



# Guide to foreign income tax offset rules 2010–11

Check if you can claim a foreign income tax offset (FITO), how to calculate the amount and what rules apply.

**Last updated** 4 May 2012

## Overview

If you have assessable income from overseas, you must declare it in your Australian income tax return. If you have paid foreign tax in another country, you may be entitled to an Australian foreign income tax offset, which provides relief from double taxation.

These rules apply for income years that start on or after 1 July 2008. Different rules apply for income periods up to 30 June 2008 (refer to [How to claim a foreign tax credit](#), NAT 2338).

You can claim a tax offset for the foreign tax you have paid on income, profits or gains (including gains of a capital nature), that are included in your Australian assessable income. In some circumstances, the offset is subject to a limit.

To be entitled to a foreign income tax offset:

- you must have **actually paid**, or be deemed to have paid, an amount of **foreign income tax**
- the income or gain on which you paid foreign income tax must be **included in your assessable income** for Australian income tax purposes.

Differences between the Australian and foreign tax systems may lead to you paying foreign income tax in a different income year from that in which the income or gain is included in your assessable income for

Australian income tax purposes. You could have paid the foreign tax in an earlier or later income year. However, the offset can only be claimed after the foreign tax is paid.

If you paid foreign income tax after the year in which the related income or gains have been included in your Australian tax return, you can claim the offset by requesting an **amended assessment** for that year. You have up to four years to request an amendment to your assessment from the date you paid the foreign income tax. You should also request an amendment if there is an increase or reduction in the amount of foreign income tax you paid that counts towards the offset.

The foreign income tax offset applies to **foreign income tax** imposed on all forms of income, profits and gains, (including gains of a capital nature) and to all taxpayers, whether individuals or other entity types.

Note that:

- while the offset mainly applies to Australian resident taxpayers, in the limited circumstances where the foreign income of a **foreign person or non-resident** is taxed as assessable income in Australia, they may be able to claim the offset
- in very limited circumstances, foreign tax imposed on **Australian source income** may count towards a foreign income tax offset.

## **Calculating the offset**

You claim the **foreign income tax offset** in your income tax return.

If claiming an offset of \$1,000 or less, you only need to record the actual amount of foreign income tax paid on your assessable income (up to \$1,000).

If claiming a foreign income tax offset of more than \$1,000, you will first need to work out your **foreign income tax offset limit**.

Before you calculate your net income, you must convert all foreign income deductions and foreign tax paid to Australian dollars, refer to **Converting foreign income to Australian dollars**.

All types of income are treated the same for the purposes of working out the foreign income tax offset.

## **Record keeping**

To claim a foreign income tax offset, you will need to keep adequate records of your foreign income and tax paid.

## Transitional rules

Any excess amount of foreign tax that cannot be recouped as an offset in an income year cannot be carried forward (unlike the previous system of foreign tax credits). However, transitional rules enable a taxpayer with pre-existing excess foreign tax credits to use some of these amounts in certain circumstances.

## Attributed foreign income

If you have interests in a foreign entity, your share of its income may be attributed to you for income tax purposes, even if the income has not yet been distributed.

If you have attributed foreign income, you may be entitled to a foreign income tax offset for foreign income tax, income tax, or withholding tax paid by a controlled foreign company (CFC) in which you hold an interest.

For more information on the tax treatment of attributed income, refer to the publication Attributed foreign income

**When a foreign income tax offset applies** >

**Calculating and claiming your foreign income tax offset** >

**Record keeping** >

**Transitional rules for using excess foreign tax credits** >

**Attributed foreign income**



**Special circumstances**



QC 28013

## When a foreign income tax offset applies

Last updated 4 May 2012

To be entitled to a foreign income tax offset:

- the foreign tax must be foreign income tax
- you must have actually paid, or be deemed to have paid, the foreign income tax
- the income or gain on which you paid foreign income tax must be included in your assessable income in Australia.

The offset is available in the income year in which the income or gain (on which the foreign income tax has been paid) forms part of your assessable income in Australia.

**The foreign tax must be foreign income tax**



**You must have actually paid, or be deemed to have paid, the foreign income tax**



## Foreign income tax must have been paid on assessable income



QC 28013

# The foreign tax must be foreign income tax

Last updated 4 May 2012

To count towards a tax offset, foreign income tax must be imposed under a law other than an Australian law and be:

- a tax on income
- a tax on profits or gains, whether of an income or capital nature, or
- any other tax that is subject to an agreement covered by the *International Tax Agreements Act 1953* (Agreements Act).

The foreign income tax includes taxes similar to Australian withholding tax that is imposed in place of a tax on the net amount of income.

(For examples, refer to [Taxes imposed by Australia's major trading partners for which a foreign income tax offset is available](#).)

The foreign income tax must be correctly imposed under the relevant foreign law and in accordance with any tax treaty the country has with Australia. For example, if country A is limited under a tax treaty to taxing at a rate of up to 10% interest derived in that country by an Australian resident but country A imposes a domestic tax rate of 25% for interest derived by all foreign residents, only 10% of the tax counts towards the tax offset. The taxpayer would need to seek a refund of the balance (that is, 15%) from country A's tax authority.

The foreign income tax may be imposed at a supra-national, national, state, provincial, local or municipal level. An example of a supra-national tax is that imposed by the European Union on pensions paid to its former employees.

## Foreign taxes not included

The following types of foreign tax do not count towards a foreign income tax offset:

- inheritance taxes
- annual wealth taxes
- net worth taxes
- taxes based on production
- credit absorption taxes, that is, a tax that is payable only because the taxpayer or another entity is entitled to foreign income tax offset in Australia
- unitary taxes, that is, a tax on income, profits or gains of a company derived from sources within the country where the tax is imposed that takes into account income, losses, outgoings or assets of the company (or of an associated company) derived, incurred or situated outside that country, except where the tax only takes those factors into account
  - if such an associated company is a resident of the foreign country for the purposes of the law of the foreign country, or
  - for the purposes of granting any form of relief in relation to tax imposed on dividends received by one company from another company.

Penalties, fines and interest do not qualify as foreign income tax.

If you are unsure about whether a specific foreign tax is a foreign income tax, you can write to us and request a private binding ruling.

## Taxes imposed by Australia's major trading partners for which a foreign income tax offset is available

A foreign income tax offset may be available for the foreign taxes listed below. This list is not exhaustive nor, except for India, does it include local or state taxes.

### Argentina

Income tax (Impuesto a las ganancias)

### **Canada**

Income taxes imposed by the Government of Canada under the Income Tax Act.

### **China**

Income tax

### **France**

Income tax and corporation tax, including any related withholding tax, prepayment (precompte) or advance payment

### **Germany**

Income tax (einkommensteuer)

Corporation tax (korperschaftsteuer)

### **India**

Income tax, including any surcharge

Capital gains tax

Non-resident withholding tax

State government imposed taxes on various agriculture incomes

### **Italy**

Individual income tax (l'imposta sul reddito delle persone fisiche)

Corporate income tax (l'imposta sul reddito delle societ , formerly l'imposta sul reddito delle persone giuridiche)

### **Japan**

Income tax

Corporation tax

### **New Zealand**

Income tax

Non-resident withholding tax

Tax on profits from property sales

## **Singapore**

Income tax

## **South Africa**

Normal tax

Secondary tax on companies (due to be replaced with a withholding tax on dividends)

Withholding tax on royalties

## **South Korea**

Income tax

Corporations tax

Inhabitant tax

## **United Kingdom**

Income tax

Capital gains tax

Corporations tax

## **United States**

Federal income taxes imposed by the Internal Revenue Code

QC 28013

# **You must have actually paid, or be deemed to have paid, the foreign income tax**

**Last updated** 4 May 2012

To count towards a tax offset, the foreign income tax must have actually been paid by the taxpayer or be deemed to have been paid by them. It is not enough that the tax is payable.

If the taxpayer is entitled to a refund of the foreign income tax, or if another benefit worked out by reference to the amount of the foreign income tax (other than a reduction in the amount of the foreign tax) is received as a result of a tax payment, the tax is not considered to have been paid.

It is not necessary for you to have paid the foreign income tax in the same income year in which the income or gain on which the tax has been paid is included in your assessable income. The tax could be paid before or after the income year in which you derive the assessable income. However, the offset can only arise when the foreign income tax is paid, and it is applied to the income year in which the relevant income or gain is included in your assessable income, refer to Special amendment rules for foreign income tax offsets.

### **Example**

A resident taxpayer holds a qualifying security (Division 16E of Part III of the ITAA 1936) for the income years ending 30 June 2010 through to 30 June 2015. The taxpayer pays foreign income tax on the income from the security in the income year ending 30 June 2015.

Under Australian tax law, the taxpayer includes amounts in their assessable income for the 2010-15 income years on an accruals basis. Only when the taxpayer pays the foreign income tax are they eligible for a tax offset. However, the offset arises in each of the income years in which the taxpayer's assessable income includes an amount on which foreign income tax is later paid.

Once the foreign tax is paid, the taxpayer is required to apportion the paid foreign income tax among the income years in which the amount is included in their assessable income. As a result, once they have paid the foreign income tax they will need to lodge amended assessments for the earlier income years in order to claim an offset for the foreign income tax paid.

## **The tax may have been effectively paid by someone else**

A taxpayer is treated as having paid foreign income tax on all or part of their assessable income where the tax has been paid in respect of that income by someone else on their behalf under an arrangement with the taxpayer or under the law relating to that tax.

This tax-paid deeming rule ensures that the right taxpayer obtains the tax offset. It applies in situations where the foreign income tax has actually been paid by someone else in a representative capacity for the taxpayer, with the latter bearing the economic burden of the tax. Specifically, it applies where foreign income tax has been paid by:

- deduction or withholding
- a trust in which the taxpayer is a beneficiary
- a partnership in which the taxpayer is a partner, or
- the taxpayer's spouse.

### **Example**

Tim, an Australian resident, derives interest income of \$1,000 from a foreign country. As that country's laws require the payer of the interest to withhold tax at a rate of 10%, Tim receives \$900 (that is, \$1,000 less tax of \$100). Although he has not directly paid the foreign income tax, Tim is taken to have paid that tax because it was paid under the law relating to the foreign income tax. Tim includes \$1,000 in his Australian assessable income and claims a tax offset of \$100.

### **Example**

A partnership of two Australian partners with equal interests in all income of the partnership derives net income of \$1,000 on which \$100 of foreign income tax is paid.

Each partner includes \$500 in their assessable income, being their share of the net income of the partnership. They will both be entitled to a tax offset to the extent that foreign income tax is paid on the amount that is part of their assessable income.

The foreign income tax paid is apportioned according to each partner's share of the net income of the partnership included in their assessable income. Therefore, each claims an offset for \$50 of foreign income tax, as this is the proportionate amount of foreign income tax they are taken to have paid on the amount included in their assessable income (that is,  $(500/1,000) \times \$100$ ).

### **Example**

Married couple Arthur and Lucy, both Australian residents, derive net rental income from a foreign country. Under that country's laws, joint filing of tax returns is allowed. Consequently, the net

rental income is included in their jointly-filed return and income tax is paid jointly on that income. However, under Australian tax law, each person must show their share of the net rental income in their own tax return. Although the foreign income tax has been jointly paid under the laws of the foreign country, Arthur and Lucy are each deemed to have paid their relevant share of the foreign income tax that has been paid jointly

### **Example**

The S trust estate derives rental income from commercial property investments in a foreign country, on which the trustee pays foreign income tax. Samantha, an Australian resident, is the sole beneficiary of the S trust estate and is presently entitled to all of its income. As such, she is assessed on the whole of the trust's net income. Although Samantha hasn't directly paid the foreign income tax, she is deemed to have paid it.

## **Special tax-paid deeming rules for beneficiaries of trust estates**

A specific rule deems a taxpayer to have paid the relevant foreign income tax where they are presently entitled to a share of the trust income that can be directly or indirectly attributed to income received by the trust on which foreign income tax has already been paid by an entity other than the trust itself. This tax-paid deeming rule applies where:

- section 6B of the ITAA 1936 treats an amount of assessable income as being attributable to another amount of income having a particular character or source
- foreign income tax has been paid in respect of the other amount of income
- the assessable income attributed under section 6B is less than it would have been if the foreign income tax had not been paid.

These rules ensure that a beneficiary of a trust can be deemed to have paid the relevant tax on its share of trust income that is attributable to income that flows through the trust (or chain of trusts) on which foreign income tax is paid by another entity.

The amount of the foreign income tax that is taken to have been paid by the taxpayer is the amount by which the income included in their

assessable income has been reduced because of the payment of the foreign income tax.

### **Example**

Holly is the sole beneficiary of the B trust estate and is presently entitled to all of its income. B derives foreign dividend income of \$100,000 on which foreign dividend withholding tax of \$10,000 is paid. B subsequently distributes all its income to Holly (that is, \$90,000 net of withholding). As Holly's share of the trust income is attributable to the dividend income received by B (by virtue of section 6B of the ITAA 1936), she can treat the withholding tax paid on the dividend as having been paid by her. Holly also includes \$100,000 in her assessable income.

### **Example**

Tim, an Australian resident, is the only unit holder in Managed Fund A, which in turn is the only unit holder in Managed Fund B, which has an interest in a US company. Both managed funds are unit trusts. The US company pays a dividend of \$1,000 to Managed Fund B, on which withholding tax of \$150 is payable, making the net distribution \$850. This amount of \$850 flows through both managed funds to Tim. The terms and conditions of the two managed funds are such that Tim is the beneficial owner of the shares on which the dividend was paid.

Tim grosses up the \$850 by the amount of the \$150 withholding tax and includes \$1,000 in his assessable income. As Tim's share of the trust income is attributable to the dividend income received by Managed Fund B, he can treat the withholding tax paid on the dividend as having been paid by him (even though the amount included in his assessable income is attributable to the dividend income that has flowed through a chain of trusts).

## **When foreign income tax is not treated as paid by the taxpayer**

A taxpayer is not entitled to a tax offset for foreign income tax to the extent they, or any other entity, are entitled to:

- a refund of the foreign tax, or
- any other benefit worked out by reference to the amount of foreign income tax (other than a reduction in the amount of the foreign

income tax).

The entitlement to a benefit may arise from the exploitation of arbitrage opportunities resulting from mismatches in debt and equity classifications and the different status granted to foreign hybrid entities (for example, where an enhanced yield is obtained by a taxpayer entering into a structured financing arrangement).

However, the taxpayer may still be entitled to a tax offset where the only benefit is a reduction in the tax liability of the taxpayer or another entity, such as that provided by an imputation credit, a rebate of tax or a similar type of concession, provided that the concession does not result in a refund to the taxpayer or other entity.

### **Example**

In a foreign country, Austco derives net rental income on which income tax of \$50,000 is paid in that country.

Austco later finds out that it is entitled to a special concession in the foreign country, under which the \$50,000 is fully refunded. Accordingly, Austco is taken to not have paid foreign income tax on that income.

QC 28013

## **Foreign income tax must have been paid on assessable income**

**Last updated** 4 May 2012

To count towards a tax offset, the foreign income tax must have been paid on income, profits or gains that are included in your assessable income.

Where, for example, a person receives a dividend from a foreign company, the foreign income tax on the underlying company profits (the source of the dividend) is not paid in respect of the shareholder's dividend income. Similarly, a person receiving a pension from a foreign superannuation fund has not paid the foreign income tax levied on the income of the superannuation fund. In both of these cases the tax that

has been paid relates to the income or gains of the other entity, which is being taxed in its own right.

However, where an entity has been formed under a foreign country's laws that treat the entity as 'fiscally transparent' (that is, its profits are taxed in the hands of its members), income tax imposed by that country on a distribution to an Australian member may be counted towards their tax offset. This is the case even where the entity is treated as a company for Australian tax purposes and the distribution is characterised as a dividend.

This situation could arise, for example, where an Australian taxpayer is a member of a US limited liability company (LLC) that is treated as fiscally transparent under US tax law, but under Australian tax law the Australian member of the US LLC does not elect to treat the LLC as a foreign hybrid.

### **Example**

Aust Super Fund is a trustee of a complying superannuation entity and an Australian resident taxpayer with a 2% interest in a US limited partnership (a foreign investment fund interest).

Under US tax law, the US limited partnership is treated as fiscally transparent; that is, it is not taxed on its profits but rather tax is borne by the partners on their share of the partnership distribution.

Aust Super Fund's share of the US limited partnership's profits is \$1 million, on which tax of \$350,000 is withheld by the partnership (under US tax law). The tax is imposed in accordance with the Australia-US tax treaty.

Under Australian tax law, Aust Super Fund has not made an election under former subsection 485AA(1) of the ITAA 1936 or paragraph 830-10(2)(b) of the *Income Tax Assessment Act 1997* (ITAA 1997) to treat the US limited partnership as a foreign hybrid limited partnership. Accordingly, the US limited partnership is taxed under Australian tax law as a company in accordance with Division 5A of Part III of the ITAA 1936.

The net amount of \$650,000 received by Aust Super Fund is characterised as a dividend for Australian tax law purposes and is included in its assessable income. Although Aust Super Fund has not paid the US tax of \$350,000 personally (as the US limited partnership has been taxed on the distribution on a withholding

basis), it will be treated as having paid it, as the US tax is imposed on the distribution rather than on the underlying profits of the US limited partnership out of which the distribution is made.

Aust Super Fund is also required to gross-up its assessable income by the \$350,000 of foreign income tax that it is deemed to have paid in relation to the dividend distribution.

## Foreign income tax paid on part of an amount included in assessable income

In some situations, only part of an amount on which foreign tax has been paid is included in Australian assessable income. In this situation, only that proportion of the foreign income tax which equates to the proportion of foreign income included would be available as a tax offset.

In other situations, the foreign income tax paid relates to only part of an amount included in the taxpayer's assessable income. This typically applies where a foreign source gain on which foreign income tax has been paid is part of a net amount included in a taxpayer's assessable income. In these situations, the foreign income tax counts towards the tax offset only to the extent that it is paid in respect of that part of the amount that is included in the taxpayer's assessable income.

This may be relevant where, for example, a taxpayer has both a capital gain and a capital loss and only the net amount is included in their assessable income. Under the capital gains tax rules, a taxpayer can choose the order in which capital losses are offset against gains. In particular, a taxpayer can choose to offset capital losses (whether current year or prior-year unapplied net capital losses) firstly against domestic capital gains or foreign gains on which no foreign tax has been paid. Such an ordering of the losses maximises the foreign source capital gain component of a net capital gain on which foreign income tax has been paid.

### Example

Company C derives the following capital gains and losses on disposals of assets during the year:

Domestic capital gain on land:	\$100,000
--------------------------------	-----------

Foreign capital gain on asset B:	\$50,000 (no foreign tax paid)
Foreign capital gain on asset C:	\$20,000 (on which foreign income tax of \$2,000 is paid)
Domestic capital loss on asset A:	(\$160,000)
Net capital gain:	\$10,000

As the foreign income tax offset can only apply where foreign income tax has been paid on an amount included in the taxpayer assessable income, company C chooses to offset its domestic capital loss on asset A of \$160,000 first against the domestic gain on land of \$100,000, then \$50,000 against the foreign capital gain on asset B on which no foreign income tax has been paid and the balance of \$10,000 against the foreign capital gain on asset C. Therefore, the net capital gain of \$10,000 relates to the foreign capital gain on asset C. As this is the amount included in assessable income on which foreign income tax has been paid, the proportionate share of tax paid of \$1,000 (that is,  $(10,000 / 20,000) \times 2,000$ ) counts towards company C's foreign income tax offset.

Similarly, if only part of a foreign capital gain is assessable in Australia (for example the gain is subject to the discount capital gains concessions in Division 115 of the ITAA 1997) the foreign tax paid on the gain must be apportioned accordingly.

Where foreign income tax is paid on a foreign source gain but the taxpayer is in an overall capital loss situation for the income year because of other capital losses, none of the foreign income tax paid counts towards a tax offset because the gain is not included in the taxpayer's assessable income.

### **Example**

On the sale of an asset, an Australian-resident taxpayer makes a foreign source capital gain of \$10,000, on which foreign income tax of \$2,000 has been paid.

The taxpayer also realises a capital loss of \$10,000 on the disposal of an Australian asset.

The loss of \$10,000 is offset against the foreign gain of \$10,000, which results in no net capital gain being included in the taxpayer's assessable income. As their assessable income does not include an amount on which foreign income tax has been paid, the taxpayer is not eligible for a foreign income tax offset for the foreign income tax paid on the foreign source capital gain.

The same principle applies where foreign income tax has been paid on an amount that forms part of a partnership or trust's assessable income, but because there is an overall partnership or trust loss for the year (rather than there being net income), the relevant foreign income is not included in the partner or beneficiary's assessable income.

## **Foreign income tax and deferred non-commercial business losses**

Foreign income tax paid on foreign source business income counts towards a tax offset regardless of whether there is a net business loss from the activity because all foreign business income forms part of the taxpayer's assessable income. In this respect, the treatment of business losses differs from the treatment of a net capital gain where only the net amount is included in assessable income.

However when calculating the offset limit (see below) similar principles apply for deferred business losses as apply for capital losses.

If a taxpayer has both Australian and foreign source income and prior year deferred losses, from the same or similar business activity, they can choose whether the losses are taken to be a deduction against the business income from the Australian source or the foreign source. For example, they can choose to offset deferred losses firstly against Australian business income, until the Australian business income is reduced to nil, and then against the foreign business income.

Offsetting the losses in this way maximises the foreign source component of the net business income which will maximise any claim for the foreign income tax offset.

## **Foreign income tax on exempt or non-assessable non-exempt income**

Foreign income tax paid on amounts that are exempt or non-assessable non-exempt (NANE) income in Australia does not count

towards a tax offset (except where the taxpayer derives NANE income under section 23AI or 23AK of the ITAA 1936).

### **Example**

Austco, an Australian-resident company, wholly owns Foreignco, which pays a dividend of \$10 million to Austco out of which foreign income tax of \$2 million is paid. The dividend is not paid out of previously attributed income. As the dividend is NANE income of Austco under section 23AJ of the ITAA 1936, the foreign income tax paid of \$2 million does not count towards Austco's tax offset.

## **Foreign income must be grossed up**

Where you have paid foreign income tax on an amount that forms part of your assessable income, you must include the gross amount (including any tax paid by you) in your assessable income on your tax return.

### **Example**

An Australian-resident taxpayer invests directly in a foreign company, which pays a dividend of \$100 from which it deducts \$15 withholding tax.

The taxpayer must gross-up the net distribution of \$85, adding the foreign income tax withheld of \$15, to show \$100 in their tax return. This is the amount on which the taxpayer is assessed for income tax purposes.

## **Attributed income**

A special grossing-up rule applies to attributable taxpayers that are deemed to have paid foreign income tax that is actually paid by their controlled foreign company (CFC). In respect of the attributed income of a CFC, a notional deduction is allowed for any foreign income tax, income tax or withholding tax it pays. The attributable taxpayer includes in their assessable income this net amount multiplied by their attribution percentage. Thus, the attributable taxpayer is effectively entitled to a deduction for foreign income tax, income tax or withholding tax paid on an amount included in the CFC's attributed income.

Where the attributable taxpayer is deemed to have paid the foreign income tax that is actually paid by the CFC and counts that towards

their tax offset, they have to gross-up their attributed income by the amount of foreign income tax (including withholding tax) they are deemed to have paid.

Note that there are special rules for claiming an offset for foreign income tax paid on attributed income.

### **Example**

A co is an Australian-resident company with a 100% interest in Y co, a CFC. Y co works out its notional assessable income as \$1.2 million and claims a notional allowable deduction of \$200,000 for foreign tax paid by it, thereby resulting in attributed income of \$1 million. A co includes the amount of \$1 million in its assessable income under section 456, as its attribution percentage is 100%. A co is also required to treat the foreign income tax paid by Y co as having been paid by it under the special tax-paid deeming rules that apply to attributable taxpayers. Accordingly, A co is required to gross-up its attributed income of \$1m by the \$200,000 of foreign income tax that it is deemed to have paid.

QC 28013

## **Calculating and claiming your foreign income tax offset**

**Last updated** 4 May 2012

You claim the foreign income tax offset in your income tax return.

Before you calculate your net income, you must convert all foreign income deductions and foreign tax paid to Australian dollars, refer to [Converting foreign income to Australian dollars](#).

To claim a foreign income tax offset of up to \$1,000, you only need to record the actual amount of foreign income tax paid on your assessable income (up to \$1,000).

If you are claiming a foreign income tax offset of more than \$1,000, you have to work out your **foreign income tax offset limit**. This may result in your tax offset being reduced to the limit. Any foreign income tax paid

in excess of the limit is not available to be carried forward to a later income year and cannot be refunded to you.

If you paid foreign income tax after the year in which the related income or gains have been included in your assessable income, you may amend your assessment for that year to claim the offset.

The foreign income tax offset reduces your income tax payable (including Medicare levy and Medicare levy surcharge). Under the tax offset ordering rules, it is applied after all other non-refundable tax and non-transferable offsets. Once your tax payable, Medicare levy and Medicare levy surcharge has been reduced to nil, any unused foreign income tax offset is not refunded to you, nor can it be carried forward to later income years.

## Calculating your offset limit



## Special amendment rules for foreign income tax offsets



QC 28013

# Calculating your offset limit

**Last updated** 4 May 2012

If you are claiming a foreign income tax offset of more than \$1,000, you will first need to work out your foreign income tax offset limit. This amount is based on a comparison between your tax liability and the tax liability you would have if certain foreign-taxed and foreign-sourced income and related deductions were disregarded.

## Step 1

Work out the income tax payable by you (including Medicare levy and Medicare levy surcharge), for the relevant income year excluding penalties and interest and disregarding any tax offsets.

## Step 2

Work out the income tax that would be payable by you (including Medicare levy and Medicare levy surcharge), excluding penalties and interest and disregarding any tax offsets, if the following assumptions were made:

- your assessable income did not include
  - any amount included in your assessable income on which foreign income tax has been paid that counts towards your foreign income tax offset
  - any other income or gains from a non-Australian source
- you were not entitled to the following (where such deductions are actually allowable)
  - debt deductions attributable to your overseas permanent establishment
  - any other deductions (other than debt deductions) that are reasonably related to any amount covered by the first dot point above
  - an amount of the foreign loss component of one or more tax losses deducted in the income year.

For the purpose of this step, where deductions relate exclusively to the disregarded income amounts, you should assume that you were not entitled to the deductions.

The meaning of 'reasonably related to' is broad. It includes a relationship that may either be direct or indirect, provided that the relationship consists of a real connection; however a merely remote relationship is insufficient. Whether a deduction reasonably relates to the disregarded assessable income amounts will be a question of fact depending on the circumstances of the taxpayer.

Where deductions relate to both disregarded income amounts and other assessable income (as would typically be the case with head office and general administration expenses), you will need to apportion the deductions on a reasonable basis.

Allowable deductions for items such as gifts, contributions, superannuation and tax agent's fees are not considered to be reasonably related to any amount on which foreign income tax has been paid or other non-Australian source income.

Where foreign income is subject to averaging (for example where the special professional income rules or primary production income rules apply) only the foreign income for the current year is excluded at this step. It is not necessary to separate the Australian and foreign amounts for prior years.

### Step 3

Take away the result of step 2 from step 1. If the result is greater than \$1,000, this is your offset limit.

#### Example

Anna, an Australian-resident taxpayer, has income and expenses and pays foreign income tax for the income year as follows:

	(A\$)
Employment income from Australia	22,000
Employment income from United States	6,000
Employment income from United Kingdom	4,000
Rental income from United Kingdom	1,000
Dividend income from United Kingdom	600
Interest income from United Kingdom	400
<b>Total assessable income</b>	<b>34,000</b>

Expenses incurred in deriving employment income from Australia	2,000
--	-------

Expenses incurred in deriving employment income from United States	450
Expenses incurred in deriving rental income from United Kingdom	250
Interest (debt deduction) incurred in deriving dividend income from United Kingdom	70
Expenses (debt deduction) incurred in deriving interest income from United Kingdom	30
Gift to deductible gift recipient	70
<b>Total allowable deductions</b>	<b>2,870</b>

<b>Taxable income</b>	<b>31,130</b>
-----------------------	---------------

<b>Foreign income tax paid:</b>	
Employment income from United States	1,800
Dividend income from United Kingdom	60
Interest income from United Kingdom	40
Rental income from United Kingdom	300
<b>Total foreign income tax paid</b>	<b>2,200</b>

Anna calculates her foreign income tax offset limit as follows:

**Step 1: Work out the tax payable on her taxable income**

Tax on \$31,130: \$4,236.45 (includes Medicare levy)

**Step 2: Work out the tax that would be payable if:**

(a) Her assessable income does not include any amount of foreign income in respect of which foreign income tax has been paid, provided that the tax counts towards her foreign income tax offset. Other non-Australian source amounts are also disregarded as follows:

	<b>(A\$)</b>
Employment income from United States	6,000
Employment income from United Kingdom	4,000
Rental income from United Kingdom	1,000
Dividend income from United Kingdom	600
Interest income from United Kingdom	400
<b>Total</b>	<b>12,000</b>

Although Anna has not paid foreign income tax on her employment income of \$4,000 from the United Kingdom, it is subtracted from her assessable income at this step as it is from a non-Australian source.

(b) Certain expenses are disregarded. These are any expenses that relate to amounts included in her assessable income on which foreign income tax has been paid, provided that tax counts towards her foreign income tax offset, or expenses relating to other non-Australian amounts that are part of her assessable income (excluding debt deductions).

Expenses	<b>(A\$)</b>
Expenses incurred in deriving employment income from United States	450
Expenses incurred in deriving rental income from United Kingdom	250
<b>Total expenses</b>	<b>700</b>

**Note:** that the debt deductions of \$100 that relate to the United Kingdom dividend and interest income are not disregarded as Anna does not have an overseas permanent establishment. Nor is the deduction of \$70 for the gift to a deductible gift recipient disregarded, as it does not reasonably relate to the excluded assessable income amounts at step 2(a).

### Calculation

Taxable income (disregarding step 2(a) amount):	\$22,000
Less allowable deduction (disregarding step 2(b) amount):	2,170
Taxable income under step 2 assumptions:	19,830

Tax on \$19,830: \$2,208.70 (includes Medicare levy)

### Step 3: Take away the result of step 2 from step 1

$$\$4,236.45 - \$2,208.70 = \$2,027.75$$

This is Anna's foreign income tax offset limit. Although she has paid foreign income tax of \$2,200, her foreign income tax offset is limited to \$2,027.75.

The difference between the foreign income tax that Anna has paid and the offset limit cannot be refunded or carried forward to a future income year. The foreign income tax offset limit calculated reduces your income tax payable, Medicare levy and Medicare levy surcharge.

## Deferred non-commercial business losses

If a current year foreign business loss is required to be deferred because of the non-commercial business loss rules, then step 2 in the foreign income tax offset limit calculation needs to be adjusted for the amount of any foreign business loss that is deferred. This is done before working out the amount of foreign income and expenses to be disregarded.

Note that to be eligible for the foreign income tax offset where you have a net foreign business loss there must be other foreign income

included in assessable income on which foreign income tax has been paid.

To work out the amount of foreign income and expenses to disregard at step 2, add back the foreign component of the current year deferred non-commercial business loss to the net foreign income amount and then subtract the net foreign income from taxable income.

If the net foreign amount is zero or negative after adding back the deferred foreign loss component then the foreign income tax offset amount will be the lower of the foreign income tax paid or the default foreign income tax offset limit amount of \$1,000.

### Example

Assume for the year ended 30 June 2011, Karen has an Australian salary of \$60,000 and a \$7,000 business loss made up of \$4,000 Australian loss and \$3,000 foreign loss and the current year loss is required to be deferred as it does not meet one of the four non-commercial loss tests. There is also \$20,000 of other foreign income on which foreign income tax of \$2,000 has been paid. The net foreign income is  $(\$20,000 - \$3,000) = \$17,000$ .

Add the foreign component of deferred loss back to the net foreign income and then **subtract** the adjusted net foreign income amount from taxable income.

Salary		60,000
Australian component of net business loss		(4,000)
Foreign component of net business loss	(3,000)	
Other foreign income (tax paid \$2,000)	20,000	
Net foreign income		17,000
Deferred loss added back		7,000
Taxable income		80,000

Net foreign income after adding back foreign component of deferred loss	(17,000 + 3000)	20,000
Taxable income disregarding any foreign income and expenses	(80,000 - 20,000)	60,000

**Step 1: Work out the tax payable on her taxable income**

Tax on \$80,000: \$18,750 (includes Medicare levy)

**Step 2: Work out the tax that would be payable based on the stated assumptions**

Taxable income under step 2 assumptions: \$60,000

Tax on \$60,000: \$12,450 (includes Medicare levy)

**Step 3: Take away the result of step 2 from step 1**

$$\$18,750 - \$12,450 = \$6,300$$

In this situation, all the foreign income tax of \$2,000 would be available as a tax offset as the foreign income tax offset limit exceeds the foreign income tax paid.

QC 28013

## Special amendment rules for foreign income tax offsets

Last updated 4 May 2012

Differences between the Australian and foreign tax systems may lead to you paying foreign income tax in a different income year to that in which you include the related income or gains in your Australian assessable income.

If you paid foreign income tax after the year in which the related income or gains have been included in your Australian assessable income, you can amend your assessment for that year to claim the

offset. You can lodge an amended assessment within four years of paying foreign income tax that counts towards your tax offset. This time period applies irrespective of when the income or gains were included in your Australian assessable income. In this situation, the foreign income tax must be paid after you have lodged your Australian income tax return for the relevant year.

The four-year amendment period also applies where there has been an increase or decrease in the amount of foreign income tax paid that counts towards your tax offset. The special amendment rules also apply to amendments initiated by the Australian Taxation Office (ATO), which may have the effect of extending the normal period of review. In these cases, the four year period starts when the increase in foreign income tax has been paid or when the foreign income tax has been reduced (for example by way of a refund).

The special amendment rules apply only where you have paid foreign income tax or there has been an increase or decrease in the tax paid that counts towards your tax offset. In all other circumstances, the normal amendment rules apply.

For example, where an audit by the ATO has detected an incorrect calculation of the foreign income tax offset limit affecting the amount of the foreign income tax offset previously claimed, we can only amend a taxpayer's assessment within the usual time limits set out in section 170 of the ITAA 1936.

### **Example**

Aust Co, an Australian resident company, sells a rental property in the US, making a gain in the 2010-11 income year. The gain is taxed in the US and Australia. Aust Co pays the US income tax before lodging its Australian return for the 2010-11 income year.

In February 2012, Aust Co receives a refund of part of the US tax paid because of the favourable outcome of a dispute over the calculation of the gain. An amendment to Aust Co's 2010-12 assessment to reflect the reduction in US tax paid, and consequently its foreign income tax offset, can be made on or before February 2016.

# Record keeping

Last updated 4 May 2012

As with your tax affairs generally, you need **written evidence** to support a claim for a foreign income tax offset, and you must **keep such evidence** so you can provide it to the ATO on request. If we require information that is held overseas we will advise you in writing, giving you time to provide it.

If you use a tax agent to prepare and lodge your return, you need to advise them if you have earned any assessable income on which foreign income tax has been paid and provide them with evidence of payment of the tax.

**Written evidence**



**You must keep the evidence**



**We may ask you to get information from overseas**



QC 28013

## Written evidence

Last updated 4 May 2012

Written evidence of foreign tax paid should include the following details:

- the amount of foreign income or gains in the foreign currency

- the foreign tax year in which the income or gains were derived
- the nature and amount of foreign tax levied on the foreign income or gains
- the date on which the foreign tax was paid
- whether the tax paid represents an advance, instalment, or final foreign tax payment in relation to the relevant foreign income or gains.

You should provide the best available evidence to show that foreign tax has been paid. You are not entitled to a credit for foreign tax if that foreign tax has been refunded to you.

The following documents are acceptable evidence of the payment of foreign tax:

- a statement from the foreign tax authority setting out the particulars that would normally be recorded on a notice of assessment, a similar official receipt or other document evidencing payment of foreign income tax. If the foreign notice has no provision for a cash register receipt, taxpayers will be required to provide a separate receipt to indicate that the foreign tax liability has been paid. A notice of assessment which does not show that the foreign tax has been paid will not constitute sufficient proof that the tax shown on such a notice has been paid
- a certificate for deduction of withholding tax issued by the person who pays the interest, dividends or any other income that is subject to a deduction of foreign tax
- a distribution statement, or a similar document from a trustee of a managed fund or unit trust, stating the amount of foreign tax paid, for example, the details of foreign tax paid shown in trust distribution advices provided to beneficiaries or unit-holders will generally be sufficient to support a claim for a foreign income tax offset
- payslips, payment summaries or similar documents that shows the amount of foreign tax paid will be accepted where there is no requirement in a foreign country to lodge an income tax return
- a copy of the foreign income tax return accompanied by a receipt verifying that the foreign tax, as calculated on the basis of the return, has been paid, or

- a letter from the relevant foreign tax authority stating all taxes for that income year have been paid.

QC 28013

## You must keep the evidence

**Last updated** 4 May 2012

You don't need to provide the written evidence with your tax return, but you must retain the original documents because we may need to see them at a later date.

Generally, you must keep records for five years after you prepared or obtained them, or after you completed the relevant transactions or acts, whichever is later.

We may generally amend an income tax assessment for an income year within two years of issuing the notice of assessment for that year in the case of individuals and very small businesses or four years for other taxpayers.

This period of review may be extended by an order of the Federal Court of Australia or with your consent. Where this occurs, you must keep your records for five years or to the end of the period during which the assessment may be amended, whichever is later.

The period of review may also be extended by the effect of special amendment rules that allow an assessment to be amended within four years of a payment of foreign income tax or an increase or decrease in the tax paid.

You do not need to keep records where the Commissioner has notified you that they are not required or where your company has gone into liquidation and been finally dissolved.

QC 28013

# We may ask you to get information from overseas

Last updated 4 May 2012

If we believe that information relevant to your assessment is held overseas, you may receive an offshore information notice asking you to get the information for us within 90 days.

If you need extra time, you should apply in writing before the time runs out.

QC 28013

# Transitional rules for using excess foreign tax credits

Last updated 4 May 2012

Transitional rules allow taxpayers to use certain excess foreign tax credits that existed when the foreign tax offset rules came into effect on 1 July 2008.

At this time, taxpayers with unused excess foreign tax credits belonging to any class of foreign assessable income from the previous five income years can convert these amounts to one bundle of **pre-commencement excess foreign income tax** for each of those five years subject to the following limits:

- for company taxpayers, excess foreign tax credits in the 'other income' class cannot be converted where they relate to amounts that would be non-assessable non-exempt income if derived in the commencement year
- offshore banking units; existing excess foreign tax credits in the 'offshore banking income' class are converted by multiplying them by the offshore banking eligible fraction (currently one-third).

## Using pre-commencement excess foreign income tax

QC 28013

# Using pre-commencement excess foreign income tax

Last updated 4 May 2012

A taxpayer must use pre-commencement excess foreign income tax within five years of the year of income in which the pre-commencement excess foreign income tax arises. For example, any pre-commencement excess foreign income tax that relates to the 2006-07 income year can only be used up to the 2011-12 income year.

The amount used in any one income year cannot exceed the amount by which the foreign tax paid for that year is less than the taxpayer's foreign income tax offset limit. In effect, the taxpayer can top-up the amount of foreign income tax paid to the foreign tax offset limit using pre-commencement excess foreign income tax amounts.

Given the five-year limitation rule, taxpayers should use pre-commencement excess foreign income tax on a first-in first-out basis. For example, a taxpayer with pre-commencement excess foreign income tax relating to both the 2006-07 and 2007-08 income years should use those that relate to the 2006-07 income year first as they will expire in 2011-12. Any pre-commencement excess foreign income tax that has not been used within the five year time limit cannot be offset as it has expired.

### Example

Austco is an Australian resident company that converts excess foreign tax credits of \$5,000 relating to the 2006-07 income year into pre-commencement excess foreign income tax of \$5,000 for that income year.

For the 2010-11 income year, Austco pays foreign income tax of \$7,000 on income included in its assessable income and calculates

its foreign income tax offset limit as \$10,000. As the tax offset of \$7,000 (before the application of the pre-commencement excess foreign income tax) is less than the tax offset limit of \$10,000, Austco can add pre-commencement excess foreign tax of \$3,000 to the tax offset for 2010-11.

This leaves \$2,000 of unused pre-commencement excess foreign tax.

For the 2011-12 income year, Austco pays foreign income tax of \$4,000 on income included in its assessable income and calculates its foreign income tax offset limit as \$5,000. As the tax offset of \$4,000 (before the application of any pre-commencement excess foreign income tax) is less than the tax offset limit of \$5,000, Austco can add pre-commencement excess foreign income tax of \$1,000 to the tax offset for 2011-12.

This leaves \$1,000 of unused pre-commencement excess foreign income tax.

For the 2012-13 income year, Austco pays foreign income tax of \$8,000 on income included in its assessable income and calculates its foreign tax offset limit as \$10,000. Although the tax offset of \$8,000 (before the application of any pre-commencement excess foreign income tax) is less than the tax offset limit by \$2,000, the unused \$1,000 of pre-commencement excess foreign income tax cannot be used to increase the tax offset for 2012-13 as it expired in the previous year.

QC 28013

## Attributed foreign income

**Last updated** 4 May 2012

If you have attributed foreign income, you may be entitled to a foreign income tax offset for foreign income tax, income tax or withholding tax paid by the controlled foreign company (CFC) in which you hold an interest.

Specifically, a foreign income tax offset may arise:

- for a resident company that is an attributable taxpayer with a CFC interest and includes an amount in its assessable income under section 456 or 457 of the ITAA 1936
- for resident taxpayers that receive a distribution that is treated as non-assessable non-exempt (NANE) income under section 23AI or 23AK of the ITAA 1936.

In these circumstances, the attributable taxpayer is deemed to have paid foreign income tax in respect of their CFC interest, with the tax paid counting towards their tax offset. In their assessable income, the section 456 and 457 amounts must be grossed up by the amount of the foreign income tax that is deemed to have been paid.

For more information on the tax treatment of attributed income, refer to the publication *Attributed foreign income*.

**Resident company with interest in CFC**



**Foreign income tax paid on NANE income**



QC 28013

## Resident company with interest in CFC

**Last updated** 4 May 2012

A resident company with a CFC interest can treat foreign income tax as having been paid by them in respect of their attributed income if the following conditions are met:

- their assessable income includes an amount under sections 456 or 457 of the ITAA 1936 in relation to their CFC interest
- where the income is included in the company's assessable income under section 457, foreign income tax, income tax, or withholding

tax has been paid by the CFC

- where the income is included in the company's assessable income under section 456, foreign income tax, income tax or withholding tax has been paid by the CFC on part or all of its notional assessable income for its relevant statutory accounting period
- they have an attribution percentage of 10% or more, worked out at the end of the CFC's statutory accounting period for a section 456 amount or at residence-change time for a section 457 amount.

If these conditions are met, the amount of foreign income tax they are deemed to have paid is worked out as follows:

- for a section 456 amount, the sum of the foreign income tax, income tax or withholding taxes paid for the statutory accounting period of the CFC multiplied by the attributable taxpayer's attribution percentage (worked out at the end of the CFC's statutory accounting period)
- for a section 457 amount, the sum of the foreign income tax, income tax or withholding taxes paid, to the extent that they are attributable to the section 457 amount included in the company's assessable income.

The tax that is deemed to have been paid by the resident company counts towards its tax offset. The section 456 and 457 amounts must be grossed up by the amount of the foreign income tax that is deemed to have been paid.

### **Example**

Austco owns 50% of the paid-up capital of Foreignco, a CFC. Foreignco's attributable income for the statutory accounting period is worked out as \$1m, which takes into account a notional allowable deduction for foreign income tax that Foreignco has paid of \$200,000. As Austco's attribution percentage is 50%, it includes \$500,000 under section 456 in its assessable income for the income year in which the CFC's statutory accounting period ends.

Austco meets the conditions for the tax-paid deeming rules to apply in relation to its interest in the CFC, namely that:

- it is a resident company
- foreign income tax has been paid by the CFC in respect of the amount included in its notional assessable income for the

relevant statutory accounting period

- it has an attribution percentage of 10% or more at the end of the relevant statutory accounting period.

The amount of foreign income tax that Austco is deemed to have paid on its attributed income is the \$200,000 paid by Foreignco multiplied by Austco's attribution percentage of 50% (that is, \$100,000). Austco must also gross-up its assessable income by the \$100,000 of foreign income tax that it is deemed to have paid.

## **Tax paid deeming rule applies only to a resident company directly subject to attribution**

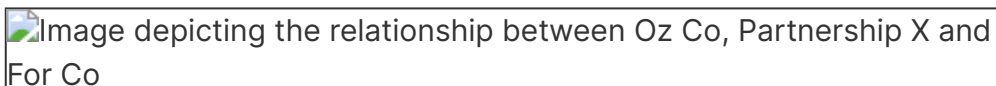
The tax-paid deeming rule only applies to resident companies that are directly subject to attribution under section 456 or 457. Where a resident company is a partner in a partnership or a beneficiary in an Australian trust with a CFC interest, the resident company is assessed on their share of the partnership or trust net income under sections 92 or 97 of the ITAA 1936 rather than under sections 456 or 457.

In this case, the partnership or Australian trust is the attributable taxpayer and it includes in its net income the relevant attribution amount under sections 456 or 457. As the partnership or Australian trust is not a resident company and the resident company is not the attributable taxpayer, the tax-paid deeming rules cannot apply to the CFC interests held by the resident company through a partnership or Australian trust.

### **Example**

Oz Co Pty Ltd, a Part X Australian resident, has a 50% interest in partnership X formed in Foreign Country 1. Partnership X wholly owns For Co, a company that is resident in Foreign Country 2. For Co is a CFC for Australian tax purposes.

During the income year, For Co pays income tax under the laws of Country 2.

Image depicting the relationship between Oz Co, Partnership X and For Co

As partnership X is a partnership for Australian income tax purposes, Oz Co's assessable income will include its share of the partnership's net income, calculated as if it were an Australian resident.

As For Co is a CFC and partnership X is an attributable taxpayer by virtue of its being an Australian partnership for the purposes of Part X of the ITAA 1936, the partnership net income includes attributed income under section 456 of the ITAA 1936.

In calculating For Co's attributed income, a notional allowable deduction is allowed for the foreign income tax paid. However, the foreign income tax paid by For Co does not count towards Oz Co's foreign income tax offset for the relevant income year because Oz Co is not treated, pursuant to section 770-135 of the ITAA 1997, as having paid the foreign income tax for the purposes of subsection 770-10(1) of the ITAA 1997.

QC 28013

## Foreign income tax paid on NANE income

**Last updated** 4 May 2012

Resident taxpayers are entitled to a foreign income tax offset for foreign income tax they pay on an amount that is non-assessable non-exempt (NANE) income of the taxpayer under sections 23AI or 23AK of the ITAA 1936.

For more information on how the attribution account rules work in relation to attributable taxpayers with CFC or former foreign investment fund (FIF) interests, refer to chapter 1 and chapter 4 of the [Foreign income return form guide](#).

Only foreign income tax amounts that are paid in respect of income that is NANE under sections 23AI or 23AK count towards a tax offset. Also, the amount of foreign income tax taken to be paid on the distribution is not affected by the tax-paid deeming rules that apply to previously attributed income amounts included in the taxpayer's assessable income.

Usually, the foreign income tax will be a withholding amount on a dividend distribution. In such a case, where the tax is paid by someone else under the law of a foreign country, the tax-paid deeming rules apply to treat the attributable taxpayer as having paid the foreign income tax, providing it can be demonstrated that such tax is paid in respect of the section 23AI or 23AK amounts.

The tax offset limit is increased by the relevant amount of foreign income tax paid in respect of section 23AI or 23AK amounts.

### **Example**

Lynette owns 100% of Forco paid-up capital. She has previously included in her assessable income \$1 million in respect of Forco under section 456. Forco subsequently declares and pays a dividend of \$1 million to Lynette, on which withholding tax of \$100,000 is imposed.

As the dividend amount does not exceed her attribution account surplus in relation to Forco, it is treated as her NANE income under section 23AI. Lynette is also deemed to have paid the \$100,000 foreign income tax withheld (which counts towards her tax offset), as it is paid in respect of the dividend income.

Where a resident taxpayer is a partner in a partnership or a beneficiary of an Australian trust with a CFC interest, the partnership or trust is the attributable taxpayer. These entities include, in their net income, the relevant attributed amount under sections 456 or 457. In turn, the partner or beneficiary includes, in their assessable income, their share of the partnership or trust net income that relates to the attributed amount.

However, where a CFC makes a distribution to the partnership or trust out of profits that have been previously subject to attribution, the attribution account rules ensure that the resident partner or beneficiary with an interest in the partnership or trust will get the benefit of section 23AI.

Where a foreign entity that was previously treated as a FIF makes a distribution to an Australian resident out of profits that have been previously subject to attribution, the attribution account rules ensure that the income received by the Australian resident will get the benefit of section 23AK. If the distribution is subject to foreign income tax, the amount of foreign tax paid counts towards a foreign income tax offset.

# Special circumstances

Last updated 4 May 2012

## Superannuation funds

Limits apply to the foreign income tax offset allowed for foreign income taxes paid by a superannuation fund or approved deposit fund where the fund changes:

- from a complying superannuation fund to a non-complying superannuation fund, or
- from a non-resident superannuation fund to a resident superannuation fund.

Where a non-complying fund or a resident fund includes an amount in assessable income under items 2 and 3 in the table in [section 295-320 of the ITAA 1997](#), and the fund paid foreign income tax on that amount (before the start of the income year), the fund is not entitled to a tax offset for the foreign income tax paid by the provider.

**Consolidated groups**



**Life insurance companies**



**Offshore banking units**



**Foreign non-residents**

QC 28013

# Consolidated groups

**Last updated** 4 May 2012

Only the head company of a consolidated group or multiple entry consolidated (MEC) group is entitled to a foreign income tax offset for foreign income tax paid on income or gains that are included in its assessable income under the single entity rule. Where a subsidiary member pays foreign income tax on income or gains included in the head company's assessable income, the head company is treated as having paid the tax.

The head company's foreign income tax offset is determined in the same way as for taxpayers outside the consolidation regime.

Special transitional rules allow a joining entity to transfer any unused pre-commencement excess foreign income tax to the head company at joining time. The pre-commencement excess foreign income tax transferred from the joining entity is pooled with any other pre-commencement excess foreign income tax of the head company and subsidiary members. If the head company has unused pre-commencement excess foreign income tax which arose in the same year as the joining entity's unused pre-commencement excess foreign income tax, the amounts are pooled. The head company is subject to the five-year limitation rule on using pre-commencement excess foreign income tax. Pre-commencement excess foreign tax in the pool must be separately identified according to the income years in which it arose.

The head company can apply pre-commencement excess foreign income tax transferred from a joining entity in an income year starting at or after the joining time, subject to the general transitional rules.

If an entity leaves a consolidated or MEC group, it will not have access to any pre-commencement excess foreign income tax that it transferred to the head company when it joined the group.

More detailed information on the operation of the foreign income tax offset rules for consolidated groups or MEC groups, including the special transitional rules for pre-commencement excess foreign income tax, is contained in the [Consolidation reference manual](#).

QC 28013

## Life insurance companies

Last updated 4 May 2012

The core rules for the foreign income tax offset apply to life insurance companies. However, as the income of a life insurance company is taxed at two different rates (ordinary class, taxed at 30%, and complying superannuation/FHSA class, taxed at 15%), it is necessary to determine the amount of assessable income in each class on which foreign income tax has been paid at step 2 of the [foreign income tax offset limit calculation](#).

### Example

Life Insurance Co derives the following assessable income in each class of income:

Income Class	Assessable Income (includes income subject to Foreign Income Tax)	Assessable Income subject to Foreign Income tax	Foreign Income Tax
Ordinary	\$5 million	\$1 million	\$200
Complying superannuation/FHSA	\$5 million	\$2 million	\$400

Assuming there are no allowable deductions in relation to the classes of assessable income, the foreign income tax offset limit is worked out as follows:

**Step 1: Work out the tax payable on Life Insurance Co's taxable income**

Tax on assessable income in the:

- Ordinary Class: \$5 million x 30% = \$1.5 million
- Complying superannuation/FHSA Class: \$5 million x 15% = \$750,000

Total tax payable for step 1 is \$2.25 million.

**Step 2: Work out the tax that would be payable if the income of the two classes on which foreign income tax has been paid is not included in Life Insurance Co's assessable income**

There are two income amounts on which foreign income tax has been paid that need to be excluded from assessable income for the purposes of this step:

- \$1 million that belongs to the assessable income in the ordinary class; and
- \$2 million that belongs to the assessable income in the complying superannuation/FHSA class.

In working out the tax that would have been payable had these amounts not been included in assessable income, it is necessary to identify the relevant class to which such amounts belong as follows:

Tax on assessable income excluding the income amount on which foreign income tax has been paid:

- Ordinary class: (\$5 million - \$1 million) x 30% = \$1.2 million
- Complying superannuation/FHSA class: (\$5 million - \$2 million) x 15% = \$450,000

Total tax that would be payable for step 2 is \$1.65 million.

**Step 3: Determine the foreign income tax offset limit**

Step 1 less step 2: \$2.25 million - \$1.65 million = \$600,000

This is the foreign income tax offset limit.

As the actual foreign income tax paid on the two income amounts is also \$600,000, the foreign income tax offset of Life Insurance

Co is \$600,000.

Foreign income tax paid on non-assessable non-exempt income derived from segregated exempt assets does not count towards a tax offset.

QC 28013

## Offshore banking units

**Last updated** 4 May 2012

Specific rules apply to calculating the tax offset for foreign income tax paid on the assessable offshore banking income of an offshore banking unit (OBU).

The foreign income tax paid on the offshore banking income of an OBU is taken to be one-third (the current offshore banking eligible fraction) of the amount of tax actually paid. This approach mirrors the tax treatment of assessable offshore banking income, which results in only one-third of that amount actually being included in assessable income, with the other two-thirds being treated as non-assessable non-exempt income.

### Example

Big Bank Ltd is an Australian resident bank that is declared an OBU. Big Bank Ltd derives offshore banking income and pays foreign income tax of \$21,000 in respect of such income as follows:

<b>Source</b>	<b>Income (A\$)</b>	<b>Expenses (A\$)</b>	<b>Foreign tax paid (A\$)</b>
Borrowing and lending activity: commission	15,000	900	1,500
Borrowing and lending activity: interest	20,000	600	3,000

Advisory activity	50,000	6,000	16,500
<b>Total foreign income tax paid on assessable offshore banking income</b>	<b>85,000</b>	<b>7,500</b>	<b>21,000</b>

The amount of foreign income tax paid on the assessable portion of offshore banking income is the amount of foreign income tax paid multiplied by the eligible fraction:

$$\$21,000 \times \frac{10}{30} = \$7,000$$

This is the amount of foreign income tax that counts towards Big Bank Ltd's tax offset for the income year.

QC 28013

## Foreign non-residents

Last updated 4 May 2012

While the offset mainly applies to residents, where the foreign income of a foreign non-resident is taxed in Australia, they may be able to claim an offset.

These circumstances apply where a foreign resident pays income tax in a foreign country on an amount that is included in their assessable income (under Australian tax law) and such tax is imposed because the income is sourced in that country. By contrast, where a foreign country imposes tax on the amount included in an entity's assessable income merely because it is a resident of that country (that is residence-based taxation), a foreign income tax offset entitlement does not arise if the tax is imposed on income from a source outside the foreign country.

### Example

XYZ PLC is a United Kingdom resident that carries on a business through a permanent establishment (PE) in Australia. In carrying on such activities, it derives US source income, which is subject to

tax in that country. The US source income is derived in connection with the PE activity in Australia, and a combination of Articles 7 and 21 of the Australia-UK tax treaty permits Australia to tax the income and treat it as being derived from sources within Australia, and therefore subject to Australian tax. Given that the US source income is taxed in that country on a source basis, the US tax paid counts towards a tax offset in Australia.

If XYZ pays UK tax on the US source income that is attributable to the Australian PE activity, the tax would be imposed on a residence basis on the non-UK sourced income and would not count towards the taxpayer's tax offset.

QC 28013

## Australian source income

Last updated 4 May 2012

While Australian residents are normally subject to foreign income tax only on their foreign source income, the foreign income tax offset applies to all income on which foreign income tax has been correctly applied. This situation will arise in very limited circumstances.

For example, foreign income tax imposed by East Timor in accordance with Annexure G (the taxation code) of the Timor Sea treaty (refer to the *Petroleum (Timor Sea Treaty) Act 2003*) on assessable income derived by an Australian-resident taxpayer from certain activities carried out in the Joint Petroleum Development Area of the Timor Sea will count towards the taxpayer's tax offset.

QC 28013

### Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet

your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.

## **Copyright notice**

© Australian Taxation Office for the Commonwealth of Australia

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).