foreign investment funds guide

FOREIGN INVESTMENT FUNDS 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.

Feedback

Reader feedback helps us to improve the information we provide. If you have you any comments to make about this booklet, please write to:

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About this publication

This publication is available free from the Australian Taxation Office (ATO). The ATO prohibits any party from selling it. We regularly revise our publications to take account of changes to the law.

If you have an enquiry relating to your circumstances which this publication does not cover, ring the general enquiries helpline **13 2861** or get help from a tax adviser.

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

Australian Taxation Office

www.ato.gov.au

Foreign investment funds guide

Update 1999–2000

Insert the following on page 12, immediately before chapter 4.

Exemption for interests in certain FIFs resident in the United States

An exemption is available for your FIF interests in:

- an entity that is treated as a corporation and is subject to tax on its worldwide income and
- a company or trust that is treated as a regulated investment company or real estate investment trust

for the purpose of the United States internal revenue code 1986.

Subject to the conditions outlined below, an exemption is available for your FIF interests in:

- a limited partnership or a limited liability company formed under a United States law or United States State law and
- a common trust fund recognised under the United States internal revenue code 1986.

'Entity' in the following text refers to limited partnerships, limited liability companies and common trust funds.

Your FIF interests in the entity are exempt if:

- your interest in the entity is held for the sole purpose of investing in:
  - a business conducted in the United States of America (USA) or
  - real property located in the USA, and
- the entity does not:
  - have an interest in income or gains from non-USA sources
  - hold an interest in a FIF not resident in the USA or
  - hold real property outside the USA.

Your FIF interests in the entity are also exempt where:

- the above interests and property do not exceed 5 per cent of the value of the entity's total interests and
- property and the value of assets held by the entity that:
  - produce income from sources outside the USA or
  - if disposed of would give rise to a gain from a source outside the USA,

  do not exceed 5 per cent of the value of assets held by the entity.

The exemption applies to notional accounting periods of FIFs ending on and after 2 July 1998.

This exemption is also available when determining FIF income under the calculation method. The amendments to the calculation method apply to assessments for income years ending on and after 2 July 1998.

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NAT 2130U—6.2000

Australian Taxation Office

Foreign investment funds guide (NAT 2130—6.1998)

Update 2001–02

To replace step 3 on page 17

Step 3—Working out the FIF amount—box C

Once the opening deemed value has been decided, the FIF amount—that is, the movement in the value of the FIF during the notional accounting period—is worked out by applying the following formula:

$$\text{Opening value} \times \text{deemed rate of return} \times \frac{\text{number of days held}}{365}$$

Opening value is the amount worked out in step 2 on page 16.

Deemed rate of return is the same interest rate as the 'basic statutory interest rate' plus 4 per cent [section 555(2)].

The basic statutory interest rate is the monthly average yield of the 90-day bank accepted bill rate [section 214A of ITAA 1936 and section 8AAD(2) of TAA 1953].

The interest rate is published by the Reserve Bank of Australia every quarter. If 2 or more rates apply in the income year, use the weighted average of those rates.

Number of days held is the number of days in the notional accounting period in which you had the interests in the group.

Contents

Summary of how the foreign investment funds legislation could affect you

Did you have interests in a foreign company, a foreign trust or a foreign life policy?
Read chapters 2 and 5 of this guide.

NO → The FIF measures do not apply to you.

YES ↓

If you were a resident at any time during the year of income, did you:
- have an interest in a foreign investment fund (FIF) at the end of the income year or
- have an interest in a foreign life policy (FLP) at any time during the income year?

Read chapters 2 and 5 of this guide.

NO → The FIF measures do not apply to you.

YES ↓

Does an exemption apply to your interest in a FIF or FLP?
Read chapter 3 of this guide.

YES → Do not include any amount in your assessable income from the interests in that FIF.
Read chapter 8 of this guide to work out the records you need to keep.

NO ↓

Determining the amount of foreign investment fund income to include in your assessable income

There are three methods for working out taxation for an interest in a FIF and two methods for an interest in a FLP, depending on your access to certain information on the FIF or FLP.

Interest in a FIF—read chapter 4 of this guide

- The majority of taxpayers liable to tax under the FIF measures will use the market value method. See pages 13–16.
- Use the deemed rate of return method if you are unable to establish a market value for your FIF interest and you have not elected to use the calculation method. See pages 16–18.
- Use the calculation method if you have access to the financial accounts of the FIF and you are able to determine your share of the FIF's calculated profit or calculated loss. See pages 18–20.

Interest in a FLP—read chapter 5 of this guide

If you have invested in a foreign life policy, you can use:

- the deemed rate of return method or
- the cash surrender value method.

Abbreviations

ATO	Australian Taxation Office
CFC	controlled foreign company
CFT	controlled foreign trust
FIF	foreign investment fund
FLP	foreign life assurance policy
The Act	*Income Tax Assessment Act 1936*

CHAPTER 1

Introduction

Overview

A major element of Australian taxation is the comprehensive system for taxing foreign source income. The foreign investment fund (FIF) measures, introduced by the *Income Tax Assessment Amendment (Foreign Investment) Act 1992,* formed the third and final element in the development of that system. The FIF measures operated from 1 January 1993.

The first element, introduced in 1987–88, was the foreign tax credit system. The second element, introduced in 1990–91, was the foreign source income measures relating to controlled foreign companies (CFCs) and transferor trusts.

Prior to the foreign tax credit system, most foreign source income of Australian residents was exempt from taxation. With the introduction of the foreign tax credit system, most foreign income derived by a taxpayer was taxed in Australia, with a credit for the foreign tax paid.

However, the foreign tax credit system did not address the problem of Australian residents investing offshore in companies that did not declare dividends and in non-resident trusts in which the investor had no present entitlement to the trust income and which did not distribute the trust income. In the vast majority of these cases, it was obvious that income was accumulating for the benefit of the Australian investors in foreign companies and foreign trusts. However, the law was unable to tax this income as it accrued. The foreign source income measures introduced the taxation of income as it accrued to Australian residents in CFCs and controlled foreign trusts (CFTs). These measures focused on substantial investments or involvement by Australians in foreign companies and foreign trusts which were able to shelter low-taxed income.

The foreign source income measures went some way towards overcoming the tax deferral available under the foreign tax credit system. However, gaps still existed. For example, Australian residents could avoid current Australian taxation of income accumulating in the companies and trusts for their benefit if they had:

- investments in foreign companies that were not CFCs and
- an interest in, but no present entitlement to, the income of a foreign trust.

The FIF measures were introduced to reduce the extent to which Australian residents can defer Australian tax where they hold interests in foreign entities. The measures apply to income and gains accumulating in foreign companies that are not controlled by Australians or foreign trusts that fall outside the scope of the foreign source income measures. They also apply when working out the income of the CFCs and CFTs. The FIF measures extend to certain foreign life assurance policies (FLPs) that have an investment component, such as life bonds.

Additional information

Although this guide is quite comprehensive, it is not possible, in a publication of this nature, to include all of the qualifications and conditions contained in the law which may affect how you work out the amount of FIF income to include in your assessable income for a particular year.

For further information, contact the Australian Taxation Office (ATO).

CHAPTER 2

Key concepts for the FIF measures

What is a FIF?

A FIF is any foreign company or foreign trust. [SUBSECTION 481(1)]

A company is a foreign company if it is not a resident of Australia. Whether a company is a resident of Australia is a question of fact which must be decided by reference to the definition of a 'resident of Australia' in subsection 6(1) of the *Income Tax Assessment Act 1936* (the Act) and the residency provisions of any relevant double taxation agreement. [SUBSECTION 481(2)]

A trust estate is a foreign trust if it:

- is not an Australian trust and
- did not result from:
  - a will, a codicil or a court order that varied or modified a will or a codicil or
  - intestacy or a court order that varied or modified the application of the law relating to the distribution of the estates of persons who die without leaving a will. [SUBSECTION 481(3)]

What is a FLP?

A FLP is a life assurance policy issued by an entity that was a non-resident of Australia at any time in the income year.

The FIF measures apply only to certain life policies. Four categories of policies are not included in the measures. They are:

- an Australian policy, as defined by section 110 of the Act, issued by an entity authorised under the *Life Insurance Act 1995* to carry on life insurance business in Australia when it issued the policy
- policies which provide only life cover or life or permanent disability cover
- policies issued before 1 July 1992 which cannot, after that date, be cancelled, surrendered or redeemed and for which the terms have not been materially altered
- a contract of reinsurance of pure life cover between a resident insurer and a non-resident reinsurer. [SECTION 482]

What is an interest in a FIF?

An interest in a FIF is:

- a share in the company including an ordinary, a preference, a bonus, a deferred and a redeemable preference share other than an eligible finance share* or
- a legal document that confers an entitlement to acquire such a share—including an entitlement arising from an option or convertible note. [SUBSECTION 483(1)]

Your name does not have to be on a share certificate or share register of a foreign company as the legal owner of those shares. You will have an interest in a FIF if you have a beneficial interest in that FIF without the legal title to it. [SECTION 488]

An interest in a foreign trust is:

- an interest in the capital or income of the trust—including a unit in a unit trust or
- a legal document that confers an entitlement to acquire such an interest—including an entitlement arising from an option or convertible note. [SUBSECTION 483(2)]

What is an interest in a FLP?

You have an interest in a FLP if you have the legal title to the FLP. [SUBSECTION 483(3)]

Interests in a FIF or FLP subject to the FIF measures

The FIF measures apply to your interest in a FIF for a notional accounting period that ended in your income year if you:

- had an interest in a FIF at the end of the income year and
- were a resident of Australia at any time in that income year. [SUBSECTION 485(3)]

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* A share in a company is an eligible finance share if the shareholder is an Australian financial institution or subsidiary, the share was issued by the company in the ordinary course of business carried on by the shareholder and the shareholder is not an associate of the company. Section 327 of the Act has more detail.

The measures do not apply to an interest in a FIF if you dispose of that interest on or before 30 June. However, the normal provisions of the Act may apply to the interest—for example, capital gains tax.

The FIF measures apply to your interest in a FLP for a notional accounting period that ended in your income year if you:

- had an interest in a FLP at any time during that year and
- you were a resident of Australia at any time in that year. [SUBSECTION 485(4)]

As a transitional arrangement, the measures did not apply to an interest in a FLP if you disposed of that interest before 30 June 1993. [SUBSECTION 485(5)]

The FIF measures will not attribute income to a dual resident of Australia and another country where Australia has agreed, in a double taxation agreement, to treat that resident solely as a resident of the other country.

Notional accounting period of a FIF

The FIF measures apply to an accounting period of a FIF called a notional accounting period. This provides a measurement point for the application of the FIF provisions. A notional accounting period is referred to for a variety of purposes including the application of the various methods of determining FIF income and for some of the exemptions. In particular, you must return attributable income from the FIF for the notional accounting period which ends in your income year.

The notional accounting period of a FIF will generally coincide with your income year. [SUBSECTION 486(2)]

If the period for which a FIF prepares its accounts is different to your income year and this period is not more than 12 months, then you may elect for the notional accounting period of the FIF to coincide with the period for which the accounts of the FIF are prepared. This election is irrevocable for as long as you have the FIF interest. [SUBSECTIONS 486(3) and (4)]

EXAMPLE

Gary acquires an interest in a FIF on 1 March 1996. The FIF prepares its annual accounts for the accounting period 1 April to 30 March and Gary elects to align the notional accounting period with the accounting period of the FIF.

He would have to return attributable income from the FIF for the period 1 March 1996, the date of acquisition, to 30 March 1996, the end of the elected notional period, in his return for the income year ended 30 June 1996. This is because the notional accounting period of the FIF ended during the Australian financial year for which Gary is lodging his tax return.

If the FIF prepared its annual accounts for the accounting period 1 January to 31 December each year and Gary elected to align the notional accounting period with the accounting period of the FIF, he would have to return attributable income from the FIF for the period 1 March 1996—the date of acquisition—to 31 December 1996—the end of the elected notional accounting period—in his return for the year ended 30 June 1997 as that is the year in which the notional accounting period ended.

Direct investments

The FIF legislation refers to an interest that is a share in a foreign company or an interest in the capital or income of a foreign trust. Where foreign investments are personally and directly owned by an Australian taxpayer, and not through a company or a trust, the legislation does not cover physical assets such as land, livestock, plant and debt instruments, or intangibles such as goodwill, patents and copyright. Other provisions of the income tax law apply to such investments.

Bare trustee or nominee arrangements

Where a trustee holds an interest in a FIF or FLP on behalf of a beneficiary who is absolutely entitled to the interest in the FIF or FLP, the beneficiary will be taken to hold the interest under the FIF measures. [SUBSECTION 484(1)]

Deceased estates

Foreign trusts that are deceased estates are excluded from the FIF measures. For further information, see *What is a FIF?* on page 2.

Note that other trust provisions of the Act may apply to deceased estates.

CHAPTER 3

Exemptions

To allow the FIF measures to focus on cases that provide the greatest opportunity for deferral of Australian tax, there are a number of exemptions from FIF taxation.

Exemption for attributable taxpayers

The existing foreign source income measures consist of two components—the CFC measures and the transferor trust measures. These measures attribute specified income and gains of foreign companies and trusts to certain Australian residents—known as attributable taxpayers. The FIF measures may overlap with the foreign source income measures. Where this occurs the foreign source income measures apply and, in general, the FIF measures will not apply. However, the FIF measures do apply in working out the income of a CFC, CFT or transferor trust which holds an interest in a FIF. [SECTIONS 493 and 494]

Exemption for active business

The active business exemption exempts you from taxation under the FIF measures for interests you have in foreign companies principally engaged in certain active businesses, known as eligible activities. [SECTION 497]

The active business exemption does not apply to an interest in a non-resident trust. The exemption does apply, however, when working out the net income of a trust estate where the trust invests directly in a foreign company engaged in an active business.

The active business exemption also applies when working out the FIF income of a CFC or a CFT. This is because the income of a CFC or CFT is worked out as though they were a resident taxpayer.

Meaning of eligible activities

To satisfy the exemption, you must establish that the foreign company was principally engaged in one or more eligible activities. [SECTION 496]

All activities that are not named in Schedule 4 of the Act are defined as eligible activities. Mining or agriculture are eligible activities. Schedule 4 does not render them ineligible activities.

See appendix 2 *Business activities that are not eligible activities* on page 46 for more information.

There are two methods for establishing whether a foreign company is principally engaged in eligible activities:

- the stock exchange listing method and
- the balance sheet method.

If both of the methods can be applied, you may choose which one to use. [SECTION 498]

Stock exchange listing method

You may use the stock exchange listing method to decide whether a FIF is principally engaged in one or more eligible activities only where the FIF is a company. Your interest in the FIF must be included in a class of interests quoted on a stock market of an approved stock exchange. See appendix 1 *Approved stock exchanges* on page 44 for more information. [SECTION 499]

Under this method, your interests in the FIF will be exempt if you can establish that the foreign company FIF is included in a class of companies classified or designated as engaged in an eligible activity on either:

- an approved stock exchange or
- an approved international sectoral classification system. See appendix 3 *Approved international sectoral classification systems* on page 47 for more information.

Balance sheet method

The balance sheet method tests whether a foreign company was principally engaged in eligible activities by reference to its balance sheet and, if appropriate, the balance sheets of its subsidiaries. [SUBSECTION 500(1)]

A company is principally engaged in eligible activities if 50 per cent or more of the gross value of the company's assets were for use in eligible activities—the '50 per cent assets test'. [SUBSECTION 500(2)]

This percentage is worked out as follows:

$$\frac{\textbf{Gross value of the company's assets used in eligible activities}}{\textbf{Gross value of all of the company's assets}} \times \frac{100}{1}$$

The gross value of an asset is its value shown in the company's balance sheet prepared for reporting to the shareholders on an annual basis. The balance sheet test cannot be used if the balance sheet for the company was not prepared in accordance with commercially accepted accounting principles or if it does not give a true and fair view of the financial position of the company. [SUBSECTION 500(9)]

Balance sheet method and lower-tier companies

An offshore holding company may not satisfy the active business exemption in its own right under the balance sheet test if the company does not have any active business of its own. To prevent this result, the exemption allows the first-tier foreign holding company to look through to the underlying assets of certain subsidiaries.

This look-through rule is available where a holding company owns 50 per cent or more of the paid up share capital of another company:

- directly
- indirectly or
- directly and indirectly.

Companies which satisfy this requirement are referred to as subsidiaries of the holding company. [SUBSECTION 500(3)]

The look-through rule allows a holding company to look through to its share of the underlying assets of its subsidiaries. [SUBSECTION 500(3)]

The holding company treats its share of the underlying assets of its subsidiaries as its own in using the balance sheet method to claim the active business exemption. [SUBSECTION 500(3)]

There is no limit to the number of tiers of companies that a holding company may look through, provided the holding company has an interest of 50 per cent or more in each lower-tier company. [SECTION 501]

Whenever the look-through rule applies, any intercompany indebtedness in relation to the holding company and its subsidiaries is not taken into account when working out the percentage of the holding company's assets used in eligible activities. Shares held by the holding company or its subsidiaries in subsidiaries of the holding company are also not taken into account. [SUBSECTION 500(5)]

Exemption for an interest in a foreign bank

The opportunity to invest in a company FIF which is a bank without attracting FIF taxation is provided through a specific exemption.

This exemption is available for your interest in a foreign bank where the following requirements are satisfied.

- *Approved stock exchange*
  You must hold shares in the bank of a class listed on a stock exchange approved in regulation 152N, Schedule 12 of the *Income Tax Regulations* (the Regulations). See appendix 1 *Approved stock exchanges* on page 44 for more information. Unlisted shares issued by some banks as a substitute for deposits with the bank would not satisfy this criterion.
- *Trading requirement*
  The class of shares you hold in the bank must be widely held and actively traded on a regular basis on a stock market of an approved stock exchange during the period for which you are seeking the exemption.
- *Authorised to carry on banking business*
  The bank must be authorised under the law of its place of residence to carry on banking business.
- *Principally engaged in the banking business*
  The bank must be principally engaged in the active carrying on of banking business. [SECTION 503]

Exemption for an interest in a foreign holding company of a foreign bank

It is not uncommon for a banking business to be structured so that shares in the licensed bank are held by a holding company. Members of the public invest in the bank by acquiring publicly listed shares in the holding company. To allow for this, the exemption for certain shares in a publicly listed foreign bank is extended to an interest that an Australian resident holds in a holding company with a wholly owned subsidiary that is a foreign bank. [SECTION 504]

A company will qualify for the exemption from the FIF measures as a holding company of a bank if the following requirements are satisfied.

- *Approved stock exchange*
  You hold shares in the holding company of a class listed on any stock market of a stock exchange approved in regulation 152N, Schedule 12 of the Regulations. See appendix 1 *Approved stock exchanges* on page 44 for more information.
- *Designated a bank*
  The holding company is included in a class of companies designated as a bank or engaged in banking on either:
  - an approved stock exchange or
  - an approved international sectoral classification system.

  See appendix 3 *Approved international sectoral classification systems* on page 47 for more information.
- *Trading requirement*
  - The class of shares you have in the holding company must be widely held and actively traded on a regular basis on a stock market of an approved stock exchange during the period in which the exemption applies.
  - If the holding company has only one subsidiary, that subsidiary must be wholly owned and have been principally engaged in the active carrying on of a banking business.
  - If the holding company has more than one subsidiary, the principal activities of the wholly owned subsidiaries in the group, taken together as an economic unit, must be the active carrying on of a banking business.

In each case, the subsidiary or, where there is more than one subsidiary, at least one of the wholly owned subsidiaries must be authorised under the law of its place of residence to carry on banking business.

Exemption for an interest in a foreign life insurance company

The opportunity to invest in a foreign life insurance company without attracting FIF taxation is provided through a specific exemption. [SECTION 506]

A foreign company is considered to be engaged in life insurance business as defined in the *Life Insurance Act 1995* only if:

- the company is authorised in its country of residence to carry on life insurance business and
- the balance sheet of the company shows that at least 50 per cent of the gross value of the company's assets were for use in carrying on life insurance business. [SECTION 507]

Look-through rule

The foreign life insurance company may have an interest in a subsidiary company. Accordingly, the measures provide a look-through rule to a 50 per cent owned subsidiary. The subsidiary's assets are looked at to decide whether the foreign life insurance company passes the 50 per cent assets test. [SUBSECTIONS 507(3) to (11)]

Exemption for an interest in a foreign holding company of a foreign life insurance company

A company will qualify for the exemption from the FIF measures as a holding company of a life insurance company if the following requirements are satisfied.

- *Approved stock exchange*
  You must hold shares in the holding company of a class listed on any stock market of a stock exchange approved in regulation 152N, Schedule 12 of the Regulations. See appendix 1 *Approved stock exchanges* on page 44 for more information.
- *Designated a life insurance company*
  The holding company is included in a class of companies designated as engaged in life insurance on either:
  - an approved stock exchange or
  - an approved international sectoral classification system. See appendix 3 *Approved international sectoral classification systems* on page 47 for more information.
- *Trading requirement*
  - The class of shares you have in the holding company must be widely held and actively traded on a regular basis on a stock market of an approved stock exchange during the period in which the exemption applies.
  - If the holding company has only one subsidiary, that subsidiary must be wholly owned and have been principally engaged in the active carrying on of life insurance business.

- If the holding company has more than one subsidiary, each must be wholly owned and the principal activities of the subsidiaries in the group, taken together as an economic unit, must be the active carrying on of life insurance business.

In each case, the subsidiary or, where there is more than one subsidiary, at least one of the wholly owned subsidiaries must be authorised under the law of its place of residence to carry on life insurance business.

Whether the subsidiary or subsidiaries were principally engaged in the active carrying on of life insurance business is decided by a balance sheet test. This test requires that at least 50 per cent of the gross value of the company's assets were for use in carrying on life insurance business as defined in section 11 of the *Life Insurance Act 1995*.
[SECTION 507A].

Exemption for an interest in a foreign general insurance company

An exemption is provided to an Australian resident for shares in a publicly listed general insurance company where the following requirements are satisfied.

- *Approved stock exchange*
  Shares you hold in the company must be of a class listed on any stock market of a stock exchange approved in Schedule 3 of the Act. See appendix 1 *Approved stock exchanges* on page 44 for more information.
- *Trading requirement*
  The class of shares you hold in the company must be widely held and actively traded on a regular basis on a stock market of an approved stock exchange during the period in which the exemption applies.
- *Authorised to carry on general insurance business*
  The general insurance company must be authorised under the law of its place of residence to carry on general insurance business. This requirement ensures that the company meets regulatory requirements for general insurance businesses in its country of residence.
- *Principally engaged in general insurance business*
  An additional requirement is that the general insurance company is principally engaged in the active carrying on of general insurance business during the period in which the exemption applies.
  [SECTION 509]

Exemption for an interest in a foreign holding company of a foreign general insurance company

A company will qualify for the exemption from the FIF measures as a holding company of a general insurance company if the following requirements are satisfied.

- *Approved stock exchange*
  The shares you have in the holding company must be of a class listed on any stock market of a stock exchange approved in Schedule 3 of the Act. See appendix 1 *Approved stock exchanges* on page 44 for more information.
- *Designated a general insurance company*
  The holding company is included in a class of companies designated as engaged in general insurance on either:
  - an approved stock exchange or
  - an approved international sectoral classification system. See appendix 3 *Approved international sectoral classification systems* on page 47 for more information.
- *Trading requirement*
  - The class of shares you have in the holding company must be widely held and actively traded on a regular basis on a stock market of an approved stock exchange.
  - If the holding company has only one subsidiary, that subsidiary must be wholly owned and be principally engaged in the active carrying on of general insurance business.
  - If the holding company has more than one subsidiary, each subsidiary must be wholly owned and the principal activities of the wholly owned subsidiaries in the group, taken together as an economic unit, must be the active carrying on of general insurance business.

- – The subsidiary or, where there is a group of subsidiaries, at least one of the wholly owned subsidiaries must be authorised under the law of its place of residence to carry on general insurance business. [SECTION 509A]

Exemption for an interest in a foreign company engaged in certain activities connected with real property

A specific exemption is provided for an interest consisting of shares in a publicly listed company whose activities are connected with commercial real property where the following requirements are satisfied.

- *Approved stock exchange*
  You hold shares in the company of a class listed on any stock market of a stock exchange approved in regulation 152N, Schedule 12 of the Regulations. See appendix 1 *Approved stock exchanges* on page 44 for more information.
- *Trading requirement*
  The class of shares you hold in the foreign company must be widely held and actively traded on a regular basis on a stock market of an approved stock exchange during the period in which the exemption applies. [SECTION 511]

Foreign company principally engaged in real property activities

The company must be principally engaged in the active carrying on of one or more activities connected with real property. This requires that the foreign company be principally engaged in one or more of the specified activities, which are:

- construction
- development of real property through capital improvement
- receipt of rental income from commercial real property owned by the foreign company where the management, maintenance and security services for the commercial property are principally provided by directors or employees of the foreign company or by a wholly owned subsidiary that is principally engaged in providing those services through its directors and employees
- provision of management services through directors or employees of the foreign company
- acting as agent for the sale or purchase of commercial real property. [SUBPARAGRAPH 511(b)(ii)]

Exemption for an interest in a foreign holding company of a foreign real property company

A company will qualify for the exemption from the FIF measures as a holding company of a real property company if the following requirements are satisfied.

- *Approved stock exchange*
  You hold shares in the holding company of a class listed on any stock market of a stock exchange approved in regulation 152N, Schedule 12 of the Regulations. See appendix 1 *Approved stock exchanges* on page 44 for more information.
- *Designated a real property company*
  The holding company is included in a class of companies designated as engaged in one or more of the activities mentioned above on either:
  - – an approved stock exchange or
  - – an approved international sectoral classification system. See appendix 3 *Approved international sectoral classification systems* on page 47 for more information.
- *Trading requirement*
  - – The class of shares you have in the holding company must be widely held and actively traded on a regular basis on a stock market of an approved stock exchange.
  - – If the holding company has only one subsidiary, that subsidiary must be wholly owned and be principally engaged in the active carrying on of one or more of the activities mentioned above that are connected with real property.
  - – If the holding company has more than one subsidiary, each subsidiary must be wholly owned and the principal activities of the wholly owned subsidiaries in the group, taken together as an economic unit, must be the active carrying on of one or more of the activities mentioned above. [SECTION 511A]

Exemption for an interest in foreign trusts

Recent reforms in emerging markets have liberalised investment rules. Australians can now directly invest on the stock market of countries that previously restricted their investment. Therefore the exemption for interest in foreign trusts or funds previously listed in appendix 4 or regulation 152M, Schedule 11 of the Regulations, is no longer required and ceased on 31 December 1996. Investments previously exempt under the foreign trust exemption must now comply with either the active business or another exemption to obtain relief from taxation under the FIF measures. The foreign trusts previously exempt are listed in appendix 4 on page 47. [SECTION 513]

Exemption for an interest of $A50 000 or less

A small investor exemption is provided for both direct and indirect interests in FIFs. The exemption is only available if you are a natural person and your interest, together with those of your associates, in FIFs, FLPs and resident public unit trusts is $A50 000 or less at the end of the financial year. [SECTIONS 96A and 515]

Associates

An associate includes:

- your spouse, but does not include your spouse who, although legally married to you, has been living separately and apart from you for at least 12 months
- your child, whether or not the child lives with you
- your stepchild who lives with you
- your partner in a partnership and a spouse or child of the partner
- a trustee of a trust, other than a public unit trust or an eligible Part IX entity—broadly, a superannuation fund, an approved deposit fund or a pooled superannuation trust—if you or an associate benefit under the trust and
- a company in which you and your associates have a majority voting interest or which is sufficiently influenced by your and your associates.

If you are under 18 years of age, your associates include, in addition to the above:

- your parents and
- your brother or sister. [SECTION 491]

EXAMPLE

Exemption for an interest of $A50 000 or less

Direct interests of the taxpayer and associates in FIFs and FLPs	*Direct interests of the taxpayer and associates in resident public unit trusts*	*Total of interests in FIFs, FLPs and resident public unit trusts*	*Application of the small investor exemption to the taxpayer's direct interests in FIFs and FLPs*	*Application of the small investor exemption to the taxpayer's interests in resident public unit trusts*
$30 000	$15 000	$45 000	Exemption applies—taxpayer's direct interests in FIFs and FLPs are exempt from the FIF measures.	Exemption applies—taxpayer's share of the resident public unit trust's net income does not include those amounts which relate to FIF income of the trust.
$26 000	$25 000	$51 000	Exemption applies—taxpayer's direct interests in FIFs and FLPS are exempt from the FIF measures.	Exemption does not apply—taxpayer's share of the net income of the resident public unit trust includes those amounts which relate to FIF income of the trust.
$50 000	$1000	$51 000	Exemption applies—taxpayer's direct interest in FIFs and FLPS are exempt from the FIF measures.	Exemption does not apply—taxpayer's share of the net income of the resident public unit trust includes those amounts which relate to FIF income of the trust.
nil	$60 000	$60 000	Exemption applies—taxpayer's direct interests in FIFs and FLPS are exempt from the FIF measures.	Exemption does not apply—taxpayer's share of the net income of the resident public unit trust includes those amounts which relate to FIF income of the trust.

Direct interests in FIFs and FLPs

Where the direct interests in FIFs and FLPs of you and your associates are $A50 000 or less, the FIF taxation provisions do not apply. [SUBSECTION 515(1)]

Direct interests in resident public unit trusts

This test measures the interests in Australian resident public unit trusts, FIFs and FLPs of you and your associates. Where the total of these interests is $A50 000 or less, your share of the net income of the resident public unit trust will not include any amount included in the net income of the trust under the FIF measures because of the FIF interests held by the trust. If the interests are more than $50 000 under both tests, then the exemption is not available. The example on page 9 sets out how the exemption applies. [SUBSECTION 96A(2)]

Exemption for visitors to Australia

The FIF measures do not apply to you if you are a natural person who is a resident of Australia for an income year if you satisfy all of the following conditions.

- You have a temporary entry visa granted under the *Migration Act 1958.*
- The period of time from the issue date of the first entry visa which is current until its expiry date is 4 years or less. Where the current visa was issued as an extension of an earlier visa, the period of time from the issue date of the earliest visa until the expiry date of the current visa is 4 years or less.
- You are not awaiting the outcome of an application for permanent residency under the *Migration Act 1958.*

A new entry visa or permit issued under the *Migration Act 1958* as an extension of the original entry visa or permit is considered to be an extension of the original visa or permit.

New Zealand citizens

You are also excluded from the FIF measures under this exemption if you:

- are a New Zealand citizen
- have not lived in Australia for more than 4 years
- do not intend to reside in Australia permanently. [SECTION 517]

Exemption for employer-sponsored foreign superannuation

This exemption is available to you if you are a natural person with an interest in a FIF that is an employer-sponsored superannuation fund. The FIF must be a superannuation fund maintained by your employer, or an associate of your employer, for the benefit of their employees. Also, you must be an employee or former employee of the employer. [SECTION 519]

Exemption for an interest in a FIF that is trading stock

Where an interest in a FIF forms part of your trading stock and you elect, under the trading stock provisions of the Act or section 70 of the *Income Tax (Transitional Provisions) Act 1997*, to bring those interests to account at market value, you are not subject to FIF taxation on income accruing from that interest. [SECTION 521]

If you bring an interest in a FIF to account as trading stock but do not avail yourself of the election, a change to the valuation methods available in the trading stock provisions will apply. The change will prevent movement between the methods of valuation and will require closing stock for the 1991–92 and subsequent income years to be valued consistently at cost. One exception to this treatment is where you used market value or replacement value for the opening value of an article of trading stock that is a FIF interest at the start of 1991–92. In this case, you use that value for that FIF interest.

This exemption is not available to a CFC that has an interest in a FIF as part of its trading stock. This is because a CFC cannot elect to value its trading stock at anything but cost when working out its attributable income under Part X of the Act. For further information, refer to *Taxation Determination TD96/39.* [SUBSECTION 31(7)]

Exemption for an interest in a multi-industry foreign company

Your interest in a multi-industry foreign company is exempt from FIF taxation if the foreign company is principally engaged in two or more of the following activities:

- construction

- development of real property through capital improvement
- receipt of rental income from commercial real property owned by the company where the management, maintenance and security services for the property are principally provided by the directors or employees of the company or by a wholly owned subsidiary that is principally engaged in providing those services through the directors and employees of that subsidiary
- provision of management services for real property by the directors or employees of the company
- acting as agent in connection with the sale or purchase of commercial real property
- general insurance business of a kind that the company was authorised to carry on under the law of its place of residence
- life insurance business of a kind that the company was authorised to carry on under the law of its place of residence
- activities that allow an exemption under the active business exemption, discussed on pages 4, 5 and 6. [SUBPARAGRAPH 523(b)(ii)]

In addition to being involved in certain activities, the foreign company must be listed on a stock market of any approved stock exchange. The class of shares you hold in the foreign company must be widely held and actively traded on a regular basis on a stock market of an approved stock exchange during the period in which the exemption applies to you. A list of approved stock exchanges is contained at Schedule 12 of the Regulations. See appendix 1 *Approved stock exchanges* on page 44. [SECTION 523]

Exemption for an interest in a foreign holding company of a foreign mixed activity company

Your FIF interest will qualify for the exemption from the FIF measures as a holding company if the following requirements are satisfied. [SECTION 523A]

- *Approved stock exchange*
  Your shares in the holding company are of a class listed on any stock market of a stock exchange approved in Schedule 12 of the Regulations. See appendix 1 *Approved stock exchanges* on page 44.
- *Trading requirement*
  - The class of shares you have in the holding company must be widely held and actively traded on a regular basis on a stock market of an approved stock exchange.
  - If the holding company has only one subsidiary, that subsidiary must be wholly owned and have been principally engaged in actively carrying on two or more of the activities mentioned above or in subparagraph 523(b)(ii).
  - If the holding company has more than one subsidiary, the principal activities of the wholly owned subsidiaries in the group, taken together as an economic unit, must be the active carrying on of two or more of the activities mentioned above or in subparagraph 523(b)(ii).

Exemption for underwriting members of Lloyd's

If you are an underwriting member of Lloyd's and have an interest in assets that form part of a Lloyd's Premiums Trust Fund, you are exempt from taxation for FIF income from that interest. Funds which qualify as Premiums Trust Funds are referred to in section 83 of the *Insurance Companies Act 1982* of the United Kingdom. [SECTION 527]

Exemption for a balanced investment portfolio in FIFs

If you invest in a wide spread of shares in foreign companies, you may find that your investments in non-exempt FIF activities may typically be less than 5 per cent of your investment portfolio. Because these cases of portfolio diversification involve minimal scope for deferral, an exemption is provided for investments in non-exempt FIF activities if their aggregate value is not more than 5 per cent of the value of your total investments in FIFs.

For the purposes of this exemption, your total investments do not include your interests which, at the end of a notional accounting period, are excluded from the FIF measures because of exemptions for:

- the attributable taxpayer—see page 4
- interest in an employer-sponsored superannuation fund—see page 10.

You value your FIF interests at the end of the income year at cost or market value, whichever is the greater. [SECTION 525]

There are no restrictions on the types of FIFs that are eligible for this balanced portfolio exemption. The FIFs may include non-exempt activities such as financial services. They may or may not be listed on any stock exchange, approved or otherwise. They may also include trusts.

In the example below, Marika's interests in FIFs are excluded from the FIF measures because her interests in non-exempt FIFs—the foreign funds management company and the Swedish Foreign Trust—are not more than 5 per cent of her total FIF interests.

The United Kingdom superannuation fund is not included when working out total FIF interests, as it is an employer-sponsored superannuation fund.

EXAMPLE

Investments in FIFs

Marika's FIF interest	*Amount invested in FIFs*	*Exempt FIFs: percentage of total investments*	*Non-exempt FIFs: percentage of total investments*
Company X—exempt shares listed on Athens stock exchange	\$25 000	$\frac{\$25\,000}{\$171\,000} \times \frac{100}{1}$ = 14.6%	
Foreign funds management company—non-exempt	\$ 3 000		$\frac{\$3\,000}{\$171\,000} \times \frac{100}{1}$ = 1.8%
Company Y—satisfies active business exemption	\$75 000	$\frac{\$75\,000}{\$171\,000} \times \frac{100}{1}$ = 43.9%	
United Kingdom employer superannuation fund	\$150 000	*This is a Division 11 amount and is not included in the total of FIF investments*	
Bank of United States—satisfies bank exemption	\$63 000	$\frac{\$63\,000}{\$171\,000} \times \frac{100}{1}$ = 36.8%	
Swedish Foreign Trust—non-exempt	\$5 000		$\frac{\$5\,000}{\$171\,000} \times \frac{100}{1}$ = 2.9%
Total	\$171 000	95.3%	4.7%

CHAPTER 4

Methods of FIF taxation

You must work out the FIF or FLP income accruing to you separately for each FIF or FLP in which you hold an interest or interests.

Use one of the following methods to decide the amount of FIF income accruing to you from a FIF company or trust during a notional accounting period:

- market value method
- deemed rate of return method
- calculation method.

It is expected that the majority of taxpayers who will be liable to tax under the FIF measures will use the market value method to work out the FIF income to include in their assessable income. You would use the deemed rate of return method only where you are unable to establish a market value for your FIF interest and you have not elected to use the calculation method. You may use the calculation method if you have access to the financial accounts of the FIF and are able to determine your share of the FIF's calculated profit or calculated loss.

If you use the calculation method for a FIF you must also elect the 12 month accounting period used by that FIF as its notional accounting period. [SUBSECTIONS 486(3) and 535(5)]

There are two methods for determining the amount of FIF income that accrues from an interest in a FLP:

- the deemed rate of return method and
- the cash surrender value method.

The method you adopt will depend upon the access you have to information on the company or trust in which you hold an interest.

Part-year resident

Where you are a resident of Australia for a part or parts of an income year in which a notional accounting period of a FIF or FLP ended, then the amount of FIF income assessable to you is worked out using the following formula:

$$\textbf{FIF income} \times \frac{\textbf{Number of days of residence}}{\textbf{Total number of days}}$$

FIF income means the amount of FIF income that accrued to you from the FIF or FLP during the notional accounting period under one of the methods of working out FIF income.

Number of days of residence means the number of days in the notional accounting period of the FIF or FLP that you were a resident of Australia.

Total number of days means the total number of days in the notional accounting period. [PARAGRAPH 529(2)(b)]

Value for the acquisition or disposal of an interest in a FIF or FLP

In determining FIF income, if you acquire or dispose of interests in a FIF or FLP for no consideration or inadequate or excessive consideration, you must value the interests at market value. The valuation is to occur at the time of acquisition or disposal of the interests. [SECTION 490]

Market value method

Overview

Under the market value method, the amount of FIF income is decided in two steps. The first step works out the movement in the market value of the FIF interest, generally between two annual reporting dates. The second step allows for the deduction of any previous year's FIF losses if the losses have not been used in an earlier year. Working through these steps gives you the amount of FIF income to include in your assessable income.

The following information will help you to complete Worksheet 1 *Market value method* on page 48.

Step 1—Working out the movement in the market value [SECTION 538]

Box A

Insert the market value of your interests in the FIF on the last day of the notional accounting period.

Box B

Insert the total value of distributions to you by the FIF during the notional accounting period for the interests held on the last day of the notional accounting period. Where you dispose of an interest in a FIF during the notional accounting period, also include the value of distributions made by the FIF before disposal.

Box C

Insert the opening market value at the beginning of the notional accounting period of the interests held on the last day of the notional accounting period.

Box D

Insert the total cost of any interests in the FIF which you acquired during the notional accounting period and held on the last day of that period.

Usually, you must express the amounts in boxes B, C and D in the currency you used for the amount in box A. [SUBSECTION 538(3)]

However, the market value method provides you with an irrevocable election to use Australian currency in working out all your FIF income. This brings to account currency exchange gains and losses at the time the transactions and values relevant to the determination of FIF income occurred. If you make the election, you must express the amounts in boxes A to D in Australian currency. [SUBSECTIONS 538(4) and (5)]

Exchange rates for FIF values	
Use exchange rates applicable on the following days for the market value method	*when converting the following to Australian currency*
Last day of each relevant notional accounting period for each FIF interest	market value of a FIF interest
Day of each distribution made by a FIF	distribution made by a FIF
Day you acquired the FIF interest	acquisition value of a FIF
Last day of the notional accounting period of the FIF for the relevant income year	excess of FIF income over FIF losses
Last day of the notional accounting period of the FIF in which the loss occurred	FIF loss
Last day of the notional accounting period of the FIF	FIF losses to the same currency as the gross FIF income—*not necessarily Australian currency*

Box E

Take away the sum of C and D from the sum of A and B. This is the FIF amount.

- *Gross FIF income*

  If the FIF amount is positive, that amount represents the gross FIF income of the FIF as it relates to you. [SECTION 540]

- *FIF loss*

  If the FIF amount is negative, a FIF loss has occurred. This FIF loss may be used to offset your assessable income, but only to the extent that you have previously been subject to FIF taxation from that FIF—that is, to the extent that you have a FIF attribution surplus in relation to that FIF.

  Where there is no FIF attribution surplus the FIF loss must be carried forward to be applied against future gross FIF income of that FIF. You cannot use a FIF loss in relation to one FIF to reduce the gross FIF income of another FIF. [SECTIONS 532 and 541]

Step 2—working out the amount to include in assessable income

Box F

Insert the total of any unapplied previous FIF losses. [SUBSECTION 542(2)]

If it is not already the case, you must convert the unapplied previous FIF loss to the same currency as the gross FIF income—that is, the amount in box E. [SUBSECTION 542(8)]

Unapplied previous FIF loss

An unapplied previous FIF loss is the amount by which the undeducted amount of a foreign investment fund loss is more than the sum of any gross FIF income from your interest in a particular FIF. [SUBSECTION 542(6)]

The undeducted amount of a FIF loss referred to above is the amount of a FIF loss that has not been allowed as a deduction from your assessable income. [SECTION 532 and SUBSECTION 542(6)]

You may include losses that arose in relation to the FIF even though one of the following FIF exemptions applied:

- an attributable taxpayer—see page 4
- a foreign company engaged in active business—see page 4
- a foreign bank—see page 5
- a life insurance company—see page 6

- a general insurance company—see page 7
- certain companies engaged in commercial activities associated with real property—see page 8
- small investors—see page 9
- employer-sponsored superannuation—see page 10.

Once you have used a FIF loss to work out if there was, for any notional accounting period, an unapplied previous FIF loss, you cannot use that loss again in later notional accounting periods. [SUBSECTION 542(7)]

In working out your unapplied previous FIF losses, apply only that gross FIF income accruing after the notional accounting period in which you incurred the loss and before the current notional accounting period in which you have a gross FIF income. [SUBSECTION 542(5)]

Box G

Take away the amount in F from the amount in E. This gives you your FIF income.

Box H

Convert your FIF income to Australian dollars at the rate of exchange applying at the end of the relevant notional accounting period. Insert the converted amount at H.

The amount at H is your FIF income. Include it in your assessable income after allowing for a reduction for assessable distributions from the FIF. Read chapter 6 *Avoiding double taxation* on page 25 for more information.

Boxes I, J and K

If any of the distributions referred to above are dividends, interest payments or trust distributions, or your FIF interest relates to shares acquired under an employee acquisition scheme—see *Reduction of FIF income for FIF interests acquired under an employee share scheme* on page 25—use I, J and K to arrive at the amount to include in your assessable income. [SECTIONS 530, 530A and 603]

If you are entitled to a reduction of FIF income, add the amount of the reduction to any amount at J.

Determining market value

You determine market value by referring to the quoted market values for the FIF interests. Only quotations from an approved stock exchange will be accepted. See appendix 1 *Approved stock exchanges* on page 44. [SECTION 539]

For FIFs that are not listed on an approved stock exchange, you may use

- a buy-back, offer or redemption price or
- the price of an offer to purchase a particular FIF by an associate of that FIF.

The buy-back, offer or redemption price must be:

- publicly available
- offered to all persons having an interest of that class in the FIF
- worked out by reference to the market value of the assets of the company or trust
- of an amount that independent parties would accept.

Worksheet 1 *Market value method* on page 48 will help you to understand the following examples.

EXAMPLE

FIF income included in assessable income

The opening value of a FIF interest, at 1 July, was $HK50 000 (C). At the end of the notional accounting period, 30 June, the closing value of the interest was $HK53 000 (A). There were no brought forward losses or acquisitions or disposals during the notional accounting period (D). On 30 April, during the notional accounting period, there was a distribution—interim dividend—of $HK1000 (B). The FIF amount, as worked out in Step 1 is:

[$HK53 000 (A) + $HK1000 (B)] – [$HK50 000 (C) – nil (D)]

= $HK4000 (E)

This amount is converted to Australian currency, using the rate of exchange that applied at the end of the notional accounting period, 30 June. If the exchange rate is $A1.00 = $HK5.00, the FIF income is $A800—that is, $HK4000 divided by 5.

The distribution of $HK1000 = $A200 and is assessable under section 44 of the Act.

Applying subsection 530(1), the FIF income of $A800 is reduced by the amount of the distribution of $A200. Therefore, your assessable income would include $A600 FIF income.

EXAMPLE

Unapplied previous FIF loss

The opening value of a FIF interest was $HK50 000 (C) and, at the end of the notional accounting period, 30 June, the closing value of the interest was $HK45 000 (A). There were no brought forward losses or acquisitions, disposals (D) or distributions (B) during the accounting period. The decrease in market value—that is, the FIF amount—would be:

[$HK45 000 (A) + nil (B)] – [$HK50 000 (C) – nil (D)]

= $HK5000 (E)

This FIF loss of $HK5000 may be used to reduce gross FIF income in later years.

Deemed rate of return method

You may use this method where you cannot apply the market value method.

The following four steps will help you to complete Worksheet 2 *Deemed rate of return method for FIFs* on page 49.

Step 1—Group your interests

Apply the deemed rate of return method separately to each group of interests. Determine the group or groups of interests you hold in a FIF at the end of the FIF's notional accounting period. [SECTION 544]

Meaning of a group of interests in a FIF

If you had only one interest in a FIF during the notional accounting period, that interest is a group. [SUBSECTION 544(2)]

Interests in a FIF that are of the same class—for example, two parcels of class A shares—and which you held during the same period, are treated as a group of interests. However, if interests are of different classes—for example, class A and B shares with different rights—you would treat each class as a separate group. Shares of the same class which are not held for the same period during the FIF's notional accounting period also form different groups. If you had two or more interests in a FIF that are not of the same group of interests, apply the deemed rate of return method separately to each group. [SUBSECTIONS 544(3), (4) and (5)]

Step 2—Working out the opening value—box A

This step determines the opening value of your interest in the FIF at the beginning of the notional accounting period.

Opening value where the interests in a FIF were acquired during a notional accounting period

If you acquired the interests in a FIF during the notional accounting period, the opening value of the interests is the consideration you paid or gave for the acquisition. [SECTION 554]

Opening value where the deemed rate of return method applied in the previous year

Where you applied the deemed rate of return method to a group of FIFs in the immediately previous notional accounting period, work out the opening value of the FIF for the current period as follows:

- use the opening value of the group of FIFs at the beginning of the previous period
- add the FIF income for the previous notional accounting period
- take away any distributions made by the FIF in the previous notional accounting period. [SECTION 551]

Distributions include any amount paid or credited or property distributed to you by the FIF, either as income or capital. They include the issue to you of further interests in the FIF in lieu of your entitlement to a payment by the FIF.

Distributions do not include the issue to you of further interests where you do not pay consideration or forgo payment in exchange for those further interests. [SECTION 474]

Opening value where the market value method applied in the previous year

If the market value method applied in the immediately previous notional accounting period, the opening value for the current year is the market value of the interest in the FIF at the end of that period. [SECTION 553]

Opening value where the calculation method or an exemption applied in the previous year

Where the calculation method or an exemption from FIF taxation applied or the operative provision did not apply in the immediately previous notional accounting period, use one of the following methods to decide the opening value for the current period.

- Where the FIF interest was quoted on an approved stock exchange at any time during the immediately previous notional accounting period, use the quoted price for the latest day of that period as the opening value for the current period.

- If the FIF interest was not quoted on an approved stock exchange on the last day of the previous notional accounting period, begin with the original consideration paid and apply the deemed rate of return notionally to every notional accounting period, from the date of acquisition up to the immediately previous notional accounting period. This determines an opening value for the current period. [SECTION 552]

Previous year losses

When you switch to the deemed rate of return method, the legislation does not allow you to apply previous year FIF losses that you accumulated under either the calculation method or the market value method.

Step 3—Working out the FIF amount—box C

Once the opening deemed value has been decided, the FIF amount—that is, the movement in the value of the FIF during the notional accounting period—is worked out by applying the following formula. [SECTION 555]

$$\text{Opening value} \times \text{Deemed rate of return} \times \frac{\text{Number of days held}}{365}$$

Opening value means the amount worked out in Step 2 on page 16.

Deemed rate of return means the same interest rate as the 'basic statutory interest rate' plus 4 per cent. As the basic statutory interest rate is the 13 week Treasury Note yield less 4 per cent, effectively the deemed rate of return will be the same as the Treasury Note yield. [SECTION 214A]

If two or more rates apply in the income year, use the weighted average of those rates.

The interest rate is published by the Commissioner of Taxation in the Commonwealth gazette for government notices each June and December for the subsequent six-month period.

Number of days held means the number of days in the notional accounting period in which you had the interests in the group.

Step 4—Determining the amount of FIF income to include in assessable income

The final step in applying the deemed rate of return method is to convert the FIF amount to Australian currency. [SECTIONS 556 and 557]

Use the rate of exchange that applied at the end of the notional accounting period to convert the FIF amount worked out in step 3 for each group of interests to the corresponding amount in Australian currency. If there is only one group of interests, the FIF income will be the amount converted into Australian currency. If there is more than one group, the FIF income will be the total of the FIF amounts. [SECTION 556]

Include the FIF income in your assessable income subject to reduction by certain assessable distributions from the FIF. [SECTIONS 529 and 557] See *Reduction of FIF income for distributed profits* on page 25 for more information.

EXAMPLE

On 1 January 1997, Harold acquired 2000 Class A shares and 1000 Class B shares in a Hong Kong company. Each class of shares is a different group. The parcel of Class A shares had a value of $HK200 000 and the parcel of Class B shares had a value of $HK100 000. He worked out his FIF income under the deemed rate of return method as follows:

$$\textbf{Opening value} \times \textbf{10.5\%} \times \frac{\textbf{Number of days held}}{\textbf{365}}$$

Class A shares: $\$HK200\ 000 \times 10.5\% \times \frac{181}{365}$

FIF amount: $HK10 414

Class B shares: $\$HK100\ 000 \times 10.5\% \times \frac{181}{365}$

FIF amount: $HK5207

The FIF amounts for the groups are $HK10 414 and $HK5207. The opening deemed value of the parcel of Class A shares for the following notional accounting period would be $HK210 414 and the opening deemed value of the parcel of Class B shares for the following notional accounting period would be $HK105 207.

Harold acquired 1000 Class C shares on 1 October 1996, 92 days into the FIF's notional accounting period, for $HK240 000. He applied the deemed rate of return method for the group constituted by the Class C shares as follows:

$$\textbf{Opening value} \times \textbf{10.8\%*} \times \frac{\textbf{Number of days held}}{\textbf{365}}$$

Class C shares: $\$HK240\,000 \times 10.8\% \times \frac{273}{365}$

FIF amount: $HK19 387

Assume that the exchange rate is $A1.00 = $HK5.00. The FIF income for the three groups of A, B and C class shares is the sum of:

Class A shares:	$\frac{\$HK\ 10\,414}{5}$	$A2083
Class B shares:	$\frac{\$HK\ 5207}{5}$	$A1041
Class C shares:	$\frac{\$HK\ 19\,387}{5}$	$A3877
Total FIF income		$A7001

Harold included $A7001 in his assessable income. [SECTION 529]

*10.8% = weighted average of two 6-monthly rates [(11.5 × 92/273) + (10.5 × 181/273)]

Calculation method

Overview

This method requires you to work out the calculated profit or calculated loss of a FIF for a notional accounting period. You will need access to detailed information about your FIF interest. The calculation method uses a simplified version of our taxation law to work out the profit of your FIF which is then attributed to you and included in your assessable income. The calculation method applies to foreign companies and foreign trusts. [SECTIONS 580 and 582]

If there is a calculated loss, you may carry your share forward and take it into account for subsequent notional accounting periods. If there is a calculated profit, you must determine your share. You do this by multiplying the calculated profit of the FIF for the notional accounting period by your percentage interest in the FIF at the end of that period. Work out the calculated profit or loss in the currency of the FIF accounts and then convert the amount to Australian currency at the exchange rate that applies for the last day of the notional accounting period. Include the resulting amount in your assessable income for the income year in which the notional accounting period of the FIF ends. [SECTIONS 572, 558 and 559]

Worksheet 3 *Calculation method* on page 50 will help you to work out your calculated profit or loss.

Election to use the calculation method

You can use the calculation method only if you elect to do so. You must then apply it to all interests in a particular FIF. If you subsequently use another method for the same FIF interests, you cannot use the calculation method again for that FIF or any interests you acquire in that FIF in the future. [SECTION 535]

Where you make an election to use the calculation method, you must also elect to use the period for which the FIF makes out its accounts as its notional accounting period. [SUBSECTIONS 486(3) and 535(5)]

The first notional accounting period of the FIF for which you use the calculation method may be for a shorter period than the period for which the FIF makes out its accounts. In this case, you will work out FIF income for the entire period for which the FIF makes out its accounts and apportion the resulting FIF income on a time basis.

Working out the calculated profit or loss of the FIF

In determining the calculated profit or calculated loss of a FIF, you must first work out the notional income of the FIF. The second step is to work out the notional deductions for that notional income. If the notional income is greater than the notional deductions, the difference is the calculated profit of the FIF for the notional accounting period. If the notional income is less than the notional deductions, the difference is the calculated loss of the FIF for the notional accounting period. [SECTION 559]

Determining the notional income of a FIF—boxA

The notional income of a FIF takes into account the gross income and profits or gains of a capital or revenue nature, that the FIF derives during its notional accounting period. [SUBSECTION 560(1) and SECTION 566]

It includes:

- foreign or Australian taxes paid by the FIF
- net income from partnerships
- discounted amounts or deferred interest from securities treated as derived in the FIF accounts
- income, profits or gains reinvested, accumulated, capitalised, carried to a reserve, sinking fund, insurance fund or similar fund on behalf of the FIF. [SECTIONS 560 to 566]

Profits of a revenue nature and gains of a capital nature are included in notional income when 'derived' by the FIF, usually as a net amount. The net amount does not include any amount previously taken or subsequently to be taken into account because an amount cannot be deducted twice. [SUBSECTIONS 560(2) and 574(2)]

Where a FIF—first tier FIF—has an interest in another FIF or a FLP—second tier FIF—an amount of second tier FIF income will be included in the notional income of the first tier FIF. [SECTION 576]

In applying the FIF measures to the second tier FIF, you can elect to use the calculation method to determine the FIF income of the second tier FIF. The FIF income is worked out as though the first tier FIF were a resident but without granting the exemptions available to Australian residents. [SECTION 575]

If you do not make an election to use the calculation method for the second tier FIF, you must work out the FIF income arising from the second tier FIF using the market value method or the deemed rate of return method. [SECTION 535]

Where you elect to use the calculation method for a second tier FIF, the notional income of the second tier FIF will include FIF income from a FIF or a FLP—third tier FIF—in which the second tier FIF has an interest. [SECTION 579]

The notional income of a FIF for a notional accounting period which ended during the income year does not include any dividend or distribution paid to the FIF by another FIF. [SECTION 564]

Where you elect to use the calculation method for a second tier FIF, the notional income of the second tier FIF includes FIF income from a third tier FIF using either the market value method or the deemed rate of return method. You cannot use the calculation method for a third tier FIF. [SUBSECTION 577(2)]

Determining the notional deductions—box B

Certain expenses of a FIF are deductible in a notional accounting period in which they are incurred, provided that those expenses relate to income and profits or gains of a revenue or capital nature included when working out the notional income of the FIF. [SECTIONS 567 to 574]

Notional deductions include:

- expenditure in acquiring trading stock except acquisition costs of securities, interest in shares, trusts or partnerships which are brought to account on a revenue basis
- the FIF's share of a partnership loss
- calculated unapplied losses of the FIF for previous periods used in the order in which they were incurred
- taxes paid by the FIF
- amortisation of acquisition costs of plants and articles and industrial properties based on the effective life of such items but only if such an amount is included in the FIF's accounts
- net capital losses but not:
  - amounts previously allowed as a notional deduction
  - amounts that would have been allowed as a notional deduction if the calculation method had been applied but was not because, for example, an exemption applied.

Notional deductions do not generally include:

- acquisition costs—other than for incidental costs and trading stock
- debt repayments
- expenditure brought to account as incurred
- amortisation of acquisition of property except plant and equipment, licences and patents.

Working out the attribution percentage for interests in a FIF

Your assessable income must include your attribution percentage of a FIF's calculated profit.

Attribution percentage for interests in a foreign company—boxes E and G

The attribution percentage for your FIF interest is equal to the percentage that you hold or were entitled to acquire at the end of the notional accounting period in:

- the total paid-up share capital of the company
- the total rights to vote or to participate in decision making in relation to:
  - distributions of profit or capital of the company
  - the constituent document of the company
  - a variation to the share capital of the company or
- the total rights to distributions of profit or capital on winding-up, or at any other time.

Where different percentages arise under the different types of rights described above, the FIF attribution percentage will be the greatest of these percentages. [SECTION 581]

Where Australian residents hold or were entitled to acquire attribution percentages which together are greater than 100 per cent for a particular FIF, the total percentage is reduced to 100 per cent and each individual taxpayer's attribution percentage is reduced proportionately. [SUBSECTION 581(4)]

Attribution percentage for interests in a foreign trust—boxes E and G

When all the income, profits or gains—referred to below as income—derived by a foreign trust during a notional accounting period consist of either or both:

- income to which beneficiaries were presently entitled
- income to which beneficiaries were not presently entitled, but which was distributed to beneficiaries during, or within two months after the end of, the notional accounting period,

then the attribution percentage is the percentage of the total income derived by the trust to which you were presently entitled or were not presently entitled but which was distributed to you during, or within two months after the end of, the notional accounting period.

If the income, profits or gains of a foreign trust are not fully distributed or allocated to beneficiaries, then your attribution percentage will be equal to the greater of the percentages of your interest in or entitlement to acquire:

- the income of the trust
- the capital of the trust.

Where the total of all Australian residents' attribution percentages are greater than 100 per cent, each individual taxpayer's attribution percentage is reduced proportionally so that the total is 100 per cent. [SUBSECTION 582(6A)]

Working out the amount to include in assessable income

To work out the FIF income, multiply the calculated profit of a FIF for a notional accounting period by your attribution percentage in the FIF at the end of that period. [SECTIONS 580 and 582]

Taxpayer's share of FIF income = **Calculated profit** × **Attribution percentage**

The FIF income is included in your assessable income subject to reduction by certain assessable distributions from the FIF. See chapter 6 *Avoiding double taxation* on page 25 for more information.

Part-year holding

The calculation method allows for an interest in a FIF that you acquired during a notional accounting period. Modify the above formula by multiplying it by the proportion of the number of days throughout the period in which you held the interest.

EXAMPLE

Agostino acquires a 1 per cent interest in a FIF on 1 January. He uses the calculation method and accordingly elects for the notional accounting period of the FIF to be the same as the period for which the FIF makes out its accounts—that is, 1 July to 30 June each year. The calculated profit of the FIF for the period 1 July to 30 June is $A10 million. Agostino would include $A49 589 in his assessable income, worked out as follows:

$$\$A10\text{ million} \times 1\% \times \frac{181}{365} = \$A49\,589$$

CHAPTER 5

Foreign life policies

Meaning of a foreign life policy

Your foreign life insurance policy (FLP) for an income year is a life insurance policy issued by an entity that was a non-resident at any time in that income year.

A life insurance policy is one which provides for the payment of benefits upon death, other than death by accident or specified sickness, or on the happening of a specified event which relates to the ending or continuing of a human life. A life insurance policy also includes an instrument which grants an annuity for a term dependent upon a human life. [SECTION 482]

The FIF measures do not apply to the following four categories of life policies:

- an Australian policy, provided that the entity which issued the policy was authorised under the *Life Insurance Act 1945* to carry on life insurance business in Australia when it issued the policy
- those policies which provide for payment of benefits on death, or death or permanent disability only
- those policies issued before 1 July 1992 which cannot, after that date, be cancelled, surrendered or redeemed and for which the terms have not, after that date, been altered in any material wayor
- a contract of reinsurance between a resident insurer and a non-resident reinsurer for life insurance policies which provide only life cover. [PARAGRAPHS 482(2)(e) and (f)]

You have an interest in a FLP if you have a legal title to the FLP. [SUBSECTION 483(3)]

Interest in a FLP subject to taxation

Your assessable income for an income year includes FIF income if you had an interest in a FLP at any time during a FLP's notional accounting period that ends in your income year and you were a resident at any time in that income year. [SUBSECTION 485(4)]

The measures do not apply to an interest in a FLP if you disposed of that interest before 30 June 1993. [SUBSECTION 485(5)]

Notional accounting period of a FLP

A notional accounting period of your FLP is a 12 month period ending 30 June each year. You may elect a different notional accounting period if a cash surrender value of your FLP is available in the same month of each year. This election is irreversible for as long as you hold an interest in that particular FLP. Your FLP's new notional accounting period will begin:

- on the first day of the month following the last day of the month in which the cash surrender value of your FLP is available in each year and
- in the month immediately prior to your electing a new notional accounting period in which the cash surrender value of your FLP is available each year. [SUBSECTIONS 487(3) and (7)]

EXAMPLE

The current notional accounting period of Judith's FLP is 1 July to 30 June each year. In November of each year a cash surrender value will be available for her FLP. In September 1997 she elects to use a different notional accounting period for her FLP. The new notional accounting period will begin on the first day of the month following November—that is, 1 December—and end 12 months later on 30 November each year.

However, the first new notional accounting period of Judith's FLP does not begin in the December following the election (December 1997) but begins in the December before the election is made (December 1996). Therefore the first new notional accounting period for Judith's FLP is 1 December 1996 to 30 November 1997.

The months between the start of her old notional accounting period (1 July 1996) to the start of her new notional accounting period (1 December 1996) is also a notional accounting period—that is, 1 July 1996 to 30 November 1996. [SECTION 487]

The FIF income for the period 1 July 1996 to 30 November 1996 will be returned in the 1996–97 income year. The FIF income for the period 1 December 1996 to 30 November 1997 will be included in the 1997–98 income year.

Methods of taxation applicable to FLPs

You must work out FIF income for an interest in a FLP using either:

- the deemed rate of return method or
- the cash surrender value method.

Choosing the taxation method

You would generally use the deemed rate of return method for your interest in a FLP. However, you may elect to use the cash surrender value method. [SUBSECTION 536(2)]

If you elect to use the cash surrender value method, you must also elect to use a notional accounting period for the FLP that coincides with the period for which the cash surrender values are available. [SECTION 487 and SUBSECTION 536(3)]

An election to apply the cash surrender value method is irrevocable. [SUBSECTIONS 487(3) and 536(5)]

Deemed rate of return method

The deemed rate of return method for FLPs is similar to the deemed rate of return method for FIFs. Four steps are used to work out your FIF income.

The following information will help you to complete Worksheet 4 *Deemed rate of return method for FLPs* on page 52.

Step 1—Groups of interests

The first step is to decide whether you have one or more interests in the FLP during a notional accounting period.

If you acquired interests in the same FLP at different times during a notional accounting period, you must apply the deemed rate of return method separately for each interest for the period from when you acquired it. [SECTION 585]

Step 2—Working out the opening value —box A

This step decides the opening value of the FLP.

If you had the interest in the FLP at the beginning of a notional accounting period, the opening value is the value on the day before the first day of the period.

Opening value where the deemed rate of return method has been applied in the previous year.

If you used the deemed rate of return method in the immediately previous notional accounting period, work out the opening value as follows.

- Determine the deemed value of the FLP at the commencement of the previous notional accounting period.
- Add the FIF income of the FLP for its previous notional accounting period.
- Add the value of any premiums paid during the previous notional accounting period.
- Take away any distributions the FLP made in the previous notional accounting period. [SECTIONS 586 and 590]

Opening value where the interest is acquired during the notional accounting period.

If you acquired the interest in the FLP during a notional accounting period, the opening value is its cost if you paid the full consideration. In any other case, the value is the amount of the first premium paid. [PARAGRAPH 586(b) and SECTION 591]

Please note:

- There are special rules for working out the opening value in the first operative year of the measures—that is, 1 January 1993 to 30 June 1993. [SECTION 588]
- There are also special rules when reverting to the deemed rate of return method following the application of the cash surrender method. [SUBSECTIONS 536(8) to (9)]

Step 3—Working out the movement in the value of the FLP—box C

Once you have determined the opening deemed value, work out the FIF amount—that is, the movement in the value of the FLP—by applying the following formula: [SECTION 592]

$$\text{Opening value} \times \text{Deemed rate of return} \times \frac{\text{Number of days held}}{365}$$

Opening value means the amount determined in Step 2.

Deemed rate of return means the basic statutory rate which is the same rate of interest as the 13 week Treasury Note or the Treasury Note yield less 4 per cent. This rate is published by the Commissioner of Taxation in the Commonwealth gazette for government notices each June and December for the subsequent six-month period. [SECTIONS 214A and 529]

If two or more rates apply in the relevant income year, use the weighted average of those rates.

Number of days held means the number of days in the notional accounting period in which you had the interests in the group.

Step 4—Working out the amount to include in assessable income—box D

The final step in applying the deemed rate of return method is to convert the FIF amount to Australian currency.

Use the rate of exchange that applied at the end of the notional accounting period to convert each FIF amount in box C to FIF income in Australian currency. [SECTIONS 593 and 594]

The FIF income is included in your assessable income, subject to reduction by certain assessable distributions from the FLP. Chapter 6 *Avoiding double taxation* on page 25 has more information.

EXAMPLE

Lal acquires a FLP on 1 January 1997 for $HK250 000.

For the first year, under the deemed rate of return method, he multiplies the opening value by the deemed rate of return as follows:

$$\$HK250\,000 \times 10.5\% \times \frac{181}{365}$$

FIF income = $HK13 017

Lal includes the FIF income in his assessable income after converting it to Australian dollars using the exchange rate applicable on 30 June.

Cash surrender value method

Overview

The cash surrender value method of working out FIF income applies only to FLPs. This method decides whether any FIF income accrues to you from an interest in a FLP by taking into account changes over a 12-month period in the cash surrender value of your interest in the FLP.

Under the cash surrender value method, the amount of the FIF income is decided in two steps. The first step works out the movement in the cash surrender value of the FLP, generally between two annual reporting dates. The second step allows an adjustment for losses of prior years. The result of these calculations is the amount of foreign investment fund income that you must include in your assessable income.

The following information will help you to complete Worksheet 5 *Cash surrender value method for FLPs* on page 53.

Step 1—Working out the movement in the cash surrender value—boxes A to F

The movement in the cash surrender value of your interests in the FLP which have a cash surrender value at the end of the notional accounting period is worked out as follows. [SECTION 596]

Use the same currency in boxes B to G as you use for the cash surrender value in box A. [SUBSECTION 596(3)]

Box A

Insert the cash surrender value of your interests in the FLP on the last day of the notional accounting period.

Box B

Insert the value of distributions the FLP made to you during the notional accounting period for those interests held on the last day of the notional accounting period.

Boxes C and D

If you disposed of an interest in the FLP during the notional accounting period, insert:

- the amount you received for the disposal and
- the value of distributions the FLP made to you for that disposed interest.

Box E

Insert the opening cash surrender value of the interest at the commencement of the notional accounting period.

If you used the deemed rate of return method for the same interest in the immediately preceding notional accounting period, use the value determined by that method for the last day of that period.

Box F

Insert the amount you paid or gave for contributions to the interest in the FLP during the notional accounting period.

Box G

Take away the sum of E and F from the sum of A to D. This gives you the FIF amount.

- *Gross FIF income*
  If the FIF amount is positive, it is your gross FIF income from the FLP. [SECTION 598]
- *FIF loss*
  If the FIF amount is negative, a FIF loss has occurred. In certain circumstances, you may use this FIF loss to offset your assessable income in later income years. See *chapter 6 Avoiding double taxation* on page 25. [SECTIONS 533 and 599]

Step 2—Working out the amount to include in assessable income

This step works out the amount of FIF income. [SECTION 600]

Box H

Insert the total of any unapplied previous FIF losses for your FLP. [SUBSECTION 600(2)]

If it is not already the case, convert the unapplied previous FIF loss to the same currency as the gross FIF income in box G. [SUBSECTION 600(8)]

Unapplied previous FIF losses

An unapplied previous FIF loss is the amount by which the undeducted amount of a foreign investment fund loss is more than the sum of any gross FIF income applying to your interest in a FLP. This is so even if the operative provision did not apply because of any of the exemptions listed on pages 14–15. [SUBSECTION 600(5)]

In working out the unapplied previous FIF losses, the undeducted amount of a FIF loss is that part of a FIF loss that has not been allowed as a deduction from your assessable income in a previous income year. [SUBSECTION 600(6)]

Once you have used a FIF loss to work out if there was, for any notional accounting period, an unapplied previous FIF loss, you cannot use that loss again in later notional accounting periods. [SUBSECTION 600(7)]

Also, in determining the gross FIF income to use to work out the unapplied previous FIF losses, apply only that gross FIF income accruing after the notional accounting period in which you incurred the loss and before the current notional accounting period in which you have a gross FIF income. [SUBSECTION 600(5)]

Box I

Take away the amount in H from the amount in G. This will give you your FIF income.

Box J

Convert your FIF income to Australian dollars at the rate of exchange that applies at the end of the relevant notional accounting period. Insert the converted amount at J. [SUBSECTION 600 (8)]

The amount at J is your FIF income. Include it in your assessable income after allowing for a reduction for certain assessable distributions from the FLP. Read chapter 6 *Avoiding double taxation* on page 25 for more information.

Boxes K, L and M

If any of the distributions referred to above are payments made by the entity which issued the FLP to you, use K, L and M to arrive at the amount to include in your assessable income.

You must read the next chapter, *Avoiding double taxation,* as the reduction of your FIF income cannot be more than the total of your FIF income for the current income year. [SECTIONS 530 and 603]

EXAMPLE

Increase in cash surrender value

The opening cash surrender value of an interest in a FLP, at 1 July, was $HK50 000 (E). At the end of the notional accounting period, 30 June, the closing value of the interest was $HK53 000 (A). There were no brought forward losses and no acquisitions, disposals or distributions (B, C, D and F) during the notional accounting period. The increase in cash surrender value, the FIF amount, is $HK3000, worked out as follows:

$HK53 000 (A) + nil (B) + nil (C) + nil (D) – $HK50 000 (E) – nil (F)

= $HK3000

CHAPTER 6

Avoiding double taxation

The FIF measures contain a number of mechanisms designed to prevent double taxation of a FIF's profits.

Reduction of FIF income for distributed profits

The amount of FIF income for a notional accounting period of the FIF or FLP that you are to include in your assessable income under the FIF measures for an income year is reduced by an amount of income that the FIF or the FLP distributes to you—for example, an interim dividend—during that notional accounting period.

Reduce the FIF income to be included in your assessable income under the FIF measures by the amount that was distributed to you by a FIF or FLP to the extent it was:

- included in your assessable income as a general item of income such as interest or a dividend
- included in your assessable income in the income year immediately preceding the year in which the FIF or FLP income is assessed
- an exempt non-portfolio dividend paid to an Australian resident company [SECTION 23AJ] or
- notional exempt income of a CFC under paragraphs 402(2)(c), 403(b) or section 404. [SECTIONS 530 and 603]

The *Foreign income return form guide*, available free from the Australian Taxation Office, has more information about exempt income of a CFC.

The amount of the reduction of FIF or FLP income cannot be more than the total FIF income you would otherwise have included in assessable income for the current income year for that particular FIF or FLP. [SUBSECTION 530(1)]

EXAMPLE

Market value method

Fiona had an interest in a FIF at the end of her income year (30 June) and her interest was not exempt from the FIF measures. She used the market value method to decide the amount to include in her assessable income under the FIF measures for the notional accounting period 1 July to 30 June. The FIF income worked out under that method was $A20 000.

On 25 June, the FIF paid her an assessable dividend of $A10 000.

Normally, Fiona's FIF income would be $A20 000. However, because of subsection 530(1), her FIF income is reduced by the amount of the assessable dividend—that is, from $A20 000 to $A10 000.

EXAMPLE

Cash surrender value method

At the end of his income year, Ken held a FLP that was subject to the FIF measures. He elected to use the cash surrender value method to decide the amount to include in his assessable income under the measures. He also elected to use a notional accounting period of 1 January to 31 December, as this was when the cash surrender value was available. The FIF income worked out under this method for the notional accounting period 1 January 1996 to 31 December 1996 was $A15 000.

The entity which issued the FLP made a payment of $A5000 on 10 January 1996. Ken included this payment in his assessable income in 1995–96.

Normally, his FIF income for 1996–97 would be $A15 000. However, because of subsection 530(1), he can reduce his FIF income by the payment made and assessed in the previous income year that related to his 1996–97 FIF income. Therefore, Ken's FIF income for 1996–97 will be reduced from $A15 000 to $A10 000 because the $A5000 was assessed in 1995–96.

Reduction of FIF income for FIF interests acquired under an employee share scheme

Overview

New arrangements apply with general effect from 28 March 1995 for the taxation of benefits provided under an employee share scheme. Rules were also introduced at the same time to ensure that double taxation does not arise under the FIF measures where FIF interests are issued under an employee share scheme. These rules prevent double taxation by reducing FIF income by the amount which will be taxed under the new employee share scheme arrangements. [SECTION 530A]

Are you entitled to a reduction of FIF income?

You may be entitled to a reduction of FIF income if you acquired a share or right in a FIF under an employee share scheme.

Under the new employee share scheme arrangements, you must normally include in your assessable income a discount you received on a share or right issued under an employee share acquisition scheme. You cannot reduce your FIF income if you included the discount in your assessable income at the time the share or right was issued. There are, however, instances where you can defer the taxation of a discount on a share or right until a later time. In these cases, you can reduce your FIF income by the amount of unrealised gains on a share or right that accrues before the discount becomes assessable.

To work out the reduction of FIF income, you need to work out whether the discount on a share or right has become assessable. If the discount is not assessable until after the end of a notional accounting period of a FIF, your FIF income for the period is reduced for the entire period by the increase in the market value of the share or right. If the discount became assessable during the notional accounting period, your FIF income is reduced only by the increase in the market value of the share or right from the beginning of the period until the time the discount became assessable. You cannot reduce your FIF income if the discount was assessable before the beginning of a notional accounting period. Work out the market value of a share or right on a particular day using the rules provided in the employee share scheme arrangements.

For further information on the rules, contact the Australian Taxation Office.

Using the worksheets to work out FIF income

Record the reduction of FIF income in the relevant worksheet, at the label dealing with a reduction for distributions of the type to which subsection 530(1) applies. If you have already shown an amount at the label referred to, add the amount of the reduction you can claim to that amount.

Use Worksheet 1—part 3, label J—on page 48 if you are using the market value method.

Use Worksheet 2—part 4, label G—on page 49 if you are using the deemed rate of return method.

Use Worksheet 3—part 6, label L—on page 51 if you are using the calculation method.

Use Worksheet 4—part 4, label G—on page 52 if you are using the deemed rate of return method for FLPs.

Use Worksheet 5—part 3, label L—on page 54 if you are using the cash surrender value method for FLPs.

Attribution accounts

Overview

FIF attribution accounts record the income attributed or distributed to you from each of your interests in a FIF or FLP. They allow you to claim exemptions for FIF income previously attributed to you. Therefore they operate to prevent double taxation where, after being subject to FIF taxation under the FIF measures, you later:

- receive a distribution of income or gains from a FIF or FLP [SECTION 23AK]
- dispose of the interest in a FIF or FLP [SECTION 613] or
- use a FIF loss to reduce assessable income. [SECTIONS 532 and 533]

In maintaining attribution accounts, you need to keep records of:

- income attributed to you from a FIF or FLP
- income distributed to you by a FIF or FLP either directly or through interposed FIF attribution account entities—defined on page 27
- the amount of any reduction of consideration you can claim on disposal of an interest in the FIF or FLP and
- the amount of any deduction from assessable income you claim because of a FIF loss.

Attribution accounts operate on the simple basis of credits and debits. In the FIF measures, a credit is referred to as a FIF attribution credit and a debit is referred to as a FIF attribution debit. Where the amount of FIF attribution credits in an attribution account is more than the amount of FIF attribution debits, the excess is referred to as a FIF attribution surplus. This chapter explains these concepts and the way in which double taxation is avoided.

Attribution accounts enable you to keep track of amounts attributed to you under the FIF measures and amounts distributed to you from the FIF or FLP out of those attributed amounts. You must maintain attribution accounts if you wish to prevent double taxation under the FIF measures.

Terminology

To help you to understand how FIF attribution accounts operate, the terms are explained below. You must keep attribution accounts for each FIF or FLP interest you hold directly or indirectly.

FIF attribution account entity

A FIF attribution account entity is:

- a company that is not a resident of Australia
- a partnership
- a trust or
- a FLP.

[SECTION 601]

FIF attribution account payments

A FIF attribution account payment occurs when a FIF in which you have an interest makes a payment to you or to another FIF in which you also have an interest.

FIF attribution account payments include:

- a dividend paid by a company to a shareholder
- an amount of interest paid to the holder of a convertible note
- a partner's share of the net income of a partnership for the income year
- a beneficiary's share of the net income of a trust estate for the income year
- an amount included in the assessable income of a beneficiary under section 99B during the income year for a distribution made by a trust estate
- an amount of the income, profits or gains of the trust estate on which the trustee would be assessable under section 99 or 99A
- a payment made by the entity which issued a FLP to a person who has an interest in the FLP
- superannuation, termination of employment and similar payments included in your assessable income under Subdivision AA of Division 2 of Part III of the Act. [SECTION 603]

FIF attribution surplus

The surplus in a FIF attribution account at the time a FIF attribution account payment is made is the amount by which the FIF attribution credits are more than the FIF attribution debits. [SECTION 604]

Where an attribution account has an attribution surplus, it generally means that a greater amount of income from a FIF has accrued to you than has been distributed to you.

FIF attribution credit

Your FIF will have a FIF attribution credit recorded in its attribution account if an amount of FIF income is included in your assessable income under the FIF measures under section 529. The attribution credit arises at the end of the relevant notional accounting period. [SUBSECTION 605(1), PARAGRAPHS 605(7)(a), (b) and (c)]

An attribution credit will also occur where you maintain attribution accounts for two FIFs and one FIF makes a distribution—that is, an attribution account payment—to the second FIF.

You will record an attribution credit for the FIF receiving the distribution or other attribution account payment in its attribution account. The FIF making the distribution or other attribution account payment will have recorded an attribution debit in its attribution account. In this case, the attribution credit is recorded at the time the FIF makes the distribution or other attribution account payment. [PARAGRAPHS 605(1)(d) and 605(7)(d)]

In either case, the amount of the FIF attribution credit is equal to the amount included in your assessable income or the amount of the FIF attribution debit which arises for the FIF attribution account entity making the distribution. [SUBSECTION 605(2)]

FIF attribution debit

You will record a FIF attribution debit when the FIF in which you have an interest makes a distribution to you. Debits trace the movements of profits included in your assessable income under the FIF measures and prevent that income, where it has been attributed to you, from being taxed again.

You will have recorded a FIF attribution debit for a FIF attribution account entity where:

- the entity makes a FIF attribution account payment to you or to a FIF attribution account entity in which you have an interest and
- immediately before the payment is made, the entity making the FIF attribution account payment has a FIF attribution surplus in relation to you. [SUBSECTION 606(1)]

Your attribution account entity will record a FIF attribution debit at the time it makes an attribution account payment. [SUBSECTION 606(3)]

The amount of the FIF attribution debit is the lesser of the FIF attribution surplus and:

- if the FIF attribution account payment was made to you, the FIF attribution account payment
- in any other case, your FIF attribution account percentage for the FIF that receives the FIF attribution account payment. [SUBSECTION 606(2)]

The attribution debit may be reduced where a first tier FIF was previously a CFC under Part X of the Act. The current FIF attribution debit may be reduced only where an attribution debit under the CFC measures was recorded for the entity when it was a CFC. The reduction for the current FIF attribution credit is equal to the CFC attribution credit recorded when the FIF was a CFC. This allows the FIF attribution credit to be deferred until the attribution surplus for the CFC is used.

In addition, a FIF attribution debit also arises where the whole or part of a FIF unapplied loss for a notional accounting period is an allowable deduction from your assessable income. In this case the amount of the FIF attribution debit is the amount of the deduction and the debit arises at the end of the notional accounting period of the FIF. The debit is only allowed for an unapplied FIF loss worked out under:

- the market value method for a FIF (company or trust) or
- the cash surrender value method for a FLP. [SECTION 607]

FIF attribution account percentage

Your FIF attribution account percentage in a FIF attribution account entity is the interest you hold, directly or indirectly through one or more interposed FIF attribution account entities, in the income or profits of the entity. [SECTION 602]

Attribution credit to an Australian partnership or trust or where a FIF has an interest in another FIF

Special rules apply for determining the amount of the FIF attribution credit which arises where:

- you hold an interest in a FIF or FLP through an Australian partnership or Australian trust or
- you use the calculation method to decide the foreign investment fund income of a FIF which has an interest in another FIF or FLP.

Interest held through interposed partnership or trust

Where the FIF or FLP attribution payment is to an Australian partnership or an Australian trust, a FIF attribution credit does not arise for the partnership or trust. Instead, it arises for the person paying tax—that is, the partner, the beneficiary or the trustee. [SUBSECTION 605(8)]

Where there are multiple trusts or a chain of partnerships and trusts, the credit arises for the person who ultimately pays the tax. [SUBPARAGRAPH 605(9)(a)(ii)]

This is achieved by using the concept of a tax detriment. A tax detriment is the effect on the assessable income of a person as a result of the inclusion of an amount in the net income of an Australian partnership or an Australian trust.

The tax detriment is the increase or reduction or the sum of an increase or reduction in the assessable income of the partner, beneficiary or trustee. [SECTION 478]

Where there is such a tax detriment, a FIF attribution credit arises equal to the amount of the tax detriment. The credit is in relation to the partner, beneficiary or trustee who suffered the tax detriment and it will arise at the same time that the credit would have arisen to the partnership or trust. [SUBSECTION 605(8)]

The rules outlined above relating to attribution for interests held through interposed partnerships and trusts do not apply to:

- a corporate unit trust within the meaning of Division 6B of Part III of the Act
- a public trading trust—see Division 6C of Part III
- a Part IX entity—see Part IX of the Act—or
- a resident public unit trust—see subsection 96A(4) of the Act.

In other words, the attribution credit attaches to that type of trust and does not flow through to the beneficiary of the trust. [SUBSECTION 605(11)]

FIF attribution credit for FIF income where a FIF has an interest in another FIF—diagram 1

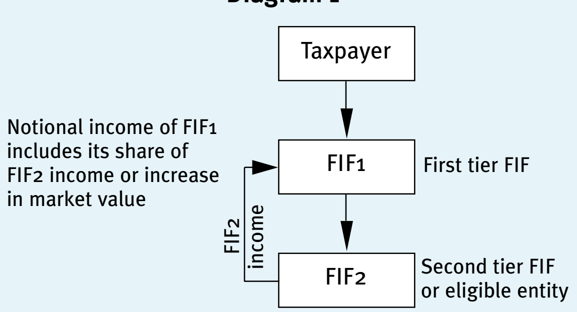
Under the calculation method, an interest held by a FIF—the interposed FIF (FIF1 in diagram 1)—in another FIF or FLP (FIF2 in diagram 1) is taken into account when working out the notional income of the interposed FIF. A FIF attribution credit may be recorded in the attribution accounts you keep for an interposed FIF because an amount of FIF income is included in your assessable income under the FIF measures through section 529. To the extent that the credit arises as a result of FIF1's interest in FIF2, the credit will be made to the FIF attribution account of FIF2. The credit will arise at the end of the notional accounting period of FIF2.
[PARAGRAPH 605(1)(b), SUBSECTION 605(3) and PARAGRAPH 605(7)(b)]

The formula below is used to work out the amount of the FIF attribution credit which will arise for FIF2. It also works out how much of the FIF income included in a resident taxpayer's assessable income comes from FIF2. [SUBSECTIONS 605(1) and (3)]

$$\text{FIF2 attribution credit} = \frac{\text{FIF income} \times \text{Section 529 amount}}{\text{Notional income}}$$

FIF income means the amount of the foreign investment fund income of FIF1 which came from FIF2—see diagram 1.

Diagram 1



Section 529 amount means the amount included in your assessable income under the FIF measures in relation to the FIF (FIF1) which has an interest in the eligible entity (FIF2)—see diagram 1.

Notional income means the notional income of FIF1, including its income from FIF2.

You must apply the above formula to each FIF or FLP in which FIF1 has an interest. You must also reduce the FIF attribution credit which would otherwise arise for FIF1. Reduce FIF1 attribution credit by the sum of the amounts of the FIF attribution credits worked out under the formula for FIF2.
[SUBSECTIONS 605(1), (3) and (5)]

FIFs held by a second tier FIF—diagram 2

If you use the calculation method to work out the attributable income of the second tier FIF (FIF2 in diagram 2), you must maintain separate FIF attribution accounts for each FIF or FLP that you hold through a second tier FIF.

You need these accounts to prevent double taxation by allocating the FIF income that you included in your assessable income to the different FIFs or FLPs in the chain of FIFs and FLPs.

Use the following formula to work out the amount of the FIF attribution credit which will arise for the third tier FIF eligible entity (FIF3).
[PARAGRAPH 605(1)(c) and SUBSECTION 605(4)]

$$\text{FIF3 attribution credit} = \frac{\text{FIF income} \times \text{Section 529 amount}}{\text{Notional income of FIF1}}$$

FIF income means the amount worked out using the formula:

$$\frac{\text{Section 579 amount} \times \text{Section 576 amount}}{\text{Notional income of FIF2}}$$

Section 579 amount means the amount included in the notional income of FIF2 from FIF3.

Section 576 amount means the amount included in the notional income of FIF1 from FIF2.

Notional income of FIF2 means its notional income for its notional accounting period worked out under the calculation method.

Section 529 amount means the amount included in your assessable income under the FIF measures because you have an interest in FIF1.

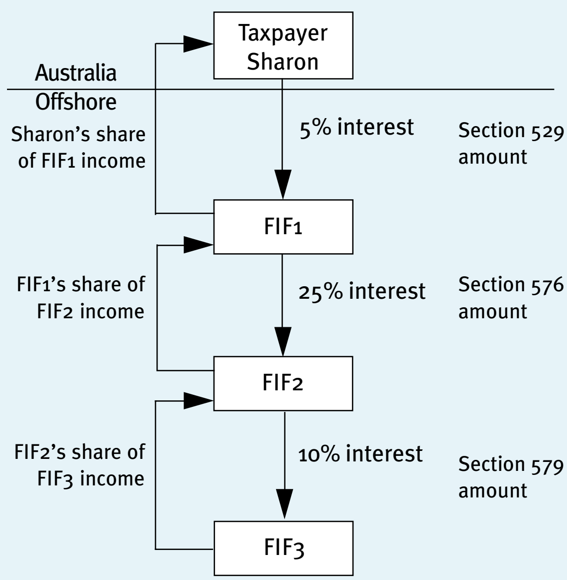
Notional income of FIF1 means its notional income for its notional accounting period worked out under the calculation method.

This formula will apply to each FIF or FLP in which FIF2 has an interest. Further, the FIF attribution credit which would otherwise arise for FIF2 under the first formula used in relation to diagram 1 is to be reduced by the sum of the FIF attribution credits which arise for FIF3. [SUBSECTION 605(6)]

EXAMPLE

Sharon, a resident taxpayer, has a 5 per cent interest in a first tier FIF (FIF1) which has a 25 per cent interest in a second tier FIF (FIF2). In turn, FIF2 has a 10 per cent interest in another FIF (FIF3).

Diagram 2



Working out the amount to be included in Sharon's assessable income because of her interest in FIF1—diagram 3

The calculation method is used for FIF1 and FIF2. It cannot be used to determine the FIF income of a third tier FIF. The market value method is used to determine the change in value of FIF3.

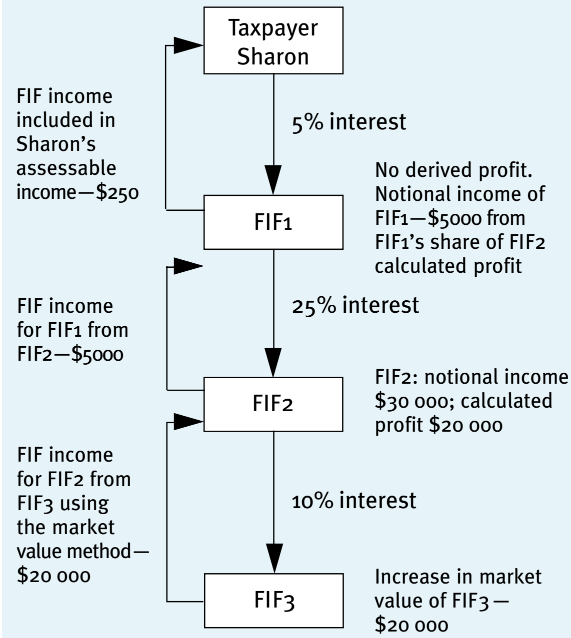
Each FIF has a notional accounting period ending 30 June 1998. During the relevant period, FIF1 does not derive any income. FIF2 derives $10 000 income. In addition, under the market value method, FIF2 is taken to have derived $20 000 FIF income from FIF3. FIF2 has a past calculated loss of $10 000.

FIF2 has notional income of $30 000—section 579 amount $20 000 + $10 000 of derived income. FIF2's calculated profit would be $20 000—that is, $30 000 less its past calculated loss of $10 000.

FIF1's notional income will include $5000 FIF income under section 576 (25% X $20 000), which is its share of FIF2's calculated profit. The calculated profit of FIF1 would be $5000.

Sharon's assessable income would include an amount of $250 (5% X $5000) under the FIF measures as a result of her interest in FIF1.

Diagram 3



FIF attribution credits—diagram 3

Sharon's attribution accounts would look like this:

Sharon's FIF attribution account—FIF1

DEBIT	CREDIT
	30.6.98 $0 ($250-$250)

Sharon's FIF attribution account—FIF2

DEBIT	CREDIT
	30.6.98 $83.34 ($250-$166.66)

Sharon's FIF attribution account—FIF3

DEBIT	CREDIT
	30.6.98 $166.66

The FIF attribution credit which would arise for FIF3 in relation to Sharon is worked out using the following formula:

$$\frac{\textbf{FIF income} \times \textbf{Section 529 amount}}{\textbf{Notional income of FIF1}}$$

This formula is used in working out the part of the FIF income included in Sharon's assessable income that can be attributed to FIF3.

FIF3

FIF3's 'FIF income'—a component used in the formula for determining the FIF attribution credit which arises for FIF3 in relation to Sharon—would be worked out using the following formula:

$$\frac{\textbf{Section 579 amount} \times \textbf{Section 576 amount}}{\textbf{Notional income of FIF2}}$$

$$\text{FIF income} = \frac{\$20\,000 \times \$5000}{\$30\,000}$$

$$= \$3333.33$$

This result indicates that of the $5000 of FIF2's income that is included in FIF1's income, $3333.33 is referable to FIF2's interest in FIF3.

Substituting the relevant amounts in the first formula above, then:

$$\text{FIF3's attribution credit} = \frac{\$3333.33 \times \$250}{\$5000}$$

$$= \$166.66$$

FIF2

If FIF2's notional income was $30 000 without including FIF3's income, the FIF attribution credit which would arise for FIF2 in relation to Sharon would be worked out using the formula:

$$\frac{\textbf{FIF2 income included in FIF1 income} \times \textbf{Section 529 amount}}{\textbf{Notional income of FIF1}}$$

$$\text{FIF2's attribution credit} = \frac{\$5000 \times \$250}{\$5000}$$

$$= \$250$$

This amount must be reduced by the amount of the FIF attribution credit which would arise for FIF3. Consequently, a FIF attribution credit of $83.34 ($250 – $166.66) would arise for FIF2 in relation to Sharon.

FIF1

Normally a FIF attribution credit of $250 would arise for FIF1 in relation to Sharon. However, this credit must be reduced by the amount of the unmodified credit which would arise for FIF2. Consequently, the FIF attribution credit which arises for FIF1 is nil ($250 – $250)—see diagram 3. [SUBSECTION 605(3)]

Exemption of distributions

A dividend or other FIF attribution account payment you receive from a FIF attribution account entity may be exempt from tax. [SECTION 23AK]

The amount of the FIF attribution account payment that will be exempt when you receive it will be decided by the attribution surplus in the attribution accounts of the FIF making the distribution. If the payment is more than the attribution surplus, the part of the payment equal to the surplus will be exempt from tax under section 23AK of the Act.

Exemption under section 23AK for previously attributed FIF income derived through a partnership or trust

Where you receive the distribution from a FIF or FLP through an interposed partnership or trust, the exemption will operate where:

- after the distribution of an amount from the FIF to the partnership or trust, you would be required to include an amount in respect of the trust or partnership in your assessable income and
- at the time of that distribution, you had a FIF attribution surplus in relation to the FIF or FLP.

The distribution to the partnership or trust will still be included when working out the net income of the trust or partnership. However, once your share of that net income is determined, an amount equal to your attribution surplus will be exempt income.

Reduction of disposal consideration if FIF attributed income is not distributed

The disposal of an interest in a FIF attribution account entity is normally taken into account in working out your assessable income under the existing provisions of the Act, either—for example—as income under section 25 or under the capital gains tax provisions in Part IIIA.

To avoid double taxation, the consideration received on the disposal of an interest in a FIF attribution account entity, which is to be taken into account for the purposes of the relevant assessment provision, will be deemed to be reduced by any amount previously attributed to you that has not been distributed to you.

The amount by which the disposal consideration will be reduced cannot exceed the lesser of either the disposal consideration or the attribution surplus of the FIF. An attribution debit for the same amount arises at the time you dispose of the FIF. [PARAGRAPH 613(1)(c)]

Where you dispose of only part of an interest in a FIF attribution account entity, your FIF attribution surplus that can be used to reduce the consideration on disposal is reduced proportionately. [SUBSECTION 613(3)]

FIF attribution debit for amount of loss used to reduce assessable income

A FIF loss that arises under the market value method or a FLP loss that arises under the cash surrender value method can be used to reduce your assessable income where you have a FIF attribution surplus for the FIF or FLP. Where the amount of a loss is used to offset assessable income, a FIF attribution debit arises for that amount in relation to the FIF or FLP. [SECTIONS 532, 533, 533A and 607]

FIF losses are converted to Australian currency to work out the availability of a deduction under the market value or cash surrender value methods of working out FIF income. Use the rate of exchange applicable at the end of the notional accounting period in which the loss arose. [SECTION 533A]

Note that section 79D of the Act, which operates to quarantine deductions where the income belongs to the passive class of foreign income, does not apply to deductions available under sections 532 and 533. [SUBSECTION 160AFD(9)]

EXAMPLE 1

Attribution accounts

Beryl, a resident individual, has an interest in a foreign company—Forco—that is not a CFC. Forco's notional accounting period ends on 30 June, as does Beryl's income year. In the year ended 30 June 1994, she had FIF income in respect of Forco of $5000. The $5000 would be included in her assessable income under section 529.

In this case, she will be exempt from tax for the next $5000 of dividends paid by Forco. To achieve this, Beryl would credit the FIF attribution account for Forco with the $5000 at the end of Forco's notional accounting period as follows:

Beryl's FIF attribution account—Forco

DEBIT			CREDIT		
			30.6.94	Attribution	$5000

In the year ended 30 June 1995, Beryl's FIF income from her interest in Forco was $4000. On 31 December 1994, Forco paid her a dividend of $3000.

The dividend is a FIF attribution account payment. Beryl would debit her FIF attribution account with the $3000 at the time the dividend was paid as follows:

Beryl's FIF attribution account—Forco

DEBIT			CREDIT		
31.12.94	Dividend	$3000	30.6.94	Attribution	$5000

The $3000 dividend that Beryl received would be exempt income under section 23AK. The $4000 FIF income for her interest in the FIF would be included in her assessable income under section 529. She would credit her FIF attribution account with $4000 at the end of Forco's notional accounting period as follows:

Beryl's FIF attribution account—Forco

DEBIT			CREDIT		
31.12.94	Dividend	$3000	30.6.94	Attribution	$5000
			30.6.95	Attribution	$4000

On 30 June 1996, Forco paid Beryl a dividend of $7000. There was no FIF income in that year. Beryl would debit the FIF attribution account with $6000—the lesser of the dividend and the surplus in the account—at the time the dividend was paid.

Beryl's FIF attribution account—Forco

DEBIT			CREDIT		
31.12.95	dividend	$3000	30.6.94	attribution	$5000
	balance	$6000	30.6.95	attribution	$4000
30.6.96	dividend	$6000	31.12.95	surplus	$6000

Beryl would include in her assessable income the amount of the dividend that is more than the amount debited to the FIF attribution account—that is, $1000. The remainder of the attribution account payment—that is, $6000—would be exempt from tax under section 23AK of the Act.

CHAPTER 7

Avoiding double taxation—relief for foreign taxes under the calculation method

This chapter applies only if you use the calculation method to decide the amount of FIF income to include in your assessable income.

Overview of the foreign tax credit system

Under the foreign tax credit system, foreign source income derived by Australian residents—apart from certain dividends and listed country branch profits, salary and wages—is generally subjected to Australian income tax. A credit for foreign tax paid, up to the amount of the Australian income tax applying to the foreign income, is allowed against the Australian tax payable. Credit is allowable for foreign taxes imposed by central, state and local governments, provided the taxes are equivalent in nature to Australia's income tax. [SECTION 160AF]

Resident taxpayers—whether corporate or non-corporate—who include in their assessable income the whole or part of a dividend from a non-resident company are entitled to a credit for the direct foreign tax paid on that dividend. For example, the foreign company may have paid a dividend withholding tax . The Australian resident is entitled to credit for the withholding tax.

Non-portfolio dividends paid to resident corporate taxpayers from the exempting receipts of a CFC do not attract foreign tax credits.
[SECTION 23AJ and SUBSECTION 160AFC(5A)]

An Australian resident company that receives a dividend from a related foreign company is also allowed a credit for taxes paid by the foreign company on that portion of the profits from which the dividends are paid—that is, the underlying foreign tax. [SECTION 160AFC]

Related companies

A foreign company is related to an Australian company if the Australian company has a direct voting interest of at least 10 per cent of the voting power of the foreign company. This relationship could extend through any number of tiers of foreign companies if each company in the chain has at least a 10 per cent voting interest in the company in the tier below, and the Australian company has a direct or indirect voting interest of at least 5 per cent in the foreign company. [SECTION 160AFB]

Market value and deemed rate of return methods

There will be no credits for foreign taxes where the FIF income is worked out under the market value or deemed rate of return methods.

In these cases, credits for foreign tax will apply only when distributions are received from the FIF. The current foreign tax credit system rules, as outlined above, apply to these distributions.

Calculation method

The foreign tax credit system has been altered to cater for taxpayers who use the calculation method to decide the amount of FIF income to include in their assessable income. However, the changes have been limited to situations where:

- the FIF is a company which is related to a company taxpayer [SECTIONS 160AFCE and 160AFCF]
- the taxpayer is a beneficiary of a FIF which is a trust estate. [SECTIONS 160AFCG and 160AFCH]

This is consistent with the general treatment of foreign taxes paid on underlying income under the foreign tax credit system and is also consistent with the CFC measures.

Changes to the foreign tax credit system—company FIFs

Credits on attribution from company FIFs

Under the foreign tax credit system, a foreign tax credit may be allowed for a share of the foreign tax paid by a first tier FIF on its income and gains where:

- a resident company and the FIF are related companies and
- the resident company has used the calculation method to decide the FIF income for the company's interest in the FIF.

In addition, a credit for tax paid by the second tier FIF may be given where the resident company:

- has used the calculation method to decide the FIF income of the second tier FIF
- the taxpayer and the first and second tier FIFs are companies and

- the taxpayer is related to both the first and second tier FIFs.

In this case, a foreign tax credit may be allowed in accordance with the foreign tax credit system for a share of the foreign tax paid by the second tier FIF on its income and gains.

A credit will be allowed only where the resident company and the FIF or FIFs are related companies. This is consistent with the general treatment of foreign taxes paid on underlying income under the foreign tax credit system and is also consistent with the CFC measures.

Credits on distribution from corporate FIFs

The allowance of credits on distribution—that is, by way of a dividend—follows the credits allowed under the existing foreign tax credit system. In addition, you are allowed a credit where the dividend is exempt because the profits out of which the dividend has been paid have been subject to attribution in a previous year. The credit is allowed on a similar basis to the credit allowed where a dividend is assessable but is limited to the amount not already allowed as a credit at the time of attribution of the FIF income. [SECTION 160AFCJ]

Further, the provisions of the Act which allow for excess foreign tax credits to be carried forward for up to five years apply where excess foreign tax credits arise in relation to an interest in a FIF and, where appropriate, an indirect interest in a second tier FIF. As under the existing foreign tax credit system, there is no carry back of credits. [SECTION 160AFE]

Changes to the foreign tax credit system—trust FIFs

Credits on attribution from trust FIFs

Under the foreign tax credit system, the treatment of foreign taxes paid by the trustee of a foreign trust is different to that of companies. The beneficiary of the trust is deemed to have paid the foreign tax paid by the trustee. In general, this distinction is maintained for taxpayers with an interest in a trust FIF. [SECTION 6AB]

Where the calculation method is used at first tier

Consistent with the treatment of company FIFs, where you have used the calculation method to work out attributable income of a trust FIF, a foreign tax credit is allowed for the foreign tax paid by the trustee of the trust on the income and gains of the trust FIF. The calculation is made in the same way as for a related company FIF. [SECTION 160AFCG]

Where the calculation method is used at second tier

Where you used the calculation method for the second tier trust FIF, a foreign tax credit is allowed for the foreign tax paid by the trustee of the trust on the income and gains of the trust FIF. The calculation is made in the same way as for a related company FIF. [SECTION 160AFCH]

Credits on distribution from trust FIFs

The allowance of credits on distribution is similar to the credits under the existing foreign tax credit system. Broadly, this means that, if the amount of the distribution is included in assessable income, both companies and other taxpayers are allowed a credit for foreign taxes paid:

- directly by the taxpayer—for example, a withholding tax on a dividend—and
- by the trustee of the trust—including accruals-type taxes in respect of lower tier entities.

In addition to the normal operation of the foreign tax credit system, you are allowed a credit where the trust distribution is exempt because it has been subject to attribution of FIF income in a previous year. This is limited to the amount not already allowed as a credit at the time of attribution when the calculation method was used. [SECTION 160AFCJ]

FIF attributed tax accounts

Overview

FIF attributed tax accounts ensure that a credit you can claim for foreign tax paid by a FIF when an amount is included in your assessable income under the calculation method cannot be claimed again when you receive a distribution from the FIF. In other words, they ensure that you cannot claim a foreign tax credit twice for the same amount of foreign tax paid by a FIF. [SECTIONS 608 to 612]

There are no foreign tax credits for foreign taxes where FIF income is worked out under the market value and deemed rate of return methods. In practice, you will need to maintain FIF attributed tax accounts only where you use the calculation method for working out the amount to include in your assessable income under the FIF measures and either:

- the FIF is a company which is related to the company taxpayer [SECTIONS 160AFCE and 160AFCF] or
- you are a beneficiary of a FIF which is a trust estate. [SECTIONS 160AFCG and 160AFCH]

The system for the maintenance of FIF attributed tax accounts parallels that for FIF attribution accounts. That is, when income which has been previously attributed is distributed to you, the foreign tax credit you can claim is initially worked out on the basis that no foreign tax credit was allowed for foreign tax paid on the attributed income at the time it was attributed. The foreign tax credit worked out in this way is then reduced by the foreign tax credit allowed at the time the attributable income of the FIF—that is, FIF income—was included in your assessable income.

The FIF attributed tax accounts trace the foreign tax credit that was allowed at the attribution stage so that this reduction may be made.

CHAPTER 8

Record keeping

You must support your assessment of, or exemption from, FIF taxation with records. The record keeping outlined in this chapter is a statutory requirement and there are prosecution provisions which may apply if you do not maintain the appropriate records.

You should also maintain attribution account records. For more information, read chapter 6 *Avoiding double taxation* on page 25. If you do not keep these records, you will not be able to take advantage of:

- the exemption of distributions paid out of profits which were previously attributed to you [SECTION 23AK]—see *Exemption of distributions* on page 31 for more information
- a reduction of the amount to include in your assessable income after the disposal of a FIF interest [SECTION 613]—see *Reduction of disposal consideration if FIF attributed income is not distributed* on page 31
- the adjustments for FIF losses that have been used to reduce other assessable income [SECTIONS 532, 533 and 607]—see *FIF attribution debit for amount of loss used to reduce assessable income* on page 32.

Generally, you must keep records for a period of five years after you prepared or obtained them or after you completed the transactions or acts to which those records relate, whichever is the later. [SECTION 262A]

The period in which the Commissioner may amend an assessment may be extended by an order of the Federal Court of Australia or with your consent. Where this occurs, you must keep your records for five years or to the end of the period during which the assessment may be amended, whichever is later. [PARAGRAPH 170(2)(b), SUBSECTIONS 170(4A) and 170(4B)]

You do not need to keep records where the Commissioner has notified you that retention of records is not required or if your company has gone into liquidation and finally dissolved. [SUBSECTION 262A(5)]

You must keep records in the English language or, if not in written form—for example, on magnetic tape or computer disk—in a form which can be readily accessed and converted into writing in English.

You must also keep records to allow your liability to tax to be readily worked out. [SECTION 622]

What is the purpose of the FIF record keeping provisions?

The FIF record keeping provisions:

- set out the records that you have to keep to enable you to work out your liability to FIF taxation and
- ensure that you have the necessary records to support the way you worked out your FIF income or loss or claim for exemption from FIF taxation.

Who must keep records?

If you are a resident of Australia at any time during an income year and have an interest in a FIF at the end of that year or an interest in a FLP during that year, you must make and keep records in Australia. This includes a foreign branch of an Australian company which has an interest in a FIF or FLP. [SECTIONS 485 and 614]

If you are an attributable taxpayer in respect of a CFC or CFT that holds an interest in a FIF or FLP, you are subject to similar record keeping requirements for the CFC or CFT. [DIVISION 11 of Part X]

What records must you keep for FIFs and FLPs?

If you have an interest in a FIF or FLP, you must make and keep records of the acts, transactions and other circumstances that gave you that interest in the FIF at the end of an income year or in the FLP during the income year. You must keep these records whether or not the interest in the FIF or FLP is exempt for a particular notional accounting period.

In addition, you must keep records showing how you worked out your interest in the FIF or FLP for the notional accounting period which ended during your income year.

Record keeping for each method of taxation

The records you must keep for your interest in a FIF or a FLP will depend on the method you use to work out the foreign investment fund income.

Market value method or cash surrender value

If you use the market value method or the cash surrender value method, make and keep records showing how you worked out:

- any FIF income that you accrued or FIF loss that you incurred from an interest in a FIF or a FLP for the current period
- any FIF loss that you incurred from the interest in the FIF or the FLP for the previous periods that has not been used to reduce income. [SECTIONS 616 or 619]

Also keep records relating to:

- the market value of your interest in the FIF on the last day of the notional accounting period or the cash surrender value of your interest in the FLP on the last day of the notional accounting period
- distributions received from the FIF or the FLP
- disposal of interests in a FIF or a FLP
- market value of your interest in the FIF or the cash surrender value of your interest in the FLP at the commencement of the notional accounting period and
- acquisition of interests in a FIF or a FLP.

You also need to keep details of how you worked out the market value or cash surrender value.

If you used the market value method, keep a record of the following.

- If the market value is based on a quoted value on a stock exchange, record the quoted price, the date quoted, the class of interest—share—and the name of the stock exchange.
- If the market value is based on a buy-back or redemption price, record details of the offer of the buy-back or redemption price.

Previous year losses

You may offset an unapplied FIF loss from an interest in a FIF or a FLP against assessable income for the part of the income from that interest that was taxed previously. You may also carry forward an unapplied FIF loss and offset it against any market value increase from the same FIF or FLP in subsequent periods. Keep records of these losses.

Deemed rate of return method

If you use the deemed rate of return method of taxation, keep records showing how you worked out the foreign investment fund income.
[SECTIONS 617 or 619]

The records are to include details of:

- the calculation of the opening value of the FIF or FLP interest
- the acquisition and sale of interests in a FIF or FLP and
- the distributions received from a FIF or FLP.

The calculation method

At the first tier

For the first tier FIF, keep records detailing how you worked out:

- the calculated profit or loss for the current notional accounting period
- any unapplied calculated losses of previous notional accounting periods
- the FIF income that accrued to you. [SECTION 618]

At the second tier

Where a first tier FIF has an interest in another FIF—a second tier FIF—you may elect to use the calculation method at the second tier. If you make that election, you must keep the same records for the second tier FIF that you keep for the first tier FIF.
[SECTION 618]

In addition, you may also need access to the underlying accounts and accounting records of the FIF. On audit, these may be called for to support your calculations.

Exempt in a previous year

Where your interest in a FIF was exempt in a previous income year and you elect to use the calculation method for the current year, keep details of the losses from any previous years which are to be offset against FIF income in the current income year.

Exemptions from the FIF measures

If you have an interest in a FIF or FLP which is wholly or partly exempt from FIF taxation for a notional accounting period ending in your income year, keep records showing why the exemption applied.
[SECTION 620]

In addition to the records indicated below, you must keep records for each interest in a FIF or FLP for which you are claiming an exemption.

Active business exemption

Stock exchange listing method

If you are claiming an exemption from the FIF measures under the active business exemption using the stock exchange listing method, keep records relating to:

- the name of the approved stock exchange in which the class of interests to which your FIF interest belongs was listed
- the class of the company designated by:
  - the approved stock exchange or
  - the approved international sectoral classification system
- the activities that the company is engaged in.

Balance sheet method

If you are claiming an active business exemption from the FIF measures using the balance sheet method, keep records of the gross value of all of the company's assets shown in the balance sheet and to what extent the assets are held at the balance date for use in eligible activities.

Where the foreign holding company is the direct or indirect owner of 50 per cent or more of the paid-up share capital of another company—subsidiary—the holding company may use the gross value of the subsidiary's assets for the balance sheet method. Keep records of the subsidiary's assets as shown in its balance sheet and of the extent to which the assets are held at the balance date for use in eligible activities. For more information, read appendix 2 *Business activities that are not eligible activities* on page 46.

Employer-sponsored foreign superannuation fund exemption

If you are claiming an employer-sponsored foreign superannuation fund exemption, keep details such as the name and location of the foreign superannuation fund and whether you are an employee or past employee, a director or an associate.

Exclusion of a FIF that is a CFC, CFT or a transferor trust

If you have an interest in a FIF which is also a CFC or CFT to which Part X of the Act applies, Part X requires you to keep records for the CFC measures.

Specific exemptions

Although some industries such as banking, insurance and real estate are listed as ineligible activities for the purposes of the active business test, there are specific exemptions for certain publicly listed and widely held investments in these industries. [DIVISIONS 4 to 7]

There are also specific exemptions for interests in FIFs that are trading stock, multi-industry foreign companies and Lloyd's of London. Your interests in FIFs which would otherwise be caught and taxed under the measures are exempt where the total value of those FIFs is 5 per cent or less of the total value of all your FIF interests. [DIVISIONS 12 to 15]

If you are claiming an exemption under one or more of these provisions, keep records showing how the FIF interest satisfied the conditions of the particular exemption. Read chapter 3 *Exemptions* on page 4 for the conditions that relate to the particular exemption.

Small investor exemption

Direct interests in FIFs and FLPs

For the small investor exemption, keep a record of how you worked out your aggregate interests and those of your associates in foreign companies, foreign trusts and foreign life policies. The aggregate must show that the amount of those interests is $A50 000 or less at the end of the notional accounting period.

Direct interests in resident public unit trusts

The small investor exemption does not include FIF income from the assessable income of a resident public unit trust. The exemption applies where you hold direct interests in resident public unit trusts and, at the end of your income year, your total interests and those of any of your associates in

- FIFs and FLPs and
- resident public unit trusts where, for that income year, the income of one or more of those resident public unit trusts includes any FIF income

are $A50 000 or less.

Keep a record of how you and your associates worked out your aggregate interests in any FIFs, FLPs and resident public unit trusts.

Exemption for visitors to Australia

If you are a short-term resident claiming exemption from the FIF measures as an exempt visitor, you must keep your contract of employment, passport, visa information and details of your date of arrival in Australia.

Elections

As a result of self-assessment, the majority of elections no longer have to be made in writing and lodged with the Commissioner of Taxation.

However, some elections and notifications which affect the taxation treatment of future transactions or events, or which cause the Commissioner to take some action in relation to an assessment, must be in writing and lodged with the Commissioner.

If you elect to use the calculation method, you will not have to lodge a written notice of the election. In making an election, you need to decide which provision of the Act to apply in working out a component of taxable income. You will also need to keep a record which verifies the calculation. These records and the way you worked out taxable income on your tax return will show whether you have made an election.

Prosecution provisions

Why have prosecution provisions?

Prosecution provisions are required to ensure compliance with the FIF record keeping measures. These provisions generally correspond with the prosecution provisions of the CFC measures. However, you cannot be prosecuted for failing to keep records before 18 December 1992.

A maximum penalty of $3000 may be imposed by the court if you are convicted of a breach of the record keeping requirements. [SECTION 621]

If you are prosecuted for failing to keep records of underlying accounts and accounting records in relation to the calculation method, you may rely, in certain circumstances, on a statutory defence. The defence will apply if you made reasonable efforts to obtain the required documents but were unable to get them. [SECTION 623]

If you do not have access to full information relating to a FIF, do not use the calculation method. You must keep records of the information on which you based your calculation of FIF income. However, section 623 is intended to apply if you had access to the information provided by the FIF or a third party but, due to a change in circumstances, do not have sufficient control to access the underlying accounts of the FIF after making reasonable attempts to do so. You would not be expected to use this defence unless exceptional circumstances existed.

A partnership will be treated as a person under the record keeping provisions. This allows the record keeping and related prosecution provisions to apply to the partnership. Accordingly, an offence committed by the partnership is treated as having been committed by each of the partners. [SUBSECTIONS 624 (1) and (2)]

However, a partner prosecuted for such an offence may have a defence where it can be proved they were not knowingly involved in any way in the commission of the offence. [SUBSECTION 624(3)]

CHAPTER 9

Taxation of non-resident trusts

Overview

The FIF amendments to the taxation of non-resident trusts, which commenced in the 1992–93 income year, supplemented the objective of the foreign source income measures in preventing the deferral of Australian tax. The FIF measures tax Australian resident beneficiaries with an interest or entitlement to acquire an interest in the income or capital of a foreign trust on their share of the trust income. They are taxed on an accruals basis at the time the income is derived by the trust rather then when its income or capital is distributed. You work out your share of the FIF income of a non-resident trust to which the FIF measures apply in the same way you would for other FIFs such as foreign companies.

Where the FIF measures apply to a beneficiary of a non-resident trust estate, they will:

- ensure no amount is included in the assessable income of
  - an Australian beneficiary under section 97 or
  - a trustee, under subsections 98(1) or (2), on behalf of an Australian beneficiary under a legal disability
- set out the way in which the income of a non-resident trust estate is worked out and attributed to Australian beneficiaries [SECTIONS 531 to 600]
- exempt from FIF taxation the beneficiary's and associates' interests in FIFs, FLPs and resident public unit trusts which do not exceed $50 000 at the end of an income year [SECTIONS 96A and 517]
- exempt an Australian beneficiary of a deceased estate from an interest charge on amounts that have been paid to or applied for the beneficiary's benefit within three years after the death of the person that gave rise to the estate [SUBSECTION 102AAM(1B)]
- exempt a beneficiary from an interest charge on an amount received or applied for the beneficiary's benefit from a public unit trust as defined under the transferor trust measures and which was not a controlled foreign trust under the CFC measures [SUBSECTION 102AAM(1C)]

- exempt from an interest charge on distribution an amount that was paid to or applied for the benefit of the beneficiary and which was paid out of accumulated profits:
  - other than eligible designated concession income of a broad-exemption listed country trust estate or
  - that has been subjected to tax in any broad-exemption listed country. [SECTIONS 102AAE and 102AAM]

The broad-exemption listed countries are:

Canada	New Zealand
France	United Kingdom of Great Britain and Northern Ireland
Germany	
Japan	United States of America

[SCHEDULE 10 of the Act and R152 of the Regulations]

Who do the FIF measures apply to?

The FIF measures apply to you for all or part of an income year in which you are an Australian resident. [SECTION 485]

Even though you are an Australian resident you are not taxed under the FIF measures for an interest in a foreign trust that you dispose of during an income year —that is, before 30 June each income year. See *Interests in a FIF or FLP subject to the FIF measures* on page 2. Where you dispose of an interest in a non-resident trust, other areas of the Act may apply. [SECTION 485]

Trusts to which the FIF measures apply

The FIF measures will apply to you if you are a beneficiary of or have an interest in a foreign or non-resident trust. A trust is a foreign trust if it is not:

- an Australian trust [SECTIONS 481 and 473]
- a public trading trust which is also a resident unit trust [SECTIONS 102G, 102H, 102J, 473 and 481]
- a corporate unit trust which is also a resident unit trust [SECTIONS 102J, 102H, 473 and 481]
- an Australian superannuation fund
- a complying approved deposit fund
- a pooled superannuation trust. [SECTIONS 267, 470, 477 and 481]

A trust is an Australian trust if the trustee was a resident, or the central management and control of the trust was in Australia, for 12 months preceding the end of your income year. [SECTIONS 473, 481 and 485]

What is an Interest in a foreign trust?

You will have an interest in a FIF that is a foreign trust if you have:

- an interest in the capital or income of the trust—including a unit in a unit trust—or
- an entitlement to acquire such an interest through an option, convertible note, or other instrument. [SECTIONS 470, 475, 482]

Your entitlement to acquire an interest in the income or capital may be absolute or be contingent on some other event. It may arise through a document of a company or the exercise of a right or option or for any other reason. [SECTION 475]

Taxpayers exempt from the FIF measures

You are exempt from the FIF measures if you are an Australian resident and also:

- an attributable taxpayer of a transferor trust or controlled foreign trusts [SECTION 493]
- a beneficiary of a deceased estate—see *What is a FIF?* on page 2 [SECTION 481]
- an exempt small investor—see *Exemption for an interest of $50 000 or less* on page 9 [SECTION 515]
- an exempt visitor—see *Exemption for visitors to Australia* on page 10 [SECTION 517]
- a member of an employer-sponsored foreign superannuation fund—see *Exemption for employer-sponsored foreign superannuation* on page 10. [SECTION 519]

Exempt attributable taxpayer

An attributable taxpayer of a transferor trust or controlled foreign trust is not taxed under the FIF measures because they are attributed income from the foreign trust under other provisions of the Act. See *Exemption for attributable taxpayers* on page 4. [SECTIONS 102AAA, 102 AAZG, 342, 348 and 493]

Small investor exclusion

Certain small investors are exempt from the FIF measures. See *Exemption for an interest of $A50 000 or less* on page 9 for more information.

Consistent with this exemption, the FIF measures excluded FIF income from the assessable income of a resident public unit trust when working out a small investor's share of the net income of the trust estate. This exclusion applies only to natural persons and will apply to you if the sum of your interests and those of your associates in FIFs, FLPs and resident public unit trusts at the end of the income year are $50 000 or less. [SUBSECTION 96A(2)]

In a subsequent year of income, you must work out the trust's net income by ignoring attribution credits which arose during income years when you were exempt because of this small investor's exemption. [PARAGRAPH 96A(2)(d)]

This means that you as the beneficiary will not benefit from:

- the exemption, which applies for amounts previously attributed under the FIF measures [SECTION 23AK]
- a reduction in the disposal consideration of the FIF interest because of an unused FIF attribution account surplus from income attributed but not distributed before disposal of the FIF interest. [SECTION 613]

These two benefits arise because FIF income was included in the net income of the trust in a year when you as a beneficiary of the public unit trust were not taxed on that FIF income because of the small investor's exclusion. [PARAGRAPHS 96A(2)(d) to (e)]

Exempt beneficiaries of a foreign deceased estate

The measures do not apply to an Australian resident beneficiary of a foreign trust arising in relation to the estate of deceased persons. The estate of a deceased person who made or did not make a will is not covered by the FIF measures. The measures do not apply even where a court has made an order in respect of the estate of a deceased person. For further information, see *What is a FIF?* on page 2. Also see *Deceased estates* on page 43 for an exemption from an interest charge.

Exempt member of an employer-sponsored foreign superannuation fund

For your exemption from FIF taxation on your interest in an employer-sponsored foreign superannuation fund see page 10.

Attribution of non-resident trust income under the FIF measures

Prior to the FIF measures the assessable income of an Australian beneficiary who was not under a legal disability included the share of the net income of a non-resident trust estate to which the beneficiary was presently entitled and which was attributed to a period when the beneficiary was a resident of Australia. [SECTION 97]

Since the FIF measures your share of the income of a FIF which is a foreign trust is worked out in the same manner as other FIFs, either by the:

- market value method
- deemed rate of return method or
- calculation method.

Since the commencement of the FIF measures, where an amount is worked out in accordance with one of the above methods and included in the assessable income of the beneficiary as FIF income or loss, no amounts are included in the assessable income of an Australian beneficiary under the general trust provisions. [SECTIONS 96A, 97 and 529]

Attribution of non-resident trust income where the FIF measures do not apply

From 1992–93, the share of the income of an Australian beneficiary of a non-resident trust who is not assessed under the FIF measures is worked out by one of two methods. [SECTIONS 96B and 96C]

Method 1

This method is used where all the income, profits or gains derived by the non-resident trust estate during the income year consisted of either or both:

- income, profits or gains to which beneficiaries of the non-resident trust estate were presently entitled
- income, profits or gains to which beneficiaries of the non-resident trust estate were not presently entitled but which were distributed to the beneficiaries within 2 months after the end of the income year.

In the above cases, the beneficiaries are deemed to be presently entitled to a share of the net income of the non-resident trust estate equal to the percentage of the total income, profits or gains of the non-resident trust represented by the total of the amounts:

- to which the beneficiaries were presently entitled or
- to which the beneficiaries were not presently entitled but which were distributed to the beneficiaries of the trust estate within 2 months after the end of the income year. [SUBSECTION 96C(1)]

Method 2

In any other case, the beneficiaries are deemed to be presently entitled to a share of the net income of the non-resident trust equal to whichever is the greater percentage of:

- the income of the non-resident trust estate represented by the share of income to which the beneficiaries were entitled or were entitled to acquire or
- the capital of the non-resident trust estate represented by the share of the capital to which the beneficiaries were entitled or were entitled to acquire. [SUBSECTION 96C(2)]

Where the aggregate of the Australian beneficiaries' present entitlement is more than 100 per cent of the income of the non-resident trust estate, the total interests are reduced to 100 percent and each beneficiary's interests are reduced proportionally. [SUBSECTION 96C(6)]

Australian resident beneficiary of a non-resident trust estate under a legal disability

Prior to the FIF measures the assessable income of a trustee included the share of the net income of a trust estate which related to a period when:

- a beneficiary under a legal disability was a resident of Australia or
- a beneficiary who was deemed to be presently entitled to a share of the net income of the trust estate, because they had a vested and indefeasible interest in the income of the trust estate, was a resident of Australia. [SUBSECTIONS 95A(2), 98(1) and (2)]

Since the FIF measures a trustee is now not assessed on behalf of a beneficiary of a non-resident trust estate where the beneficiary is under a legal disability as the beneficiary is deemed not to be under a legal disability. However, the beneficiary is assessed under section 97—the general assessing provision for trusts. The beneficiary's own share of the net income of the non-resident trust estate is now worked out under the provisions of section 96C—see the commentary above on section 96C and the FIF measures. [SUBSECTIONS 96B(2), 98(1) and (2)]

Non-resident trusts exempt from interest charges

Public unit trusts

The transferor trust measures do not apply to arm's length transfers to non-resident public unit trusts. [SUB-SUBPARAGRAPH 102AAT(1)(a)(i)(B)]

Consistent with this treatment, from the 1992–93 income year you are exempt from an interest charge on amounts received, or which have been applied for your benefit, that are attributable to the income or profits of a non-resident trust estate which at all times during the year was:

- a public unit trust under the transferor trust measures [DIVISION 6AAA] and
- not a controlled foreign trust within the meaning of Part X. [SUBSECTION 102AAM(1C)]

A unit trust will be a public unit trust if, at any time during the year, any of the units in the unit trust were listed on a stock exchange in Australia or elsewhere or were offered to the public.

In addition, a unit trust will be a public unit trust if, at all times during the year, the units in the unit trust were held by 50 or more persons. A unit trust will not be treated as a public unit trust where 20 or fewer persons hold 75 per cent or more of the beneficial interests of the income or property of the trust. [SECTION 102ABF]

You must take the following into account when deciding whether a unit trust is a public unit trust at all times during the year of income.

- An entity and its associates are taken to be one person.
- Where units in the trust are held by the trustee of another trust estate that is a public unit trust at all times during the income year, a person who has a beneficial interest in the second trust estate is taken to hold those units. [SUBSECTION 102AAF(3)]

A public unit trust cannot also be a controlled foreign trust (CFT). A trust estate will be a CFT if there is an eligible transferor in respect of the trust—that is, if an Australian entity or a controlled foreign partnership, CFT or CFC transferred value to the trust estate:

- in the case of a discretionary trust estate, at any time [SECTION 347]
- in the case of a non-discretionary trust estate, after 12 April 1989 for non-arm's length consideration. [SECTIONS 342 and 348]

A trust estate will also be a CFT if there is a group of five or fewer Australian entities with a 1 per cent interest in the trust estate totalling 50 per cent or more. [SECTION 342]

When you are working out if an Australian entity has a 1 per cent interest in the trust, include the direct and indirect interests of the entity's associates in the same trust or trusts.

Deceased estates

Generally, where property of a trust estate is paid to or applied for the benefit of a beneficiary, an amount—unless it has already been subjected to tax in the hands of the trustee or beneficiary—is included in the assessable income of that beneficiary. Under those circumstances, an interest charge usually applies to amounts that are included in the assessable income of that beneficiary. [SECTIONS 99B and 102AAM]

However, from the 1992–93 income year, a beneficiary is exempt from the interest charge on amounts received from the estate of a deceased person where those amounts are paid to, or applied for the benefit of, the beneficiary within three years after the death of that person. [SUBSECTION 102AAM(1B)]

Amounts taxed at comparable rates

Where a non-resident trust estate is a broad-exemption listed country trust estate—see page 40—in an income year, only distributions from certain concessionally taxed income of the trust estate are subject to the interest charge under section 102AAM. Where a non-resident trust estate is not a broad-exemption listed country trust estate in an income year, distributions made from the income and profits of the trust estate for that year are subject to the interest charge if the amount has not been subject to tax in any listed country in a tax accounting period:

- ending before the end of the non-resident trust's income year or
- commencing during the non-resident trust's income year. [PARAGRAPH 102AAM(1)(b)]

Before that amount will be exempt from the section 102AAM interest charge on distribution, you will have to show that an amount that was the property of a trust estate was paid to you or applied for your benefit out of accumulated profits which relate to:

- in the case of a broad-exemption listed country trust estate, income other than eligible designated concession income or
- in any other case, income that has been subject to tax in any broad-exemption listed country. [SUBSECTION 102AAM(1A)]

APPENDIX 1

Approved stock exchanges

Schedule 3—Approved stock exchanges under Part XI

Argentina
Buenos Aires stock exchange
Córdoba stock exchange
La Plata stock exchange
Mendoza stock exchange
Rosario stock exchange

Australia
Australian Stock Exchange Limited

Austria
Vienna stock exchange

Belgium
Antwerp stock exchange
Brussels stock exchange
Liege stock exchange

Brazil
Belo Horizonte stock exchange
Curitiba stock exchange
Fortaleza stock exchange
Porto Alegre stock exchange
Recife stock exchange
Rio de Janeiro stock exchange
Salvador stock exchange
Santos stock exchange
Sao Paulo stock exchange

Canada
Calgary stock exchange
Montreal stock exchange
Toronto stock exchange
Vancouver stock exchange
Winnipeg stock exchange

Chile
Santiago stock exchange
Valparaiso stock exchange

China
Shanghai stock exchange
Shenzhen stock exchange

Colombia
Bogota stock exchange

Denmark
Copenhagen stock exchange

Finland
Helsinki stock exchange

France
Bordeaux stock exchange
Lille stock exchange
Lyon stock exchange
Marseille stock exchange
Paris stock exchange

Germany
Berlin stock exchange
Dusseldorf stock exchange
Frankfurt stock exchange
Hamburg stock exchange
Hannover stock exchange
Munich stock exchange
Stuttgart stock exchange

Greece
Athens stock exchange

Hong Kong
Hong Kong stock exchange

Hungary
Budapest stock exchange

India
Bombay stock exchange
Calcutta stock exchange
Delhi stock exchange
Madras stock exchange

Indonesia
Jakarta stock exchange
Surabaya stock exchange

Ireland
Dublin stock exchange

Israel
Tel Aviv stock exchange

Italy
Bologna stock exchange
Florence stock exchange
Genoa stock exchange
Milan stock exchange
Naples stock exchange
Palermo stock exchange
Rome stock exchange
Trieste stock exchange
Turin stock exchange
Venice stock exchange

Jamaica
Jamaica stock exchange

Japan
Fukuoka stock exchange
Hiroshima stock exchange
Kyoto stock exchange
Nagoya stock exchange
Niigata stock exchange
Osaka stock exchange
Sapporo stock exchange
Tokyo stock exchange

Korea, Republic of
Seoul stock exchange

Luxembourg
Luxembourg stock exchange

Malaysia
Kuala Lumpur stock exchange

Mexico
Mexican stock exchange

Netherlands
Amsterdam stock exchange

New Zealand
New Zealand stock exchange

Nigeria
Nigerian stock exchange

Norway
Oslo stock exchange

Pakistan
Karachi stock exchange

Peru
Lima stock exchange

Philippines
Makati stock exchange
Manila stock exchange

Poland
Warsaw stock exchange

Portugal
Lisbon stock exchange
Oporto stock exchange

Singapore
Singapore stock exchange

Slovakia
Bratislava stock exchange

Slovenia
Ljubljana stock exchange

South Africa
Johannesburg stock exchange

Spain
Barcelona stock exchange
Bilbao stock exchange
Madrid stock exchange
Valencia stock exchange

Sri Lanka
Colombo stock exchange

Sweden
Stockholm stock exchange

Switzerland
Basel stock exchange
Geneva stock exchange
Zurich stock exchange

Taiwan
Taiwan stock exchange

Thailand
Thailand stock exchange

Trinidad and Tobago
Trinidad and Tobago stock exchange

Turkey
Istanbul stock exchange

United Kingdom
London stock exchange

United States
American stock exchange
Boston stock exchange
Cincinnati stock exchange
Midwest stock exchange
NASDAQ stock exchange
New York stock exchange
Pacific stock exchange
Philadelphia stock exchange

Uruguay
Montevideo stock exchange

Venezuela
Caracas stock exchange
Maracaibo stock exchange

Yugoslavia
Belgrade stock exchange

Zimbabwe
Zimbabwe stock exchange

APPENDIX 2

Business activities that are not eligible activities

Schedule 4—Business activities that are not eligible activities under Division 3 of Part XI

- Banking* and the provision of finance
- Financial services
- Investment in tainted assets, or tainted commodity investments, within the meaning of section 317*
- Life insurance business*
- General insurance business*
- Management of funds
- Certain activities in connection with real property other than in connection with construction*

*Although, in this schedule, banking, investment, life insurance business, general insurance business and activities in connection with real property are referred to as not being eligible activities, under subsection 496(2) the exemptions provided for by Divisions 4, 5, 6 and 7 of Part XI are not affected.

APPENDIX 3

Approved international sectoral classification systems

Schedule 5—Approved international sectoral classification systems under Part XI

Bloomberg's Information Systems

Extel Financial Workstation

Financial Times—Actuaries World Index

International Finance Corporation Composite Index

Morgan Stanley Capital International Index

Salomon—Russell Global Equity Index

Standard and Poor's Composite Index (S&P 500)

APPENDIX 4

Previously exempt foreign trusts

Exempt foreign trusts under Part XI.

Established in countries that prohibit direct foreign investment on stock exchanges in those countries.

Chile

Genesis Chile Fund

India

Himalaya Fund
Indian Fund
India Growth Fund
India Magnum Fund

Korea, Republic of

Baring Korea Fund
Baring New Korea Trust
Daechan Korea Trust
GT Korean Fund
Jardine Fleming (JF) Korea Trust
Korea Asian Fund Ltd
Korea Emerging Company Trust
Korea Equity Trust
Korea-Euro Fund
Korea Growth
Korea International Trust
Korea Liberalisation Fund Ltd
Korea Nineteen Ninety Trust
Korea Small Company Fund
Korea Trust
Seoul International
Seoul Trust

Taiwan

Formosan Fund
JF Taipei Trust
JF Taiwan Trust
Taipei Fund
Taiwan Fund
Taiwan (RoC) Fund

Worksheet 1—Market value method

Complete the relevant parts of the worksheet for the interests you hold in the FIF.

Description of interests in the FIF. ______________________________

Part 1

Express the amounts in B to D in the same currency as the amount in A. Alternatively, you may irrevocably elect to express the amounts in A to D in Australian currency. This will bring to account currency exchange gains and losses at the times the transactions and values relevant to the calculations occurred.

The market value of your interests held in the FIF on the last day of the notional accounting period. Notional accounting period is explained on page 3. **A** ______

The amount of all distributions you received from the FIF during the notional accounting period. **B** ______

The market value of the interest you held in the FIF on the day immediately before the first day of the notional accounting period for the interests in A. **C** ______

The amount you gave for acquiring any interests in the FIF during the notional accounting period if that interest is included in A. **D** ______

Add C and D and take the total away from the sum of A and B. **E** ______

This is the FIF amount.

If the amount at E is negative, you have incurred a current year FIF loss. You may take this loss into account for future years as an unapplied previous FIF loss, but only for the same FIF.

If the amount at E is positive, go to part 2.

Part 2

Any unapplied previous FIF losses. **F** ______

Take the amount at F away from the amount at E. **G** ______

Convert to $A. If the amount at G is positive—that is, you have FIF income—and the amounts in part 1 were expressed in foreign currency, convert the amount at G to Australian currency and include it at H. Use the rate of exchange applying at the end of the notional accounting period.
If the amount at G is in Australian currency, include the same amount at H.
If the amount at G is negative, you can take that amount into account in future years as an unapplied previous FIF loss. **H** $A ______

Part 3

Did you receive any distributions from the FIF during the notional accounting period?

If No, then the amount at H is not reduced. Copy the amount from H to I. Include this amount in your assessable income. **I** ______

If Yes, insert the amount, if any, of the distributions that are of the type to which subsection 530(1) applies. Include any reductions of FIF income under employee share acquisition schemes. See *Reduction of FIF income for distributed profits* on page 25 . [SECTION 530A] **J** ______

Take J away from H. **K** ______

If the amount at K is positive, include it in your assessable income.

If the amount at K is negative, do not include any amount in your assessable income under the FIF measures.

For details on how to complete your tax return, refer to the attributed foreign income question in *TaxPack* or the instruction guides for company, trust, partnership and superannuation fund tax returns.

Worksheet 2—Deemed rate of return method for FIFs

Complete the relevant parts of the worksheet for the interests you hold in the FIF on the last day of the notional accounting period—notional accounting period is explained on page 3. Interests in the FIF which you dispose of before the end of the notional accounting period are not taxed under FIF measures.

Part 1

Description of the group of interests in the FIF. ______________________

Opening value.	A	
Multiply A by the deemed rate of return.	B	
Multiply B by $\dfrac{\text{the number of days in the notional accounting period for which you held the interests in the group}}{\text{the number of days in the notional accounting period (generally 365)}}$	C	

Part 2

Convert the amount at C to Australian currency at the rate of exchange applying at the end of the notional accounting period.	D	$A

Part 3

If you have more than one group of interests in the FIF and completed more than one part 1 and part 2, add the amounts in each box D and show the total amount at E.

If you had only one interest in the FIF, copy the amount from D to E.	E	

Part 4

Did you receive any distributions from the FIF during the notional accounting period? See chapter 6 for information about reductions of FIF income.

If No, then the amount at E is not reduced. Copy the amount from E to F. Include this amount in your assessable income.	F	
If Yes, insert the amount, if any, of the distributions that are of the type to which subsection 530(1) applies. Include any reductions of FIF income for employee share acquisition schemes—see page 25. [SECTION 530A]	G	
Take G away from E.	H	

If the amount at H is positive, include it in your assessable income.

If the amount at H is negative, do not include any amount in your assessable income under the FIF measures.

For details on how to complete your tax return, refer to the attributed foreign income question in *TaxPack* or the instruction guides for company, trust, partnership and superannuation fund tax returns.

Worksheet 3—Calculation method

Complete the relevant parts of the worksheet for those interests you held in the FIF on the last day of the notional accounting period. Notional accounting period is explained on page 3. Interests in the FIF that you dispose of before the end of the notional accounting period are not taxed under the FIF measures.

Description of the FIF. ____________________

Part 1—Use the currency in which the accounts of the FIF are made out.

The notional income of the FIF for the notional accounting period.	A	
The notional deductions of the FIF for the notional accounting period.	B	
Subtract B from A.	C	

If the amount at C is negative, the FIF has a calculated loss. This loss is allowed as a notional deduction for the same FIF in future years.

If the amount at C is positive, the FIF has a calculated profit. Go to part 2.

Part 2

If the amount at C is positive, convert the amount to Australian currency at the rate of exchange applying at the end of the notional accounting period. Now complete parts 3 and 4, as appropriate.	D	$A

Part 3

Complete this part for interests you held in the FIF for the entire notional accounting period.

Your attribution percentage for your interest in the FIF held for the whole of the notional accounting period.	E	%
Multiply D by E.	F	

Part 4

Complete this part for interests in the FIF acquired throughout a particular part of the notional accounting period. Do not apply the calculation method for interests in the FIF which you dispose of before the end of the notional accounting period. These interests may be dealt with under other provisions of the Act—for example, the capital gains tax provisions. Repeat part 4 for interests in the FIF that you acquired at different times throughout the notional accounting period.

Your attribution percentage for interests in the FIF held throughout a particular part of the notional accounting period.	G	%
Multiply D by G.	H	

Multiply H by

$$\frac{\text{the number of days in the notional accounting period for which you held the interests in the FIF}}{\text{the number of days in the notional accounting period (generally 365)}}$$

I ____

Part 5

Add F and I, where applicable, to determine your FIF income. J [ ]

Now go to part 6.

Part 6

Did you receive any distributions from the FIF during the notional accounting period?

If No, then the amount at J is not reduced. Copy the amount from J to K.

Include this amount in your assessable income. K [ ]

If Yes, insert the amount, if any, of the distributions that are of the type to which subsection 530(1) applies. Include any reduction of FIF income resulting from employee share schemes [SECTION 530A]. See chapter 6 on page 25 for more information. L [ ]

Subtract L from J M [ ]

If the amount at M is positive, include it in your assessable income.

If the amount at M is negative, do not include any amount in your assessable income under the FIF measures.

For details on how to complete your tax return, refer to the attributed foreign income question in *TaxPack* or the instruction guides for company, trust, partnership and superannuation fund tax returns.

Worksheet 4—Deemed rate of return method for FLPs

Complete the relevant parts of the worksheet for the interests you hold in the FLP.
Read page 22—*Deemed rate of return method*—for more information.

Part 1

Description of the group of interests in the FLP. ______________________

Opening value.	A	
Multiply A by the deemed rate of return.	B	
Multiply B by $\dfrac{\text{the number of days you held the interest in the FLP during the notional accounting period}}{\text{the number of days in the notional accounting period (generally 365)}}$	C	

Part 2

Convert the FIF amount at C to Australian currency at the rate of exchange applying at the end of the notional accounting period.	D	$A

Part 3

If you have more than one group of interests in the FLP and completed more than one part 1 and part 2, add the amounts in D and insert the total amount at E.

If you had only one interest in the FLP, copy the amount from D to E.	E	

Part 4

Did you receive any distributions from the FLP during the notional accounting period? See chapter 6 for information about reductions of FIF income.

If No, then the amount at E is not reduced. Copy the amount from E to F. Include this amount in your assessable income.	F	
If Yes, insert the amount, if any, of the distributions that are of the type to which subsection 530(1) applies—see page 25.	G	
Subtract G from E.	H	

If the amount at H is positive, include it in your assessable income.

If the amount at H is negative, do not include any amount in your assessable income under the FIF measures.

For details on how to complete your tax return, refer to the attributed foreign income question in *TaxPack* or the instruction guides for company, trust, partnership and superannuation fund tax returns.

Worksheet 5—Cash surrender value method for FLPs

Complete the relevant parts of the worksheet for the interests you hold in the FLP.
See page 23—*Cash surrender value method*—for more information.

Description of interests in the FLP. ____

Part 1

Express the amounts in B to F in the same currency as the amount in A.

The cash surrender value of your interests held in the FLP on the last day of the notional accounting period.	A	
The amount of distributions you received from the FLP during the notional accounting period for those interests you held on the last day of the period.	B	
Where you have disposed of interests in the FLP during the notional accounting period, insert:		
• the amount of distributions you received for those interests from the FLP during the notional accounting period—if more convenient, include this amount at B—and	C	
• the amount you received for the disposal of the interests in the FLP.	D	
The cash surrender value of the interests you held in the FLP on the day immediately before the first day of the notional accounting period or the deemed rate of return value for the same interests on the last day of the previous period where the deemed rate of return method was used for that period.	E	
The amount you paid for acquiring any interest in the FLP during the notional accounting period.	F	
Add E and F and take the total away from the sum of A to D.	G	

This is the gross FIF income amount. If the amount at G is negative, you have incurred a current year FIF loss. You may take this loss into account in future years as an unapplied previous FIF loss, but only for the same FLP.

If the amount at G is positive, go to part 2.

Part 2

Enter any unapplied previous FIF losses.	H	
Subtract the amount at H from the amount at G.	I	
If the amount at I is positive—that is, you have FIF income—convert the amount to Australian currency at the rate of exchange applying at the end of the notional accounting period. If the amount at I is negative, you may use the amount in future years as an unapplied previous FIF loss.	J	$A

Part 3

Did you receive any distributions from the FLP during the notional accounting period?

If No, then the amount at J is not reduced. Copy the amount from J to K.

Include this amount in your assessable income. K

If Yes, insert the amount, if any, of the distributions that are of the type to which subsection 530(1) applies—see page 25. L

Subtract L from J. M

If the amount at M is positive, include it in your assessable income.

If the amount at M is negative, do not include any amount in your assessable income under the FIF measures.

For details on how to complete your tax return, refer to the attributed foreign income question in *TaxPack* or the instruction guides for company, trust, partnership and superannuation fund tax returns.