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Tax Alert

Burton and Federal Commissioner of Taxation [2018] FCA 1857

The Full Federal Court has dismissed a taxpayers appeal to claim the full Foreign Income Tax Offset (FITO) in respect of a discount capital gain.

This decision should prompt taxpayers claiming FITO's on foreign capital gains to ensure that they are only claiming the FITO on the amount of the capital gain that is assessable in Australia, rather than the amount of capital gain assessable in a foreign jurisdiction.

Background of the case

Under s 770-10 of the ITAA 1997, a taxpayer is entitled to claim a FITO in relation to foreign income tax paid. Specifically, an amount of foreign income tax counts towards the FITO if it is paid in respect of an amount that is all or part of an amount included in the taxpayers assessable income.

It was on this basis that the taxpayer claimed an eligibility to a FITO equal to 100% of the US taxes paid on the gain which arose on the sale of US investments. However, the issue of contention was that only half of the capital gain was included in the taxpayers Australian assessable income. This is because the capital gain in question was eligible for the 50% Capital Gains Tax discount.

The Court considered the operation of Division 770 and in particular whether the amount of the foreign tax taken into account in working out the FITO is all the US income tax arising on the capital gain, or merely half of the tax on the basis that only half of the gain was included in assessable income and subject to Australian taxation.

The Full Court was also required to have regard to the impact of Article 22(2) of the USA - Australian Double Tax Agreement (DTA), which allows for taxes paid on sources of US income to be allowed as a credit against Australian tax payable in respect of the income.

Findings of the Court

On the basis that a FITO can only be used to offset assessable income for Australian income tax purposes, the Full Court concluded that the amount of US taxes paid in respect of the 50% of capital gains which was not included in the taxpayers Australian assessable income (i.e. the discount component) did not give rise to a FITO.

The judgement was consistent with the Federal Court's single judge decision in 2018 as well as the ATO view detailed in ATO ID 2010/175.

Key takeaways

- When investing overseas it is important to factor in the potential foreign tax leakage that can occur when paying foreign tax on capital gains eligible for the CGT discount
- This case is one of many changes to the interpretation of tax law relating to the domestic taxation of foreign investment. Accordingly investors need to be well advised from an income tax point of view when considering their foreign investment strategy
- Parties deriving foreign income need to be aware of both Australian domestic tax laws and international DTAs and their interactions.

Get in touch

Our experts can assist with further information.

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