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B: Good faith in domestic and international tax law
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Summary and conclusions

The expression "good faith" is not unknown in Australian domestic law, but its occurrence and use appears to be significantly more limited than in jurisdictions that are not derived from English common law.

In domestic law the most relevant considerations of it occur in contract law, in administrative law and in some statute law. In contract law it is an aide to interpreting the behaviour of the parties when determining whether that behaviour complies with the terms of the agreement. In administrative law it informs the question of whether an administrator made an appropriate decision. In statute law it is given limited application in specific situations, which do not include taxation and do not directly inform how the concept might be relevant to taxation. The statutory uses are consistent with the previous two categories.

The expression is also used in connection with our international treaties, and in particular the Vienna Convention.[2] It is possible that this represents an avenue through which the concept may become more broadly relevant to Australian law, and taxation law in particular. Decisions by Australia in relation to the interpretation and performance of its treaty obligations are required to be in good faith.

Australian taxation disputes are generally conducted within a specific dispute framework set out in the domestic legislation. Questions regarding the operation of treaties are determined using principles of statutory interpretation, and good faith has not to date had a role. There are, however, other litigation avenues which may enable taxpayers to challenge provisions in the domestic law which are not consistent with our treaty obligations, and where good faith may be raised.

Our international treaties are incorporated into domestic law by domestic statute. Extrinsic material is also relevant to the interpretation of treaties, and in some cases may have the force of law. Extrinsic material which requires good faith in interpretation and action may therefore increase the rights of taxpayers in Australia under our treaties. At present there appears to be little such material. Such material would also need to define the term good faith in order to have the maximum effect since the domestic discussion of the concept is limited.

[1] Tax partner DLA Piper.

[2] Vienna Convention on the Law of Treaties 1969.

Part One: Introduction and defining the principle of good faith

1.1. General overview

Australia is a common law jurisdiction. The legal system is derived from, but no longer dependent on English law.

It is also a dualist jurisdiction (being one where international law, including treaties Australia has signed, have no domestic legal effect without enabling domestic legislation).[3] As a consequence, international legal concepts must generally find a domestic legislative route into the Australian legal system.

Although references to the expression "good faith" can be found in Australian domestic case law, its use is limited because of the historical development of Australian law from English law. There are also some references to good faith in administrative material issued by the Australian Taxation Office (the "ATO"), the administrator, but these uses are not accompanied by a definition of the term and are generally not binding on the ATO or taxpayers.

The concept of "good faith" has been traced to an origin in Roman law,[4] principally in contract law. It has therefore been a fundamental doctrine of European law. In English law the legal duty of good faith was adopted through Chancery law into principles of "conscientious conduct and the protection of those with special vulnerability". It became a feature of the Chancery Court and the law of equity, not of common law generally, including commercial contract.[5]

The lack of an extensive engagement with the concept in Australia has led the High Court to observe that in fact "it is sometimes impossible to be certain of the meaning intended to be conveyed by such expressions as, for example, good faith and bad faith."[6]

Cases referring to good faith in Australia occur in several groups, the most relevant of which are discussed below. Corcoran[7] has identified thirteen factors which she says, although emphasis may vary depending on the area of the law under discussion, may be relevant in determining whether good faith behaviour can be said to exist:

- Honesty
- Intention (as evidenced)
- Knowledge and scienter
- Freedom from malice
- Diligence and inquiry
- Reasonable cooperation
- Fair dealing and fair consequences
- Full disclosure, lack of deceit
- Proper purpose and proper exercise of discretion
- Due process, substantive and procedural
- No misuse of power

3 Per Mason CJ, Deane and Toohey JJ in Minister for Immigration and Ethnic Affairs v Teoh (1995).

4 Corcoran, S. Good faith as a Principle of Interpretation. What is the positive content of good faith? (2012) 36 Aust Bar Rev 1; at 3.

5 Corcoran ibid at 5.

6 *The Queen* v *Toohey*; *Ex parte Northern Land Council* (1981) 151 CLR 170 at 232.

7 Ibid.

- Degree of compliance with statutory or common law obligations
- Track record.

A final general point worth noting is that in most taxation contexts the taxpayer alleging a lack of good faith bears the burden and onus of proof. Such matters have generally involved administrative decision making. Where a decision may appear unfair, but where there may be no real evidence to prove a lack of good faith. This can be particularly difficult for taxpayers to accept where the powers given to the ATO range to extremely forceful. If the legislature has granted great power, then its thoughtful exercise may rarely be simply said to be lacking in good faith solely because of the impact of the outcome.

1.2. Good faith in contract

The most common group it is found in, is as a tool in interpretation of contracts. Here, it has been said that "good faith" is "a principle of interpretation that can be defined as involving a finding that the purported intention and conduct of a party or parties is, or is not, appropriate for legal recognition given the factual and legal context. It can be described as a credibility finding because someone must engage in the activity of interpreting that intention and conduct as acceptable when viewed in light of its context".[8]

Australian courts do appear to accept "a growing tendency" for an obligation of "good faith" to be implied as being required in the interpretation of contracts and in carrying out obligations under contracts.[9] It is also clear that the scope of the doctrine is still developing in this context. Good faith in Australian contract law then appears to be a principle of interpretation rather than the basis on which a right of action may be built.

In Australia the relationship between a taxpayer and the tax authority is not usually based in contract. Exceptions may exist for certain settlement agreements, and in this context the principles of good faith that are relevant to contract law may become relevant.[10]

Our international treaties are generally seen as binding agreements and the Vienna Convention requirements are similar to the good faith requirements in domestic contract law.

The concept is given clear operation in the interpretation of our international "Agreements for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income" (together with other international treaties dealing with tax such as the Multilateral Instrument, simply referred to as "tax treaties" in this report), because of the Vienna Convention requirement that we interpret tax treaties through the lens of "good faith". It is well accepted that article 31 of the Vienna Convention, with its requirement of interpretation "in good faith", applies to Australian tax treaties.[11]

There are now a number of court decisions in Australia dealing with tax treaty interpretation and acknowledging the role of the Vienna Convention and specifically

[8] Corcoran ibid at 8.

[9] Ryal Botanic Gardens and Domain Trust v South Sydney City Council (2002) 240 CLR 45; esp at 17, 53.

[10] S. 361-5(1) Taxation Administration Act 1953 (Cth) provides some reduction in administrative penalties where the taxpayer reasonably relies in good faith on the Commissioner's practice. No explanation has been given of the meaning of the expression where it is used.

[11] Thiel v Federal Commissioner of Taxation (1990) 94 ALR 647.

acknowledging this requirement of "good faith",[12] but none of them deal with the meaning or operation of good faith. Each turn on other issues. Tax treaties are, however, regarded under domestic law as binding agreements entered into by Australia.[13] It is conceivable that, in a suitable case, the actions of Australia in relation to a taxpayer may be challenged on the basis that the treaty interpretation supporting those actions was not arrived at in good faith. The question of the proper application of a tax treaty to a taxpayer is an act of interpretation by the ATO.

Review of taxation assessments (which are raised on an incorrect interpretation) in Australia normally occurs under the provisions of Part IVC of the Taxation Administration Act 1953 Cth. Through this mechanism a decision of the ATO that incorrectly interpreted a treaty may be set aside by a court.[14] It is not a relevant fact that the assessment was motivated by a lack of good faith. Australian courts also separately have jurisdiction to set aside assessments by the ATO where they are made for an improper purpose or in "bad faith".[15] In tax matters, there is some indication that "acting other than in good faith" may be seen as the equivalent of acting "in bad faith".[16] But Australian courts have not yet dealt with a matter where the taxpayer was able to provide satisfactory (to the court) evidence of bad faith, or lack of good faith on the part of the ATO.[17] It is possible that a taxpayer could base an action in such a case on the proposition that the tax treaty gave rise to a legitimate expectation that decisions would be made consistently with Australia's obligations.[18]

In Futuris[19] the Commissioner of Taxation effectively issued two assessments in relation to the same transaction. The taxpayer commenced proceedings for a review of the decision to issue the second assessment, arguing (in part) that it was not made in good faith in the sense that the double counting was deliberate and the second assessment was not a proper exercise of the power to assess. It was an application of the Act to facts which the Commissioner knew to be untrue. The High Court held that there was another factor, an intention to correct the situation in the future, which prevented a conclusion that the totality of the evidence supported a finding of a lack of good faith.

Article 26 of the Vienna Convention imposes a slightly different requirement however, that the treaty "must be *performed* by (the parties) in good faith". This requirement goes to the behaviour of execution of the treaty, rather than only its interpretation.

12 Thiel v Federal Commissioner of Taxation (1990) 94 ALR 647; Commissioner of Taxation v Lamesa Holdings BV (1997) 77 FCR 597; McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation (2005) 142 FCR 134; Virgin Holdings SA v Commissioner of Taxation (2008) 214 FCR 278; Russell v Federal Cmr of Taxation (2011) 190 FCR 449; Federal Commissioner of Taxation v SNF (Australia) Pty Ltd (2011) 193 FCR 149; Resource Capital Fund III LP v Commissioner of Taxation (2013) 95 ATR 504; Tech Mahindra Ltd v Commissioner of Taxation [2015] FCA 1082; Bywater Investments Ltd v Commissioner of Taxation; Hua Wang Bank Berhad v Same [2016] HCA 45; Addy v Commissioner of Taxation [2021] HCA 34.

13 See also Part Three of this report below.

14 Such as in FC of T v Addy [2021] HCA 34.

15 DFC of T v Richard Walter Pty Ltd 95 ATC 4067; FC of T v Futuris Corporation Ltd [2020] HCA 32.

16 Kordan Pty Ltd v Federal Commissioner of Taxation [2000] ATC 4812, at 4815. Quoted in FC of T v Futuris Corporation Ltd [2008] ATC.

17 Futuris supra, at pp. 19 and 20.

18 *Minister for Immigration and Ethnic Affairs* v *Teoh* (1995) 128 ALR 353, see also part 1.2 of this report.

19 FC of T v Futuris Corporation Ltd [2008] HCA 32.

In CWY20[20] the Federal Court of Australia observed in the context of non-tax treaties that:

> Article 26 of the Vienna Convention on the Law of Treaties, opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980), and the principle of pacta sunt servanda, impose upon the Australian Government an obligation to observe and perform, in good faith, those treaties to which it is a party. Failure to do so exposes the nation to responsibility for internationally wrongful acts under the Draft Articles on Responsibility of States for Internationally Wrongful Acts, commended by the General Assembly on 28 January 2002, A/RES/56/83 and on 8 January 2008, A/RES/62/61, in which case Australia may face legal consequences (Art 28), including, but not limited to: cessation and non-repetition (Art 30), reparation (Art 31) in the form of restitution (Art 35), compensation (Art 36) and satisfaction (Art 37), in addition to countermeasures (Art 49). Whether or not these legal consequences in fact arise, a breach of a treaty is a breach of international law, which is a breach of law nonetheless.

The admonition to *perform* "in good faith" has not been further elaborated in Australian cases. The majority of cases simply consider whether a treaty obligation has been breached, and the consequences of the breach, rather than whether the breach was a result of a lack of good faith. In CWY20, for instance, the question was whether a decision might be said to be "in the national interest" even though it amounted to a breach. And the conclusion was that it could. So, the question in Australian taxation disputes may again simply turn on whether a domestic provision was in breach of a tax treaty, and whether as a result an assessment can be put aside.

In this context, the question is about whether the Australian Parliament failed to perform its tax treaty obligations in good faith when it passed inconsistent domestic legislation. This would be a question about the legislative behavior of Parliament. Such an argument is unlikely to be a successful basis for challenging a domestic provision.[21]

Firstly, the inconsistency itself may result in the tax treaty provision overriding the domestic one[22] unless there is a clear intention that the treaty be overridden giving a taxpayer a basis of appeal under the domestic rules, and secondly it is unlikely that a court would conclude that the inconsistency was, alone, sufficient evidence of a lack of good faith. It also seems likely that generally a foreign taxpayer will lack standing to bring its own action against Australia for a breach of a tax treaty since tax treaties do not themselves give taxpayers a right to do so. The best approach open to taxpayers is an appeal within the domestic tax system, arguing that the tax treaty provision governs their situation.

Separately, it is possible that an argument may be made in a suitable case that the actions of the ATO were inconsistent with an obligation to "perform in good faith" Australia's obligations under a tax treaty. This argument may arise, for example, in the context of provisions of tax treaties which relate to behaviour of a tax authority, rather than taxing rights. In the Australia/United States tax treaty, for instance, article 25 authorises exchange of information in certain circumstances. As discussed above, however, courts in Australia have not yet been presented with a case where the evidence justified a conclusion that

[20] Acting Minister for Immigration, Citizenship, Migrant Services and Multicultural Affairs v CWY20 (2021) 288 FCR 565.

[21] Polites v The Cth [1945] 70 CLR 60.

[22] International Tax Agreements Act 1953 (Cth), s. 4(2).

the tax authority had acted in bad faith. Taxpayers are likely to face difficulty obtaining evidence regarding internal decision making in the ATO which would support such a matter. As noted above, there is the possibility that a taxpayer may argue that there was a legitimate expectation that the treaty would be complied with.[23]

1.3. Good faith in administrative law

The discussion above touches on the ability to bring an action alleging that an assessment was not made in good faith and the difficulties of doing so. This is an example of the broader application of the principle in domestic administrative law, in the consideration of Government decision making generally, including the exercise of statutory discretions and powers.

In DC of T v Widdup[24] the court said:

> It is now well established that statutory powers are almost invariably conferred subject to the implied limitation that they be exercised reasonably: see Minister for Immigration and Citizenship v Li (2013) 249 CLR 332; [2013] HCA 18. A statutory power cannot be exercised arbitrarily, capriciously, in bad faith or for an improper purpose.

In this context proof of bad faith was said to generally require:[25]

> …proof of extreme circumstances, such as "dishonesty", "improper or ulterior motive" or "deliberate impropriety", and will generally only be made out in rare and extreme cases: see Daihatsu Australia Pty Ltd v Commissioner of Taxation (2001) 184 ALR 576; [2001] FCA 588 at [36]-[38], [48]; Federal Commissioner of Taxation v Futuris (2008) 237 CLR 146; [2008] HCA 32 at [55]; Kordan Pty Ltd v Federal Commissioner of Taxation [2000] FCA 1807 at [4].

The case law in this area follows the principles outlined above in the discussion in relation to tax treaty interpretation.

1.4. Good faith in specific statutes

Some Australian statutes introduce a specific requirement of good faith in certain circumstances. These do not generally assist the enquiry which is the subject of this report since the definition is limited to the particular statute in which it is used.

The Corporations Act 2001 (C'wlth) contains a provision that requires a court to be satisfied that certain applications are made "in good faith".[26] Directors of companies are also required to exercise their powers "in good faith",[27] and are said to owe their companies

23 *Minister for Immigration and Ethnic Affairs* v *Teoh* (1995) 128 ALR 353 and part 1.2 of this report.

24 [2022] FCA 1403, at para 44.

25 Widdup, supra at para 9.

26 S. 274A.

27 S. 181 Corporations Act 2001.

an equitable duty of good faith.[28] The concept in this context extends to more than good intentions and an absence of self-interest and extends to a requirement to act in a way which is conceived to be for the benefit of the company as a whole.[29]

The term is also used in Bankruptcy law in defining payments that are protected from being repaid as "preference" payments. Here, protection is given if the creditor acted in good faith in relation to the payment.[30] Essentially the creditor should not have had a reason to suspect that the debtor was unable to pay debts and that the effect of the transaction was to confer an advantage over other creditors.[31]

1.5. Good faith under a different name

Of the concepts which might fit under this heading, the Australian domestic legal system generally only recognizes the concepts of "legitimate expectation" and "estoppel". The scope of these concepts is different to that of "good faith" as discussed in part 1.1 of this report, above.

These concepts were considered in a taxation context in Daniels v Cranston.[32] The ATO there first gave an undertaking as to certain events, but later acted inconsistently with the undertaking. The taxpayer argued that either the ATO was estopped from acting inconsistently, or that the taxpayer had a legitimate expectation that the ATO would not so act. The court held that in Australia the doctrine of legitimate expectation was a procedural protection only, requiring that the administrator apply the rules of natural justice. This had been done here by suitable engagement with the taxpayer. There was also no estoppel.

The expression "estoppel" is most widely used in Australian law to refer several related rules of evidence. It arises where, once a court judgement was made, the issue in dispute and the facts found by the court and the issues of law decided could not be further challenged.[33] It may also arise where a representation is made, intending that another party acts on it, .preventing it later being denied.[34]

The ATO is generally not estopped from properly applying the law by an earlier error, or by conduct.[35] Although, some public rulings may be binding.[36]

28 Westpac Banking Corporation v The Bell Group Ltd (in liq) [No 3] (2012) WASCA 157.
29 Australian Growth Resources Corp Pty Ltd v van Reesema & Orts (1988) 6 ACLC 529.
30 S. 122(2) Bankruptcy Act 1966 (Cth).
31 S. 122(4) Bankruptcy Act 1966 (Cth).
32 [2009] FCA 1412.
33 *Blair v Curran (1939) 62 CLR 464*.
34 Sotoris v Irwin (1962) NSWR 1079.
35 *FC of T* v *Wade (1951)* 84 CLR 105.
36 See PS LA 2001/4.

Part Two: Good faith in domestic tax law

2.1. General overview

The concept of good faith only has a limited role in Australia's domestic tax system, as discussed in part 1.1 above.

Its role in contract law gives it operation in settlement agreements[37] between the ATO and taxpayers. It also has a limited role in certain court actions to review administrative decisions.

2.2. Good faith in the enactment of law

Good faith does not generally have a role in these aspects of Australian taxation law.

The interpretation of tax statutes in Australia focuses initially on the text of the legislation itself. This will include the context of the provision in the Act and related provisions. It may, in the case of ambiguity, include reference to certain extrinsic materials such as related legislative material as the provision passed through Parliament, explaining Parliament's intent.[38] If there is ambiguity a construction that promotes "the purpose or object" of the Act is preferred.[39]

Retrospective or retroactive legislation is not uncommon in Australia, although parliamentary rules usually limit this to fairly short periods, such as from the date of the announcement of the measure. It is, however, accepted that the Parliament may pass retrospective and retroactive legislation[40]. Notably this has recently been done in relation to our transfer pricing measures, with provisions enacted in 2012 applying to years starting on or after 1 July 2004.[41] While these changes were described as simply "clarifying" the law, this was strongly criticized.[42]

The ATO has issued PS LA 2011/27 indicating the circumstances where it may not retrospectively apply changes in its view of the law. This is a non-binding administrative guidance. It broadly suggests that if there has been a reasonable basis for believing the ATO had accepted an approach in the past, then retrospectivity would be avoided.

Australia has a General Anti Avoidance Rule, Part IVA of the Income Tax Assessment Act 1936 (Cth). The principal provision is (broadly speaking) triggered where, on the evidence, it could be objectively concluded that a dominant purpose of an arrangement was to avoid tax. Being the tax that would have been paid if the particular arrangement was not entered into. Legislative purpose is not relevant to this analysis and questions of good faith do not arise.

37 See for example PS LA 2015/1, where the Commissioner only considers himself bound by an agreement if it was negotiated in good faith. Without defining that expression.

38 FC of T v Shell Energy Holdings Australia Ltd [2022] FCAFC 2; Section 15AB Acts Interpretation Act 1901 Cth.

39 Section 15AA Acts Interpretation Act 1901 Cth.

40 Polyukhovich v Cth (1991) HCA 32: see, for example Crimes (Taxation Offences) Act 1980 (Cth) ss. 5, 8, 13.

41 The *Tax Laws Amendment (Cross-Border Transfer Pricing) Act (No. 1) 2012* (Cth), enacted on 8 September 2012, made amendments to the *Income Tax Assessment Act 1997* (Cth), with retrospective operation to apply to income years starting on or after 1 July 2004.
Law Council of Australia, Submission 75.

2.3. Good faith in the administration of the tax system

The role of good faith in the relationship between the ATO and taxpayers has been described above. It is limited to certain issues of contract and administrative law.

The ATO has extremely extensive powers to gather information.[43] As discussed in Part One of this report, a challenge to such requests might be made if they were proved to not be issued in good faith, but there have not yet been cases were this was proved. Information provided by taxpayers must not be false or misleading, with criminal prosecution possible for breaches.[44] Most offences are offences of strict liability. The absence or presence of good faith is not relevant to the offence.

Binding private rulings are only binding against the ATO to the extent that the facts which the ATO were given are accurate.[45] The question of accuracy is not modified by concepts of good faith.

APA's in Australia are not binding contracts or made under a specific legislative regime. They are then less likely to be subject to the contract or administrative law principles relating to good faith discussed in Part One. In PS LA2015/4 (a non-binding administrative guidance) the ATO sets out the expectations of both parties in the process as:

- Cooperating fully
- Treating the request on its merits
- Transparently disclosing all relevant and material facts
- Providing prompt and complete replies to reasonable queries.

These expectations bear some resemblance to the types of behavior that might be expected by parties negotiating in good faith.

Tax audits are generally governed by strict liability statutory offences relating to complying with requests and not making false or misleading statements. In the same manner as discussed in relation to information gathering powers above.

Tax audits settlements are commonly recorded in a binding contract entered into between the ATO and the taxpayer dealing with any disputed issues. The principles of good faith in relation to contracts, set out in Part One above, have application.

Taxpayers and the ATO have fixed rights to amendment of prior year tax positions, which are not dependent on principles of good faith. Where a taxpayer return is amended to increase tax payable, this normally attracts the potential operation of provisions imposing interest and penalties by way of additional tax. In PS LA 2012/5 the ATO has accepted that decisions to remit penalties should be made in good faith. The Taxation Administration Act 1953 also specifically provides that interest is to be remitted where a taxpayer reasonably relies in good faith on advice, statements or the general administrative practice of the ATO.[46] Similar protection is available in relation to penalty amounts, although the equivalent provision does not contain the requirement for good faith.[47]

43 Taxation Administration Act 1953 (Cth), schedule 1.

44 Taxation Administration Act 1953 (Cth), Part III.

45 Taxpayer v Commissioner of Taxation [2013] AATA 566.

46 S. 361-5, Taxation Administration Act 1953.

47 S. 284-224 TAA 1953.

Part Three: Good faith in international tax law

3.1. General overview

This part will consider how treaties are entered into and their legal effect. It will also consider the legal status of other international material which may be relevant to identifying how international concepts relating to "good faith" might be imported into Australian taxation law.

Status of tax treaties

Australia (meaning the Government of the Commonwealth of Australia, also sometimes referred to as "the Commonwealth") has (at October 2022) entered into 46 bilateral Conventions "for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income", or "tax treaties".

These are based on, but do not precisely replicate the terms of the OECD Model Tax Convention on Income and Capital, now in its 10th edition dated 2017 "the OECD Model". The OECD Model also has authorised "Commentaries", which elaborate on the meaning to be given to terms used in the model, and note reservations that various nations have made to the terms of the OECD Model. Below, we later deal with the status of the text of the actual Model Convention and Commentaries.

Australia's tax treaties are "treaties" entered into under the Executive power in section 61 of the Australian Constitution.[48] Treaties are a legally binding commitment by the Commonwealth under international law. They are an exercise of the prerogative powers of the Crown in right of Australia, represented by the Australian Governor General who is the head of the Executive Branch of Government in Australia. As such, treaties are actually executed by a representative of the Executive Branch of the Government.

Australia's treaty practice is governed by the 1969 Vienna Convention on the Law of Treaties which was acceded to by Australia in 1974 and has been in force since 21 January 1980.

Under the Vienna Convention, every treaty is binding on the parties to it and must be performed by them in good faith (article 26). It is generally not possible for a party to a treaty to invoke the provisions of its internal laws as justification for its failure to perform its treaty obligations (article 27), meaning that treaty obligations will usually prevail over domestic law.

As McHugh J said in *Thiel*[49] (in the course of discussing the 1980 Swiss–Australia double tax agreement):

> The Agreement is a treaty and is to be interpreted in accordance with the rules of interpretation recognised by international lawyers: *Shipping Corporation of India Ltd* v *Gamlen Chemical Co (A/Asia) Pty Ltd* (1980) 147 CLR 142 at 159. Those rules have been codified by the Vienna Convention on the Law of Treaties to which Australia, but not Switzerland, is a party. Nevertheless, because the interpretation provisions of the Vienna Convention reflect the customary rules for the interpretation of treaties, it is proper to have regard to the terms of the Convention in interpreting the Agreement, even though Switzerland is not a party to that Convention.

48 Commonwealth of Australia Constitution Act 1900.

49 *Thiel* v *FC of T* 90 ATC 4717.

His Honour went on to refer to articles 31 and 32 of the Vienna Convention and concluded that, because the meaning of the term "enterprise" in articles 3 and 7 of the Swiss 1980 agreement was ambiguous, it was proper to consider the "supplementary means of interpretation" contained in the 1977 OECD Model Tax Convention and the Commentaries thereon (Mason CJ and Brennan and Gaudron JJ agreed with McHugh J on this point).

It is important to distinguish treaties from other international memoranda which are not binding under international law ("memoranda of understanding").

Section 61 of the Australian Constitution provides:

> The executive power of the Commonwealth is vested in the Queen and is exercisable by the Governor-General as the Queen's representative, and extends to the execution and maintenance of this Constitution, and the laws of the Commonwealth.

The High Court has held that the powers of the Executive Branch are not limited by section 61, but in fact extend to the prerogative powers of the Crown. These are exercised by the Governor-General, by convention on ministerial advice. They are, essentially, the powers that the Executive Branch has to act, without reference to the Parliament. In this case the Executive may enter into international treaties.[50]

Once a treaty is concluded, section 51(xxix) of the Constitution allows Parliament to make laws implementing the terms of the treaty in order to fulfil our international obligations arising under it. The High Court has held that such legislation is in fact necessary:

> The provisions of an international treaty to which Australia is a party do not form part of Australian law unless those provisions have been incorporated into municipal law by statute and cannot operate as a direct source of individual rights and obligations under that law.[51]

Since 2013, Australia's tax treaties are given the force of law in Australia by the passage of an Act of Federal Parliament inserting reference to the Agreement into the list of Agreements referred to in the section 3AAA of the International Agreements Act 1953 ("IAA") definition of "current agreements", and amending section 5 to refer to any other provisions coming in to force with its date of effect.

Section 5 IAA then provides that "current agreements" have force of law from the date of their entry into force, according to their tenor (or "as written"). Section 4 IAA provides that the provisions of the Assessment Acts are incorporated and read as one with the IAA, but that to the extent of any inconsistency, the IAA has primacy. This primacy is limited in the case of some ITAA provisions such as the general anti-avoidance rule in Part IVA which prevails in the case of inconsistency.[52]

The result is a system where both the tax treaties and the domestic Assessment Acts are effectively consolidated into a single omnibus statute. All read together.

[50] The Executive Power of the commonwealth: its scope and limits – Parliament of Australia (aph.gov.au) Dr Max Spry. Research Paper 28 1995-96.

[51] Per Mason CJ, Deane and Toohey JJ in *Minister for Immigration and Ethnic Affairs* v *Teoh* (1995) 128 ALR 353 at p354.; see also Treaty-Making Options For Australia – Parliament of Australia (aph.gov.au) Susan Downing Current Issues Brief 17 1995-96:

[52] S. 177B(1) ITAA 1936.

The status of materials related to the treaty which may assist in its understanding is a little more complex under Australian law.

Status of aids in interpretation

The Vienna Convention also deals with the use of additional materials in interpreting a treaty.

The appropriate approach to interpretation of Australia's international treaties was considered in the High Court decision in *Applicant A*.[53] While that case dealt with the interpretation of the *Convention Relating to the Status of Refugees*, no distinction is to be drawn between the principles of interpretation applicable to double tax treaties and other international treaties.[54]

In *Applicant A*, McHugh J (at p 351–352) set out a number of propositions relating to the interpretation of international treaties.

- A "holistic" approach to the interpretation of treaties was *required* by article 31 of the *Vienna Convention* (see below). Primacy was to be given to the written text of the Convention but the context, object and purpose of the treaty must also be taken into consideration.
- Taking the text as the starting point was consistent with the basic principle of interpretation that courts should focus their attention on the "four corners of the actual text" in discerning the meaning of that text. The need to give the text primacy in interpretation was accentuated by the tendency of multinational instruments to be the result of various compromises by various States or groups of States.
- The mandatory requirement that courts look to the context, object and purpose of treaty provisions as well as the text was consistent with the general principle that international instruments should be interpreted in a more liberal manner than would be adopted if a court was required to construe exclusively domestic legislation.
- International treaties often fail to exhibit the precision of domestic legislation. This was sometimes the necessary price paid for multinational political comity. The lack of precision in treaties confirmed the need to adopt interpretative principles which were founded on the view that treaties could not be expected to be applied with taut logical precision.

This approach was followed in McDermott:[55]

Where it was said:

> … The following principles can be said to be applicable:
> - Regard should be had to the "four corners of the actual text". The text must be given primacy in the interpretation process. The ordinary meaning of the words used are presumed to be "the authentic representation of the parties' intentions"….
> - The courts must, however, in addition to having regard to the text, have regard as

53 *Applicant A* v *Minister for Immigration and Ethnic Affairs* (1997) 142 ALR 331.

54 *FC of T* v *Lamesa Holdings BV* 97 ATC 4752.

55 *McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation (2005) 142 FCR 134, at para 38.*

well to the context, object and purpose of the treaty provisions. The approach to interpretation involves a holistic approach.
- International agreements should be interpreted "liberally". Treaties often fail to demonstrate the precision of domestic legislation and should thus not be applied with "taut logical precision".

The full role of what Justice Davies refers to as "soft law" in Australian tax law remains to be explored.[56] Davies J includes in this category: "the *Model Convention* and its commentary, the OECD's 2010 *Transfer Pricing Guidelines* and the commentaries on the *MLI*."

In *Thiel*[57] the High Court accepted that the OECD Model Taxation Convention's official Commentaries are relevant to the interpretation of tax treaties based on the OECD Model. In *Thiel*, McHugh J (with whom the majority agreed in their joint judgment) approved recourse to the OECD Model and Commentaries. Dawson J also approved reference to the Model and Commentaries 'as a supplementary means of interpretation to which recourse may be had under article 32 of the Vienna Convention'. His Honour went further, however, by expressing the view that the OECD Model and Commentaries were also relevant under article 32 of the Vienna Convention, *as primary materials to be considered even when there was no ambiguity or the like.*

In addition, the Commentary has been referred to by the NSW Supreme Court in *Unisys Corporation Inc v Federal Commissioner of Taxation*,[58] as well as the Federal Court in *McDermott* (see below) in the interpretation of tax treaties.

The OECD Commentary was also referred to at paragraph 10 of the IBM decision:[59]

> There is no dispute as to the relevant principles to be applied in the interpretation of the Treaty and the primacy to be given to the text. Regard is to be had to the context, object and purpose of the Treaty provisions (McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation (2005) 142 FCR 134 at [38]).

McDermott considered the issue of whether a Singaporean company had a permanent establishment in Australia under article 4 of the Australia/ Singapore tax treaty. In doing so, reference was made to the OECD commentary. In particular to paragraph 37:

> Double tax treaties are bilateral treaties entered into between two states. As such they are to be interpreted in accordance with the requirements of the Vienna Convention on the Law of Treaties (23 May 1969, entered into force on 22 January 1974) … and in particular Article 31 of the Convention.

At paragraph 42:

> A useful starting point is the commentary to the draft OECD Model Convention for the Avoidance of Double Taxation with respect to Taxes on Income and on Capital, presented in the 1963 ("OECD Model Convention"), which has served as a model for

[56] Davies, Jennifer --- "Tax Stability" [2020] MelbULawRw 29; (2020) 44(1) Melbourne University Law Review 424 (austlii.edu.au).

[57] *Thiel* v *FC of T* 90 ATC 4717.

[58] Unisys Corporation v Federal Commissioner of Taxation [2002] NSWSC 1115.

[59] *International Business Machines Corporation* v *FC of T* 2011 ATC.

> many although not all of Australia's double tax agreements. Certainly, the commentary has been used to assist in the interpretation of double tax agreements based upon it…

It will be noted that article 32 only applies in certain circumstances, such as where a term's meaning is ambiguous after it has been interpreted in accordance with article 31. In *Thiel's case*, Dawson J, concluded (as McHugh J did) that the OECD Model Convention and Commentaries were a supplementary means of interpretation which could be used pursuant to article 32 of the Vienna Convention. However, his Honour also went further and said that:

> Article 31 of the Convention provides that a treaty is to be interpreted 'in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'. The context includes, in addition to the text, any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. For my part, I do not see why the OECD model convention and commentaries should not be regarded as having been made in connection with and accepted by the parties to a bilateral treaty subsequently concluded in accordance with the framework of the model.

Although he also referred to commentators who had doubted the applicability of article 31 to the interpretation of double tax agreements, Dawson J's comments appear to favour the wide use of the OECD Model Convention and Commentaries (via article 31) on the basis that they form part of the context in which an agreement is signed. This would permit the use of the Model and Commentaries even where article 32 does not apply.

It is clear, following the decision in the *Applicant A case*, that the records of a treaty's preparation are legitimate interpretative material under Australian law (per McHugh J 142 ALR 331 at p 355).

It remains to consider whether the OECD Model Convention and Commentaries contain expressions of the principle of good faith that would be imported into Australian tax law under the principles discussed above.

The concept is discussed in the Model Tax Convention on Income and on Capital, Condensed version, 21 November 2017 in a number of places.

At para 16.2 the role of article 31(1) of the Vienna Convention is acknowledged. This is consistent with Australia's existing law.

In paragraphs 57 to 65 of the Commentary on article 1 there is a discussion of the role of good faith in preventing treaty abuse. The Commentary recognises that if a treaty lacks an "anti-abuse" clause, a state may still take a view that abuse of the treaty is a breach of the requirement to interpret the treaty with recognition of the object and purpose of the treaty, interpreted in good faith. Australia has adopted the MLI principal purpose test in article 7 and noted that a number of its agreements already contain anti-abuse provisions. The effect of article 7(1) of the MLI is to prevent benefits where one of the principles purposes was the obtaining of the benefit. But this denial of benefit does not occur where "it is established that granting the benefit…would be in accordance with the object and purpose" of the agreement. The OECD Model Commentary, read with the MLI provision suggest that the object and purpose here must be determined "in good faith". Thus, perhaps importing the concept into this aspect of Australian treaty interpretation. Although it must

be remembered that Australian treaties are generally subject to the operation of our GAAR, which does not contain a good faith element.

The term is used again in the Commentary on article 7, at paragraph 59.1 to describe a quality of a type of taxpayer initiated adjustment to their tax position which justifies a corresponding adjustment to the tax position in another state. A similar situation is discussed in paragraph 61 of the article 9 Commentary.

These are the extent of the references to good faith in the Commentary. But, it seems clear that if there was an emerging international consensus on the role of the concept of good faith, and clarity around its operation, then embedding that into the MLI, or the OECD Model Agreement and Commentary would likely result in it being relevant to the Australian interpretation of its tax treaties.

3.2. Good faith in treaty interpretation

As has been discussed above in part 1.1 of this report, there are now a significant number of court decisions in Australia which acknowledge the full text of the Vienna Convention provisions requiring interpretation and performance of tax treaties in good faith. But, there are no decisions dealing with the question of what those expressions mean, and whether the requirement has been breached. Under Australian treaties terms are to be given their usual meaning in domestic law.

These decisions clearly acknowledge the permitted use of extraneous materials that are relevant to the interpretation of the treaty, and the use of an interpretation process that focusses not only on the literal meaning of the text but also on its context, taking a more liberal approach than might normally be adopted in interpreting a domestic statute.

A recent interesting example of this process arose in relation to the Indian/Australian tax treaty.[60] Although not involving an argument of good faith, the decision dealt with an argument that the ATO interpretation of a treaty was overly literal and ignored the "object and purpose" of the provision. The taxpayer argued that the ATO interpretation would result in a taxation outcome in Australia which was different to that arising in India. The court held that, if so, this was a result of differences in Australia's domestic law, not in treaty interpretation. The court accepted evidence of the position under Indian law. India went on to quickly negotiate a new treaty with Australia that reversed the effect of the court decision.

3.3. Potential treaty breaches of good faith

There are no situations where it is clear that domestic provisions have been entered into with the explicit purpose of avoiding or altering the operation of a tax treaty.

There have been three instances recently where the Australian Parliament has enacted provisions which raise the question of whether they are inconsistent with the object and purpose of tax treaties. Because of the discussion above, it is not clear that taxpayers would be successful in arguing that the circumstances support a conclusion that Australia has not performed a treaty in good faith, in the manner contemplated by article 26 of the Vienna

[60] Satyam Computer Services Limited v Commissioner of Taxation [23018] FCAFC 172.

Convention.

The first involved a personal tax measure which imposed a different effective rate of personal tax on individuals who were in Australia on a "working holiday" visa. The taxpayer argued that the anti-discrimination language in article 25 of the UK/Australian tax treaty operated to prevent Australia taxing her at the higher rate. The High Court held in her favour.[61]

The second involved the introduction of certain anti-avoidance provisions. These were the Multinational Anti-Avoidance Law[62] ("MAAL") and Diverted Profits Tax[63] ("DPT"). Both of these measures had the potential effect of imposing a new tax liability on certain corporations, including some who might be resident in jurisdictions Australia had a tax treaty with, and who would likely have faced a lesser Australian tax burden under the tax treaties alone.

Parliament, however, introduced the MAAL and DPT by inserting them into our GAAR, Part IVA. Australia's tax treaties expressly provide that they are "subject to" the operation of our GAAR. So, it is argued that the extension in scope of our GAAR is not inconsistent with the object and purpose of our tax treaties. The MAAL was introduced with the express aim of having foreign taxpayers create or increase their taxable presence in Australia. Most did so fairly simply, complying with the parliamentary intent and avoiding the operation of the MAAL. It is therefore unlikely the question, of whether the MAAL is an action which is inconsistent with a good faith execution of our tax treaty obligations, will ever arise.

The same question could, however, arise in relation to the operation of the DPT. The ATO has considered the application of the provisions to a significant number of taxpayers and the first such matter was filed recently in Australia's Federal Court.

The third set of provisions which raise concern are those in relation to intangibles and royalties announced by the Government in the Federal Budget of October 2022.[64] These provisions target payments, directly or indirectly, to low or no-tax jurisdictions, for intangibles. Although the details are still to be settled, it is possible that the provisions may impact certain payments to treaty residents, which would be royalties or payments for services. The normal treaty outcomes for such payments would be, respectively, withholding tax, or no withholding tax, subject to the operation of our anti-hybrid rules. The proposed consequence of the new measures is loss of Australian tax deductions for the amounts. The result may be an adverse tax outcome under domestic law that alters the outcome which would otherwise arise under a tax treaty.

The Australian Government generally refers to such provisions as "integrity measures". The expression has no accepted domestic or international definition and appears to be variously used for both measures designed to counter serious tax evasion[65] and measures addressing what one state considers "unfair" behaviour[66] or perhaps behaviour that is not in good faith.

61 FC of T v Addy [2021] HCA 34.

62 S. 177DA Income Tax Assessment Act 1936 (Cth).

63 S. 177J Income Tax Assessment Act 1936 (Cth).

64 Budget Paper No. 2, p. 15.

65 See for instance the ATO Tax Integrity Centre, to which individuals can report suspicions of illegal behavior.

66 See for example "Government election commitments: Multinational tax integrity and enhanced tax transparency"; Australian Treasury Consultation Paper August 2022.

Part Four: Remedies for a breach of good faith between contracting states

No such matters have been identified.


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