foreign income return form guide

FOREIGN INCOME RETURN FORM GUIDE

1997–98

Australian Taxation Office

www.ato.gov.au

How self-assessment affects most individuals

Self-assessment means the Australian Taxation Office (ATO) uses the information you give in your tax return to work out your refund or tax bill. You are required by law to make sure you have shown all your assessable income and claimed only the deductions and rebates to which you are entitled.

What are your responsibilities?

Even if someone else—including a tax agent—helps you to prepare your tax return, you are still legally responsible for the accuracy of the information.

What if you lodge an incorrect tax return?

Our computers continually check for missing or wrong information. We have audit programs designed to detect where taxpayers have not declared all of their assessable income or where they have incorrectly claimed deductions or rebates. If you become aware that your tax return is incorrect, you must contact us straightaway.

Initiatives to complement self-assessment

There are a number of initiatives administered by the ATO which complement self-assessment. Examples include:

- a change in penalty provisions so that, if you take reasonable care with your tax affairs, you will not receive a penalty for honest mistakes—but please note that interest on omitted income or overclaimed deductions and rebates could still be payable
- the process for applying for a private ruling
- your entitlement to interest on early payment—or overpayment—of a tax debt
- the process for applying for an amendment if you find you left something out of your tax return.

Do you need to ask for a private ruling?

If you have a concern about the way tax law applies to your personal tax affairs, you may want to ask for a private ruling. A private ruling will relate just to your situation. Write to the ATO describing your situation in detail and ask for advice. Include your tax file number. If you lodge your tax return before you receive your private ruling, be aware that the ruling may alter the accuracy of your return.

You can ask for a review of a private ruling decision if you disagree with it, even if you have not received your assessment. The tax office that made the ruling can give you more information about review procedures.

Foreign income

return form guide

Australian Taxation Office
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About this publication

This publication is available free of charge from the Australian Taxation Office (ATO), which prohibits any party from selling it. Please get help from the ATO—the general enquiries number is **13 2861**—or a tax adviser if you feel the publication does not fully cover your circumstances.

We regularly revise our publications to take account of changes to the law. Contact the ATO if you think this edition may not be the latest.

As part of our commitment to produce accurate publications, taxpayers will not be subject to penalties if it is demonstrated that they have based a tax claim on wrong information supplied by the ATO.

CONTENTS

Chapter 2

Transferor trust and related measures

Chapter 3

Taxation of foreign dividends and branch profits and the foreign tax credit system

Some abbreviations used in this publication

ATO	Australian Taxation Office
CFC	controlled foreign company
CFE	controlled foreign entity
CFP	controlled foreign partnership
CFT	controlled foreign trust
DTA	double taxation agreement
DWT	dividend withholding tax
EDCI	eligible designated concession income
FIF	foreign investment fund
FTC	foreign tax credit
FTCS	foreign tax credit system
NFI	net foreign income
P/Y loss	previous years losses
The Act	*Income Tax Assessment Act 1936*

Introduction

How to use the *Foreign income return form guide*

Each chapter of the *Foreign income return form guide* (the guide) contains an explanation of measures relating to the taxation of foreign income derived by, or attributed to, Australian residents. They are:

Chapter 1	Attribution of current year profits of a controlled foreign company
Chapter 2	Transferor trust and related measures
Chapter 3	Taxation of foreign dividends and branch profits and the foreign tax credit system.

Summary sheets at the end of the guide provide a quick reference to assist you in determining if and to what extent the measures apply to you. Where necessary, worksheets have also been provided to help you work out your tax liability.

Although the guide is quite detailed, it may not cover all the qualifications and conditions contained in the law that relate to your circumstances. For instance, it does not discuss the special rules that apply in working out attributable income for companies conducting banking or insurance activities. If you are not sure about the application of the law, please contact the tax office where you lodge your tax return.

Unless otherwise stated, references in this guide to provisions of the law are to provisions of the *Income Tax Assessment Act 1936*.

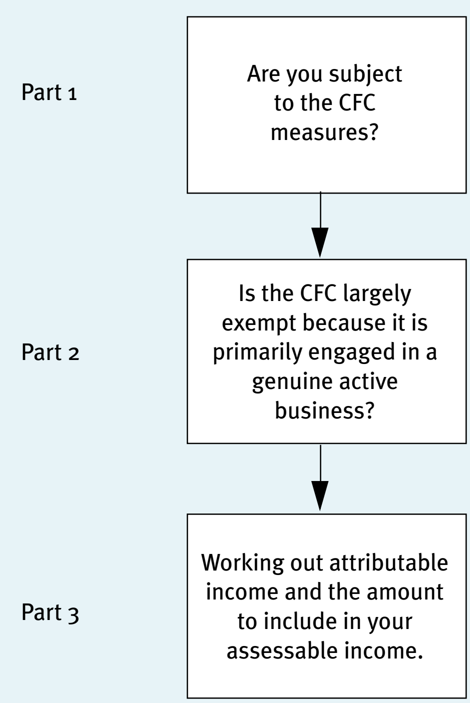
Chapter 1

Attribution of the current year profit of a controlled foreign company

This chapter explains the accruals tax system for residents with interests in foreign companies.

The accruals tax system applies to Australian residents who have a substantial interest in a foreign company controlled by Australians—referred to as a controlled foreign company (CFC). The system operates to include a taxpayer's share of specified income and gains of a CFC in the taxpayer's assessable income. This is called attribution. Subject to some modifications, the income and gains of CFCs are worked out using the same tax rules that apply for residents.

Summary of chapter 1

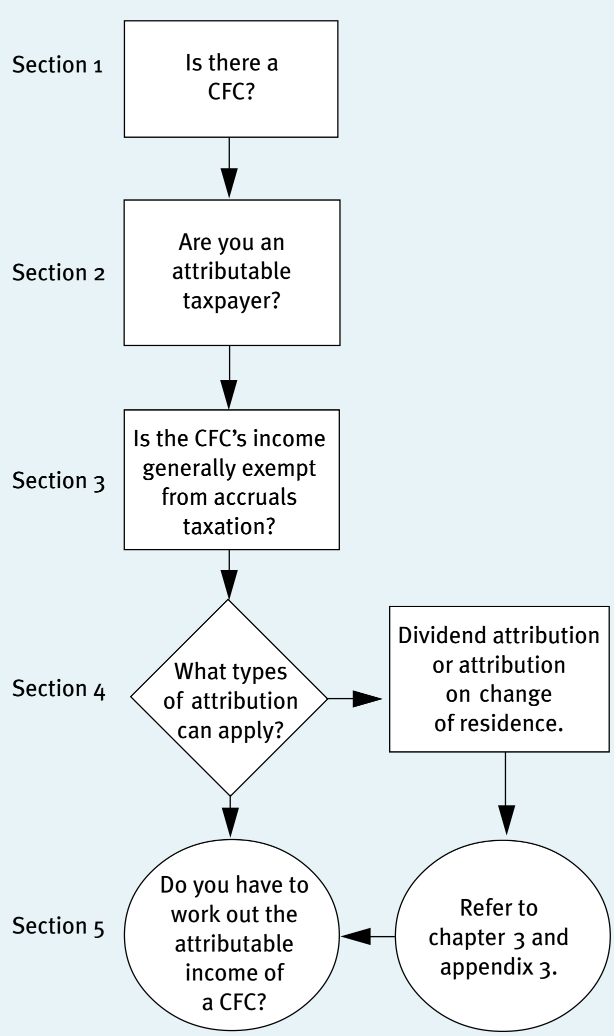


Part 1—Are you subject to the CFC measures?

The accruals tax system may apply to you if you are an Australian resident who has a substantial interest in a CFC. This part explains:

- when a foreign company is a CFC
- the types of interests in a foreign company that are taken into account in testing whether that company is a CFC
- the size of an interest in a CFC you need before you must include an amount in your assessable income
- how to determine the size of your interest in a CFC
- whether income of a CFC is to be included in your assessable income for the current income year.

Summary of part 1



Section 1—Is there a CFC?

Three control tests

A CFC is a non-resident company that satisfies one of three control tests. Whether a company is a resident of a foreign country is determined according to the Australian tax law as modified by double taxation agreements with other countries.

The three control tests are the:

- strict control test
- assumed controller test
- de facto control test.

Strict control test

A foreign company will be treated as a CFC under the strict control test if a group of five or fewer Australian 1 per cent entities, together with their associates, own or are entitled to acquire a control interest of at least 50 per cent in the foreign company.

An *Australian 1 per cent entity* is an Australian entity that, together with its associates, holds an interest of at least 1 per cent in the foreign company.

An *Australian entity* is an Australian partnership, an Australian trust, or an entity—other than a partnership or trust—that is a Part X Australian resident. A Part X Australian resident is a resident of Australia who is not treated solely as a resident of another country under a double taxation agreement between Australia and that country.

The associate-inclusive control interest of an entity is the sum of interests held by the entity and its associates in the foreign company. Interests that the entity and its associates are entitled to acquire are also taken into account.

EXAMPLE 1

Strict control test

This test will be satisfied if three Australian residents each hold interests of 30 per cent, 10 per cent and 10 per cent respectively in a foreign company.

Assumed controller test

A foreign company will normally be treated as a CFC under the assumed controller test if a single Australian entity owns, or is entitled to acquire, an associate-inclusive control interest of at least 40 per cent in the foreign company. An entity's associate inclusive control interest in a foreign company is the sum of the interests held in the company by the entity and the associates of the entity. A foreign company will not be treated as a CFC under the assumed controller test, however, if the company is controlled by a party or parties unrelated to the single resident or its associates.

EXAMPLE 2

Assumed controller test

If an Australian entity holds 45 per cent of the interests in a foreign company and the remaining 55 per cent is held by several non-residents, it would be assumed under this test that the Australian controls the foreign company.

De facto control test
A foreign company will be treated as a CFC under the de facto control test if a group of five or fewer Australian entities, either alone or with associates, effectively control the foreign company.

EXAMPLE 3

De facto control test

If an Australian entity can control the appointment of the directors of a foreign company, the Australian entity will generally be taken to have de facto control of that foreign company.

When is control measured?

A statutory accounting period of a CFC is a period of 12 months ending 30 June, unless the CFC makes an election to use another period. The control test is applied at the end of a CFC's statutory accounting period to check whether income of the CFC is to be attributed.

It may also be necessary to measure control at the time a CFC pays a dividend to another CFC or to a controlled foreign trust or at the time a CFC changes residence.

Election to change a CFC's statutory accounting period
A CFC can make an election to change its statutory accounting period only if the accounting period is:

- regularly used by the CFC for complying with the tax law of a foreign country or
- regularly used by the CFC for reporting to its shareholders.

A CFC may also elect in writing to adopt a statutory accounting period ending on a date other than 30 June if the period is regularly used for complying with the tax laws of the CFC's country of residence or is regularly used for reporting to the CFC's shareholders. You may make this election on behalf of a wholly owned CFC.

A CFC may subsequently elect another statutory account period ending on any date, including 30 June, provided the above conditions are satisfied.

Where a CFC chooses another statutory accounting period, it must complete the current statutory accounting period. The intervening statutory accounting period—from the last day of the current period to the beginning of the new period—will be less than twelve months. The new and subsequent statutory accounting periods will be of twelve months duration.

EXAMPLE 4

Statutory accounting periods

If a company with a statutory accounting period ending 30 June 1995 elected on 30 August 1994 to change to a statutory account period ending 30 September, it would have statutory accounting periods of:

- 1 July 1994 to 30 June 1995
- 1 July 1995 to 30 September 1995
- 1 October 1995 to 30 September 1996 and
- subsequent 12 month statutory accounting periods ending 30 September.

It is not necessary for a CFC to complete the current statutory accounting period before beginning a new period if the election is made when the CFC first comes into existence or where a company first becomes a CFC.

What interests in a foreign company are taken into account in the control tests?

In most cases, an interest in a foreign company will be held in the form of shares. This interest can be held either directly or indirectly through other entities. At a particular time, your interests in a foreign company include the interests you hold in the company as well as the interests you are entitled to acquire.

The interests of your associates in a foreign company are also relevant for determining whether you have an interest in the company.

Direct control interest in a foreign company

Your direct control interest in a foreign company is the greatest of the percentages that you hold, or are entitled to acquire, of the following:

- total paid-up share capital in the foreign company
- total rights to vote, or to participate in any decision making, in relation to:
  - the distributions of capital or profits
  - the changing of constituent documents
  - the varying of share capital of the company
- total rights to distributions of capital or profits of the company on winding-up or
- total rights to distributions of capital or profits of the company other than on winding-up.

EXAMPLE 5

Direct control interest in a foreign company

A foreign company is established issuing 100 ordinary shares. An Australian taxpayer purchases 50 of these shares which entitle the taxpayer to 50 per cent of the income, voting and capital rights of the company. The direct control interest of the Australian taxpayer in the foreign company is 50 per cent.

EXAMPLE 6

Direct control interest in a foreign company where shares confer different rights

An Australian company has a 50 per cent voting interest and a 75 per cent income interest in a foreign company. The direct control interest of the Australian company in the foreign company is 75 per cent.

How is a direct control interest measured if the test time occurs before the end of an accounting period?

A taxpayer's direct control interest in a company has to be measured at a point in time—referred to as the test time.

However, in some cases it may not be possible to measure the percentage a taxpayer holds of the total rights to the profits of a company, or to a distribution of capital on winding up of the company, before the end of the accounting period of the company.

This would be the case, for example, if some shareholders are entitled to a fixed return of capital or profits.

In these cases, the taxpayer's rights to capital or profits are measured at the end of the accounting period of the company. It is assumed for this purpose that the rights held by the taxpayer at the test time are held at the end of the accounting period of the company.

Exclusion of eligible finance shares

Eligible finance shares are not taken into account in working out an entity's direct control interest in a company. Broadly, these are shares issued under preference share financing arrangements with Australian financial intermediaries—for example, banks—and their subsidiaries. In effect, the shares are issued in place of loans.

Indirect control interest in a company

A taxpayer may hold a direct control interest in an entity—entity A—which holds a direct control interest in another entity—entity B. In this case, the taxpayer has an indirect control interest in entity B.

A taxpayer's indirect control interest in entity B is obtained by multiplying the direct control interest of the taxpayer in entity A by the entity's direct control interest in entity B.

This process of multiplication is continued where there are further entities in the chain.

Indirect control interest may only be traced through a controlled foreign entity

An indirect control interest in a foreign entity can be traced only through controlled foreign entities (CFEs). These are CFCs, controlled foreign partnerships (CFPs) and controlled foreign trusts (CFTs).

A CFP is a partnership which does not have a resident partner and has at least one CFC or a CFT as a partner. A CFT is a trust, other than a resident trust:

- that has an eligible transferor—see appendix 2—or
- where five or fewer residents and their associates hold, or are entitled to acquire, 50 per cent or more of the income or capital of the trust.

Deeming rules for tracing an indirect control interest

For determining the indirect control interest in an entity—but not for working out the amount of the income to be attributed to a taxpayer—a resident or an interposed CFC is deemed, in the following specified circumstances, to own a 100 per cent interest in a lower tier entity.

The control tracing interest of an entity will be treated as 100 per cent if, together with associates, the entity:

- has an interest of at least 50 per cent in a foreign company
- satisfies the assumed controller test in relation to a foreign company
- actually controls the foreign company
- is a partner in a partnership that is not an Australian partnership
- is an eligible transferor in relation to a trust or
- has an interest of at least 50 per cent in a trust that is not an Australian trust.

EXAMPLE 7

Indirect control interest

A resident company holds a 60 per cent interest in a foreign company, FC1, which holds a 35 per cent interest in another foreign company, FC2. FC2 holds a 60 per cent interest in foreign company FC3. Another resident holds a 20 per cent interest in FC2.

The indirect control interest of the resident company in FC3 is worked out as follows:

Resident company	*Direct control interest* %	*Control tracing interest* %
FC1	60	100
FC2	35	35
FC3	60	100

The indirect control interest of the resident in FC3 is therefore:

100% × 35% × 100% = 35%

It is possible to trace interests through FC2 because it is a CFC. FC3 is also a CFC because the resident company has an indirect control interest of 35 per cent in FC3 and another resident has an indirect control interest of 20 per cent in FC3—that is, 20 per cent in FC2 x 100 per cent interest for tracing control of FC2 in FC3.

Associate inclusive control interest

Your associate-inclusive control interest in a foreign company is the sum of:

- your direct control interests in the foreign company
- your indirect control interests in the foreign company
- the direct and indirect control interests of your associates in the foreign company.

To avoid double counting, an indirect control interest is not taken into account when determining a direct control interest or another indirect control interest which have been counted.

Section 2—Are you an attributable taxpayer?

If you have an interest in a CFC you must determine if you are an attributable taxpayer. You are only required to include an amount of attributable income from a CFC in your assessable income if you are an attributable taxpayer in relation to the CFC.

You will be an attributable taxpayer if:

- you have an associate-inclusive control interest of 10 per cent or more in a CFC or
- all of the following rules apply:
  - the CFC is a CFC because of the application of the de facto control test
  - you are an Australian 1 per cent entity
  - you are part of a group of five or fewer Australian entities who, alone or with associates—regardless of whether the associates are Australian entities—control the CFC.

What share of the attributable income of a CFC must you include in your assessable income?

If you are an attributable taxpayer, you may be attributed a share of a CFC's attributable income. Your share is called an attribution percentage and is based on your rights to profits from the CFC.

Working out your attribution percentage

Your attribution percentage in a CFC is the sum of your:

- direct attribution interest in the CFC and
- indirect attribution interests in the CFC.

The interests of your associates are not included.

Direct attribution interest in a CFC

Your direct attribution interest in a CFC is the greatest of the percentages that you hold or are entitled to acquire, of the following:

- total paid up share capital in the CFC
- total rights to vote, or to participate in any decision making, in relation to:
  - the distributions of capital or profits
  - changing of constituent documents
  - varying of share capital of the CFC
- total rights to distributions of capital or profits of the CFC on winding-up or
- total rights to distributions of capital or profits of the CFC other than on winding-up.

Test time

Your direct attribution interest in a CFC is measured at a point in time called a test time. The test time may occur during the accounting period of a CFC.

In some cases, it may not be possible to measure the percentage you hold of the total rights to the profits of a company or to a distribution of capital on winding-up of the company before the end of the company's accounting period.

In these cases, your rights to capital or profits are measured at the end of the accounting period of the company. It is assumed for this purpose that the rights you held at the test time are held at the end of the company's accounting period.

Exclusion of eligible finance shares

In working out your direct attribution interest in a CFC, eligible finance shares in the CFC are not taken into account.

Indirect attribution interest in a CFC

You may hold an attribution tracing interest in an entity—entity A—which holds an attribution tracing interest in another entity—entity B.

Your indirect attribution interest in entity B is obtained by multiplying your attribution tracing interest in entity A by that entity's attribution tracing interest in entity B.

This process of multiplication is continued where there are further CFEs in the chain of entities.

Attribution tracing interests in a CFC

Your attribution tracing interest in a CFC is equal to your direct attribution interest in the CFC—the deemed 100 per cent rule for tracing control does not apply when tracing your attribution percentage.

Attribution tracing interest in a CFP

The attribution tracing interest of a partner in a partnership is the percentage the partner holds or is entitled to acquire of the profits of the partnership or of the partnership property. Where the two percentages differ, the attribution tracing interest will be the greater of those percentages.

Attribution tracing interest in a CFT

The attribution tracing interest that a beneficiary of a trust holds in the trust is the percentage of the income or property of the trust to which the beneficiary is presently entitled. The beneficiary's attribution tracing interest also includes a percentage of the income or property of the trust which the beneficiary is entitled to acquire. If the percentage of the income and the percentage of the property differ, the higher percentage is treated as the attribution tracing interest.

An eligible transferor has an attribution tracing interest in the CFT equal to 100 per cent. Refer to part 1 of chapter 2 to determine whether you are an eligible transferor.

Reduction of the attribution percentage where the total percentage is more than 100 per cent

In some cases, the total of the attribution percentage of all attributable taxpayers may be more than 100 per cent. In these cases, the aggregate is reduced to 100 per cent by reducing proportionately the interest of each attributable taxpayer.

EXAMPLE 8

Reduction where attribution percentage is more than 100 per cent

A foreign company has two classes of shares on issue. Class A carries the right to vote but no income rights. Class B carries the right to income and is non-voting. An Australian resident—Res1— owns 25 per cent of the Class A shares and 75 per cent of the Class B shares. Another resident owns the remaining shares in each class. The foreign company is a CFC and both residents are attributable taxpayers.

Res1's attribution percentage (greater of 25% and 75%)	75%
Res2's attribution percentage (greater of 75% and 25%)	75%
Total interest of residents	150%

Each attributable taxpayer's attribution percentage is reduced in proportion, so that the aggregate interests of all attributable taxpayers is 100 per cent.

$$\text{Res1's reduced attribution percentage} = \frac{\text{attribution percentage}}{\text{total interest of attributable taxpayers}}$$

$$= \frac{75}{150} = 50\%$$

$$\text{Res2's reduced attribution percentage} = \frac{\text{attribution percentage}}{\text{total interest of attributable taxpayers}}$$

$$= \frac{75}{150} = 50\%$$

Section 3—Is the CFC's income generally exempt from accruals taxation?

A number of exemptions from accruals taxation are provided for amounts taxed in a comparable tax country listed in the Income Tax Regulations. Before 1 July 1997, the same list was also used to provide exemptions under the foreign tax credit system. There are now separate lists for the exemptions.

Countries listed for accruals taxation purposes are called broad-exemption listed countries. These countries are listed in part 1 of attachment A in appendix 1. Countries not listed for accruals taxation purposes are called non-broad-exemption listed countries.

Countries listed for the purposes of the foreign tax credit system but not for accruals taxation purposes are called limited-exemption listed countries. These countries are listed in part 2 of attachment A in appendix 1. Countries on either the broad-exemption or limited-exemption lists are treated as listed for the purposes of the foreign tax credit system. Countries not on either list are called unlisted countries.

Summary of the terms used to refer to countries

Broad-exemption listed countries

The term broad-exemption reflects that amounts taxed at full rates by countries on the broad-exemption list are generally exempt from both accruals taxation and taxation on repatriation to Australia.

Limited-exemption listed countries

The term limited-exemption reflects that amounts taxed at full rates by countries on the limited-exemption list are generally exempt from tax on repatriation to Australia. An exemption from accruals taxation is not available, however, for amounts taxed in a limited-exemption listed country.

Listed countries

Listed countries are countries on the list of broad-exemption countries or on the list of limited-exemption countries.

Unlisted countries

Unlisted countries are countries that are not on either the broad-exemption or limited-exemption lists.

Non-broad-exemption listed countries

Non-broad-exemption listed countries are countries that are not on the list of broad-exemption countries. They comprise unlisted countries and countries on the list of limited-exemption countries.

Transitional rules

The broad-exemption and limited-exemption lists apply for statutory account periods of CFCs commencing on or after 1 July 1997. Unless otherwise stated, references to broad-exemption listed countries in this guide are to be treated as references to countries on the original list in working out the attributable income of a CFC for a statutory accounting period commencing before 1 July 1997. Countries on the original list are listed in part 3 of attachment A in appendix 1.

When is a CFC a resident of a broad-exemption listed country?

A CFC is treated as a resident of a broad-exemption listed country if:

- the CFC is not a Part X Australian resident and
- the CFC is treated as a resident of the broad-exemption listed country under the tax laws of that country.

A CFC that is a resident of both a broad-exemption listed country and another country is treated as a resident of a broad-exemption listed country.

When is a CFC a resident of a limited-exemption listed country?

A CFC is treated as a resident of a limited-exemption listed country if:

- the CFC is not a Part X Australian resident and
- the CFC is treated as a resident of the limited-exemption listed country under the tax laws of that country.

A CFC that is a resident of both a limited-exemption listed country and an unlisted country is treated as a resident of a limited-exemption listed country.

When is a company a resident of an unlisted country?

A company is treated as a resident of an unlisted country if the company is neither a Part X Australian resident nor a resident of a listed country.

Rules that determine the particular country of residence

In some cases, it is necessary to determine whether a company is treated as a resident of a particular unlisted country—for example, for determining the active income test.

A company is treated as a resident of a particular unlisted country if :

- the company is treated as resident under a tax law of the unlisted country and
- the company is not treated as resident of any other unlisted country under the tax law of that country.

If a company is treated as a resident of more than one unlisted country under the tax laws of those countries and is incorporated in one of those countries, it is treated as resident in the country of incorporation.

If a company is not treated as a resident under the tax law of any unlisted country, it will be a resident of the unlisted country in which its management and control is solely or principally located.

If a company is not treated as a resident under the tax law of any unlisted country and does not have its central management and control solely or principally in an unlisted country, it will be a resident of the unlisted country in which it is incorporated.

Section 4—What types of attribution can apply?

Sections 1 and 2 asked the following questions:

- is the foreign company a CFC?
- are you an attributable taxpayer?

If the answer to both of these questions is yes, the next step is to determine whether you must include an amount in your assessable income. There are three types of attribution.

Dividend attribution

If you were an attributable taxpayer of a CFC resident in an unlisted country and the CFC paid a dividend while you were an attributable taxpayer, you may be subject to dividend attribution.

Attribution on change of residence

If you were an attributable taxpayer of a CFC resident in an unlisted country and the CFC changed its residence to a listed country or to Australia while you were an attributable taxpayer, you may be subject to attribution on your share of the accumulated profits of the CFC.

Attribution of current year profits

If you are an attributable taxpayer of a CFC at the end of the CFC's statutory accounting period, you may need to include the whole or a part of the profits of that period in your assessable income.

The attribution of current year profits of a CFC may be reduced if you have been subject to dividend attribution or attribution on change of residence by the CFC. Read chapter 3 and appendix 3 to see whether either of these apply to you.

Section 5—Do you have to work out the attributable income of a CFC?

This section will tell you whether you need to work out the attributable income of the CFC. A brief description of the calculation follows.

Overview of the calculation

If you are an attributable taxpayer, your assessable income may include a share of the profit, if any, from certain types of income and gains of the CFC. The profit of the CFC is called attributable income and is worked out before taking into account your share of the profit—called your attribution percentage.

You work out attributable income based on the existing rules for working out the taxable income of a resident company. However, not all of the profits of a CFC are taken into account in working out the attributable income of the CFC.

The general rule
The general rule is that only amounts that arise from certain transactions which are classified as prone to tax minimisation are taken into account—called tainted income. These will only be taken into account if a CFC is not mainly engaged in genuine business activities—that is, where the CFC fails the active income test.

Exception for a listed country
An exception to the general rule is made for a CFC that is a resident of a listed country and derives certain untaxed income or gains from sources outside the listed country. These amounts are taken into account whether or not the CFC passes the active income test.

Exception for trust amounts
Another exception to the general rule is for certain trust amounts derived by a CFC. These will be taken into account whether or not the CFC passes the active income test.

Exception for foreign investment fund income
Income arising under the foreign investment fund (FIF) measures will also be taken into account even if the CFC passes the active income test.

Exception for comparably taxed amounts
Further, amounts are only taken into account if they are not taxed in full in Australia or comparably taxed in a broad-exemption listed country. Amounts arising in a broad-exemption listed country are assumed to be comparably taxed if they do not qualify as eligible designated concession income described in the Income Tax Regulations and in appendix 1 of this guide.

Relevant period

An amount will normally only be included in your assessable income if the CFC's statutory accounting period ends in your income year.

EXAMPLE 9

Taxpayer with a standard year of income

A taxpayer whose income year ends on 30 June has a CFC with a statutory accounting period which also ends on 30 June. For the taxpayer's income year ending 30 June 1998, the taxpayer must include a share of the attributable income of the CFC for the statutory accounting period ending 30 June 1998.

EXAMPLE 10

Taxpayer who balances early

A taxpayer whose income year ends on 31 March has a CFC with a statutory accounting period ending 30 June. For the taxpayer's income year ending 31 March 1998, the taxpayer must include a share of the attributable income of the CFC for the statutory accounting period ending 30 June 1997. The CFC's attributable income for the period 1 July 1997 to 30 June 1998 would not be included in the taxpayer's assessable income until the income year ending 31 March 1999.

Special rule for companies that cease to exist
If a company that was a CFC at the beginning of its statutory accounting period ceases to exist before the end of that period, the end of the company's statutory accounting period is deemed to be immediately before it ceased to exist.

EXAMPLE 11

Shortened statutory accounting period when a company ceases to exist

A CFC elects a statutory accounting period that aligns with its usual accounting period of 1 January to 31 December. The company members pass a resolution to wind up the company on 1 August 1995 and it is finally de-registered on 2 November 1995 in accordance with the corporation law in the company's country of residence. As the company ceased to exist during what was its statutory accounting period, the company's statutory accounting period is taken to be from 1 January 1995 to 2 November 1995.

Conditions to be met before you work out attributable income

You only need to work out attributable income if a foreign company is a CFC at the end of the foreign company's statutory accounting period. In addition, you will only need to work it out if you are an attributable taxpayer at the end of the period.

If you have an interest in a CFC at the end of the CFC's statutory accounting period, you must work out the attributable income of the CFC for the entire period, not just for the time you held the interest.

EXAMPLE 12

Disposal of a CFC before the end of a statutory accounting period

A resident individual with an income year ending 30 June has a CFC with a statutory accounting period that coincides with the individual's income year. On 31 December 1997 the individual disposes of the CFC to an unassociated resident company.

In this case, the resident individual will not be an attributable taxpayer for the CFC's statutory accounting period ending 30 June 1998. Consequently, the resident individual will not include in their assessable income any of the attributable income of the CFC for the period.

EXAMPLE 13

Acquisition of a CFC part way through a statutory accounting period

Taking the facts from the previous example, the resident company would be an attributable taxpayer for the CFC's statutory accounting period ending 30 June 1998. The company would therefore be taxed on the attributable income of the CFC for the entire period even though the company owned the foreign company for only the second half of that period.

Note that, where there is an arrangement that is designed to avoid the CFC measures by selling an interest before the end of a CFC's statutory accounting period and acquiring the interest after the end of the period, you will be treated as if the interest were not sold.

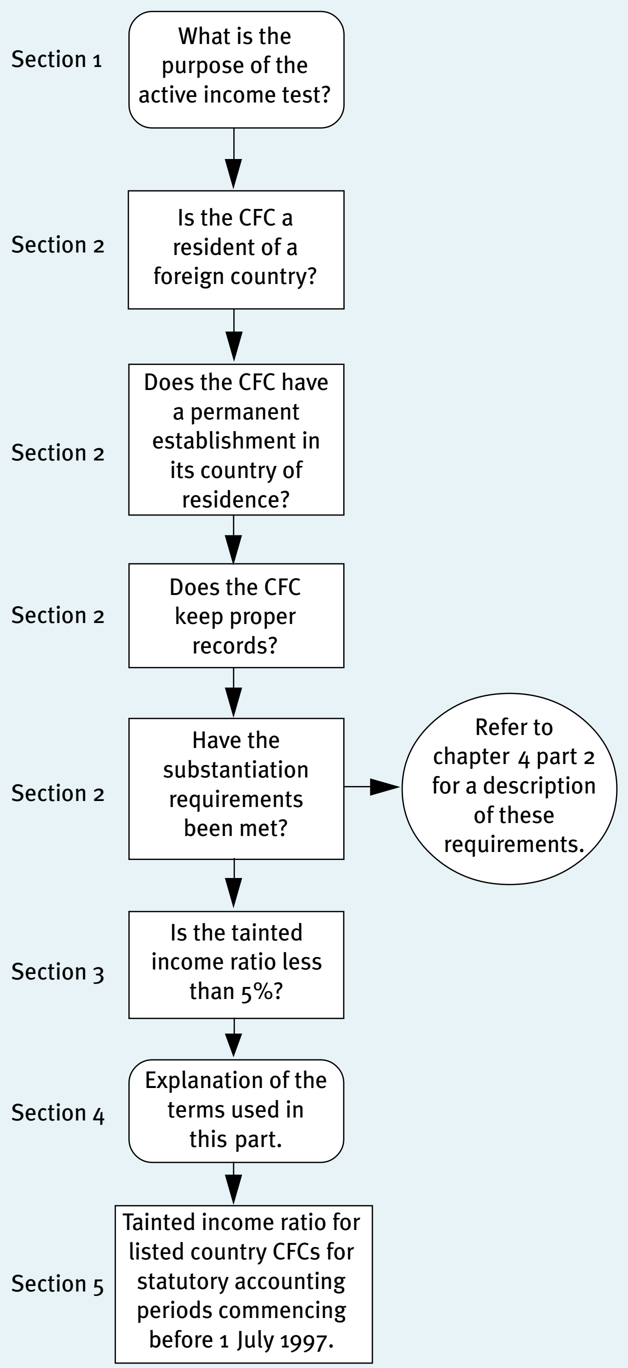
If you were an attributable taxpayer at the end of the CFC's statutory accounting period, read on.

If you were not an attributable taxpayer at the end of the CFC's statutory accounting period, you do not need to work out attributable income and do not need to read on.

Part 2—Is the CFC largely exempt because it is primarily engaged in a genuine active business?

Part 2 deals with the normal operation of the active income test. Special rules for banks, other financial institutions and insurance companies are not included.

Summary of part 2



Section 1—What is the purpose of the active income test?

The active income test is used to determine whether a CFC is predominantly engaged in carrying on an active business. An exemption from accruals taxation is available for certain amounts if the test is satisfied.

To determine whether the CFC is mainly engaged in carrying on an active business, the first step is to determine amounts that are likely to be earned in a low tax jurisdiction to defer Australian tax. These amounts are compared to the CFC's total income to determine the proportion of potential tax deferral activities. Only if this proportion is less than 5 per cent will the CFC be taken to be mainly engaged in genuine business activities.

The meaning of special terms used in the following commentary are contained in section 4 of this part.

Section 2—Conditions to be met to satisfy the test

A CFC has to satisfy the following five conditions to pass the active income test.

Condition 1—Is the CFC a resident of a foreign country?

The CFC must be a resident of a particular country throughout the statutory accounting period. A change of residence of the CFC does not mean that the CFC will fail the active income test. However, it must have been a resident of a particular country both before and after the change.

New companies
If a CFC was in existence for only part of a statutory accounting period, it must be a resident of a particular country throughout the period in which it existed—that is, in the period from incorporation to the end of the statutory accounting period.

Treatment of dormant companies
The term *in existence* does not include a company that is dormant within the meaning of Part VI of the *Companies Act 1981*. A CFC that is dormant for the whole of the statutory accounting period will fail the active income test. However, because the CFC is dormant, it will have no income or gains and will have no attributable income.

If the CFC is resident in a particular country, read on.

If the CFC is not a resident in a particular country, it has failed the active income test. Go straight to part 3.

Condition 2—Does the CFC have a permanent establishment in its country of residence?

The CFC must carry on business through a permanent establishment in its country of residence for the whole of a statutory accounting period in which it is in existence.

What is a permanent establishment?
The definition of permanent establishment is contained in section 6 of the Act. Broadly, the term includes a place at or through which normal business activities are carried on. However, it specifically excludes a place where a person:

- is engaged in business dealings through a commission agent or broker who is acting in the ordinary course of business and receiving customary rates of remuneration or
- is carrying on business through an agent who does not have or does not usually exercise a general authority to negotiate or conclude contracts or to fill orders from stock situated in the country or
- maintains the place solely for the purpose of purchasing goods or merchandise.

Partnership with a permanent establishment
Even if the CFC did not carry on business at or through a permanent establishment, the CFC will satisfy this condition if any partnership in which it is a member carried on business at or through a permanent establishment in the country of residence of the CFC.

If the CFC directly or indirectly through a partnership, carried on business through a permanent establishment in its country of residence, read on.

If the CFC did not carry on business through a permanent establishment in its country of residence, it has failed the active income test. Go straight to part 3.

Condition 3—Does the CFC keep proper records?

The figures used in the active income test are mainly drawn from accounting records and, in general, are not adjusted to comply with tax law concepts. Therefore, the accounts of the company must be properly prepared.

The accounts must be prepared in accordance with commercially accepted accounting principles. Where there are commercially accepted accounting principles in the country of residence of the CFC, it is acceptable if the accounts of the CFC comply with those principles. In other cases, it is acceptable if the accounts of the CFC comply with Australian commercially accepted accounting principles.

The documents you must take into consideration are:

- the profit and loss statement and balance sheet
- any ledgers or journals
- any notes, statements or reports that are attached to, or meant to be read with, these accounts.

The accounts of a CFC for a statutory accounting period must give a true and fair view of the financial position of the CFC. If the accounts are prepared in accordance with commercially accepted accounting principles but do not give a true and fair view, the CFC will fail the active income test.

Treatment of partnerships
Where a CFC is a partner in a partnership, the CFC's share of the partnership income must be taken into account. This means that the partnership must also keep proper accounts. If the partnership does not keep proper accounts, the CFC will fail the active income test.

If both the CFC and every partnership in which it was a partner kept proper accounts that give a true and fair view, read on.

If the CFC and every partnership did not keep proper accounts, the CFC has failed the active income test. Go straight to part 3.

Condition 4—Have the substantiation requirements been met

A CFC must have, and be able to produce, accounts to substantiate your claim that the CFC has passed the active income test. If the CFC is a partner in a partnership, that partnership must also keep accounts to substantiate amounts derived by the partnership. If the CFC or partnership does not have the accounts, or does not produce them, the CFC is taken to have failed the active income test. See chapter 4 for details of the substantiation requirements and the procedures.

> **If the CFC and any partnership in which the CFC is a partner is able to substantiate your claim, read on.**
>
> **If the CFC or the partnership cannot substantiate your claim, the CFC has failed the active income test. Go straight to part 3.**

Condition 5—Tainted income ratio less than 5 per cent

To pass the active income test, the tainted income ratio of a CFC for a statutory accounting period must be less than 0.05—that is, less than 5 per cent. If both the bottom line and the top line of the relevant formula is nil, the CFC is taken to have passed the active income test.

Section 3—Is the tainted income ratio less than 5 per cent?

The tainted income ratio for a CFC is worked out as follows:

$$\frac{\textbf{gross tainted turnover}}{\textbf{gross turnover}}$$

A different tainted income ratio applies for statutory accounting periods of listed country CFCs commencing before 1 July 1997. The ratio is discussed in section 5.

Gross turnover

Broadly, the gross turnover of a CFC is the sum of the company's net gains and gross revenue. Work out the gross turnover using the following five steps:

- identify the total gross revenue derived by the CFC
- exclude certain comparably taxed amounts
- exclude the proceeds of certain asset disposals
- add back net gains arising from certain asset disposals
- add the CFC's share of the gross turnover of each partnership in which it was a partner.

The figures used are mainly drawn from the accounts of the CFC. If the accounts are prepared in a foreign currency, there is no need to translate the amounts to Australian dollars.

Step 1—Identify total gross revenue
The total gross revenue is the sum of amounts shown in the accounts of a CFC as gross revenue—that is, deductions are not taken into account. Do not include amounts that have not been brought to account in the period. For example, an amount may not be recognised in the accounts because its receipt is extremely doubtful. This amount would not be included in gross revenue. The exclusion of the amount must, however, be in accordance with commercially accepted accounting principles and give a true and fair view of the CFC's financial position.

Step 2—Exclusion of comparably taxed amounts
Certain comparably taxed amounts are excluded from the active income test. They are:

- a franked dividend
- an amount included in the CFC's assessable income in any year of income, unless the amount is subject only to dividend or interest withholding tax or is not fully taxed—for example, certain shipping income or insurance premiums
- an amount arising from the disposal of a taxable Australian asset—refer to section 3 of part 3 for an explanation of a taxable Australian asset
- an amount that is an attribution account payment to the extent the profits from which the payment was made have previously been attributed to you
- an amount derived through a branch in a broad-exemption listed country if the amount is taxed in that country—the exclusion does not apply to amounts derived in a CFC's country of residence or to amounts of eligible designated concession income
- a non-portfolio dividend derived from a company resident in a listed country

- a non-portfolio dividend derived from a company resident in an unlisted country if the underlying profit from which the dividend was paid has been taxed in a listed country—this is called the exempting profits part of the dividend.

Because trust amounts arising to a CFC are attributed regardless of whether the CFC passes the active income test, they are also excluded from the test. So too are any dividends paid by an unlisted country CFC.

Step 3—Exclusion of proceeds from certain asset disposals

Amounts that arise from asset disposals are excluded from the gross revenue. However, this exclusion does not extend to disposals of trading stock. Amounts included in gross revenue from currency exchange rate fluctuations and commodity investments are also excluded.

Step 4—Add back net gains

The amounts that were excluded under step 3 are brought back into gross turnover as net amounts. There are three separate net amounts:

- the net gain from the disposal of commodity investments
- the net gain from currency exchange rate fluctuations
- the net gain from the disposal of other assets that are not trading stock or commodity investments.

In each case, to determine the net gain, the sum of the individual gains is reduced by the sum of the losses. If there is a net loss, the amount is ignored—it does not reduce the gross turnover. It is important to note that there is a separate calculation of net gain for each of the categories. Do not take comparably taxed amounts into account.

Consideration paid or received for asset disposals must be included at market value. Where an amount has been written down in the accounts, the write-down is to be ignored.

Step 5—Inclusion of partnership turnover

A CFC's share of the gross turnover of a partnership must be added to the CFC's gross turnover. This is done for each partnership in which the CFC is a partner. This means that you must go through the same process—steps 1 to 4—for each partnership.

In working out the total, treat the partnership as if it were a CFC. The partnership is assumed to be a resident of the same country as the CFC.

Result of steps 1 to 5

Add the amounts at steps 2 and 3. Take this total away from the total revenue at step 1. The balance is the gross revenue after exclusions.

Add the totals of steps 4 and 5. This is the CFC's gross turnover.

Gross tainted turnover

Gross tainted turnover is the part of the gross turnover that is either passive income, tainted sales income or tainted services income.

Broadly, passive income includes:

- dividends
- tainted interest income
- annuity income
- tainted rental income
- tainted royalty income
- amounts derived as consideration for the assignment in whole or part of any copyright, patent, design, trade mark or other like property or right
- net gains on the disposal of tainted asset
- income derived in carrying on a business of trading in tainted assets
- net tainted commodity gains
- net tainted currency exchange gains.

Tainted sales income and tainted services income are, broadly, income from certain transactions with, or originating from, associates or Australian residents.

The gross tainted turnover is worked out using the following five steps:

Step 1

Identify the part of gross revenue that is passive income.

Step 2

Add the part of gross revenue that is tainted services income.

Step 3

Add the part of gross revenue that is tainted sales income.

Step 4
Add the part of the gross turnover that is net tainted gains.

Step 5
Add the CFC's share of the gross tainted turnover of each partnership in which it was a partner.

Steps 1, 2 and 3—Identify the tainted part of gross revenue
Identify which parts of the gross revenue are passive income, tainted sales income or tainted services income—that is, determine the tainted part of the result after step 3 of the calculation of gross turnover.

Step 4—Identify tainted net gains
Identify the parts of the net gains that are tainted—that is:

- the part of the net gain from the disposal of commodity investments that is tainted
- the part of the net gain from currency exchange rate fluctuations that is tainted
- the part of the net gain from the disposal of assets—other than trading stock or commodity investments—that is tainted.

Each of the net tainted gains is calculated separately and cannot exceed the amount of the net gain to which it relates. To do this you will need, in each case, to calculate the net gain and the net tainted gain. If the net tainted gain is greater than the net gain, use the net gain instead of the net tainted gain.

Step 5—Identify the CFC's share of a partnership's gross tainted turnover
Go through steps 1 to 4 for each partnership in which a CFC was a partner. The CFC's share of the gross tainted turnover of each partnership is then added to the CFC's tainted income that was derived directly.

Working out the ratio

The tainted income ratio is worked out by dividing the gross tainted turnover of a CFC by the gross turnover of the CFC.

The following is a simple example of how to work out the tainted income ratio.

EXAMPLE 14

Working out the active income test ratio

	$HK shown in accounts
Interest—passive	2m
Royalty—passive	1m
Business income—from goods manufactured in Hong Kong	60m
Manufacturing expenses	40m

$$\text{Tainted income ratio} = \frac{\text{gross tainted turnover}}{\text{gross turnover}} = \frac{3m}{63m} = 4.8\%$$

Therefore, the CFC passes the test.

If the tainted income ratio is less than 5 per cent, the CFC has passed the active income test. If the tainted income ratio is 5 per cent or more, the CFC has failed the active income test. Go to part 3.

Section 4—Explanation of terms used in this part

Meaning of passive income

Dividends
Passive income includes all dividends. The term dividend includes:

- unit trust dividends received from a corporate unit trust or a public trading trust
- a distribution made by a liquidator which is deemed to be a dividend.

Interest income
Passive income includes tainted interest income, which is all interest income except for interest derived through an offshore banking unit. It also specifically includes:

- amounts in the nature of interest—for example, discounts
- income earned from hire purchase and other property financing transactions

- accrued interest on discounted and other deferred interest securities issued after 16 December 1984
- interest deemed to be derived where a CFC assumes the rights of a lender through the purchase of securities through a secondary market
- factoring income.

Tainted rental income

There are three categories of tainted rental income.

- **Rent from associates**
  Income from any leases between a CFC and an associate and any income that arises where rent is paid to the CFC by an associate.
- **Lease of land**
  Income from related party lease transactions and income from leases of land—including all fixtures—except where the land is located in the same country as the CFC is resident. The income from the lease of the land will not be tainted if the CFC provides labour-intensive property management by directors or employees of the CFC.
- **Ships and aircraft**
  Income from the lease of ships or aircraft, cargo containers for use on ships or aircraft or plant or equipment for use on board ships, unless the income relates to the provision of operating crew in relation to ships and aircraft or maintenance or management services by the CFC's directors or employees.

Excluded rental income

An amount of rental income will not be treated as tainted if the following three requirements are satisfied:

- the amount is derived from an associated CFC resident in the same country
- the amount is subject to the normal company rate of tax in that country
- the payment of the amount did not wholly or partly give rise to a notional allowable deduction for the associated CFC.

The second requirement is based on whether an amount has been subject to the normal company rate of tax in a country. For an amount to be treated as taxed at a country's normal company rate, the amount must be taxed at the same rate applicable to the company's other income or at a higher rate. In addition, there can be no entitlement to a credit, offset or tax concession in the taxation of the amount.

For the third requirement, it is assumed that the associated CFC failed the active income test. The requirement will not be satisfied if a payment would have resulted in a notional allowable deduction for an associated CFC if the CFC had been required to work out its attributable income.

This exclusion applies only for statutory accounting periods of CFCs commencing on or after 1 July 1997.

Tainted royalty income

Tainted royalty income includes income derived from assigning any copyright, patent, trademark or other like property or right.

Specifically excluded from tainted royalty income are royalties received from unrelated persons in the course of carrying on a business where the CFC substantially develops or improves the property or right for which the royalty is paid. For example, if a CFC develops software and licenses it to an unrelated party, the royalty income is not tainted.

Net gains on the disposal of tainted assets

The net gain—that is, the sum of gains less losses—from the disposal of tainted assets is included in passive income.

What is a tainted asset?

Tainted assets include:

- all shares, interests in trusts and interests in partnerships
- most financial instruments—such as loans, forward and futures contracts, swaps, other securities and life assurance policies
- rights or options over any of the above.

An asset will also be tainted if it is held by a CFC to derive tainted rental income. In order to determine whether an asset is used to produce tainted rental income, you must look at the use of the asset over the whole time of ownership. If the purpose changed during that period, the asset will be treated as being used to produce tainted rental income if this was the purpose for the majority of the period of ownership.

An asset will be treated as a tainted asset if it is not trading stock and is not used solely in carrying on business.

Exclusion of commodity investments

Commodity investments are not tainted assets. They are treated separately when working out net tainted commodity gains.

Proceeds from trading in tainted assets

Income derived in carrying on a business of trading in tainted assets is included in passive income.

Net tainted commodity gains

The net gain on the disposal of tainted commodity investments is included in passive income.

What is a tainted commodity gain?

A tainted commodity gain or loss arises from the disposal of a tainted commodity investment.

What is a tainted commodity investment?

Commodity investments that are tainted include futures or forward contracts for a commodity—or a right or option on such a contract—unless the company carries on a business of producing or processing the commodity or uses the commodity as a raw material. To be excluded, the contract right or option must relate to the carrying on of that business and the resultant physical sale of the commodity must not be tainted sales income.

Net tainted currency exchange gains

A net tainted currency gain is the sum of the tainted currency exchange gains less the sum of the tainted currency exchange losses. If this is positive there is a net gain. If not, the amount is ignored.

What is tainted currency exchange gain or loss?

A gain or loss from a currency exchange fluctuation will be tainted unless it falls within one of the following categories:

- the underlying transaction was for the purchase of goods from an unassociated person or
- the underlying transaction was for the purchase or sale of depreciable plant or equipment that was used mainly to produce income that is not passive, tainted sales or tainted services or
- the underlying transaction was a hedge for one of the preceding transactions or
- the CFC was carrying on business as a currency trader and no other party to the transaction was an associate or an Australian resident.

Meaning of tainted sales income

The tainted sales income of a CFC includes that part of gross turnover that represents sales income where the goods sold were purchased from or sold to:

- an associate who is a Part X Australian resident or
- an associate who is not a Part X Australian resident but carried on business in Australia through a permanent establishment.

Sales which result in tainted sales income

	Purchased from	*Tainted sales?*
Sold to anyone →	Associated Australian	Yes
	Associated non-resident (via Australian branch)	Yes
	Unassociated Australian	No
	Associated non-resident (not via Australian branch)	No
	Unassociated non-resident	No

Purchases which result in tainted sales income on sale

	Sold to	*Tainted sales?*
Purchased from anyone →	Associated Australian	Yes
	Associated non-resident (via Australian branch)	Yes
	Unassociated Australian	No
	Associated non-resident (not via Australian branch)	No
	Unassociated non-resident	No

Exclusions from tainted sales income

Manufacturing exclusion

The main exclusion from tainted sales income is sales where the CFC manufactures, extracts, produces or substantially alters the goods sold. This would include, for example, sales from mining and quarrying operations.

This exclusion will apply only where the goods sold were manufactured, produced or substantially altered by the directors or employees of the CFC. The packaging and labelling of goods is not considered to be a substantial alteration of those goods.

The exclusion will not be available where the CFC subcontracts the manufacture, production or substantial alteration to agents or subcontractors. However, the fact that a CFC subcontracts some operations will not disqualify it from the manufacturing exclusion if directors or employees of the CFC carry out a substantial part of the manufacture, production or substantial alteration.

Hospitality exclusion

Also excluded from tainted sales income are sales that, broadly, arise from the tourism and hospitality industry. These are sales provided in connection with a hotel, motel, guesthouse, restaurant, bar or other place of entertainment or recreation.

Passive income exclusion

Amounts of passive income are excluded from tainted sales income. This prevents double counting.

Meaning of tainted services income

Tainted services income, in broad terms, means income derived from the provision of services to either:

- an associate of the CFC
- a resident of Australia or
- in connection with a permanent establishment in Australia.

Services includes any benefit, right or privilege provided under an arrangement for the performance of work or the provision of facilities—for example, performance of technical, managerial or transport work.

Tainted services income

Provided to		*Tainted services?*
Associated Australian	→	Yes
Associated non-resident (via Australian branch)	→	Yes
Unassociated Australian	→	Yes
Associated non-resident (not via Australian branch)	→	Yes
Unassociated non-resident (via Australian branch)	→	Yes
Unassociated non-resident (not via Australian branch)	→	No

Exclusions from tainted services income

General exclusions

Tainted services income does not include:

- royalties
- any income in respect of a lease of land
- any income from trading in tainted assets
- gains from currency exchange rate fluctuations, commodity investments and assets.

Manufacturing exclusion

There is an exclusion from tainted services income where the service relates to goods manufactured by a CFC. For example, payments for after sales service or income derived under a service contract for equipment manufactured by a CFC.

Hospitality exclusion

Also not included in tainted services income are services that, broadly, arise from the tourism and hospitality industry. These amounts are services provided in connection with a hotel, motel, guesthouse, restaurant, bar or other place of entertainment or recreation.

Passive and tainted services income exclusion

Tainted services income does not include passive income or tainted sales income. This prevents double counting.

Exclusion for services income derived from a CFC resident in the same country

Amounts of services income will not be treated as tainted if the following three requirements are satisfied:

- the amounts are derived from an associated CFC resident in the same country
- the amounts are subject to the normal company rate of tax in that country and
- the payment of the amounts did not wholly or partly give rise to a notional allowable deduction for the associated CFC.

For more information on these requirements, refer to the exclusion for rental income discussed earlier in this section.

This exclusion is available only for statutory accounting periods of CFCs commencing on or after 1 July 1997.

Section 5—Tainted income ratio for listed country CFCs for statutory accounting periods commencing before 1 July 1997

The following tainted income ratio is used to determine the active income test for a CFC in a country on the original list for statutory accounting periods commencing before 1 July 1997:

$$\frac{\textbf{tainted eligible designated concession income}}{\textbf{eligible designated concession income}}$$

Countries on the original list are shown at attachment A in appendix 1.

Eligible designated concession income (EDCI) is the part of gross turnover that is both:

- designated as a concession by the Income Tax Regulations—see appendix 1
- is not taxed in any listed country other than under a designated concession.

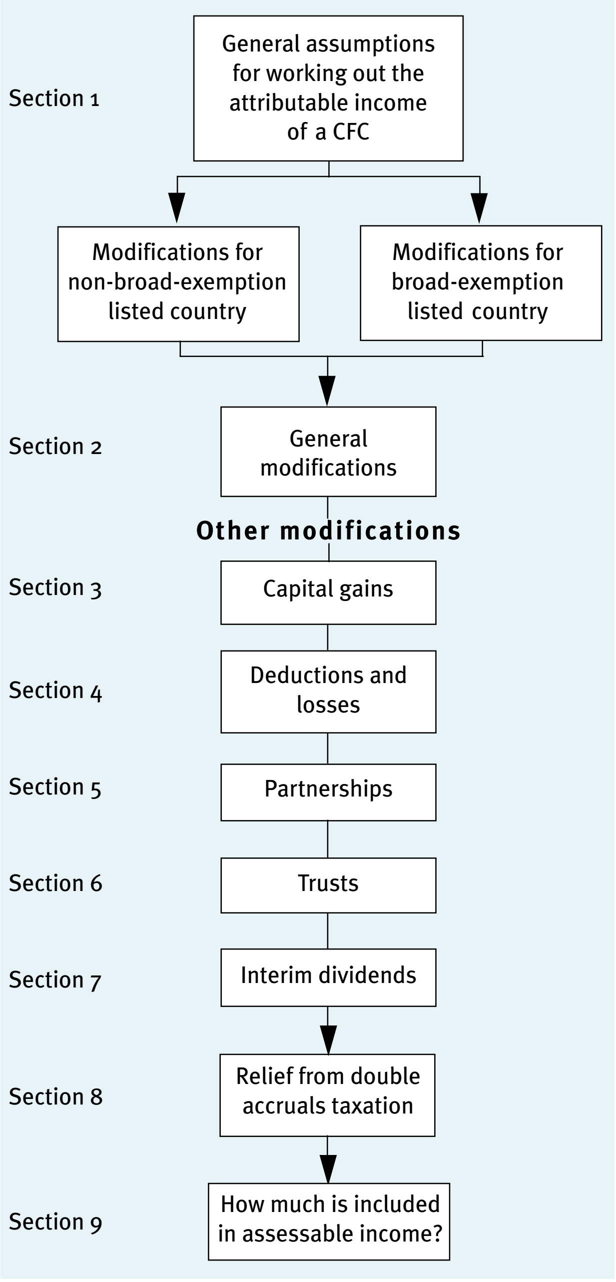
Tainted EDCI is EDCI that is also passive income, tainted sales income or tainted services income.

Part 3—Working out attributable income and the amount to include in your assessable income

This part explains how to work out the attributable income of a CFC. Your share of the attributable income is included in your assessable income.

Even if the CFC passes the active income test, you will still need to read on. Passing the test will eliminate many, but not all, types of attributed income and gains.

Summary of part 3



Section 1—General assumptions for working out the attributable income of a CFC

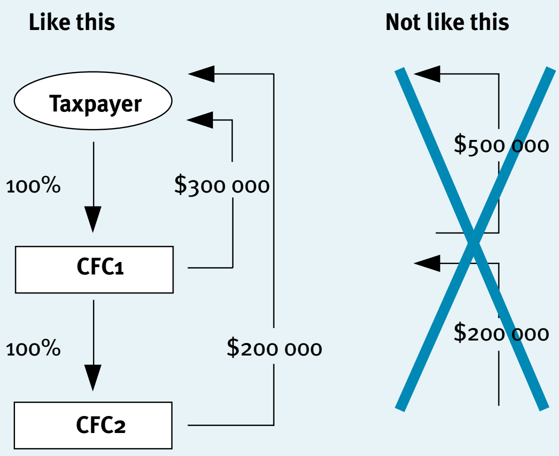
Attributable income is included directly in your assessable income. It is not necessary to aggregate amounts of attributable income as you trace through a chain of CFCs.

EXAMPLE 15

Attribution directly to taxpayer

Assume you wholly own a foreign company which, in turn, wholly owns another foreign company. Also assume that the first company has $300 000 attributable income and the second company has $200 000 attributable income.

You include an amount in your assessable income as follows:



Attributable income is taxable income

Attributable income is a hypothetical amount. It is the amount that would be the taxable income of a CFC, based on certain assumptions. These are explained below.

Assume the CFC is a resident taxpayer

To work out attributable income it must first be assumed that the CFC is both a resident of Australia and a taxpayer for the whole of a statutory accounting period. You can then work out the attributable income in the same way as you work out the taxable income of a resident company. Amounts derived by a CFC from all sources will be taken into account because residents are taxable on their world wide income and gains.

To distinguish the calculation of attributable income from a 'real' calculation of taxable income, the amounts used to work out attributable income are called notional amounts. Thus, attributable income is the amount by which the notional assessable income is greater than notional allowable deductions. Income that is not notional assessable income is notional exempt income.

The assumption that a CFC is a resident of Australia does not change the nature of the activities of the CFC—that is, events that occur in a foreign country will not be taken to have occurred in Australia.

Modifications in working out the attributable income of a CFC

In applying the Act to work out a CFC's hypothetical taxable income, assume that certain modifications have been made to the Act and read the Act as if those modifications were incorporated.

In some cases, provisions are ignored because the application is not appropriate. In other cases, provisions have been replaced with similar provisions that are tailored to the way the attributable income is worked out.

In addition, provisions have been included that are not comparable to other provisions of the Act. These modifications are explained later in this part.

Some provisions of the Act clearly cannot apply when working out attributable income—for example, Part IV, which deals with the making of returns or assessments. Although these provisions of the Act are not specifically excluded from the calculation, for practical purposes they have no effect and can be ignored.

Accounting period is the year of income

Taxable income is worked out for a period called an income year. To apply the Act, the statutory accounting period of a CFC is assumed to be an income year. The particular income year referred to in working out attributable income will be the income year of the attributable taxpayer in which the statutory accounting period ends.

EXAMPLE 16

Assume you are working out the amount to be included in assessable income for the year ending 30 June 1997 and the statutory accounting period of the CFC ended on 30 September 1996. The attributable income of the CFC for that statutory accounting period is to be worked out in accordance with the provisions of the Act that applied for the year ended 30 June 1997.

Work out attributable income separately

You must work out your attributable income for a CFC separately to other attributable taxpayers. Different taxpayers may work out different amounts of attributable income for a CFC—that is, the amount included in assessable income may be different for each attributable taxpayer even if they have the same attribution percentage in the CFC.

There are differences in working out attributable income depending on whether a CFC is a resident of a broad-exemption or non-broad-exemption listed country.

Modifications for a non-broad-exemption listed country

The notional assessable income of a CFC includes only amounts that fall into specified categories. All other amounts are treated as notional exempt income.

The excluded amounts depend on whether the CFC passed or failed the active income test.

What if a CFC fails the active income test?

If a CFC fails the active income test, amounts that would be assessable if the CFC were a resident are included in attributable income to the extent they represent the following:

- adjusted tainted income derived by the CFC directly
- adjusted tainted income derived by the CFC indirectly as a partner in a partnership
- trust amounts arising directly
- trust amounts arising indirectly because the CFC is a partner in a partnership
- foreign investment fund (FIF) income derived by the CFC directly or indirectly as a partner in a partnership
- low-taxed third country income derived by a CFC in a limited-exemption listed country.

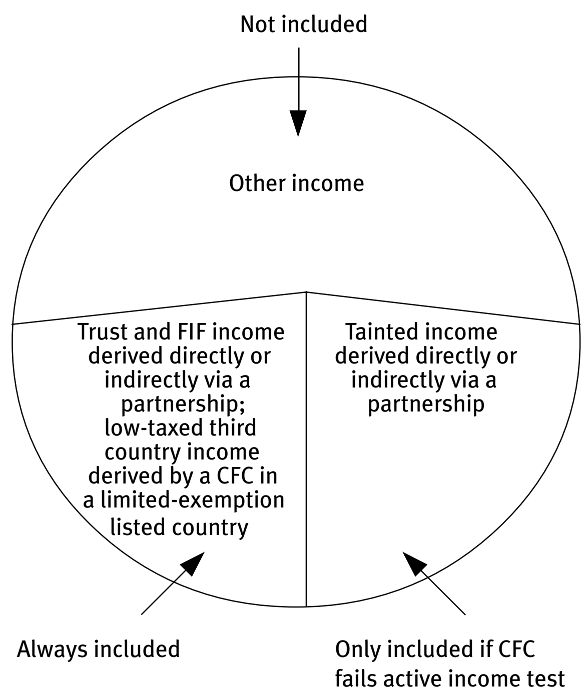
What if a CFC passes the active income test?

If a CFC passes the active income test, amounts that would be assessable if the CFC were a resident are included in attributable income to the extent they represent the following:

- FIF income derived by the CFC directly or indirectly as a partner in a partnership
- trust amounts arising to the CFC directly
- trust amounts arising to the CFC indirectly because the CFC is a partner in a partnership
- low-taxed third country income derived by a CFC in a limited-exemption listed country.

These amounts are explained in sections 5 and 6. Any other income is notional exempt income.

Diagram of amounts taken into account



What is adjusted tainted income?

Adjusted tainted income is based on the definition of tainted income used for the active income test. Broadly, it comprises amounts that are either passive income, tainted sales income or tainted services income.

The main difference in the definition of tainted income for the active income test and the definition for working out attributable income is that net gains are included in determining the active income test whereas the entire consideration on disposal of an asset is included when working out attributable income.

Low-taxed third country income

The notional assessable income of a CFC in a limited-exemption listed country includes amounts derived from sources outside the CFC's country of residence if the amounts are not subject to tax in a listed country. This rule does not apply to amounts of adjusted tainted income—these amounts are included in attributable income if the CFC fails the active income test. The source of an amount is to be determined according to the laws of the CFC's country of residence.

FIF income

The FIF rules apply in working out the attributable income of a CFC because of the assumption that the company is a resident of Australia. However, rules apply to prevent double taxation where a company FIF is also a CFC. These rules provide an exemption from the FIF measures for an interest held by a CFC in a company FIF if a share of the attributable income of the company FIF is included in your assessable income under the CFC measures for:

- a statutory accounting period coinciding with the notional accounting period of the company FIF for FIF taxation purposes or
- statutory accounting periods ending and commencing during the notional accounting period of the company FIF.

For the purposes of the above tests, the ATO will accept that a share of the attributable income of a company FIF has been included in your assessable income if no amount was included solely because the company FIF had no attributable income. Refer to *Taxation Determination TD 93/167* for further assistance.

Amounts not included

Some amounts that would normally be assessable if derived by a resident company are treated as notional exempt income in working out the attributable income of a CFC. Certain exemptions are also disregarded when working out attributable income. These exemptions have been replaced with similar provisions that are tailored for working out attributable income.

Amounts taxed in Australia

Amounts that have been taxed in full in Australia are not included in notional assessable income. Amounts will be treated as taxed in full if they have been included in a CFC's assessable income—for example, income sourced in Australia from a CFC's branch in Australia would normally be included in the CFC's assessable income in Australia. Amounts that will not be considered fully taxed, although subject to Australian taxation, are:

- amounts subject to interest or dividend withholding tax
- certain shipping income, film and video tape royalties and insurance premiums.

Dividends that are franked under the imputation provisions are treated as notional exempt income.

Branch in a broad-exemption listed country

An amount derived by a CFC in an unlisted country from carrying on business through a permanent establishment—for example, a branch—in a broad-exemption listed country is excluded, provided that the amount has been comparably taxed. An amount will be treated as comparably taxed if it is subject to tax in a broad-exemption listed country and is not eligible designated concession income.

Exclusion of dividends

Most dividends paid to the CFC by a foreign company are not included in the notional assessable income of the CFC. The only dividends you must include for a CFC resident in an unlisted country are:

- dividends that are not non-portfolio dividends—see chapter 3—paid to the CFC
- non-portfolio dividends paid to the CFC by a non-CFC that was a resident of an unlisted country when the dividends were paid unless the dividends were paid from profits taxed in a listed country.

The only dividends you must include for a CFC resident in a limited-exemption listed country are:

- dividends—other than non-portfolio dividends—paid to the CFC by a company that was a resident of an unlisted country when the dividends were paid

- non-portfolio dividends paid to the CFC by a non-CFC that was a resident of an unlisted country when the dividends were paid, unless the dividends were paid from profits taxed in a listed country.

These dividends will not be included in notional assessable income if they are paid from profits which have previously been attributed to you.

Modifications for a broad-exemption listed country

Working out attributable income for a CFC in a broad-exemption listed country is similar to working out attributable income for a CFC in a non-broad-exemption listed country. However, more exemptions are provided for CFCs in broad-exemption listed countries.

What if a CFC fails the active income test?
If a CFC fails the active income test, amounts that would be assessable if the CFC were a resident are included in attributable income to the extent they represent the following:

- eligible designated concession income that is adjusted tainted income
- low-taxed third country income
- trust amounts arising to the CFC directly that are not subject to tax in a broad-exemption listed country
- trust amounts arising to the CFC indirectly because the CFC is a partner in a partnership, provided that the amounts are not subject to tax in a broad-exemption listed country
- FIF income derived by the CFC directly or indirectly as a partner in a partnership.

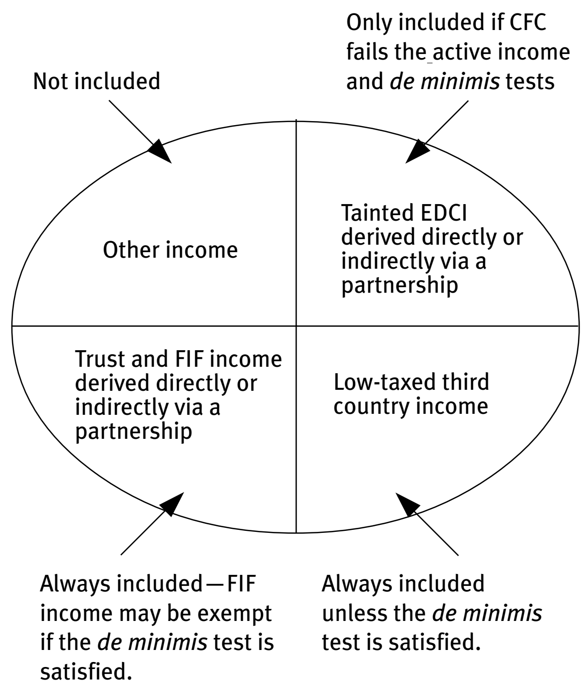
Any other amounts of income are notional exempt income.

What if a CFC passes the active income test?
If a CFC passes the active income test, amounts that would be assessable if the CFC were a resident are included in attributable income to the extent they represent the following:

- low-taxed third country income
- trust amounts arising to the CFC directly that are not subject to tax in a broad-exemption listed country
- trust amounts arising to the CFC indirectly because the CFC is a partner in a partnership, provided that the amounts are not subject to tax in a broad-exemption listed country
- FIF income derived by the CFC directly or indirectly as a partner in a partnership.

Any other income is notional exempt income.

Diagram of amounts taken into account



Adjusted tainted income
Adjusted tainted income is based on the definition of tainted income used for the active income test. Broadly, it comprises amounts that are either passive income, tainted sales income or tainted services income.

The difference in the definition of tainted income for the active income test and the definition for working out attributable income is that net gains are included in determining the active income test whereas the entire consideration on disposal of an asset is included when working out attributable income.

Low-taxed third country income
The notional assessable income of a CFC in a broad-exemption listed country includes amounts derived from sources outside the CFC's country of residence if the amounts are not taxed in a listed country. This rule does not apply to amounts of eligible designated concession income—these amounts may be included if the CFC fails the active income test.

Amounts of adjusted tainted income derived from sources outside a CFC's country of residence will also be included if they have not been taxed in a broad-exemption listed country. The source of an amount is to be determined according to the laws of the CFC's country of residence.

FIF income

The FIF rules apply when working out the attributable income of a CFC because of the assumption that the company is a resident of Australia. However, rules apply to prevent double taxation where a company FIF is also a CFC. These rules provide an exemption from the FIF measures for an interest held by a CFC in a company FIF if a share of the attributable income of the company FIF is included in your assessable income under the CFC measures for:

- a statutory accounting period coinciding with the notional accounting period of the company FIF for FIF taxation purposes or
- statutory accounting periods ending and commencing during the notional accounting period of the company FIF.

For the purposes of the above tests, the ATO will accept that a share of the attributable income of a company FIF has been included in the assessable income of an attributable taxpayer if no amount was included solely because the company FIF had no attributable income. Refer to *Taxation Determination TD 93/167* for further assistance.

Amounts taxed in Australia

Amounts that have been taxed in full in Australia are not included in notional assessable income. Amounts will be treated as taxed in full if they have been included in a CFC's assessable income. Amounts that will not be considered fully taxed, although subject to Australian taxation, are:

- amounts subject to Australian interest or dividend withholding tax
- certain shipping income, film and video tape royalties and insurance premiums.

Dividends that have been franked under the imputation provisions are treated as notional exempt income.

Dividends not included

Most dividends paid to a CFC by a foreign company are not included. The only dividends you must include are:

- dividends—other than non-portfolio dividends—paid to the CFC by a company that was a resident of an unlisted country when the dividends were paid and
- non-portfolio dividends paid to the CFC by a non-CFC that was a resident of an unlisted country when the dividends were paid unless the dividends were paid from profits taxed in a listed country.

These amounts will not be included in notional assessable income if the profits from which the dividends were paid have previously been attributed to you. They will also not be included in notional assessable income where they are subject to tax in the listed country.

Exemption for small amounts

An exemption applies for CFCs in broad-exemption listed countries if the total of:

- eligible designated concession income
- low-taxed foreign source income and
- FIF income

is not greater than a threshold amount. There is no similar exemption for a CFC that is a resident of a non-broad-exemption listed country.

Threshold amount

If the CFC has a gross turnover of $1 million or more, the threshold amount is $50 000—that is, the exemption will only apply if the total of the amounts is $50 000 or less.

If a CFC has a gross turnover of less than $1 million, the threshold amount is 5 per cent of the CFC's gross turnover—that is, the exemption will only apply if the sum of the amounts is less than or equal to 5 per cent.

How does the exemption operate?

If the threshold is not exceeded, a CFC's eligible designated concession income, low-taxed foreign source income and FIF income are not included in the notional assessable income of the CFC. The general anti-avoidance provisions of the Act may apply where attempts are made to split income among a number of CFCs to take advantage of the exemption.

Section 2—General modifications to the law

This section explains a number of general modifications to the taxation law which apply when working out the attributable income of a CFC. There are also modifications to:

- the treatment of gains and losses made by a CFC on the disposal of a capital asset
- the treatment of losses incurred by a CFC, including the quarantining of deductions
- the treatment of amounts derived through a partnership.

These modifications are dealt with in sections 3, 4 and 5 of part 3.

Elections to be made by the taxpayer

You can make most elections on behalf of a CFC in working out its attributable income. You must make the elections when you lodge your return. The Australian Taxation Office may extend the time for making the elections.

Lodgment of elections

In the case of companies and superannuation funds, no notice of the election is to be sent to the ATO. Only give notice if a taxation officer requests you to do so.

Exception to the rule

An election for roll-over relief under the capital gains tax provisions must normally be made by a CFC, although you can make the election for a wholly-owned CFC. The rules for making these elections are explained in section 3 of part 3.

Foreign currency conversion rules

You must express all amounts in Australian dollars. There are no special rules for converting capital amounts. The conversion is made using the rules that apply for converting capital amounts under the usual operation of the Act. Amounts that are taken into account in determining the cost base of an asset are converted at the time the costs were incurred. Amounts arising from the disposal of an asset are converted at the time of disposal.

The following rules apply for the conversion of income or expenses of a revenue nature.

Accounts kept in a foreign currency

A CFC may keep its records in one foreign currency or predominantly in one foreign currency. These amounts must be converted to Australian dollars for the purposes of working out the attributable income of the CFC. The amounts can be converted using the average exchange rate that prevailed during the CFC's statutory accounting period. The average rate may take into account a weighted average rate determined on the volume of transactions involved. Alternatively, you may elect to use the rate that prevailed on the last day of the CFC's statutory accounting period.

If there is a predominant currency and there are one or more other currencies, the other currencies are to be converted into the predominant currency on any reasonable basis and then converted into Australian dollars using one of the two methods outlined above.

Where there is no single or predominant currency and the amount being converted is not a foreign tax, any reasonable basis can be used to convert the amounts.

Whether a basis for conversion is reasonable depends on the facts of each case and you must consider the nature of the amount. Depending on the situation, it may be reasonable to convert on a transaction by transaction basis—for example, where the CFC receives a small number of interest payments. If the CFC conducts a business with a large number of transactions, it would be more appropriate to use a weighted average rate. The same method should be used for both CFCs when converting a payment made by one CFC to another CFC.

For help on particular transactions, contact the tax office where you lodge your tax return.

Election to use the end rate

If you want to use the exchange rate applicable at the end of a CFC's statutory accounting period, you must elect to do so—in your tax return—for the first year that you are required to include an amount of attributable income in your assessable income. The ATO may extend the time for making this election. The election applies for all future years—that is, the election cannot be changed even though the circumstances of the CFC have changed. Where there is no single or predominant currency, the election cannot be made.

Foreign exchange gains and losses
Foreign exchange gains and losses of a CFC may be worked out by reference to the currency in which it generally transacts business and keeps accounts. The net gain or loss is then translated into Australian currency on the basis of the rules provided above.

EXAMPLE 17

- On 1 January 1994, a CFC in country X borrowed $US1 million. On that date, country X's exchange rate is 100 florins to $US1.
- The CFC keeps its accounts in the currency of country X—florins.
- On 1 April 1998, the $US1 million loan was repaid at an exchange rate of 90 florins.
- This results in an exchange gain of 10 million florins.
- The exchange gain of 10 million florins is converted into Australian dollars using the conversion method adopted for the CFC.

Self-assessment—lodgment of elections
Under Ruling IT2624, companies and superannuation funds should not send a notice of election to the Australian Taxation Office (ATO). Only give notice if the ATO requires you to.

What about foreign taxes?
Foreign taxes are converted using the exchange rate applicable on the day the payment was made.

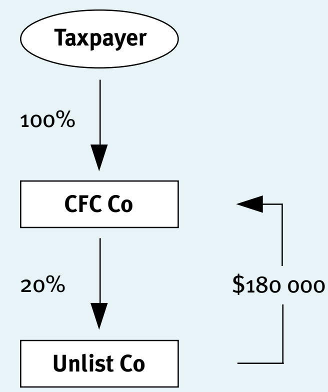
Treatment of foreign and Australian taxes

Deduction for taxes
A notional allowable deduction is available for foreign or Australian tax paid on amounts included in the attributable income of a CFC. An Australian tax is defined to be a withholding or income tax. It does not include additional taxes such as late payment penalties. If the tax is paid in a subsequent year, the earlier year's assessment can be amended subject to the time limits for amendments to allow a deduction for the tax.

EXAMPLE 18

Taxes paid directly by a CFC

Assume a CFC—CFC Co—owns 20 per cent of the voting shares in a company—Unlist Co. Unlist Co is a company resident in an unlisted country and is not a CFC. Unlist Co pays CFC Co a dividend of $180 000. CFC Co receives $162 000 because tax of $18 000 is withheld. Unlist Co has no profits that have been taxed in a listed country or in Australia.



Because of the dividend, the notional assessable income of CFC Co will include $180 000—the dividend before withholding tax—and a notional allowable deduction may be claimed for the $18 000 tax paid by CFC Co.

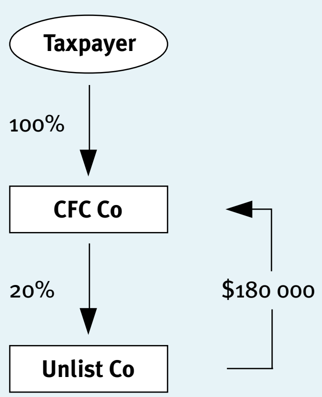
What about underlying tax?
Where a non-portfolio dividend is included in the notional assessable income of the CFC, a corporate taxpayer may claim a notional allowable deduction for taxes paid on the profits from which the dividend was paid. This tax is called underlying tax. Where the profits from which the dividend was paid include a dividend from a related company or that has passed through a number of related companies, the underlying tax may also include tax paid by the related companies. See chapter 3, part 3, for an explanation of related companies and for further information on working out underlying tax.

The notional allowable deduction for underlying tax is used to work out the foreign tax credit you can claim. The notional allowable deduction is effectively reversed because the dividend to which the underlying tax relates is increased by the amount of the underlying tax. If, for instance, a CFC receives a $100 dividend and is taken to have paid $20 underlying tax on the dividend, the amount of the dividend is increased to $120 to work out attributable income. A notional allowable deduction of $20 is then available for the underlying tax.

EXAMPLE 19

Underlying taxes

Assume a corporate taxpayer wholly owns a CFC—CFC Co. CFC Co in turn owns 20 per cent of the voting shares in a company—Unlist Co. Unlist Co is a company resident in an unlisted country and is not a CFC. Unlist Co has accumulated profits of $900 000 and has paid tax of $100 000. It distributes all of the profits. CFC Co receives $162 000 because tax of $18 000 is withheld. None of Unlist Co's profits have been taxed in a listed country or in Australia.



The underlying tax would be 20 per cent of $100 000	$20 000

A notional allowable deduction may be claimed for the $20 000 tax deemed paid by CFC Co as well as for the $18 000 withholding tax. The dividend is increased by the amount of the underlying tax deemed paid—that is, $20 000. The amount included in notional assessable income as a result of the dividend payment would therefore be $200 000.

A corporate taxpayer can claim a foreign tax credit for both the direct tax paid by the CFC and the underlying tax. However, when working out the attributable income, only a deduction is allowed. The subsequent claim for a credit reverses this deduction because the attributable income is grossed up—that is, increased—by the amount of the foreign tax credit. This is explained in part 3 of chapter 3.

Trading stock provisions

Valuation is cost only

In working out attributable income you must value trading stock at cost. The normal rules for determining the cost of trading stock are to apply.

What happens to obsolete stock?

In working out taxable income, a special valuation is allowed for obsolete stock. This valuation is not allowed when working out attributable income.

Depreciation provisions

Basis for depreciation

Generally, the normal depreciation rules apply for working out the attributable income of a CFC. This means you can choose to depreciate assets by the diminishing value method or the prime cost method. In addition, the rates of depreciation that apply for working out taxable income will also apply in working out attributable income.

EXAMPLE 20

Deduction for depreciation

A CFC purchased a depreciable asset on 1 July 1997 and uses it solely for the production of notional assessable income. For the statutory accounting period ended 30 June 1998, depreciation would be worked out as follows using the diminishing value method.

	$
Cost at 1 July 1997	20 000
Depreciation —20% × 20 000	4 000
Written down value at 30 June 1998	16 000
Depreciation in 1997–98	4 000

Apportionment for exempt usage

A notional allowable deduction for depreciation must be reduced if an asset is only partially used for the production of notional assessable income. The normal rules apply in working out the reduction.

EXAMPLE 21

Apportionment of deduction for depreciation

A CFC purchased a depreciable asset on 1 July 1997 and used it for the production of income. For the statutory accounting period ended 30 June 1998, only 50 per cent of the usage was for the production of notional assessable income. Depreciation, using the diminishing value method, would be worked out as follows.

	$
Cost at 1 July 1997	20 000
20% depreciation to 30 June 1998	4 000
Written down value at 30 June 1998	16 000
Depreciation in 1997–98 (50% of $4000)	2 000

Asset used in a non-attributable period

Special rules apply for an asset held by a CFC during a period for which it was either:

- not necessary to work out the attributable income of the CFC or
- not necessary to take depreciation on the asset into account in working out the attributable income of the CFC.

In such cases, the depreciation rules apply as if the asset were held solely for the production of notional assessable income during the period.

EXAMPLE 22

Deduction for depreciation in non-attributable period

A CFC purchased a depreciable asset on 1 July 1996 and used it for the production of income. It was not necessary to work out the attributable income of the CFC for the period ending 30 June 1997. For the statutory accounting period ended 30 June 1998, only 50 per cent of the usage was for the production of notional assessable income. In working out the depreciation for the 1997–98 period using the diminishing value method, the first step is to notionally depreciate the asset to the beginning of the income year.

	$
Cost at 1 July 1996	60 000
20% depreciation to 30 June 1997	4 000
Notional written down value at 30 June 1997	16 000

The next step is to determine the depreciation for the 1997–98 income year	$
Notional written down value at 30 June 1997	16 000
20% depreciation to 30 June 1998	3 200
Notional written down value at 30 June 1998	12 800

The last step is to apportion the depreciation because the asset is not used wholly for the production of notional assessable income.

Depreciation in 1997–98 (50% of $3200)	1 600

Sale of a depreciable asset

Under the normal operation of the Act, a deduction for the difference may be allowed where an asset is sold for less than the notional depreciated value of the asset. This deduction is also allowable in working out the attributable income of a CFC.

EXAMPLE 23

Deduction on disposal

In the next statutory accounting period the depreciable asset in example 22 was again used for 50 per cent of the time to derive notional assessable income. At the end of the year it was sold for $9000. The depreciation calculation would be as follows.

	$
Notional written down value at 30 June 1998	12 800
20% depreciation to 30 June 1999	2 560
Notional written down value at 30 June 1999	10 240
Proceeds of sale	9 000
Notional loss	1 240
Depreciation in 1998–99 (50% of $2560)	1 280
Deduction for loss (50% of $1240)	620

An amount may also be included in notional assessable income as a result of the sale of the asset.

EXAMPLE 24

Notional assessable income on disposal

Use the same facts as in example 23, but assume that the asset was sold for $18 000. In this case an amount would be included in notional assessable income as follows.

	$
Cost at 1 July 1996	20 000
Depreciation allowed	2 880
Actual written down value at 30 June 1999	17 120
Proceeds of sale	18 000
Actual written down value	17 120
Notional assessable income on disposal	880

Contact the tax office where you lodge your return for further details.

What about other capital deductions?
There are other provisions of the Act that allow for a deduction of the capital amounts and these may apply when working out attributable income—for example, Division 10 of Part III. Where the assets were used in a non-attributable income period, the Australian Taxation Office (ATO) must determine the amount of the deduction allowed or the recoupment included in notional assessable income. However, it is not expected that this will often occur. Contact the tax office where you lodge your tax return for further details.

Transfer pricing rules

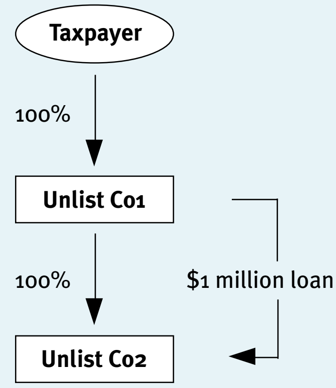
The Act contains measures to counter arrangements designed to move profits from one entity to another. These arrangements are commonly called transfer pricing or profit shifting. Broadly, the transfer pricing rules allow the ATO to increase a taxpayer's assessable income or decrease allowable deductions to negate the effect of the arrangement—see Division 13 of Part III.

International agreement
The rules apply only where there is an international agreement. For the purpose of applying the definition of an international agreement, the CFC is treated as a resident of a foreign country. The result is that the transfer pricing rules apply to most non-arm's length arrangements involving the CFC.

EXAMPLE 25

CFC in an unlisted country

Unlist Co1, which you wholly own, is a CFC resident of an unlisted country. In turn, Unlist Co1 wholly owns another CFC in an unlisted country—Unlist Co2. Unlist Co1 lends Unlist Co2 $1 million and there is no interest payable on the loan. The market interest rate is 10 per cent.



Unlist Co1 will be taken to have received $100 000 on the loan. This amount will be tainted interest income and will be included in the tainted income of the company. If the company fails the active income test, the notional assessable income of Unlist Co1 will include $100 000.

Application of the transfer pricing rules to non-arm's length arrangements involving CFCs resident in the same broad-exemption listed country

The transfer pricing rules do not apply to arrangements involving CFCs resident in the same broad-exemption listed country at any time when an international agreement is in force.

Impact on the active income test
The ATO can make adjustments reflecting arm's length values to amounts used in determining whether a CFC has passed the active income test. An adjustment can be made if, in working out the attributable income of a CFC, the ATO would make a transfer pricing adjustment in relation to the acquisition or supply of property by the CFC.

Requests for rulings
You can request a ruling from the ATO on whether Division 13, as modified, applies to an arrangement.

Compensating adjustments

To avoid double taxation, the ATO may make adjustments in the assessment of another taxpayer to compensate for a transfer pricing adjustment. A compensatory adjustment may be required, for instance, where a transfer pricing adjustment is made to decrease the amount of a royalty payment made to a related company. In this case, a compensatory adjustment could be made to reduce the amount included in the assessable income of the related company as a result of the royalty payment.

As with the usual operation of the transfer pricing rules, where one CFC's notional assessable income or notional allowable deductions are adjusted, the ATO may make a compensating adjustment to:

- a taxpayer's allowable deductions or assessable income
- another CFC's notional assessable income or notional allowable deductions or
- the attributable income of a transferor trust estate.

Similarly, compensating adjustments may be made to the attributable income of a CFC when the transfer pricing rules have been applied to:

- a taxpayer's allowable deductions or assessable income or
- the attributable income of a transferor trust estate.

Deduction for eligible finance shares

A deduction is not normally available for the payment of a dividend. A notional allowable deduction is available, however, for an eligible finance share dividend paid by a CFC. Broadly, this is a dividend paid on a share issued under a preference share financing arrangement with an Australian financial intermediary—for example, a bank—and its subsidiaries. In effect, the issue of eligible finance shares is treated as a type of loan.

Dividends on eligible finance shares are treated as an interest expense. A notional allowable deduction is available for the dividends to the extent a notional allowable deduction would have been payable if the dividends had been an interest outgoing.

Deduction for widely distributed and transitional finance shares

A deduction, similar to that provided for eligible finance shares, is available for dividends paid by a CFC on widely distributed finance shares. Widely distributed finance shares include shares issued by a CFC as a public issue under a preference share financing arrangement to persons who are not associates of the CFC and who have provided finance on arm's length terms. To qualify, the shareholders should have no interest in the CFC apart from ensuring repayment of the funds and regular payment of the dividends in a form which is, in effect, a substitution for interest on a loan.

A deduction is also available for dividends paid by a CFC on transitional finance shares. Transitional finance shares are shares issued by a CFC to a related CFC and paid for by the related CFC out of funds raised by the issue of widely distributed finance shares. The transitional finance shares must be issued under similar terms to the widely distributed finance shares.

The deduction for dividends paid on transitional finance shares is only available where the shares were issued before 12 April 1989. A sunset clause is provided so that a deduction for dividends paid on transitional finance shares is only available for dividends paid by the CFC prior to 1 July 1998.

Diagram 1—Operation of widely distributed finance share measures

CFC B ← funds may be lent ← CFC A ← funds raised by public issue of widely distributed finance shares ← members of the public

Diagram 2—Operation of transitional finance share measures

CFC B ← funds provided through share issue ← CFC A ← funds raised by public issue of widely distributed finance shares ← members of the public

In each of the diagrams, a deduction is available from the attributable income of CFC A for dividends paid on its widely distributed finance shares.

In diagram 1, CFC B is allowed a deduction for interest paid to CFC A on the loan from that company.

In diagram 2, a deduction is available from the attributable income of CFC B for dividends paid on shares that it issued to CFC A on substantially the same terms as widely distributed finance shares issued by CFC A.

Section 3—Modifications to the treatment of capital gains and losses

The operation of Part IIIA of the Act—the capital gains tax provisions—is modified for working out attributable income.

Assets included in the calculation

Only capital gains and losses arising on the disposal of non-taxable Australian assets are taken into account in working out attributable income.

What is a non-taxable Australian asset?
A non-taxable Australian asset is an asset that is not a taxable Australian asset. Broadly, a taxable Australian asset is:

- land or buildings in Australia
- assets used in carrying on business through a permanent establishment in Australia
- a share, or an interest in a share, in a company which was a resident private company in the income year in which the disposal took place
- a share, or an interest in a share, of a company which was an Australian resident and not a private company and at any time in the preceding 5 years a taxpayer or an associate, alone or together, owned 10 per cent of the issued capital of the company
- an interest in an Australian resident trust
- a unit in a unit trust which was an Australian resident where, at any time in the preceding 5 years, a taxpayer or an associate, alone or together, owned 10 per cent of the units in the unit trust
- an option or right to acquire an asset referred to above
- certain assets that have been transferred under the roll-over provisions
- certain rights that have a connection with Australia.

A capital gain or loss on the disposal of these assets will be taken into account in working out the real assessable income of the CFC and is therefore excluded from the calculation of the attributable income of the CFC. This exclusion applies even where a taxable Australian asset is not subject to capital gains tax because it was acquired before 20 September 1985.

In determining whether an asset is a taxable Australian asset, the assumption that the CFC is a resident of Australia is ignored. In almost all cases, however, the residency assumption will make no difference.

Assets used to produce notional exempt income
In working out taxable income, the capital gains tax provisions do not normally apply to the disposal of assets used solely for the production of exempt income. However, in working out attributable income, capital gains or losses on the disposal of assets used to derive notional exempt income can be taken into account.

Removal of exemption of pre-20 September 1985 assets
When applying the capital gains tax provisions in working out attributable income, all non-taxable Australian assets owned by the CFC at 30 June 1990 are deemed to be acquired by the CFC on 30 June 1990 regardless of the date the asset was acquired.

Cost base of assets for companies which become CFCs after 30 June 1990
The cost base of assets owned by a company that became a CFC after 30 June 1990 is their market value at the time the company became a CFC.

EXAMPLE 26

Cost base of asset

A company that became a CFC on 1 March 1993 disposes of an asset on 1 October 1995. The asset was acquired on 1 May 1992.

Consequences

The asset will be deemed to have been acquired for market value on 1 March 1993—that is, when the company became a CFC. The capital gain or loss is therefore worked out taking into account the change in value of the asset from 1 March 1993 to 1 October 1995.

Working out a gain or loss on disposal

You work out the amount to include in a CFC's notional assessable income in broadly the same way as for the usual operation of the capital gains tax provisions. That is, you must determine the excess of a CFC's capital gains over the CFC's capital losses and include that excess—the net capital gain—in the CFC's notional assessable income. A net loss can only be carried forward to be offset against future capital gains. However, there are certain modifications to the capital gains tax provisions that apply when working out attributable income.

Valuation date for assets owned on 30 June 1990

An unrealised gain that accumulated before 1 July 1990 will not be taxed. Correspondingly, any unrealised loss accumulated up to that date will not be allowed. This is done by valuing the assets on 30 June 1990 and, in general, using that value as the consideration paid.

However, where an asset had decreased in value before 1 July 1990, the gain using the market value as the consideration paid could be bigger than the actual gain. Similarly, where the asset had appreciated in value before 1 July 1990, the loss using the market value as the consideration paid could be greater than the actual loss. In either of these cases, only the actual gain or loss is taken into account. To achieve this result, you must use as the consideration paid for such assets either the market value of the asset at 30 June 1990 or the actual cost base of the asset, whichever produces the smaller gain or loss. That is:

- in working out a gain, use the greater of the unindexed cost base and the market value on 30 June 1990
- in working out a loss, use the lower of the unindexed cost base and market value on 30 June 1990.

Indexation of the cost base

The cost base of an asset is indexed for inflation and only the amount of the consideration that is more than the indexed cost base is treated as a capital gain. Generally, an asset must be held for 12 months before indexation applies.

Indexation factor

The indexation factor used is the same as that normally used under the capital gains tax provisions. You can obtain the indexation factor from the Australian Bureau of Statistics in your capital city or from any tax office.

Adjustment to the cost base

In some cases, the cost base of an asset will need to be adjusted. This would occur where, for example, there was a return of capital on shares or a tax free distribution from a unit trust. For further information, contact the tax office where you lodge your return.

Examples of how to work out a gain or loss

EXAMPLE 27

Capital gain—market value more than cost

A CFC bought shares on 1 January 1980 for $100 000. On 30 June 1990 the shares were valued at $400 000. On 31 December 1990 the shares were sold for $600 000.

Since the market value of the shares on 30 June 1990 is greater than their actual cost, the market value is used to work out the capital gain.

	$
Consideration	600 000
Less cost base—indexation factor 1.034	413 600
Capital gain	186 400

EXAMPLE 28

Capital gain—cost more than market value

A CFC bought shares on 1 January 1980 for $500 000. On 30 June 1990 the shares were valued at $400 000. On 31 December 1990 the shares were sold for $600 000.

Since the actual cost of the shares is greater than their market value on 30 June 1990, the actual cost is used to work out the capital gain.

	$
Consideration	600 000
Less cost base—indexation factor 1.034	517 000
Capital gain	83 000

EXAMPLE 29

Capital loss—cost more than market value

A CFC bought shares on 1 January 1980 for $100 000. On 30 June 1990 the shares were valued at $80 000. On 31 December 1990 the shares were sold for $50 000.

Since the actual cost of the shares is greater than their market value on 30 June 1990, the actual cost is used to work out the capital loss.

	$
Cost base	80 000
Less consideration	50 000
Capital loss	30 000

EXAMPLE 30

Capital loss—cost more than market value

A CFC bought shares on 1 January 1980 for $100 000. On 30 June 1990 the shares were valued at $120 000. On 31 December 1990 the shares were sold for $50 000.

Since the market value of the shares on 30 June 1990 is greater than their actual cost, the actual cost is used to work out the capital loss.

	$
Cost base	100 000
Less consideration	50 000
Capital loss	50 000

Provisions for profit making ventures

The provisions of the Act that include in assessable income a gain from the disposal of an asset purchased for profit making by sale or from carrying out a profit making undertaking or that allow a deduction for a loss—that is, sections 25A and 52—do not apply in working out the attributable income of a CFC.

Treatment of a net capital loss under Part IIIA

In working out taxable income, capital losses are offset against capital gains to determine the net capital gain to include in assessable income. Where there is a net capital loss, you cannot use the loss to reduce assessable income. The same rules will apply in working out attributable income.

A net capital loss under Part IIIA cannot reduce notional assessable income of the CFC. It can only be carried forward for offset against capital gains in future years.

You cannot transfer a loss to reduce the notional assessable income of another CFC or your own assessable income.

You cannot take into account a loss on the disposal of an asset where the disposal occurred before 1 July 1990.

Where a company becomes a CFC after 30 June 1995, asset disposals made prior to the company becoming a CFC are not taken into account when working out attributable income. This ensures that a capital loss is not available where it is incurred prior to a company becoming a CFC.

Roll-over of assets and Part IIIA

Forced disposals

The capital gains tax provisions allow you to defer working out a gain or loss where the disposal was:

- as a result of a breakdown of marriage
- caused by the loss or destruction of the asset
- from certain resumptions of property
- from the disposal of certain mining leases.

These roll-over provisions will apply in working out the attributable income because of the assumption that the CFC is a resident.

Most of these provisions require that the person disposing of the asset must make an election. You can make the election on behalf of a wholly owned CFC. For more details, read *Procedures for election that the roll-over provisions apply* on page 34.

Group transfers

The roll-over provisions allow companies that have 100 per cent common ownership to defer, in certain circumstances, capital gains or losses on assets transferred between companies in the group. The circumstances in which the roll-over provisions apply to the transfer of assets between CFCs with 100 per cent common ownership are modified.

Transfer by a CFC in a broad-exemption listed country

The group roll-over rules are available where the transferor CFC is a resident of a broad-exemption listed country and the transferee is either:

- a CFC resident of the same broad-exemption listed country or
- an Australian resident company or
- a CFC resident of a particular non-broad-exemption listed country and immediately before the disposal, the asset was used in connection with a permanent establishment of the transferor in a non-broad-exemption listed country at or through which the transferor carried on a business.

Roll-overs permitted for a CFC transferor resident in a broad-exemption listed country

Transferor	*Asset*	*Transferee*
	Any asset	CFC in the same country
CFC in a broad-exemption listed country	Any asset	Australian company
	Assets used by a branch in a non-broad-exemption listed country	CFC in a non-broad-exemption listed country

Transfer by a CFC in a non-broad-exemption listed country

The group roll-over provisions will also apply where the transferor CFC is a resident of a non-broad-exemption listed country and the transferee is either:

- a CFC resident of a non-broad-exemption listed country or
- an Australian resident company.

Roll-overs permitted for a CFC transferor resident in a non-broad-exemption listed country

Transferor	*Asset*	*Transferee*
CFC in a non-broad-exemption listed country	Any asset	CFC in any non-broad-exemption listed country
	Any asset	Australian company

The assumption that a CFC is a resident of Australia is ignored in determining its residence for the group transfer provisions.

Procedures for electing that the roll-over provisions apply

How to elect for roll-over relief

If an election for roll-over relief is required, a CFC—or in the case of group roll-overs, both the transferor and transferee—must elect in writing that the particular roll-over provision applies.

The CFC must normally make the election. An attributable taxpayer may, however, make an election on behalf of a wholly owned CFC.

Timing of elections

An election must be lodged with the ATO on or before the lodgment of a return by an attributable taxpayer that is affected by the election. If more than one attributable taxpayer is affected, the election will be valid if made on or before the lodgment of the affected tax returns.

Self-assessment—extension of time to make an election

The self-assessment guidelines do not apply to an election by a CFC for roll-over relief and *Taxation Ruling IT 2624* does not authorise an extension of time in which to make the election. If an extension of time is required, the CFC or its agent should approach the ATO. For convenience, the request should go to the tax office where the tax return of the largest attributable taxpayer is lodged. If this is not readily apparent, the request can be lodged at any tax office.

Which officer makes the election?

The person who acts for the CFC should make the election. In Australia, that person would normally be the public officer of the company. However, foreign laws may require a different officer to act for the company. Whoever is authorised—whether under the foreign law or, if no law governs this, under the constituent document of the CFC—may make the election.

Election by an agent in Australia

The requirement that a CFC make an election will also be satisfied where an agent makes the election for or on behalf of the CFC, provided that the person is authorised by the CFC to do so. For example, the Australian parent of the CFC or the CFC's tax agent in Australia, if authorised, could make the election.

Reduction of disposal consideration where attributable income is not distributed

An adjustment will be made to the consideration received by a CFC in respect of the disposal of an interest in an attribution account entity if the income or profits of that entity have been attributed to you but have not been distributed. The adjustment only applies where the consideration is included in working out notional assessable income—whether under the capital gains tax provisions or any other provision.

The adjustment is mandatory and does not depend on any finding that the share price reflects the retained earnings. If you think that it applies to the CFC, you can contact the tax office where you lodge your return for more information.

Section 4—Quarantining of losses

Quarantining

Where a CFC's notional allowable deductions relating to a particular class are more than the notional assessable income of that class for an accounting period, the excess cannot be claimed against notional assessable income of another class or used to reduce a net capital gain under the capital gains tax provisions.

The excess loss of a class of income is carried forward and can be claimed as a notional allowable deduction against income of the same class.

What are the classes of income?

Notional assessable income is divided into four classes. The classes of income are interest, offshore banking, modified passive and other income.

The classes may include both income and gains of a capital nature. However, capital gains under the capital gains tax provisions are not included in any of the classes. In effect, these capital gains are treated as a separate class of income.

Interest

Most interest income including payments in the nature of interest, fall into the interest class.

Excluded are:

- interest that falls in the offshore banking income class
- interest that is received in the active conduct of a trade or business—for example, interest on receivables
- interest derived from money lending—for example, a banking business.

Offshore banking income

Offshore banking income is income derived through an offshore banking unit. It is unlikely that a CFC will have this type of income.

Modified passive income

Modified passive income is passive income other than amounts that fall within the interest class or the offshore banking income class. As mentioned previously, capital gains under the capital gains tax provisions are not included. Passive income includes rent, royalties, dividends, annuities, capital gains and amounts derived from the assignment of, for example, copyrights.

Other income

The other income class comprises amounts that do not fall within the other classes.

Deductions for sometimes exempt income loss

You may claim a notional allowable deduction for a 'sometimes exempt income loss'. A sometimes exempt income loss can arise for a CFC in an accounting period if:

- the CFC passed the active income test for the period or
- the CFC gained the benefit of the *de minimis* exemption for the period

and the CFC has any expenses that are not notional allowable deductions but would have been if the CFC had not passed the active income test or gained the benefit of the *de minimis* exemption.

How is the sometimes exempt income loss worked out?
The sometimes exempt income loss is worked out by:
- assuming that the CFC had passed the active income test and did not have the benefit of the *de minimis* exemption
- working out the amounts that would be included in the notional assessable income—called the sometimes exempt income
- working out notional allowable deductions that would be available if the sometimes exempt income were assessable—called sometimes exempt deductions.

If sometimes exempt deductions of a class of income are more than the sometimes exempt income of that class, the difference is a sometimes exempt income loss.

Deductions for previous year losses

You may claim a notional allowable deduction for a CFC's previous years' losses. Do this separately for each class of income. In determining the loss for a particular class of notional assessable income, only the notional allowable deductions that relate to that particular class and were derived in that period are taken into account. If the notional allowable deductions are more than the notional assessable income, the difference is set off against the sometimes exempt income gain of that class for the period. The amount that remains is the CFC's loss for that class for the period.

How is a sometimes exempt income gain worked out?
The sometimes exempt income gain for each class of income is the amount of sometimes exempt income that is more than the sometimes exempt deductions. The sometimes exempt income gain reduces a CFC's loss in a class of income. Losses in the current period are reduced before losses carried forward from a previous period.

Conditions before a loss is allowed
You are allowed a notional deduction for a previous year's loss only if the CFC was a CFC when the loss was incurred and at the end of each period until the loss is claimed.

In working out the previous years' losses of the CFC, you must assume that you were always an attributable taxpayer who was required to work out attributable income. Therefore, it is possible to carry forward a loss from a period when you were not an attributable taxpayer.

You cannot take into account any loss incurred in a statutory accounting period that commenced before 1 July 1983.

Residency requirement for losses

A notional deduction is not allowable for a previous year loss if a CFC does not satisfy the residency requirement in the period when the loss was incurred. The general rule is that a CFC resident in a broad-exemption listed country can only claim a notional deduction for a previous year loss if:
- the loss was incurred in a statutory accounting period commencing on or after 1 July 1997 and the CFC was a resident of a broad-exemption listed country in that period or
- the loss was incurred in a statutory accounting period commencing before 1 July 1997 and the CFC was a resident of a listed country in that period.

The general rule for a CFC resident in a non-broad-exemption listed country is that the CFC can only claim a notional deduction for a previous year loss if:
- the loss was incurred in a statutory accounting period commencing on or after 1 July 1997 and the CFC was a resident of a non-broad-exemption listed country in that period or
- the loss was incurred in a statutory accounting period commencing before 1 July 1997 and the CFC was a resident of an unlisted country in that period.

Modifications to the general rule deal with cases where a company:
- remains a resident of the same country
- is treated as changing residence from a listed country to an unlisted country or vice versa as a result of changes to the list(s) of countries or political developments—for example, as a result of the dissolution of a country.

In these cases, the losses incurred by a CFC in an earlier period are not denied solely because the listing status of a CFC's country of residence changes. The following table summarises the availability of losses incurred in statutory accounting periods commencing before 1 July 1997.

Scenario	CFC's current country of residence	Availability of losses for statutory accounting periods commencing after 1 July 1997
Losses incurred by a listed country CFC in a statutory accounting period commencing before 1 July 1997.	Broad-exemption listed country	**Allowable***
	Non-broad-exemption listed country	**Generally not allowable** **Allowable*** if the non-broad-exemption listed country arises from the dissolution of the listed country. **Allowable*** if the non-broad-exemption listed country is the same country as the listed country.
Losses incurred by an unlisted country CFC in a statutory accounting period commencing before 1 July 1997.	Broad-exemption listed country	**Generally not allowable** **Allowable*** if the broad-exemption listed country is the same country as the unlisted country.
	Non-broad-exemption listed country	**Allowable***
Losses incurred by a listed country CFC in a statutory accounting period commencing before 1 July 1997. The CFC subsequently changes residence to another listed country in a statutory accounting period commencing before 1 July 1997.	Broad-exemption listed country	**Allowable***
	Non-broad-exemption listed country	**Generally not allowable**. **Allowable*** if the non-broad-exemption listed country arises from the dissolution of the last-mentioned listed country. **Allowable*** if the non-broad-exemption listed country is the same country as the last-mentioned listed country.
Losses incurred by an unlisted country CFC in a statutory accounting period commencing before 1 July 1997. The CFC subsequently changes residence to a listed country in a statutory accounting period commencing before 1 July 1997.	Broad-exemption listed country	**Not allowable** because the losses would have been denied previously.
	Non-broad-exemption listed country	**Not allowable** because the losses would have been denied previously.
Losses incurred by a listed country CFC in a statutory accounting period commencing before 1 July 1997. The CFC subsequently changes residence to an unlisted country in a statutory accounting period commencing before 1 July 1997.	Broad-exemption listed country	**Not allowable** because the losses would have been denied previously.
	Non-broad-exemption listed country	**Not allowable** because the losses would have been denied previously.
Losses incurred by a broad-exemption listed country CFC in a statutory accounting period commencing after 1 July 1997.	Broad-exemption listed country	**Allowable***
	Non-broad-exemption listed country	**Generally not allowable** **Allowable*** if the non-broad-exemption listed country arises from the dissolution of the broad-exemption listed country. **Allowable*** if the non-broad-exemption listed country is the same country as the broad-exemption listed country.
Losses incurred by a non-broad-exemption listed country CFC in a statutory accounting period commencing after 1 July 1997.	Broad-exemption listed country	**Generally not allowable** **Allowable*** if the broad-exemption listed country is the same country as the non-broad-exemption listed country.
	Non-broad-exemption listed country	**Allowable***

* The losses are not allowable if they were denied in an earlier statutory accounting period.

Losses confined to the CFC
Where a CFC has incurred a loss of a class of income, you cannot transfer the loss to reduce the notional assessable income of another CFC or your own assessable income. The loss is locked into the CFC.

Ordering

If there is more than one previous year's loss, the losses are claimed in the order in which they were incurred.

Section 5—Working out the net income of a partnership

The notional assessable income of a CFC includes the CFC's share of the net income of a partnership. You work out the net income of the partnership in accordance with the partnership provisions of the Act. However, it is assumed that:

- the partnership derived only certain income and gains
- the operation of the Act is modified.

Assumption about income and gains

The assumptions made for amounts derived by a partnership mirror the assumptions made for working out the income and gains of a CFC. The amounts taken into account in working out the net income of the partnership depends on whether the CFC passes the active income test. The amounts also depend on whether the CFC is a resident of a broad-exemption listed country or a non-broad-exemption listed country.

Non-broad-exemption listed country CFC passes the active income test
Where a non-broad-exemption listed country CFC passes the active income test, the only amounts taken into account in determining the net income of the partnership are trust amounts arising for the partnership and amounts of FIF income.

Non-broad-exemption listed country CFC fails the active income test
Where a non-broad-exemption listed country CFC fails the active income test, only the following amounts are taken into account in determining the net income of the partnership:

- adjusted tainted income
- trust amounts arising for the partnership
- FIF income
- if the CFC is a resident of a limited-exemption listed country, amounts of low-taxed third country income.

Broad-exemption listed country CFC passes the active income test
Where a broad-exemption listed country CFC passes the active income test, only the following amounts are taken into account in determining the net income of the partnership:

- low-taxed third country income
- FIF income
- trust amounts arising for the partnership that are not subject to comparable tax in a broad-exemption listed country.

Broad-exemption listed country CFC fails the active income test
Where a broad-exemption listed country CFC fails the active income test, only the following amounts are taken into account in determining the net income of the partnership:

- eligible designated concession income that is adjusted tainted income
- low-taxed third country income
- FIF income
- trust amounts arising for the partnership that are not subject to comparable tax in a broad-exemption listed country.

Assumption about modifications to the Act

The modifications that apply in working out the net income of a partnership are similar to those that apply for working out notional assessable income and notional allowable deductions of a CFC—refer to sections 3 to 5.

Additional modifications to the Act
Three additional modifications are made in working out the net income of a partnership.

- First, the partnership is treated as a resident of the same country as the CFC.
- Secondly, a dividend will not be notional exempt income of a partnership unless the dividend is paid out of previously attributed income.
- Thirdly, the capital gains tax provisions apply to assets acquired by a partnership after 19 September 1985—the deemed acquisition of assets on 30 June 1990 for CFCs does not apply to assets held by partnerships.

Section 6—Trust amounts

The notional assessable income of a CFC may include certain trust amounts arising for the CFC in the statutory accounting period. There are three types of trust amounts:

- amounts derived as a beneficiary of a trust estate where the CFC is personally entitled to a share of the net income of the trust estate
- other amounts paid to, or applied for the benefit of, the CFC by the trustee of a trust estate
- amounts attributed to the CFC under the transferor trust measures.

CFC a beneficiary of a trust—present entitlement

Where the CFC is presently entitled to a share of the net income of a trust estate, the CFC must include the share of the net income in notional assessable income. The calculation of the net income of the trust estate is made under the existing trust provisions of the Act. The modifications that apply in working out the net income of a trust are similar to those that apply for working out notional assessable income and notional allowable deductions of the CFC—see sections 3 to 5.

Additional modifications that apply when working out the net income of a trust are outlined below.

Trust is a resident of the same country as the CFC
A trust estate is treated as a resident of the same country as the CFC.

Dividends
A dividend will not be notional exempt income of a trust unless the dividend is paid out of previously attributed income.

Trust is treated as a resident trust estate
A trust is treated as an Australian resident trust estate or a resident unit trust for the purposes of the capital gains tax provisions.

Modifications to capital gains tax provisions
The modifications to the capital gains tax provisions—see section 4— that provide for the removal of the exemption for assets acquired before 20 September 1985 do not apply in working out the net income of a trust. Consequently, the capital gains tax provisions apply to assets acquired by a trust after 19 September 1985.

Transferor trust measures

The transferor trust measures apply in working out the attributable income of a CFC. Refer to chapter 2 to determine whether the CFC will have an amount attributed to it.

Section 7—Reduction of attributable income because of interim dividends

The attributable income of a CFC is reduced if you are taxed on a dividend paid by the CFC out of current year profits. A dividend is treated as paid out of current year profits only after profits from previous years have been distributed. The amount of the reduction is equal to the attributable income of the CFC referable to the current year profits that were distributed. Your attributable income is also reduced in the same way if you are taxed on a non-portfolio dividend paid by the CFC out of current year profits to another entity you control.

Working out the reduction

Dividend paid to an attributable taxpayer
If the dividend is paid to you, the amount of the reduction in attributable income is worked out as follows:

$$\frac{\textbf{Amount of the dividend assessed}}{\textbf{Your attribution percentage in the CFC}}$$

EXAMPLE 31

Dividend paid wholly out of attributed income

A taxpayer has a 50 per cent attribution percentage in a CFC resident of an unlisted country. The CFC has no profits from previous years and $1 million current year profits are distributed as a dividend. The dividend was paid wholly from profits referable to the attributable income of the CFC. The $500 000 received by the taxpayer is included in the taxpayer's assessable income.

The amount by which the attributable income would be reduced is worked out as follows:

$$\frac{\$500\ 000}{50\%} = \$1 \text{ million}$$

EXAMPLE 32

Dividend paid partly out of attributed income

A taxpayer has a 50 per cent attribution percentage in a CFC resident of an unlisted country. The CFC has an accumulated profit of $2 million. The CFC pays a dividend of $2.2 million. The dividend would be taken to have been paid out of the accumulated profits first. The whole of the $200 000 component of the dividend paid from current year profits is referable to the attributable income of the CFC.

The reduction would be:

$$\$100\,000 = \frac{\$200\,000}{50\%}$$

EXAMPLE 33

Dividend is exempt

A resident company has a 50 per cent interest in a CFC resident of a listed country. The CFC has no profits from previous years and distributes all of the current year profits as an exempt dividend.

There is no reduction of attributable income in this case because the dividend was not assessable.

Dividend paid to another CFC or CFT

If a CFC resident in an unlisted country pays an interim dividend directly to either another CFC or CFT, the reduction is worked out as follows:

$$\frac{\textbf{Amount of the dividend assessed}}{\textbf{Your attribution percentage in the recipient}}$$

Dividend paid to a partnership or Australian trust

If a CFC resident in an unlisted country pays an interim dividend indirectly to either another CFC or CFT through either a partnership or an Australian trust, the reduction is worked out as follows:

$$\frac{\textbf{Amount of the dividend assessed}}{\textbf{Your attribution percentage in the dividend}}$$

Your indirect interest in the dividend is worked out by multiplying your interest in the partnership or trust by your attribution percentage in the CFC of CFT receiving the dividend.

Section 8 — Relief from double accruals taxation

If an amount of income or gain is to be included in your assessable income as a result of tracing control through a foreign entity and that foreign entity has also been taxed on that amount under the accruals tax laws of another country, you may reduce your assessable income by an amount calculated as follows:

Indirect attribution interests through a controlled foreign entity (CFE) × **Foreign accruals-taxed attributable income**

Your indirect attribution interest through a CFE is your attribution interest in a CFC traced through the CFE.

The foreign accruals-taxed attributable income is that part of an amount of income or gain derived by a CFC on which an interposed CFE has been taxed under an accruals tax law of a broad-exemption listed country. The income or gain must be taxed at that country's normal company rate of tax and during a tax accounting period which commences or ends either in your year of income or the statutory accounting period of the CFC.

Only countries listed in the Income Tax Regulations as having accruals tax laws are recognised for the purpose of granting this relief. They are:

Canada	New Zealand
France	United Kingdom
Germany	United States of America
Japan	

EXAMPLE 34

Reduction of an otherwise assessable section 456 amount

Scenario

- Ausco owns 50 per cent of the share capital of US Co — a company resident in the United States — which in turn owns 50 per cent of the share capital of a company that is a resident of an unlisted country. Ausco also holds a direct interest of 25 per cent of the unlisted country company.

  Because of the interests Ausco holds in US Co and the unlisted country company, both foreign companies are CFCs.

- For the 1995–96 period, the unlisted country CFC's only item of income was interest income. The amount of this interest income was determined to be $8000 under Australia's income tax laws.
- The United States taxed US Co on an accruals basis on the item of interest income derived by the listed country CFC. US Co's interest in the unlisted country company was 50 per cent. Therefore, only half of the item of interest income was attributed to US Co by the United States.
- Australia applied the transfer pricing provisions to an interest free loan which the unlisted country company provided to a related CFC. Consequently, another $2000 interest income was included in the unlisted country CFC's attributable income under Australia's accruals tax laws. This amount was not included in the unlisted country CFC's attributable income under the accruals tax laws of the United States.

Working out the amount to be attributed to Ausco

Step 1—Determine Ausco's otherwise assessable amount

Ausco's attributed percentage of the attributable income of the unlisted country CFC is:

direct attribution interest	25%
indirect attribution interest	25%
attribution percentage	50%

Ausco's otherwise assessable amount is $5000 (50 per cent attribution percentage x ($8000 interest income plus $2000 interest income)) arising from the application of the transfer pricing provisions.

Step 2—Determine Ausco's indirect attribution interests through US Co

Ausco's indirect attribution interest through US Co in the unlisted country CFC is 25 per cent—that is, Ausco's 50 per cent direct interest in US Co multiplied by US Co's 50 per cent interest in the unlisted country CFC.

Step 3—Determine the unlisted country CFC's foreign accruals-taxed attributable income

The unlisted country CFC's foreign accruals-taxed attributable income worked out under Australian accruals tax rules equals $8000. This amount is referable to the item of interest income included in the attributable income of the unlisted country CFC under the accruals tax laws of the United States. It is important to note that the amount is not necessarily the same as the amount worked out under the accruals tax laws of the United States.

Step 4—Determine the amount by which Ausco's otherwise assessable amount is to be reduced

Reduce the otherwise assessable amount by $2000—that is, step 2 multiplied by step 3.

Step 5—Determine Ausco's assessability in respect of the unlisted country CFC's attributable income

Ausco's assessability for the unlisted country CFC's attributable income is $3000—that is, step 1 minus step 4.

Section 9—How much is included in assessable income?

You need to work out how much of the attributable income of the CFC to include in your assessable income. Multiply your attribution percentage in the CFC at the end of the statutory accounting period by the attributable income of the CFC. Include the result in your assessable income.

Chapter 2

Transferor trust and related measures

This chapter:

- helps Australian residents who have transferred, or are deemed to have transferred, property or services to a non-resident trust estate to:
  - determine whether, under the transferor trust measures, any income or capital gains derived by the trust estate should be attributed to them for inclusion in their assessable income
  - work out the amount to be attributed
- helps Australian beneficiaries who have received a distribution from a non-resident trust estate to determine whether an interest charge applies to the distribution.

Introduction

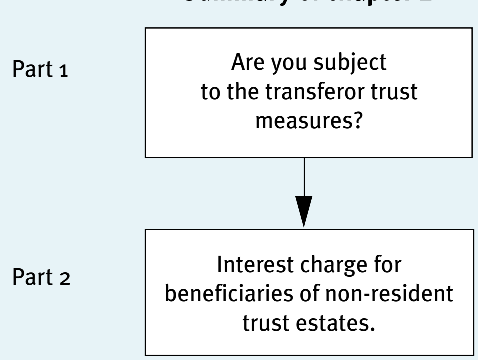
The transferor trust measures operate to accruals tax residents of Australia who have transferred property or services to a non-resident trust estate on certain profits derived by the trust.

Related measures also operate to impose an interest charge on certain trust distributions from non-resident trusts that are included in the assessable income of a resident beneficiary. Broadly, the interest charge applies if the profits of the trust from which the distribution was made were not subject to tax:

- in a broad-exemption listed country or
- on an attribution basis under the transferor trust measures.

Refer to the glossary in appendix 2 to find the meaning of certain words and expressions used in this chapter.

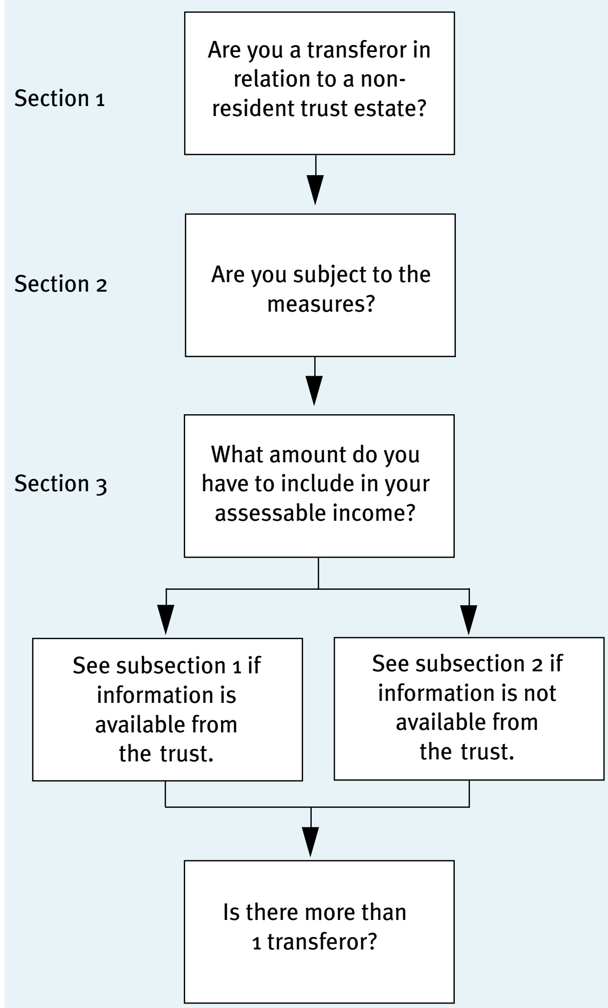
Summary of chapter 2



Part 1—Are you subject to the transferor trust measures?

This part helps you determine whether you are subject to the transferor trust measures. It also shows how to work out the amount to include in your assessable income if the measures do apply.

Summary of part 1



Section 1—Are you a transferor in relation to a non-resident trust estate?

Transfers of property or services

If you have transferred property or services to a non-resident trust estate, the profits of the trust may be attributed to you—that is, the profits may be included in your assessable income even though you have not received a distribution from the trust.

You will be regarded as a transferor if you:

- have at any time transferred property or services to a non-resident discretionary trust estate or
- transferred property or services after 7.30 p.m. on 12 April 1989 to a non-resident trust estate that is non-discretionary for either no consideration or for consideration less than an arm's length amount.

Deemed transfers

Certain transfers of property or services made to another entity may be deemed to have been made to a trust estate if the transfer is connected with a transfer to the trust estate.

EXAMPLE 1

Deemed transfer to a trust estate

Entity A transfers property to Entity B on condition that Entity B transfers the property to a trust estate. In this case, Entity A would be deemed to have transferred to the trust estate the property transferred by Entity B.

EXAMPLE 2

Marketing of units in a unit trust

The trustee of a unit trust issues units to Entity A, which acts as manager, underwriter or dealer for the placement of the units. Entity A then disposes of the units to Entity B, which transfers property or services to Entity A as consideration for the acquisition of the units.

In this case, Entity B is deemed to have transferred the property or services that Entity A originally transferred to the unit trust. In the circumstances, Entity A will not be taken to have transferred property or services to the trust estate.

Where a partnership has transferred property or services to a non-resident trust estate, each partner is deemed to have transferred property or services in proportion to their interest in the partnership.

Where a trust estate has transferred property or services to a non-resident trust estate, each person who has transferred property or services to the first mentioned trust estate is deemed to have transferred property or services to the second mentioned trust estate.

If the partnership or trust estate is in existence at the end of the non-resident trust estate's year of income, any attributable income of the non-resident trust estate is attributed to the partnership or trust estate. If the partnership or trust estate is not in existence at the end of the non-resident trust estate's year of income, any attributable income of the non-resident trust estate is attributed to the partners of the partnership or the original transferors to the trust estate.

The ATO may also treat you as having transferred property or services to a trust if you benefited from a transfer by a company, partnership or trust that ceases to exist.

If you need further information on deemed transfers, contact the ATO.

Section 2—Are you subject to the measures?

The amount to be included in the assessable income of a resident transferor for profits derived by a non-resident trust estate is called 'attributable income' and the resident transferor to whom it is attributed is called an 'attributable taxpayer'.

Exemptions from the transferor trust measures

A number of exemptions are provided from the transferor trust measures. These exemptions depend on the type of trust estate to which you have transferred property or services.

Public unit trusts

The transferor trust measures do not apply to a transfer of property or services to a non-resident trust estate if:

- the trust estate is a public unit trust at all times during the transferor's year of income
- the transfer was made for arm's length consideration
- the sole purpose of the transfer was the arm's length acquisition of units in the unit trust.

A unit trust will be a public unit trust if, at any time during the income year, any of the units were listed on a stock exchange in Australia or elsewhere or were offered to the public. A unit trust will also be a public unit trust if, at all times during the income year, the units in the unit trust were held by 50 or more persons.

The transferor trust measures will apply to you if you make a transfer of property or services to a non-resident public unit trust on or after 12 April 1989 for less than arm's length consideration.

Deceased estates

The transferor trust measures generally do not apply to a trustee of a deceased estate who transfers property or services to a non-resident trust estate according to directions contained in the deceased person's will or codicil, or according to a court order which varies the will or codicil. The measures will apply, however, if:

- the transfer is made through the exercise of the power of appointment or of a discretion by the trustee or any other person—for example, where the trustee of a deceased estate has a discretion to invest money of the trust estate and decides to transfer the money to a discretionary trust estate or
- the trustee transfers property or services to a non-resident trust estate but the transfer was caused by another entity—other than a deceased person—in which case, the entity that caused the transfer is treated as a transferor.

Non-resident family trusts

The transferor trust measures do not apply to a natural person who has transferred property or services to a non-resident family trust. However, the trust must be a non-resident family trust at all times when it is in existence after the beginning of the transferor's 1990–91 income year until the end of the current income year—that is, the income year for which the transferor is working out assessable income.

An exemption from the transferor trust measures is also available to a natural person who:

- first becomes an Australian resident after 12 April 1989
- makes a transfer to a non-resident family trust before taking up residency in Australia.

To qualify, the trust estate must be a non-resident family trust at all times after the transferor becomes a resident of Australia.

The exception does not apply to a natural person who, as trustee, transferred any property or services to the non-resident family trust from any other trust estate.

Two types of non-resident family trusts are covered by this exception—post-marital family trusts and family relief trusts.

Post-marital family trusts

Post-marital family trusts come into existence after a decree or order of dissolution or annulment of a marriage or a decree or order of judicial separation or similar instrument. Trusts resulting from the breakdown of a de facto marriage also qualify. The beneficiaries of the trust estate must be non-resident natural persons and:

- the spouse or former spouse of the natural person or
- a child of the natural person or of the spouse of the natural person or
- a person who was a child of the former spouse of the natural person during the marriage.

Family relief trusts

Family relief trusts are established and operated to help non-resident family members. Trusts with Australian or non-family beneficiaries do not qualify as family trusts. The only beneficiaries permitted are non-residents who are related to the transferor. The following persons are treated as related to the transferor for this purpose.

- a spouse or former spouse
- a parent of the transferor or of the transferor's spouse or former spouse

- a child of the transferor or of the transferor's spouse or former spouse
- a grandparent of the transferor
- a grandchild of the transferor
- a brother or sister of the transferor or of the transferor's spouse or former spouse
- a child of the transferor's brother or sister
- a child of a brother or sister of the transferor's spouse or former spouse.

A trust estate will generally not qualify as a family trust if the assets of the trust are excessive given the requirements of the beneficiaries. There is an exception to this rule, however, if there have been no transfers of property or services to the trust after 12 April 1989. In this case the trust can have excessive assets and still qualify as a family trust.

Contingent beneficiaries

A trust estate can still be a family trust estate if, in the event of the death of a family member, one or more natural persons benefit or are capable of benefiting under the trust. These persons must, however, be:

- non residents
- children of the deceased family member.

If all beneficiaries die, the trust estate can still be a family trust estate if there are one or more funds, authorities or institutions covered by section 78—the gift provisions—of the Act that would benefit or be capable of benefiting under the trust.

Migrant transferors

A natural person who first became an Australian resident after 12 April 1989 will not be subject to the transferor trust measures if they transferred property or services to a non-resident trust estate before becoming a resident.

Discretionary trust estates

The transferor trust measures do not apply to a transferor who has transferred property or services to a discretionary trust estate if both of the following conditions are satisfied:

- the transfer was made in the course of carrying on a business
- the transfer was made in terms identical or similar to those that relate to transactions undertaken by the transferor, at or about the time of the transfer, in the ordinary course of business with ordinary clients or customers—that is, on an arm's length basis and subject to similar terms and conditions.

If the transfer was not made on an arm's length basis in the course of carrying on a business, the transferor trust measures will normally apply if at any time after the transfer the transferor or the transferor's associates were in a position to control the trust estate. However, if the transfer was made before 12 April 1989, the transferor trust measures will only apply if the transferor or the transferor's associates were in a position to control the trust after 12 April 1989.

If a transferor subsequently gains control of the discretionary trust estate, all years before the commencement of the transferor trust measures become subject to the measures.

A transferor is taken to be in a position to control a non-resident trust estate if the transferor or any associates:

- have power, by whatever means, to obtain the beneficial enjoyment of the corpus or income of the trust estate
- were able to control, directly or indirectly, the application of the income or corpus of the trust estate
- were capable, under a scheme, of gaining the enjoyment or control referred to in the above two points
- could expect the trustee to follow their directions, instructions or wishes or
- have the ability to remove or appoint any trustees of the trust estate.

All factors must be taken into account in determining whether the trustee of a trust estate was accustomed, or might reasonably be expected, to follow directions, instructions or wishes of a transferor or an associate of the transferor.

For example, a requirement in a trust deed for the trustee to ignore directions, instructions or wishes would not pre-empt the examination of the actual circumstances to determine whether the transferor or an associate controls the trustee. The way in which the trustee has acted in the past, the relationship between the transferor or transferor's associate and the trustee and the amount of property or services transferred to the trust estate, are some of the other matters that need to be considered.

Non-discretionary trust estates

The transferor trust measures will not apply to a transferor who transferred property or services to a non-discretionary trust estate before 12 April 1989. Moreover, the measures will not apply to a transfer of property or services after 12 April 1989 if:

- the trust estate was a non-discretionary trust estate at all times during the transferor's current year of income
- the transfer was made for arm's length consideration.

Where:

- one transferor—the original transferor—makes transfers of property or services to a non-resident non-discretionary trust estate which were all made for consideration at an arm's length amount and
- another transferor—the second transferor—makes a transfer of property or services to the same non-resident trust estate on or after 12 April 1989 which is made for no consideration or consideration at less than an arm's length amount,

the second transferor—but not the original transferor—would become an attributable taxpayer in relation to the trust estate. Therefore, all the attributable income of the trust estate would be attributed to the second transferor.

Section 3—What amount do you have to include in your assessable income?

This section is relevant only if you are an attributable taxpayer in relation to a non-resident trust estate.

You must follow the steps in subsection 1 to work out your attributable income if you can obtain the necessary information.

If you cannot reasonably be expected to have access to the necessary information, work out the amount to be included in your assessable income following the steps in subsection 2.

Once you have worked out the amount to include in your assessable income, you may be able to apply for a reduction of this amount. Subsection 3 explains how to do this.

Subsection 1—Working out your assessable income where information is available

Working out the attributable income of a non-resident trust estate

To determine the attributable income of a non-resident trust estate you must first work out its net income. The net income of a trust estate is worked out as though the trust estate were an Australian resident and taxpayer. The foreign loss quarantining rules will, for instance, apply when working out the net income of the trust estate.

In working out the net income of a non-resident trust estate, you need to identify whether it is a broad-exemption listed country trust estate.

If it is a broad-exemption listed country trust estate, only the trust's eligible designated concession income is taken into account when working out the net income. The balance of the income of the trust estate is treated as exempt income.

If it is not a non-broad-exemption listed country trust estate, all its income or gains are included in working out its net income.

A non-resident trust estate is treated as a broad-exemption listed country trust estate if all the income of the trust estate—other than eligible designated concession income—is either subject to tax in a broad-exemption listed country or is assessable in Australia in the hands of the trustee or a beneficiary.

For income years commencing before 1 July 1997, the calculation of attributable income for listed country trust estates was the same as that described above for broad-exemption listed country trust estates. The list of countries used prior to 1 July 1997 is in attachment A of appendix 1.

Amounts that may be excluded from attributable income

In determining the attributable amount, the net income of a non-resident trust estate is reduced by the following amounts to the extent they relate to amounts included in the net income of the trust estate:

- amounts that have been included in the assessable income of a beneficiary under section 97 of the Act—that is, amounts to which a beneficiary is presently entitled

- amounts where the trustee of the non-resident trust estate has been assessed and is liable to pay tax under section 98 of the Act—for example, on behalf of a resident beneficiary under a legal disability
- amounts where the trustee of the non-resident trust estate has been assessed and is liable to pay tax under section 99 or 99A—for example, where the trust has undistributed Australian source income
- amounts paid to beneficiaries who are residents of a broad-exemption listed country if those amounts are paid during the year of income of the non-resident trust estate or within one month after the end of the year of income. These amounts must be subject to tax in a broad-exemption listed country in a tax accounting period ending before the year of income or commencing during the year of income
- franked dividends—that is, dividends paid by Australian companies or similar amounts paid by corporate unit trusts and public trading trusts, out of profits that have been subject to Australian tax
- amounts included in the assessable income of the trustee of a trust estate where a dividend is grossed up for dividend imputation purposes
- amounts received by a trustee from another trust estate to the extent that the amount has already been attributed to a transferor
- dividends received from a CFC that have been included in the assessable income of a taxpayer under section 458 of the Act—see chapter 1 of the guide
- amounts received by the trustee that are referable to the income or profits of a CFC that have been included in the assessable income of any resident taxpayer under the CFC measures
- income or profits of the trust estate—other than eligible designated concession income—that are subject to tax in any broad-exemption listed country in a tax accounting period ending before the end of, or commencing during, the year of income of the non-resident trust estate
- FIF income attributed to the trust estate for a notional accounting period of a company FIF if a share of the attributable income of the company FIF is included in your assessable income under the CFC measures for:
  – a statutory accounting period coinciding with the notional account period of the company FIF or
  – statutory accounting periods ending and commencing during the notional accounting period of the company FIF
- amounts of foreign tax or Australian tax paid by the trustee or a beneficiary on amounts included in the attributable income of the trust estate.

For a broad-exemption listed country trust estate, exclude only the amounts that relate to the part of the net income that consists of eligible designated concession income.

Modifications made to Australian tax law

Rules that do not apply in working out the attributable income of a trust estate

The following rules do not apply in working out the attributable income of a trust estate:

- the general currency conversion rules in section 20
- the exemption for distributions from profits that have been taxed under the CFC measures
- the rules in sections 38 to 43 dealing with the taxation of a business only partly carried on in Australia
- the exemption for amounts that have been subject to withholding tax in Australia
- the CFC measures.

Conversion of income and expenses to Australian dollars

All amounts are to be expressed in Australian dollars. The following rules apply for the conversion of amounts of income or expenses of a revenue nature. The rules do not apply for the conversion of amounts of a capital nature or for the conversion of foreign taxes.

A non-resident trust estate may keep its records in one foreign currency or predominantly in one foreign currency. These amounts can be converted to Australian dollars using the average exchange rate that prevailed during the income year of the trust estate. Alternatively, the trustee may elect to use the rate that prevailed on the last day of the trust estate's income year. This election must be made within 30 days of the end of the income year concerned and the election will apply for all subsequent income years. The ATO may allow an extension for the lodgment of the election.

If there is a predominant currency but there are one or more other currencies, the other currencies are to be converted into the predominant currency on any reasonable basis and then converted into Australian dollars using one of the two methods outlined above.

Where there is no single or predominant currency, any reasonable basis can be used to convert the amounts.

Conversion of amounts of foreign tax to Australian dollars

If foreign tax is paid by deduction from another amount, the foreign tax is converted to Australian currency using the method adopted for converting the other amount. Withholding tax paid on interest received by a trust would, for instance, be converted to Australian currency using the method for converting the interest to Australian currency.

In any other case, an amount of foreign tax is to be converted to Australian currency using the rate of exchange that applied at the time the foreign tax was paid.

Conversion of capital amounts to Australian dollars

There are no special rules for converting capital amounts. The conversion is made using the rules that apply for converting capital amounts under the usual operation of the Act. Amounts that are taken into account in determining the cost base of an asset are converted at the time the costs were incurred. Amounts arising from the disposal of an asset are converted at the time of disposal.

Modified application of trading stock provisions

All items of trading stock are to be valued at cost when brought to account by a non-resident trust estate.

Modified application of depreciation provisions

A non-resident trust estate is allowed depreciation on the same basis as a resident taxpayer. However, assets are treated as having been held for the production of assessable income in income years where there was no calculation of attributable income.

Where the trustee has used a property during an income year partly for producing exempt income and partly for producing assessable income, the ATO can determine the amount that is an allowable deduction.

Modified application of the transfer pricing rules

The ATO can make adjustments reflecting arm's length values to amounts used in working out the attributable income of a trust estate. To avoid double taxation, the ATO can make a corresponding adjustment to an amount in determining the taxable income of another taxpayer.

Modifications relating to capital gains tax

The capital gains tax provisions of the Act—that is, Part IIIA—apply as if the non-resident trust estate were a resident trust estate. This ensures that a gain on the disposal of a non-taxable Australian asset is taken into account under the transferor trust measures. It also ensures that the pre-20 September 1985 status of assets is retained.

Special rules apply to prevent double taxation of capital gains where a trust estate was formerly a resident of Australia. In this case, the cost base of assets that were taxed under the capital gains tax provisions at the residence change time is taken to be the market value of the assets at that time.

Modification of loss provisions

Losses are not available for income years commencing before 1 July 1990.

De minimis *exemption*

The *de minimis* exemption ensures that the transferor trust measures do not apply to small amounts derived by a trust estate in a broad-exemption listed country.

The *de minimis* exemption is worked out having regard to the total of the attributable incomes of all trust estates for which a taxpayer is an attributable taxpayer. The *de minimis* exemption will be satisfied if the total of the attributable incomes of all the trust estates is equal to or less than the lesser of:

- $20 000 or
- 10 per cent of the total of the net incomes of those trust estates.

If these tests are satisfied, the attributable income of broad-exemption listed country trust estates will not be included in the assessable income of the attributable taxpayer. The attributable income from the non-broad-exemption listed country trust estates would still be included.

Working out the amount of attributable income to include in your assessable income

If you are an attributable taxpayer in relation to a non-resident trust estate, all the attributable income of the non-resident trust estate for an income year coinciding with your income year is included in your assessable income.

If there is more than one attributable taxpayer, the ATO may allow a reduction of the amount of attributable income to be included in the assessable income of each attributable taxpayer. To obtain the reduction, the taxpayer must apply to the ATO—refer to subsection 3 for more information.

Resident for part of a year

If you are a resident for only part of the income year, the attributable income included in your assessable income is reduced. The amount included is worked out as follows:

$$\textbf{Notional attributable income} \times \frac{\textbf{the number of days during the period that you were a resident}}{\textbf{total number of days in the period}}$$

EXAMPLE 3

Part-year residency

George is a resident of Australia for 200 days out of the 365 days in the income year 1 July 1996 to 30 June 1997. He is an attributable taxpayer in relation to YZ trust that was a non-resident trust with the same income year. The attributable income of the trust estate was $40 000.

The amount George is required to include in assessable income for 1996–97 is:

$$\$40\,000 \times \frac{200}{365} = \$21\,917$$

Overlapping years of income

If you are an attributable taxpayer and your income year is different from that of a non-resident trust estate, the trust estate's attributable income for the two income years which overlap your income year is apportioned using the number of days that fall within your current income year.

EXAMPLE 4

Overlapping years of residency

Helen's current income year is 1 July 1996 to 30 June 1997. She is an attributable taxpayer in relation to XY trust estate. The trust estate's income years are 1 January 1996 to 31 December 1996 and 1 January 1997 to 31 December 1997. The attributable income of the trust estate is $30 000 for the 1996 income year and $40 000 for the 1997 income year.

The amount worked out for the trust estate's 1996 income year is:

$$\$30\,000 \times \frac{184}{365} = \$15\,123$$

For the trust estate's 1997 income year, the amount is:

$$\$40\,000 \times \frac{181}{365} = \$19\,835$$

Helen adds the amounts to give a total attributable income of $34 958 for her 1996–97 income year.

Partnerships and trusts

The attributable income from a trust estate is included in working out the net income of a partnership or a trust estate and is treated as having a foreign source.

Where a partner of a partnership or a beneficiary of a trust estate is an Australian resident for the whole income year, they are to include in their assessable income their share of the net income—including attributable income—of the partnership or trust estate.

Where a partner or beneficiary is a non-resident of Australia at all times during an income year, they would not include any attributable income of the partnership or trust estate in their assessable income.

Subsection 2—Working out your assessable income where you do not have sufficient information to work out attributable income

If you are unable to obtain the information necessary to work out the attributable income of a trust estate, you must include an amount worked out using the following formula in your assessable income.

The formula is to be used for each transfer of property or services you made to the trust estate that is subject to the transferor trust measures.

The amount to include in your assessable income is worked out by applying a deemed rate of return to the market value of the property or services you transferred to the trust estate. The market value is adjusted for this calculation to reflect deemed returns for previous periods. The deemed rate of return for a particular period is 5 per cent above the rate of interest that applies for that period under section 214A of the Act less 4 percentage points. If there are two or more rates of interest for the income year, you use the weighted average of these rates for the income year. The weighted average of the section 214A rate less 4 percentage points is referred to as the weighted statutory interest rate.

Use the following formulas to determine the amount to include in your assessable income for transfers of property or services after 12 April 1989.

Transfers made after 12 April 1989

Amount to be included in assessable income	**=**	**Adjusted value of the transfer**	**×**	**Weighted statutory interest rate plus 5 per cent**

The adjusted value for transfers made during the current income year is worked out as follows.

Adjusted value of the transfer	**=**	**Market value, immediately before the transfer of property or services**	**×**	**Days after the transfer to the end of the income year, divided by days in income year**

EXAMPLE 5

Transfer during current income year

An attributable taxpayer transferred property worth $30 000 to a non-resident trust estate on 31 May 1998. There are 30 days between the transfer on 31 May and the end of the year—30 June 1998.

The adjusted value is worked out as follows:

$$\$30\,000 \times \frac{30}{365} = \$2465$$

If the transfer occurred before the taxpayer's current income year, the adjusted value of the transfer is the total of:

- the market value, immediately before the transfer, of the property or services transferred and
- the total of the amounts that would have been included in the transferor's assessable income for that transfer in the income years preceding the taxpayer's current income year, if this method had been used in those years.

Where more than one transfer was made after 12 April 1989, the formula is applied separately to each transfer and then the relevant amounts are added together.

Transfers made before 12 April 1989

Use the following formula to determine the amount to include in your assessable income for transfers of property or services before 12 April 1989.

Amount to be included in assessable income	**=**	**Adjusted net worth of the trust estate**	**×**	**Weighted statutory interest rate plus 5 per cent**

The adjusted net worth of a trust estate is its net worth adjusted for the deemed return on the property or services transferred before 12 April 1989.

The net worth of the trust estate is determined on 1 July 1990. The 1 July 1990 net worth of a trust estate is the market value at 1 July 1990 of the assets of the trust estate, reduced by its liabilities on 1 July 1990.

To determine the adjusted net worth, the net worth is increased by the total of amounts that would be worked out in each previous income year commencing on or after 1 July 1990 using the above formula.

When using the formula method to work out the amount to include in your assessable income, if two or more taxpayers have transferred property or services to the trust estate, the ATO is empowered to provide relief along lines similar to those referred to below in subsection 3.

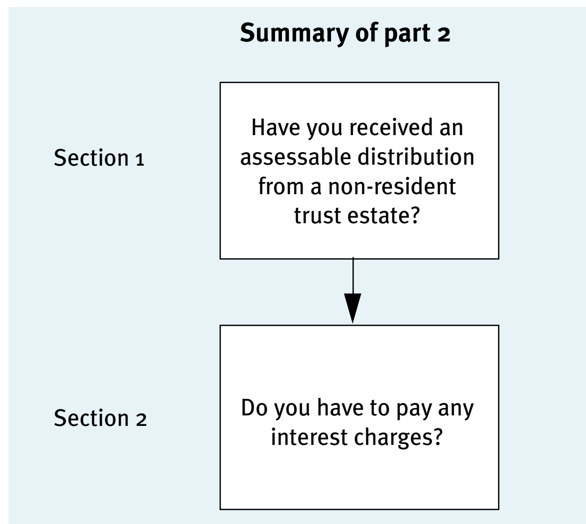
Subsection 3—What happens if there is more than one transferor?

The assessable income of a transferor in relation to a non-resident trust estate will include the part of the attributable income of the trust estate relating to the period that the transferor was a resident of Australia. This can have the effect of subjecting more than one person to tax for the same income.

The ATO can reduce the amount included your assessable income if there is more than one transferor. When determining the amount of the reduction, the ATO takes into account the amount of attributable income of the trust estate that relates to the property or services transferred to the trust estate and to any other matters that are considered relevant. You will need to apply to the ATO for the reduction.

Part 2—Interest charge for beneficiaries of non-resident trust estates

This part explains how distributions received by Australian residents from non-resident trusts are taxed under section 99B of the Act. It also explains when an interest charge will be payable on these distributions.



Section 1—Have you received an assessable distribution from a non-resident trust estate?

This section explains the tax treatment under section 99B of distributions made by a non-resident trust estate—whether or not the distribution was made out of income or gains which have previously been attributed to an attributable taxpayer.

Is the distribution assessable?
Under section 99B, distributions made by a non-resident trust estate to Australian resident beneficiaries are assessable in the hands of the beneficiaries, except in the following five cases:

- the distribution is capital of the trust estate—an amount derived by the trust estate which would have been subject to tax if it had been derived by a resident taxpayer will not be taken to represent capital

- the distribution is an amount that has been taxed or is liable to tax in the hands of the beneficiary under section 97 or in the hands of the trustee under sections 98, 99 or 99A
- the distribution paid to or applied for the benefit of a resident taxpayer—other than a company—represents an amount of attributable income of a non-resident trust estate that has previously been included in the assessable income of any taxpayer
- the distribution paid or applied for the benefit of a company represents an amount of attributable income of a non-resident trust estate that has previously been included in the assessable income of that same company. This exemption applies where the company is acting as a beneficiary, not as a trustee
- the distribution is from any amount that would not have been assessable income in the hands of a resident taxpayer—for example, exempt income. This would include an amount that, if it had been derived by a resident taxpayer, would have been exempt from tax under section 23AH and former paragraph 23(q).

Section 2—Do you have to pay an interest charge?

If you are an Australian resident beneficiary of a non-resident trust estate and section 99B includes a distribution of accumulated income from the non-resident trust estate in your assessable income, you may be liable to pay additional tax in the nature of an interest charge on the distribution.

The interest charge does not apply if the amount included in your assessable income was paid from profits that have previously been taxed on an accruals basis under the transferor trust measures.

The charge is also not applicable for distributions from a public unit trust unless it is a controlled foreign trust.

The interest charge may apply to a distribution of profits from a non-resident trust estate to the extent the distribution was made from profits that:

- are referable to eligible designated concession income derived in an income year when the trust was a resident of a broad-exemption listed country or
- were not subject to tax in a broad-exemption listed country and were derived in an income year when the trust was a resident of a non-broad-exemption listed country.

Listed countries are to be treated as broad-exemption listed countries for this purpose if the trust estate's income year commences before 1 July 1997.

Working out the amount of the interest charge

The amount on which interest is payable is worked out using the following formula:

$$\textbf{Amount on which interest is payable} = \left[\textbf{Distributed amount} \times \textbf{Applicable rate of tax}\right] - \textbf{Foreign tax}$$

Distributed amount
The distributed amount is the amount of the distribution that is included in your assessable income under section 99B. This amount is grossed up for any foreign tax you can claim on that share.

Applicable rate of tax
The applicable rate of tax for a company is the general rate of Australian tax imposed on companies for the income year in which the company receives a trust distribution. The general rate will apply irrespective of the actual rate of tax applicable to the company.

For a taxpayer other than a company, the applicable rate of tax is the maximum marginal rate that applies for the income year of the taxpayer in which the trust distribution is received. The maximum rate would apply irrespective of the actual marginal rate of tax applicable to the taxpayer.

Foreign tax credit
The foreign tax credit is the credit you can claim on the amount included in your assessable income for the distribution made by the non-resident trust.

EXAMPLE 7

Non-broad-exemption country trust estate

During the 1997–98 income year, a resident individual received a distribution of $10 000 from a non-broad-exemption listed country trust estate. The entire amount was included in the taxpayer's assessable income under section 99B. The distribution was paid from $20 000 foreign income derived by the trust in the 1990–91 income year. The income was not subject to tax in a broad-exemption listed country and the trust paid foreign tax of $5000.

Interest is payable on the distributed amount of $10 000 grossed up by the amount of foreign tax relating to the distributed amount—$3333—multiplied by the applicable rate of tax—47 per cent—less the amount of foreign tax credit.

($13 333 × 47%) – $3333 = $2934

Note: The foreign tax credit is worked out by allocating, on a pro rata basis, the foreign tax paid by the trust estate on its foreign income. The profits and income of the trust estate that were available for distribution were:

$20 000 – $5000	$15 000
Amount of the distribution	$10 000
Foreign tax attributable to the distribution $= \frac{\$10\,000 \times \$5000}{\$15\,000}$	$ 3 333

Period over which the interest charge accrues

The interest charge commences to accrue as follows:

- where the trust distribution is paid out of trust income or profits accumulated before 1990–91, the charge will accrue from the commencement of the beneficiary's 1990–91 income year
- where the trust distribution is paid out of trust income accumulated by the non-resident trust estate in the 1990–91 or a subsequent income year, the charge will accrue from the start of the beneficiary's next income year—that is, the income year first following the income year of the trust estate for which the income would have been included in the assessable income of the trust if the trust had been a resident trust estate.

The interest charge will cease to accrue on the last day of the income year in which the distributed amount is included in the assessable income of the beneficiary.

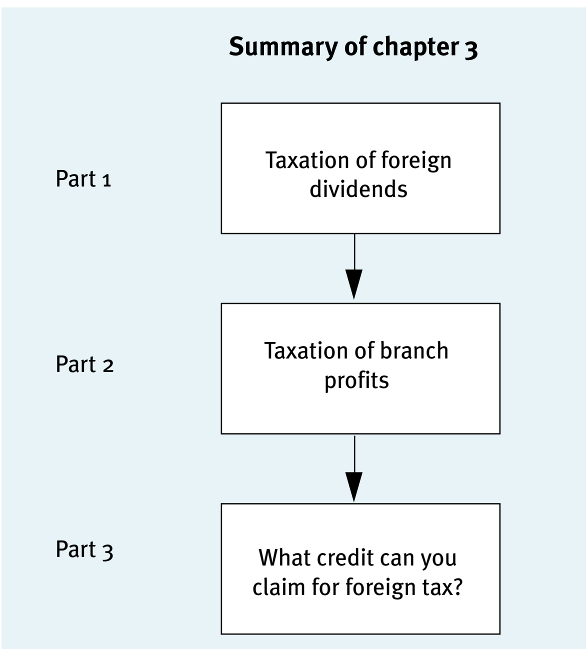
What interest rate applies?

The rate of interest that applies before 1 July 1994 is the rate applicable under section 10 of the *Taxation (Interest on overpayments) Act 1983*. The rate after 30 June 1994 is the rate applying under section 214A of the *Income Tax Assessment Act 1936* less 4 percentage points.

Chapter 3

Taxation of foreign dividends and branch profits and the foreign tax credit system

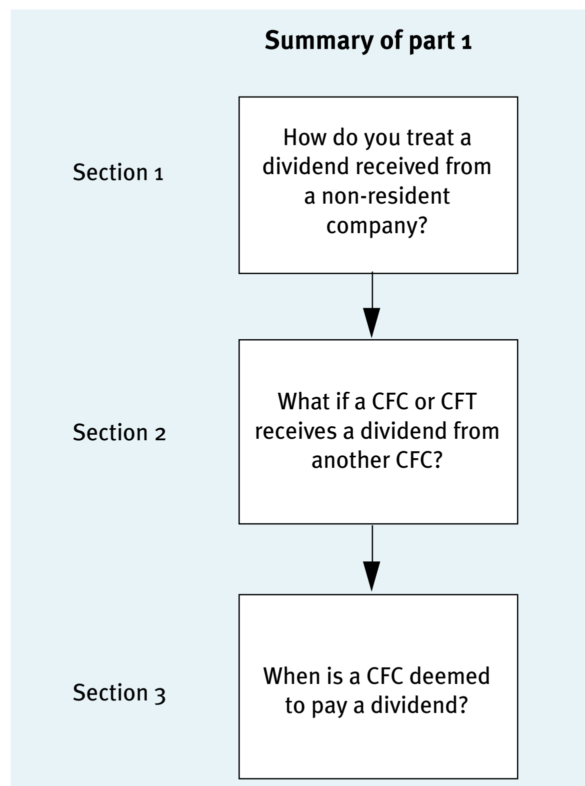
This chapter explains the taxation treatment of foreign dividends and of branch profits derived by Australian companies. It also explains the rules for claiming a foreign tax credit.



Part 1—Taxation of foreign dividends

This part explains how dividends paid by a foreign company are taxed in Australia. This can occur in two ways:

- when a resident taxpayer is taxed on a dividend received from a non-resident company or
- when an attributable taxpayer in relation to a controlled foreign company (CFC) or a controlled foreign trust (CFT) is liable to tax on the taxpayer's share of a dividend paid by an unlisted country CFC directly or indirectly to another CFC or a CFT.



Section 1—How do you treat a dividend received from a non-resident company?

This section sets out the basis for taxing dividends received by a resident from a non-resident company.

Non-portfolio dividends

Definition of non-portfolio dividends

The concept of a non-portfolio dividend is central to the scheme of taxation of foreign dividends. A dividend is a non-portfolio dividend if five conditions are met. These are:

- the dividend is paid to a company
- the company receiving the dividend has a 10 per cent or greater voting interest in the voting power of the company that paid the dividend

  The voting power in a company is the maximum number of votes that can be cast on a poll at a general meeting of the company at which all matters that can be referred to such a meeting are decided.
- the shareholder is the beneficial owner of the shares that carry the required voting interest
- the voting interest is held at the time the dividend is paid
- there is no arrangement in force at that time by which any person is in a position—or may become in a position—to affect the voting right.

Non-portfolio dividends received from a listed country company

Non-portfolio dividends received by a resident company from a listed country company are exempt from tax. These dividends are exempt because they are paid out of:

- profits of a CFC that have been attributed to the resident company under the accruals tax measures—section 23AI
- profits that are treated as having been comparably taxed in a listed country—section 23AJ.

A non-portfolio dividend paid by a listed country company to a resident company is treated as paid first from profits that have been attributed to the resident company, and then from other profits.

EXAMPLE 1

Non-portfolio dividend paid from comparably taxed profits

On 1 January 1998, a company that is a resident of the United Kingdom paid a resident company a non-portfolio dividend of $10 000. None of the income of the UK company had been attributed under the accruals tax system.

In this case, the dividend will be exempt under section 23AJ.

EXAMPLE 2

Non-portfolio dividend paid partly from profits taxed on an accruals basis

Resco, a resident company, has a CFC in a listed country. Attributable income of $10 000 from the CFC was included in Resco's assessable income for the 1996–97 income year.

The CFC then paid a dividend of $25 000 to Resco on 1 August 1997.

$10 000 of the dividend will be exempt from tax under section 23AI as a distribution of attributed income. The $15 000 balance of the dividend will be exempt from tax under section 23AJ.

Non-portfolio dividends received from an unlisted country company

The taxation of a non-portfolio dividend paid by an unlisted country company to a resident company depends on the profits from which the dividend was paid. There are three types of profits:

- comparably taxed profits—called exempting profits—from accounting periods ending after 30 June 1990
- income attributed to the shareholder under the accruals tax measures
- other profits.

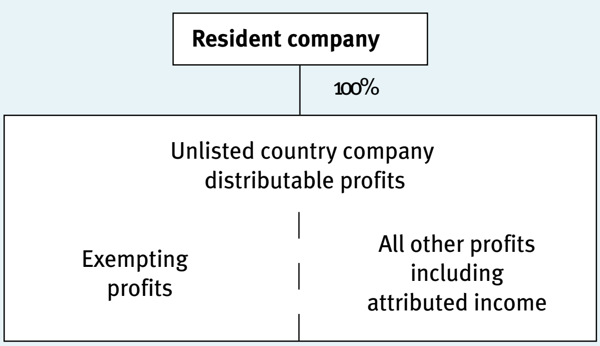
In the three simplest cases, a non-portfolio dividend paid to a resident company from a company resident in an unlisted country will be treated as follows:

- if all the profits of the unlisted country company are exempting profits, the dividend will be exempt from Australian tax
- if all the profits of an unlisted country company have been attributed to the resident company, the dividend paid out of those profits will also be exempt from Australian tax

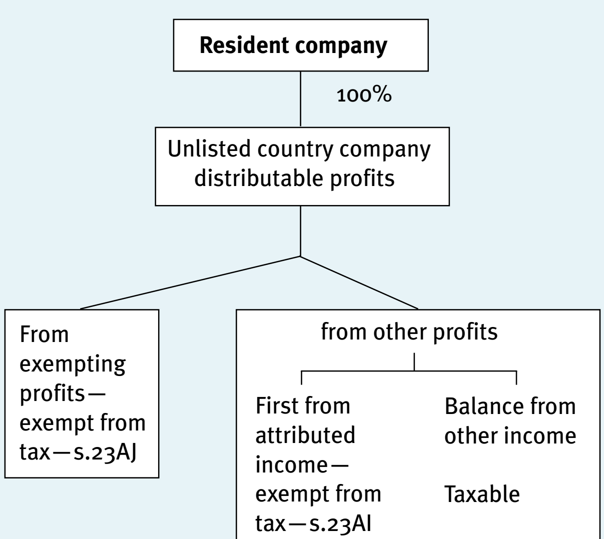
- if the unlisted country company has no exempting profits or profits which have been accruals taxed, the dividend will be subject to Australian tax.

If an unlisted country company has exempting profits and other profits, a non-portfolio dividend paid by the company is treated as paid proportionately from its exempting profits and other profits. The part of the dividend that is treated as paid from other profits is in turn treated as paid first from attributed income, and then from other profits.

To work out the exemption you will need to determine how much of the dividend is treated as paid respectively from exempting profits, attributed income and other profits. The following guidelines and examples tell you how to do this.



The dividend paid by the unlisted country company is treated as paid proportionately from exempting profits and other profits



Working out the exempting profits percentage of a non-portfolio dividend paid by an unlisted country company

The exempting profits percentage of a dividend paid by an unlisted country company is calculated using the formula:

$$\textbf{Exempting profits percentage of dividend} = \frac{\textbf{Exempting profits}}{\textbf{Distributable profit}} \times 100$$

This percentage represents the part of a non-portfolio dividend paid by an unlisted country company that is exempt from Australian tax because it is paid from exempting profits.

Distributable profits

A distributable profit is the amount a company can distribute as dividends. Any decision or requirement restricting the availability of profits for distribution as dividends, other than any requirement providing for the following provisions or reserves, is disregarded:

- a provision or reserve which is required to be maintained by law
- a provision for any liability in respect of foreign tax or Australian tax
- a reserve maintained for the purpose of qualifying for relief from foreign tax
- a provision or reserve for depreciation, bad or doubtful debts or leave payments or
- any other provision or reserve of a kind prescribed by regulations—to date, no regulations have been made for this purpose.

Exempting profits

Exempting profits are the distributable profits of a company that result from exempting receipts. Exempting profits are worked out using the formula:

$$\textbf{Exempting profits} = \textbf{Exempting receipts} - \textbf{Expenses and taxes attributable to those receipts}$$

There are special rules for working out exempting profits of an unlisted country CFC which has changed residence from a listed country. The exempting profits are determined in the normal manner except that distributable profits the CFC had at the time it changed residence are also treated as exempting profits. However, profits taxed previously under the CFC measures are not treated as exempting profits.

Exempting receipts

In broad terms, exempting receipts are amounts received by a company that have been either:

- included in assessable income for Australian tax purposes or
- taxed at comparable tax rates in a listed country.

Only amounts received by a company in accounting periods that end after 30 June 1990 can constitute exempting receipts.

The following seven types of amounts received by an unlisted country company qualify as exempting receipts:

- amounts derived by the company in carrying on a business in a broad-exemption listed country through a permanent establishment in that country providing:
  - the amounts are not eligible designated concession income
  - the amounts are subject to tax in a listed country in an accounting period ending or commencing during the statutory accounting period of the CFC
- amounts derived by the company in carrying on a business in a limited-exemption listed country through a permanent establishment in that country providing:
  - the amounts are not adjusted tainted income
  - the amounts are subject to tax in a listed country in an accounting period ending or commencing during the statutory accounting period of the CFC
- income derived by the company that is included in the assessable income of the company for Australian tax purposes and is taxed by assessment
- net capital gains included in assessable income on the disposal of a taxable Australian asset
- non-portfolio dividends paid to the company by a listed country company—except where the dividend is treated as paid out of previously attributed income
- fully franked dividends paid by resident companies
- the exempting profits percentage of a non-portfolio dividend paid to the company by another unlisted country company.

The first four types of exempting receipts mentioned above could flow to the company through either a partnership or a trust. If the receipts flow to the company through a partnership of which it is a partner, the exempting receipt will be the company's share of the after-tax profits of the partnership that can be attributed to those receipts. The company's share of those exempting receipts could also be distributed to the partnership through other partnerships and trusts.

If the receipts flow to the company through a trust, the exempting receipt will be the trust distribution. Again, the receipts could be derived by the trust directly or through other trusts and partnerships.

Accounting records for exempting receipts and exempting profits

The law does not set out the records that have to be kept to identify exempting receipts and exempting profits. However, if you claim that a part of a dividend paid by an unlisted country company was paid from exempting profits, you will have to maintain adequate records to substantiate this claim.

Adequate records include:

- a statement of the exempting receipts of the foreign company
- an analysis of the outgoings and expenses incurred by the foreign company that are attributable to the exempting receipts
- an analysis of the taxes paid or provided for by the foreign company that are attributable to the exempting receipts.

Distributions of attributed income—maintaining records to support a claim for exemption

Attribution accounts

To be able to work out and claim the exemption from income tax for distributions out of attributed income of a CFC, you will need to keep certain records called attribution accounts.

You must maintain an attribution account for:

- each CFC from which income is attributed to you. This account will contain a record of:
  - income attributed to you from the CFC
  - income distributed to you by the CFC which is treated as distributed from attributed income

- each entity through which the income of that CFC is distributed to you. These entities may be:
  - partnerships
  - trusts
  - companies that are not Part X Australian residents
- each FIF where an amount of FIF income is included in the notional assessable income of the CFC
- each CFC that has changed residence from an unlisted country to Australia. You can claim an exemption from tax on dividends paid by a company out of profits which were attributed to you prior to the company becoming a resident of Australia.

These accounts are used to keep track of profits that have been taxed on an accruals basis so that you can claim an exemption when you receive a distribution from those profits.

EXAMPLE 3

Attribution accounts

A resident company—Resco—owns all the share capital of a CFC that is a resident of an unlisted country. The CFC commenced business on 1 July 1997. For the 1997–98 income year, its only income was attributable income of $2500. It paid no tax. On 1 August 1998, it paid a dividend of $2500 to Resco.

Attribution credit:

Resco will open an attribution account for the CFC and credit it with $2500 on 30 June 1998 because this amount was included at that time in Resco's assessable income under the CFC measures. The CFC is called an attribution account entity.

Attribution debit:

Resco will debit $2500 to the attribution account for the CFC on 1 August 1998 because of the dividend paid by the CFC. The debit is referred to as an 'attribution debit'. The amount of the debit cannot be more than the credit balance in the account—called the 'attribution surplus'—at the time the debit is made. In this case, the debit could not be more than $2500.

The dividend received by Resco is exempt from tax to the extent the dividend gave rise to an attribution debit. In this case, Resco can claim an exemption from Australian tax in the 1998–99 income year for the whole amount of the dividend. The effect is that Resco only pays tax on the CFC's income when it is attributed, and not again when it is distributed.

An attribution account maintained by you for a CFC is specific to you. This means that when you sell shares in a CFC, you cannot transfer the attribution account to the purchaser of the shares.

Tracing the path of distributions of attributed income

There are a number of ways you can receive amounts that were paid from profits that have previously been attributed to you. In general, these amounts will be distributed to you as a dividend. The dividend may be distributed to you directly, or indirectly through a chain of companies, partnerships, or trusts.

When are attribution account payments made?

To work out your exemption, you will need to know the date on which attribution account payments are taken to have been made.

The following table sets out:

- the types of attribution account payments that can occur
- the entities that are treated as making and receiving an attribution account payment
- the date on which the payment is taken to be made.

Type of attribution payment	Entity making payment	Entity receiving payment	Date payment made
Dividend	paying company	shareholder	on date dividend is paid
Partner’s share in the net income of a partnership	partnership	partner	at the end of the income year of the partnership
Share of the net income of a trust estate equal to the beneficiary’s present entitlement	trust	beneficiary	at the end of the income year of the trust
Whole or part of the net income of a trust estate is assessable to the trustee—s.99 or s.99A	trust	trustee	at the end of the income year of the trust
Other distribution of accumulated trust income	trust	beneficiary	income year in which the distribution was made

What accounting entries should you make?

As mentioned earlier, attribution accounts link distributions a CFC has made to you—either directly or through other entities—to the income of the CFC that has already been attributed to you. The link is made when you:

- debit the attribution account of the entity that makes the payment and
- credit the account of the entity that receives the payment.

Continue this process down a chain of entities until you receive a distribution made by the CFC.

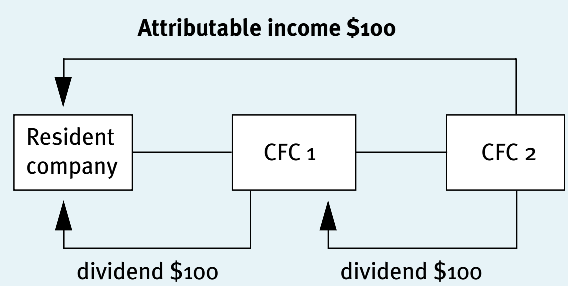
EXAMPLE 4

Distribution of attributed income

A resident company—Resco—owns all of the shares of CFC1, which owns all of the shares of CFC2. The CFCs are residents of unlisted countries.

CFC2 commenced business on 1 July 1997 and for the 1998 income year CFC2 derived $100 which was attributed under the CFC measures. The company paid no tax on the attributed amount. On 1 August 1998 the company paid its first dividend of $100 to CFC1, which paid the dividend to Resco on the same day.

All the entities close accounts to 30 June 1999.



Attribution accounts

CFC2

Debit		**Credit**	
1 August 1998 dividend to CFC1	$100	30 June 1998 amount attributed to Resco	$100

CFC1

Debit		**Credit**	
1 August 1998 dividend to Resco	$100	1 August 1998 dividend from CFC2	$100

As the $100 attributed from CFC2 to Resco on 30 June 1998 was included in Resco’s 1998 assessable income, and as the distribution Resco received on 1 August 1998 is no more than the income already attributed, Resco will be exempt from tax on the dividend.

Proportionate interests in the CFC and in interposed entities

A resident taxpayer might hold only a proportion—that is, less than 100 per cent—of the interests in a CFC. That interest may be held directly or indirectly through interests in other foreign entities.

If you hold an interest of less than 100 per cent in a CFC, only a proportion of the attributable income of the CFC is included in your assessable income. The proportion to use depends on the interest—called the attribution percentage—you have in the CFC—see chapter 1.

When tracing a distribution made by a CFC through a chain of interposed entities to yourself, note any proportionate interests you have in any of these entities.

Your interest in the CFC—and in each interposed entity—is called your attribution account percentage. This interest may differ from your attribution percentage in an entity. The foreign entities in the chain along which the attributed income of the CFC is later distributed to you need not necessarily be controlled foreign entities.

If you have both direct and indirect attribution account interests in an entity, then your attribution account percentage in that entity is the sum of the interests as follows

Attribution account percentage	**=**	**direct attribution account interest**	**+**	**indirect attribution account interest**

How do you work out your direct attribution account interest in an entity?

Your direct attribution account interest in an entity will depend on the type of entity it is.

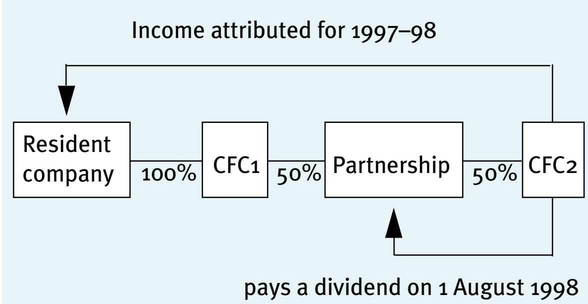
If the entity is a foreign company, your direct attribution account interest in the company is the same as your direct attribution interest in that company.

If the entity is a partnership of which you are a partner, your direct attribution account interest is the percentage that you hold—and any percentage you are entitled to acquire—of either the partnership's profits or the partnership's property. If the two percentages differ, use the higher percentage as your direct attribution account interest.

Your interest in a partnership is measured at the end of the accounting period in which the dividend is distributed through the partnership to you. The date of the dividend payment is called the test time. You should assume that you held the same interest in the profits and property of the partnership throughout the accounting period that you held at the test time. When working out your interest in the profits, use the amount of profit for the whole of the period.

EXAMPLE 5

Attribution account interest in a partnership



It is necessary to measure the direct attribution account interest of CFC1 in the partnership in order to measure the attribution account percentage of the resident individual in the partnership when the dividend is paid.

If the entity is a trust of which you are a beneficiary, your interest in the trust is the percentage of either the income or property of the trust to which you are presently entitled—and any percentage you are entitled to acquire. If the two percentages differ, use the higher percentage as your attribution account interest.

As in the case of an interest in a partnership, your interest in a trust is measured at the end of the accounting period of the trust in which the dividend is distributed through the trust to you. The date of this payment is called the test time. You should assume that you held the same interest in the income or property of the trust throughout the accounting period as you held at the test time. When working out your interest in the income, use the amount of income earned for the whole period.

How do you work out your indirect attribution account interest in an entity?

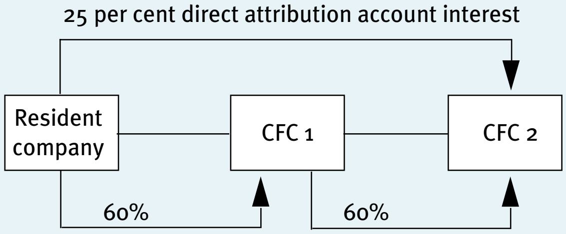
Your attribution account percentage in an entity is the sum of your direct and indirect interests in that entity. To work out your indirect interest in an entity—entity B—which is held through another entity—entity A—multiply your direct interest in entity A by entity A's direct interest in entity B.

If there are more than two entities in a chain, continue the process of multiplication along the chain until you reach the entity in which you are measuring your indirect interest.

EXAMPLE 6

Attribution account interest

25 per cent direct attribution account interest



36 per cent indirect attribution account interest (60% X 60%)

In this case, the resident taxpayer's attribution account percentage in CFC2 is 61 per cent—that is, the taxpayer has a direct attribution account interest of 25 per cent plus an indirect attribution account interest of 36 per cent.

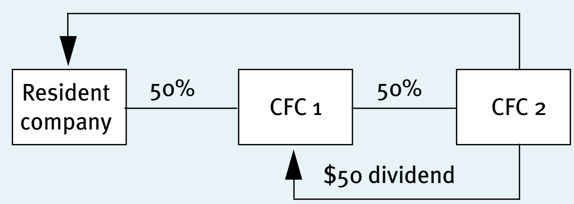
EXAMPLE 7

Direct and indirect attribution account percentage

The following example shows how to work out direct and indirect interests and the attribution account percentage in an entity.

A resident company owns 50 per cent of the share capital of CFC1 and CFC1 owns 50 per cent of the share capital of CFC2. The CFCs are residents of unlisted countries. CFC2 commenced business on 1 July 1997. For the 1998 financial year the only income of CFC2 was attributable income of $100. On 1 August 1998, CFC2 paid a dividend of $50 to CFC1.

Attributable income $25 (25% of $100)



Dividend paid to CFC1 = $50 (50% of $100)
Resident company's share of the dividend = $25 (50% of $50)

The resident company's attribution percentage in CFC2 is 25 per cent—that is, 50 per cent of 50 per cent. The resident company's share of the attributable income of the CFC is therefore $25—that is, 25 per cent of $100.

The dividend of $50 paid to CFC1 is an attribution account payment. When the dividend is paid to CFC1 it is necessary to measure how much of the dividend can be treated as a distribution of CFC2's previously attributed income. The amount is worked out by applying the attribution account percentage of the resident company in CFC1 to the dividend paid to CFC1.

The direct attribution account interests will be as follows:

Direct attribution account interest of the resident company in CFC1	=	50%
Direct attribution account interest of CFC1 in CFC2	=	50%

The indirect attribution account interest is obtained by multiplying the direct attribution interests along the chain. The indirect attribution account interest of the resident in CFC2 will be 25 per cent (50% x 50%). Up to $25 of the dividend can therefore be treated as paid from previously attributed income.

EXAMPLE 8

Attribution debit

A resident individual has a direct attribution account interest of 80 per cent in CFC1. CFC1 has a direct attribution interest of 90 per cent in CFC2. The CFCs are resident in unlisted countries.

CFC2 commenced business on 1 July 1997. For the 1998 income year, its only income was attributable income of $100. It paid no tax. On 1 August 1998 it distributed its 1998 income. On the same day, CFC1 distributed the full amount of the dividend it received from CFC2.

Attribution accounts

CFC2

Debit		Credit	
1 August 1998 dividend to CFC1 (note 2)	$72	30 June 1998 attributed income (note 1)	$72

CFC1

Debit		Credit	
1 August 1998 dividend to Resco (note 4)	$72	1 August 1998 dividend from CFC2 (note 3)	$72

Note 1
This represents CFC2's attributable income of $100 multiplied by the resident's attribution percentage in CFC2—that is, 80 per cent (interest of the resident in CFC1) x 90% (interest of CFC1 in CFC2) x $100 = $72.

Note 2
This represents the resident's attribution account percentage in the dividend received by CFC1—that is, 80 per cent of the $90 dividend.

Note 3
The resident's attribution account percentage in the dividend received by CFC1—worked out as in note 2.

Note 4
The dividend paid by CFC1 to the resident.

The dividend of $72 received by the resident is exempt from tax to the extent of the attribution debit that arose when the dividend was paid. As this debit was also $72, the dividend is fully exempt from tax.

When should you make a credit in an attribution account?

You must make a credit in an attribution account if you include an amount in your assessable income because:

- an amount of the CFC's income has been attributed to you—section 456. The credit amount will be the amount of the attributed income included in your assessable income under section 456 without any addition for foreign or Australian tax paid by the CFC on that income. You must enter the credit at the end of the CFC's statutory accounting period. Where a company is a CFC at the beginning of its statutory accounting period but ceases to exist during that period, the statutory accounting period is deemed to end immediately before the company ceases to exist. However, in this circumstance the credit arises at the beginning of the statutory account period
- an amount of FIF income is included in the attributable income of a CFC. In this case a credit arises in relation to the FIF equal to the amount included in your assessable income under section 456 that is referable to the FIF income. The credit that would otherwise arise for the CFC is reduced by the amount that arises for the FIF. If a FIF has an interest in another FIF and the calculation method applies to determine the FIF income of the first FIF, a credit will arise for the second FIF. The FIF income is based on the FIF income of the first FIF referable to the FIF income of the second FIF. In this case, the attribution credit for the first FIF is reduced by the credit that arises for the second FIF
- the CFC has both:
  - ceased to be a resident of an unlisted country
  - become a resident of a listed country or of Australia.

  The amount of the credit will be the amount you included in your assessable income under section 457 without any addition for foreign or Australian tax the CFC paid on that amount. You must normally enter the credit at the time the CFC changed residence. You have the option to defer the credit, however, to the extent it relates to an amount included in attributable income under section 457 for an unrealised gain on an asset.

The credit may be deferred until the CFC pays a dividend out of profits arising from the subsequent disposal of the asset or

- an unlisted country CFC paid a non-portfolio dividend to either:
  - a CFC resident in another country or
  - in certain circumstances, to a CFT or partnership or Australian trust.

  The credit is for the amount you included in your assessable income under section 458 without the addition of any foreign tax treated as paid by the CFC on that dividend. You must enter the credit at the time the dividend was paid.

You must also make a credit in an entity's attribution account if:

- that entity receives an attribution account payment from another entity and
- the payment gives rise to an attribution debit for the paying entity.

The credit amount will be the same as the attribution debit. You must enter the credit on the date of the attribution account payment.

An attribution credit will not arise when an amount is included in your assessable income under section 459.

How are credits made when the taxpayer is an Australian partnership or Australian trust?

Only the taxpayer who is actually liable to tax on the attributed income of the CFC can obtain an exemption from tax for distributions of that income.

This means that if the income of a CFC is attributed to an Australian partnership or Australian trust, the credit you make in the CFC's account is for the partner of the partnership or for the trust beneficiary who is presently entitled to the trust income. If there is no such beneficiary, the credit arises for the trustee.

The credit does not normally arise for the partnership or trust itself. There is an exception where the trust is a corporate unit trust, a public trading trust, an approved deposit fund, an eligible superannuation fund or a pooled superannuation trust.

When is the credit reduced for foreign taxes paid?

If a non-resident company pays a non-portfolio dividend to another non-resident company of which you are an attributable taxpayer, you may make an attribution credit in the second company's account. The general rule is that the credit will be equal to the amount included in your assessable income under section 458, without the addition of any foreign tax paid by the company that received the dividend. Reduce this credit by the amount of any foreign tax payable by the company that received the dividend to the extent the tax is related to either the dividend or to income that includes the dividend.

If, for example, an unlisted country CFC pays a non-portfolio dividend to a listed country CFC of which you are an attributable taxpayer, you may be attributed certain amounts of the dividend—see section 458. If this is so, you will make an attribution credit for yourself in the listed country CFC's attribution account. The credit amount will be equal to the dividend minus any foreign tax payable in a foreign country on the dividend.

If the listed country taxes the non-portfolio dividend at its normal company tax rate, there will be no attribution of the income to you and no attribution credit will arise for the dividend—refer to section 2 of this part.

EXAMPLE 9

Reduction of an attribution credit for foreign tax

Resco, a resident company, owns CFC1—a subsidiary in a listed country—which owns CFC2—a subsidiary in an unlisted country. CFC2 pays a dividend of $100 to CFC1. The listed country's normal company tax rate is 35 per cent, however the dividend is taxed at only 10 per cent in that country.

The attribution credit in CFC1's account will be for $90—that is, $100 minus the foreign tax of $10.

When should you make debits in attribution accounts?

You must make an attribution debit in an entity's attribution account if that entity makes an attribution account payment to either:

- an attributable taxpayer or
- another attribution account entity.

There are, however, two rules you must observe. These are that:

- you can only make a debit if there is an attribution surplus in the attribution account at the time the attribution account payment is made—that is, the account balance must be more than nil
- the debit cannot be more than the amount of the surplus in the account at the time.

What is the amount of the attribution debit?

There are again two rules to observe:

- if an entity makes an attribution account payment to a resident taxpayer, the debit is the same as the amount of the payment
- if the entity makes an attribution account payment to another entity, the debit will equal the resident taxpayer's attribution account percentage of the payment received by the second entity.

Working out the amount of the attribution debit where a non-portfolio dividend is paid by an unlisted country company

If a company that is a member of a non-portfolio company group pays a non-portfolio dividend to another member of the same group, you must reduce the amount of the attribution account debit by the exempting profits percentage of the dividend.

A non-portfolio company group will arise if an Australian company has a 10 per cent or greater voting interest in a foreign company. If this occurs, the two companies are members of a non-portfolio company group.

If the foreign company has a 10 per cent or greater voting interest in another foreign company, the Australian company and the two foreign companies constitute the non-portfolio company group. Other companies are added to the group if each company has a 10 per cent or greater voting interest in the company immediately below it.

The attribution debit that you make in the attribution account for the company that paid the dividend is equal to your attribution account percentage of the balance of the dividend—that is, the dividend less the exempting profits percentage.

Working out the exempting receipt resulting from a dividend paid by a listed country company to an unlisted country company

The method for working out the exempting profits percentage of a non-portfolio dividend paid by an unlisted country company was discussed earlier in this section. One type of exempting receipt that could give rise to exempting profits is where a listed country company pays a non-portfolio dividend to an unlisted country company.

The dividend may be paid:

- out of income of the listed country company that was attributed to you under the accruals tax measures or
- out of other income.

Before you can work out the exempting profits percentage of the dividend you will need to determine:

- the amount of the dividend paid by the listed country company that is to be treated as an exempting receipt of the unlisted country company
- the amount to be treated as paid out of income previously attributed to you.

To work out the amount of the exempting receipt, use the formula:

$$\textbf{Exempting receipt} = \textbf{dividend} - \textbf{grossed up attribution debit}$$

The grossed up attribution debit is the attribution debit arising from the attribution account payment divided by your attribution account percentage for the payment.

The attribution debit is the debit that arose for the listed country company when it paid the dividend. The debit is for the amount of your interest in the dividend—that is, your attribution account percentage in the unlisted country company that received the dividend multiplied by the dividend. Note, however, that the debit cannot be more than the attribution surplus in the attribution account of the listed country company.

EXAMPLE 10

Exempting receipts arising on the payment of a non-portfolio dividend

Resco, a resident company, owns 100 per cent of an unlisted country company. The unlisted country company owns 60 per cent of a listed country company. The listed country company commenced business on 12 July 1997. It had distributable profits of $20 000 which represent attributable income of $2000 and other profits of $18 000. On 1 August 1998, the listed country company paid a dividend of $10 000 to the unlisted country company.

On attribution

Resco will open an attribution account for the listed country company and credit it $1200.

On the dividend being paid

Resco will debit the attribution account for the listed country company with $1200. Resco will open an attribution account for the unlisted country company and credit the account with $1200 (60% of $2000).

The exempting receipt of the unlisted country company will be the dividend less the grossed up attribution debit:

$$\$10\,000 - \left(\frac{\text{attribution debit } \$1200}{100\%}\right) = \$8800$$

Further examples showing how to work out exempting profits

EXAMPLE 11

Resco, a resident company, has a wholly owned subsidiary, Subco, in an unlisted country. The distributable profits of Subco on 1 July 1997 were $15 000.

In the year ended 30 June 1998, the subsidiary derived the following profits:

	$
Passive income from its business in the unlisted country—see chapter 1	6 000
Profits from its branch in a broad-exemption listed country	16 000

Subco paid tax of $1000 on its unlisted country income and $6000 in the broad-exemption listed country on its branch profits.

On 1 August 1998 it paid a dividend of $15 000 to Resco.

The attributable income of Subco for the 1998 income year was worked out as follows:

	$
Passive income from business in the unlisted country	6 000
deduct: foreign tax	1 000
Subco's attributable income for 1998	5 000
Subco's distributable profits on 30 June 1998 were:	
distributable profits on 1 July 1997	15 000
distributable profits derived in the year ended 30 June 1997:	
from unlisted country operations ($6000 – tax $1000)	5 000
from the broad-exemption listed country branch ($16 000 – tax $6000)	10 000
Distributable profits 30 June 1998	30 000

The dividend of $15 000 paid to Resco on 1 August 1998 was treated as paid from exempting profits and other profits as follows:

Resco's exempting profits that were included in distributable profits—that is, profits from the broad-exemption listed country branch for the accounting years ending on or after 1 July 1997	10 000
Resco's other profits that were included in distributable profits—	20 000

consisting of $15 000 distributable profits for the period prior to 1 July 1997 plus $5000 distributable profits from unlisted country operations in the year ended 30 June 1998.

Exempting profits percentage of the dividend

$$= \frac{\text{exempting profits}}{\text{distributable profits}} \times 100$$

$$= \frac{10\,000}{30\,000} \times 100$$

$$= 33\ 1/3\%$$

A third of the dividend of $15 000—that is, $5000—was treated as paid from exempting profits and the balance of the dividend—$10 000—was treated as paid from other profits.

$5000 of the dividend that is treated as paid from exempting profits was exempt from Australian tax.

The balance of the dividend—$10 000—was treated as paid first from previously attributed income. It was exempt from Australian tax up to the amount of the attribution debit that arose when the dividend was paid.

The attributable income of Subco for the 1997–98 income year was $5000. When the income was included in Resco's assessable income, Resco opened an attribution account for Subco and credited it with $5000. On 1 August 1998, when the dividend was paid, there was an attribution surplus of $5000 in the attribution account.

When the $15 000 dividend was received by Resco, $10 000 was treated as paid out of profits other than exempting profits. An attribution debit of $5000 was made and an exemption from tax claimed for that amount.

The $5000 balance of the dividend was taxable. The amount of this dividend is increased by the amount of foreign tax for which a foreign tax credit was claimed—see chapter 3 part 3.

Summary

The dividend of $15 000 is divided into:

	$
exempt dividend paid out of exempting profits	5 000
exempt dividend paid out of attributed income	5 000
assessable dividend	5 000
	15 000

EXAMPLE 12

It is assumed, in this example, that Subco is owned by another unlisted country company, Parentco, which is owned by Resco. The data used is the same as in the previous example, except that the dividend is paid to Parentco.

On 1 July 1998, Parentco had distributable profits of $60 000 made up of $20 000 exempting profits and $40 000 other profits. On 1 August 1998, Parentco received the dividend of $15 000 from Subco. Parentco did not pay any foreign tax on the dividend.

For the year ended 30 June 1999, Parentco derived distributable profits—excluding the dividend from Subco—of $30 000 made up of $10 000 exempting profits and $20 000 active income, none of which was attributable income.

On 1 August 1999, Parentco paid a dividend of $75 000 to Resco.

In this case, the exempting profits of Parentco are worked out as follows:

	Exempting profits $	Other profits $	Distributable profits $
On 1 July 1998	20 000	40 000	60 000
In relation to the dividend from Subco	5 000	10 000	15 000
On other profits for the year ended 30 June 1999	10 000	20 000	30 000
Total	35 000	70 000	105 000

The dividend that Parentco paid to Resco was divided into an exempting profits part and the balance as follows:

The exempting profits percentage of the dividend

$$= \frac{\text{exempting profits}}{\text{distributable profits}} \times 100$$

$$= \frac{35\ 000}{105\ 000} \times 100$$

$$= 33\ 1/3\%$$

The exempting profits part of the dividend

$$= 33\ 1/3\% \times \$75\ 000$$

$$= \$25\ 000$$

This amount is exempt from Australian tax.

Attribution accounts

When the attributable income of Subco was attributable to Resco, Resco opened an attribution account for Subco and credited it $5000.

When Subco paid the dividend of $15 000 to Parentco, Resco debited the attribution account of Subco with $5000, opened an attribution account for Parentco and credited it with $5000. The debit was for the amount of the dividend not treated as paid from exempting profits. Note, however, that the debit was limited to the attribution surplus.

When Parentco paid the dividend of $75 000 to Resco, Resco debited $5000 to the attribution account of Parentco and claimed an exemption from tax for $5000.

The balance of the dividend was liable to Australian tax—that is:

Dividend		$75 000
Less:		
part paid from exempting profits	$25 000	
part paid from attributed income	$5 000	
	$30 000	
Taxable part of dividend		$45 000

This $45 000 was increased by the amount of foreign tax for which a foreign tax credit was claimed—see chapter 3 part 3.

Dividends other than non-portfolio dividends

Portfolio dividends are generally taxable unless they are paid from profits taxed previously on an accruals basis. Portfolio dividends are dividends that do not qualify as non-portfolio dividends.

You must maintain an attribution account for each CFC from which income is attributed to you. An explanation of how these accounts are maintained was provided earlier in this part.

Section 2—What if a CFC or CFT receives a dividend from another CFC?

Non-portfolio dividends paid by a listed country company to a resident company are always exempt from tax. Non-portfolio dividends paid by an unlisted country company to a resident company, however, are exempt from tax only in very limited circumstances. It is possible therefore that a resident company with an interest in an unlisted country company held through a listed country company may try to minimise Australian tax by arranging for the dividends from the unlisted country company to flow back to Australia through the listed country company.

This could be effective if the unlisted country company could distribute its low-taxed profits as dividends to a listed country company which taxed those dividends at very low rates, and if the listed country company in turn distributes those non-portfolio dividends to its Australian parent company free of tax. There are rules in section 458 to prevent this form of tax avoidance.

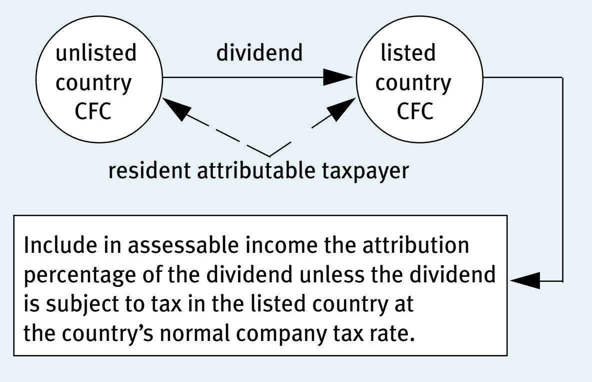
Non-portfolio dividends

Paid to a listed country CFC

The general rule is that section 458 will include a share of a dividend in your assessable income where a non-portfolio dividend is paid from an unlisted country CFC to a listed country CFC and you are an attributable taxpayer in relation to both CFCs. To work out the amount to include in your assessable income, you will need to know your attribution percentage in the listed country CFC receiving the dividend.

There is an exception to the general rule if a listed country taxes the dividend at its normal company tax rate. In this case, the dividend will not be attributed to you. To qualify for the exemption the dividend must be subject to tax in the listed country at the same rate as, or at a higher rate than, the rate of tax that applies to non-dividend income of a company resident in that country. The tax law of the listed country should not provide any credit, rebate or other concession in respect of the dividend other than for foreign tax payable in another country.

The dividend will also qualify for the exemption if it was exempt from tax in a broad-exemption listed country because it was paid from income previously attributed in that country under an accruals tax law and it was subject to tax at or above the country's normal company tax rate.



The attributable dividend is reduced by the exempting profits percentage of the dividend if:

- you are a resident company with a non-portfolio interest in both CFCs at the time the dividend is paid
- the CFC receiving the dividend has a non-portfolio interest in the paying CFC
- both CFCs are in a non-portfolio group with you—that is, each company in the group must have a non-portfolio interest in the company in the tier immediately below it.

Apply your attribution account percentage in the CFC that received the dividend to the balance of the dividend. Take away from this amount an attribution debit or a FIF attribution debit that arose at the time the dividend was paid.

You must include the remaining amount in your assessable income.

EXAMPLE 13

Reduction for exempting profits

Ausco has an interest of 75 per cent in a listed country subsidiary, CFC1. CFC1 has a wholly owned subsidiary, CFC2, in an unlisted country.

On 1 November 1997, CFC2 paid a non-portfolio dividend of $15 000 from its distributable profits. The distributable profits on that date comprised $20 000 exempting profits and $10 000 other profits. None of these profits had been attributed to Ausco. The dividend was not taxed in the listed country at its normal company tax rate.

The amount that Ausco included in its assessable income for 1998 is worked out as follows:

Dividend paid by CFC2	$15 000
deduct the exempting profits part of the dividend	
$\frac{\$20\,000}{\$30\,000} \times \$15\,000$	$10 000
	$ 5 000
Ausco's interest in CFC1 75% of $5000	$ 3 750

$3750 was included in assessable income. This amount is increased by the amount of a foreign tax credit that can be claimed under section 160AFCC.

EXAMPLE 14

Reduction for an attribution debit

The facts are the same as in the previous example except that Ausco was attributed a part of the income of CFC2 and had an attribution surplus of $1000 for CFC2 at the time the dividend was paid.

In this case, the amount of $3750 that was to be included in Ausco's assessable income is further reduced by the attribution debit that arose in the attribution account for CFC2 when CFC2 paid the dividend.

Since the attribution debit cannot be more than the attribution surplus, the attribution debit was the lesser of:

- the attribution surplus—$1000 or
- Ausco's attribution account interest in the dividend paid by CFC2 multiplied by the dividend that was not paid out of exempting profits—that is:
75% × $5000 = $3750

This means that the attribution debit was $1000.

The amount included in the assessable income of Ausco will be:

the amount in Example 13	$3750
deduct attribution debit	$1000
amount included in assessable income	$2750

This amount is increased by the amount of a foreign tax credit that can be claimed under section 160AFCC.

Paid to an entity other than a CFC

Similar rules apply where an unlisted country CFC pays a dividend to:

- a controlled foreign trust (CFT)
- a partnership of which a CFC or a CFT is a partner
- an Australian trust of which a CFC or a CFT is a beneficiary or
- a partnership or Australian trust from which a CFC (or a CFT) benefits through interests in interposed entities.

The rules apply if:

- the dividend paid by the unlisted country CFC would have been a non-portfolio dividend if it had been paid to a company instead of the partnership or trust and
- the resident taxpayer was an attributable taxpayer for both the CFC that paid the dividend, and the CFC or CFT that received the dividend.

Paid to another unlisted country CFC

In general, section 458 does not apply to a dividend paid to an unlisted country CFC unless the payment of the dividend was part of a dividend stripping scheme or a scheme of that nature.

Section 3—When is a CFC deemed to pay a dividend?

It is possible that a resident taxpayer with an interest in an unlisted country CFC may try to minimise Australian tax by arranging for the CFC to distribute benefits in a form other than dividends to its shareholders or their associates.

There are rules to prevent this form of tax avoidance in section 47A. These rules deem certain transfers and payments made by an unlisted country CFC to be dividends. These dividends are then taxed in the normal way.

For section 47A to apply, a CFC must provide a benefit to:

- a resident who is a shareholder or an associate of a shareholder of the CFC or
- another CFC or CFT, directly or through other entities, where the first entity that received the dividend is a shareholder or an associate of a shareholder of the CFC.

When should you deem a dividend to have been paid by a CFC?

Types of benefits that are covered under section 47A

The following seven types of benefits provided by a CFC could be treated as dividends:

- the waiver by the CFC of a debt owed by another entity
- the grant by the CFC of a non-arm's length loan to another entity
- the grant by the CFC of a loan—whether at arm's length or not—to another entity to facilitate, directly or indirectly, the payment by that entity of a dividend that would be either:
  - exempt from tax or
  - an exempting receipt of an unlisted country company
- the transfer by the CFC to another entity of property or services for no consideration, or for inadequate consideration
- a payment made by the CFC for allotment of:
  - shares in a company
  - rights or options to acquire shares
  - units in a unit trust or
  - rights or options to acquire units—see below
- a payment made by the CFC in respect of calls on shares in another company—see below
- the grant by the CFC of a loan—whether at arm's length or not—to another entity to facilitate a transaction of the type referred to in any of the above points.

Treat the fifth and sixth types of payments as dividends only if:

- a shareholder of the CFC—or shareholder's associate—holds any direct interest, or later acquires any direct interest, in any of the shares of the company in which the CFC acquired shares or in the unit trust in which the units were acquired or
- the company—or unit trust—uses the proceeds of the issue to facilitate a transaction providing any of the above types of benefits.

Entities providing and receiving the benefit

For a benefit to be treated as a deemed dividend, the benefit must be provided by the CFC to a shareholder or an associate of a shareholder.

The benefit must be provided by either:

- an unlisted country CFC or
- another entity under an arrangement with the CFC, where the CFC has transferred property or services in consideration for the benefit to:
  - the other entity or
  - any other entity

These transfers of property or services are referred to as arrangement transfers.

The time the benefits are deemed to have been provided

The following table sets out some of the types of benefits provided by a CFC that are subject to section 47A, the time at which they are taken to be provided and the amount of the benefit.

Type of benefit	Time	Amount
Waiver of a debt	time the debt was waived	amount of the debt
Non-arm's length loan	time the loan was made	amount of the loan
Transfer of property for no consideration	time the property was transferred	market value at time of transfer
Transfer of property or services for consideration less than market value	time the property or services were transferred	difference between the market value of the property or services and consideration paid
Payment or transfer of property for the allotment of shares or units	time the payment or transfer was made	amount paid or market value of the property transferred
Benefit provided by another entity under an arrangement with the CFC—if there is one 'arrangement transfer'	time the CFC made the arrangement transfer	amount of the arrangement transfer or market value of arrangement transfer
Benefit provided by another entity under an arrangement with the CFC—if there are several arrangement transfers	time the agreement to make the arrangement transfers was entered into	total amount of the arrangement transfers or the total market value of the arrangement transfers

Working out the amount of the deemed dividend
The amount of a benefit that can be treated as a dividend paid by a CFC cannot be more than the CFC's profits at the time the benefit was provided.

In this context, profits does not mean distributable profits. Profits in this situation means commercial profits, of either an income or capital nature, that the company has at the time the benefit is provided. Work out these profits at the time the company provided the benefit.

If the CFC provided a benefit by transferring property or services at less than their market value, work out the CFC's profits at the time the benefit was provided as if the property or services were transferred for their full market value.

Effect of deeming a benefit to be a dividend

A deemed dividend paid to a resident taxpayer is generally treated the same as other dividend payments. In this regard, a dividend from an unlisted country company paid to an Australian company is normally assessable unless the dividend was paid from exempting profits or previously attributable income.

Dividends deemed paid by a CFC to a CFC or CFT

If a non-portfolio dividend is deemed, under section 47A, to have been paid by an unlisted country CFC to:

- a listed country CFC or
- a controlled foreign trust (CFT) or
- a CFC or CFT through interposed partnerships or Australian trusts

and a resident taxpayer holds an attribution interest in the CFC deemed to have paid the dividend and in the other CFC or CFT, the taxpayer's attribution percentage of the deemed dividend will be included in its assessable income—see section 458. However, this attribution will not occur if the dividend is taxed in a listed country at its normal company tax rate.

Disclosure of deemed dividends

You will be denied access to certain credits and exemptions in relation to a section 47A deemed dividend if you:

- do not disclose the deemed dividend in your tax return
- do not notify the ATO of the deemed dividend within one year of the end of the income year in which the dividend is deemed to have been paid.

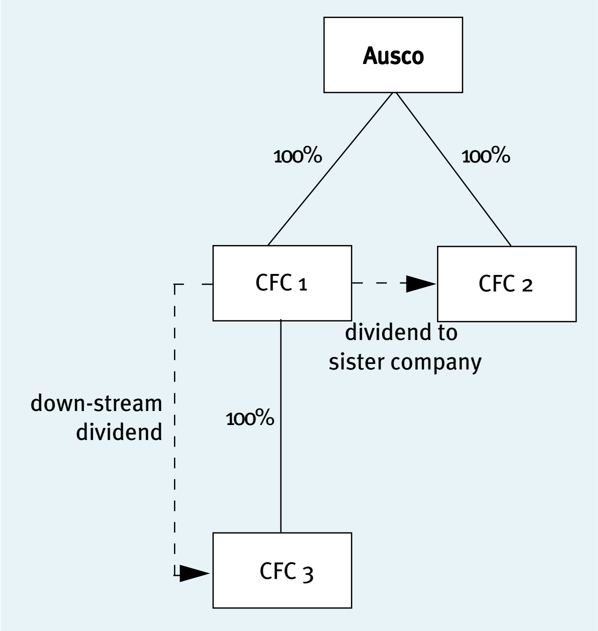
The credits and exemptions you will lose are:

- any credit for foreign taxes you have paid on the dividend
- any possibility that a part of the deemed dividend will be treated as an exempting receipt
- any possibility that a part of the deemed dividend may be treated as exempt from tax as a payment out of the income of a CFC already attributed to you.

The deemed dividend will also not give rise to an attribution credit.

Portfolio dividends

Not all deemed dividends paid by a CFC directly or through other entities to a CFC or CFT are non-portfolio dividends. These dividends may be attributed to a resident taxpayer under section 459. An example of how a portfolio dividend can arise under section 47A is where a dividend is deemed to have been paid to a lower tier company or a sister subsidiary. The following diagram illustrates two such dividends.



When are portfolio dividends taxable under section 459?

The following five conditions must be satisfied for a portfolio dividend to be included in the assessable income of a resident taxpayer under section 459:

- the dividend must be deemed, under section 47A, to have been paid by an unlisted country CFC
- the dividend must be paid to:
  - a listed country CFC or
  - a CFT or
  - an amount of that dividend must flow to a listed country CFC or to a CFT through interposed partnerships or Australian trusts
- a resident taxpayer must be an attributable taxpayer for the CFC that pays the dividend and for the recipient CFC or CFT
- section 458 must not apply to the dividend
- the dividend must not be subject to tax in a listed country at its normal company tax rate.

Amount included in assessable income

The amount of a dividend paid to a CFC or CFT that is included in the assessable income of an attributable taxpayer depends on the taxpayer's attribution percentage in the CFC or CFT.

Do not adjust the dividend for any exempting profits part or any part paid from previously attributed income. No part of the dividend will be an exempting receipt, and no foreign tax credit is allowed.

EXAMPLE 15

Dividends included in assessable income

Ausco has an attribution percentage of 80 per cent in unlisted country CFC1 and 80 per cent in listed country CFC2. CFC1 is deemed, under section 47A, to have paid a dividend of $1000 to CFC2 on 1 August 1997. Under section 459, Ausco has to include $800 in its assessable income.

Other deemed dividends—section 108

Under section 108 of the Act, the ATO may treat as a dividend:

- an amount paid by a private company to a shareholder—or a shareholder's associate—by way of an advance or loan or
- an amount paid or credited on behalf of, or for the individual benefit of, a shareholder or a shareholder's associate.

To deem these payments to be dividends, the ATO must be of the opinion that the payments and credits represent a distribution of profits.

Section 108 will not apply to an amount paid or credited after 2 June 1990 by an unlisted country CFC if that amount is deemed, under section 47A, to be a dividend.

Part 2—Taxation of branch profits

Exemption for listed country branch income of a resident company

Which resident companies qualify?

Two broad groups qualify for an exemption from Australian tax on certain branch profits. These are resident companies that either:

- carry on business through a permanent establishment—for example, a branch—in a listed country or
- are partners of a partnership—or are presently entitled beneficiaries of a trust—that carries on business through a permanent establishment in a listed country.

The exemption does not apply to:

- resident companies with permanent establishments in unlisted countries
- resident taxpayers, other than companies, with foreign permanent establishments.

What is a permanent establishment?

A permanent establishment of an Australian resident company is a place through which the business of the company is carried on. The term 'permanent establishment' is defined in section 6 of the Act.

If the listed country is one with which Australia has a double taxation agreement, the meaning of the term permanent establishment is determined by the agreement.

Permanent establishments are referred to as branches in this part.

What income is exempt?

The exemption for branch profits depends on whether the branch is in a broad-exemption or limited-exemption listed country.

If you are applying the exemption for amounts derived by a branch before 1 July 1997, treat countries on the former list of comparable tax countries—refer to attachment A of appendix 1—as broad-exemption listed countries. Branches in other countries were not eligible for the exemption.

Exemption for branches in broad-exemption listed countries

In general, an exemption is available for income derived by a resident company through a branch in a broad-exemption listed country if the income:

- is from carrying on a business in the country
- is subject to tax in the country on a current basis and
- is not eligible designated concession income.

You must test each item of income individually against these criteria to see if it is exempt.

Exemption for branches in limited-exemption listed countries

The exemption is generally available for income derived by a resident company through a branch in a limited-exemption listed country if the income:

- is from carrying on a business in the country
- is subject to tax in the country on a current basis
- is not adjusted tainted income or is adjusted tainted income and the branch satisfies an active income test.

The same concept of adjusted tainted income is used for this purpose as that used in determining the attributable income of a CFC. The following modifications apply, however, in determining the adjusted tainted income of a branch:

- the passive income of a branch conducting life assurance activities is not reduced under subsection 446(2)
- a branch and its Australian head office are treated as separate legal entities for the purpose of determining whether the branch has derived tainted sales income
- branches of Australian financial institutions (AFIs) are provided with an exemption for banking income broadly consistent with the exclusion from accruals taxation available under the CFC measures for AFI subsidiaries

An active income test concession is provided to allow branches in limited-exemption listed countries to derive up to 5 per cent of gross turnover as tainted income and still obtain full exemption under section 23AH for income amounts.

Broadly, this active income test is the same as that for CFCs. The following modifications are made to the test for branches:

- the only amounts taken into account are those derived through the branch
- the year of income of the company with the branch is used for the purposes of the test
- those conditions of the active income test relating to the existence and residency of a CFC do not apply because they are not relevant to branches
- the modifications to the adjusted tainted income of a branch referred to above also apply in determining the adjusted tainted income of the branch for the purposes of the active income test.

The meaning of income subject to tax on a current basis

The income of a branch for an accounting period is treated as subject to tax in a foreign country on a current basis if the income is included in the tax base of the country for a tax year ending or commencing in the accounting period.

What branch capital gains are exempt from tax?

An exemption is also available for capital gains derived by a resident company on disposal of plant, equipment, land and buildings that are used wholly or principally for deriving foreign income through a branch in a listed country if:

- the whole of the gain is subject to tax in the country in which the branch is located and
- the asset was used at some time in the income year in which it was disposed of, or in the previous year, in carrying on business through the branch.

The exemption will not apply to a gain derived by a branch in a broad-exemption listed country if the gain gives rise to an amount of eligible designated concession income. Similarly, the exemption will not apply to a gain derived by a branch in a limited-exemption listed country if the gain gives rise to an amount of adjusted tainted income.

The exemption is also available if the above conditions are satisfied for capital gains arising on the disposal of assets on the closure of a branch.

Disposals of assets other than those mentioned above, such as goodwill, will be subject to Australian tax.

Branch income derived through a partnership or trust

The net income calculation of a partnership or trust is modified where a resident company derives branch income through the partnership or trust. The modification applies only to determine the amount to be included in the assessable income of the resident company. The net income of the partnership or trust is worked out for this purpose as if the branch income, that would have been exempt if derived directly by the resident company, were exempt income.

Effect of the exemption on a resident company's deductions, losses and foreign tax credits

A deduction is not allowable for:

- outgoings or expenses connected to exempt branch income and gains
- capital losses on the disposal of a branch asset if, had there been a profit on the disposal, the profit would have been exempt from tax.

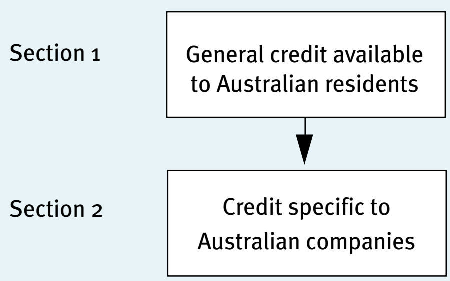
Current year losses or carried forward losses of a resident company are not reduced by exempt branch income or gains.

Foreign tax credits are not allowed for foreign taxes paid on exempt branch income.

Part 3—What credit can you claim for foreign tax?

This part explains the general foreign tax credit rules for Australian residents and the rules that apply specifically to Australian companies.

Summary of part 3



The general rule is that:

- if you are an Australian resident for taxation purposes, you may be entitled to a credit for the foreign tax you have paid and
- if you are an Australian company, you may also be entitled to a credit for foreign underlying tax paid by a related company on profits out of which a dividend is paid.

Section 1—Foreign tax credits available to all Australian residents

Partnerships

Partners can claim a credit for their share of foreign tax paid on foreign income derived through a partnership. The amount of foreign income and the credit for foreign tax paid should be included in each partner's return.

Trusts

Where an amount of trust income is included in the return of a beneficiary, that beneficiary may claim a credit for the foreign tax paid by the trust.

The trust's income must be divided into the appropriate classes of income. The beneficiary's share of the trust income must also be divided into the appropriate classes of income.

The trustee has to state in the trust return the amount of foreign income and attributed foreign income and the amount of foreign tax paid and deemed paid in respect of that income. The trustee is also required to state in the trust return the amount of foreign income to which no beneficiary is presently entitled.

A credit is not available for foreign tax paid in respect of income that is attributed to a transferor as a result of the transferor trust measures. For details on the transferor trust measures, refer to chapter 2.

Unit trusts

The foreign income of a unit trust is treated in the same manner as foreign income of any other trust.

For which types of foreign tax is a credit allowable?

Creditable taxes include:

- foreign tax equivalent in nature to Australian income tax—for example, a tax on net income or capital gains
- foreign withholding tax similar to Australian withholding tax on interest and dividends
- foreign taxes listed in Australia's double taxation agreements.

Taxation ruling IT 2507 provides a list of creditable taxes. The list in the ruling is not exhaustive. If you wish to seek credit for foreign taxes not identified in the list you should ask for a ruling from the Australian Taxation Office, using the format set out in *Taxation Ruling IT 2507*.

You are not allowed a credit for penalties, fines, interest, and unitary or credit absorption taxes.

Credit for notional tax foregone by developing countries

Certain double taxation agreements with developing countries provide for 'tax sparing'. Tax sparing preserves taxation incentives which are provided by a treaty partner to promote economic development. If tax sparing applies to a tax incentive, you can claim a credit for tax foregone by a treaty partner under the incentive. The double taxation agreements list the taxes for which tax sparing is provided.

Foreign tax credit allowable for a dividend paid from income which has previously been attributed

An exemption applies for dividends derived by an Australian resident from profits that have been taxed on an accruals basis. A credit is available for tax paid by the Australian resident on these dividends even though they are exempt from tax.

Credit for foreign taxes paid after your assessment
You are allowed a credit only for foreign tax which you have actually paid or which you are deemed to have paid. You will need to request that a determination of your foreign tax credit entitlement be made or amended if you wish to claim a credit for foreign tax paid after your original assessment. Your assessment may also need to be amended to gross up your foreign income for any additional foreign tax credit you claim.

For further information please refer to *Taxation Ruling IT 2529*. Note that the three-year period for claiming a credit referred to in the ruling has since been extended to four years.

Refunds of foreign tax
You cannot claim a credit for foreign tax refunded to you or to another person. Nor can you claim a credit where any other benefit is provided as a result of the payment of the foreign tax.

Two types of benefits will not result in the denial of a tax credit:

- a general benefit which arises as a result of the payment of foreign tax—a general benefit is a benefit not directly linked with the payment of foreign tax
- a benefit which is a reduction of a tax liability.

A credit will therefore not be denied solely because a country provides an imputation credit, a rebate of tax or a foreign tax credit for the foreign tax.

Evidence of foreign tax paid

The following documents will be acceptable as evidence of payment of foreign tax:

- a notice of assessment and receipt for the tax paid or
- a statement from a foreign tax authority setting out particulars normally recorded on a notice of assessment and receipt for payment or
- 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.

In all cases, retain the original documents for future reference because the Australian Taxation Office may need to see them at a later date.

If the documentary evidence is in a foreign language, you will need a translation of the documents.

For further information refer to *Taxation Ruling IT 2527*.

Working out your foreign tax credits

You must work out your foreign tax credit entitlement separately for each class of foreign income. This is called quarantining. Your foreign tax credit for each class cannot be more than the Australian tax applicable to that class of your taxable foreign income.

What are the classes of foreign income?
Foreign income is divided into four classes for the purpose of allowing a foreign tax credit:

- passive income
- offshore banking income
- certain lump sum payments from foreign non-complying superannuation funds
- other income.

What is passive income?
Passive income includes dividends, interest, annuities, rental income, royalties, amounts received for the assignment of a patent, copyright, capital gains, passive commodity gains and amounts included in assessable income under the CFC, FIF or transferor trust measures.

Capital gains
An assessable gain or profit of a capital nature is deemed to be foreign income for working out a foreign tax credit if it is derived from a source in a foreign country. Capital gains are included in the 'passive' class of foreign income.

For further details on credits for foreign tax paid on capital gains, please refer to *Taxation Ruling IT 2562*.

What is offshore banking income?
Offshore banking income includes:

- interest, fees, commissions or similar income derived from offshore banking transfers
- dividends paid by a company out of profits derived from offshore banking transfers.

What are lump sum payments from foreign non-complying superannuation funds?

These lump sum payments included in assessable income under section 27CAA are treated as a separate class of income.

What is other income?

Other income is income that does not belong to any of the other classes of income. For instance, it would include income from commercial activities, salary or wages and most pensions.

Working out the amount of assessable foreign income for creditable foreign taxes

Your assessable foreign income for each class is 'grossed up' by the amount of foreign tax credit you can claim for that class of income. A company must also include an amount equal to any credit allowable for foreign underlying tax.

EXAMPLE 1

Creditable foreign taxes

A company resident in New Zealand pays a dividend of $100 to an Australian resident individual. As New Zealand deducts $15 withholding tax, the taxpayer actually received $85. The taxpayer's assessable foreign income for that dividend will be $100—that is, the amount of the dividend before the payment of withholding tax.

What deductions are allowable?

You may claim the following deductions for each class of assessable foreign income:

- expenses directly related to that class of foreign income
- other deductions relating to that class of foreign income
- a share of the apportionable deductions—that is, deductions that cannot be related to a particular type of income—for example, gifts
- unused quarantined foreign losses from prior years
- prior year domestic losses, if you make an election to offset those losses against a class of foreign income
- if your allowable deductions for the current year are more than your domestic source income, the amount by which those deductions are more than your domestic source income.

Refer to appendix 3 of this guide and to *Taxation Ruling IT 2446* for more information on allowable deductions.

Working out your Australian tax payable

The foreign tax credit you are allowed for each class of foreign income is limited to the Australian tax payable on that class of income. Therefore, you first must work out the Australian tax payable.

To do this, multiply your average rate of Australian tax by your adjusted net foreign income. Deduct any rebates which apply to that income—apart from a rebate under an Act fixing the rates of income tax or under an Act imposing income tax. Expressed as a formula, the calculation is as follows:

$$\mathbf{ATP = AR \times ANFI}$$

ATP Australian tax payable

AR average rate of Australian tax

ANFI adjusted net foreign income

How is the average rate of Australian tax worked out?

The average rate of Australian tax (AR) is worked out by dividing the gross tax on your taxable income less certain rebates by your taxable income. Expressed as a formula, the calculation is as follows:

$$\mathbf{AR = \frac{gross\ tax + Medicare\ levy - rebates}{taxable\ income}}$$

For this calculation, deduct concessional, zone or overseas service rebates.

What is the adjusted net foreign income?

The adjusted net foreign income is your net foreign income adjusted for apportionable deductions. Apportionable deductions are deductions of a concessional nature that do not relate directly to income producing activities —for example, gifts.

Net foreign income is your gross assessable foreign income less:

- allowable deductions relating exclusively to your foreign income
- any domestic loss carried forward that you have elected to use against your foreign income
- deductions allowed as being appropriately related to your foreign income.

How is adjusted net foreign income determined?

Your adjusted net foreign income is determined as follows:

- if your net foreign income exceeds the sum of your taxable income plus apportionable deductions, your adjusted net foreign income will equal your taxable income
- if your net foreign income consists of two or more classes of income —that is, quarantining applies—and your combined net foreign income from all classes is more than the sum of your taxable income plus apportionable deductions, your adjusted net foreign income (ANFI) for each class will equal your taxable income. This is divided proportionately, as shown in Example 2, into:

  ANFI—passive income

  ANFI—offshore banking income

  ANFI—lump sum payments assessable under section 27CAA

  ANFI—other income

- in any other case, your adjusted net foreign income is your net foreign income multiplied by your taxable income divided by the total of your taxable income and apportionable deductions. Expressed as a formula, the calculation is as follows:

$$\mathbf{ANFI} = \mathbf{NFI} \times \frac{\mathbf{TI}}{\mathbf{TI + AD}}$$

ANFI	adjusted net foreign income
NFI	net foreign income of a class
TI	taxable income
AD	apportionable deductions

EXAMPLE 2

Working out adjusted net foreign income

	$
An individual has:	
domestic source income	7 000
allowable deductions from domestic source income	10 000
net passive foreign income	2 000
net other foreign income	5 000
apportionable deductions	100
Taxable income ($7000 – $10 000 + $2000 + $5000 – $100)	3 900
Taxable income plus apportionable deductions ($3900 + $100)	4 000
Net foreign income ($2000 + $5000)	7 000

The net foreign income is greater than the taxable income and apportionable deductions. Therefore, the adjusted net foreign income is taken to equal taxable income. As there are two classes of foreign income, it is necessary to apportion the adjusted net foreign income into the relevant classes—that is, passive income and other income.

The taxpayer's passive income is 2/7 and other income 5/7 of the combined net foreign income. The adjusted net foreign income for each class is as follows:

	$
ANFI—passive Income (2/7 of the taxable income of $3900)	1 114
ANFI—other Income (5/7 of the taxable income of $3900)	2 786

EXAMPLE 3

Working out adjusted net foreign income

	$
An individual has:	
domestic income	7 000
passive foreign income	2 000
other foreign income	5 000
apportionable deductions	100

First work out ANFI for passive income:

	$
The taxpayer's taxable income (7000 + 2000 + 5000 – 100)	13 900
ANFI—passive income $2000 \times \dfrac{13\,900}{(13\,900 + 100)}$	1 986

then work out ANFI for other income:

ANFI —other Income $5000 \times \dfrac{13\,900}{(13\,900 + 100)}$	4 964

Working out the credit

Your foreign tax credit entitlement for a class of foreign income is the lesser of:

- the creditable foreign tax which you have paid on that class of income and
- the Australian tax payable on that class of income, worked out using the above procedure.

The following example shows the steps to use to work out your foreign tax credit.

EXAMPLE 4

Working out the foreign tax credit

An individual has:	$
domestic income	7 000
passive income—net of foreign tax	2 000
foreign tax paid—passive income	200
other income—net of foreign tax	5 000
foreign tax paid—other income	1 000
apportionable deductions	100

Step 1

Work out taxable income.

Gross up foreign income by the amount of creditable foreign tax paid:

Assessable passive income (2000 + 200)	2 200
Assessable other income (5000 + 1000)	6 000
Taxable income (7000 + 2200 + 6000 – 100)	15 100

Step 2

Work out the average rate (AR) of Australian tax.

$$\textbf{AR} = \frac{\textbf{gross tax + Medicare levy – rebates}}{\textbf{taxable income}}$$

	$
Gross tax on 15 100	1940.00
Medicare levy	226.50
Rebates	0
AR $= \dfrac{1940 + 226.50 - 0}{15\,100}$	0.144

Step 3

Work out adjusted net foreign income.

For the passive class of income:

$$\textbf{ANFI (passive income)} = \frac{\textbf{NFI} \times \textbf{TI}}{\textbf{TI} + \textbf{AD}}$$

NFI—net foreign passive income	2 200
TI—taxable income	15 100
AD—apportionable deductions	100
ANFI (passive income) $= 2200 \times \dfrac{15\,100}{15\,100 + 100}$	2 185.53

For the other class of income:

NFI—net foreign other income	6 000
TI—taxable income	15 100
AD—apportionable deductions	100
ANFI (other income) $= 6000 \times \dfrac{15\,100}{15\,100 + 100}$	5 960.53

Step 4

Work out the Australian tax payable (ATP) on each class of income.

For foreign passive income:

ATP = AR × ANFI (passive income)

ATP = 0.144 × 2185.53	314.72

For foreign other income:

ATP = AR × ANFI (other income)

ATP = 0.144 × 5960.53	858.32

Step 5

Determine allowable foreign tax credit for each class of foreign income.

	$
Foreign tax paid on passive income	200
Australian tax payable	314.72
As the foreign tax paid is less than the Australian tax payable, the foreign tax credit is	200
Foreign tax paid on other income	1000
Australian tax payable	858.32

As the foreign tax paid is more than the Australian tax payable, the foreign tax credit is limited to the extent of the Australian tax payable on the foreign income—that is, $858.32.

The excess credit of $141.68 can be carried forward for offset in later years against Australian tax payable on the same class of foreign income.

Carry forward of excess foreign tax credits

You will have an excess foreign tax credit for an income year if the amount of foreign tax you have paid is more than the Australian tax payable on that class of foreign income.

You may carry forward an excess foreign tax credit that arises in an income year for a class of foreign income for 5 years immediately following that income year. Your excess credit for a class of income may only be used where there is a credit shortfall for the same class of income in a later year. A credit shortfall will arise where the credit allowed for a class of foreign income for an income year is less than the Australian tax payable on that class of foreign income.

If you have incurred a loss for a class of foreign income, you cannot claim a tax credit in that year because the Australian tax payable on that class of income is nil. You may, however, carry forward the foreign tax credit relating to that class of income to subsequent years.

Section 2—Credits available only to resident companies

Australian resident companies are entitled to a foreign tax credit as worked out in section 1. In addition, in some circumstances a company—other than a company in the capacity of trustee—may be:

- entitled to a credit for foreign underlying tax—see section 160 AFC
- entitled to a credit for tax paid by a CFC on amounts attributed to the Australian company
- able to transfer a foreign tax credit to another group company
- exempt from tax on foreign non-portfolio dividends where those dividends are an exempting receipt of that company—see part 1 of this chapter
- exempt from tax on foreign income derived through a branch in a listed country—see part 2 of this chapter.

Credits available to resident companies for underlying tax

An Australian resident company which receives a dividend from a related company is entitled to a credit for both:

- the direct foreign tax—for example, withholding tax—on the dividend received and
- the underlying tax paid by a foreign company on the portion of the distributable profits out of which the dividend was paid.

These credits will generally be available only where the dividend is included in assessable income. The only exception is where a dividend is received from a related foreign company and is treated as paid out of income previously attributed to the resident company under the accruals tax system. A tax credit can be claimed for both the direct foreign tax and underlying tax on these exempt dividends.

Related foreign companies

Under section 160AFB, an Australian company is treated as related to any number of linked foreign companies provided that:

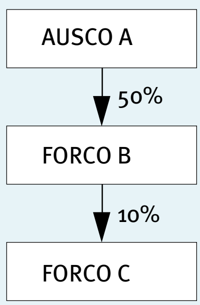
- each company in the chain—starting with the Australian company—has at least a 10 per cent voting interest in the company in the tier below it and

- the Australian company has a direct or indirect interest of at least 5 per cent in the voting shares of each foreign company that is a member of the chain.

A chain of related companies cannot include a trust or partnership—that is, the chain will be broken by the interposition of a trust or partnership.

EXAMPLE 5

Related foreign companies



Australian company A has a 50 per cent voting interest in foreign company B, which in turn has a 10 per cent voting interest in foreign company C. Both B and C will be treated as related to A.

Step 1

Are the companies members of the same group?

Yes—each company in the chain, starting with the Australian company, has at least a 10 per cent voting interest in the company in the tier below it.

Step 2

Does company A have a 5 per cent or more direct or indirect voting interest?

Yes—company A has a voting interest of 50 per cent (50% x 100%) in company B and a voting interest of 5 per cent (50% x 10%) in company C.

Step 3

Are the companies related?

Yes—both tests are satisfied for both companies B and C. Therefore, they are both related to company A.

Working out underlying tax

Underlying tax is traced through a chain of related companies. In each successive distribution in the chain, the portion of underlying tax deemed paid by the recipient company is worked out by multiplying the underlying tax paid by the company making the dividend by the amount of the dividend divided by the paying company's distributable profits.

Working out underlying tax where there are only two companies in a dividend series

The following formula is used to work out underlying tax deemed paid when there are only two companies in a dividend series.

$$\text{FUT} = \frac{\text{D} \times \text{UT}}{\text{DP}}$$

FUT	foreign underlying tax deemed paid
D	the amount of the dividend
UT	the amount of the underlying tax
DP	the number of whole dollars in the distributable profits out of which the dividend was paid

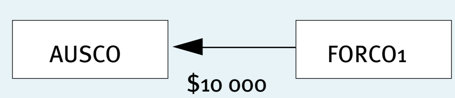
EXAMPLE 6

Underlying tax where there are two companies

On 1 August 1997 an Australian resident company—Ausco—received a dividend from a wholly owned subsidiary—Forco1—in an unlisted country.

Forco1

Distributable profit—that is, profits which accumulated during accounting periods commencing after 30 June 1987	$ 50 000
The distributable profits did not include exempting profits or attributed income.	
Foreign tax paid on those profits	5 000
Dividend paid to Ausco	10 000



Ausco is deemed to have paid foreign tax on the dividend of 1000

$\left(10\,000 \times \frac{5\,000}{50\,000}\right)$

Working out underlying tax where there are more than two companies in a dividend series

The following formula is used to work out underlying tax deemed paid where there are more than two companies in a dividend series:

$$\mathbf{FUT2} = \frac{\mathbf{D\,(UT + FUT1)}}{\mathbf{DP}}$$

FUT2	underlying tax deemed paid
D	amount of the dividend
UT	amount of underlying tax paid that relates to the distributable profits out of which the dividend was paid
FUT1	amount of foreign tax deemed to have been paid by the previous calculation in relation to the dividend series
DP	number of whole dollars in the distributable profits out of which the dividend was paid

EXAMPLE 7

Underlying tax where there are more than two companies

On 1 August 1997, an Australian resident company—Ausco—received a dividend from a wholly owned unlisted country subsidiary—Forco1. Forco1 paid the dividend out of distributable profits that included a dividend it received from Forco2. Forco2 is a wholly owned unlisted country subsidiary of Forco1. The distributable profits did not include exempting profits or attributed income.

	$
Forco1	
Distributable profit	50 000
Dividend paid to Ausco	10 000
Foreign tax paid	5000
Forco2	
Distributable profit	20 000
Foreign tax paid on those profits	2000
Dividend paid to Forco1	5000

AUSCO ← $ 10 000 ← FORCO1 ← $5000 ← FORCO2

	$
Forco1 is deemed to have paid foreign tax on the dividend of	500
$\left(5000 \times \dfrac{(2000 + 0)}{20\,000}\right)$	
Ausco is deemed to have paid foreign tax on the dividend of	1100
$\left(1000 \times \dfrac{(5000 + 500)}{50\,000}\right)$	

Working out underlying tax when a dividend is wholly or partly an exempting receipt

An Australian resident company is not entitled to a foreign tax credit for the exempting receipts component of a non-portfolio dividend because the component is not included in the assessable income of the resident company.

Exempting receipts of an Australian resident company

The following are exempting receipts of an Australian resident company:

- a non-portfolio dividend received from a company resident in a listed country. The extent to which the dividend is treated as an exempting receipt depends on whether an attribution debit arises for the company paying the dividend. If no attribution debit arises in relation to the payment, all of the dividend is an exempting receipt. If an attribution debit arises—refer to part 1 of this chapter—the amount of the dividend that is more than the attribution debit is an exempting receipt
- the exempting profits percentage—refer to part 1—of a non-portfolio dividend received from a company resident in an unlisted country.

The exempting profits percentage for a dividend from the unlisted country company is worked out using the following formula.

$$\mathbf{EPP} = \frac{\mathbf{EP}}{\mathbf{DP}} \times \mathbf{100}$$

EPP	exempting profits percentage
EP	exempting profits
DP	distributable profit

The distributable profit is the amount of profits of the company that would be available for distribution as dividends if any decision or requirement restricting their distribution as dividends was disregarded—other than any requirement providing for an eligible provision or reserve. An eligible provision or reserve is:

- a provision or reserve which is required to be maintained by law
- a provision for any liability in respect of foreign tax or Australian tax
- a reserve maintained for the purpose of qualifying for relief from foreign tax
- a provision or reserve for depreciation, bad or doubtful debts or leave payments or
- any other provision or reserve of a kind prescribed by regulations.

The exempting profits of an unlisted country company is the amount of the distributable profit that is attributable to exempting receipts of the unlisted country company.

Working out foreign underlying tax credits if a dividend is paid by a listed country company from previously attributed income

A resident company will be entitled to a foreign tax credit for a non-portfolio dividend received from a listed country company if part of the dividend is paid from previously attributed income. The credit for that part of the dividend is worked out as follows. The credit is reduced by the amount of a foreign tax credit allowed previously when the income was attributed.

$$\mathbf{FUT = D \times \frac{UT}{DP}}$$

D amount of the dividend that is not an exempting receipt

UT amount of underlying tax relating to the amount of the distributable profits attributable to the attribution surplus—that is, UT = AST + (GT × ASP)

AST amount of underlying tax relating exclusively to that part of the distributable profits attributable to any attribution surplus immediately before the payment of the dividend

GT amount of underlying tax relating to both attributed profits—in respect of the attribution surplus—and the remainder of the distributable profits

ASP percentage of the general tax that may reasonably be related to the part of distributable profits relating to that attribution surplus

DP amount of distributable profits relating to an attribution surplus existing immediately before the dividend was paid

Working out foreign underlying tax credits if a dividend is paid by an unlisted country company from exempting profits

The foreign underlying tax credit for a dividend received from an unlisted country company which is partly an exempting receipt of an Australian resident company is worked out as follows.

$$\mathbf{FUT = D \times \frac{UT}{DP}}$$

D amount of the dividend that is not an exempting receipt

UT amount of underlying tax relating to the distributable profits, worked out as follows:

$$\mathbf{UT = N - ET + (GT \times N - EP)}$$

N – ET amount of the underlying tax relating exclusively to non-exempting profits—that is, profits other than exempting profits

GT amount of underlying tax that relates to both exempting and non-exempting profits

N – EP percentage of GT that may reasonably be related to non-exempting profits of the Australian company and that form part of the distributable profits

DP number of whole dollars in the non-exempting portion of the distributable profit out of which the dividend was paid

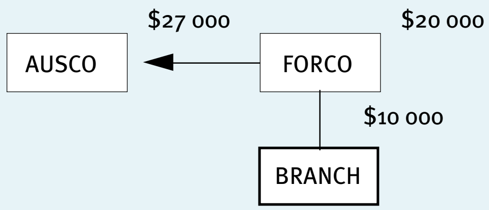
EXAMPLE 8

Dividend paid by an unlisted country company

Ausco is an Australian resident company which has a wholly owned subsidiary —Forco—that is a resident of an unlisted country.

Forco has distributable profits of $30 000. Of this amount, $20 000 represents profits from operations in the unlisted country and $10 000 represents profits from a branch located in a listed country. None of these profits have been attributed to Ausco.

	$
Dividend paid to Ausco	27 000
Tax paid in the unlisted country	2 500
Tax paid by the branch in the listed country—no tax credit was allowed for this tax in the unlisted country	4 000
Distributable profits that are exempting profits	10 000
Distributable profits that are other profits	20 000



The dividend is treated as paid proportionately from exempting profits and other profits.

		$
Dividend paid out of exempting profits $\left(\frac{10\,000}{30\,000} \times 27\,000\right)$		9 000
D	dividend that is not an exempting receipt (27 000 – 9000)	18 000

UT uses the following components:

N – ET	underlying tax that relates exclusively to the non-exempt portion of distributable profits	nil
GT	amount of underlying tax which relates to both exempting and non-exempting profits	2 500
N – EP	percentage of GT that may reasonably be related to non-exempting profits, in relation to the Australian company, forming part of the distributable profits—$20 000 divided by $30 000 = 2/3. This example assumes that the accounting profits were also the taxable income of the company.	
UT =	N – ET + (GT × N – EP) (nil + (2500 × 2/3))	1 666.67
DP	number of whole dollars in the non-exempting portion of the distributable profit out of which the dividend was paid	20 000
Underlying tax is therefore $\left(\frac{18\,000}{20\,000} \times 1\,666.67\right)$		1 500

Credits available to resident companies for attributed income

Working out the foreign tax credit when income is attributed

Where a company is related to a CFC at the end of the CFC's statutory accounting period and the assessable income of the company includes a share of the attributable income of the CFC—refer to chapter 1—the company is allowed a credit for an amount of tax equal to its attribution percentage of the CFC's notional allowable deductions for taxes paid.

A CFC can claim a notional deduction for foreign or Australian tax paid by the CFC on amounts included in the CFC's notional assessable income.

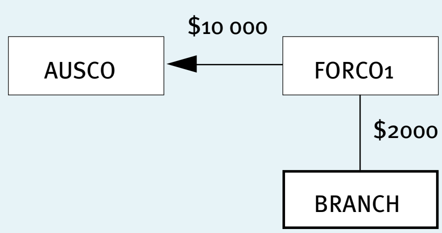
If the notional assessable income of the CFC includes a non-portfolio dividend from a related company, a notional deduction is also allowable for underlying tax the CFC is taken to have paid on the dividend.

EXAMPLE 9

Foreign tax credit for attributed income

An Australian resident company—Ausco—has a 60 per cent interest in a CFC resident in an unlisted country—Forco.

Forco details:	$
Profits from a foreign branch in a listed country—not attributable income	2 000
Tax paid in the listed country on foreign branch income	600
Income derived in an unlisted country—it is all attributable income	10 000
Tax paid in the unlisted country on all income—this includes the foreign branch income	1 200



Ausco is deemed to have paid the following amount of tax on the attributed income:

Attribution percentage: 60 per cent

Tax paid on attributed income $\left(\frac{10\,000}{12\,000} \times 1200\right)$	1 000
Tax deemed paid by Ausco $\left(1000 \times \frac{60}{100}\right)$	600

Ausco must gross up its assessable foreign income by this amount. It can claim a foreign tax credit for $600.

Credits where benefits deemed to be dividends are attributed

If a benefit provided by a CFC is deemed to be a dividend under section 47A and is attributed to a taxpayer, a credit for foreign tax paid will be allowed only if:

- the amount of the deemed dividend is included in the taxpayer's assessable income in their return lodged in the year of the distribution or
- the taxpayer notifies the ATO, in writing, within twelve months after the end of the income year in which the benefit was provided.

Credits where income is attributed due to a change in residence of a CFC

A resident company is allowed a credit for foreign tax paid by a CFC where an amount of income is attributed to it because the CFC changed its residence from an unlisted country to a listed country or to Australia. The credit is available, however, only if the resident company is related to the CFC at the time of the change of residence—see section 160 AFCB. The company is allowed a credit for the foreign tax and the Australian tax paid by the CFC on the attributed amount.

An underlying tax credit may also be available for an attributed amount referable to a non-portfolio dividend paid to the CFC from a foreign company. A credit will be allowed only if the foreign company was related to the resident company at the time the dividend was paid. In this case, the tax deemed paid by the resident company will include an amount equal to its attribution percentage—at the residence-change time—of the underlying tax that the CFC would have been taken to have paid if the CFC were an Australian resident company.

Credits when income is attributed due to a CFC paying dividends to another CFC

Income may be attributed to a taxpayer if:

- a CFC resident in an unlisted country pays a dividend to another CFC
- both the CFCs are related to the taxpayer at the time the dividend was paid—see section 160AFCC.

The income attributed is referred to as the section 458 amount.

Where a section 458 amount is included in the assessable income of a company, the company is allowed a credit for foreign tax paid on the amount.

The credit can be claimed for:

- the part of the foreign tax paid on the dividend that relates to the amount included in the assessable income of the resident company—this is referred to as the 'adjusted foreign tax paid'
- the part of the foreign underlying tax paid on the dividend that relates to the amount included in the assessable income of the resident company—this is referred to as the 'adjusted foreign underlying tax'.

The amount of adjusted foreign tax paid by the CFC receiving the dividend does not include tax paid under the taxation law of the country in which it is resident. The amount is worked out using the formula:

$$\textbf{AFT} = \textbf{section 458 amount} \times \frac{\textbf{FT}}{\textbf{D}}$$

AFT	adjusted foreign tax paid by the CFC receiving the dividend on that part of the dividend which is not deemed to be paid out of exempting profits
FT	foreign tax paid by the CFC receiving the dividend
D	amount of the dividend

The adjusted foreign underlying tax deemed paid by the CFC receiving the dividend is worked out as follows:

$$\textbf{AFUT} = \textbf{FUT} \times \frac{\textbf{section 458 amount}}{\textbf{D} - \textbf{EPP}}$$

AFUT	adjusted foreign underlying tax
FUT	foreign underlying tax deemed paid by the CFC receiving the dividend
D	amount of the dividend
EPP	that part of the dividend which relates to exempting profits

EXAMPLE 10

Adjusted foreign tax

Ausco has a wholly owned subsidiary—Forco1—which is a resident of a listed country. Forco1 has a wholly owned subsidiary—Forco2—which is a resident of an unlisted country. Forco2 pays a dividend of $50 000 to Forco1. There has been no previous attribution of Forco2 income—that is, there are no attribution credits—and no withholding tax has been paid on the dividend.

Forco2	$
Exempting receipts less expenses	10 000
Other net income	42 000
Tax paid	2 000
Distributable profits (10 000 + 42 000 –2000)	50 000

The income attributed to Forco1 under section 458 would be worked out as follows:

$$\textbf{Section 458 amount} = \textbf{AP} \times (\textbf{D} - \textbf{GD} - \textbf{EPP} - \textbf{T})$$

AP	attribution percentage:	100%
		$
D	amount of the dividend	50 000
GD	grossed up amount of any attribution debit	nil
EPP	that part of the dividend which relates to exempting profits—that is, exempting profits divided by distributable profits multiplied by the amount of the dividend	

The exempting profits are the part of the distributable profits that relates to exempting receipts.

Tax relating to the exempting receipts $\left(\frac{10\ 000}{52\ 000} \times 2000\right)$	384.62
Exempting profits (10 000 – 384.62)	9 615

EPP $\quad \dfrac{\text{exempting profits}}{\text{distributable profits}} \times$ dividend amount

$$\frac{9\ 615}{50\ 000} \times 50\ 000 \qquad 9\ 615$$

T $\quad$ any foreign tax deducted from the dividend by or on behalf of the CFC receiving the dividend, multiplied by the percentage of the dividend represented by (D – GD – EPP)

$$\frac{\text{nil} \times (50\ 000 - \text{nil} - 9615)}{50\ 000} \qquad \text{nil}$$

section 458 amount $\quad$ 40 385

$$100\% \times (50\ 000 - \text{nil} - 9615 - \text{nil})$$

The adjusted foreign tax paid by the CFC receiving the dividend is worked out as follows:

AFT $\quad$ section 458 amount $\times \dfrac{\text{FT}}{\text{D}}$

AFT $\quad$ adjusted foreign tax paid by the CFC receiving the dividend

		$
FT	foreign tax paid by the CFC receiving the dividend	nil
Section 458 amount		40 385
D	amount of the dividend	50 000
AFT	$\text{nil} \times \frac{40\,385}{52\,000}$	nil

The adjusted foreign underlying tax deemed paid by the CFC receiving the dividend is worked out as follows:

AFUT	$\text{FUT} \times \frac{\text{section 458 amount}}{\text{D} - \text{EPP}}$	
AFUT	adjusted foreign underlying tax	
FUT	foreign underlying tax deemed paid by the CFC receiving the dividend $\left(2000 \times \frac{42\,000}{50\,000}\right)$	1615.39
Section 458 amount		40 385
D	amount of the dividend less withholding tax	50 000
EPP	that part of the dividend which relates to exempting profits	9 615
AFUT	$1615.39 \times \frac{40\,385}{(50\,000 - 9615)}$	1615.39

Working out a foreign tax credit when a dividend is paid from income which was previously attributed to an Australian resident company

A dividend paid out of income previously attributed to an Australian resident is exempt from tax—refer to part 1 of this chapter. In addition, an Australian resident company is allowed a credit for foreign tax—including foreign underlying tax—paid on a dividend from attributed income. The credit is reduced to the extent a credit was claimed for taxes paid when the income was attributable.

The formula to work out the foreign tax for which a credit is due when a dividend is received from previously attributed income is:

$$\text{FTP} = (\text{EP} \times \text{DT}) + (\text{AEP} \times \text{UT}) - \text{AT}$$

FTP	foreign tax paid on previously attributed income for which a credit is now allowable
EP	percentage of the payment which is exempt because the income has been previously attributed
DT	amount of foreign tax which the taxpayer is taken to have paid, and to have been personally liable for, in relation to the attribution account payment
AEP	percentage that would be EP if the attribution account payment were reduced by the amount of any exempting receipts of the Australian resident company
UT	foreign underlying tax credit allowable for the attribution account payment, except CFC-type foreign tax—that is, foreign tax which generally corresponds to tax payable under Australia's accruals tax measures
AT	amount of the attributed tax account debit arising from the payment of the dividend that is equal to or less than AEP × UT

EXAMPLE 11

Credit for foreign taxes on a dividend paid from profits attributed to an Australian company

Ausco has a wholly owned subsidiary, Subco, in an unlisted country. Subco had distributable profits of $10 000 on which it paid foreign tax of $1000. These profits have previously been attributed to Ausco.

On 1 August 1998, Subco paid a dividend of $10 000 to Ausco. The unlisted country levied dividend withholding tax at a rate of 10 per cent.

The dividend received by Ausco is exempt from tax because it was paid from previously attributed income. At the attribution stage, Ausco would have received a credit of $1000 for foreign tax paid.

Even though the dividend was not included in Ausco's assessable income, a foreign tax credit is available for withholding tax and underlying tax relating to the dividend. This is because the profits out of which the dividend was paid were attributed to Ausco and taxed in Australia.

The method by which this credit is granted is as follows:

Step 1

Work out the foreign tax credit for dividend withholding tax and for underlying tax on the dividend as though the dividend was paid from income that had not been attributed to Ausco.

Step 2

Reduce the credit by the amount of a credit given at the attribution stage.

	$
Dividend	10 000
Dividend withholding tax	1 000

Underlying tax (UT) is worked out as though the dividend was paid from income that was not attributed:

$$\frac{\textbf{dividend}}{\textbf{distributable profits}} \times \textbf{tax paid on profits out of which the dividend was paid}$$

$$= \frac{\$10\,000}{\$10\,000} \times \$1000$$

$$= \$1000$$

Under the first step, Ausco's credit is the total of the amounts of dividend withholding tax and underlying tax (\$1000 + \$1000)	2 000

This credit is reduced, under the second step, by the $1000 credit given at the attribution stage.

The formula for working out the foreign tax credit Ausco can claim is as follows:

$$\textbf{FTP} = (\textbf{EP} \times \textbf{DT}) + (\textbf{AEP} \times \textbf{UT}) - \textbf{AT}$$

This formula can be broken down as follows

EP × DT tax paid on the dividend paid out of previously attributed income

EP percentage of the dividend paid from previously attributed income —100 per cent in the example

DT tax paid on the dividend—dividend withholding tax of $1000 in the example

AEP × UT underlying tax in relation to the dividend—$1000 tax was paid in the unlisted country on the profits out of which the dividend was paid

AEP referred to as the adjusted exempt percentage of the dividend. This is the dividend reduced by the exempting profits part of the dividend. In the example, there is no exempting profits part of the dividend, therefore, AEP = 100%

UT underlying tax paid on the dividend—do not include tax paid under an accruals tax law of another country

AT tax for which a credit was allowed when the income of the unlisted country company was attributed to Resco—$1000 in the example. The amount of the tax is worked out using accounts referred to as attributable tax accounts. These accounts trace the tax for which credit was allowed at the attribution stage

In this example, when the income of $10 000 was attributed to Resco and a credit was given for $1000, Resco would have opened accounts as follows:

Attribution Account for Subco		*Attributed Tax Account for Subco*	
Attributed income	$10 000	Tax credited	$1000

When the dividend is received, Resco will debit the attribution account $10 000 and claim exemption for the dividend. It will also debit $1000 to the attributed tax account.

This debit is the amount referred to as AT.

Attributed tax accounts are dealt with below.

Evidence of underlying tax paid

Your company should retain full particulars of the material on which its underlying tax credit has been worked out. Obtain a statement from the company which paid the dividend, certifying the amount of tax paid on the distributable profits out of which the dividend was paid. When underlying tax paid is traced down a chain of related foreign companies, such details will be required for each company in the chain.

Attribution accounts relevant to foreign tax credits for companies

Attributed tax accounts

What is the purpose of attributed tax accounts?

A resident company can claim a foreign tax credit for dividend withholding tax and certain underlying taxes on an exempt dividend paid from previously attributed profits.

The credit is initially worked out on the basis that no foreign tax credit was allowed at the time the profits were attributable. The foreign tax credit worked out in this way is then reduced by the credit allowed at the time the attributable income of the CFC was included in the assessable income of the resident company. The attributed tax accounts trace the foreign tax credit allowed at the attribution stage so that this reduction can be made.

Who should maintain attributed tax accounts?

Attributed tax accounts are to be maintained by a resident company to which the attributable income of a related foreign company has been attributed under the CFC measures. Other taxpayers need not maintain these accounts.

Attributed tax account credits

An attributed tax account credit can arise in relation to a CFC where an amount is attributed under any of the following sections:

- section 160AFCA where the attribution of income of the CFC arises under section 456
- section 160AFCB where the attribution of income of the CFC on a change of residence arises under section 457
- section 160AFCC where the attribution of certain dividends paid by the CFC arises under section 458.

Each time a credit is made to an attribution account—as explained in part 1 of this chapter—a corresponding credit must be made to an attributed tax account for the entity for which the attribution account is operated.

Attributed tax account debits

An attributed tax account debit must be made each time the attribution account entity pays a dividend. The attributed tax account debit is worked out using the following formula.

$$\textbf{Attributed tax account debit} = \frac{\textbf{attribution debit}}{\textbf{attribution surplus}} \times \textbf{Attributed tax account surplus}$$

In order to claim a credit for foreign tax paid on income that was previously attributed, the amount of attributed tax account debit must be verifiable. The attributed tax accounts for each of the relevant entities in respect of the taxpayer claiming the credit must be available or a credit will not be allowed.

EXAMPLE 12

Credit for foreign tax reduced by credits previously allowed

Forco1 is a resident of an unlisted country and is a wholly owned subsidiary of Ausco. Forco1 derived income of $16 500 from sources in its country of residence, all of which is attributed to Ausco, and pays foreign tax of $1500.

Forco1 has distributable profits of $15 000 ($16 500 – $1500).

It pays a dividend of $10 000 to Ausco in the following year, from which withholding tax of $1500 was deducted—the net dividend is therefore $8500.

The dividend Ausco received is exempt from Australian tax. Ausco is also entitled to a credit for foreign tax paid on the income which was previously attributed. The credit is reduced, however, to the extent a credit for foreign tax was allowed when the income was attributed to Ausco. The exempt income is not included when working out the Australian tax payable on the foreign income and thus does not increase Ausco's foreign tax credit limit.

The credit is worked out as follows:

$$\textbf{FTP} = (\textbf{EP} \times \textbf{DT}) + (\textbf{AEP} \times \textbf{UT}) - \textbf{AT}$$

FTP	foreign tax paid on previously attributed income for which a credit is now allowable
EP	percentage of the payment which is exempt because the income has been previously attributed—that is, profits which have been previously attributed or distributable profits. In this example EP is 100 per cent as the dividend is paid from previously attributed income
DT	amount of foreign tax which the taxpayer is taken to have paid and to have been personally liable for, in relation to the attribution account payment—that is, $1500 withholding tax
AEP	percentage that would be EP if the attribution account payment were reduced by any amount of that payment which is an exempting receipt of the Australian resident company. In this case, AEP is 100 per cent because there is no exempting receipt

UT foreign underlying tax credit allowable for the attribution account payment, other than CFC-type foreign tax—that is, foreign tax arising from laws that generally correspond with Australia's accruals measures

$\frac{D}{DP} \times$ tax on distributable profits

$\frac{10\,000}{15\,000} \times 1500$ $1000

AT amount of the attributed tax account debit for the tax credit previously allowed on the attributed income that is equal to or less than AEP x UT. The attributed tax account debit is equal to

$\frac{\text{attribution debit}}{\text{attribution surplus}} \times$ attributed tax account surplus

$\frac{10\,000}{15\,000} \times 1500$ $1000

Note: When $15 000 income was attributed to Ausco, Ausco would have credited an attribution account for Forco1 with $15 000. It would also have credited $1500 tax to the attributed tax account for Forco1—that is, tax for which a credit was allowed at the attributed stage. When the dividend was paid by Forco, this would have remained as an attribution surplus. The dividend of $10 000 is an attribution account payment.

FTP 1500 + 1000 − 1000 $1500

Transfer of excess foreign tax credits

A resident company that is a member of a company group may transfer an excess credit to another member of the group if:

- there is 100 per cent common ownership within the group
- there is a shortfall of foreign tax credits in a class of income for the company receiving the transfer
- the shortfall is for income of the same class as that for which there is an excess foreign tax credit in the company transferring the credit
- both companies retain a record of the transfer showing the credit transferred.

The transfer of an excess credit may include credit carried forward from five prior years as well as the current year. The transfer operates only for the following two classes of income:

- passive income
- other income—excluding offshore banking income.

A company can transfer only an amount equal to the credit shortfall for that class of income—that is, the transferee cannot carry forward the transferred amount.

Carry forward of foreign losses by companies

An overall foreign loss for a class of assessable foreign income may be carried forward indefinitely and used to reduce a future year's assessable foreign income for that class.

Losses incurred by a company before the 1990–91 income year can be carried forward only for seven years and are therefore no longer available.

Claiming foreign tax credits on your foreign income

To work out if you can claim a foreign tax credit on your foreign income, read the booklet *How to claim a foreign tax credit*. This publication is available from the Australian Taxation Office.

Chapter 4

Overview

This chapter details the types of records you need to keep to substantiate your tax assessment.

Proving your assessment

You will need to keep receipts, invoices, ledgers and other accounting records of a company or trust that relate to the calculation of its notional assessable income.

In addition, you will need to keep details of your interest in the company, the interests of your associates and how you worked out the amount you included in your assessable income.

This chapter also explains the substantiation requirements of the active income test, the use of offshore information notices and the keeping of records of elections.

Summary of chapter 4

	Part 1	Part 2	Part 3	Part 4
Subject	Record keeping for attribution	Substantiation for active income test	Offshore information notice	Elections
Applies to	Attributable taxpayer	Attributable taxpayer	Taxpayer	CFC or taxpayer
Action	Keep records of attributable amount	Supply accounts and accounting information to ATO	Produce documents	Make election
If not done	Prosecution $3000	No offence if not supplied—but CFC fails active income test	Evidentiary sanction—no documents can be used in evidence without Commissioner's consent	Treated as if no election made

Part 1—Record keeping for attributable taxpayers

Who needs to keep records?

A person who is an attributable taxpayer of:

- a controlled foreign company (CFC), or
- a non-resident trust estate

is subject to the record keeping requirements set out below.

An attributable taxpayer is a person who:

- alone, or together with associates, has an interest in a CFC or a controlled foreign trust of at least 10 per cent or
- is a transferor of a non-resident trust or
- is one of the actual controllers of the CFC with an interest of at least 1 per cent.

Record keeping for a controlled foreign company

You will need to keep records of your interest in a CFC and of its financial transactions if you meet both of the following conditions:

- you are an attributable taxpayer of a controlled CFC at the end of the company's statutory accounting period and
- the company has attributable income.

You must keep records of:

- the circumstances that resulted in you becoming an attributable taxpayer for the statutory accounting period of the CFC
- how you worked out your direct and indirect attribution interest and your attribution percentage for the CFC's statutory accounting period and
- how you worked out the amount you included in your assessable income.

You must keep records of your calculations even if they show that no amount is to be included in your assessable income.

Specific record keeping requirements called attribution accounts apply where an amount is included in an attributable taxpayer's assessable income due to a CFC paying a dividend to another controlled entity.

Record keeping for non-resident trusts

You are required to keep records for a non-resident trust estate if you are an attributable taxpayer in relation to the trust estate.

You must keep records of:

- how you became an attributable taxpayer for the non-resident trust
- how you worked out the trust's attributable income for each of the trust's income years which falls wholly or partly within your year of income and
- how you worked out the amount included in your assessable income.

If you cannot get the information necessary to work out the trust's attributable income, the amount to be included in your assessable income is worked out using a formula—see chapter 2.

You must keep these records even if no amount is to be included in your assessable income.

Record keeping for partnerships

A partnership needs to keep records if it is an attributable taxpayer.

A partnership may be an attributable taxpayer if it:

- has transferred property or services to a non-resident trust or
- is an attributable taxpayer in relation to a controlled foreign company.

It is important to note that each individual partner could be liable if the partnership breaches the record keeping requirements.

What happens if the records are not kept?

You may be prosecuted and fined up to $3000 by a court if you fail to keep adequate records.

You will not be convicted if you can show that any of the following statutory defences apply to you:

- you did not know that you had an obligation to keep the records and you had no reason to suspect the obligation existed—if you suspected that the record keeping requirements applied to you, you won't be able to claim the benefit of this exemption—or
- you did not know that you had an obligation to keep the records even after you had made all reasonable efforts to find out whether there was an obligation to keep the records or
- if you have made all reasonable efforts to obtain the information required but simply can't get it—if you had actual or effective control of the company or another entity which has the information, you would not be considered to have made a reasonable effort unless you used your position of influence in a genuine attempt to get the information required.

If you wish to take advantage of any of these exemptions, you will have to prove that reasonable grounds existed or that you made reasonable efforts. To do this, you will need to keep a record of the efforts you have made to get the information.

How should the records be kept and for how long?

If you are required to keep records you must:

- keep written records in English. If records are not in a written form—for example, if kept on magnetic tape or computer disc—you must be able to get access to them readily to convert them into written English
- keep records in a way that allows your tax liability to be readily determined
- keep the records either for 5 years after they were prepared or obtained, or for 5 years after the completion of the transactions to which those records relate, whichever is the later.

The records need not necessarily be kept in Australia but they must be kept by the attributable taxpayer. This means that you, as the attributable taxpayer, are responsible for the custody and control of the records. If an Australian company allows its CFC to physically keep records outside Australia, the Australian company must maintain custody and control of those records.

Are you required to keep attribution accounts?

There is no legal requirement for an attributable taxpayer of a CFC to keep attribution accounts. However, without such accounts you may not be able to justify a claim of exemption from Australian tax on dividends paid to you by the CFC out of income attributed to you.

Are you required to keep accounting records for exempting receipts and exempting profits?

The law does not set out the records that have to be kept to identify exempting receipts and exempting profits. However, a taxpayer who asserts that a part of a dividend paid by an unlisted country company is paid from exempting profits has to maintain adequate records to substantiate this claim.

Part 2—Passing the active income test

Who has to prove they have passed the test?

A person who is an attributable taxpayer for a CFC and who claims that the CFC has passed the active income test may be asked to prove that the CFC has passed the test.

How do you prove that you meet the requirements?

If you wish to claim a tax exemption on the basis that a CFC has passed the active income test—see chapter 1—you must:

- ensure that the company has kept accounts for the statutory accounting period. These accounts must:
  - be prepared in accordance with commercially accepted accounting principles
  - give a true and fair view of the financial position of the company
- ensure that the CFC will assist by providing accounting and other information which the Australian Taxation Office may ask you to supply.

Commissioner's notice to an attributable taxpayer

If you prepared a tax return claiming the active income test exemption, the ATO may give you a Commissioner's notice asking you to prove that the test has been passed. In this notice, the Commissioner will ask you to get copies of accounts and other documents from the CFC.

If the documents are not in English, you will have to translate them and give the documents and translations to the ATO within the allotted time.

The ATO will allow you a minimum of 90 days to produce these documents. If you want extra time you must apply in writing to the ATO before the time runs out. The ATO may agree to extend the time allowed.

Extra time will be granted if the ATO has not answered your request before the time allowed runs out.

Taxpayer's notice to a CFC

To get the documents from the CFC, you may send the CFC a written request—a *Taxpayer's Notice*.

General accounting records

So that you can get the documents that the ATO may ask for, the ATO requires the company to keep general accounting records. These may be kept either in Australia or elsewhere.

These records include:

- invoices
- receipts
- orders for the payment of money
- bills of exchange
- cheques
- promissory notes
- vouchers and
- other documents of prime entry.

The records would also include any working papers and other documents necessary to explain how the accounts are made up.

General accounting records should also correctly record and explain the matters, transactions, acts and operations that are relevant to the preparation of the CFC's recognised accounts for the statutory accounting period. These records must be available if the ATO needs to check the matters and figures in the accounts.

Recognised accounts

Recognised accounts are accounts kept for the statutory accounting period that are:

- prepared in accordance with commercially accepted accounting principles and
- give a true and fair view of the financial position of the company.

These accounts include:

- journals
- ledgers
- profit and loss accounts
- balance sheets
- other financial statements
- reports and notes attached to, or intended to be read with, the accounts.

The company must keep both the recognised accounts and the general accounting records for 5 years starting from the end of the statutory accounting period of the company.

If you ask the CFC for copies of documents included in or drawn from the recognised accounts and general accounting records, the CFC must give them to you—but you must allow the CFC at least 60 days to comply.

In your taxpayer's notice to the CFC, you may ask the CFC for any or all of the following:

- copies of the recognised accounts of the company for the statutory accounting period
- copies of the general accounting records of the company for the statutory accounting period
- copies of a document showing how the tainted income ratio of the company was worked out for the statutory accounting period. This document will summarise information drawn from the recognised accounts and general accounts to work out the tainted income ratio.

CFC's notice to its partnership

If the CFC is a partner, the CFC may ask the partnership for information it needs to answer the taxpayer's notice. The CFC's notice must allow the partnership at least 30 days to comply.

MINIMUM TIME FOR NOTICE TO PRODUCE DOCUMENTS

ATO → Taxpayer → CFC → Partnership

minimum 90 days notice   min 60 days   min 30 days

What will happen if you don't fully meet the substantiation requirements of the active income test?

If you refuse or fail to comply with the Commissioner's notice, you have not committed an offence. This means you will not be prosecuted if the CFC or a partnership involving a CFC does not keep the records listed above.

However, if you fail to meet the substantiation requirements because you have not produced the documents requested, the CFC will be treated as if it has failed the active income test.

As a result, the ATO may amend your tax assessment to include attributable income. You may also have to pay a penalty for the tax that would have been paid if you had not claimed the active income test exemption.

Part 3—Can the Australian Taxation Office ask you to get information from overseas?

Offshore information notices

If the Australian Taxation Office (ATO) believes that information relevant to your assessment is held overseas, you may receive a written 'offshore information notice' asking you to get the information for the ATO.

The ATO will give you 90 days to supply the information. You may ask for extra time by applying in writing to a tax office before the time runs out. If you are allowed extra time, you will be advised of this in writing. The extra time will be given if the ATO has not answered your request before the time allowed runs out.

The ATO may change the notice in writing to:
- reduce its scope or
- correct a clerical error or obvious mistake.

The ATO may also issue you with another notice or vary or withdraw a notice.

If you fail or refuse to comply with an offshore information notice, you have not committed an offence.

However, if you don't give the ATO all of the information asked for, you could be stopped from using it as evidence in proceedings in which you dispute the assessment.

The ATO may consent to information being admissible in proceedings where the Commissioner considers that its use would not be misleading.

Part 4—What records of elections must you keep?

If you have been required to:
- make an election
- make a declaration
- make a selection or
- give certain notices

to the ATO when working out your attributable income, you are required to keep a record of this.

You are also required to keep a record of a CFC's election if you are claiming the benefit made either:
- under capital gains tax roll-over provisions or
- due to a change in its statutory accounting period.

Note that the CFC may make an election to vary its statutory accounting period from the standard period ending 30 June.

APPENDIX 1

Foreign income regulations

Introduction

Part 8A of the regulations and associated schedules deal with the taxation of foreign source income. The provisions:

- declare those countries that are to be treated as broad-exemption or limited-exemption listed
- provide that Swiss Cantonal taxes are to be treated as Federal taxes
- specify when capital gains are taken to have been subject to tax for the purposes of the CFC measures, the transferor trust measures and the exemption for branches of Australian companies in listed countries
- contain rules for determining whether an amount is designated concession income
- set out the accruals taxation laws of other countries that are recognised for the purposes of providing relief from double accruals taxation.

Listed countries

The regulations specify those countries which are to be treated as broad-exemption and limited-exemption listed. These lists are reproduced at attachment A.

Broad-exemption listed countries

The term 'broad-exemption' reflects that amounts taxed at full rates by countries on the list are generally exempt from both accruals taxation and taxation on repatriation to Australia.

Limited-exemption listed countries

The term 'limited-exemption' reflects that amounts which are taxed at full rates by countries on the list are generally exempt from tax on repatriation to Australia. An exemption from accruals taxation will not be available, however, on the basis that an amount has been taxed in a limited-exemption listed country.

Swiss Cantonal taxes

Swiss Cantonal tax is to be treated as if it were an additional federal foreign tax of Switzerland.

Capital gains deemed subject to tax

Broadly, a gain will be taken to be subject to tax in a listed country if the gain was not subject to tax because of a roll-over provision of a kind specified in the regulations. Roll-over relief provides for the deferral of tax on a capital profit arising from the disposal of an asset.

Designated concession income

Normally, amounts derived in a broad-exemption listed country are exempt from accruals taxation. The exemption does not apply, however, for amounts of eligible designated concession income. Broadly, an amount is treated as designated concession income if it is concessionally taxed in a broad-exemption listed country. The amount will be treated as eligible designated concession income if it is not subject to full tax in any broad-exemption listed country.

What kinds of income or profits are specified as designated concession income?

The following types of income or profits are designated concession income:

- capital gains which are exempt from tax in a broad-exemption listed country
- interest, royalties, shipping income or offshore income that is subject to a reduction of tax in a broad-exemption listed country
- income or profits derived by an entity, where the entity is of a type specified in the regulations. A list of these entities is shown at attachment B.

Capital gains which are exempt from tax in a broad-exemption listed country

Capital gains are defined in the regulations as gains or profits of a capital nature that arise from the sale or disposal of an asset.

A capital gain will not be treated as exempt from tax for this purpose if the gain would have been taxed in a listed country if not for roll-over provisions of a kind specified in the regulations.

Interest, royalties, shipping and offshore income

Definitions from the regulations

Interest income

This term refers to interest and amounts in the nature of interest—for example, discounts—and amounts that would be assessable income under Division 16E of Part III of the Act if the entity deriving the amount were a resident of Australia.

Royalties

The term royalties has the same meaning as it has in subsection 6(1).

Shipping income

This term includes rental income from the leasing of ships and containers and income derived from normal shipping operations—that is, from the carriage of goods, passengers, mail and livestock.

Offshore income

This term is defined in the regulations as income derived by an entity from carrying on an:

- offshore banking business
- offshore financial business
- offshore insurance business
- offshore investment business or
- offshore re-insurance business.

When are interest, royalties and shipping income not treated as designated income?

Interest income and royalties are not to be regarded as designated concession income if they are taxed in a broad-exemption listed country on a withholding tax basis at the normal company tax rate that applies in the broad-exemption listed country.

Shipping income derived from sources outside a broad-exemption listed country is not designated concession income if it is taxed on a withholding tax type basis in the country where it originates at a rate which is not less than 5 per cent of the gross amount of shipping income.

Income or profits subject to a reduction of tax

Amounts will be treated as subject to a reduction of tax if they are:

- exempt from tax
- subject to a concessional rate of tax
- not used as a basis for determining the taxable income, taxable profits or tax base, as the case may be, or in establishing the tax liability of an entity—for example, amounts derived by foreign sales corporations located in certain countries which are taxed on a cost-plus basis
- reduced other than for normal expenses or losses—for example, reduced on an arbitrary or notional basis in accordance with a statutory or administrative formula or
- subject to other tax benefits which would have the effect of reducing the amount of tax otherwise payable.

What does 'normal expenses and losses' mean?

Normal expenses and losses would include:

- capital or revenue amounts taxed in a broad-exemption listed country
- prior year capital or revenue expenses
- losses, incurred by a group company, which have been transferred to the CFC.

For the purposes of the above tests, a company is treated as belonging to the same company group as another company if one of the companies is a subsidiary of the other or if they are both subsidiaries of a third company. Broadly, a company is a subsidiary of another company if the other company holds 60 per cent or more of the total rights to distributions of profits from the company. Companies in a chain of subsidiary companies are treated as group companies.

A company which transfers losses to a CFC must also be a CFC and be resident in the same broad-exemption listed country as the CFC to which the losses were transferred. The following conditions must also be satisfied:

- the broad-exemption listed country must allow the transfer
- both companies must be CFCs
- the company that incurred the loss must have been a CFC in relation to the same attributable taxpayer during the period from when the loss was incurred until the end of the period in which the loss is offset.

Loss transfers from a group company to a branch of an Australian company in a broad-exemption listed country are also available if that country permits the loss transfer and the group company is a CFC resident in the broad-exemption listed country.

What are 'other tax benefits'?

A tax benefit includes a credit, rebate or other tax concession provided for income or profits, other than a credit or rebate for tax payable under a law of another country.

Attachment A

Broad-exemption countries

Canada
France
Germany
Japan
New Zealand
United Kingdom of Great Britain and Northern Ireland
United States of America

Limited-exemption countries

Austria
Bangladesh
Belgium
Brazil
Brunei
Bulgaria
China*
Czech Republic
Denmark
Fiji
Finland
French Polynesia
Greece
Hungary
Iceland
India
Indonesia
Ireland
Israel
Italy
Kenya
Kiribati
Korea, Republic of
Luxembourg
Malaysia
Malta
Myanmar
Netherlands
New Caledonia
Norway
Pakistan
Papua New Guinea
Philippines
Poland
Portugal
Romania
Saudi Arabia
Singapore
Solomon Islands
Spain
Sri Lanka
Sweden
Switzerland
Taiwan
Thailand
Tokelau
Tonga
Turkey
Tuvalu
Vietnam
Western Samoa
Zimbabwe

Former list of countries

Austria
Bangladesh
Belgium
Brazil
Brunei
Bulgaria
Canada
China
Czechoslovakia
Denmark
Fiji
Finland
France
French Polynesia
German Democratic Republic
Germany, Federal Republic of
Greece
Hungary
Iceland
India
Indonesia
Ireland
Israel
Italy
Japan
Kenya
Kiribati
Korea, Republic of
Luxembourg
Malaysia
Malta
Myanmar
Netherlands
New Caledonia
New Zealand
Norway
Pakistan
Papua New Guinea
Philippines
Poland
Portugal
Romania
Saudi Arabia
Singapore
Solomon Islands
Spain
Sri Lanka
Sweden
Switzerland
Taiwan
Thailand
Tokelau
Tonga
Turkey
Tuvalu
Union of Soviet Socialist Republics
United Kingdom of Great Britain and Northern Ireland
United States of America
Western Samoa
Yugoslavia
Zimbabwe

*Except the Hong Kong special administrative region

Attachment B—Specific types of designated concession income

Amounts derived by the following entities are treated as designated concession income:

- an entity that operates in Canada as an international banking centre under a law of Canada
- an entity that operates in Canada as a non-resident owned investment corporation under a law of Canada
- an entity that operates in France as a headquarters or coordination entity, or as a logistics centre under a law of France or by virtue of an administrative arrangement with the French authorities
- an entity that operates in France as a *société d' investissement à capital variable* (SICAV) or as a *société de capital risque* (SCR) under a law of France
- an entity that operates in Germany as a headquarters or coordination entity under a law of Germany or by virtue of an administrative arrangement with the German authorities.

Amounts derived by the following entities and from the following activities are treated as designated concession income for statutory accounting periods of CFCs commencing before 1 July 1997.

Belgium

- Coordination centres
- Foreign sales corporations
- Distribution centres

Brazil

- Authorised investment funds

Bulgaria

- Entities in duty free zones

France

- Headquarters of foreign companies

Germany, Federal Republic of

- Management centres (Kontrollstellenerlass)

Greece

- Offshore companies

Hungary

- Banking activities of foreign financial institutions

Ireland, Republic of

- Income—including income from financial services and shipping—taxed at 10 per cent
- Headquarters operations

Israel

- Foreign international trade companies

Luxembourg

- Holding companies
- Re-insurance business
- Coordination centres

Malaysia

- Inward re-insurance business
- Offshore insurance income
- Operational headquarters

Malta

- Offshore activities

Netherlands

- Headquarters of foreign companies
- Foreign sales corporation

Pakistan

- Air transport operations

Philippines

- Regional headquarters of multinational companies
- Offshore banking units
- Foreign currency deposit units

Portugal

- Madeira and Azores tax free zones

Singapore

- Asian currency units
- Approved securities companies
- Insurance and Re-insurance of risks outside Singapore
- Gold bullion, gold features and financial futures
- Syndicated offshore credit and underwriting facilities
- Operational headquarters
- Offshore managed funds
- Oil futures concession

Solomon Islands

- Air transport operations
- Insurance business

Spain

- Headquarters of foreign companies
- Venture capital companies and funds

Sri Lanka

- Offshore banking services
- Income from services rendered outside Sri Lanka

Switzerland

- Holding companies
- Service or auxiliary companies
- Domiciliary companies
- * Participation exemption

Tonga

- Offshore banking

Turkey

- Export incentives, including international transport earnings

Western Samoa

- International offshore centres

APPENDIX 2

Glossary of terms

A number of words and expressions used in this guide have special meanings. For ease of reference, these words and expressions are outlined below, together with an explanation of what they mean.

Accruals taxation

Accruals taxation is the taxation of Australian residents on profits derived through a foreign company or trust as they are earned by the company or trust. Normally, the profits would not be taxed in Australia until they are distributed to the taxpayer as a dividend or trust distribution.

Act

In this Guide, the term 'the Act' means the *Income Tax Assessment Act 1936*, as amended.

Active income test

The active income test ensures that small amounts of tainted income derived by a CFC are exempt from accruals taxation. An exemption is provided from accruals taxation for most amounts derived by a CFC if the test is satisfied.

Adjusted net foreign income

In relation to foreign tax credits, adjusted net foreign income is net foreign income adjusted for apportionable deductions.

Adjusted tainted income

Adjusted tainted income comprises passive, tainted sales and tainted services income.

Apportionable deductions

In relation to foreign tax credits, apportionable deductions are those deductions of a concessional nature which do not relate directly to income-producing activities—for example, gifts.

Arm's length amount

This expression means, in relation to an actual transfer of property or services to a non-resident trust estate, the amount that the trustee of the non-resident trust might reasonably be expected to pay to the transferor for the property or services if the property or services had been transferred under an arrangement between independent parties dealing at arm's length with each other.

Associates

There are four parts to determining who are the associates of an entity. They deal with:

- associates of an individual
- associates of a company
- associates of a trustee
- associates of a partnership.

Part 1—Associates of an individual

The associates of an individual—other than an individual acting in the capacity of a trustee—are:

- relatives of the individual—that is, the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of the individual or of his or her spouse; and the spouse of the individual or of any other person mentioned above
- a partner of the individual or a partnership of which the individual is a partner
- the spouse, including de facto spouse, or child of a partner, where the partner is also an individual—other than an individual acting in the capacity of a trustee
- the trustee of a trust, where the individual or another entity that is an associate by virtue of this part benefits under the trust
- a company where that company is sufficiently influenced by:
  - the individual
  - another entity that is an associate of the individual because of the rules in this part or
  - another company which is sufficiently influenced by the individual or
  - two or more of the above entities or
- a company where the capacity to cast or control greater than 50 per cent of the maximum votes at a general meeting of the company is held by:
  - the individual
  - associates of the individual under the rules in this part
  - the individual and the associates.

Part 2—Associates of a company

Part 2 deals with the associates of a company—called company A. The associates of company A include:

- a partner of company A
- a partnership of which company A is a partner
- where a partner of company A is a natural person otherwise than in the capacity of a trustee, the spouse or child of the partner
- the trustee of a trust where company A, or an entity that is an associate of company A, benefits under the trust
- an entity (entity B) that exerts sufficient influence over company A or holds a majority voting interest in company A. The influence may be exerted by entity B alone or together with other entities. The majority interest may be held by entity B alone or together with entities that would be associates of entity B if it were treated as company A
- a company (company C) that is sufficiently influenced by company A or in which company A holds a majority voting interest. The influence may be exerted by company A alone or together with other entities that are sufficiently influenced by company A or in which company A holds majority voting interests. The majority voting interests may be held by company A alone or together with entities that are associates of company A
- any other entity (entity D) that would be an associate of a third entity (entity E) which would be an associate of company A if the associates of entity E were determined by treating it as company A.

Majority voting interest

An entity holds a majority voting interest in a company where:

- the entity's direct shareholding in the company and
- the entity's indirect shareholding in the company—for example, through a subsidiary

amount to 50 per cent or more of the maximum number of votes that can be cast at a general meeting of the company. An example is where a company has a wholly owned subsidiary which has a 75 per cent voting interest in another company. Both the parent and subsidiary would be associates of the third company because the subsidiary has a majority voting interest in the third company and the parent has a majority voting interest in the subsidiary.

Sufficient influence

An entity is sufficiently influenced by a second entity or other entities if the entity is accustomed, under an obligation or might reasonably be expected to act in accordance with directions, instructions or wishes of the second entity or other entities.

Part 3—Associates of a trustee

The associates of a trustee are:

- any entity that benefits under the trust
- any entity that is an associate of an individual who benefits under the trust or
- where a company is an associate of the trustee under either of the two above dot points, an entity that is an associate of the company.

Rules relating to public unit trusts

In applying the tests for associates, the trustee of a public unit trust is treated as if it were a company. Special rules apply to determine whether a public unit trust is sufficiently influenced by another entity or whether an entity has a majority voting interest in the public unit trust.

Generally, a public unit trust will be sufficiently influenced by another entity or entities where the trust is accustomed to act or is under an obligation to act or might reasonably be expected to act in accordance with the directions, instructions or wishes of the entity or entities.

The concept of a majority voting interest in relation to a public unit trust is determined by reference to the capital or income of the trust. If an entity is entitled to, or is entitled to acquire, 50 per cent or more of the income or capital of the trust, the entity is considered to hold a majority voting interest in the public unit trust. Corresponding rules apply to test whether a group of entities have a majority voting interest in the trust.

Part 4—Associates of a partnership

The associates of a partnership are:

- a partner in the partnership
- where the partner is an individual, any entity that would be an associate of the individual or
- where the partner is a company, any entity that would be an associate of the company.

Attributable income

Amounts taxed on an accruals basis under the CFC, transferor trust or FIF measures.

Attributable taxpayer

An attributable taxpayer is an Australian entity that is liable to pay tax on attributable income.

Attribution

The process by which income is taxed on an accruals basis under the CFC, transferor trust or FIF measures.

Attribution percentage

The attribution percentage is the pro rata share of a CFC's attributable income that will be attributed to a particular taxpayer's assessable income.

Australian 1 per cent entity

An Australian 1 per cent entity, in relation to a company or trust, is an Australian entity whose associate inclusive control interest in the company or trust is at least 1 per cent.

Australian entity

An Australian entity is an Australian partnership, an Australian trust, or an entity—other than a partnership or trust—that is a Part X Australian resident.

Australian partnership

An Australian partnership is a partnership of which at least one of the partners is an Australian entity.

Australian tax payable

In relation to foreign tax credits, Australian tax payable is the product of the average rate of Australian tax and adjusted net foreign income less any rebates which are applicable to that income.

Australian trust

An Australian trust is a trust which at a particular time—or at a time in the twelve months before that time—has a trustee who is a Part X Australian resident or has its central control and management in Australia. It includes a corporate unit trust and a public trading trust as defined in the Act.

Average rate of Australian tax

In relation to foreign tax credits, average rate of Australian tax is gross tax on taxable income—less certain rebates—divided by taxable income.

Branch

See *Permanent establishment on page 104*.

Broad-exemption listed country

A country listed in the Income Tax Regulations as a broad-exemption country. The list of broad-exemption countries—see page 97—will be used for the purposes of exemptions from accruals taxation under the CFC and transferor trust measures. These countries are also treated as listed for the purposes of exemptions under the Foreign Tax Credit System.

Broad-exemption listed country trust estate

A non-resident trust estate is a broad-exemption listed country trust estate in an income year if all of the income or profits derived by the trust estate during that income year are either:

- subject to tax in one or more broad-exemption listed countries in a tax accounting period ending before the end of, or commencing during, the income year or
- designated concession income in relation to any broad-exemption listed country.

A non-resident trust estate could be treated as a resident of a non-broad-exemption listed country under that country's tax laws—for example, the trustee may be a resident of that country. However, for the purposes of the transferor trust measures, the trust would be treated as a broad-exemption listed country trust estate if all of the trust's income is derived from one or more broad-exemption listed countries and is subject to tax in those countries.

CFC measures

The CFC measures deal with the accruals taxation of Australian residents that have a controlling interest in a foreign company.

Controlled foreign company

Broadly, a controlled foreign company (CFC) is a company that is not a resident of Australia and is controlled by 5 or fewer residents.

Creditable taxes

Creditable taxes are, broadly, foreign taxes which are equivalent in nature to Australian income tax—for example, a tax on net income or capital gains—including tax imposed on attributed income.

Designated concession income

Designated concession income is income or profits of a kind that are specified in Part 8A of the Income Tax Regulations. Broadly, it refers to income or profits which are subject to a tax concession in a broad-exemption listed country. Details of the particular types of income or profits are set out in appendix 1 of this guide.

Discretionary trust estate

A discretionary trust estate is a trust estate for which:

- both of the following conditions are satisfied:
  - a person—including the trustee—has a power of appointment or other discretion and
  - the exercise of, or the failure to exercise, the power or discretion has the effect of determining, to any extent, either or both of the following:
    - the persons who may benefit under the trust
    - how the beneficiaries are to benefit under the trust or
- one or more of the beneficiaries under the trust have a contingent or defeasible interest in some or all of the capital or income of the trust estate or
- the trustee of another trust estate that satisfies both conditions in the first dot point above benefits or is capable of benefiting under the first-mentioned trust estate.

Double taxation agreement

A double taxation agreement (DTA) is an agreement made between the Australian Government and another State under the *International Tax Agreements Act 1953*.

Eligible designated concession income

Eligible designated concession income is designated concession income, in relation to a particular broad-exemption listed country, derived by an entity in an income year and that is not subject to tax in another broad-exemption listed country in a tax accounting period that ends before the end of, or commences during, the income year.

The expression also includes designated concession income in relation to a particular broad-exemption listed country that is subject to tax in another broad-exemption listed country but is also designated concession income in relation to that other listed country.

Eligible transferor

For the purposes of accruals taxation under the CFC measures, an eligible transferor is an Australian entity or a controlled foreign entity that has transferred property or services in certain specified circumstances to a non-resident trust.

If the transfer was to a trust which is a discretionary trust before the IP time*, the transferor will be an eligible transferor if he or she was able to control the trust at any time after the IP time and before the transfer.

An exception is made where the transfer was an ordinary business transaction for full value. If the transfer was made after the IP time, the transferor will be an eligible transferor unless the transfer was for full value and the transferor did not have control of the trust after the transfer.

If the transfer was made after the IP time to a trust that is a non-discretionary trust or a public unit trust at the test time, the transferor will be an eligible transferor if the transfer was made for no consideration or for inadequate consideration.

Exempting profits

The total of the exempting receipts held as distributable profits by a company resident in an unlisted country.

Exempting receipt

Exempting receipts are, generally, amounts earned by a company resident in an unlisted country that can be distributed as exempt dividends.

FIF measures

The FIF measures deal with the accruals taxation of Australian residents that have a non-controlling interest in a foreign company or foreign trust.

Financial intermediary business

A banking business or a business whose income is principally derived from the lending of money.

Foreign investment fund

A foreign investment fund (FIF) is any foreign company or foreign trust—other than a deceased estate.

*The IP time means 7.30 p.m. by standard time in the Australian Capital Territory on 12 April 1989.

Foreign tax credit system

Under the foreign tax credit system (FTCS), foreign source income derived by Australian residents—apart from certain salary and wage income—is generally subject to Australian tax. A credit for foreign tax paid is allowed against the Australian tax payable, up to the amount of the Australian income tax referable to the foreign income.

Income year

An income year—or year of income—is, in effect, a 12-month period ending on 30 June, or a 12-month period ending on another date where the Commissioner has approved that other date under section 18 of the Act.

Limited-exemption listed country

A country listed in the Income Tax Regulations as a limited-exemption country—see page 97. These countries will basically comprise the original list of countries in Schedule 10 of the Income Tax Regulations, excluding broad-exemption listed countries. The list has been updated by adding the Czech Republic and Vietnam and removing countries that no longer exist.

Listed country

A country listed for the purposes of dividend and branch profit exemptions under the foreign tax credit system. Countries on either the broad-exemption or limited-exemption list are treated as listed countries.

Net income

In relation to a non-resident trust estate, net income essentially means the total assessable income of the trust estate, worked out as though the trustee were an Australian resident and a taxpayer in respect of that income, less all allowable deductions, as provided by section 95 of the Act.

Net foreign income

In relation to foreign tax credits, net foreign income is gross assessable foreign income less:

- allowable deductions relating exclusively to foreign income
- any domestic loss carried forward that you have elected to use against foreign income and
- deductions allowed by the Commissioner as being appropriately related to foreign income.

Non-broad-exemption listed country

A country that is either a limited-exemption listed country or an unlisted country.

Non-broad-exemption listed country trust estate

An non-broad-exemption listed country trust estate is a non-resident trust estate which is not a broad-exemption listed country trust estate.

Non-discretionary trust estate

A non-resident trust estate is a non-discretionary trust estate if it is not a discretionary trust estate.

Non-portfolio dividends

Broadly, non-portfolio dividends are dividends paid to a company where that company has a 10 per cent or greater voting interest in the company paying the dividend.

Non-resident trust estate

A non-resident trust estate is trust other than an Australian resident trust.

An Australian resident trust is:

- a trust estate which, at any time during an income year, has a trustee who is a resident of Australia or has its central management and control in Australia
- a corporate unit trust or public trading trust which is taxed in the same way as a company or
- a superannuation fund, approved deposit fund or pooled superannuation trust within the meaning of Part IX of the Act.

Notional accounting period

A notional accounting period is the period used to determine the attributable income of a FIF or a foreign life assurance policy (FLP).

Notional assessable income

The assessable income of a CFC for the purposes of determining the CFC's attributable income.

Offshore banking income

In relation to foreign tax credits, offshore banking income includes interest, fees, commissions or similar income derived from offshore banking transfers and dividends paid by a company out of profits derived from offshore banking transfers.

Other income

In relation to foreign tax credits, other income is income other than passive income, offshore banking income or certain lump sum payments from a foreign non-complying superannuation fund which are assessable under section 27CAA. It includes income from normal commercial activities, salary and wages and most pensions.

Part X Australian resident

A Part X Australian resident is a resident of Australia who is not treated solely as a resident of a treaty partner country under a double taxation agreement between Australia and that country.

Passive income

Passive income includes certain types of dividend, interest, royalty, annuity and rental income (section 446). It also includes gains on the disposal of assets that produce passive income or that are not used solely in carrying on a business.

Permanent establishment

A permanent establishment is widely defined in subsection 6(1). Generally, it can be described as a place through or at which an entity in Australia conducts its business in another country. A permanent establishment has been referred to as a branch in this Guide.

Property

This term includes money, a chose in action, any trust estate and interest, right or power, whether at law or in equity, in or over property.

Related foreign companies

Generally, an Australian company is related to a foreign company for the purposes of the FTCS when:

- the companies are both group companies and
- the Australian company has, either directly or indirectly, a voting interest of at least 5 per cent in the foreign company (section 160AFB).

For these purposes, a company is a group company when the Australian parent has a voting interest of at least 10 per cent in the foreign company. If the foreign company has an equivalent interest in a second foreign company, then that second foreign company will also be a group company. This result will continue to apply through any number of tiers of companies.

Services

This term includes any benefit, right, privilege or facility. Services include a right in relation to real or personal property as well as an interest in real or personal property. Services also include a right, benefit, privilege, service or facility that is provided or is to be provided:

- under an arrangement for or in relation to:
  - the performance of work, whether or not property was also provided as part of the work performed
  - the provision of entertainment, recreation or instruction or the use of facilities for entertainment, recreation or instruction or
  - the conferring of benefits, rights or privileges for which remuneration is payable in the form of a royalty, tribute, levy or similar payment
- under a contract of insurance, including life assurance or
- under an arrangement for, or in relation to, the lending of money.

Statutory accounting period

A statutory accounting period is the period used to determine the attributable income of a CFC.

Tainted income

Tainted income includes passive income, tainted sales income and tainted services income.

Tainted rental income

Tainted rental income includes rental income of a CFC where:

- land is leased to an associate or the rent is paid by an associate or
- land is leased by a company not resident in the same country.

It can also include rental income from particular leases on ships, aircraft or cargo containers.

Tainted sales income

Tainted sales income is income of a CFC from the sale of goods purchased from or sold to:

- an associate who is an Australian resident or
- an associate who is not an Australian resident but carries on business in Australia through a permanent establishment.

Tainted services income

Tainted services income is income derived from the provision of services by a CFC:

- to an associate of the CFC
- to a resident of Australia or
- in connection with a permanent establishment in Australia.

Tax sparing

Tax sparing deems tax foregone by a foreign country in providing a specified concession to an Australian resident to be foreign tax paid for the purposes of Australia's foreign tax credit rules. The Australian resident may therefore be entitled to claim a credit for the tax foregone by the foreign country.

Transfer

Transfer is defined in broad terms.

In relation to the transfer of property, it includes a disposal of property by assignment, creation of a trust or any other manner or the provision of property.

For the transfer of services, it includes such concepts as allow, confer, give, grant, perform or provide.

Transfer pricing rules

Transfer pricing rules are contained in Division 13 of Part III of the Act. This Division seeks to impose 'arms-length' consideration on agreements for the sale of property between Australians and non-residents when the agreement effectively shifts profits from Australia.

Transferor trust

A non-resident trust to which a resident has made, or is deemed to have made, a transfer of property or services (Division 6AAA of Part III).

Transferor trust measures

The transferor trust measures deal with the accruals taxation of Australian residents who have directly or indirectly transferred value to a non-resident trust. Broadly, the rules operate to accruals tax the undistributed income of the trust.

Underlying tax

Underlying tax refers to the tax paid on the taxable profits of a company.

Unlisted country

An unlisted country means a foreign country which is not a listed country.

APPENDIX 3

Accruals taxation on the change of residence of a CFC from an unlisted country to a listed country or to Australia

The Australian controllers of a CFC are normally taxed under section 457 on the CFC's accumulated profits if the CFC changes residence from an unlisted to a listed country or to Australia. The profits are taxed at the residence change time because they are likely to be low taxed and can be distributed as exempt dividends after the CFC becomes a resident of a listed country.

Change of residence of a CFC from an unlisted country to Australia

If a CFC changes residence from an unlisted country to Australia, a resident taxpayer who is an attributable taxpayer of the CFC is taxable on the taxpayer's attribution percentage of the distributable profits of the CFC. However, the amount of the distributable profits that is taxable to a resident taxpayer does not include:

- amounts that represent income which has been previously attributed or
- if the resident taxpayer is a company with a non-portfolio interest in the CFC, the exempting profits of the CFC.

EXAMPLE 1

Attribution percentage

Ausco owns 75 per cent of a CFC that is a resident of an unlisted country. The CFC became a resident of Australia on 1 July 1997. Its distributable profits at that time were $20 000.

The amount included in the assessable income of Ausco for 1997–98 was 75 per cent of $20 000—that is, $15 000.

EXAMPLE 2

Exempting profits

Ausco owns 75 per cent of a CFC that is a resident of an unlisted country. The CFC became a resident of Australia on 1 October 1997. Ausco's 1997–98 income year commenced on 1 October 1997, as did the statutory accounting period of the CFC. The accounting period of the CFC is accepted as its income year.

The distributable profits of the CFC at the time of change of residence were as follows:

	$
Exempting profits	10 000
Other profits	20 000

On 1 October 1997, Ausco had an attribution surplus of $10 000 in its attribution account for the CFC.

The amount to be included in the assessable income of Ausco for 1997–98 was worked out as follows:

	$
Distributable profits on 1 October 1997	30 000
Take away exempting profits	10 000
	20 000
Ausco's share (75% of 20 000)	15 000
Take away attribution surplus	10 000
Amount to be included in Ausco's income for 1997–98	5 000

Tax consequences of a change of residence of a CFC from an unlisted country to a listed country

If a CFC changes residence from an unlisted country to a listed country, a resident attributable taxpayer has to include in assessable income a share of the distributable profits of the CFC.

The amount to be included is worked out in the same way as the amount that arises where an unlisted country CFC becomes a resident of Australia. However, a further adjustment is made to the CFC's distributable profits. The CFC is treated as having disposed of all of its assets for their market value at the time it changed residence. Accordingly, the distributable profits also include a net profit arising on the deemed disposal of those assets.

EXAMPLE 3

Distributable profits

Ausco owns 75 per cent of a CFC that is a resident of an unlisted country. The CFC became a resident of a listed country on 1 July 1997. Its distributable profits at the time of change of residence were $30 000. This includes an amount of $10 000 that would arise if all the assets of the CFC were disposed of at the time of the change of residence.

Ausco's assessable income will include the following amounts:

	$
Distributable profits on 1 July 1997	30 000
Take away exempting profits	10 000
	20 000
Ausco's share (75% of $20 000)	15 000
Take away attribution surplus	10 000
Amount to be included in Ausco's income for 1997–98	5000

Treatment of residence changes arising from changes to the lists of countries

The operation of section 457 is modified where an unlisted country CFC is treated as having changed residence to a listed country as a result of the unlisted country becoming listed. In this case, section 457 will not apply to tax the retained profits of a CFC if the CFC was a resident of the newly listed country for 3 or more years before the country became listed.

Where a CFC has been a resident of a newly listed country for less than 3 years, section 457 does apply but only to the realised profits of the CFC. Gains on the disposal of assets held at the residence change time are included in the attributable income of the CFC when they are realised. These gains are included in attributable income even though the CFC may satisfy the active income test in the period when the gains are realised.

APPENDIX 4

Summaries and worksheets

Overview

Section 1 of this appendix contains the following summary sheets that may be useful when preparing your tax return:

- summary sheet 1 — attributed income
- summary sheet 2 — working out your share of the attributable income of a CFC
- summary sheet 3 — active income test.

Section 1 also contains the following worksheets:

- worksheet 1 — working out your control and attribution percentages
- worksheet 2 — working out the tainted income ratio for a CFC
- worksheet 3 — working out amounts from partnerships to be included in the tainted income ratio
- worksheet 4 — working out the tainted income ratio for listed country CFCs for statutory accounting periods commencing before 1 July 1997
- worksheet 5 — working out amounts from partnerships to include in the tainted income ratio for listed country CFCs for statutory accounting periods commencing before 1 July 1997
- worksheet 6 — working out the attributable income of a CFC.

Section 2 contains a summary sheet for the transferor trust measures. Section 3 contains a summary sheet for working out the amount of foreign dividend income to include in your assessable income.

The summaries and worksheets are intended as guides only and may not cover all the qualifications and conditions contained in the law that may apply to a particular case.

Section 1

Summary sheet 1—Attributed income

This summary sheet will enable you to total the amounts of attributed income to be included in your tax return. Prepare a separate schedule if you need more space for any part.

Part A—Attributable income from CFCs

Include your share of:

- the attributable income of each CFC in which you have an attribution interest
- attributable dividends, including deemed dividends, paid by an unlisted country CFC, directly or indirectly, to another CFC or to a controlled foreign trust
- attributable amounts arising where an unlisted country CFC changes residence to a listed country or to Australia.

Name of the CFC	Amount of attributable income or dividend
1	$
2	$
3	$
4	$
5	$
Total	$

Refer to summary sheet 2 to determine whether you have to include attributable income from a CFC.

Part B—Income attributed to you from a non-resident trust under the transferor trust measures

Name of the trust	Amount of attributable income or dividend
1	$
2	$
3	$
4	$
5	$
Total	$

Refer to section 2 to determine whether you have to include attributable income from a trust under the transferor trust measures.

Part C—Your share of the net income of any partnership or trust that consists of income attributed to the partnership or trust under the accruals tax measures, whether from a CFC or a non-resident trust estate

Name of partnership or trust	Amount of attributable income
1	$
2	$
3	$
4	$
5	$
Total	$

Part D—Total of the amounts in Parts A, B and C

Part A	$
Part B	$
Part C	$
Total	$

Include this total amount in your tax return at the appropriate labels as set out in *TaxPack* or the return form instructions.

Summary sheet 2

Working out your share of the attributable income of a CFC

Use this summary sheet if you had an interest in a foreign company during your income year. Use a separate summary sheet for each foreign company.

Your name ☐

Tax file number ☐

Name of foreign company ☐

1 Were you a Part X Australian resident at the end of the CFC's statutory accounting period?

YES ☐ *Go to question 2.* **NO** ☐ *Read below.*

You do not have to work out the foreign company's attributable income for the income year.

2 Was the foreign company a CFC at the end of its statutory accounting period?

Answer questions 1 to 10 of worksheet 1 to find out if the foreign company is a CFC at the end of its statutory accounting period. Treat references to the test time in worksheet 1 as references to the end of the CFC's statutory accounting period.

YES ☐ *Go to question 3.* **NO** ☐ *Read below.*

You do not have to work out the foreign company's attributable income for the income year.

3 Were you an attributable taxpayer at the end of the CFC's statutory accounting period?

Answer questions 11 and 12 of worksheet 1 to find out if you were an attributable taxpayer. Treat references to the test time in worksheet 1 as references to the end of the CFC's statutory accounting period.

YES ☐ *Work out the CFC's attributable income. Go to questions 4 to 7* **NO** ☐ *Read below.*

You do not need to work out the CFC's attributable income for the income year.

4 **Was the CFC resident in a broad-exemption listed country or in a non-broad-exemption listed country at the end of the statutory accounting period?**

BROAD-EXEMPTION LISTED COUNTRY
☐ *State below the name of the country or countries of residence.*

NON-BROAD-EXEMPTION LISTED COUNTRY
☐ *State below the name of the country or countries of residence.*

5 **Did the CFC pass or fail the active income test?**
Use summary sheet 3 and associated worksheets to determine whether the CFC passed the active income test.

PASS ☐ **FAIL** ☐

6 **What was the CFC's attributable income?** $

Complete worksheet 6 to answer this question.
Copy the amount at label A of that worksheet to this box.

7 **What was your share of the CFC's attributable income?** $

Complete worksheet 6 to answer this question.
Copy the amount at label B of that worksheet to this box.

Summary sheet 3—Active income test

Use this summary sheet to determine whether a CFC passes the active income test.

1 Was the CFC resident in a particular broad-exemption listed country or in a particular non-broad-exemption listed country at all times during the CFC' statutory accounting period?

YES ☐ *Go to question 2.* **NO** ☐ *Read below.*

The CFC has failed the active income test. Tick Fail at question 5 of summary sheet 2.

2 Did the CFC, or a partnership in which the CFC was a partner, have a permanent establishment in the CFC's country of residence at all times during the period?

YES ☐ *Go to question 3.* **NO** ☐ *Read below.*

The CFC has failed the active income test. Tick Fail at question 5 of summary sheet 2.

3 Has the CFC, and every partnership in which it was a partner, kept accounts according to commercially accepted accounting principles which give a true and fair view of its financial position?

YES ☐ *Go to question 4.* **NO** ☐ *Read below.*

The CFC has failed the active income test. Tick Fail at question 5 of summary sheet 2.

4 Has the CFC complied with the substantiation requirements in chapter 4?

YES ☐ *Go to question 5.* **NO** ☐ *Read below.*

The CFC has failed the active income test. Tick fail at question 5 of Summary sheet 2.

5 Is the tainted income ratio less than 0.05?

YES ☐ *The CFC passes the income test. Tick Pass at question 5 on summary sheet 2.*

NO ☐ *The CFC fails the active active income test. Tick Fail at question 5 on summary sheet 2.*

If the CFC's statutory accounting period commenced after 1 July 1997, you can use worksheet 2 to answer this question. Alternatively, use worksheet 4.

Worksheet 1

Working out your control and attribution percentages

Answer the following questions to determine:

- if a foreign company is a CFC
- if you are an attributable taxpayer in a CFC
- your attribution percentage.

In the questions that follow, the test time is the end of the statutory accounting period of the foreign company that falls within your income year, or the time at which a dividend was paid by a foreign company. Fill out a separate worksheet for each test time.

1 Have you or your associates held, or had an entitlement to acquire, any interest in a foreign company during the income year? The interest may be held directly or through other entities.

YES ☐ **NO** ☐

If you ticked no, the CFC measures do not apply.

2 Did you or your associates have an interest in the foreign company at the test time? The interest may be held directly or through other entities.

YES ☐ **NO** ☐

If you ticked no, the CFC measures do not apply.

If you ticked yes, go to question 3.

3 What was your direct control interest in the foreign company at the test time?

To work this out, take the highest of the following interests that you held, or were entitled to acquire, in the foreign company at the test time.

- percentage of the total paid-up capital of the company ____ %
- percentage of the total rights to vote, or participate in any decision making, concerning any of the following:
  - making distributions of capital or profits ____ %
  - changing the constituent documents ____ %
  - varying the share capital ____ %
- percentage of the total rights to distributions of capital of the company on winding up ____ %
- percentage of the total rights to distributions of profits on winding up ____ %
- percentage of the total rights to distributions of capital of the company other than on winding up ____ %
- percentage of the total rights to distributions of profits of the company other than on winding up. ____ %

Insert the highest percentage of the above interests here. **a** ____ %

4 At the test time, did any of your associates hold, or have an entitlement to acquire, a direct interest in the foreign company?

YES ☐ **NO** ☐

If you ticked yes, work out that interest and enter it here. **b** ____ %

5 At the test time, did you hold, or have an entitlement to acquire, an indirect control interest in the foreign company through another controlled foreign company, controlled foreign partnership or controlled foreign trust?

YES ☐ **NO** ☐

If you ticked yes, work out that interest and enter it here.
Do not include interests taken into account in question 4. **c** ____ %

6 At the test time, did any of your associates hold, or have an entitlement to acquire, an indirect interest in the foreign company?

YES ☐ **NO** ☐

If you ticked yes, work out the total of those interests and enter it here.
Do not include an interest taken into account in questions 3, 4 or 5. **d** ____ %

7 At the test time, did you have an associate-inclusive control interest of 1 per cent or more in the foreign company?
To answer this, add the following amounts:

your direct interest in the foreign company—from **a** question 3.	**a**	%
your associates' direct interest in the foreign company—from **b** question 4.	**b**	%
your indirect interests in the foreign company—from **c** question 5.	**c**	%
your associates' indirect interests in the foreign company—from **d** question 6.	**d**	%
Total of (a + b + c + d)		%

This is your associate-inclusive control interest in the CFC.

If your answer is less than 1 per cent, the CFC measures do not apply.
If it is 1 per cent or more, go to question 8.

8 At the test time, did 5 or fewer Australian entities, each with an associate-inclusive control interest of 1 per cent or more, have a total associate inclusive control interest of 50 per cent or more in the foreign company?

YES ☐ **NO** ☐

If the answer is yes, the foreign company is a CFC at the test time. Go to question 11.
If the answer is no, go to question 9.

9 At the test time, is there a single Australian entity whose associate-inclusive control interest in the company is at least 40 per cent? Tick no if the foreign company is controlled by an unassociated party or parties.

YES ☐ **NO** ☐

If the answer is yes, the foreign company is a CFC at the test time. Go to question 11.

If the answer is no, go to question 10.

10 Is the foreign company in fact controlled by a group of 5 or fewer Australian entities, alone or with associates?

YES ☐ **NO** ☐

If the answer is yes, the foreign company is a CFC at the test time. Go to question 11.

If the answer is no, the CFC measures do not apply.

11 At the test time, do you have an associate-inclusive control interest of at least 10 per cent in the CFC?

YES ☐ **NO** ☐

If the answer is yes, you are an attributable taxpayer. You have to work out the attributable income of the CFC at the test time. Go to question 13.

If the answer is no, go to question 12.

12 If the CFC is controlled by a group of 5 or fewer Australian entities, either alone or with associates, are you an Australian 1 per cent entity who is one of those 5 entities?

YES ☐ **NO** ☐

If the answer is yes, you are an attributable taxpayer. Go to question 13.

If the answer is no, the CFC measures do not apply.

13 What is your direct attribution interest in the CFC?

This is the same percentage as the direct control interest.
Copy the answer from (a) at question 3. ☐ %

Go to question 14.

14 What is the total of your indirect attribution interests in the CFC?

Do not include the interests of your associates. ☐ %

Go to question 15.

15 Add the answers to questions 13 and 14

This is your attribution percentage in the CFC at the test time. ☐ %

Worksheet 2—Working out the tainted income ratio for a CFC

You can use this worksheet to work out the tainted income ratio for a CFC. Special rules apply, however, for listed country CFCs in statutory accounting periods commencing before 1 July 1997. If these rules apply, use worksheet 4.

Show all amounts in the currency in which the accounts of the company are kept—do not convert to Australian dollars.

Part A—Working out the CFC's gross turnover

Step 1 Work out the CFC's gross revenue as shown in the CFC's accounts. Do not include income from partnerships. **a** $

Step 2 Work out the following amounts included in **a**. These amounts are to be excluded from gross turnover.

Category	Amount $
Amounts already assessed in Australia	
Amounts derived through a branch in a broad-exemption listed country	
Exempting profits part of dividend—non CFC	
Non-portfolio dividends—listed country company	
Non-portfolio dividends—unlisted country CFC	
If the CFC is a resident of a listed country, portfolio dividends from a listed country	
Dividends out of profits previously attributed	
Trust amounts	

Total → **b** $

Step 3 Work out the following gross amounts included in **a**. The net amounts are added back at step 4. Do not count amounts that fall in the categories listed in step 2.

Category	Amount $
Revenue from commodity contracts	
Revenue from exchange gains	
Revenue from other asset disposals	

Total → **c** $

Step 4 Work out net gains to be included in gross turnover. Do not count amounts that fall in the categories listed in step 2.

Category	Amount $
Net commodity gain	
Net exchange gain	
Net gain from other asset disposals	

Total → **d** $

Step 5 Work out the CFC's share of the gross turnover of partnerships in which the CFC is a partner—refer to worksheet 3.

Name of partnership	Amount $

Total → **e** $

Gross turnover (a + b + c + d + e) **A** $

Part B—Working out the CFC's gross tainted turnover

Step 1 List amounts included in the CFC's gross revenue after exclusions—item (a) from part A less items (b) and (c) from part A—that fall into the following categories of passive income.

Category of passive income	Amount $
Interest	
Annuities	
Tainted royalty income	
Tainted rental income	
Dividends	
Other passive income	

Total → **a** $

Step 2 Work out the CFC's gross revenue that is tainted sales income after exclusions—item (a) from part A less items (b) and (c) from part A. **b** $

Step 3 Work out the CFC's gross revenue that is tainted services income after exclusions—item (a) from part A less items (b) and (c) from part A. **c** $

Step 4 Work out the part of the CFC's net gains included in gross turnover that are tainted income.

Category	Amount $
Net commodity gain—from part A	
Net tainted commodity gain	
Smaller amount	

Category	Amount $
Net exchange gain—from part A	
Net tainted exchange gain	
Smaller amount	

Category	Amount $
Net gain from assets—from part A	
Net gain from tainted assets	
Smaller amount	

Total → **d** $

Step 5 Work out the CFC's share of the gross tainted turnover of partnerships in which the CFC is a partner—refer to worksheet 3.

Name of partnership	Amount $

Total → **e** $

Gross tainted turnover (a + b + c + d + e) **B** $

Part C—The tainted income ratio

The tainted income ratio is as follows:

$$\frac{\text{Amount at label B}}{\text{Amount at label A}} = \quad \textbf{C} \ \$$$

Use the amount at label C to answer question 5 of summary sheet 3.

Worksheet 3—Working out amounts from partnerships to include in the tainted income ratio

Use this worksheet if you have been referred here from worksheet 2. Use a separate worksheet for each partnership. All amounts are to be in the currency in which the accounts of the partnership are kept—do not convert to Australian dollars.

Part A—Working out the partnership's gross turnover

Step 1 Work out the partnership's gross revenue as shown in the partnership's accounts. **a** $

Step 2 Work out the following amounts which are included in **a**. Do not include these amounts in the ratio.

Category of gross revenue	Amount $
Amounts already assessed in Australia	
Amounts from a branch in a broad-exemption listed country	
Dividends out of profits previously attributed	
Trust amounts	

Total → **b** $

Step 3 Work out the following gross amounts which are included in **a**. Do not count amounts already excluded under step 2. The net amounts are added back at step 4.

Category of gross revenue	Amount $
Revenue from commodity contracts	
Revenue from exchange gains	
Revenue from other asset disposals	

Total → **c** $

Step 4 Work out net gains included in gross turnover. Do not count amounts that fall in the categories in step 2.

Category of net gain	Amount $
Net commodity gain	
Net exchange gain	
Net gain from disposal of other assets	

Total → **d** $

Gross turnover of the partnership (a – b – c + d) **A** $

Part B—Working out the partnership's gross tainted turnover

Step 1 Work out the partnership's gross revenue that is passive income after exclusions—item (a) from part A less items (b) and (c) from part A—that falls into following categories of passive income.

Category of passive income	Amount $
Interest	
Annuities	
Tainted royalty income	
Tainted rental income	
Dividends	
Other	

Total → **a** $

Step 2 Work out the partnership's gross revenue that is tainted sales income after exclusions—item (a) from part A less items (b) and (c) from part A. **b** $

Step 3 Work out the CFC's gross revenue that is tainted services income after exclusions—item (a) from part A less items (b) and (c) from part A. **c** $

Step 4 Work out the part of the partnership's net gains included in gross turnover that are tainted income.

Category	Amount $
Net commodity gain—from part A	
Net tainted commodity gain	
Smaller amount	
Net exchange gain—from part A	
Net tainted exchange gain	
Smaller amount	
Net gain from assets—from part A	
Net gain from tainted assets	
Smaller amount	

Total → **d** $

Gross tainted turnover of the partnership (a + b + c + d) **B** $

Part C—CFC's share of the gross turnover and gross tainted turnover

CFC's percentage interest in the net income of the partnership				
CFC's share of the gross turnover of the partnership	×	Label A from part A	C	**$** Use this amount to fill in step 5 of part A of worksheet 2
CFC's share of the gross tainted turnover of the partnership	×	Label B from part B	D	**$** Use this amount to fill in step 5 of part B of worksheet 2

Worksheet 4—Working out the tainted income ratio for listed country CFCs for statutory accounting periods commencing before 1 July 1997

Use this worksheet to work out the tainted income ratio for a CFC resident of a listed country for a statutory accounting period commencing before 1 July 1997. All amounts are to be in the currency in which the accounts of the company are kept—do not convert to Australian dollars.

Part A—Working out the gross turnover that is EDCI

Step 1 Work out the CFC's gross revenue that is eligible designated concession income (EDCI) as shown in the CFC's accounts. Do not include income from partnerships. **a** $

Step 2 Work out the following amounts included in **a**. Do not include these amounts in the ratio.

Category	Amount $
Amounts already assessed in Australia	
Amounts from a branch in a listed country	
Exempting profits part of dividend—non CFC	
Non-portfolio dividends—listed country company	
Non-portfolio dividends—unlisted country CFC	
Dividends out of profits previously attributed	
Trust amounts	

Total → **b** $

Step 3 Work out the following gross amounts included in **a**. Do not count amounts that fall in the categories in step 2. The net amounts are added back at step 4.

Category	Amount $
Revenue from commodity contracts	
Revenue from exchange gains	
Revenue from other asset disposals	

Total → **c** $

Step 4 Work out net gains that are EDCI and included in gross turnover. Do not count amounts that fall in the categories in step 2.

Category of net gain	Amount $
Net commodity gains	
Net tainted commodity gains from EDCI	
Smaller amount	

Net exchange gain	
Net tainted exchange gain from EDCI	
Smaller amount	

Net gain from assets	
Net gain from tainted assets	
Smaller amount	

Total → **d** $

Step 5 Work out the CFC's share of the gross turnover that is EDCI of partnerships in which the CFC is a partner—refer to worksheet 5.

Name of partnership	Amount $

Total → **e** $

Gross turnover of the CFC that is EDCI (a – b – c + d + e) **A** $

Part B—Working out the gross tainted turnover of the EDCI

Step 1 Work out the CFC's gross revenue that is passive income after exclusions—item (a) from part A less items (b) and (c) from part A.

Category of passive income	Amount $
Interest	
Annuities	
Tainted royalty income	
Tainted rental income	
Dividends	
Other	

Total → **a** $

Step 2 Work out the CFC's gross revenue that is tainted sales income after exclusions—item (a) from part A less items (b) and (c) from part A. **b** $

Step 3 Work out the CFC's gross revenue that is tainted services income after exclusions—item (a) from part A less items (b) and (c) from part A. **c** $

Step 4 Work out the part of the net gains included in gross turnover that are tainted income.

Category	Amount $
Net EDCI commodity gain—from part A	
Net EDCI tainted commodity gain	
Smaller amount	
Net EDCI exchange gain—from part A	
Net EDCI tainted exchange gain	
Smaller amount	
Net EDCI gain from assets—from part A	
Net EDCI gain from tainted assets	
Smaller amount	

Total → **d** $

Step 5 Work out the CFC's share of the gross tainted turnover that is EDCI of partnerships in which the CFC is a partner—refer to worksheet 5.

Name of partnership	Amount $

Total → **e** $

Gross tainted turnover (EDCI) of the CFC (a + b + c + d + e) **B** $

Part C—The tainted income ratio

The tainted income ratio for a CFC resident of a listed country is:

$$\frac{\text{Amount at label B}}{\text{Amount at label A}} = \quad \textbf{C} \ \$$$

Use the amount at label C to answer question 5 on summary sheet 3.

Worksheet 5—Working out amounts from partnerships to include in the tainted income ratio for listed country CFCs for statutory accounting periods commencing before 1 July 1997

Use this worksheet if you have been referred here from worksheet 4, to help you to work out the CFC's share of the gross turnover and the gross tainted turnover of a partnership.

Part A—Working out the gross turnover that is EDCI

Step 1 Work out the partnership's gross revenue that is EDCI as shown in the partnership's accounts. **a** $

Step 2 Work out the following amounts included in **a**.
Do not include these amounts in the ratio.

Category of gross revenue	Amount $
Amounts already assessed in Australia	
Amounts from branch in listed country	
Dividends out of profits previously attributed	
Trust amounts	

Total → **b** $

Step 3 Work out the following gross amounts included in **a**.
Do not count amounts that fall in the categories in step 2.
The net amounts are added back at step 4.

Category of gross revenue	Amount $
Revenue from commodity contracts	
Revenue from exchange gains	
Revenue from other asset disposals	

Total → **c** $

Step 4 Work out the part of each net gain of the partnership that is EDCI and that is included in gross turnover.
Do not count amounts that fall in the categories in step 2.

Category	Amount $
Net commodity gain	
Net EDCI commodity gain	
Smaller amount	
Net exchange gain	
Net EDCI exchange gain	
Smaller amount	
Net gain from other assets	
Net EDCI gain from other assets	
Smaller amount	

Total → **d** $

Gross turnover—EDCI—of the partnership (a – b – c + d) **A** $

Part B—Working out the gross tainted turnover that is EDCI

Step 1 Work out the partnership's gross revenue that is passive income after exclusions—item **a** from part A less items **b** and **c** from part A.

Category of passive income	Amount $
Interest	
Annuities	
Tainted royalty income	
Tainted rental income	
Dividends	
Other	

Total → **a** $

Step 2 Work out the partnership's gross revenue that is tainted sales income after exclusions—item **a** from part A less items **b** and **c** from part A. **b** $

Step 3 Work out the partnership's gross revenue that is tainted services income after exclusions—item **a** from part A less items **b** and **c** from part A. **c** $

Step 4 Work out the part of the partnership's net gains that are EDCI, included in gross turnover and tainted income.

Category	Amount $
Net EDCI commodity gain—from part A	
Net EDCI tainted commodity gain	
Smaller amount	
Net EDCI exchange gain—from part A	
Net EDCI tainted exchange gain	
Smaller amount	
Net EDCI gain from assets—from part A	
Net EDCI gain from tainted assets	
Smaller amount	

Total → **d** $

Gross tainted turnover—EDCI—of the partnership (a + b + c + d) **B** $

Part C—CFC's share of the gross turnover and gross tainted turnover—EDCI

CFC's percentage interest in the net income of the partnership

CFC's share of the gross turnover of the partnership that is EDCI × Label A from part A **C** $

Use this amount to fill in step 5 of part A of worksheet 4

CFC's share of the gross tainted turnover of the partnership that is EDCI × Label B from part B **D** $

Use this amount to fill in step 5 of part B of worksheet 4

Worksheet 6—Working out the attributable income of a CFC

Use this worksheet to work out the attributable income of a CFC and the amount to include in your assessable income.

Part A—Working out attributable income

Step 1 Summary of the notional assessable income of the CFC.

Category of notional assessable income	Amount $
Net capital gain under Part IIIA	
Interest class	
Offshore banking class	
Modified passive class	
Other class	
Total → **a**	$

Step 2 Summary of the notional allowable deductions of the CFC. The subtotal for any class of income should not be more than the amount of income shown in step 1 for that class. If you work out a higher amount, reduce it to the amount in step 1 for that class.

Class	Amount		SEXI loss		P/Y loss		Subtotal
Interest		+		+		=	
Offshore banking		+		+		=	
Modified passive		+		+		=	
Other		+		+		=	
Non-quarantined		→					
							Total → **b** $

Amount is the total of the notional allowable deductions of each class of income before any quarantining and previous years' losses. It does not include a sometimes exempt income loss.

SEXI loss is the sometimes exempt income loss of each class of income.

P/Y loss is the notional allowable deduction for previous years losses of a class of income.

Step 3	Attributable income of the CFC before any reduction for interim dividends paid—item (a) less item (b).	**c**	$
Step 4	Interim dividends paid by the CFC from the amount at item (c).	**d**	$
	Attributable income of the CFC (c – d)	**A**	$

Part B—Working out your share of attributable income

Step 1	Insert your attribution percentage in the CFC at the end of the CFC's statutory period—as previously worked out in worksheet 1.		$
Step 2	Work out your assessable income—multiply the amount at item A, from part A, by the attribution percentage.		$
Step 3	Insert the reduction amount you can claim if the CFC has income or gains which were accruals-taxed in a foreign country.		$
Step 4	Take the amount in step 3 away from the amount in step 2.	**B**	$

Section 2

Summary sheet—Transferor trust and related measures

The following summary sheet will help you to determine:

- whether a transfer or deemed transfer of property or services you have made to a non-resident trust estate is subject to the transferor trust measures and
- whether you may be liable to pay additional tax in the form of an interest charge on distributions from a non-resident trust estate.

1 **Have you, at any time, transferred any property or services to a non-resident trust estate?**

YES ☐ *Go to both questions 2 and 3.* **NO** ☐ *Go to question 13.*

Individuals, partnerships, trust estates, companies and superannuation funds also need to answer this question at the appropriate items on their tax returns.

2 **Have you, at any time, transferred any property or services to a non-resident trust estate that is a discretionary trust estate?**

YES ☐ *Go to question 4.* **NO** ☐ *Go to question 3.*

3 **Have you, after 7.30 p.m. on 12 April 1989, transferred any property or services to a non-resident trust estate that is a non-discretionary trust estate for less than an arm's length amount?**

YES ☐ *Go to question 4.* **NO** ☐ *Go to question 13.*

4 **Have you made one or more transfers to a non-resident trust estate which is a public unit trust?**

YES ☐ *Read below.* **NO** ☐ *Go to question 5.*

If none of the transfers to that public unit trust are subject to the transferor trust measures—refer to chapter 2—you are not an attributable taxpayer in relation to the public unit trust. Go to question 5.

If one or more of the transfers to the public unit trust is subject to the measures, you are an attributable taxpayer in relation to the public unit trust. Go to both questions 5 and 10.

5 **Have you made one or more transfers to a non-resident trust estate under directions contained in a deceased person's will or codicil, or a court order which varies the will or codicil?**

YES ☐ *Read below.* **NO** ☐ *Go to question 6.*

If none of the exceptions applies to any one of the transfers—refer to chapter 2—you are not an attributable taxpayer in relation to the trust estate. Go to question 6.

If one of the exceptions applies to any one of the transfers, you are an attributable taxpayer in relation to the trust estate. Go to both questions 6 and 10.

6 Have you made one or more transfers to a non-resident trust estate that is a non-resident family trust?

YES ☐ *Read below.* **NO** ☐ *Go to question 7.*

If, at all times during your income year, the trust estate:

- has been a non-resident family trust, you are not an attributable taxpayer in relation to the trust estate. Go to question 7.
- has not been a non-resident family trust, you are an attributable taxpayer in relation to the trust estate. Go to both questions 7 and 10.

7 Before migrating to Australia for the first time—provided you migrated after 12 April 1989—did you make a transfer to a non-resident trust estate before migrating?

YES ☐ *Read on.* **NO** ☐ *Go to question 8.*

If you were not in a position to control the trust estate between:

- the commencement of the first income year after you became a resident and
- the end of your current income year, you are not an attributable taxpayer in relation to the trust estate. Go to question 8.

If you were in a position to control the trust estate between the two dates mentioned above, you are an attributable taxpayer in relation to the trust estate. Go to both questions 8 and 10.

8 Did you make one or more transfers to any other non-resident trust estate that is a discretionary trust estate?

YES ☐ *Read below.* **NO** ☐ *Go to question 9.*

If none of the transfers to that discretionary trust estate are subject to the transferor trust measures, you are not an attributable taxpayer in relation to that trust estate. Go to question 9.

If one or more of the transfers to that trust estate is subject to the measures, you are an attributable taxpayer in relation to that trust estate. Go to both questions 9 and 10.

9 Did you make one or more transfers to any other non-resident trust estate that is a non-discretionary trust estate?

YES ☐ *Read below.* **NO** ☐ *Go to question 10 if you are an attributable taxpayer in relation to another non-resident trust estate. If not, go to question 13.*

If none of the transfers to the non-discretionary trust estate are subject to the transferor trust measures, you are not an attributable taxpayer in relation to that non-discretionary trust estate.

Go to question 10 if you are an attributable taxpayer in relation to another non-resident trust estate. If not, go to question 13.

If one or more of the transfers to that trust estate is subject to the measures, you are an attributable taxpayer in relation to that non-discretionary trust estate. Go to question 10.

10 **Do you have—or are you able to obtain—the necessary information to work out the net income of the non-resident trust estate?**

YES ☐ *Work out the amount of attributable income of the trust estate based on the net income calculation, then go to question 11.*

NO ☐ *Read below.*

Work out the amount of attributable income using the deemed rate of return approach. Include this amount in summary sheet 1 in section 1 of this appendix. Then go to question 13.

11 **Is the non-resident trust estate a broad-exemption listed country trust estate?**

YES ☐ *Read below.*

NO ☐ *Go to question 12.*

Work out the total attributable income of all trust estates for which you are an attributable taxpayer.

If that amount is is equal to or less than:

- $20 000 or
- 10 per cent of the total of the net incomes of each broad-exemption listed country trust estates in which you have an interest.

include in your assessable income only the attributable income of non-broad-exemption listed country trust estates. Then go to question 12.

12 **Have you worked out an amount of attributable income of a non-resident trust estate other than that excluded by question 11?**

YES ☐ *Read below.*

NO ☐ *Go to question 13.*

Include the amounts in summary sheet 1 in section 1 of this appendix. Then go to question 13.

13 **Have you received a distribution from a non-resident trust estate during your income year?**

YES ☐ *Read below.*

NO ☐ *You do not need to read on.*

Work out the amount of the distribution to include in your assessable income. Then go to question 14.

Individuals, partnerships, trust estates, companies and superannuation funds also need to answer this question at the appropriate items on their tax returns.

14 **Have you included an amount in your assessable income for a trust distribution from a non-resident trust estate during your income year?**

YES ☐ *Read below.*

NO ☐ *You do not need to read on.*

Work out the amount, if any, of the interest charge for the distribution to include in your tax return—refer to part 2 of chapter 2.

Section 3

Summary sheet

Working out the amount of foreign dividend income to include in your assessable income

Part A—Non-portfolio dividends received by a resident company from a listed country company

These dividends are always exempt from tax. Do not include them in assessable income.

Part B—Non-portfolio dividends received by a resident company from an unlisted country company

For each of these dividends, proceed as follows:

Step 1 Work out the exempting profits percentage of the dividend.

Gross amount of the dividend	**D**	$
Distributable profits of the company when the dividend was paid	**DP**	$
Amount of the exempting profits of the unlisted country company when the dividend was paid	**EP**	$
The exempting profits percentage of the dividend—that is, the gross amount of the dividend divided by the distributable profits, multiplied by the exempting profits $\left(\frac{D}{DP} \times EP\right)$	**EPP**	$

The exempting profits percentage amount of the dividend is exempt from tax.

Step 2

Take away the amount at EPP from the amount at D to get the balance of the dividend	**BalD**	$
Take away the amount of the attribution surplus (attS) for the unlisted country company when the dividend was paid	**attS**	$

This amount is exempt from tax because it is paid from previously attributed income.

Step 3

Take away the amount at attS from the amount at BalD	**RemD**	$
Add the amount of the foreign tax credit claimed on the dividend.	**RemD + FTC**	$

Include this amount in assessable income.

Part C—Foreign dividends received by a resident—other than non-portfolio dividends received by a resident company

These dividends are taxable unless the resident had an attribution surplus for the paying company at the time the dividend was paid.

Step 1	Gross amount of each dividend .	**GD**	$
Step 2	Take away the amount of any attribution surplus (attS) up to the amount of the gross dividend.	**attS**	$
	Balance of the dividend.	**BalD**	$
	Repeat steps 1 and 2 for each dividend. Include this amount in assessable income.		
Step 3	Gross amount of all dividends—other than non-portfolio dividends—where there were no attribution surpluses for the paying companies.	**GD**	$
	Include this amount in assessable income.		

Part D—Working out the amount to include in assessable income when a listed country CFC or CFT receives, directly or through other entities, a non-portfolio dividend paid by an unlisted country CFC

This part applies if you have an interest in a dividend paid by an unlisted country CFC to a listed country CFC and the dividend is not taxed at the listed country's normal company tax rate. Part D can also apply to an interest in a dividend paid by an unlisted country CFC to another unlisted country CFC if the dividend was paid as part of a dividend strip arrangement.

Step 1	Work out your attribution percentage in the CFC or CFT that receives the dividend from an unlisted country CFC.	**att%**	
Step 2	Gross amount of the dividend received by the CFC or CFT.	**D**	$
Step 3	Exempting profits percentage of the dividend—this applies only if the dividend was received by a CFC in a non-portfolio group of companies.	**EPP**	$
Step 4	Take away the amount at EPP from the amount at D to get the balance of the dividend.	**BalD**	$
Step 5	Multiply the amount of the attribution percentage by the balance of the dividend (att% x BalD).	**net BalD**	$
Step 6	Take away from the net balance of the dividend, the amount of the attribution debit—if any—that arose for the CFC in relation to the resident company when the dividend was paid (net BalD – attS).	**Bal Amt**	$

Step 7	Work out the amount of the dividend withholding tax $\left(\frac{\text{DWT}}{\text{dividend}} \times \text{Bal Amt} \right)$	**DWT Amt**	**$**
Step 8	Take away the amount at step 7 from the amount at step 6	**Div**	**$**
Step 9	Add the amount at step 8 to any foreign tax credit claimed in assessable income	**Div + FTC**	**$**

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The Editor
Public Assistance Branch
Australian Taxation Office
2 Constitution Avenue
CANBERRA ACT 2601