# FOREIGN INCOME RETURN FORM GUIDE

UPDATE 2002–03

Australian Taxation Office
Canberra

NAT 1840U—6.2003

# Foreign income return form guide (NAT 1840—5.1998) Update 2002-03

**Addition to CONTENTS:**


- **Chapter 5: Consolidation (consolidated income tax treatment for groups of entities)**
- Section 1– Overview
- Section 2 – Excess foreign tax credits
- Section 3 – Attribution account surpluses and attribution tax account surpluses
- Section 4 – Elections
- Section 5 – More information on consolidation


**REPLACEMENT TEXT – Page 31**

To replace the Section 3 text.

## Section 3 – Modifications to the treatment of capital gains and losses

The operation of the capital gains tax provisions of the Tax Acts is modified for working out the attributable income for a controlled foreign company (CFC).

### *Assets included in the calculation*

Capital gains and losses taken into account in working out attributable income for a CFC are those arising on:

- the disposal of non-taxable Australian assets for the purposes of Part IIIA of the *Income Tax Assessment Act 1936* (ITAA 1936), and
- 'non-CGT assets having the necessary connection with Australia' for the purposes Subdivision 136A of Chapter 3 of the *Income Tax Assessment Act 1997* (ITAA 1997).

(A capital gain or loss on the disposal of a taxable Australian asset or a CGT asset having the necessary connection with Australia will be taken into account in working out the real assessable income of the CFC as a non-resident taxpayer and is therefore **excluded** from the calculation of the CFC's attributable income. **Note**: This exclusion applies even where the relevant asset is not subject to capital gains tax because it was acquired before 20 September 1985.)

#### What is a taxable Australian asset and a CGT asset having the necessary connection with Australia?

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

Broadly, a taxable Australian asset or a CGT asset having the necessary connection with Australia is:

- land or buildings in Australia
- assets used in carrying on business through a permanent establishment in Australia
- a share, or an interest in a share, in a company which was a resident private company in the income year in which the disposal took place

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

**NOTE** The specific list of CGT assets having the necessary connection with Australia is set out in section 136-25 of ITAA 1997.

### Assets used to produce notional exempt income

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

### Removal of exemption of pre-20 September 1985 assets

When applying the capital gains tax provisions in working out attributable income, all non-taxable Australian assets and non-CGT assets having the necessary connection with Australia that a CFC owned at 30 June 1990 are deemed to have been acquired by the CFC on 30 June 1990 regardless of the date the asset was acquired.

### Cost base of assets for companies which become CFCs after 30 June 1990

The cost base of assets owned by a company that became a CFC after 30 June 1990 is market value of those assets at the time the company became a CFC.

## Example 26

***Cost base of asset***

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

***Consequences***

The asset will be deemed to have been acquired for market value on 1 March 1993 – that is, when the company became a CFC. The capital gain or loss is therefore worked out using the change in the asset's value between 1 March 1993 and 1 October 1995.

**REPLACEMENT TEXT – Page 33**

To replace 'Treatment of a net capital loss under Part IIIA' and 'Roll-over of assets and Part IIIA'

## Treatment of a net capital loss under the capital gains tax provisions

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

A CFC cannot use a net capital loss under the CGT provisions to reduce its notional assessable income. It can only carry the loss forward for offset against capital gains in subsequent years.

You cannot transfer a loss, for example, you cannot use the loss of one CFC to reduce the notional assessable income of another CFC or your own assessable income.

In working out attributable income you cannot take into account a capital loss incurred on the disposal of an asset where the disposal occurred before 1 July 1990.

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

## Roll-over of assets under the capital gains tax provisions

### *Forced disposals*

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

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

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

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

### *Group transfers*

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

**NEW TEXT: Chapter 5**

To insert after page 94.

# Chapter 5: Consolidation (consolidated income tax treatment for groups of entities)

## *Part 1 – Overview*

For income tax purposes, consolidation is optional. However, if the head company of a wholly owned resident group decides to consolidate, all its wholly owned Australian resident group entities must become members of that consolidated group. Once a group has consolidated it is treated as a single entity for income tax purposes. Where a foreign company, either directly or through its wholly owned foreign group, has multiple entry points of investment into Australia through Australian resident companies, special multiple entry consolidated (MEC) group rules will apply to the wholly owned resident companies and their wholly owned resident subsidiary entities.

The following losses and tax attributes can generally be brought into a consolidated group and used by the group's head company:

- losses (including foreign losses)
- franking credits
- excess foreign tax credits
- attribution account surpluses, and
- attribution tax account surpluses.

It is important to note that this chapter simply provides a summary of the provisions that relate to the application of income attributed from controlled foreign companies (CFCs) and included in the assessable income of a head company of a consolidated group. Detailed information on the operation of consolidation is contained in the *Consolidated Reference Manual* – see also Part 5 below.

## *Part 2 – Excess foreign tax credits*

The new consolidation regime ensures that only the head company of a consolidated group includes the foreign income of the consolidated group in its assessable income. Therefore, only the head company needs to use foreign tax credits to reduce its Australian tax liabilities to avoid double taxation. To enable the head company of the consolidated group to access the excess foreign tax credits carried forward by subsidiary members, the excess credits are transferred to the head company. Generally, the head company can only use the transferred excess credits at the end of the income year after the year the entity joined the group; however, transitional rules will apply to groups that consolidate within the transitional period of 1 July 2002 to 30 June 2004.

Where an entity pays foreign tax on foreign income while it is a member of a consolidated group, the head company will be assessed on the foreign income and will be taken to have paid and been personally liable for the foreign tax paid by the subsidiary member.

Where an entity leaves a consolidated group it cannot take any excess foreign tax credits with it and it is only required to include foreign income in its assessable income for the period it is not a member of any consolidated group.

The provisions relating to excess foreign tax credits became effective on 1 July 2002. These provisions were contained in the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* which received royal assent on 24 October 2002.

## *Part 3 – Attribution account surpluses and attributed tax account surpluses*

During the period of consolidation, only the head company is required to operate attribution accounts and attributed tax accounts for the purposes of the CFC measures. Subsidiary companies transfer the pre-consolidation balances of their attribution accounts and attributed tax accounts to the head company to facilitate its use of any pre-consolidation surpluses during consolidation.

Once the account balances have been transferred to the head company of a consolidated group, the attribution and attributed tax accounts of subsidiary members become inoperative. However, the attribution and attributed tax account surpluses are transferred to the head company so that, to the extent that income had previously been attributed to the entity company. Subsequent distributions of income from an attribution entity, for example, a CFC, that had previously been attributed to the entity company, are not assessed to the head company.

When a company with an interest in a CFC leaves a group, a proportion of the attribution and attributed tax account surpluses that the head company has in relation to the interests in the CFC that leave the group with the leaving company will be transferred to the leaving company.

The provisions relating to attribution accounts and attributed tax accounts became effective on 1 July 2002. These provisions were contained in the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* which received royal assent on 24 October 2002.

## *Part 4 – Elections*

A proposed technical amendment is included in New Business Tax System (Consolidation and Other Measures) Bill (No.2) 2002. The amendment deals with elections made under Part X (the CFC measures) of ITAA 1936 where entities become subsidiary members of a consolidated group and where members leave a group. The rules ensure that the entry history rule in Part 3-90 of ITAA 1997 does not adversely affect the head company's ability to make elections in relation to its interests in CFCs. Similarly, they ensure the exit history rule in Part 3-90 does not adversely affect the leaving company's ability to make elections in relation to interests in CFCs that the leaving company takes with it on exit.

## *Part 5 – More information on consolidation*

The *Consolidated Reference Manual* (NAT 6835) provides detailed information on the operation of consolidation, including its practical impacts for business. It is available on the ATO website: **www.ato.gov.au**

- Go to the "Other Websites' drop-down menu and choose 'Tax Reform';
- Go to either 'Business – including non-profit' link or the 'Tax Practitioners' link;
- Go to 'Newly released Consolidation material'.

Doing this will take you to the links that allow you to download the *Consolidated reference manual,* as well as the legislation and explanatory material to the legislation.

(ATO officers may access the manual through ATO*connect*.)

If you have tax technical queries, you may also phone the Business Tax Reform Infoline on **13 24 78**.

You can e-mail any enquiries to **consolidation@ato.gov.au**