The Trust Rewrite and the Reform of the Foreign Source Income Attribution Rules

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Not surprisingly, the trust rewrite remains a long way away; see the speech given by the Assistant Treasurer, the Hon David Bradbury on 30 July 2012: (http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=speeches/2012/006.htm&pageID=005&min=djba&Year=&DocType=)

The same may be said of the revised foreign source income attribution rules: see Treasury's Forward Work Program as at August 2012, which refers to an Exposure Draft being released in mid-2013.

These are complex matters and, if recent history is any guide, we can be certain that whatever is passed by Parliament it is likely that the revised legislation will create as many problems as are solved.

Clearly, seeking to guess what will be put forward is pointless.

However, in preparing any legislation, the Parliamentary draftsman should consider a recent Canadian case; *The Queen v Sommerer* 2012 FCA 207 – (13 July 2012) – a decision of the Canadian Federal Court of Appeal.

The decision concerned an appeal by the Canada Revenue Agency (CRA) from the decision of Justice Campbell Miller in *Sommerer v The Queen* 2011 TCC 212, a decision I commented upon in my article at 2011 WTB 44 [1647]. The CRA appeal was dismissed.

The case at first instance raised issues relevant to Australia with respect to our transferor trust rules and the interpretation of double tax agreements.

The most interesting issue concerns the analysis of the relationship between an Austrian private foundation and property held by the foundation. Justice Miller rejected arguments that the foundation (which was established pursuant to and governed by Austrian law) was a company or a trust, but held that the relationship between the foundation and the property it held was a trust for the purposes of Canadian tax rules that have some similarity to our transferor trust rules.

Whilst the Federal Court of Appeal dismissed the appeal, it did so without having to decide whether Justice Miller was correct in his analysis because the Crown accepted that Justice Miller was correct in holding that the foundation held the property in trust.

Having said that it was not required to consider the correctness of that aspect of the decision at first instance, the Court made it plain that the judge was almost certainly wrong. Paragraphs [37] to [43] are worth reading to see how easily the judge and then the Crown fell in to error. For example, at [41] it was said that:

> "Assuming it is theoretically possible for an Austrian private foundation to hold its property in trust (that is, subject to conditions that are analogous to the legal and equitable obligations of a trustee in a common law jurisdiction), that possibility cannot be realized unless those

> conditions are formally established. Nothing in the constating documents of the Sommerer Private Foundation or the law of Austria, as reflected in the record of this case, supports the conclusion that the right of the Sommerer Private Foundation to deal with its property is constrained by any legal or equitable obligations analogous to those of a common law trustee."

The case still has resonance for Australia, in relation to trusts generally and the transferor trust and controlled foreign company rules more particularly and one would expect the Parliamentary draftsman to clarify the status of such entities as part of the both the trusts rewrite and the reform of the foreign source income attribution rules.

The case is also relevant to the interpretation of double tax agreements, particularly because it takes a view that conflicts with that taken by our Full Federal Court in *Russell v FCT* [2011] FCA 10. As the judgment neatly puts it at para [66]:

> "**The OECD model conventions, including the *Canada-Austria Income Tax Convention*, generally have two purposes – the avoidance of double taxation** and the prevention of fiscal evasion. Article XIII (5) of the *Canada-Austria Income Tax Convention* speaks only to the avoidance of double taxation. 'Double taxation' may mean either juridical double taxation (for example, imposing on a person Canadian and foreign tax on the same income) or economic double taxation (for example, imposing Canadian tax on a Canadian taxpayer for the attributed income of a foreign taxpayer, where the economic burden of foreign tax on that income is also borne indirectly by the Canadian taxpayer). **By definition, an attribution rule may be expected to result only in economic double taxation**." [Emphasis added]

In other words, because a double tax agreement is there to avoid double taxation, attribution rules, such as our transferor trust, controlled foreign company and *personal service income* regimes, are inconsistent with that principle and, as the Court then went on to say:

> "The Crown's argument requires the interpretation of a specific income tax convention to be approached on the basis of a premise that excludes, from the outset, the notion that the convention is not intended to avoid economic double taxation. That approach was rejected by Justice Miller, correctly in my view."

In *Russell*, the Federal Court took the opposite approach and essentially said that the issue is not economic double taxation, but juridical double taxation. The High Court refused an application by Mr Russell for special leave, and, in doing so, left a key element in the interpretation of double tax agreements unresolved.