

Worked example

Calculating the foreign income tax offset

Description This example shows how a head company determines its entitlement to a foreign income tax offset and calculates the amount of the offset.

Commentary The foreign income tax offset rules allow a non-refundable tax offset for foreign income tax paid on an amount included in assessable income. The taxpayer is entitled to a tax offset in the income year in which the amount is included in its assessable income.

The foreign income tax offset rules replace the foreign tax credit rules from the first income year starting on or after 1 July 2008. From the commencement year, transitional rules apply to the transfer and utilisation of pre-commencement excess foreign income tax → worked example 'Foreign income tax offset – transitional rules', C6-2-120.

Under the single entity rule, the head company of a consolidated or MEC group is assessed on foreign income derived by it and subsidiary members of the group. Where a subsidiary member pays foreign income tax on an amount included in the head company's assessable income, the head company is treated as having paid the foreign income tax, and only it is entitled to the corresponding foreign income tax offset.

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

The head company is deemed to have paid foreign income tax on an amount included in its assessable income where the foreign income tax has been paid by another entity under an arrangement or under the law relating to the foreign income tax, such as payments by a partnership or trust. The deeming rules cannot apply to a subsidiary member while it is a member of the consolidated or MEC group because the subsidiary member does not include the amount on which the foreign income tax has been paid in its assessable income.

Deeming rules extend the flow-through of a tax offset entitlement to ensure that a beneficiary of a trust can be deemed to have paid any foreign income tax on its share of trust income that is attributable to income flowing through a trust (or chain of trusts) on which foreign income tax is paid by another entity. Where income beneficially derived by a subsidiary member is attributable to income received by a trust on which foreign income tax has already been paid, the head company is treated as having paid the foreign income tax where the income is included in its assessable income due to the operation of the single entity rule.

Example

Facts HCo is the head company of a consolidated group, which has two subsidiary members, ACo and BCo, at the start of the 2009-10 income year.

ACo holds a 50% interest in a partnership that earns foreign income.

BCo is one of two beneficiaries of a trust that has shares in a foreign company, FCo. Both beneficiaries have equal entitlement to income and capital of the trust but the other beneficiary is not a subsidiary member of the HCo consolidated group.

In the income year beginning 1 July 2009, the following transactions occur:

- The partnership in which ACo is a partner earns \$1,000 of net partnership income on which it pays \$200 foreign income tax.
- FCo pays a dividend of \$6,000 to the trust and deducts \$900 withholding tax, leaving a net distribution of \$5,100. The trust distributes \$2,550 to BCo.

On 1 January 2010, HCo acquires all the membership interests in CCo (which has the same income year as HCo).

CCo derives \$10,000 of foreign income in the non-membership period from 1 July 2009 to 31 December 2009. In May 2010, CCo pays foreign income tax of \$2,500 on this amount of foreign income.

Neither HCo nor CCo has any pre-commencement excess foreign income tax from previous income years.

Calculation Under the single entity rule, HCo includes the income of the subsidiary members in its assessable income. Under the foreign income tax offset rules, the amount included in assessable income is the grossed-up amount: that is, the amount before the payment of foreign income tax.

For the year ending 30 June 2010, HCo's assessable income will include:

ACo's share of the partnership's income: \$500 (grossed-up amount)

BCo's distribution from the trust: \$3,000 (grossed-up amount)

CCo joined the group part way through the income year and treats the non-membership period from 1 July 2009 to 31 December 2009 as an income year. CCo's assessable income includes \$10,000 of foreign income.

These grossed-up amounts are the double-taxed amounts for the purposes of determining the foreign income tax offset entitlement.

Foreign income tax offset entitlement

HCo will be deemed to have paid the foreign income tax paid by the partnership on the income included in HCo's assessable income: that is, \$100 (being a 50% share of tax paid by the partnership).

The amount distributed to BCo by the trust and included in HCo's assessable income is ultimately attributable to the dividend paid by the foreign company, FCo. HCo will be treated as having paid the withholding tax deducted from the dividend paid by FCo (\$450).

HCo will be eligible for a foreign income tax offset for foreign tax paid on:

- income received from the partnership, and
- the dividend paid by FCo to the trust.

The amount of the foreign income tax offset is determined in accordance with the foreign income tax offset limit.

HCo can calculate the foreign income tax offset limit as the lesser of the foreign income tax paid or the Australian tax payable on the double taxed amounts, or choose to use the \$1,000 de minimis cap. HCo opts for the cap because its total foreign income tax paid is less than \$1,000. HCo is entitled to a foreign income tax offset of \$550 (that is, \$100 + \$450).

CCo is entitled to a foreign income tax offset for the foreign income tax it paid after joining the group because it relates to an amount included in CCo's assessable income for the non-membership period.

CCo calculates the Australian tax payable on its foreign income of \$10,000 as \$3,000. However, as the foreign income tax paid by CCo is less than its foreign income tax offset limit, CCo's foreign income tax offset is limited to the amount of foreign income tax paid: that is, \$2,500.

References

Income Tax Assessment Act 1997, Subdivision 717-A and Division 770, as amended by *Tax Laws Amendment (2007 Measures No. 4) Act 2007*

Income Tax (Transitional Provisions) Act 1997, Subdivisions 770-D and 770-E, as amended by *Tax Laws Amendment (2007 Measures No. 4) Act 2007*

Explanatory Memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007, Chapter 1

Revision history

Section C6-2-130 first published 30 June 2009.

Proposed changes to consolidation

Proposed changes to consolidation announced by the Government are not incorporated into the *Consolidation reference manual* until they become law. In the interim, information about such changes can be viewed at:

- <http://assistant.treasurer.gov.au> (Assistant Treasurer's press releases)
- www.treasury.gov.au (Treasury papers on refinements to the consolidation regime).



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