Treatment of foreign income tax offsets, excess foreign tax credits, attribution surpluses, conduit foreign income and irrevocable elections

Key points

On consolidation:

- the head company can claim a foreign income tax offset for foreign income tax paid by joining entities in relation to amounts included in the head company's assessable income
- excess foreign tax credits of joining entities accumulated before 1 July 2008 are transferred to the head company under special transitional rules
- the attribution account surpluses in respect of a controlled foreign company (CFC) are transferred to the head company
- from the 2010-11 income year onwards, the post-FIF (foreign investment fund) abolition surpluses in respect of a FIF or foreign life assurance policy (FLP) are transferred to the head company
- conduit foreign income received by an entity before it joins a consolidated group can be treated by the head company as its conduit foreign income
- irrevocable elections or choices made by a joining entity or head company in relation to interests in CFCs are not inherited by the head company or a leaving entity respectively.

Foreign income tax offset rules

The foreign income tax offset rules replace the foreign tax credit rules from an entity's first income year starting on or after 1 July 2008. Transitional rules provide for the utilisation of an entity's existing excess foreign tax credits (FTCs).

The application of the FTC rules to consolidated groups is dealt with in this section from p. 2.

Under the foreign income tax offset rules a taxpayer is entitled to a non-refundable tax offset for foreign income tax paid on an amount included in its assessable income. The taxpayer becomes entitled to a foreign income tax offset in the income year the amount is included in its assessable income. This may not be in the same year in which the foreign income tax is paid. There is no mechanism for allowing the carry-forward of excess foreign income tax.

Under the single entity rule, the income of a consolidated group or multiple entry consolidated (MEC) group is included in the head company's assessable income. Where a subsidiary member has paid foreign income tax on an amount included in the head company's assessable income, the head company is treated as having paid the tax. Once consolidated, only the head company is entitled to a foreign income tax offset for foreign income tax paid on an amount included in the head company's assessable income.

Where an entity joins a consolidated or MEC group part way through an income year, the joining entity is entitled to a foreign income tax offset for foreign income tax paid on an amount included in its assessable income for its non-membership period.

Transitional rules for excess foreign tax credits

Transitional rules allow the joining entity to transfer pre-commencement excess foreign income tax to the head company at the joining time. These transitional rules reflect the previous FTC rules on the transfer of excess FTCs to the head company at the joining time.

The pre-commencement excess foreign income tax transferred from the joining entity is pooled with any pre-commencement excess foreign income tax of the head company (and any other transferred pre-commencement excess foreign income tax from other subsidiary members). As there is a five year limit on the utilisation of pre-commencement excess foreign income tax by the head company, the 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 tax transferred from a joining entity in an income year starting on or after the joining time.

Leaving a consolidated group

Where an entity leaves a consolidated or MEC group, it is only required to include foreign income in its assessable income for the period it is not a member of any consolidated or MEC group. The leaving entity does not have access to any pre-commencement excess foreign income tax that it had before it joined the consolidated or MEC group, or that arose in the group while it was a subsidiary member.

→ 'Treatment of foreign income tax offsets, attribution surpluses and conduit foreign income', C6-1

Excess foreign tax credits (pre 1 July 2008)

For income years starting before 1 July 2008, the former FTC rules applied, with modifications for tax consolidation set out in Subdivision 717-A of the *Income Tax Assessment Act 1997* (ITAA 1997). Under the former provisions, the head company was deemed to have paid and been personally liable for the foreign tax paid by the members of the group. This means the head company could claim an FTC against Australian tax payable on the foreign income of all the members of the consolidated group included in the head company's assessable income – using not only the head company's own FTCs, but also the FTCs of subsidiary members and excess FTCs transferred into the group from joining entities.

On consolidation, the excess FTCs of companies joining or forming a consolidated or MEC group were transferred to the head company. The excess FTCs were then pooled by the head company according to the class and income year in which they arose.

The head company generally could not use the excess FTCs of a subsidiary member until the end of the head company's income year following the one in which the member joined the group, unless the member joined at the start of the head company's income year.

Where an entity was not a member of a consolidated or MEC group for part of an income year, it was entitled to excess FTCs that arose in a non-membership period before it joined the MEC group. However, where the excess FTCs had been transferred to the head company of a consolidated group because the entity became a subsidiary member of that group, the entity relinquished any future entitlement to those excess FTCs in later income years and non-membership periods, or if it joined another group.

→ 'Treatment of foreign income tax offsets, attribution surpluses and conduit foreign income', C6-1

Attribution surpluses

Part X and former Part XI of the ITAA 1936 provide rules for maintaining attribution accounts in order to prevent double taxation of the profits of controlled foreign companies (CFCs), foreign investment funds (FIFs) and foreign life assurance policies (FLPs). A surplus in the attribution account at any point in time occurs when the credits in the account exceed the debits.

A company that becomes a subsidiary member of a consolidated group may hold interests in a CFC, FIF or FLP. If the balance of any relevant attribution account kept by that company is in surplus immediately before the joining time, the surplus is transferred to the head company of that group.
→ Subdivision 717-D, ITAA 1997

This ensures that distributions from CFCs, FIFs and FLPs are not taxed to the head company where the joining company has already been taxed on the attributed income.

After the transfer of surpluses, the attribution accounts of the joining company become inoperative. Any attribution account debits or credits that would have arisen in the attribution accounts kept by the joining company during the time it is a member of the consolidated group will now arise in the attribution accounts kept by the head company.

When a company leaves a consolidated group it may take with it interests in a CFC, FIF or FLP. Where this happens, the head company transfers to the leaving company a proportion of the attribution account surplus that the head company has in relation to these interests. The proportion is based on the percentage of the group's interest in the CFC, FIF or FLP held by the leaving company. → Subdivision 717-E, ITAA 1997

The FIF rules were repealed with effect from the 2010-11 income year. Companies with interests in a FIF or FLP will no longer be subject to the requirements of the attribution rules.

FIF income (pre-2010-11)

For income years prior to 2010-11, before the repeal of the FIF rules, special rules applied to ensure that the correct amount of FIF income was assessed to the correct taxpayer where a company joined or left a consolidated group during the notional accounting period of a FIF. To achieve this, where the FIF's notional accounting period did not actually end at the joining time, the FIF income was allocated to the joining company for the period from the beginning of the FIF's notional accounting period until the joining time, and the head company was allocated FIF income from the joining time onwards. Similarly, when a company left the group the FIF income was allocated between the head company and the leaving company.

FIF income (2010-11 onwards)

From the 2010-11 income year onwards, any FIF attribution surpluses that previously arose for the head company of a consolidated group, including those transferred to it and those of its own, will become part of its post-FIF abolition surplus.

When a company becomes a subsidiary member of a consolidated group and it has a post-FIF abolition surplus, the surplus is transferred to the head company of that group. → section 717-220, ITAA 1997

When a company leaves a consolidated group and takes with it interests in a FIF or FLP, the head company transfers to the leaving company a proportion of the post-FIF abolition surplus that it has in relation to those interests. The proportion is based on the percentage of the group's interest in the FIF or FLP held by the leaving company. → section 717-255, ITAA 1997

Under section 23AK of the ITAA 1936, when the head company or the leaving company receives a distribution paid out of previously attributed FIF income, it will continue to be exempt from tax.

Under section 23B of the ITAA 1936 (which was introduced to preserve the effect of former section 613 of the ITAA 1936), when the head company or the leaving company disposes of an interest in a FIF or FLP where the FIF income has been attributed but not distributed before disposal, the head company or the leaving company may reduce its capital proceeds. The capital proceeds may be reduced by so much of the post-FIF abolition surplus that it has in relation to those interests not exceeding the capital proceeds.

Therefore, on disposal of an interest in a FIF or a FLP, the head company or the leaving company can continue to take advantage of the section 23AK exemption or the former section 613 reduction of capital proceeds.

→ 'Treatment of foreign income tax offsets, attribution surpluses and conduit foreign income', C6-1

Elections relating to CFCs, FIFs and FLPs

An entity can make irrevocable elections in relation to calculating the attributable income of CFCs, or FIF income for FIFs or FLPs. If a subsidiary member makes irrevocable elections before the joining time, the elections are not taken to have been made by the head company for the head company core purposes. Any irrevocable elections made by a head company before consolidation continue to apply to interests in CFCs, FIFs and FLPs that the head company holds under the single entity principle. → section 715-660, ITAA 1997

Due to the repeal of the FIF rules, a consequential amendment was made to section 715-660 of the ITAA 1997. This is because from the 2010-11 income year onwards, taxpayers with interests in FIFs or FLPs are no longer subject to the attribution rules and are not required to make any elections in relation to calculating FIF income.

→ 'Treatment of foreign income tax offsets, attribution surpluses and conduit foreign income', C6-1

Conduit foreign income

The conduit foreign income rules replace the foreign dividend account rules from an entity's first income year commencing on or after 1 July 2005. Transitional rules apply to this first income year.

The operation of the foreign dividend account rules is dealt with under 'Foreign dividend accounts' on p. 6.

The conduit foreign income rules provide an exemption from withholding tax on unfranked (but frankable) distributions declared to be conduit foreign income received by non-resident members of an Australian corporate tax entity.

Without limiting the effect of the single entity and the entry history rules, both have effect for all purposes of the conduit foreign income rules.
→ section 715-875, ITAA 1997

The single entity rule treats conduit foreign income derived by any member of a consolidated group to be conduit foreign income derived by the head company.

On an entity joining a consolidated group, the entry history rule applies so that any conduit foreign income of the joining entity becomes conduit foreign income of the head company.

Where an entity leaves a consolidated group, it does not take any conduit foreign income with it. The conduit foreign income remains with the head company.

The conduit foreign income rules also provide that conduit foreign income can be distributed through a chain of Australian corporate tax entities and retain its character as conduit foreign income provided the income is distributed within the required time. This rule has no application for distributions between members of the same consolidated group while they are members of the group. The head company can distribute conduit foreign income within the required time.

The conduit foreign income rules apply in the same way to MEC groups.

→ 'Treatment of foreign income tax offsets, attribution surpluses and conduit foreign income', C6-1

Foreign dividend accounts

Before the introduction of the conduit foreign income rules, a foreign dividend account (FDA) was kept by a company so that it could pay dividends to non-resident shareholders free from dividend withholding tax where those dividends were paid out of certain non-portfolio dividends received by the company.

The head company of a consolidated group operated a single FDA by pooling any FDA surpluses and deficits transferred to it by subsidiary members at the joining time. The foreign investments of all the subsidiary members were aggregated so that the head company could credit the FDA for the total non-portfolio dividends received and debit the account for the total foreign tax paid. The head company was then taken to have made the FDA declarations for dividends paid to its shareholders and the shareholders of its subsidiary members.

Special rules applied in relation to MEC groups.

When a company ceased to be a subsidiary member of a group it could not take an FDA balance with it on exit.

→ 'Treatment of foreign income tax offsets, attribution surpluses and conduit foreign income', C6-1

Offshore banking units

If a member of a consolidated group is a gazetted offshore banking unit, the consolidation rules deem the head company of the consolidated group to be an offshore banking unit for the period in which the subsidiary member has this status. → 'Treatment of foreign income tax offsets, attribution surpluses and conduit foreign income', C6-1

References

Income Tax Assessment Act 1997, Subdivision 717-A; as amended by *Tax Laws Amendment (2007 Measures No. 4) Act 2007* (No. 143 of 2007), Schedule 1

Income Tax (Transitional Provisions) Act 1997, Division 770; as amended by *Tax Laws Amendment (2007 Measures No. 4) Act 2007* (No. 143 of 2007), Schedule 1

Explanatory Memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007

Income Tax Assessment Act 1997, former Division 717-A; as amended by

- *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 6
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 7
- Tax *Laws Amendment (2004 Measures No. 2) Act 2004* (No. 83 of 2004), Schedule 2

Income Tax Assessment Act 1997, Subdivisions 717-D and 717-E; as amended by

- *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 6
- *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 8
- *Tax Laws Amendment (2007 Measures No. 4) Act 2007* (No. 143 of 2007), Schedule 1
- *Tax Laws Amendment (Foreign Source Income Deferral) Act (No. 1) 2010* (No. 114 of 2010), Schedule 1

Explanatory Memorandum to Tax Laws Amendment (Foreign Source Income Deferral) Bill (No. 1) 2010

Income Tax Assessment Act 1997, Subdivisions 715-J and 715-K; as amended by *Tax Laws Amendment (2004 Measures No. 6) Act 2005* (No. 23 of 2005), Schedule 1

Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 6) Bill 2004

Income Tax Assessment Act 1997, Subdivision 715-U and Division 802; as amended by *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005* (No. 147 of 2005), Schedule 2

Explanatory Memorandum to Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005

Income Tax Assessment Act 1997, Subdivision 717-J; as amended by:

- *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 9

- *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005* (No. 147 of 2005), Schedule 2

Income Tax Assessment Act 1997, Subdivision 717-O; as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 10

Revision history

Section B2-5 first published (excluding drafts) 2 December 2002 and updated 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
14.7.04	Note on recent changes to consolidation rules.	Legislative amendments.
3.11.04	Certain irrevocable elections are not inherited by head company or leaving entity.	Reflect amendments in *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (83 of 2004).
	Remove 14.7.04 notes on recent changes to consolidation rules.	Text amended to reflect the changed rules.
30.6.09	Extensively revised to take account of new rules for foreign income tax offsets and conduit foreign income.	Amendments in *Tax Laws Amendment (2007 Measures No. 4) Act 2007* and *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005*.
6.5.11	Revised to take into account the repeal of Part XI of the ITAA 1936 in relation to the FIF and FLP rules.	Legislative amendments.