 because its income tax rates in that period were high relative to the rest of the world.

⁷⁹ United Kingdom, *supra* note 18 at p171, paragraph 24.

⁸⁰ United Kingdom, *supra* note 18 at p171 paragraph 25.

Revenue put forward a proposal which the Sub-Committee considered embodied the principles which should govern the allocation of the cost of relief ‘on the basis of mutual sacrifice’.⁸¹ The initial proposal by Harrison was that a United Kingdom resident should receive a credit for Dominion income tax against the appropriate rate of United Kingdom tax (including Super-tax) up to 1/- in the £ (ie 5%) and one half (if any) of the Dominion rate beyond the first shilling. This would have been subject to an overall limit of relief equal to one half of the rate chargeable to any taxpayer in the United Kingdom (ie the top marginal rate of 6/- in the £ or 30%).⁸²

The Sub-Committee observed that the initial Harrison proposal ‘was particularly acceptable to several members because it gave broadly the same results as a method of apportionment which was regarded as theoretically just, or natural, but more difficult to administer, viz., the division of relief in such a way that the ratio between the rates in the United Kingdom and those in the Dominions remained unchanged.’⁸³

The Sub-Committee noted that the Harrison proposal ‘did not altogether satisfy the representative of the Commonwealth of Australia, and would involve complexity in the claims for repayment’.⁸⁴ In a letter to Collins dated 23rd October 1919 (but apparently not received in Australia until 2nd December 1919) Knibbs’ outlined the difficulty that he had with what was evidently Harrison’s initial scheme:

The present scheme submitted – which meets the views of most of the members of the Sub-Committee – but is not agreeable to Canada (I believe) or myself, - involves considerable losses of revenue to Australia but not to the United Kingdom: in other words does not involve equality of sacrifice. I am inclined to think that it can be arranged for equal sacrifice of revenue from the existing scheme of taxation, the double taxation disappearing.⁸⁵

Knibbs and Harrison were asked to develop a compromise proposal. Knibbs cabled the Australian Prime Minister’s Department on 12th November 1919 as follows:

Strongly urged views of Government Harrison Inland Revenue and self asked to suggest solution. After conferring unable to recommend greatest possible concessions have claimed country’s origin full tax at its graduated rate Great Britain to get considerable balance of tax since it claims on aggregate all incomes at corresponding rate. Situation appears hopeless. Possible final meeting Tuesday. Please advise.⁸⁶

The Australian Treasury, on Collins’ behalf, forwarded a copy of Knibbs’ cable to Ewing asking him for ‘an early report’.⁸⁷ Ewing sent a curt reply to Collins on 18th November 1919 suggesting that ‘Mr Knibbs be informed that in the circumstances

⁸¹ United Kingdom, *supra* note 18 at p171 paragraph 26.

⁸² United Kingdom, *supra* note 18 a p 171 paragraph 26.

⁸³ United Kingdom, *supra* note 18 at p 171 paragraph 26.

⁸⁴ United Kingdom, *supra* note 18 at p171 paragraph 27. Ewing to Collins, 17th March 1920, *supra* note 25 states that the Australian representative rejected Harrison’s initial scheme.

⁸⁵ Knibbs to Collins, 23rd October 1919, Ross, for Secretary of the Treasury to Ewing, 22nd November 1919, *supra* note 75.

⁸⁶ Cable dated 12th November 1919 Knibbs to Australian Prime Minister’s Department. Cable notes copy sent to Treasury 14th November 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

⁸⁷ Ross, for Secretary of the Treasury to Commissioner of Taxation, 17th November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, page 134.

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

The author has been unable to locate a reply by the Australian Government's to Knibbs' 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 Knibbs previously determined was 'quite sufficient for the purpose'.⁹⁰

Knibbs' next cable to the Australian Treasury dated 22nd November 1919 advised:

Double Income Tax Committee rejects both our proposals, but favours mutual sacrifice. Scheme on existing Federal and New South Wales rates implies no Australian sacrifice incomes less than £800. Sacrifice then progressively increases. At income £50,000 Australian equals three-fourth British sacrifice Federal and New South Wales Treasuries then receive slightly over 5/-. Propose provisionally approve this unless you direct otherwise. Reply urgently required.⁹¹

Collins asked Ewing for a reply to Knibbs' cable.⁹² Ewing's response was to advise that Knibbs be asked whether the scheme he described was identical with or similar to the one Ewing had proposed as an alternative to asserting the priority of source basis taxation. Ewing indicated that if the proposed scheme was identical or similar to his own it would be much easier for him to advise the Government than would be the case if the scheme were entirely different from his.⁹³

Although the author has been unable to locate a reply to Knibbs' cable of 22nd November it appears that Knibbs was asked whether the proposed scheme was identical or similar to Ewing's as Knibbs' next cable dated 24th November 1919 stated:

⁸⁸ R Ewing, Commissioner of Taxation to The Secretary of the Treasury, Canberra, 18th November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.135.

⁸⁹ Cable dated 15th November 1919 Knibbs to Australian Prime Minister. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

⁹⁰ Cable dated 18th November 1919 W A Watt to G H Knibbs. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

⁹¹ The cable is quoted in Ross, for Secretary of the Treasury to Commissioner of Taxation (Ewing), 22nd November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.136.

⁹² Ross, for Secretary of the Treasury to Ewing, 22nd November 1919, *supra* note 91.

⁹³ R W Ewing, Commissioner of Taxation to The Secretary to the Treasury, Melbourne, 28th November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I

Scheme proposed Inland Revenue Officer here somewhat similar principle Commonwealth Commissioner of Taxation. Total tax payable British rates distributed among Commonwealth, State and Great Britain, former two receiving their full tax incomes under £800. When Dominion rate reaches half British rate each share equally. This implies larger absolute loss to Great Britain effect aggregation of incomes all sources reduces Dominions sacrifice since British rate consequently high.⁹⁴

The Australian Treasury, on behalf of Collins, forwarded Knibbs' cable to Ewing 'for your information and for favour of an immediate report.'⁹⁵

Ewing's reply was that the scheme proposed for incomes under £800 should be adopted by both the Commonwealth and State Governments as it would mean that both Governments would receive the full amount of their tax. Ewing doubted whether the scheme meant that, for incomes over £800, where the combined Commonwealth and State rate did not exceed half of the British rate, the British tax would be divided between the Imperial, Commonwealth and State Treasuries pro rata to the respective taxes payable on the income subject to double tax. If so then, in this respect, the proposed scheme was identical to the one that Ewing had proposed in his letter of 17th July 1919. Ewing pointed out that there would be few cases in which this aspect of the scheme would operate as the combined Commonwealth and State tax rates were almost always more than half of the British rate except in the case of incomes in the region of £2,000 and £4000. Ewing noted, however, that the true effect of this aspect of the scheme could not be measured due to differences in assessment in different parts of the Empire. The final part of the scheme which applied when the Dominion rate became equal to or greater than one half of the British rate was, Ewing thought, more advantageous to the Dominions than his proposals of 17th July. Overall Ewing considered that the scheme proposed by the Board of Inland Revenue appeared to be more advantageous than his own scheme of 17th July.⁹⁶

Before a reply could be sent to Knibbs he sent a further cable to Australia which was passed on to the Treasury and then passed on by Collins to Ewing. The cable, as quoted in a letter from the Australian Treasury to Ewing asking for his immediate report, stated:

Sub-Committee final meeting Tuesday, believe that Commission morally forced to accept any unanimous recommendation. With existing practice but after abandoning concession section 55 British Act, percentage loss on taxation now received from Australians resident in England would be Australia 27, Great Britain 33. Recommend provisional agreement.⁹⁷

Ewing's reply to Collins referred him to Ewing's letter of 28th November and indicated that he had roughly checked the percentages of loss quoted by Knibbs and considered that they were probably correct. Ewing calculated that on incomes over £800 per annum the average loss to England was from 47% to 50% but ranged from 20% to 30% incomes up to £800. The loss to Australia ranged from 0 on incomes up to £800 to about 44%

⁹⁴ The cable is quoted in Ross, for Secretary of the Treasury to Commissioner of Taxation, 26th November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.140.

⁹⁵ Ross, for Secretary of the Treasury to Ewing, 26th November 1919, *supra* note 94.

⁹⁶ R Ewing, Commissioner of Taxation to The Secretary of the Treasury, Melbourne, 2nd December 1919 National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, pp. 148 – 149.

⁹⁷ Ross, for Secretary to the Treasury, to Commissioner of Taxation, 1 December 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.150.

on incomes of £100,000. Ewing commented that this was a ‘rare income for an individual, if it actually exists’.⁹⁸

As a result of Ewing’s letters of 28th November and 2nd December, Collins sent a cable to Knibbs advising him that in the absence of full reports of discussions and details of the recommendations placed before the Sub-Committee it was impossible to give him definite instructions. Knibbs was further advised that ‘on receipt of full information careful consideration would be given to whole matter.’⁹⁹

On 16th December 1919 Knibbs sent a memorandum to Collins and a copy of the report of the Sub-Committee of the Royal Commission and also forwarded a copy of a draft agreement prepared by the Board of Inland Revenue.¹⁰⁰ The author has been unable to locate a copy of Knibbs’ memorandum, the detailed Report, or the draft agreement but it is highly likely that the draft agreement and the detailed Report referred to in Knibbs’ letter and in cables were one and the same document and were identical with the final recommendations of the Sub-Committee which reported on 2nd January 1920.¹⁰¹ This conclusion can be drawn from the fact that the Australian Treasury does not appear to have responded to the draft agreement until 8th January 1920¹⁰² after the Sub-Committee had presented its report to the Royal Commission. Hence the Australian comments on the draft agreement could not have influenced the recommendations contained in the Sub-Committee’s report. The Sub-Committee’s report notes that the proposal that it outlines had been submitted to the various Dominion Governments but that no reply had been received as at the date of the Sub-Committee’s report. The Sub-Committee further noted that all Dominion representatives except one personally approved of the proposal and were prepared to recommend it to their respective Governments. One representative had indicated that he preferred to await instructions from his Government.¹⁰³ It is likely that the recalcitrant representative was Knibbs given Collins’ instructions to him of 10th October 1919 and the subsequent consideration of the draft agreement by the Australian Treasury. The First Report of the Australian Royal Commission On Taxation dated 2nd November 1921 notes that all other Dominions had by that time accepted the recommendation on Double Income Tax by the United Kingdom Royal Commission On The Income Tax.¹⁰⁴

⁹⁸ R W Ewing to The Secretary to the Treasury, Melbourne, 2nd December 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.151.

⁹⁹ Ross, for the Secretary to the Treasury, to Commissioner of Taxation, 21st January 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.161. The letter quotes a cable sent by Collins to Knibbs dated 21st January 1920.

¹⁰⁰ G N Knibbs to Mr Ewing, 2nd January 1920, National Archives of Australia, Series A 7072/21 Control Symbol J245/2 Part II, p.176, encloses a copy of Knibbs’ memorandum sent to Collins on 16th December 1919 and a copy of the ‘detailed Report’ which he had also sent to Collins on 16th December 1919. Knibbs asked that these documents be returned to him and a copy of neither document is currently contained in National Archives of Australia, Series A 7072/21 Control Symbol J245/2 Part II. A cable sent by the Australian Treasury to Knibbs dated 8th January 1920 refers to a cable sent by Knibbs to the Australian Government on 17th December 1919 and to a ‘Draft agreement submitted by Board of Inland Revenue’. The cable to Knibbs dated 8th January 1920 is contained in Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I. Neither Knibbs’ cable dated 17th December 1919 nor a copy of the Draft Agreement are currently contained in Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁰¹ United Kingdom, *supra* note 17 p173. The Sub-Committee’s report is dated 2nd January 1920.

¹⁰² Cable Australian Treasury to Knibbs 8th January 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁰³ United Kingdom, *supra* note 18 p172 paragraph 34.

¹⁰⁴ Australia, First Report Of The Royal Commission On Taxation, Melbourne, 1920, p31 paragraph 168.

Cables in early to mid January contained in files in the National Archives of Australia then make reference the treatment of United Kingdom Excess Profits Tax and Australian Wartime Profits Tax. It is unclear from the cables whether the United Kingdom Royal Commission proposal at this point was intended to cover these taxes or whether the United Kingdom proposed a separate scheme for these taxes. The latter appears to be more likely, as the cables refer to the scheme relating to these taxes which Ewing had developed, and, as discussed earlier, Ewing's view was that his scheme on these taxes was not relevant to the question of double income tax. The first of these cables, from the Australian Treasury to Knibbs on 8th January 1920, notes that the draft agreement submitted by the Board of Inland Revenue would require that the higher of the two taxes be collected and distributed between the two countries. As will be seen this was to be the substantive effect of the recommendation of the Sub-Committee on income tax which was adopted by the United Kingdom Royal Commission. The 8th January 1920 cable to Knibbs notes that the draft would require this result irrespective of whether the whole or part of the profits was being doubly taxed., This appears to be a reference to problems associated with differing tax bases. If a separate scheme was developed on Excess Profits Tax and War Time Profits which was perceived to have this problem then it was one which it shared with the system of Dominion Income Tax relief. Problems of differing tax bases were to return for consideration throughout the life of the Dominion Income Tax relief system. The cable further comments that:

It seems essential to ascertain amount of excess profits which is being doubly taxed and Ewing's draft would attain that end. That result would apparently be impossible of attainment under scheme proposed by Board of Inland Revenue. Can you conveniently cable full reasons why Ewig's scheme is said to be non-conformable to that contemplated by the British Finance Act.¹⁰⁵

Knibbs responded by cable to the Australian Prime Minister's Department on 15th January 1920 as follows:

FOLLOWING FOR COLLINS, Treasury – Your telegram 9th January – British Authorities now admit non-conformability section 23 Finance Act 1917 Ewing's scheme only doubtful but expresses opinion that owing temporary nature War Profits it is outside intention on which section was deliberately framed/in British opinion scientifically correct scheme involves complexities in analysing profits and standards taxation both countries and would necessitate setting up appeal machinery taxpayer would naturally desire double taxation as much profits possible and must be given right appeal against revenue decision owing temporary nature Acts British strongly advocate their scheme letter of 6th January fully expounds case.¹⁰⁶

The author has to date been unable to locate the letter from the United Kingdom Board of Inland Revenue referred to in Knibbs' cable or a draft agreement on Excess Profits Tax and War Time Profits Tax developed by the United Kingdom Board of Inland Revenue or the draft scheme relating to these taxes developed by Ewing.

¹⁰⁵ Cable Australian Treasury to Knibbs dated 8th January 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁰⁶ Cable Knibbs to Australian Prime Minister's Department dated 15th January 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

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 Kingdom Royal Commission's view was that a sound solution to the problem would 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 equivalent to the tax at the lower of the two rates imposed;
- b) that there should be no interference either by this or by a Dominion with the basis of assessment adopted by any other part of the Empire, and further that settlement should be independent of increases and decreases in rate of tax, and alternations in the bases of assessment, whether here or in the Dominions;
- c) that so far as practicable, relief should be given before payment of tax;
- d) that so far as is possible, the adjustment should be made in the country where the taxpayer resides;
- e) that there should be no inter-payments of tax between the Government of the United Kingdom and the Governments of the respective Dominions.¹⁰⁷

The solution ultimately proposed by the Sub Committee and adopted by the Royal Commission was:

Firstly, that in respect of income taxed both in the United Kingdom and in a Dominion, in substitution for the existing partial reliefs there should be deducted from the appropriate rate of United Kingdom Income Tax (including Super-tax) the whole of the rate of Dominion Income Tax charged in respect of the same income, subject to the limitation that in no case should the maximum rate of relief given by the United Kingdom exceed one-half of the rate of United Kingdom Income Tax (including Super-tax) to which the individual taxpayer might be liable; and

Secondly, that any further relief necessary in order to confer on the taxpayer relief amounting in all to the lower of the two taxes (United Kingdom and Dominion), should be given by the Dominion concerned.¹⁰⁸

The Sub Committee had noted that both the source of the income and the residence of the taxpayer represented legitimate jurisdictional taxing claims and that each State had an unrestricted right to adopt its own method of taxation within the sphere of its jurisdiction.¹⁰⁹ The Sub Committee had further considered that double income taxation was inequitable as representing two contributions to the common purpose of the well-being of the British Empire. In the Sub Committee's view the demands of equity would

¹⁰⁷ United Kingdom, *supra* note 18 at p 16 paragraph 69.

¹⁰⁸ United Kingdom, *supra* note 18 at p16 paragraph 70 (Royal Commission Report) and at p 171 paragraph 27 (Sub-Committee report).

¹⁰⁹ United Kingdom, *supra* note 18 at p 170 paragraph 16.

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 (exemption by the residence jurisdiction or an unlimited foreign tax credit granted by the residence jurisdiction) would have placed the whole burden of relief on the residence jurisdiction. Although Ewing's proposal would have been of a similar type to alternative (a) discussed in the Sub-Committee Report it had not, in his view, been put to the Sub-Committee.¹¹²

The Sub Committee rejected the apportionment of the higher tax between the two States in an agreed ratio as obscuring the independent right of taxation inherent in every State and as possibly creating the false impression that a State is exempting a class of income which it is in fact charging or that it is contributing to the revenue of another State. Hence the Sub Committee had concluded that the alternative of each State remitting a portion of its tax was to be preferred.

The Sub Committee noted that it was freely admitted in its conferences that any sacrifice must be a mutual sacrifice and that the real difficulty lay in determining what share of remission should equitably be borne by each of the respective States. The comment is consistent with the sense of hopelessness that Knibbs' cables convey following his attempts to argue for relief being entirely given by the residence jurisdiction and particularly with his comment that, 'notion here is that parties might share equally'.¹¹³

The Sub Committee noted that the initial proposal (referred to above) by Harrison of the Board of Inland Revenue 'was particularly acceptable to several members because it gave broadly the same results as a method of apportionment which was regarded as theoretically just, or natural, but more difficult to administer, viz., the division of the relief in such a way that the ratio between the rates in the United Kingdom and those in the Dominions remained unchanged'.¹¹⁴ The extent to which this was true depended on the relationship between the rates in the two countries. The effect of the proposal would have been that the ratio between the rates of tax following rebates under the proposal diverged as the ratio between the initial rates converged.

The Sub Committee's description of the initial Harrison proposal makes no mention of rebates or remissions being given by the Dominions. However, it is clear that the initial

¹¹⁰ United Kingdom, *supra* note 18 at p170 paragraph 15.

¹¹¹ United Kingdom, *supra* note 18 at p170 paragraphs 15 and 16.

¹¹² Ewing to Collins, 17th March 1920, *supra* note 25.

¹¹³ Knibbs to Secretary Prime Minister's Department 30th September 1919, *supra* note 68..

¹¹⁴ United Kingdom, *supra* note 18 at p171, paragraph 26.

Harrison proposal would have involved rebates being given by the Dominions in some circumstances. Indirect support for this conclusion is found in the Sub Committee's express requirement that any sacrifice had to be a mutual sacrifice, in its comments on preserving the ratios of taxation between the United Kingdom and the Dominions and in its description of its final proposal (which did provide for a rebate by the Dominions) as being more generous in its effects.¹¹⁵ These statements, together with Knibbs' objections to the initial Harrison proposal,¹¹⁶ make it likely that the Dominions were expected to give a rebate so that the total tax represented taxation of the higher of the two rates. Direct support is found in an example, in a letter to Collins dated 17th March 1920, of what Ewing understood to be the effect of Harrison's initial proposal. Ewing's example showed a rebate by Australia in the hypothetical situation it illustrated.¹¹⁷

The Sub Committee described its recommended proposal as being more generous in its effects than the initial Harrison proposal and as being made in an endeavour to secure a unanimous acquiescence on the part of the Dominions and to obtain simplicity in operation.¹¹⁸ Assuming that the initial Harrison proposal would have required the Dominions, in some circumstances, to grant a rebate in addition to that granted by the United Kingdom, the key difference between the Sub Committee's recommended proposal and the initial Harrison proposal was that the recommended proposal involved the United Kingdom in remitting the whole of the rate of Dominion tax payable up to a limit of one half of the applicable United Kingdom rate of income tax and super tax. By contrast, under the initial Harrison proposal, the relief provided by the United Kingdom was equal to the Dominion tax up to 1/- in the £ (or a rate of 5%) and thereafter half of the Dominion rate up to a maximum limit of half the applicable United Kingdom rate of income tax and surtax. The lower level of relief granted by the United Kingdom under the initial Harrison proposal would have meant that, for the total tax to be limited to the greater of the two rates, the Dominions would have been required, in some circumstances, to give larger rebates of tax to taxpayers. It is reasonable to infer from Knibbs' cable of 12th November 1919 that this key feature of the Sub Committee's recommended proposal was a concession that Knibbs wrought from Harrison. Note, in particular, the following portion of the cable:

greatest possible concessions have claimed country's origin full tax at its graduated rate¹¹⁹

The Sub Committee contemplated that for United Kingdom taxpayers on lower incomes the adjustment would be at nominal rather than effective United Kingdom rates and for those on higher incomes the adjustment would be based on United Kingdom tax inclusive of Super-tax. The Sub-Committee observed that this approach resulted in the United Kingdom providing greater relief than would have been the case had the United Kingdom rate be calculated by reference to the taxpayer's Dominion sourced income

¹¹⁵ United Kingdom, *supra* note 18 at p171 paragraph 27. The final proposal was more generous in its effects for the Dominions only if the initial Harrison proposal included a requirement that the Dominions give a rebate to ensure that the total tax payable did not exceed the higher of the two rates.

¹¹⁶ Given the principles that Knibbs argued during the conference it seems unlikely that he would have objected to a proposal that involved the United Kingdom bearing the sole burden of relief.

¹¹⁷ Ewing to Collins, 17th March 1920, *supra* note 25.

¹¹⁸ United Kingdom, *supra* note 18 at page 171, paragraph 27.

¹¹⁹ Cable dated 12th November 1919 Knibbs to Australian Prime Minister's Department. Cable notes copy sent to Treasury 14th November 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

only.¹²⁰ The rate of United Kingdom tax was to be calculated by reference to the taxpayer's gross income without first deducting Dominion income tax. The Royal 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 by reference to the shareholder's total income; and (2) the Dominion tax at the rate 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 represented 'a generous contribution towards relief from Double Income Tax on the part of the United Kingdom' which the Sub Committee hoped would form the basis for 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

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 shareholdings above a minimum level.

¹²³ United Kingdom, *supra* note 18 at p172 paragraphs 30 and 31 deal with the application of the system to companies and shareholders.

¹²⁴ United Kingdom, *supra* note 18 at p172 paragraph 33.

¹²⁵ United Kingdom, *supra* note 18 at p 16 paragraph 72.

the United Kingdom Royal Commission did provide some simple examples of its application.¹²⁶ The Sub Committee suggested that detailed rules would be worked out by the relevant department for applying the broad principles in practice and stated that such rules should allow repayment in respect of adjustments made, where practicable, in the taxpayer's State of residence.¹²⁷

The United Kingdom Royal Commission's recommendations were accepted by the United Kingdom Government and were enacted as s27 of the *Finance Act 1920 (UK)*. The procedure for claiming relief was set out in s28 of the *Finance Act 1921 (UK)*. The approach of the United Kingdom Inland Revenue Department to the implementation of the Dominion Income Tax Relief scheme can be seen in a circular to H.M. Inspectors of Taxes United Kingdom titled *Finance Act, 1920 – Section 27; Relief In Respect Of Dominion Income Tax* was published in December 1920.¹²⁸ The circular makes clear that for individuals average rates of United Kingdom tax after taking personal allowances into account were to be used for purposes of calculating the appropriate rate of United Kingdom tax. Average rates of Dominion tax on income sourced in the Dominion, taking into account depreciation allowances but not any Dominion personal allowances, were to be used in determining the Dominion rate of tax. The Dominion taxation year ending in the United Kingdom tax year to which the claim related was to be adopted as the basis for relief except in exceptional circumstances. It was noted that differences in tax base would arise but, as the relief depended on the rates of tax, Inspectors were advised that there was not necessarily any correspondence arithmetically between the amount of Dominion tax paid and the United Kingdom relief allowed for any particular year. Separate computations of relief were made in respect of each source of Dominion income (for example where a United Kingdom resident had income from more than one Dominion).¹²⁹

Proviso (b) to *Finance Act 1920 (UK)* s27(4) dealt with the situation where the Dominion did not provide reciprocal relief:

where under the laws in force in any Dominion no provision is made for the allowance of relief from Dominion income tax in respect of the payment of United Kingdom income tax, then in assessing or charging income tax in the United Kingdom in respect of income assessed or charged to income tax in that Dominion a deduction shall be allowed in estimating for the purpose of United Kingdom income tax an amount equal to the difference between the amount of the Dominion income tax paid or payable in respect of the income and the total amount of relief granted from the United Kingdom income tax in respect of the Dominion income tax for the period on the income of which the assessment or charge to United Kingdom income tax is computed.

This proviso had the effect of reducing the United Kingdom tax assessed but, as it was dependent on a prior calculation of the Dominion Income Tax Relief available (which in turn depended on a prior assessment of United Kingdom tax assessed), it resulted in

¹²⁶ United Kingdom, *supra* note 18 at pp 16-17, paragraphs 74 to 76.

¹²⁷ United Kingdom, *supra* note 18 at p172, paragraph 35.

¹²⁸ The printer's copy of this circular with handwritten corrections and annotations is contained in the United Kingdom National Archives file IR 40/2560.

¹²⁹ For a discussion of these aspects of the practice of the United Kingdom Board of Inland Revenue see circular to H.M. Inspectors of Taxes United Kingdom titled *Finance Act, 1920 – Section 27; Relief In Respect Of Dominion Income Tax* was published in December 1920. The printer's copy of this circular is contained in the United Kingdom National Archives file IR 40/2560.

complexities in administration which could only be dealt with by extra statutory concessions.¹³⁰

4 THE ADOPTION OF DOMINION INCOME TAX RELIEF BY THE COMMONWEALTH OF AUSTRALIA

The initial response of the Commissioner of Taxation to the details of the proposed scheme for Dominion Income Tax Relief was positive. Ewing, clearly having read the relevant portion of the Report of the Royal Commission on Income Tax and a set of examples of the intended operation of the scheme provided by Harrison to Knibbs on 21st January 1920,¹³¹ wrote to Collins on 17th March 1920. Ewing outlined the scheme proposed by the Royal Commission and noted that Commonwealth Government now had three schemes before it for the prevention of double taxation within the Empire. These were: (1) the Government's proposal that residence country taxation be limited to the excess residence tax, if any, over the source tax; (2) the Royal Commission scheme; and (3) Ewing's own scheme as set out in his letter to Collins of 17th July 1919. Ewing pointed out that the Commonwealth Government's scheme had been rejected by the imperial authorities owing to the heavy loss of revenue that it would involve for the Imperial Exchequer. Ewing noted that his own scheme had not been presented to the Sub-Committee of the Royal Commission. Ewing considered that of the schemes presented to the Sub-Committee the one which most closely approximated his own scheme was Harrison's initial scheme and noted that Knibbs had rejected this scheme at the London Conference.¹³²

Ewing considered that the scheme proposed by the Royal Commission was:

a much more liberal one at the present time to the Commonwealth than my scheme. It is of course considerably less liberal than scheme (1) proposed by the Commonwealth Government but is the most liberal scheme which the Imperial authorities are prepared to recommend.¹³³

The comment, 'at the present time', is significant. Ewing pointed out that under the Royal Commission scheme a subsequent increase in Australian rates with United Kingdom rates remaining stationary would result in greater loss of revenue for Australia while the reverse be true under Ewing's scheme.¹³⁴ Nonetheless Ewing's overall recommendation was that the Commonwealth Government accept the scheme proposed by the United Kingdom Royal Commission but pointed out that it would be necessary to obtain 'the adhesion' of the State Governments to the scheme as otherwise double

¹³⁰ For a contemporary discussion of problems associated with this provision see R Staples, *Dominion Income Tax Relief: Law and Practice*, London, GEE & Co, 1925 at pp 68 to 70 and R L Renfrew, *The Practice Of Dominion Income Tax Relief*, London, The Solicitors' Law Stationary Service Ltd., 1934 at pp 15 to 21.

¹³¹ G H Knibbs, Memorandum to The Secretary of the Treasury, Melbourne (undated) and E R Harrison to G H Knibbs, 21st January 1920 are both contained in R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 199 to 202. The letter from Harrison contains examples illustrating Harrison's interpretation of the operation of the proposed scheme. A note by Knibbs on the Harrison letter strongly implies that Knibbs to Collins letter was dated 26th January 1920.

¹³² R Ewing to The Secretary to the Treasury (Collins), Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 177 to 179.

¹³³ R Ewing to Collins, 17th March 1920, *supra* note 132.

¹³⁴ Ewing to Collins, 17th March 1920, *supra* note 132.

taxation between the States and the Commonwealth would continue.¹³⁵ Ewing's letter 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 amount of income which is being doubly taxed. It is not an insuperable difficulty.¹³⁶

Interestingly Ewing wrote again to Collins on 13th July 1920 indicating that in his view the corollary of removal of double taxation within the Empire was the taxation of all residents of Australia on a residence rather than a source basis. In Ewing's view the policy of only taxing Australian source income was now no longer necessary and that a switch to a residence basis would mean that Australia was receiving some income in circumstances where it was currently receiving nothing and, due to the existence of relief from international double taxation, Australian residents with foreign source income would be paying less foreign tax to the Imperial or other Dominion governments.¹³⁷

Apparently Ewing envisaged that Australia would, as a residence country, adopt a mirror image of the United Kingdom Dominion Income Tax Relief scheme under which the Australian credit for foreign tax would not exceed one half of the Australian rate with the Imperial Government or the relevant Dominion providing any further credit necessary to ensure that the total rate applicable did not exceed the largest of the rates applicable in the relevant jurisdictions. Despite Ewing's suggestion, Australia continued to tax exclusively on a source basis until 1930 when it moved to a nominal global basis but exempted foreign source income which had been subject to tax at source.

The next correspondence relating to Dominion Income Tax Relief that the author has been able to locate in either the United Kingdom National Archives or the National Archives of Australia is a cable from Ewing to Collins dated 11th November 1920. At the time Collins was in London and Ewing asks whether statements made in Australia to the effect that the limit to the rebate allowed by the United Kingdom would be 4/3d in the £ or whether the limit would be half of the British rate as stated by the Chancellor of the Exchequer in the budget speech.¹³⁸ Collins' reply was that that s27 of the *Finance Act 1920* provided for relief from double income tax at the rate of: (a) Dominion tax; or

¹³⁵ Ewing to Collins, 17th March 1920, *supra* note 132.

¹³⁶ Ewing to Collins, 17th March 1920, *supra* note 132.

¹³⁷ R Ewing to The Secretary to the Treasury, Melbourne, 17th July 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II.

¹³⁸ R Ewing, Proposed Telegram to Mr J R Collins at Australia House, London, 11th November 1920, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.204. It appears from a note on the copy in the file that the original telegram was sent to Collins by the Australian Treasury.

(b) half taxpayer's appropriate rate of United Kingdom tax, whichever was the less. Collins advised that, while the minimum United Kingdom rate was 3/- in the £, the maximum rate approached 12/- in the £ which would mean that the maximum rebate would be 6/- or the Dominion rate if that were higher. Collins was 'at a loss' to understand the reference to a maximum United Kingdom rate being 4/3d in the £ and asked Ewing to advise him if the position was not now clear to him.¹³⁹ Ewing advised the Acting Secretary for the Treasury by letter on 2nd December 1920 that the position was now clear.

On 17th November 1920, the Secretary of State for the Colonies cabled the Governors General of the Dominions asking, inter alia, what action the Dominion Governments were taking in relation to the proposals made by the Royal Commission for relief of double taxation within the Empire.¹⁴⁰ The Australian Government replied through the Australian Governor General on 8th December 1920 that the United Kingdom proposals had been submitted to the Australian Royal Commission (the 'Warren Kerr Commission') enquiring into Commonwealth Taxation.¹⁴¹

On 11th August 1921 Collins wrote to Ewing advising that, given that the United Kingdom had enacted partial relief from double income taxation, the Treasurer was considering whether the Commonwealth should also enact relief so that double income taxation could be entirely eliminated. Collins asked Ewing to prepare a statement showing how relief from double taxation could be implemented by Australia and the amount of revenue that would be lost by the implementation.¹⁴²

Ewing replied, by letter dated 18th August 1921, in terms which corresponded to the recommendation that he had made to the Warren Kerr Commission.¹⁴³ Ewing considered that it was difficult to estimate what the loss of revenue would be if the Australian *Income Tax Assessment Act* 1915 were to be amended to provide reciprocal relief. The matter had been examined between Ewing and Knibbs and they agreed that there was a possibility of a loss of revenue of £45,000 per year under the then present conditions. While there would be a loss of revenue, Ewing referred Collins back to Ewing's representation of 13th July 1920 that Australia should switch to taxing on a residence basis and that to do so would mitigate the revenue loss associated with providing reciprocal relief from international double taxation.

¹³⁹ Acting Secretary for the Treasury to Commissioner of Taxation, 26th November 1920, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p. 205 quotes the telegram received from Collins in reply to the telegram of 11th November 1920.

¹⁴⁰ Cable, Secretary of State for the Colonies to Governor General of the Commonwealth of Australia, 17th November 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁴¹ Cable, Secretary to the Australian Treasury to Secretary Australian Prime Minister's Department 7th December 1920, Cable Secretary Australian Prime Minister's Department to The Official Secretary to the Governor General Commonwealth of Australia 8th December 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁴² J R Collins, Secretary to the Treasury to Commissioner of Taxation, 11th August 1921, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p. 221.

¹⁴³ R Ewing, Commissioner of Taxation to Secretary to the Treasury, Melbourne, 18th August 1921, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.223. A handwritten note by Ewing on Collins to Ewing, *supra* note 142, indicates that Ewing's reply was in terms of the recommendation that he had made to the Royal Commission.

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 Kingdom Government suggested be inserted in legislation of the ‘colony’ to give effect 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 Churchill’s despatch stressed that 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 of relief in the ‘colonies’ as they were determined for the purposes of relief in the United Kingdom. Having said this Churchill’s despatch then points out that for the purposes 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 taxpayer’s income less deduction of any abatement while the rate of Dominion tax was determined by dividing the amount tax payable by the taxpayer’s income without 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 would be involved in defining ‘the appropriate rate of United Kingdom tax’ the United 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 the foreign income should be ‘grossed up’ for any foreign tax payable in calculating domestic tax payable. The despatch concluded by advising that certificates as to the appropriate rate of United Kingdom tax would be restricted to cases where a ‘colony’ made provision for reciprocal relief. Accordingly, Churchill asked to be informed immediately that such as provision was made and of the date when it was to first operate.

The Australian Treasury forwarded Churchill’s despatch to Ewing on 26th September 1921 without asking for comment at that point.¹⁴⁵ The Governor General, presumably on the advice of the Australian Government and prior to release of the first report of the Warren Kerr Commission, replied to Churchill by cable dated 30th September 1921 stating that the scheme recommended by the United Kingdom Royal Commission would be adopted so far as the Commonwealth Income Tax was concerned but that relief from State tax would be left to State Governments.¹⁴⁶ Churchill replied to the Governor

¹⁴⁴ Winston S Churchill to The Officer Administering the Government of, 30 June 1921, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 226 and 228. The despatch was a standard printed form letter which commences at p.228 of the Australian Taxation Office file. A typed copy of the letter is also contained in the Australian Taxation Office file commencing at p.226. Churchill was Secretary of State for the Colonies from 1921 until he lost his seat in the general election of 1922.

¹⁴⁵ Ross, for Secretary to the Treasury to Commissioner of Taxation, 26th September 1921, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.229.

¹⁴⁶ Extract from cablegram from His Excellency, the Governor General to the Secretary of State for the Colonies, 30th September 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.230.

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 complicated and reiterated the points made in Churchill's despatch of 26th 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

The Australian Treasury passed Churchill's cable on to Ewing for comment on 21st 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 Governor General's cable to Churchill dated 30th 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 report of the Warren Kerr Commission. Ewing's reply of 22nd November 1921 simply stated that the necessary amendment to the *Income Tax Assessment Act* 1915 was being considered and would be submitted shortly.¹⁵⁰ As will now be discussed this action was consistent with the recommendations in the first report of the Warren Kerr Commission.

The first report of the Warren Kerr Commission was released on 2nd November 1921. The Warren Kerr Commission noted the submission by the Australian Federal Commissioner of Taxation that if Australia entered into the arrangement by the United Kingdom Royal Commission then it should thereafter tax its residents on their worldwide income.¹⁵¹ A majority of the Warren Kerr Commission considered that there was no essential relationship between the adoption of the United Kingdom Royal

¹⁴⁷ Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.231.

¹⁴⁸ Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.231

¹⁴⁹ Ross, for Secretary to the Treasury to Commissioner of Taxation, 21st October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.232.

¹⁵⁰ R Ewing, Commissioner of Taxation to The Secretary to the Treasury, 22nd November 1921, Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.233

¹⁵¹ Australian, *supra* note 104 at p32 paragraph 169.

Commission's recommendation and the taxation of ex-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-Committee of the United Kingdom Royal Commission. On 19th August 1921 the Warren Kerr Commission sought advice from the United Kingdom Board of Inland Revenue as to whether, in computing relief under the British scheme, account would be taken of both Commonwealth and State income taxes or of Commonwealth taxes only.¹⁵⁶ The Board of Inland Revenue replied via the Australian High Commissioner in London on 26th August 1921 that both Commonwealth and State Income Tax were taken into account under the British proposal.¹⁵⁷ In its first report the Warren Kerr Commission while noting that the States had not been represented at the British Conference, pointed out that given that the British scheme took into account both Commonwealth and State taxation:

It is therefore, very desirable that if the Commonwealth joins in the reciprocal arrangement, each of the State Governments should give early attention to the subject with a view of defining its position, as evidently the question must arise in a practical form so soon as the Commonwealth gives effect to the proposal. The fact that the States levy different rates will not create any practical difficulty, for it is recognised that such differences will exist, and it will be merely a question of arriving at the proportionate contributions to be made by the Commonwealth and a State or States respectively, where the

¹⁵² Australia, *supra* note 104 at p32 paragraph 170. One member of the Royal Commission, M B Duffy, dissented from this recommendation. His reservation is set out at p40 of the Royal Commission's first report.

¹⁵³ Australia, *supra* note 104 at pp 32 to 33 paragraph 171.

¹⁵⁴ Australia, *supra* note 104 at p33 paragraph 172.

¹⁵⁵ Australia, *supra* note 104 at p33 paragraph 173.

¹⁵⁶ Cable, Secretary to the Australian Treasury to Secretary Australian Prime Minister's Department 17th August 1921, Cable Secretary Australian Prime Minister's Department to Australian High Commissioner's Office, London, 18th August 1921. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁵⁷ Cables, Australian High Commissioner's Office, London, to Australian Prime Minister's Department, 26th August 1921 and 31st August 1921. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

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 relevant provisions were inserted in the *Income Tax Assessment Act 1915-1918* as s12A by Act No.31 of 1921 which received the Royal Assent on 17th December 1921. Ewing wrote to Deputy Commissioners of Taxation on 6th February 1922¹⁶⁰ enclosing a copy of Churchill's cable of 15th October 1921 and a draft of his reply which quoted s12A.¹⁶¹ Ewing asked the Deputy Commissioners to consider his proposals immediately by conference with senior officials and to report without delay on them, with any suggestions for improvement. Following responses from Deputy Commissioners¹⁶², Ewing on 22nd February 1922 sent a revised advice to Collins¹⁶³ containing a draft reply to Churchill's cable of 15th October 1921.

The Australian Governor General wrote to the Secretary of State for the Colonies on 2nd May 1922 setting out the Australian legislation and providing details of what Australian administrative practice would be for providing rebates. The Governor General's letter was based on a draft prepared in the Prime Minister's Department which in turn was based on a draft from Treasury which itself was based on Ewing's draft of 22nd February

¹⁵⁸ Australia, *supra* note 104 at p 33 paragraph 175.

¹⁵⁹ Australia, *supra* note 104 at p33 paragraph 177.

¹⁶⁰ Commissioner of Taxation to Deputy Commissioners, All States (Except Darwin N.T.) 6th February 1922, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.253.

¹⁶¹ The draft is addressed to The Secretary of the Treasury and is dated 6th February 1922 and is Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 247 to 251.

¹⁶² Responses were received from Deputy Commissioners in all States and are contained in Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.255 to 262.

¹⁶³ R Ewing, Commissioner of Taxation to The Secretary to the Treasury, Melbourne, 22nd February 1922, Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.265 to 269.

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 discussed above). The letter pointed out that ‘it would appear to be necessary for both 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 particular period and the rate at which tax has been levied by the authority’.

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. The Governor General’s letter and the drafts by the Prime Minister’s Department and by Treasury dated 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.

As it happened none of the Australian States ever agreed to grant reciprocal relief. Throughout the period the States unanimously held the view that, as they only taxed income sourced within their jurisdictions, it was inequitable to ask them to provide relief from double income taxation which they regarded as attributable solely to the United Kingdom taxing residents on a worldwide basis.¹⁶⁵ The consequence was that Australia was treated as a non-participating Dominion for purposes of proviso (b) to subsection 4 of s27 of the *Finance Act 1920 (UK)* referred to above. The effect of this treatment was that, while the United Kingdom tax assessed on Australian sourced income was lower than it would otherwise have been, additional complications arose in the calculation of United Kingdom tax and greater reliance was placed by the United Kingdom tax authorities on formulae aimed at achieving approximately correct results.¹⁶⁶ The United Kingdom treatment of Australian Commonwealth taxation does

¹⁶⁵ Examples of the views of State Governments can be seen in Premier of Victoria to Prime Minister of Australia 17th October 1933 with attached memorandum by Victorian Commissioner of Taxation and in Premier of South Australia to Prime Minister of Australia 5th February 1934 with attached memorandum by South Australian Commissioner of Taxation. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁶⁶ See the discussion in R Staples, *supra* note 130 at pp37 to 39 for a discussion of the method of calculating relief depending on whether or not the Dominion was participating and in R L Renfrew, *supra* note 130 at p15 for a discussion of problems associated with calculations where the Dominion was not participating and at p53 for a list of participating Dominions. Australia, Canada and the Union of South

not appear to have changed following the practical disappearance of State income taxes as part of the Uniform Tax Scheme of 1942¹⁶⁷ and the first Uniform Tax Case.¹⁶⁸

Remarkably Australia and the United Kingdom appear to have used different approaches throughout the period for calculating the relevant tax rates for purposes of determining the amount of rebate allowed. Australia continued to dissect accounts to determine whether income was within the Australian tax base a procedure which the United Kingdom regarded as unnecessary and refused to follow. Notwithstanding the difference in methods of calculation adopted, for the purpose of calculating rebates Australia accepted certificates issued by the United Kingdom Inland Revenue authorities showing the rate of United Kingdom tax paid on what Australia had characterised as Australian source income.¹⁶⁹

The procedures adopted in the implementation of the system, particularly those adopted by the Australian Taxation Office, were extremely cumbersome requiring certification by both taxing authorities before relief could be granted by the United Kingdom and requiring further certification by Australia before it granted relief. While difficulties associated with the practical implementation of the system were discussed by correspondence, one wonders if a more workable means of administering it might have been devised if the Australian representative at the 1919 conference with the Sub-Committee of the United Kingdom Royal Commission had been someone like Garran or Ewing with intimate knowledge of the income tax laws rather than a 'strong man' like Knibbs, or if follow up meetings had been held between officials actually involved in the implementation of the system.

Having said this, the issues associated with the implementation of the Dominion Income Tax Relief system in Australia were not unique to that system at least as it was interpreted by Australia. Any foreign tax credit system based on a measured approach to relief has to have some rules for determining which income is being distributed and credited, to whom it is being credited, and for adjusting for differences in tax base between jurisdictions. There continues to be no standard practice on the first issue while generally the last is dealt with by adjustments made by the residence jurisdiction which itself often proves to be a cumbersome process. Difficulties associated with credit mismatches arising through the interaction of different systems of corporate-shareholder taxation continue and can be regarded as contributing to the demise of dividend deduction and dividend imputation systems. The United Kingdom approach to the system, however, was one of notional relief under which some of these issues were

Africa were treated as non-participating Dominions as, although relief was granted at the Federal level, it was not granted at the Provincial level in any of these cases.

¹⁶⁷ The scheme was implemented through four Acts: *Income Tax Act 1942 (Cth)*; *Income Tax Assessment Act 1942(Cth)*; *State Grants (Income Tax Reimbursement) Act 1942 (Cth)*; and *Income Tax (War-Time Arrangements) Act 1942 (Cth)*.

¹⁶⁸ *South Australia v The Commonwealth* (1942) 65 CLR 373.

¹⁶⁹ The differences in approach are highlighted in Note, dated October 1922 by the Board of Inland Revenue on dispatch of 2nd May 1922 from the Governor General of the Commonwealth of Australia on the subject of double income tax; Letter from Governor General of the Commonwealth of Australia to the Secretary of State for the Colonies dated 2nd April 1924 forwarding statement by Commonwealth Commissioner of Taxation dated 29th January 1924; and Note by Board of Inland Revenue on dispatch of 2nd April 1924, from the Governor General of the Commonwealth of Australia, forwarding a statement by the Commonwealth Commissioner of Taxation on the subject of Double Income Tax dated 29th January 1924.. The first two documents are contained in Australian National Archives, Series A11804, Control Symbol 1926/317. The third document is contained in Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

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

Despite Knibbs' fears in 1919 and 1920 that the United Kingdom would get a 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 income¹⁷² 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 proposal¹⁷⁴ but when he failed to follow up on a request for a response to his proposal Australia simply decided not to reply at all.¹⁷⁵ The concession Knibbs obtained in late 1919 and early 1920, that the United Kingdom relief would take into account the entire graduated scale of Dominion tax, had proved to be critical in allowing the Dominions to increase their tax rates while ensuring that the major portion of Dominion income tax relief rebates were borne by the United Kingdom. By the 1930s this feature of the

¹⁷⁰ For a discussion of the distinction between measured and notional approaches to relief from international double taxation and a discussion of advantages of a notional approach to relief see C John Taylor, 'Twilight Of The Neanderthals, Or Are Bi-Lateral Double Taxation Treaty Networks Sustainable?' (2010) 34 *Melbourne University Law Review* 240 to 279.

¹⁷¹ Numerous Australian Government internal documents and correspondence in this period reflect this view. See for example: Earle Page (Australian Treasurer) to S M Bruce (Australian Prime Minister) 25th August 1928; S M Bruce (Australian Prime Minister) to Secretary of State for Dominion Affairs 30th August 1928; L S Jackson (Acting Australian Commissioner of Taxation) to Secretary Prime Minister's Department, Canberra, 5th September 1934; Cable, Bruce (Australian High Commissioner, London) to Australian Treasurer and Treasury 30th April 1936. Cable, Bruce (Australian High Commissioner, London) to Australian Treasurer and Treasury 30th April 1936. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷² The proposals made at the 1930 Imperial Conference are summarised in Imperial Conference 1932 – Note On Double Taxation Within The Empire enclosed in N Chamberlain to S M Bruce (Australian High Commissioner in London) dated 24th July 1933. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷³ The attitude of the Australian representative to the proposal is clearly set out in the Memorandum from Collins (Australian representative) to Secretary Prime Minister's Department Canberra 22nd December 1930. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷⁴ Chamberlain intended to raise the issue at the 1932 Imperial Conference in Ottawa but pressure of other business prevented this. Chamberlain wrote to S M Bruce as Australian High Commissioner in London on 24th July 1933 asking him to request the Australian Government to take the issue into consideration with a view to a possible conference of financial experts. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷⁵ See L S Jackson (Acting Australian Commissioner of Taxation) to Secretary Prime Minister's Department, Canberra, 5th September 1934; Secretary to the Australian Treasury to Secretary Australian Prime Minister's Department, 27th March 1935; Cable, Bruce (Australian High Commissioner, London) to Prime Minister's Department, Canberra, 18th June 1935; Secretary to the Australian Treasury to Secretary Australian Prime Minister's Department 25th September 1935; Cable, J A Lyons (Australian Prime Minister) to S M Bruce (Australian High Commissioner, London) undated; Memorandum from Secretary to the Australian Treasury to Secretary Prime Minister's Department Canberra 21st April 1936; Cable, Lyons (Australian Prime Minister) to High Commissioner, London 22nd April 1936; Cable, Bruce (Australian High Commissioner, London) to Australian Treasurer and Treasury 30th April 1936. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

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

Prior to Australia's abandonment of its dividend 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 paid tax on its undistributed profits and received a deduction for distributions. Companies had the discretion to either pay tax at lower rate in respect of distributions to non-residents or to withhold tax from the distributions. Both resident and non-resident shareholders were taxed on an assessment basis and were entitled to a rebate on distributions of previously taxed income at the lower of the corporate rate or the shareholder's rate on income from property thus making the rebate non-refundable. Non-resident shareholders in companies which chose to pay tax on distributions to them were entitled to deduct tax paid by the company on the distribution from the tax payable by the shareholder.¹⁷⁸

At the time the United Kingdom system of corporate-shareholder taxation, although itself a form of integration system, principally provided relief at the shareholder rather than at the company level. Under United Kingdom legislation companies paid tax at the standard rate and dividends were assumed to be paid out of taxed profits and to have had tax at the standard rate deducted from them. This meant that only those natural person shareholders with a surtax liability were subject to any further tax on the dividend. Withholding tax was not applied to dividends paid to non-residents and

¹⁷⁶ N Chamberlain (United Kingdom Chancellor of the Exchequer) to S M Bruce (Australian High Commissioner, London) 24th July 1933. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷⁷ For example H W Buckley to The Federal Commissioner of Taxation, 4th August 1922, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.326. The Australian Taxation Office response to this inquiry is set out in Commissioner of Taxation, Minute Paper, Double Income Tax, Letter from Mr H W Buckley, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 344 to 346.

¹⁷⁸ The account in the text is based on the discussions of the Australian system of corporate-shareholder taxation at this time in C John Taylor, 'Development of and Prospects for Corporate-Shareholder Taxation in Australia' (2003)57 *Bulletin For International Fiscal Documentation*, pp. 346 to 357 (hereafter, 'Taylor, Development Of And Prospects For') at pp. 346 to 347, C John Taylor, 'The Negotiation and Drafting of the UK-Australia Double Taxation Treaty of 1946' [2009] *British Tax Review* pp. 201 to 241 (hereafter 'Taylor, Negotiation and Drafting 1946 Treaty') at pp. 202 to 204; and C John Taylor, 'I suppose I must have more discussion on this dreary subject': The Negotiation and Drafting of the UK – Australia Double Taxation Treaty of 1946' in J Tiley, ed., *Studies In The History Of Tax Law*, Volume 4, Hart Publishing, Oxford and Portland Oregon, 2010, pp. 213 to 266 (hereafter 'Taylor, Dreary Subject') at pp.215 to 217.

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 Australia's move to a nominal global system in 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 been envisaged by Ewing in his letter to Collins of 30th July 1920 discussed above.

In 1946 J B Chifley (as Australian Prime Minister and Treasurer) noted that while the Dominion Income Tax Relief system had been cumbersome in application and had resulted in long delays it had granted a reasonable measure of relief until changes to Australian taxation laws in 1939 made the relief inadequate.¹⁸¹ Although J B Chifley did not specify what changes to Australian tax law in 1939 made the relief inadequate it is likely that he was referring to the 1939 abolition of inter-corporate dividend rebates for non-resident holding companies. The effect of this measure was to increase the effective rate of Australian tax on dividends paid to non-resident holding companies. Further problems developed when, in 1940-1941, Australia changed its corporate-shareholder taxation system to a classical system.¹⁸² Following this change it appears that the United Kingdom, for the purpose of calculating Dominion Income Tax Relief, grossed up the dividends for Australian shareholder tax but not for Australian corporate tax. In calculating any reciprocal relief that it was obliged to provide, Australia only took account of Australian shareholder tax. The end result of the combined operation of these practices was that the effective rate of tax on dividends derived by United

¹⁷⁹ This account is based on the discussion of the United Kingdom system in Taylor, *Negotiation And Drafting 1946 Treaty*, *supra* note 178, at p.204 and Taylor, *Dreary Subject*, *supra* note 178, at pp. 217 to 218. See also the discussion in J F Avery-Jones, 'The History of the United Kingdom's First Comprehensive Double Taxation Agreement' [2007] *British Tax Review* 211 to 254 (hereafter, 'Avery-Jones, First UK Treaty') at pp. 222-223.

¹⁸⁰ See the discussion of the Australian imputation system in this period in Taylor, *Development Of And Prospects For*, *supra* note 178 at pp. 347 to 349.

¹⁸¹ Memorandum by J B Chifley for Cabinet dated 3rd June 1946. Australian National Archives, Series Number A2700 Control Symbol 1172 Barcode 3264124

¹⁸² For a discussion of the process by which the Australian imputation system of the 1930s was transformed into a classical system see Taylor, *Development Of And Prospects For*, *supra* note 178 at pp. 349 to 350.

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 country's right to tax investment income, giving the source country the major right to 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 under the system of Dominion Income Tax Relief following Australia's adoption of a classical system see 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 14; M J Graetz and M M O'Hear, 'The 'Original Intent' Of U.S. International Taxation' (1997) 46 *Duke Law Journal* 1021; P Verloren van Themaat, 'The Anglo American Group of Taxconventions, concluded since 1939, compared with the pre-war treaties' 3 *Cahiers De Droit Fiscal International* pp 1 to 21; M B Carroll, 'Double Taxation Conventions Concluded By The United States Since 1939' 5 *Cahiers De Droit Fiscal International* pp 25 to 78.

providing a foreign tax credit up to the amount of residence country tax otherwise payable.

Hence, when the United States and the United Kingdom began negotiations for a Double Taxation Agreement in 1944 the United States already had a highly developed negotiating position that reflected both its treaty practice to that time and the emerging international consensus. The United Kingdom by contrast, used the Dominion Income Tax Relief system within the Empire but otherwise had only a simple treaty with the Irish Free State and a series of agreements with other States on specific topics such as agency profits. The Double Tax Convention of 1945 between the United Kingdom and the United States that emerged from a fairly lengthy set of negotiations was consistent with the emerging international consensus and hence differed significantly from the Dominion Income Tax Relief system.¹⁸⁵ To fulfil its treaty obligations the United Kingdom introduced a foreign tax credit as part of its domestic law.¹⁸⁶

Following the negotiation of the Double Taxation Convention with the United States the United Kingdom Secretary of State for the Dominions began negotiations with each of the Dominion Governments offering to enter into Double Taxation Conventions with them on terms which were decidedly less favourable to the Dominions than those that the United Kingdom had agreed to in its Convention with the United States.¹⁸⁷ Given that the Convention with the United States provided greater relief to a United Kingdom resident with United States taxed income than that provided by the Dominion Income Tax Relief system the days of the latter system were numbered so far as the Dominions were concerned. Eventually all of the Dominions entered into Double Taxation Conventions with the United Kingdom and as they did so the system of Dominion Income Tax Relief ceased to apply to them.¹⁸⁸ As might have been expected given the history of negotiations in 1919 and the 1920s, the most difficult negotiations proved to be with Australia which clung tenaciously to its policy of maximizing its taxation of Australian sourced income.¹⁸⁹

¹⁸⁵ See Avery-Jones, First UK Treaty, *supra* note 1789 at pp. 222 to 225.

¹⁸⁶ *Finance Act (No2) 1945 (United Kingdom)* s51(4) and Sch VII.

¹⁸⁷ Details of the negotiations with Australia are contained in the following files in the United Kingdom (UK) National Archives, IR 40/13740 and DO 35/1157.

¹⁸⁸ *Finance Act (No2) 1945 (United Kingdom)* ss51(1) and (2).

¹⁸⁹ The initial steps in negotiating the Australia – UK Double Taxation Agreement of 1946 can be traced to a letter from the Australian High Commissioner, S M Bruce, to Viscount Cranbourne on 9th March 1945. Negotiations at official level eventually broke down and agreement was only eventually reached through ministerial negotiations. The Australia – UK Double Taxation Agreement was not signed until 29th October 1946, long after agreements had been concluded by the UK with other Dominions. Details of the negotiations with Australia are contained in the following files in the UK National Archives, IR 40/13740 and DO 35/1157. For a discussion of the negotiation and drafting of this treaty see Taylor, Negotiation And Drafting 1946 Treaty, *supra* note 178 and Taylor, Dreary Subject, *supra* note 178.