IT 2568 - Income tax : tax treatment of U.S. sourced dividend interest and royalty income derived by U.S. citizens resident in Australia

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TAXATION RULING NO. IT 2568

INCOME TAX : TAX TREATMENT OF U.S. SOURCED DIVIDEND INTEREST AND ROYALTY INCOME DERIVED BY U.S. CITIZENS RESIDENT IN AUSTRALIA

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1011680	U.S. CITIZENS RESIDENT IN AUSTRALIA DIVIDEND INCOME INTEREST INCOME ROYALTY INCOME	IT(IA)A US/AUST DOUBLE TAX CONVENTION; ARTICLES 1(3), 1(4), 10, 11, 12, 22(2), 22(4)

OTHER RULINGS ON TOPIC : IT 2527, IT 2542

PREAMBLE This Ruling sets out the tax treatment to be afforded to U.S. sourced dividend, interest and royalty income derived by Australian residents who are also citizens of the United States. Dividend, interest and royalty income derived by an Australian resident from sources in the United States is subject to tax in both the United States and Australia. This comes about because of differences in the bases on which a tax liability arises in each country. The United States system is based on citizenship whilst the Australian system is based on residency.

2. Generally, the tax imposed by the United States is limited by Articles 10, 11 and 12 of the Australian/United States Double Tax Convention to a maximum of 15% of the gross amount of the dividend, 10% of the gross amount of the interest and 10% of the gross amount of the royalty. The income is also taxable in Australia but a credit is allowed against Australian tax payable for the U.S. tax paid.

3. However, in the case of an Australian resident who is also a U.S. citizen, the tax imposed by the United States is not limited to the 15% or 10% rates. Under paragraph 3 of Article 1 of the Convention, each country reserves the right to tax its own citizens as if the Convention had not entered into force. Paragraph 3 of Article 1 is subject to paragraph 4 of Article 1 which provides that paragraph 3 of Article 1 will not affect certain benefits, including those conferred under Article 22 (Relief from double taxation). However, the limitations on tax at source in respect of dividends, interest and royalties are not preserved.

4. It has been suggested that where U.S. sourced dividend, interest or royalty income derived by U.S. citizens who are Australian residents is fully taxed in the United States, a credit for the full amount of U.S. tax paid should be allowed against Australian tax payable. In relation to interest and royalties derived from U.S. sources prior to the commencement of the 1987-88 year of income, it is further suggested that, because the limitation of tax at source under Articles 11 and 12 has no application, the exemption of such income from Australian tax under the former paragraph 23(q) of the Income Tax Assessment Act 1936 (ITAA) is not precluded by the now repealed paragraph 12(1)(ao) of the Income Tax (International Agreements) Act 1953 (IT(IA)A).

5. Paragraph 12(1)(ao) provided, in so far as is relevant, that paragraph 23(q) ITAA, which exempts income derived prior to the commencement of the 1987-88 year of income from sources outside Australia which is not exempt from tax in the country of source, does not apply to interest or royalties to which paragraph (1) of Article 11 or paragraph (1) of Article 12 of the Convention applies. Both paragraph 12(1)(ao) and paragraph 23(q) were repealed by Act No.51 of 1986 and do not operate in respect of assessments for the 1987-88 and subsequent years of income.

RULING

6. Where dividend, interest or royalty income is derived by an Australian resident from sources in the United States, the maximum credit allowable against Australian tax payable for U.S. tax paid on such dividends, interest or royalties is limited to 15% of the gross amount of the dividends and 10% of the gross amount of the interest or royalties. This limitation applies irrespective of whether a higher rate of U.S. tax has been imposed on the Australian resident by reason of his or her U.S. citizenship.

7. Paragraph 2 of Article 22 of the Convention provides for Australia to allow the U.S. tax paid as a credit against the Australian tax payable in respect of U.S. sourced income, other than U.S. tax imposed solely by reason of citizenship in accordance with paragraph (3) of Article 1.

8. In the case of U.S. sourced dividends, interest or royalties derived by a U.S. citizen resident in Australia, any U.S. tax imposed in excess of 15% of the gross amount of dividends or 10% of the gross amount of the interest or royalties, is considered to be tax imposed solely by reason of citizenship and is thus specifically excluded by paragraph (2) of Article 22 from the credit to be allowed against Australian tax payable.

9. Double taxation is avoided by the application of paragraph (4) of Article 22 which provides that, where a U.S. citizen is a resident of Australia, the United States shall allow as a credit against U.S. tax the income tax paid to Australia. For this purpose the income tax paid to Australia is the gross Australian tax payable less the credit allowed for U.S. tax paid (as limited by the Convention).

10. An example of the calculation of the credit to be allowed

and the application of paragraph (4) of Article 22 is as follows:

U.S. source interest	$ 100
U.S. Tax	30
Interest included in assessable income	100
Australian tax payable (say 40%)	40
Less credit for U.S. tax paid (as limited by the Convention)	10
Net Australian tax payable	$ 30
Australian tax which may be offset against U.S. tax liability under paragraph (4) of Article 22	$ 30

11. In relation to interest or royalties derived from U.S. sources by an Australian resident prior to the 1987-88 year of income, it is not accepted that the income is exempt from Australian tax by virtue of paragraph 23(q) ITAA. Paragraph 12(1)(ao) IT(IA)A provided that paragraph 23(q) ITAA did not apply to "income being interest or royalties to which paragraph (1) of Article 11 or paragraph (1) of Article 12 of the United States convention applies...".

12. Interest to which paragraph (1) of Article 11 applies is, for these purposes, interest from sources in the United States, being interest to which an Australian resident is beneficially entitled. Paragraph 12(1)(ao) applied to interest which fell within this description, notwithstanding that the ceiling of 10% under Article 11 on the source country's right to tax may have been overridden by the right of that country to tax its citizens. Hence such interest is not exempt from tax in Australia.

13. Similarly, royalties to which paragraph (1) of Article 12 applies are treated in the same manner as outlined in the preceeding paragraph. The royalties are not exempt from tax in Australia.

COMMISSIONER OF TAXATION
30 November 1989