IT 2445 - Income tax : the foreign tax credit system - the underlying tax credit

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TAXATION RULING NO. IT 2445

INCOME TAX THE FOREIGN TAX CREDIT SYSTEM - THE UNDERLYING TAX CREDIT

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I 1211132	FOREIGN TAX CREDIT SYSTEM - THE INDIRECT CREDIT (CREDIT FOR FOREIGN UNDERLYING TAX)	6AB(2) 160AE(1) 160AFC

PREAMBLE
Section 160AFC of the Income Tax Assessment Act 1936, when read with subsections 6AB(2) and 160AF(1), operates so that an Australian resident company which receives a dividend from a related foreign company (within the meaning of section 160AFB) is entitled to a credit against the Australian tax payable in respect of the dividend for the underlying foreign company tax on that portion of the profits of the related foreign company out of which the dividend is paid. This underlying tax credit is in addition to the credit available under subsection 160AF(1) for the foreign withholding or other direct tax on the dividend. Section 160AFC provides for the credit for underlying foreign company tax to be available in respect of unlimited tiers of related foreign companies.

2. The term "profits" is defined in subsection 160AE(1) to include gains, whether of an income or capital nature, and to mean, in relation to a company, the amount of profits derived by the company that is available for distribution or would be available for distribution but for the requirement to pay foreign tax. In its application to a company, the definition requires that the relevant profits be measured by having regard to the accounts of the company, any law requiring the company to maintain statutory reserves and such other matters as may reasonably be regarded as relevant. Essentially, the definition refers to the pre-tax profits of a related foreign company as disclosed in its accounts but subject to examination and adjustment as necessary to reflect the profits derived and properly available for distribution, or which would be available for distribution but for the requirement to pay foreign tax.

3. Included in section 160AFC are rules for the ordering of dividend payments, under which dividends are deemed to have been paid firstly out of a pool of profits accumulated by the

distributing subsidiary company for accounting periods commencing after 30 June 1987 and then out of profits of earlier accounting periods on a LIFO basis. That section also provides for the underlying tax attributable to a dividend payment to be calculated in accordance with specified formulae.

4. This Ruling deals with certain aspects relating to the determination of credit for underlying foreign tax in respect of a dividend, under the following headings -

	Paragraphs
(a) the meaning of "profits";	5-11
(b) the pool of profits from which a dividend is paid;	12-16
(c) treatment of second tier or later tier dividend withholding tax;	17-19
(d) treatment of losses in relation to subsection 160AFC(6);	20-22
(e) the application of subsection 160AFC(7);	23-33
(f) foreign currency translation of dividends and taxes in relation to first tier or later tier related foreign companies; and	34-38
(g) the interaction with double taxation agreements.	39-45

RULING

The meaning of "profits" in subsection 160AE(1)

5. It is not possible to issue a definitive statement of what adjustments will be necessary in each and every case to the figure of profits as shown in the accounts of a related foreign company in order to arrive at the company's "profits" within the meaning of the term as defined in subsection 160AE(1). The position will vary from company to company and each case will have to be considered separately in the light of its own circumstances.

6. Differences that arise between Australian and foreign concepts of profits available for distribution within the special meaning of the defined term have been recognised to some extent by paragraph (b) of the definition. Paragraph (c) also enables other requirements of foreign law or company or accounting rules and standards to be taken into account where relevant for those purposes.

7. Given that the definition takes as its base the profits in a related foreign company's accounts and not the profits assessed to foreign tax, the adjustments envisaged under paragraph (c) do not extend to items at variance with the relevant foreign or the Australian tax laws. An example would

be provisions for depreciation that accord with foreign law, rules or standards but that are greater than those allowable for tax purposes.

8. A distinction needs to be drawn between provisions or reserves, etc., in the accounts which are commercially necessary and those which are in effect appropriations of ascertained profits. In general, provisions or reserves, etc., which are commercially necessary should be regarded as admissable and as not forming part of the related company's profits for underlying tax credit purposes (i.e. so as not to result in any adjustment where they have been deducted in arriving at the net profit figure shown in the company's accounts for the relevant accounting period). Conversely, those which represent appropriations of ascertained profits should be treated as inadmissable, and be added back to the net profit figure shown in the accounts in order to arrive at the amount of profits properly available for distribution or that would be available for distribution but for the requirement to pay foreign tax.

9. Special mention should be made, however, of provisions for taxation. Given that the definition of "profits" in subsection 160AE(1) refers to profits which would be available for distribution but for the requirement to pay any foreign tax on those profits, any liability, or potential liability, for tax is required to be ignored. Accordingly, any provision or charge made in a company's accounts against ascertained profits of the relevant accounting period for tax payable in respect of those profits, or for under or over provisions for tax in previous periods, should be treated as inadmissable items. This approach is confirmed by the nature of the items required to be taken into account for purposes of the formulae provided in subsections 160AFC(2) and (4) for determining the creditable underlying tax attributable to a dividend payment.

10. As the definition specifically requires capital gains to be taken into account, realised capital gains will form part of the relevant profits for underlying tax credit purposes irrespective of their treatment in the accounts of a company, i.e. whether taken in the accounts directly to a capital reserve, or after first being credited to a profit and loss account, or for that matter left in the profit and loss account.

11. The following examples summarise the practical application of those guidelines in relation to paragraph (c) of the defined term :

Admissable items

(a)	Normal commercial provisions for depreciation or depletion.
(b)	Normal commercial provisions such as those for bad debts and leave pay.

(c) Reserves made to qualify for tax relief in accordance with the tax laws of a foreign country, provided those reserves are not, or will not be, available for distribution.

(d) Specific reserves where the company has a definite commitment, such as the redemption of debentures.

(e) Capital reserves where the company has made an actual commitment to capital expenditure or has undertaken such expenditure.

Inadmissable items

(a) General provisions or reserves under whatever name.

(b) Other provisions or reserves which are of a general nature, however described in the accounts, such as contingency reserves, investment reserves, special reserves, extra reserves, and capital reserves not referred to in (e) above.

(c) Dividend equalisation provisions or reserves.

(d) Provisions for tax.

The pool of profits

12. Paragraph 160AFC(6)(a) provides that a dividend paid by a foreign company which is related to an Australian company shall be treated as paid first out of the "profits accumulated" during the first accounting period commencing after 30 June 1987 and subsequent accounting periods i.e. out of a pool of accumulated profits. (An Australian company is defined in subsection 160AE(1) to mean a company that is a resident of Australia and a foreign company as a company that is not a resident of Australia.)

13. The terms of the paragraph are such as to normally require its application only in those cases where, at the time the dividend was declared, there were profits of completed accounting periods commencing after 30 June 1987. In other words, it operates on the basis that profits are not capable of being accumulated until after completion of an accounting period. Nonetheless, it is recognised that there will be

circumstances in which it can be demonstrated that a dividend (e.g. an interim dividend) was paid out of profits accumulated prior to the date of declaration of the dividend, notwithstanding that the relevant accounting period commencing after 30 June 1987 was not completed. Where a foreign company nominates current profits as bearing a dividend, or those circumstances can be otherwise satisfactorily demonstrated, the dividend would qualify for the purposes of the application of subsection 160AFC(6) as being paid out of the pool of profits envisaged by paragraph 160AFC(6)(a).

14. Given that subsection 160AFC(6) provides an arbitrary ordering basis for determining the profits out of which the payment of a dividend is funded, the reference in paragraph 160AFC(6)(a) to "profits accumulated" is also taken to imply a contrary intention to the defined meaning of "profits" in subsection 160AE(1) - as provided for by the opening words of that subsection - so as to require that regard be had, for the purposes of the application of that paragraph, to so much of the profits within the special meaning of the defined term for each of the relevant accounting periods that remain available in the pool to fund payment of a dividend after payment of the tax attributable to those profits.

15. Where there are no such profits, or where the amount of a dividend is in excess of the pool of accumulated profits in that sense, the dividend or the balance of the dividend (as the case may be) will be treated as paid out of so much of the profits (as defined in subsection 160AE(1)) of the completed accounting period immediately preceding the date of declaration of the dividend that remain available to fund payment of dividends after payment of the tax attributable to those profits and then, in sequence, out of such profits of earlier accounting periods, in accordance with paragraphs 160AFC(6)(b) and (c).

16. This approach is required in relation to the practical application of subsection 160AFC(6) notwithstanding that it is necessary, pursuant to the formulae provided in subsections 160AFC(2) and (4), to have regard to the profits within the special meaning of the defined term for each of the relevant accounting periods when determining the underlying tax attributable to a dividend deemed paid out of the pool of profits referred to in subsection 160AFC(6)(a), or out of profits of the earlier accounting periods referred to in paragraphs 160AFC(6)(b) and (c).

Second tier or later tier dividend withholding tax

17. Concerns have been expressed about the position for underlying tax credit purposes of withholding tax deducted by a second tier or later tier related foreign company from a dividend it distributes to the related company in the tier above. For example, where a second tier related foreign company pays a dividend to a first tier company, dividend withholding tax withheld by the second tier company and borne by the first tier company would be treated as part of the tax

payable by the first tier company on the profits out of which it declares a dividend to the Australian company. The definition of "underlying tax" in subsection 160AE(1) is to be construed as providing that result.

18. The practical result is that, consistent with subsection 160AFC(9), where the profits of a related foreign company located in one country include dividends from a related foreign company located in another country, the gross amount of the dividend before the deduction of any withholding tax should be included in the profits in calculating the underlying tax for the purposes of the formula provided in subsection 160AFC(4). Items A and B in that formula will apply as follows :

A is the amount of the dividend before deduction of any dividend withholding tax;

B is the amount (if any) of underlying tax paid by the company that paid the dividend on the profits out of which the dividend was paid - the underlying tax will include any dividend withholding tax borne by that company on any dividend included in the profits out of which the paying company distributed the dividends.

19. The following example illustrates the operation of section 160AFC where there are first tier and lower tier withholding taxes :

Facts:

Ausco (an Australian resident company) owns 100% of Firsco. Firsco owns 50% of Secco and Secco owns 50% of Thirco. Firsco, Secco and Thirco are located in three different foreign coutries. In 1985 Thirco pays a dividend of $550 to Secco subject to deduction of withholding tax of 10% ($55). In 1986 Secco pays a dividend of $900 to Firsco subject to deduction of withholding tax of 20% ($180) and on 1 August 1987 Firsco pays a dividend of $3,000 to Ausco, subject to deduction of withholding tax of 10% ($300). Each of the subsidiaries use a calendar year as the income year. Ausco uses the normal Australian income year. It is assumed that the gross dividends received by Secco and Firsco are subject to full company tax in their country of residence with a foreign tax credit being allowed in those countries for the foreign withholding tax. All amounts shown are expressed in Australian dollars.

Calculation of foreign tax credit of Ausco

Thirco (third tier)

(a)	1984 profits	2,000
(b)	foreign tax (45%)	900
(c)	profits after tax	1,100
(d)	dividend paid in 1985 to Secco -	

	gross dividend		550	
(e)	less withholding tax 10% (withheld by Thirco but borne by Secco)		55	495
(f)	foreign tax deemed paid by Secco:			
	(d) x (b) = 550 x 900 = (c) 1,100			450
Secco (second tier)				
(g)	1985 Income - Business	2,450		
	dividend (grossed-up)		550	3,000
(h)	foreign tax (40%)	1,200		
(i)	credit for withholding tax withheld by Thirco but borne by Secco on dividend income		55	1,145
(j)	profit after tax (3,000 - [1,145+55])			1,800
(k)	foreign tax paid (1,145+55) and deemed paid (f) 450			1,650
(l)	dividend paid in 1986 to Firsco		900	
(m)	less withholding tax 20% (withheld by Secco but borne by Firsco)		180	720
(n)	foreign tax deemed paid by Firsco			
	(l) x (k) = 900 x 1,650 = (j) 1,800			825
Firsco (first tier)				
(o)	1986 income - business	4,100		
	dividend (grossed-up)		900	5,000
(p)	foreign tax (30%)	1,500		
(q)	credit for withholding tax withheld by Secco but borne by Firsco on dividend income		180	1,320
(r)	profit after tax (5000 - [1320+180])			3,500
(s)	foreign tax paid (1320+180) and deemed paid (n) 825			2,325
(t)	dividend paid on 1-8-87 to Ausco	3,000		
(u)	less dividend withholding tax 10% (withheld by Firsco but borne by Ausco)		300	2,700
(v)	foreign tax deemed paid by Ausco:			
	(t) x (s) 3,000 x 2325 (r) 3,500			1,993
Ausco (Australian parent)				
(w)	1987/88 income - business	6,000		
	dividend (grossed-up) (i)	4,993		10,993
(x)	Australian tax (49%)			5,387
	less foreign tax credit			
	- withholding tax (u)		300	
	- deemed paid underlying tax (v) (ii)		1,993	2,293
	Balance of Australian tax payable			3,094

(i) : This amount represents the net dividend of $2700, grossed-up pursuant to section 6AC by the foreign withholding tax of $300 (u) and the deemed paid underlying tax of $1,993 (v).

(ii) : Full credit has been allowed for the foreign tax paid and deemed paid, as the sum of those amounts is less than the Australian tax on the foreign dividend income, viz -

$$\frac{2293}{4993} \times 100 = 45.92 \text{ per cent}$$

Subsection 160AFC(6) and the treatment of losses

20. The approach outlined in paragraphs 14 and 15 of this Ruling for the purposes of determining the "profits" of an accounting period for the purposes of subsection 160 AFC(6) could, of course, result in a loss position. The legislation does not specifically address the position that is to apply in those circumstances. However, as the context in which the references to "profits" throughout subsection 160AFC(6) is used requires that those references be taken as meaning profits available to fund the payment of a dividend, the scheme of the legislation is taken to require that losses be taken into account for those purposes.

21. Consequently, as a general rule, a loss so determined for the first accounting period commencing after 30 June 1987 or for any subsequent accounting period is to be treated as a negative component of the pool of profits accumulated during those periods when applying paragraph 160AFC(6)(a). Similarly, where such a loss is determined for an accounting period that commenced on or before 30 June 1987, that loss is to be treated as reducing the profits of subsequent accounting periods when applying paragraphs 160AFC(6)(b) and (c). Any losses of accounting periods that commenced on or before 30 June 1987 which had not been offset by subsequent profits of such periods, are to be carried forward to effectively reduce the profits that may constitute the pool of accumulated profits of accounting periods commencing after 30 June 1987 referred to in paragraph 160AFC(6)(a).

22. Given the variety of factual situations that may arise and in recognition that the general rules for the treatment of losses outlined in the preceding paragraph may give rise to anomalous situations in certain circumstances, some flexibility in the application of those rules may be allowed. In particular, where a foreign company has, in accordance with the relevant foreign law, distributed a dividend out of the profits of an accounting period without offsetting against those profits losses incurred in previous accounting periods, these circumstances could be taken into account in the application of subsection 160AFC(6) in determining the pool of profits or profits of earlier accounting periods, as the case

may be, out of which the dividend is treated as distributed. Consistent with this approach, those losses would also be disregarded in computing the profits out of which any subsequent dividends are distributed.

The application of subsection 160AFC(7)

23. Paragraph 160AFC(7)(a) provides that, in applying the provisions of subsection 160AFC(6), profits distributed by the company before the date of the declaration of the dividend shall be disregarded.

24. This paragraph is construed as referring to profits distributed by the company prior to 1 July 1987. Accordingly, the profits of an accounting period which have been distributed prior to 1 July 1987 will be disregarded in tracing the profits out of which a dividend declared on or after 1 July 1987 is treated as having been paid. Paragraph 160AFC(7)(b) provides that profits taken into account for the purposes of the application of subsection 160AFC(6) in relation to a previous dividend paid by the company shall be disregarded, and is interpreted as applying to dividends declared on or after 1 July 1987.

25. As subsection 160AFC(7) relates to the application of subsection 160AFC(6), it will be necessary for the purposes of the practical operation of the subsection that the references to "profits" be construed in the same way as that outlined in paragraphs 14 and 15 of this Ruling in relation to subsection 160AFC(6).

A foreign company furnishes the following particulars :-

Accounting period	profits	foreign tax	profits net of tax	dividend distributed out of profits	balance of accumulated profits for each period
1.7.83 to 30.6.84	100,000	40,000	60,000	25,000	35,000
1.7.84 to 30.6.85	150,000	60,000	90,000	50,000	40,000
1.7.85 to 30.6.86	200,000	80,000	120,000	90,000	30,000
1.7.86 to 30.6.87	250,000	100,000	150,000	190,000	-
1.7.87 to 30.6.88	300,000	120,000	180,000	200,000	-

27. It is assumed that each dividend has been distributed one month after the end of the relevant accounting period and the company has treated each of the first three dividends as paid

out of the profits of the accounting period that ended immediately before the date of declaration of the dividend. The fourth dividend is treated by the company as paid out of the profits of the accounting periods ended 30.6.87 (150,000), 30.6.86 (30,000) and 30.6.85 (10,000). The last dividend is treated by the company as paid out of the profits of the accounting periods ended 30.6.88 (to the extent of 180,000) and 30.6.84 (to the extent of 20,000).

28. In tracing the profits out of which the dividend of $190,000 distributed on 1 August 1987 is deemed to have been paid, paragraph 160AFC(7)(a) requires that the profits of $25,000, $50,000 and $90,000, distributed on 1 August 1984, 1 August 1985 and 1 August 1986 respectively, should be disregarded. Accordingly, only the remaining balance of the profits for each of those years, of $35,000, $40,000 and $30,000 respectively, are to be taken into account for the purposes of the application of subsection 160AFC(6) in relation to that dividend.

29. In this particular case, paragraph 160AFC(6)(a) would be inapplicable in relation to that dividend and application of paragraphs 160AFC(6)(b) and (c) would result in the dividend being treated as paid out of the remaining "distributable" profits for the accounting periods ended 30 June 1987, 1986 and 1985 respectively on a LIFO basis (which corresponds in this case to how it has been treated by the company). However, paragraphs 160AFC(6)(b) and (c) are applicable on a LIFO basis irrespective of whether the relevant dividend has been specifically treated by the company as distributed out of the profits of a particular accounting period.

30. Given the application of paragraph 160AFC(7)(b) described in paragraph 23 of this Ruling, the "distributable" profits of the accounting periods ended 30 June 1984, 1985, 1986 and 1987 remaining to be taken into account for the purposes of the application of subsection 160AFC(6) in relation to the dividend of $200,000 distributed on 1 August 1988 would be $35,000, $30,000, nil and nil respectively.

31. This means that, under subsection 160AFC(6), the dividend of $200,000 is treated as utilising the pool of accumulated profits of $180,000 of the accounting period ended 30 June 1988 plus $20,000 of the accounting period ended 30 June 1985 (being the next available "distributable" profits remaining from a preceding accounting period), irrespective of the manner in which the company itself allocates a dividend payment to distributable profits of accounting periods. Paragraph 160AFC(7)(b) will require that those profits of $180,000 and $20,000 respectively be disregarded in the application of subsection 160AFC(6) to any subsequent dividend distribution. Thus the pool of profits for accounting periods commencing after 1 July 1987 would be reduced to nil and the balance of the profits remaining for those purposes in relation to the accounting periods ended 30 June 1984, 1985, 1986 and 1987 would then be $35,000, $10,000, nil and nil respectively.

32. The foregoing example assumes that the company has nominated which profits of which accounting periods are being distributed as dividends. Where this does not occur but a company can demonstrate that a relevant foreign law requires a specified ordering of profit distributions, that order may be taken to apply for the purposes of the application of subsection 160AFC(7).

33. Where neither of those situations apply, a dividend distributed before 1 July 1987 will be treated for the purposes of the application of subsection 160AFC(7) as paid out of the profits of the latest accounting period which ended before the date of distribution of the dividend. If the dividend exceeds the profits of that period, it will be treated as paid out of the relevant profits of the next preceding accounting period and so on, i.e. on the basis of treating the dividend as having been paid out of the latest available profits. This will be the position, for example, where dividends are debited to a profits reserve that is maintained as a continuous account from year to year.

Currency translation of dividends and taxes in relation to first tier or later tier related foreign companies

34. Section 20 of the Income Tax Assessment Act contains rules for converting to Australian currency foreign income and foreign tax paid on that income by an Australian resident. An effect of subsections 6AB(2) and 6AC(2) is that those rules extend, in the case of a dividend received by an Australian company from a related foreign company, to the underlying foreign company tax that the Australian company is, by section 160AFC, deemed to have paid. Under paragraph 20(3)(a), for example, the amount of a foreign dividend paid and remitted to an Australian company, and the amounts of the withholding or other direct tax and the underlying tax deemed paid in respect of that dividend, are required to be converted to Australian currency at the exchange rate applicable on the day the dividend is remitted to Australia.

35. The Assessment Act does not specifically address the foreign currency translation rules to apply for purposes of the underlying tax credit calculations in relation, for example, to dividends received by a first tier or later tier related foreign company and to withholding taxes or other direct taxes paid in respect of those dividends.

36. The matter needs to be considered in the context that the currency conversion rules contained in section 20 relate to dividend distributions from a first tier related foreign company to an Australian company. Those rules must be applied to such distributions. It has to be recognised, however, that the currency conversions for the purposes of the underlying tax credit calculations at other tiers, such as those necessary in the practical application of the example given in paragraph 19 of this Ruling, would normally be computed by reference to the currencies of the countries where the first

and later tier companies are situated. It is also relevant that the dividends and related withholding or other direct taxes would have already been converted in the accounts of the dividend recipient company into the currency of the country in which it is located. On the other hand, the relevant deemed paid underlying tax at those levels, which is only calculated for purposes of section 160AFC, will not be reflected in figures in its accounts.

37. Another consideration is that it will be necessary for the purpose of calculating the available underlying tax credit in accordance with the formulae contained in subsections 160AFC(2) and (4) to obtain details from each of the relevant related foreign companies. In the circumstances, it would be appropriate in relation to dividends received by a first tier or lower tier related foreign company, and in relation to withholding taxes or other direct taxes paid in respect of those dividends, to have regard to the relevant figures used in the accounts of the company that received the dividends. As the currency conversion for purposes of the deemed paid underlying tax calculations at those levels would normally be on the basis of the relevant foreign currencies, it would be consistent for the deemed paid underlying tax at the lower level to be converted into the currency of the country in which the dividend recipient company is situated at the rate at which the dividend had been converted in that company's accounts. If that conversion rate is not readily available, it would be acceptable if the deemed paid underlying tax at the lower level is converted into that currency at the exchange rate applicable to the relevant foreign currencies at the time of receipt of the dividend by the company concerned, this being an identifiable and ascertainable rate.

38. The scheme of the underlying tax credit provisions of the law and the practical application of those provisions are taken to require that the approaches outlined above generally be followed in relation to currency conversions at first tier and lower tier company levels for purposes of underlying tax credit calculations. Situations may arise, however, where a company will be able to demonstrate that the relevant currency conversions should apply on a different basis. Where an alternative basis for currency conversions for particular tier companies is proposed by a taxpayer and a Branch Office has doubts about that proposal, it should be referred to National Office for consideration.

Interaction with double taxation agreements

39. Questions have been raised with this Office as to whether the terms of the double taxation agreements concluded by Australia with other countries, details of which are set out in the schedules to the Income Tax (International Agreements) Act 1953, would inhibit the range of operation of the underlying foreign tax credit relief provisions of section 160AFC.

40. Reference has been made in this regard to the provisions

of the respective agreements which apply where the same income may be taxed by both countries. Those provisions typically require, in the case of dividend income derived by an Australian resident from a company that is resident in the treaty partner country, that Australia allow a credit against its tax on the dividend for the other country's tax on the dividend but not for the tax paid in the treaty partner country on the profits out of which the dividend is paid.

41. As section 4 of the Income Tax (International Agreements) Act provides, in effect, for the provisions of the comprehensive agreements to generally prevail over the provisions of the Income Tax Assessment Act in the case of any inconsistency, it has been suggested that the underlying tax credit provisions of section 160AFC may not be applicable where a dividend is derived by an Australian company from a related company in a treaty partner country.

42. The relevant provisions of the agreements are taken, however, to merely set out Australia's basic obligation, consistent with their purpose of avoiding double taxation, to provide credit for the other country's tax. Those provisions are not intended to limit the scope of unilateral double taxation relief measures provided in the Income Tax Assessment Act and applicable to taxpayers generally.

43. This approach also accords with the past practice of applying the more generous exemption provisions of paragraph 23(q) of the Income Tax Assessment Act to most categories of income derived by Australian residents from treaty partner countries notwithstanding that the agreements oblige Australia to provide credit relief only.

44. The general foreign tax credit measures contained in the Income Tax Assessment Act, together with the provisions of any relevant taxation agreement, now provide the bases for relieving a resident of Australia from double taxation on income from foreign sources. Accordingly, the underlying tax credit provisions of section 160AFC will apply irrespective of the country of residence of the related foreign company from which dividends are derived by an Australian company.

45. Some double taxation agreements modify the foreign tax credit provisions of Division 18 of Part III of the Assessment Act to some extent by reason of the inclusion of 'tax sparing' provisions under which Australia has agreed to provide relief by way of a credit in respect of tax forgone by the other country under specified development incentive measures. This is recognised by subsection 6AB(5) of the Assessment Act, which provides that where such relief is granted either by way of regulations made under section 160AFF or under a double taxation agreement, the relevant foreign tax forgone will be deemed to have been paid. Accordingly, where 'tax sparing' relief extends to the underlying tax forgone by the other country on the profits out of which a dividend is paid to an Australian resident company, the underlying tax credit provisions of section 160AFC will apply as if that tax had

been paid.

COMMISSIONER OF TAXATION
10 September 1987