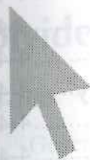
Chapter 4 Dividends • Imputation System



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If shares are sold cum dividend, the whole of the dividend subsequently paid is income of the purchaser, not the vendor. This is so even where the transfer has not yet been registered, as the vendor holds the shares as trustee for the purchaser (¶4-130).

Foreign dividend income

Where a dividend derived from foreign sources is not exempt from tax in Australia, a foreign income tax offset may be allowable (¶21-670). The recipient is assessed on the gross amount of the dividend (ie before deduction of any foreign tax).

A distribution that is declared to be conduit foreign income (¶21-100) is not assessable under s 44 (ITAA97 s 802-15).

[FTR ¶20-275]

¶4-105 Corporations law changes

The corporations law rule that dividends may only be paid out of profits of a company was replaced (from 28 June 2010) with a rule that a company must not pay a dividend unless:

- the company's assets (determined in accordance with accounting standards) exceed its liabilities (also determined in accordance with accounting standards) immediately before the dividend is declared and the excess is sufficient for the payment of the dividend
- the payment of the dividend is fair and reasonable to the company's shareholders as a whole, and
- the payment of the dividend does not materially prejudice the company's ability to pay its creditors (*Corporations Act 2001*, s 254T).

It is specifically provided that, for the purposes of ITAA36 and ITAA97, a dividend (as defined: ¶4-110) paid out of an amount other than profits is taken to be a dividend paid out of profits (ITAA36 s 44(1A)). However, the Commissioner takes the view that for the purposes of the Corporations Act and company accounting, dividends can only be paid from profits and not from "amounts other than profits" and that Corporations Act s 254T imposes three specified *additional* prohibitions on the circumstances in which a dividend can be paid (TR 2012/5). See also ¶4-620.

¶4-110 What is a dividend?

For tax purposes, the expression "dividend" is defined (ITAA36 s 6(1)) to include any distribution made by a company to its shareholders whether in money or other property (including shares in that or another company) and any amount credited by a company to its shareholders as such. The term also includes any distribution by way of redemption or cancellation of a redeemable preference share, but only to the extent that the value of the distribution exceeds the amount paid-up on the share (para (e) of the definition of "dividend").

▶ Example

Where the amount paid-up on a redeemable preference share is $10 and a company redeems the share for $15, the amount taken to be a dividend is $5.

Certain payments by private companies to associated persons may be deemed to be dividends under ITAA36 Pt III Div 7A (¶4-200) or s 109 (¶4-220).

Return of capital

A distribution of capital is generally only a dividend to the extent that it exceeds the amount debited to the share capital account (para (d) of the definition of "dividend"; ID 2004/652). However, where a company raises share capital from certain shareholders and makes a tax-preferred capital distribution to other shareholders, the distribution will be treated as a dividend (s 6(4)). Capital benefits paid under a dividend substitution scheme

may also be treated as dividends (ITAA36 s 45B: ¶4-682). Where property is distributed to a shareholder, the assessable dividend component of the distribution will generally be the money value of the property, reduced by the amount debited to a share capital account of the distributing company (TR 2003/8).

Additional measures apply to prevent the distribution of profits to shareholders as preferentially taxed capital rather than as dividends (¶4-682).

[FTR ¶2-655]

¶4-120 When is a dividend paid?

"Paid" in relation to a dividend or a non-share dividend includes "credited" or "distributed" (ITAA36 s 6(1)). The declaration of a dividend creates a debt owing to the shareholders and the payment, crediting or distribution of the dividend discharges that debt.

The declaration of an interim dividend by directors empowered under the company's articles of association to pay a dividend does not create a debt owing by the company to its shareholders. Consequently, the declaration of an interim dividend may be revoked before payment because it is subject to the will of the directors until it is paid, credited or distributed (*Brookton Co-operative Society*).

The posting of a dividend cheque is equivalent to payment and the dividend would be taxable in the year the cheque was posted by the company, even if it is not received or not banked until a later income year.

A dividend is "credited", so as to have been paid, provided a dividend has been declared, profits are appropriated to its payment and the shareholder's account with the company is credited in such a way that it may be drawn on as and when the shareholder desires. But mere book entries are not always sufficient. Offsetting the dividends against a debt owed to the company by a shareholder is payment, but crediting to a general "dividends payable account" is not crediting in the relevant sense. Where fully paid bonus shares are issued, a dividend need not be formally declared and the relevant amount is credited when the shares are issued, not when a book entry is made (IT 2603).

Dividends declared on shares owned by a deceased estate, but not paid over until after the production of probate, are not assessable until actually paid over.

A shareholder who, wishing to leave the amount of dividends on deposit with the company, tacitly or expressly authorises the company to retain the amounts payable as dividends remains assessable on the amount of the dividends.

[FTR ¶3-380, ¶20-310]

¶4-130 Dividends indirectly derived

Dividend income derived indirectly through a trust estate, trustee or nominee is not caught by ITAA36 s 44 because that section applies only to dividends derived by a shareholder, ie a person who is entered in the company's register of members as the holder of shares in it.

However, the beneficial owner of shares registered in the name of a nominee or trustee, or a beneficiary presently entitled to a share of trust income that consists directly or indirectly of dividends, would be assessable on such income either under ITAA97 s 6-5 or ITAA36 s 97 or, in the case of an infant beneficiary, the trustee might be assessable under ITAA36 s 98. The taxation of trust income is considered in Chapter 6; for the imputation provisions relating to trustees and beneficiaries, see ¶4-860.

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Dividend income thus indirectly derived by a person (companies, partnerships, etc, as well as individuals) is deemed to be "income attributable to a dividend" (ITAA36 s 6B). The provision also applies to a "non-share dividend" (¶23-125). A foreign income tax offset may be available where an Australian resident taxpayer derives foreign income attributable to dividends (¶21-670).

[FITR ¶18-200; FTR ¶13-001, ¶50-600]

¶4-140 Profits and their source

Dividends paid to Australian resident shareholders out of *any* "profits" of the company are assessable under ITAA36 s 44. The profits need not be revenue profits or assessable profits; they may be capital profits or exempt profits. Indeed, any increase in the company's assets, including an increase resulting from a gift, is a profit (*Slater Holdings (No 2)*). In certain circumstances dividends may be *deemed* to have been paid out of profits (¶4-105, ¶4-110, ¶4-300).

Conceptually, dividends are paid out of after-tax profits, ie the dividends are not deductible in arriving at either accounting income or taxable income. There is an exception in the case of co-operative companies. Co-operatives have a choice — they can pay deductible (pre-tax) distributions, which are unfrankable, or they can make non-deductible (post-tax) distributions, which are frankable (¶3-430).

It has been suggested that, to come within s 44(1), the distribution must be made wholly out of profits and that it is not enough that there is a distribution of a mass of assets that contains profits (*Slater Holdings (No 2)*).

The assessability of dividends received by a shareholder is generally determined by whether the dividend was paid out of profits, irrespective of the Australian or foreign source of those profits. (The conduit foreign income regime (¶4-190, ¶21-100) is an exception to this general rule.)

A June 2000 distribution of shares in a foreign resident demerged entity was an assessable dividend paid wholly out of profits despite the market value of the shares being nearly seven times the amount debited to the parent company's retained earnings in relation to the distribution (*Condell*).

A foreign resident who indirectly receives dividend income through a trust or nominee (¶4-130), and not as a shareholder, will be assessable only if the source of the dividend income is in Australia.

[FTR ¶20-275 – ¶20-395]

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¶4-160 Demerger dividends

Tax relief is available for demergers, ie the restructuring of corporate or trust entities or groups (other than discretionary trusts and superannuation funds) by splitting them into two or more entities or groups. The relief applies to spin-offs that happen on or after 1 July 2002, where underlying ownership is maintained and the demerging entity divests at least 80% of its ownership interests in the demerged entity. The two main elements of this relief are CGT relief (¶12-328) and tax relief on otherwise assessable dividends (discussed below). Actual examples of the application of demerger relief are discussed in a number of class rulings.

Central to the demerger dividend relief provisions are the concepts of "demerger dividend" and "demerger allocation". A *demerger dividend* is that part of a demerger allocation that is assessable as a dividend under ITAA36 s 44(1), or would be so assessable but for s 44(3) and (4). A demerger dividend is unfrankable (¶4-620). A *demerger allocation* is the total market value of the new interests in the demerged entity that each new owner of the head entity acquires under the demerger. Depending on how the demerger is effected, the demerger allocation may consist of an otherwise assessable dividend component, a return of capital or a combination of capital and profit.

Demerger relief applies to a demerger dividend if:

- just after the demerger at least 50% (by market value) of CGT assets owned by the demerged entity or its demerger subsidiaries is used in the carrying on of a business by those entities, and
- the head entity does not elect (for all shareholders) that the relief not apply.

Where demerger relief applies, a demerger dividend is taken not to be paid out of profits and is non-assessable non-exempt income (s 44(2) to (6): ¶10-890). A withholding tax exemption is provided for the assessable dividend component of the demerger dividend received by foreign resident shareholders (ITAA36 s 128B(3D)). The ITAA36 Pt III Div 7A deemed dividend provisions (¶4-200) do not apply to deem demerger dividends of a private company to have been paid out of profits (ITAA36 s 109RA).

Integrity rules limit the relief where there is a scheme that has a purpose of obtaining the non-assessable dividend (ITAA36 s 45B; 45BA: ¶4-682).

[FTR ¶20-400]

¶4-180 Dividends from listed investment companies

Eligible shareholders in listed investment companies (LICs) are entitled to an equivalent of a CGT discount on gains realised after 30 June 2001 by LICs on assets held for more than 12 months (¶11-038). Distribution statements provided by LICs must separately identify dividends sourced from such "LIC capital gains". Australian resident individuals, non-superannuation trusts and partnerships are entitled to a deduction equal to 50% of the LIC capital gain amount. A foreign resident individual is also entitled to a 50% deduction where the relevant dividend is received through the individual's permanent establishment in Australia. Resident life insurance companies (where the shares are complying superannuation assets) and complying superannuation entities are entitled to a 33 1/3% deduction. The benefit does not pass through a series of trusts or partnerships (ITAA97 s 115-280). Franking credits are available if the dividend is franked. An in-depth discussion of the rules and issues relating to LIC capital gains is provided in TR 2005/23.

A "listed investment company" is an Australian resident company listed on the ASX or other approved stock exchange, at least 90% of whose CGT assets consist of "permitted investments", being a wide range of investment and financial assets and goodwill. Direct or indirect ownership of more than 10% of another company (other than an LIC) or trust is not a permitted investment. A 100% subsidiary of an LIC that meets all the criteria except listing is also an LIC. A temporary failure to comply with the 90% requirement is not fatal if it is caused by circumstances outside the LIC's control (ITAA97 s 115-290).

[FITR ¶154-192 – ¶154-197]

¶4-190 Conduit foreign income

In general terms, conduit foreign income is foreign income that is (ultimately) received by a foreign resident through one or more interposed Australian corporate tax entities. Special rules allow conduit foreign income to flow through Australian corporate tax entities to foreign shareholders without being taxed in Australia (see ¶21-100 for details). Australian corporate tax entities that receive an unfranked distribution that is declared to be conduit foreign income will not pay Australian tax on that income if the conduit foreign income is on-paid to shareholders (net of related expenses) within a certain period. In such a case, the conduit foreign income in the unfranked distribution will be treated as non-assessable, non-exempt income of the Australian corporate tax entity. Conduit foreign income is exempt from dividend withholding tax when it is on-paid to a foreign shareholder as an unfranked distribution (¶22-010).

Deemed Dividends: Div 7A

¶4-200 Payments and loans by private companies to associated entities (Div 7A)

Under ITAA36 Pt III Div 7A (s 109B to 109ZE), amounts paid, lent or forgiven by a private company to certain associated entities (including individuals) are treated as dividends, unless they come within specified exclusions. As originally enacted, Div 7A generally applied to amounts paid, lent or forgiven on or after 4 December 1997. It applies to non-share equity interests and non-share dividends (¶23-125) in the same way that it applies to shares and dividends (s 109BA). From 1 July 2009, a closely held corporate limited partnership has been treated as a private company for the purposes of Div 7A. For what constitutes a payment, loan or debt forgiveness for this purpose, see ¶4-205, ¶4-210 and ¶4-220, respectively.

There may also be a potential deemed dividend under Div 7A in some circumstances where a private company is a presently entitled beneficiary of a trust and the trust makes a payment or loan to, or forgives a debt owing by, a shareholder (or an associate of a shareholder) of the private company (¶4-246).

Putting to one side the situation where a private company is an unpaid presently entitled beneficiary of a discretionary trust, the provisions of Div 7A apply where the recipient of the payment, loan or forgiven amount is: (a) a shareholder; (b) an associate of a shareholder; or (c) a former shareholder or former associate where a reasonable person would conclude that the amount is paid, lent or forgiven because of that former status. For these purposes, "associate" has the meaning provided in ITAA36 s 318, which covers a broad range of entities that are associates of natural persons, companies, partnerships and trustees. For example, a discretionary object of a discretionary trust and the trustee are associates under the definition.

In the case of a former shareholder or former associate, "because" in the expression "because the entity has been such a shareholder or associate at some time" means by reason that. The reason must be a real and substantial reason for the payment, loan or debt forgiveness concerned, even if it is not the main or only reason for the transaction (TD 2008/14).

A Div 7A deemed dividend is generally taken to be paid at the end of the income year of the private company in which the amount is paid, lent or forgiven. Exceptions are an "amalgamated loan" (s 109E) (¶4-240) and a loan made in the course of the winding-up of a company, which is only deemed to be paid at the end of the following year if it has not been repaid by then (s 109D(1A)). To ensure that it is assessable in the associated entity's hands as a dividend (¶4-100), a Div 7A dividend is also taken to have been paid out of the company's profits, and to have been paid to the entity in the capacity of a shareholder, whether or not the entity actually was a shareholder (s 109Z).

Where the total of all Div 7A dividends paid by the private company for the year exceeds the company's "distributable surplus" for the year, the amount of each Div 7A dividend is proportionally reduced (¶4-249).

A shareholder, former shareholder or associate who would otherwise have a two-year period of review (¶25-310) will have a four-year period of review for the purposes of Div 7A if the company has a four-year period of review (¶25-320).

A Div 7A dividend is not subject to either dividend withholding tax or PAYG withholding (s 109ZA).

Franking a deemed dividend

A deemed dividend is assessable and is generally unfrankable (¶4-620). However, a Div 7A deemed dividend may be franked if it is taken to be paid because of a family law obligation. The recipient of the dividend need not be a shareholder (ITAA36 s 109RC).

The Commissioner also has a discretion to allow franking in certain circumstances (see Commissioner's discretions below).

Interaction with FBT

A loan or a debt forgiveness that gives rise to a deemed Div 7A dividend is not subject to FBT. Also, effective 1 April 2007, a loan that is not a deemed dividend because of a Div 7A complying written loan agreement is not a fringe benefit (¶35-070; s 109ZB). On the other hand, a payment that would otherwise fall within the FBT provisions is subject to FBT and is excluded from the operation of Div 7A.

Commissioner's discretions

The Commissioner can either disregard a deemed dividend that arises under Div 7A or allow a private company to frank a deemed dividend to a shareholder that it has been taken to pay, where the failure to satisfy the requirements of Div 7A resulted from an honest mistake or inadvertent omission by the recipient, the private company or any other entity whose conduct contributed to the deemed dividend arising (ITAA36 s 109RB).

The Commissioner has issued a ruling which considers the circumstances in which the honest mistake/inadvertent omission discretion can be exercised (TR 2010/8). The ruling states that a mistake in this context is an incorrect view or opinion or misunderstanding about how Div 7A operates; about facts that are relevant to its operation; or about other matters that affect its operation. Such a mistake must be honestly made. An omission is a failure to take action that is relevant to, or affects, the operation of Div 7A. Such an omission must be inadvertent. A practice statement has been issued to provide guidance on the administration of TR 2010/8 (PS LA 2011/29). In *Case 8/2012*, the AAT exercised the honest mistake/inadvertent omission discretion in a taxpayer's favour where loan agreements did not fully comply with the Div 7A requirements.

The Commissioner is also given a discretion to extend the period during which a loan recipient may pay the minimum yearly repayment on an amalgamated loan, where the recipient is unable to make the minimum repayment due to circumstances beyond the recipient's control (ITAA36 s 109RD).

Proposed amendments

Amendments to improve the operation and administration of the Div 7A rules were announced in the context of the 2016/17 Budget to take effect from 1 July 2018. The amendments are to include:

- a self-correction mechanism for inadvertent breaches of Div 7A
- safe-harbour rules
- simplified Div 7A loan arrangements, and
- technical adjustments to improve the operation of Div 7A.

[FTR ¶56-105]

¶4-205 Division 7A: payments

For the purposes of the Div 7A deemed dividend rules, a "payment" to an entity means: (a) a payment to the entity, on the entity's behalf or for the entity's benefit; (b) a credit of an amount to the entity, on the entity's behalf or for the entity's benefit; and (c) a transfer of property to the entity (the amount of the payment will be deemed to be the arm's length value of the property less any consideration given by the entity) (s 109C(3)). Payments, and amounts credited, can be apportioned where they are made, or credited, for more than one purpose.

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A direction by a private company to a debtor to pay the debt to a shareholder is a payment by the company (*Rozman*). The release by a private company of all or part of an unpaid present entitlement that is not effectively converted to a loan constitutes a payment for the purposes of Div 7A (see (b) above) (TD 2015/20).

An amount that comes within the definition of a loan (¶4-210) is expressly excluded from the definition of a payment (s 109C(3A)). A payment or transfer of property made by a private company because of a maintenance order of the Family Court can be a payment for Div 7A purposes (ID 2004/461; ID 2004/462); however it can now be franked, whether the recipient is or is not a shareholder (s 109RC). The ATO takes the view that the creation of an interest in an asset (eg a leasehold interest in land) is a transfer of property and, hence, a payment.

A private company cannot be taken to have paid a dividend to another company pursuant to s 109C or 109D where the other company is the target entity under an interposed entity arrangement (TD 2001/2).

As noted below a payment may be converted to a loan for the purposes of Div 7A.

Provision of asset for use

The concept of a payment to an entity for the purposes of Div 7A was extended (with effect from 1 July 2009) to include the provision of an asset for use by the entity (eg a licence to use a boat, car or holiday home) (s 109CA(1)). The amount of the payment is what would have been paid for the provision of the asset on an arm's length basis less any consideration in fact given. This extension to what constitutes a payment does not apply if there would otherwise be a payment (eg on the Commissioner's view, where there is a lease of real property) (s 109CA(9)).

There are the following exceptions to this deemed payment rule: minor benefits; an otherwise deductible exclusion; business residences in some circumstances; certain main residences and company title flats and home units (s 109CA(4) to (8)). The main residence exception only applies to a dwelling acquired by a company before 1 July 2009 and only if a continuity of ownership test is met by the company on and from 1 July 2009.

A payment is taken to be made by virtue of the provision of an asset for use by an entity rule when the entity first (a) uses the asset with the permission of the provider; or (b) has a right to use the asset (whether alone or together with other entities) when the provider does not have a right, either to use the asset or to provide the asset for use by another entity. If the use or right continues into another income year there will be a separate payment made at the start of that income year (s 109CA(2), (3)).

For exclusions from the Div 7A payment rules, see ¶4-225.

[FTR ¶56-120 – ¶56-128]

¶4-210 Division 7A: loans

For the purposes of the Div 7A deemed dividend rules, a "loan" includes: (a) an advance of money; (b) a provision of credit or any other form of financial accommodation; (c) a payment of an amount for another entity if there is an obligation to repay the amount; and (d) a transaction that is in substance a loan (s 109D(3)). A loan is taken to be made at the time the loan is made or anything happens which is within the definition of loan (s 109D(4)). Where a loan made before 4 December 1997 is varied on or after that day by extending the term of the loan or increasing its amount, a new loan on the varied terms is deemed to be made at the time of the variation (s 109D(5)).

A payment that is made by a private company and is converted to a loan before the end of the company's lodgment day for the income year in which the payment is made will be treated as a loan made at the time of the payment (ITAA36 s 109D(4A)). This will enable the recipient to repay the loan or to enter into a complying loan agreement before the company's lodgment day to avoid triggering a deemed dividend. Note that s 109D(1)

and 109N(1) require the repayment to be made, or the agreement to be entered into, *before* the lodgment day (not by the end of the lodgment day). This means that the only prudent course would be to convert a payment to a loan at least one day before the lodgment day.

For the operation of the definition of loan where a private company is an unpaid presently entitled beneficiary of a trust, see ¶4-215.

For exclusions from the Div 7A loan rules, see ¶4-225. The exclusion that applies where a complying Div 7A loan agreement is put in place is discussed at ¶4-230.

[FTR ¶56-130 – ¶56-135]

¶4-215 Loan issues: private company presently entitled to income

Where a private company is presently entitled to income of a trust estate there will be cases where there is in fact a loan back by the private company to the trust (so that the present entitlement is extinguished). This includes an express or implied agreement for the loan back and could be the case where the trustee, acting pursuant to a term of the trust deed, applies the trust funds for the benefit of the private company beneficiary by crediting a loan account in the company's name and assuming a corresponding obligation to repay the amount (TR 2010/3).

Where a private company's present entitlement is not extinguished, the Commissioner now takes the view that where the private company and the trust are in the same family group and there is knowledge that funds representing the unpaid present entitlement are being used for trust purposes, rather than for the private company's sole benefit without any benefit from use accruing to the trust, the non-calling for payment of the unpaid present entitlement amounts to the provision of financial accommodation and, hence, the making of a Div 7A loan. Also, in these kinds of cases the overall transaction between the private company beneficiary and the trustee includes the beneficiary's authorisation (or acquiescence with knowledge) that funds representing the unpaid present entitlement can be used for the benefit of the trust and effects, in substance, a loan of money to the trust (TR 2010/3).

There will, however, not be a Div 7A provision of financial accommodation loan if the present entitlement is held on a sub-trust and the use of the funds in the main trust is on terms that entitle the private company to the sole benefit of any income generated by use of the funds. Note that where all unpaid present entitlements (UPEs) in a fixed trust, were mixed with the trust fund and employed by the trustee to benefit all unit holders (by retiring trust debt) in the exact same proportion as each UPE bore to the total of all UPEs, a provision of financial accommodation loan by a corporate unitholder did not arise for the purpose of Div 7A; the unit holders had not provided and were not providing any pecuniary aid or favour to the trustee or any other taxpayer but were, instead, collectively agreeing that the funds be used for their sole benefit (ID 2012/74).

These views on the operation of the provision of financial accommodation and in-substance loan limbs of the Div 7A definition of loan were a departure from the position previously taken by the Commissioner in public documents and only apply to unpaid present entitlements that arise on or after 16 December 2009 (the date of issue of TR 2010/3 in draft form).

A practice statement which provides guidance on the administration of TR 2010/3 (including where there will be a relevant sub-trust arrangement) has been issued (PS LA 2010/4). Further, in June 2011 the Commissioner issued a fact sheet which addresses certain supplementary issues that arise out of TR 2010/3 and PS LA 2010/4.

For present entitlements that arise in the 2010/11 or a later income year the sub-trust must be in place by the lodgment day of the main trust for the particular income year.

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¶4-230 Loan with minimum rate and maximum term

A loan by a private company is *not* taken to be a Div 7A dividend in the income year if, before the company's lodgment day for that year (s 109N):

- the agreement under which the loan is made is in writing
- the interest rate payable on the loan for years of income *after* the year in which the loan is made equals or exceeds the benchmark interest rate, ie the ''Indicator Lending Rates/Housing loans/Variable/Banks/Standard'' rate last published by the Reserve Bank of Australia before the start of the company's income year, and
- the loan term does not exceed the specified ''maximum term''.

The elements of the agreement that need to be in writing for these purposes are:

- the names of the parties
- the terms of the loan, ie the amount of the loan, the date that the loan amount is drawn, the requirement to repay the loan amount, the period of the loan and the interest rate payable
- that the parties have agreed to the terms
- the date of the agreement, eg the date it was signed or executed.

These essential elements may be contained in a formal written loan agreement or, for example, in an exchange of letters, emails, faxes or other means of communication, if they are dated, and provide written evidence of the terms of the loan agreement and the parties' acceptance of those terms (TD 2008/8). A number of examples are provided in the determination. A loan agreement cannot be a unilateral document (*Case 4/2009*).

When a loan agreement is being prepared after the end of the income year in which the loan was made but before the lodgment day, it is important that the agreement is drafted on the basis that there is not a new loan (to repay the original loan) but that the agreement provides the terms of the loan in fact made during the income year (ID 2012/60).

Lodgment day

The lodgment day of a company for an income year is the earlier of the actual lodgment date and the lodgment due date of the company's return for the income year in which the loan is made (s 109D(1AA)).

For the Commissioner's view on what the lodgment day is for a private company that is a subsidiary member of a consolidated group, see TD 2015/18.

Benchmark interest rates

The benchmark rates are available from the Reserve Bank website at www.rba.gov.au (TD 2001/18). For private companies with an income year ending on *30 June*, the benchmark interest rate is 5.45% for 2015/16 (TD 2015/15) and 5.40% for 2016/17 (TD 2016/11). Companies with substituted accounting periods should refer to the instructions in TD 2001/18.

Maximum term

The maximum term is 25 years if the loan is fully secured by a registered mortgage over real property and the market value of the property at the time the loan is made is at least 110% of the loan amount. In any other case the maximum term is seven years.

▶ Example

In 2014/15 Private Co makes an unsecured loan of $50,000 to its majority shareholder, Henry. The loan is covered by a signed and dated agreement which is entered into before Private Co's lodgment day for 2014/15 and states that the loan is for a term of five years with interest calculated at the benchmark interest rate applicable to the relevant year.

As the requirements for documentation, minimum interest rate and maximum term have been fulfilled, the loan will not be treated as a deemed dividend in 2014/15.

However, the loan will form all or part of an amalgamated loan (see below) for 2014/15. If Henry fails to make the minimum yearly repayment for the amalgamated loan in 2015/16 or a later year, a deemed dividend will arise in that year (see ¶4-240).

Where a loan made during an income year is the subject of a written agreement that complies with the above conditions the loan will be or form part of what is called an amalgamated loan which is dealt with in subsequent income years under the rules described at ¶4-240.

[FTR ¶56-275 – ¶56-277]

¶4-235 Repayments and refinancing a private company loan

There is a provision which is designed to prevent circumvention of the Div 7A repayment requirements by a repayment and a subsequent reborrowing (ITAA36 s 109R(2)). This provision was strengthened (from 1 July 2009) to cover the case of a new borrowing followed by a repayment.

A private company loan can be refinanced without triggering a deemed dividend under ITAA36 s 109R(2), provided the refinancing takes place because the loan becomes subordinated to another loan from another entity (eg a bank). The subordination must be beyond the control of the shareholder/associate to whom the loan was made, and the private company and the borrower must deal at arm's length with the other entity (s 109R(5)).

▶ Example

Sarah has a shareholder loan from Private Co as well as a loan from her bank. She is making the required Div 7A repayments on the company loan, but defaults on the bank loan. As a result, the bank requires the company loan to be subordinated to the bank loan. This means that Sarah must make the required repayments on the bank loan before any repayments can be made on the company loan. Under s 109R(5), Sarah could refinance the company loan to, for example, extend the term and reduce the minimum yearly repayments.

An unsecured loan (maximum term seven years) can be converted to a loan secured by a mortgage over real property with a longer maximum term. The maximum term of the new loan is 25 years, less the period of time that the old loan has already been in place (ITAA36 s 109N(3A), (3B); 109R(6)).

A loan secured by a mortgage over real property can be refinanced with an unsecured loan. The maximum term of the new loan will be seven years, reduced to the extent, if any, that the old loan was already in place for more than 18 years (ITAA36 s 109N(3C), (3D); 109R(7)).

If a private company has guaranteed a loan from a third party (eg a bank) to a shareholder/associate and the company becomes liable to make a payment to the lender, a deemed dividend will not arise under ITAA36 s 109UA if the shareholder/associate enters into a Div 7A compliant loan agreement with the company for the amount paid by the company (ITAA36 s 109UA(5)).

[FTR ¶56-300]

¶4-240 Amalgamated loans

Where a private company makes one or more loans to an entity during an income year, each of which: (a) has the same maximum term; (b) would, apart from s 109N, be treated as a Div 7A dividend in that year; and (c) is not fully repaid before the company's lodgment day for that year (s 109E(3)), the loans are brought together at the end of the year to form a single ''amalgamated loan''. The amalgamated loan is taken to have been made in the income year in which the loan(s) were in fact made (ID 2012/61). This means that there can be up to two amalgamated loans for each year, comprised of constituent loans that meet the criteria mentioned above for: (a) a maximum term of seven years; or (b) a maximum term of 25 years.

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For the income year in which a constituent loan or loans are made, the amalgamate loan will be the amount of the constituent loan(s) not repaid before the company lodgment day for the income year. However, all repayments during the income year i which that lodgment day occurs counts towards the minimum repayment for that incom year whether the repayment occurs before or on or after the lodgment day (ID 2010/82). It is not a requirement that any repayment of a loan be made before the lodgment day o the company for the income year in which the loan is made (ID 2010/206).

An amalgamated loan is not treated as a Div 7A dividend in the year in which th amalgamation occurs (s 109P), but will give rise to a deemed dividend in a subsequen income year unless the repayments in relation to the loan during that subsequent yea equal or exceed the minimum repayments specified by the formula in s 109E(6). Temporary loan repayments are generally disregarded (s 109R: ¶4-235).

▶ Example 1

A private company makes two unsecured loans to a shareholder on 1 July 2015. Each loan is mad under a written agreement, which specifies that the rate of interest payable for all future years of incom must equal or exceed that required by s 109N(1)(b). The term of one loan is five years; the other is fou years. For the year ended 30 June 2016, as all the requirements of s 109N are met, the loans are no treated as dividends under Div 7A. They are treated as an amalgamated loan.

If the amount of the amalgamated loan is $100,000, the minimum yearly repayment of the amalgamate loan for the 2016/17 year of income is calculated as follows (s 109E(6)):

$$\frac{\text{amount of the loan not repaid by the end of the previous year of income} \times \text{current year's benchmark interest rate}}{1 - \left[\dfrac{1}{1 + \text{current year's benchmark interest rate}}\right]^{\text{remaining term}}}$$

$$= \frac{\$100{,}000 \times 0.0540}{1 - [1 \div (1 + 0.0540)]^5}$$

$$= \$23{,}354 \text{ (rounded up)}$$

The "remaining term" is the difference between: (a) the number of years in the term of the longes constituent loan within the amalgamated loan; and (b) the number of years between the end of th company's income year in which the loan was made and the end of the income year preceding th income year for which the minimum yearly repayment is being worked out; rounded to the next highe whole number if the difference is not already a whole number (s 109E(6)).

If repayments made in the 2016/17 year of income equal or exceed the minimum yearly repayment, n amount is taken to be a dividend for the purposes of s 109E(1).

Amount of loan unpaid at end of previous year

Working out the "amount of the loan not repaid by the end of the previous year of income" for the purposes of the above formula sounds deceptively simple, but has proven to be controversial. It requires that the total repayments made for the year be allocated between principal and interest, so that each year the principal repayment for the current year can be deducted from the unpaid balance of the loan at the end of the previous year. Fortunately, s 109E(7) provides for interest to be calculated for this purpose at the benchmark interest rate (even if some of the constituent loans specify some higher rate). Nonetheless, issues such as simple versus compound interest and daily balances remain. An example in the ATO's Division 7A — answers to frequently asked questions document provides a methodology for working out the relevant amount.

▶ Example 2: Unpaid loan balance

A private company lent a shareholder $40,000 on 30 June 2016 under a written loan agreement that satisfies the requirements of s 109N. This was the only loan the company made to this particular shareholder in the 2015/16 year. During 2016/17, the shareholder made two repayments on the loan of $10,000 each after the company's lodgment day for the 2015/16 income year. The first payment was made on 1 January 2017 and the second was made on 30 June 2017. The benchmark interest rate is 5.40% for the 2016/17 year.

Calculations:
Interest is calculated annually in arrears by reference to the daily balance throughout the year as follows:

	Credit $	Loan balance $
		40,000.00
Principal at 1/7/2016		
Repayment at 1/1/2017	– 10,000.00	30,000.00
Repayment at 30/6/2017	– 10,000.00	20,000.00
Interest for 2016/17 (see below)	+ 1,907.50	21.097.50

Interest payable	=	(interest payable on $40,000 from 1/7/16 to 31/12/16) + (interest payable on $30,000 from 1/1/17 to 29/6/17) + (interest payable on $20,000 for 30/6/17)
	=	(5.40% × $40,000 × 184/365) + (5.40% × $30,000 × 180/365) + (5.40% × $20,000 × 1/365)
	=	$1,088.88 + $816.66 + $2.96
	=	$1,908.50

Of the $20,000 repayments made during the income year, $1,907.50 is taken to have been applied against the interest amount and $18,092.50 is taken to have been applied against the loan principal. This leaves $21,907.50 as the amount of the loan not repaid by the end of the income year. This figure is used in working out the minimum yearly repayment for the 2017/18 income year.

Consequences of not making minimum repayment

Commencing with the year in which 1 July 2006 occurs, if the actual repayments on an amalgamated loan are less than the minimum repayment for a particular year, a deemed dividend will arise equal to the *amount of the shortfall* (ITAA36 s 109E(1), (2)). Previously, where the repayments for a particular year were less than the specified minimum repayments and the loan was not repaid at the end of that year, the *entire outstanding balance* on the amalgamated loan was generally taken to be a Div 7A dividend paid at the end of that year. A shortfall amount that is treated as a dividend under ITAA36 s 109E will not be taxed again as a dividend if it is subsequently forgiven (s 109G). Note that the capital component of a shortfall in a repayment does not reduce the amount of the loan not repaid by the end of the previous year of income when applying the above minimum repayment formula in a subsequent income year (ID 2013/36).

▶ Example 3

Private Co makes a loan of $60,000 to its shareholder, Joshua. The minimum repayment for the year after the loan is made is $12,000, comprised of $8,000 principal and $4,000 interest. Joshua makes repayments of only $10,000 during the year. Under the former legislation, a deemed dividend would arise equal to the outstanding balance of the loan, ie $54,000. Under the current legislation, the deemed dividend will be only $2,000 (ie $12,000 – $10,000).

If Private Co then decides to forgive the outstanding loan balance of $54,000, the deemed dividend that arises under s 109F (as affected by s 109G) will be $52,000 (ie $54,000 – $2,000).

[FTR ¶56-140 – ¶56-143]

¶4-243 Tracing rules

Special tracing rules apply where it is reasonable to conclude that there is an arrangement under which one or more entities have been interposed between the private company and the associated entity (s 109S to 109XC).

Payments and loans through interposed entities

Under Subdiv E (ITAA36 s 109S to 109X), a private company may be taken to pay a dividend to an associated entity if an entity interposed between the private company and the target entity makes a payment or loan to the target entity under an arrangement with the private company. The rules may also operate where, for example, a private company guarantees a loan made by an interposed entity (eg a bank) to an associated entity. The Commissioner has issued a determination which sets out the factors he takes into account

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in determining the amount of a deemed payment or loan to a target entity (TD 2011/16). The interaction of the Div 7A exclusion rules where there is an interposed entity is considered in TD 2012/12.

A Div 7A compliant loan agreement between a shareholder/associate and an interposed entity can be treated as being in respect of a notional loan from the private company, and repayments against the actual loan will be able to be taken as repayments of the notional loan from the private company, so that a loan from an interposed entity is treated no more strictly than a loan directly from the private company (ITAA36 s 109W(3); 109X(2) to (4)).

[FTR ¶56-350 – ¶56-392]

¶4-246 Unpaid present entitlements

Under Subdiv EA (ITAA36 s 109XA to 109XD), a loan (¶4-210), payment or forgiven debt is subject to the deemed dividend rules of Div 7A where:

- the trustee of a trust distributes funds to a private company's non-corporate shareholder (or shareholder's non-corporate associate) as a loan, payment or forgiven debt
- in the case of a payment, the payment is a discharge or reduction of a present entitlement of the shareholder or associate that is *attributable to an unrealised gain* of a capital or income nature (ignoring any unrealised gain to the extent that it has been or would be included in the trust's assessable income, apart from Div 7A). According to the explanatory memorandum, realisation will be taken to have occurred when a gain converts into a recoverable debt. The explanatory memorandum also states that the conversion of a beneficiary's entitlement to a loan back to the trust may be caught, and
- the company is or becomes presently entitled to an amount from the trust's net income that has not been paid to the company before the earlier of the due date for lodgment or actual date of lodgment of the trust's tax return for the income year in which the transaction took place. "Net income" refers to the trust's accounting income (ID 2005/58).

A deemed dividend will not arise if the loan from the trustee is repaid or put on a commercial footing before the earlier of the lodgment date or lodgment due date of the trustee's return for the income year in which the loan was made (s 109XC).

Amounts that already have been taken into account by previous applications of the rules are not to be double counted (s 109XA(4); ID 2005/299).

Under Subdiv EB (ITAA36 s 109XE to XI), indirect payments and loans by a trustee are caught as are cases where the company's present entitlement is indirect. For the Commissioner's views on the operation of the indirect rules, see TD 2011/15.

It is important to note that the circumstances in which the Div 7A trust rules in Subdiv EA may operate in practice in the case of a company and trust which are in the same family group have been greatly diminished following the issue of TR 2010/3. As explained more fully at ¶4-215, where a sub-trust arrangement that complies with PS LA 2010/4 is not put in place, an in-substance or provision of financial accommodation loan from the company to the trust will arise for the purposes of Div 7A if the unpaid present entitlement is not paid. This will mean that the present entitlement is extinguished (subject to a technical issue) and the Div 7A company loan provisions will be relevant (¶4-200). (The technical issue, which is not adverted to in TR 2010/3, is that the Div 7A trust rules will only not apply if the company's present entitlement is paid before the relevant lodgment day.) If a sub-trust arrangement is put in place the Div 7A Subdiv EB trust rules will remain relevant.

Note too that where Trust B is a beneficiary of Trust A and there is an in substance loan by Trust B to Trust A (because of an unpaid present entitlement), the Div 7A trust rules may be attracted if a private company is an unpaid presently entitled beneficiary of Trust B that present entitlement is not put on an acceptable subtrust arrangement and Trust A is an associate of a shareholder of the private company.

[FTR ¶56-395 – ¶56-395/25]

¶4-249 Division 7A dividends limited to distributable surplus

The amount of a particular Div 7A dividend (¶4-200) is proportionately reduced if the total of all Div 7A dividends taken to be paid by the private company for the income year exceeds the "distributable surplus" of the company for that year. In this event, the assessable proportion is the distributable surplus divided by the total of all Div 7A dividends paid (s 109Y). See, for example, ID 2005/297.

To enable the associated entity to calculate the proportionate reduction, the private company is required to provide a written statement as soon as possible after year end setting out the company's distributable surplus and the total of all Div 7A dividends paid for that year.

Meaning of "distributable surplus"

A company's distributable surplus is represented by all realised and unrealised accumulated profits, irrespective of whether they are taxable, and is calculated using the following formula (s 109Y(2)):

Distributable surplus	=	Net assets + Div 7A amounts – Non-commercial loans – Paid-up share value – Repayments of non-commercial loans

Where:

Net assets is the amount (if any) by which a company's assets (as recorded in the company's accounting records) exceed the sum of: (a) the company's present legal obligations; and (b) the company's accounting provisions for depreciation, annual and long service leave, amortisation of intellectual property and trademarks. A "present legal obligation" for this purpose is an immediate obligation binding at law, whether payable and enforceable presently or at a future time (TD 2007/28). Provisions other than those mentioned in (b) may be prescribed under regulations. Future provisions are not included in the distributable surplus calculation except as mentioned in (b) (TD 2007/28).

The Full Federal Court has held that a company's income tax liability for an income year is a present legal obligation of the company at the end of the income year and therefore should be deducted when calculating the amount of a company's net assets and distributable surplus at the end of the income year (*H*). The Commissioner accepts this decision and has set out how he applies the decision (TD 2012/10). Note that: (1) to the extent that an instalment of tax for an income year remains unpaid as at 30 June, the unpaid amount is a relevant present legal obligation; and (2) if an amended assessment is issued for an income year, the amount payable under the amended assessment is taken into account in calculating the company's distributable surplus for the income year to which the amendment relates and for each subsequent income year in which the amended assessment is not paid.

Non-commercial loans is the total of any amounts the company is deemed to have paid as dividends in earlier years of income under former s 108 or the Div 7A loan rules as are shown as assets in the company's accounting records and any amounts included in the assessable income of shareholders or associates of shareholders under the Div 7A trust provisions in earlier income years.

Paid-up share value is the paid-up share capital of the company at the end of its year of income.

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Repayments of non-commercial loans is any repayments to the company of loans that have been taken to be deemed dividends, and certain amounts that have been off-set against loans that have been taken to be deemed dividends.

Division 7A amounts is the total of the dividends the company is taken to have paid in the income year as a result of payments and debt forgivenesses.

The Commissioner has a discretion to substitute a different amount where the net assets are significantly undervalued or overvalued. In exercising this discretion, the Commissioner can take into account the value of the company's assets not shown in the company's accounting records (TD 2009/5). However, this determination points out that where the company's accounting records understate the value of the company's assets because they are required to do so (eg where accounting standards require the value of internally generated goodwill to be omitted), the Commissioner will not exercise this discretion unless it is plain that the company, its shareholders and directors have acted, in making loans or other payments, in a way that treats the real and higher value of assets as their true value, that is, regardless of their value shown in the accounting records.

[FTR ¶56-400 – ¶56-400/5]

¶4-252 Offset of Div 7A dividend against subsequent dividend

The situation may arise where a Div 7A dividend (eg a loan) is offset wholly or partly against a subsequent dividend. In that case, the amount of the subsequent dividend that has been set off is treated as if it were not a dividend (and is neither assessable income nor exempt income), to the extent that the subsequent dividend is unfranked (s 109ZC). The franked portion is not reduced. There is a corresponding provision which applies where a dividend is applied to repay all or part of a loan to which the Div 7A trust rules have applied (s 109ZCA).

[FTR ¶56-420 – ¶56-425]

Other Deemed Dividends

¶4-260 Excessive payments to shareholders, directors and associates

A deemed dividend can arise where a private company pays or credits the following amounts to an associated person:

- remuneration for services rendered, or
- a retirement or termination allowance, gratuity or compensation (ITAA36 s 109).

If the Commissioner considers that the amount exceeds what is reasonable, the excess is not deductible to the company and is deemed to be a dividend paid by the company on the last day of the company's income year. To ensure, where appropriate, that it is assessable in the recipient's hands as a dividend (¶4-100), it is also deemed to have been paid out of the company's profits and to have been paid to the recipient in the capacity of a shareholder, whether or not the recipient actually was a shareholder. Transfers of property are treated as if they were payments of amounts equal to the value of the property. The deemed dividend is not subject to dividend withholding tax (s 109(1)(d)) and is unfrankable (¶4-620). The provisions governing the tax treatment of ETPs (¶14-000) do not apply to that part of an amount that is deemed to be a dividend under s 109.

For the purposes of s 109, an "associated person" means a past or present shareholder or director, or any associate of those persons. The term "associate" has the same meaning as in ITAA36 s 318, which covers a broad range of entities that are associates of natural persons, companies, partnerships and trustees.

The primary test for determining the reasonableness or otherwise of the remuneration, etc, is the value of the services, but such factors as the degree of skill and responsibility of the director or employee must be weighed against the right of capital as well as management to its reward, and against the interests of the shareholders in their capacity as such. All the circumstances of the case must be taken into account. What is reasonable for the purposes of s 109 is not necessarily the same as what is justifiable under ITAA97 s 25-50 (¶16-540).

The exercise of the Commissioner's discretion under s 109 is dependent on an assessment having been issued against the payer company in which the deductibility of the payment in the hands of the company has been considered (*Case S61*).

The provisions apply to non-share equity interests, equity holders and non-share dividends in the same way that they apply to shares, shareholders and dividends (ITAA36 s 102V).

[FTR ¶56-000]

¶4-270 Entities taxed as companies

Corporate limited partnerships (¶3-475) are taxed as if they were companies. Accordingly, distributions by corporate limited partnerships are deemed to be dividends except to the extent that they are attributable to profits or gains of an income year in which the partnership was not taxed as a company (ITAA36 s 94L). Drawings by partners of a corporate limited partnership are also deemed to be dividends (ITAA36 s 94M).

Former corporate unit trusts (¶6-280) and public trading trusts (¶6-310 – ¶6-330) are also taxed as companies. Accordingly, corporate trust distributions (ie "unit trust dividends" and "non-unit dividends") made to their equity holders are treated in the same way as dividends paid to shareholders. Note that the corporate unit trust provisions were repealed with effect in relation to the income year that commenced on 1 July 2016 and later income years.

[FTR ¶49-770 – ¶49-900]

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¶4-280 Other deemed dividends

Certain distributions in the liquidation of a company are deemed to be dividends (¶4-300 and following), as are certain "distribution payments" that represent the distribution of the profits of a CFC otherwise than by a dividend (¶21-250).

Distributions in Liquidation

¶4-300 Distributions in formal liquidations

Amounts distributed to shareholders by a liquidator in the course of winding up a company, to the extent that they represent income derived by the company (whether before or during liquidation) other than income that has been properly applied to replace a loss of paid-up share capital, are deemed for tax purposes to be dividends paid by the company out of profits derived by it (ITAA36 s 47(1)).

The term "income" covers amounts that are of an income nature, even if exempt. The meaning of the term "income" has been artificially extended (by s 47(1A)) for these purposes to include:

- any amount, other than a net capital gain, that is assessable income of the company
- any net capital gain that would arise under the CGT provisions if each capital gain were calculated without regard to indexation and any capital losses were ignored.

▶ Example

During the 2015/16 income year, X Pty Ltd disposes of four post-CGT assets that were held for m than 12 months. The relevant details relating to the acquisition and disposal of the assets are as follow

Asset	Cost base ($)	Cost base as indexed* ($)	Consideration for disposal ($)	Capital gai (loss) ($)
1	20,000	22,000	8,000	(12,000)
2	10,000	11,200	15,000	3,800
3	5,000	6,800	6,000	Nil
4	8,000	N/A	10,000	2,000

* Assumed amounts. Indexation applies only up to and including the September 1999 quarter (¶11-610

Thus, X Pty Ltd has incurred a net capital loss of $6,200 for CGT purposes.

For the purposes of s 47(1A)(b) (ie the second bullet point above) the position is:

Asset	Deemed income ($)
1	Nil
2	5,000
3	1,000
4	2,000

Instead of a loss, X Pty Ltd is taken to have derived "income" of $8,000 for the purposes of s 47(1) (o course, the s 47(1) deemed dividend cannot exceed the amount of distributable funds: TD 2000/5).

By deeming distributions to be dividends paid by the company out of its profits, they are assessable in the shareholders' hands under ITAA36 s 44 (¶4-100) as though they had been received as dividends while the company was a going concern.

It is important to remember that in a final liquidation CGT event C2 (¶11-270) would apply in relation to the shares so that a capital gain or capital loss may arise to a shareholder on shares acquired on or after 20 September 1985. Where a capital gain accrues, the provisions of ITAA97 s 118-20 are designed to prevent double taxation (¶11-690; TD 2001/27).

In the case of an interim distribution by the liquidator, CGT event G1 (¶11-310) may apply to the extent that the distribution is not a deemed dividend and the company does not cease to exist within 18 months of the distribution being paid (TD 2001/27).

The distribution by a liquidator of the exempt 50% component of a capital gain attributable to active assets of a small business (¶7-175) is not deemed to be a dividend under s 47(1) (TD 2001/14). For CGT consequences, see ¶11-270.

A deemed dividend under s 47(1) is a frankable dividend for the purposes of the imputation system (¶4-620). Therefore, care must be exercised to ensure that any distribution in the liquidation of a company, to the extent to which it is a deemed dividend, is appropriately franked.

A capital gain made by the parent company on the cancellation of its wholly owned subsidiary's shares may be reduced where, in the course of liquidating the subsidiary, the liquidator has made an *in specie* distribution involving the inter-company roll-over of a post-CGT asset (¶12-530).

The meaning of "paid-up share capital" and a liquidator's power to appropriate particular funds to particular distributions is discussed at ¶4-320.

[FTR ¶21-425, ¶21-441]

¶4-310 Distributions in informal liquidations

Distributions of cash or other property of a company appropriated to the shareholders, otherwise than by the company itself, in the course of an informal winding up or discontinuance of business are treated as though they were distributions by a liquidator in a formal winding up (ITAA36 s 47(2A)). This means that, to the extent that the distribution is made out of "income" (as defined for the purposes of s 47: ¶4-300) derived by the company, other than income properly applied to make good lost capital, it is treated as a dividend in the shareholders' hands and is usually assessable. This could occur, for example, where the company's business is discontinued and the shareholders simply appropriate the assets to themselves without making a formal application to the court for a voluntary winding up.

By way of safeguarding the revenue in these situations, s 47(2B) provides that, unless the company is dissolved within three years after the distribution or such further time as the Commissioner allows, the distribution is deemed to be a dividend paid by the company, as a going concern, out of its profits. In that event, any benefit to be gained through a liquidation, formal or informal, by way of cash distributions of non-assessable capital profits would be lost.

[FTR ¶21-550]

¶4-320 Liquidator's power to appropriate particular funds

A liquidator may, by a proper system of bookkeeping, so keep the accounts as to be able to make or appropriate particular distributions out of or to particular profits (*Archer Brothers*). Amounts so appropriated will represent the profits out of which the appropriation is made. A liquidator can rely on the *Archer Brothers* principle, except where a specific provision produces a different result (TD 95/10). In the absence of any such system or in the absence of a specific appropriation, the distribution will be prorated among the various elements in the mixed fund.

The *Archer Brothers* principle applies even where funds from an income or profit source are used to make a distribution representing a return of capital contributed by shareholders (TD 95/10).

For the *Archer Brothers* principle to apply, the ATO requires: (a) that the company accounts have been kept so that a liquidator can clearly identify a specific profit or fund in making a distribution; and (b) that the liquidator actually appropriates the specific profit or fund in making the distribution, either in the accounts or in the statement of distribution (TD 95/10). The ATO does not consider it necessary to keep separate accounts for each specific fund or profit (although the maintenance of separate accounts makes it easier to identify the source of a distribution).

"Paid-up share capital" for ITAA36 s 47 purposes expressly includes cancelled capital not previously repaid to the shareholders (s 47(3)).

[FTR ¶21-441, ¶21-475]

Simplified Imputation System

¶4-400 Summary of imputation system

The basis of the imputation system of company taxation is that shareholders who receive assessable dividends from a company are entitled to a tax offset for the tax paid by the company on its income. It is called an imputation system because the payment of company tax is imputed to shareholders. Dividends paid to shareholders may effectively become tax-free to varying extents. The company must keep records to verify the amount of tax that can be imputed to its shareholders. A simplified imputation regime, comprising ITAA97 Pt 3-6, has applied since 1 July 2002.

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The simplified imputation system can be briefly described as follows:

- the system applies to distributions (eg dividends: ¶4-460) paid by Australian resident corporate tax entities (¶4-440) to Australian resident members
- tax paid at the corporate level is allocated to members by way of franking credits attached to the distributions they receive. Such distributions are called franked distributions (¶4-640)
- a corporate tax entity can choose, for a particular franking period, the franking percentage for frankable distributions. There is a ''benchmark rule'' under which the franking percentage for the first frankable distribution made in the franking period (¶4-660) is the benchmark franking percentage for all frankable distributions made in the period
- an amount equal to the franking credits attached to franked distributions is included in the assessable income of Australian resident members, who are then entitled to a tax offset equal to the amount included in their income (¶4-800)
- tax paid and tax imputed to members is recorded in a corporate tax entity's franking account. Broadly, a credit to the entity's franking account (franking credit) arises when the entity pays income tax or receives a franked dividend (¶4-710), and a debit arises when the entity franks a dividend or receives a tax refund (¶4-720)
- where a corporate tax entity has a franking account deficit at the end of a year, it is required to pay franking deficit tax shortly after the end of the year to make good this deficit (¶4-780)
- special rules apply to franked distributions paid to a partnership or to a trustee of a trust. These rules enable the streaming of franked distributions by the trustee of a trust but otherwise ensure that the attached franking credits flow through to each partner or beneficiary (or trustee if appropriate) in proportion to their share of the net income of the trust or partnership that is attributable to franked distributions (¶4-860)
- special rules apply to prevent abuse of the imputation system (¶4-900).

Debt/equity borderline

The debt and equity provisions (¶23-100) apply to the taxation of dividends (including imputation), thin capitalisation, characterisation of payments from foreign resident entities, and the boundary between dividend and interest withholding tax. Thus, the imputation system applies to a non-share equity interest in the same way as it applies to a membership interest. It also applies to a non-member equity holder in an entity in the same way as it applies to a member of the entity (ITAA97 s 215-1).

Corporate unit trusts, public trading trusts, corporate limited partnerships

The imputation system applies not only to companies but also to distributions paid by public trading trusts and (for income years that started before 1 July 2016) corporate unit trusts, which are treated as companies for tax purposes (¶6-300, ¶6-330). Corporate limited partnerships (¶3-475) are also taxed as companies and fall within the imputation system (¶4-440).

Special rules for franking by some entities

There are special rules for franking by certain types of entities (ITAA97 s 200-45). This includes:

- venture capital franking by a PDF (¶3-555)
- franking by life insurance companies (¶4-760)
- franking by exempting entities and former exempting entities (¶4-970)
- franking by co-operative companies (¶3-430).

Imputation and the lower small business company tax rate

The company tax rate of 28.5% applies for the 2015/16 income year for companies that are small business entities (with an aggregated turnover of less than $2m) (¶7-200). Although the maximum franking credit that can be allocated to a frankable distribution is usually set by the applicable company tax rate, in the case of companies that are small business entities the franking credit cap remains at the standard corporate tax rate of 30% for 2015/16. However, the normal franking credit distribution provisions applied.

For the proposed position for the company rate changes that are to apply for the 2016/17 and later income years, see ¶4-405.

Proposed integrity measure

The government has announced that a specific measure will be introduced to prevent the distribution of franking credits where a distribution to shareholders is funded by particular capital raising activities and will address the issues raised by the ATO in TA 2015/2.

The proposed measure will apply to distributions declared by a company to its shareholders outside or additional to the company's normal dividend cycle (a special dividend), to the extent it is funded directly or indirectly by capital raising activities which result in the issue of new equity interests. Examples of capital raising activities include an underwritten dividend reinvestment plan, a placement or an underwritten rights issue. Where such arrangements are entered into, the company will be prevented from attaching franking credits to shareholder distributions.

The proposed measure will apply to distributions made after 2.00 pm (AEDT) on 19 December 2016.

Financial System Inquiry

The final report of the Financial System Inquiry which was released on 7 December 2014 states that the case for retaining dividend imputation is less clear than in the past and that to the extent that dividend imputation distorts the allocation of funding, a lower company tax rate would likely reduce such distortions. See also ¶1-720.

[FITR ¶213-000]

¶4-405 Effect of corporate tax rate changes on the imputation system

Amending legislation that has been introduced into but not yet passed by parliament (the Treasury Laws Amendment (Enterprise tax Plan) Bill 2016: ¶41-100) contains amendments to give effect to the 2016/17 Budget proposals in relation to the company rates of tax.

Very broadly, the corporate tax rate is to be reduced to 27.5% for the 2016/17 income year for corporate tax entities that are small business entities, that is, corporate tax entities that carry on a business and have an aggregated turnover of less than $10m. This lower corporate tax rate is to be progressively extended to all corporate tax entities by the 2023/24 income year. The corporate tax rate will then be reduced over the next three income years to 25%.

Amendments are also being made to the imputation system as a result of these proposed rate changes. It was officially explained that, given the rate reductions, it is not feasible to continue to operate the imputation system at the headline corporate tax rate of 30% for all corporate tax entities.

Consequently, from the 2016/17 income year, the operation of the imputation system for corporate tax entities is to be based on the company's corporate tax rate for a particular income year, worked out having regard to the entity's aggregated turnover for the previous income year. This is necessary because corporate tax entities usually pay distributions to members for an income year during that income year. However, a corporate tax entity will not know its aggregated turnover for a particular income year (and therefore its corporate tax rate for that income year) until after the end of the income year.

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As a result of this change, for the purposes of applying provisions in the imputati system, corporate tax entities will use what is to be called the "corporate tax rate f imputation purposes". This will generally mean the entity's corporate tax rate for t income year (the current income year), worked out on the assumption that the entity aggregated turnover for the income year is equal to its aggregated turnover for t previous income year.

¶4-440 Corporate tax entity and franking entity

The simplified imputation system applies to distributions made by corporate t entities to their members. An entity is a "corporate tax entity" at a particular time if th entity is (ITAA97 s 960-115):

- a company at that time
- a corporate limited partnership (¶3-475) in relation to the income year in which th time occurs
- for income years that commenced before 1 July 2016, a corporate unit tru (¶6-290) in relation to the income year in which that time occurs, or
- a public trading trust (¶6-320) in relation to the income year in which that tim occurs.

These entities are taxed separately from their members, at the corporate tax rate.

Franking entity

A franking entity is any corporate tax entity other than a mutual life insuranc company (ITAA97 s 202-15). However, it does not include a corporate trustee when it i acting in its capacity as trustee of a trust.

[FITR ¶213-040, ¶213-625, ¶762-22

¶4-460 Distributions by corporate tax entities

The core of the imputation system is the attachment of tax credits to distributions paid by corporate tax entities (called "franking") in order to pass on to members th benefit of the tax paid at the corporate tax entity level. This eliminates double taxation (a the entity level and the investor level).

A "distribution" is defined in relation to the type of corporate tax entity that makes the distribution (ITAA97 s 960-120):

- a distribution by a company is a dividend, or something that is taken to be a dividend, under the Act
- a distribution by a corporate limited partnership is either: (a) a distribution made by the partnership in money or property to a partner in the partnership (excluding amounts attributable to profits or gains arising during a year of income in relation to which the partnership was not a corporate limited partnership); or (b) something that is taken to be a dividend by the partnership under the Act
- for income years that started before 1 July 2016, a distribution by a corporate unit trust is a unit trust dividend, as defined in ITAA36 former s 102D(1) (¶6-300)
- a distribution by a public trading trust (¶6-320) is a unit trust dividend, as defined in ITAA36 s 102M (¶6-330).

A corporate tax entity makes a distribution in the form of a dividend on the day on which the dividend is paid or taken to have been paid.

[FITR ¶213-045, ¶762-225]

¶4-480 Members and membership interests

The meaning of a "member" of an entity is set out in ITAA97 s 960-130. The members of various types of entities are shown in the table in ¶8-000.

Where interests or rights that give rise to membership of an entity are held jointly, each holder of the joint interest is a member of the entity.

Membership interest

A "membership interest" in an entity means each interest or set of interests in the entity, or each right or set of rights in relation to the entity, by virtue of which a person is a member of the entity (ITAA97 s 960-135).

[FITR ¶213-050]

¶4-490 Trans-Tasman triangular imputation rules

The Australian and New Zealand governments have extended their imputation systems to include companies resident in the other country. The reforms are aimed at what is known as the "triangular tax" problem, where Australian shareholders in an NZ company operating in Australia were unable to access Australian sourced franking credits, with the same problem applying in reverse for NZ shareholders in Australian companies operating in New Zealand. The Australian rules (discussed herein) are contained in ITAA97 Div 220. For details of the NZ legislation, see ¶17-200 and following of the *New Zealand Master Tax Guide*.

NZ companies can elect (ie make an "NZ franking choice") to maintain an Australian franking account reflecting Australian tax paid (including income tax payments, franking credits attached to dividends received and Australian withholding tax on dividends, interest and royalties) (ITAA97 s 220-25 to 220-50; 220-205 to 220-300). An NZ company that makes an NZ franking choice is known as a "NZ franking company".

Where a non-Tasman company is interposed between an NZ parent company and an Australian or NZ subsidiary, franking credits that would otherwise arise in the franking account of the subsidiary (the "franking donor company") are transferred to the franking account of the NZ company (the "NZ recipient company") that holds the shares in the interposed company. This rule applies only from the time that the parent company, the NZ recipient company and the franking donor company (if it is an NZ resident) have made an NZ franking choice (s 220-300).

Trans-Tasman companies that elect to do so will distribute Australian franking credits and NZ imputation credits to all shareholders in proportion to their shareholdings in the company. However, each country's credits can be claimed only by residents of that country.

▶ Example

NZ Company is owned 80% by NZ residents and 20% by Australian residents. It pays A$100,000 of Australian tax, which it fully distributes to its shareholders through franked dividends. The Australian shareholders will receive A$20,000 of franking credits (ie 20% of the total) in the form of refundable tax offsets. The remaining A$80,000 of Australian franking credits cannot be utilised as they are allocated to NZ residents.

Assume that the company also distributes NZ$200,000 of NZ imputation credits (allocated to the same dividends). Of this amount, NZ$160,000 will be received and utilised by NZ resident shareholders. The remaining 20% of the NZ imputation credits (ie NZ$40,000) will be distributed to Australian resident shareholders, who cannot utilise them.

The franking tax offset received by an Australian shareholder of an NZ company who is eligible to receive offsets for foreign tax (eg an investor with less than 10% shareholding) is reduced to the extent of the "supplementary dividend" (see ¶26-500 of the *New Zealand Master Tax Guide*) paid by the NZ company under NZ tax law (ITAA97 s 220-400 to 220-410).

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When a public entity fails the test at the first test time and, before that time, required to test under the terms of either IT 2361 or IT 2530, the asset is taken to have been acquired on the day on which the entity was required to test or the day on which failed the test, whichever happened earlier. If neither of these days is applicable, the asset is taken to have been acquired on 20 January 1997. The earliest date on which a public entity was required to test under the terms of the above rulings is 4 May 1989 (TR 1999/4).

TR 1999/4 also makes some important points about the application of the test in this context:

- the former rules for tracing interests of less than 1% can be used, but not if the notional holder would be taken to hold more than a 20% interest or it is reasonable to assume that there had been a change in majority underlying interests. Where the notional holder has a 20% interest or less, the notional holder rules can be used unless there is clear evidence that there has been a change
- the former rules for tracing interests through interposed superannuation funds, ADFs, special companies and government bodies can be used
- public entities do not have to apply the abnormal trading principles in IT 2361 and IT 2530 to determine whether testing was required under those rulings. As a concession, the Commissioner allows public entities to retrospectively use the more flexible abnormal trading rules in the legislation (see above).

The rules for tracing underlying ownership of assets and the information used by the Commissioner to decide whether ownership has changed for CGT purposes are explained in TR 2004/7.

Cost base of assets that become post-CGT assets

If an asset stops being a pre-CGT asset, the first element of its cost base and reduced cost base is the asset's market value at the time it becomes a post-CGT asset (s 149-75).

Determinations not required for post-CGT assets

Once an asset stops being a pre-CGT asset because the Commissioner is satisfied that its majority underlying interests have changed, the entity need not give any more evidence to the Commissioner about its underlying interests (s 149-80).

[FITR ¶169-016 – ¶169-026, ¶762-300 – ¶762-33

¶12-910 Assets ceasing to be pre-CGT assets — demutualised entities

When working out the majority underlying interests in publicly listed companies, 100% beneficially owned companies and publicly traded unit trusts, simplified rules apply if the entity is a mutual insurance company or a mutual affiliate company that has demutualised since the starting day (19 September 1985 or a day chosen by the company between 1 July 1985 and 1 July 1986) (s 149-165). However, these rules only apply if, when the company demutualised, it had more than 50 members.

In such a case, the entity may require the Commissioner to treat its evidence on the assumption that an ultimate owner who:

- immediately before the demutualisation time was a member of the entity, and
- immediately after the demutualisation time held an underlying interest in the asset,

held the interest at all times from and including the end of the starting day until immediately after the demutualisation time.

Similar rules apply if there is an interposed company that has demutualised since the starting day (s 149-170).

[FITR ¶169-036, ¶169-03

Chapter 13 Superannuation Funds • Contributions

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Understanding Australian Superannuation

¶13-010 Superannuation taxation overview

This chapter covers the taxation arrangements for superannuation funds, the tax concessions for making superannuation contributions and limits on the concessional treatment of contributions under the Tax Acts, and the supervisory regime for superannuation funds under the superannuation industry supervision (SIS) legislation. The taxation arrangements for superannuation fund benefits and employment termination benefits are discussed in Chapter 14. The superannuation guarantee scheme is discussed in Chapter 39.

The chapter also outlines the taxation arrangements for other entities which make up the Australian superannuation system such as approved deposit funds, pooled superannuation trusts and providers of retirement savings accounts.

There are three stages of taxation of superannuation:

(1) concessional contributions received by complying superannuation funds are taxed at 15% in the fund while non-concessional contributions are not taxed (¶13-125). Various concessions (such as a tax deduction, tax offset or government co-contribution) are available for contributions made to complying superannuation funds if certain conditions are met (¶13-700).

Excess contributions charge or tax is payable by individuals on concessional and non-concessional contributions which exceed annual limits (¶13-775, ¶13-780)

Additional tax (Division 293 tax) is payable by individual taxpayers whose income and relevant concessionally taxed superannuation contributions exceed a threshold in an income year (¶13-750)

(2) complying superannuation funds are taxed on their earnings during the accumulation stage at 15%, while their non-arm's length income (if any) is taxed at 47% (¶13-170). Earnings from assets in complying funds which are supporting current pensions and capital gains on the disposal of those assets are tax-exempt (¶13-140)

(3) lump sum and income stream payments from complying superannuation funds, and lump sum employment termination payments and related payments, are concessionally taxed under special rules (Chapter 14).

For Australian non-complying superannuation funds, all of their taxable income is taxed at 47% (¶13-220), while special taxation rules apply to foreign superannuation funds (¶13-250). The special rules which apply to benefit payments from these funds are discussed in Chapter 14.

Many changes affecting the tax treatment superannuation contributions will come into effect from 1 July 2017 and 2018, as summarised in ¶13-012.

CCH provides additional coverage on superannuation taxation and regulation for trustees and superannuation professionals in the *2016/17 Australian Master Superannuation Guide*, *Superannuation Law & Practice* and *Superannuation Solution Finder*.

¶13-012 2016/17 Budget superannuation measures and other reforms

The income tax laws have been amended (by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Act No 81 of 2016)) to implement the 2016/17 Budget superannuation measures as summarised below:

- From 1 July 2017, there will be a $1.6m transfer balance cap on the total amount of accumulated superannuation an individual can transfer into the tax-free retirement phase. Subsequent earnings on balances in the retirement phase will not be capped or restricted. An excess transfer balance tax is payable if the cap is exceeded (¶14-320).
- From 1 July 2017, the threshold at which high income earners are liable for Division 293 tax will be lowered from $300,000 to $250,000 (¶13-750).
- From 1 July 2017, the annual cap on concessional contributions will be reduced to $25,000 for all individuals (currently $30,000 for individuals under age 50, and $35,000 for those age 50 and over) (¶13-775).
- From 1 July 2018, individuals with account balances of $500,000 or less will be allowed to make "catch up" superannuation contributions by allowing them to roll over their unused concessional caps from up to five previous financial years (¶13-775).

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- From 1 July 2017, the annual non-concessional contributions cap will be reduced to $100,000 (currently $180,000) and individuals with a superannuation balance of more than $1.6m will no longer be eligible to make non-concessional contributions. As is currently the case, individuals under age 65 will be eligible to bring forward three years of non-concessional contributions (¶13-780).
- From 1 July 2017, a Low Income Superannuation Tax Offset will be available to individuals who earn an adjusted taxable income of $37,000 or less for their superannuation contributions (the tax offset will replace the Low Income Superannuation Contribution which ceases to apply after 30 June 2017) (¶13-760).
- From 1 July 2017, the requirement that an individual must earn less than 10% of their income from their employment related activities to be able to deduct a personal contribution to superannuation will be removed. All individuals under the age of 65, and those aged 65 to 74 who meet the work test, may claim a tax deduction for personal contributions to eligible superannuation funds up to the concessional contributions cap (¶13-730).
- From 1 July 2017, eligibility for the spouse contributions tax offset will be extended to individuals whose spouses earn up to $40,000 (¶13-770).
- From 1 July 2017, the tax exemption on earnings in the retirement phase will be extended to products such as deferred lifetime annuities and group self-annuitisation products (¶13-140).
- From 1 July 2017, the tax exempt status of income from assets supporting transition to retirement income streams (TRIS) will be removed. These earnings will be taxed concessionally at 15%. Individuals will also no longer be allowed to treat certain superannuation income stream payments as a lump sum for tax purposes (¶13-140).
- From 1 July 2017, the anti-detriment provision which allows superannuation funds to claim a tax deduction for a portion of the death benefits paid to eligible dependants will be removed (¶13-150).
- From 1 July 2017, the range of existing processes for the release of amounts from individuals' superannuation using a release authority will be simplified and consolidated, as part of streamlining the administration of the Division 293 tax regime (¶13-750).

The superannuation measures are discussed further in the paragraphs to which they relate, as noted above.

Exposure draft regulations

The government has released draft regulations to support the implementation of the 2016/17 Budget superannuation reform measures (Draft Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulations 2017: consult.treasury.gov.au/retirement-income-policy-division/superannuation-reform-package-regulations). The draft regulations relate to:

- Prescribing the subsidiary objectives of the superannuation system (see below)
- Defining total superannuation balances
- Release authorities
- Lowering the annual non-concessional cap
- Improving access to tax deductions for personal contributions
- Implementing the transfer balance cap.

Objective of superannuation

The government has proposed legislation to enshrine the objective of superannuation in law.

To enhance stability in the superannuation system, the Superannuation (Objective) Bill 2016 will provide that the primary objective of the superannuation system is *to provide income in retirement to substitute or supplement the Age Pension*. From 1 July 2017, a statement of compatibility which sets out how the proposed legislation or regulation is consistent with the objective of superannuation must be prepared for any Bill or regulation relating to superannuation. Subsidiary objectives will provide a framework for assessing the compatibility of a Bill or regulation with the objective of the superannuation system (Superannuation (Objective) Bill 2016: ¶41-200).

Financial System Inquiry report

The government has agreed to most of the recommendations of the Financial System Inquiry (FSI) dealing with superannuation reforms (treasury.gov.au/PublicationsAndMedia/Publications/2015/Govt-response-to-the-FSI). The status of certain reform measures is summarised below.

Review of the efficiency and competitiveness of the superannuation system

The government has tasked the Productivity Commission (PC) to develop criteria to assess the efficiency and competitiveness of the superannuation system and to develop alternative models for a formal competitive process for allocating default fund members to MySuper products (www.pc.gov.au/inquiries/current/superannuation).

The PC's report, *How to Assess the Competitiveness and Efficiency of the Superannuation System*, is available at www.pc.gov.au/inquiries/current/superannuation/competitiveness-efficiency/report/superannuation-competitiveness-efficiency-summary.pdf.

The PC has also released an issues paper to assist participants in preparing submissions to the public inquiry into alternative default models for superannuation (available at www.pc.gov.au/inquiries/current/superannuation/alternative-default-models/issues).

Governance of superannuation

The Superannuation Legislation Amendment (Trustee Governance) Bill 2015 (now lapsed) which was introduced to implement proposed changes to governance measures for APRA-regulated superannuation funds is discussed in ¶13-800.

Choice of funds

The Superannuation Legislation Amendment (Choice of Fund) Bill 2016 (now lapsed) which was introduced to extend the choice of fund arrangements to more employees by removing the deemed choice for certain enterprise agreements and workplace determinations is discussed in ¶39-260.

¶13-015 Making superannuation contributions

The making of superannuation contributions can be compulsory or voluntary, or may be prohibited, depending on the circumstances.

Employer contributions

Employers are required to make a prescribed level of superannuation contributions in each financial year for their employees with some exceptions under the superannuation guarantee (SG) scheme (see Chapter 39). Some employers also make contributions for their employees under an industrial award, or make additional contributions under an employment contract or arrangement (eg salary sacrifice).

From 1 July 2007, employers are entitled to a deduction with no limit for their superannuation contributions for employees, where certain conditions are met (¶13-710). Employer contributions (and deductible personal contributions, see below) are

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"concessional contributions" under ITAA97 and such contributions are subject to special tax rules where they exceed certain limits (see "Contributions tax and excess contributions" below).

Under the SISR, superannuation funds can generally accept mandated employer contributions for employees (eg SG contributions or award contributions) without any restriction. Other employer contributions may similarly be accepted without restriction for members under the age of 65, while such contributions for members over age 65 can be accepted only if the members satisfy a work test (¶13-790).

Personal contributions

Superannuation funds can accept the personal contributions (member contributions) of individuals who are under the age of 65 with no restriction. For individuals who are between the age of 65 and 75, acceptance is permitted only if a work test is met and no member contributions can be accepted for individuals who are age 75 or more. In addition, a separate rule imposes a limit on the acceptance of certain member contributions (fund-capped contributions) based on the member's age (¶13-790).

Where certain conditions are met, an individual taxpayer may be entitled to tax concessions for making personal contribution, such as a tax deduction (¶13-730) or a government co-contribution or low income superannuation contribution (¶13-760). There is generally no limit on the amount of contributions that an individual can make, but certain contributions must be returned under the acceptance of contribution rules in the SISR (¶13-790).

An individual may also make superannuation contributions for his/her spouse and is entitled to a tax offset where certain conditions are met (¶13-770).

Contributions tax and excess contributions

An individual's deductible personal contributions and employer contributions for their employees are "concessional contributions" under ITAA97 (¶13-775).

Where the concessional contributions made for or by an individual exceed an annual cap, the excess contributions are included in the individual's assessable income and are taxed at marginal tax rates. An excess contributions charge is also payable on the excess contributions and, as part of the assessment process, the individual receives a non-refundable tax offset of 15% of the excess concessional contributions (¶13-775). An individual may elect to release up to 85% of the excess concessional contributions from his/her superannuation fund. The released amount is not assessable income and not exempt income (¶13-777). For years before 2013/14, excess contributions tax was payable on excess concessional contributions.

An individual's non-deductible contributions are "non-concessional contributions" under ITAA97. From 2007/08 onwards, excess contributions tax is payable if the individual's non-concessional contributions exceed an annual cap (¶13-780). From the 2013/14 year onwards, an individual with excess non-concessional contributions may elect to release an amount equal to the excess contributions plus 85% of an associated earnings amount for those contributions from his/her superannuation fund. The associated earnings amount is included in the individual's assessable income in the year the excess contribution arose and is taxed at the individual's marginal tax rate. The individual is entitled to a non-refundable tax-offset equal to 15% of the associated earnings amount included in assessable income (¶13-780).

Concessional contributions (and certain other amounts) received by a complying superannuation fund are included in the fund's assessable income and are taxed at 15%, or at 47% if a non-complying fund (this is commonly referred to as "contributions tax"). Non-concessional contributions received are not subject to contributions tax (¶13-125). The tax rate on a non-complying fund's taxable income is 47% in 2016/17 (¶13-220).

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Complying and non-complying funds must also pay tax on any no-TFN contributions received from members. A tax offset is available if the member's TFN is subsequently received (¶13-180).

From 1 July 2012, individuals whose income and relevant concessionally taxed superannuation contributions exceed $300,000 for an income year are liable to pay Division 293 tax of 15% on the excess contributions, thus reducing the tax concessions enjoyed by these individuals (¶13-750).

¶13-025 Accessing superannuation benefits

A member's benefits in a superannuation fund may be paid as one or more lump sums or pensions, or both, if permitted by the fund's governing rules and the payment rules in the SISR.

Preservation rules in the SISR ensure that the member's entitlements are retained in the superannuation fund for their stated purpose (ie to provide retirement/death benefits) and they cannot be accessed unless the member satisfies a "condition of release" as specified in the SISR (eg attaining age 65, retirement, incapacity and so on). The conditions of release include early access to benefits in certain circumstances. For example, members who have reached their preservation age (¶13-800) may access their superannuation entitlements as non-commutable income streams without having to "retire", and early release of benefits is allowed in hardship cases or on compassionate grounds or under an ATO release authority, or for temporary resident members who are departing or have left Australia.

Benefits are portable (ie transferable from fund to fund without loss of tax concessions) where permitted by the governing rules of the transferor and transferee funds and the SISR. Special tax rules govern the transfers of superannuation benefits between Australian superannuation funds and KiwiSaver schemes (¶13-380).

Over the years, successive governments have gradually tightened the taxation and access rules to encourage or enforce preservation of member benefits. The general practice has been to "grandfather" any rights that members have at the time of each change. This practice is largely responsible for the significant complexity of the Australian superannuation system, with benefits accrued before certain dates and people of various ages as of certain dates being treated differently.

The taxation of superannuation benefits is discussed at Chapter 14.

Superannuation Entities

¶13-050 Superannuation funds

A "superannuation fund" is a scheme for the payment of superannuation benefits upon retirement or death or a superannuation fund as defined in *Superannuation Industry (Supervision) Act 1993* (SISA), s 10 (ITAA36 s 6(1); ITAA97 s 995-1(1)).

Under SISA, a "superannuation fund" is: (a) an indefinitely continuing fund that is a provident, benefit, superannuation or retirement fund; or (b) a public sector superannuation scheme, ie a scheme for the payment of superannuation, retirement or death benefits established by a Commonwealth, state or territory law, or under the authority of the Commonwealth, state or territory government or a municipal corporation, local government or public authority. An "indefinitely continuing fund" means that the fund must not be one that will terminate or be wound up after a specified period. A provision in a fund's rules for the purpose of avoiding a breach of the rule against perpetuities does not prevent the fund from being an indefinitely continuing fund.

trustee or director of the corporate trustee of an SMSF in place of a member. The ATO's guidelines on trustee appointments for holders of an enduring power of attorney under s 17A(3)(b)(ii) are set out in SMSFR 2010/2.

A "disqualified person" (as defined in SISA) cannot be a superannuation fund trustee, and a person in the capacity of legal personal representative of a disqualified person also cannot be the trustee of an SMSF (s 17A(10)).

The ATO may remove or suspend a trustee in certain circumstances, and appoint an acting trustee (SISA s 133; 134; PS LA 2006/17; *Notaras*).

[AMSG ¶5-200 – ¶5-250; SLP ¶6-150 – ¶6-250]

¶13-070 ADFs, PSTs and RSAs

Approved deposit funds (ADFs), pooled superannuation trusts (PSTs), and providers of retirement savings accounts (RSAs) that are not life insurance companies, are taxed under the rules set out in ITAA97 Div 295 (¶13-120). To qualify, these entities must come within the definition of those terms in SISA (for ADFs and PSTs) and in the *Retirement Savings Accounts Act 1997* (RSAA) (for RSA providers) and comply with the prudential requirements under SISA or RSAA.

The nature and taxation of ADFs, PSTs and RSAs are discussed at ¶13-400, ¶13-430, ¶13-470 respectively. The taxation of the superannuation business of RSA providers that are life insurance companies is discussed in ¶3-480.

[AMSG ¶3-650 – ¶3-730; SLP ¶3-290 – ¶3-376, ¶60-300ff]

Taxation of Superannuation Funds

¶13-100 Complying and regulated fund status

A superannuation fund must be a "complying superannuation fund" to be eligible for concessional tax treatment under ITAA97 Div 295. To qualify, the fund must receive a notice under SISA from APRA (or the Commissioner) stating that it is a complying superannuation fund. A fund remains a complying superannuation fund for tax purposes until it is notified that its complying status has changed.

By virtue of its status, an exempt public sector superannuation scheme (¶13-300) is a complying superannuation fund.

Main requirements for complying fund status

To obtain a complying fund notice under SISA:

- a fund must be "regulated superannuation fund" that is an "Australian superannuation fund" at all times during the year of income that it was in existence (or be a resident ADF for part of the year), and
- it must comply with the regulatory provisions in SISA or, if it contravened the regulatory provisions, it must not fail the "culpability test" set out in SISA s 42(1A) or, in the case of an SMSF, the "compliance test" set out in SISA s 42A(5).

A "regulatory provision" means a provision of the SIS legislation and *Financial Sector (Collection of Data) Act 2001*, certain provisions in the *Corporations Act 2001* and, for an SMSF, certain provisions in TAA Sch 1 (SISA s 38A).

Regulated superannuation fund

A fund is a "regulated superannuation fund" if the fund has a trustee and:

- the governing rules of the fund either require an Australian corporate trustee (the "corporations route") or provide that the sole or primary purpose of the fund is to provide old-age pensions (the "pensions route"), and
- the trustee irrevocably elects for SISA to apply to the fund by lodging the election in the approved form with APRA (or other person prescribed by the regulations) within 60 days of setting up the fund (SISA s 19; SISR reg 1.04A).

The above election process to become a regulated superannuation fund forms part of the fund's registration in the tax and superannuation systems, such as applying for an ABN, a TFN and GST. The ATO is responsible for receiving and processing the election to become a regulated superannuation fund (reg 1.04A). After registration, the ATO will retain the election and fund information for SMSFs and provide APRA with the information in the case of APRA-regulated superannuation entities. An ATO system enables online registration and allows superannuation entities to change their registration details.

The government's Super Fund Lookup website (www.superfundlookup.gov.au) contains publicly available information about superannuation funds that have an ABN.

Australian superannuation fund

A fund is an "Australian superannuation fund" at a time, and for the income year in which that time occurs, if:

- the fund was established in Australia, or any asset of the fund is situated in Australia at that time
- at that time, the central management and control of the fund is ordinarily in Australia
- at that time, either the fund had no active member, or active members who are Australian residents hold at least 50% of the following:
  - (i) the total market value of the fund's assets attributable to superannuation interests held by active members, or
  - (ii) the sum of the amounts that would be payable to or in respect of active members if they voluntarily ceased to be members (ITAA97 s 295-95(2)).

The central management and control of a superannuation fund is ordinarily in Australia at a time even if that central management and control is temporarily outside Australia for a period of not more than two years (s 295-95(4); *CBNP Superannuation Fund*). A member is an "active member" at a particular time if he or she contributes to the fund at that time, or is an individual for whom contributions have been made. However, a member is not an active member at the relevant time if he or she is a foreign resident and is not a contributor at that time and the only contributions made to the fund for the member since becoming a foreign resident were made in respect of a time when he or she was an Australian resident (s 295-95(3)). Guidelines on the three tests to be an Australian superannuation fund are set out in TR 2008/9.

Loss of complying fund status

A superannuation fund automatically loses its complying fund status if it is not an Australian superannuation fund (*CBNP Superannuation Fund*).

A fund may lose its complying fund status if it breaches one or more regulatory provisions in a year and fails the culpability test in SISA s 42(1A) or, for an SMSF, the compliance test in SISA s 42A(5) (*Case 7/2009*; *Re JNVQ*; *ZDDD*; *Sutherland v Woods*; *Triway*; *Shail*; *Montgomery Wools*; *Re-Ali*).

When determining a fund's complying status, a contravention of a regulatory provision is ignored unless the contravention is an offence, a contravention of a civil penalty provision, or a contravention of certain TAA provisions (applicable to SMSFs only) (SISA s 39).

PS LA 2006/19 outlines the factors the Commissioner will consider when deciding whether a notice of non-compliance should be given to an SMSF which has breached the regulatory provisions (*XPMX*; ATO *Decision Impact Statement* VRN 3265 of 2007, 3633 of 2007: alternative options available to the ATO for breaches). The Commissioner's decision to issue a notice of non-compliance to a fund was set aside in *Pabian Park*. According to the AAT, the case was "finely balanced" and "weighing up all the factors", it would not be inconsistent with the objects of SISA to exercise the discretion

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in favour of the fund. The ATO accepted that it was open to the AAT to reach its decision on the facts, but noted that, in doing so, the AAT has accepted and followed the general approach taken in PS LA 2006/19 (ATO *Decision Impact Statement* VRN 2004 of 2010).

In certain circumstances, the Commissioner may accept an enforceable undertaking from fund trustees to rectify contraventions (PS LA 2006/18). The court's powers to grant orders in relation to enforceable undertakings under s 262A(4)(d) of the SISA include deeming a fund to be complying in an appropriate case (*Interhealth Energies*).

A regulated superannuation fund that fails to qualify as a complying superannuation fund remains regulated under the SISA at all times. That is, while the fund is taxed as a non-complying fund (¶13-220), it continues to be subject to all the regulatory provisions applicable to it, including the SISA penalty regime.

If a complying fund notice is revoked, or the decision to give the notice is set aside, the fund is treated as a non-complying fund for each of the years of income covered by that notice. Where a complying fund becomes non-complying, the tax concessions that the fund previously enjoyed are recouped (¶13-200).

The decision by APRA or the Commissioner to give a notice that a fund is or is not a complying superannuation fund, or refusal to give such a notice, is a "reviewable decision" under SISA (¶28-080).

[AMSG ¶2-130; SLP ¶2-160]

¶13-120 Taxation of complying superannuation entities

From 1 July 2007, ITAA97 Div 295 provides the special rules for the taxation of the following superannuation entities, whether they are established by an Australian law, by a public authority constituted under such a law or in some other way:

- a complying superannuation fund or non-complying superannuation fund
- a complying ADF or non-complying ADF (¶13-400), and
- a PST (¶13-430) (ITAA97 s 295-5).

Division 295 also applies to public sector superannuation schemes, although constitutionally protected funds are exempt from tax (¶13-300).

The Division also provides for the taxation of the RSA business of an RSA provider that is not a life insurance company (¶13-480). The taxation of life office RSA providers is governed by ITAA97 Div 320 (¶3-530).

A complying fund or PST is an entity that satisfies the prescribed conditions in SISA for complying superannuation funds, complying ADFs and PSTs, while a non-complying fund is an entity that fails, for whatever reason, to comply with those conditions (¶13-100, ¶13-400, ¶13-430). An entity that does not comply with the SISA conditions prescribed for PSTs is not taxed under Div 295. Such entities are taxed under the appropriate provisions of ITAA36 or ITAA97, eg as a trust or a managed investment scheme (see Chapter 6).

Taxable income and tax payable — method statement

The tax payable by a superannuation fund, ADF or PST is worked out using the steps below:

Step 1. For a superannuation fund, work out the no-TFN contributions income (¶13-180), and apply the applicable rates set out in the *Income Tax Rates Act 1986* (ITRA) to that income.

Step 2. Work out the entity's assessable income and deductions taking account of the special rules in Div 295 (these rules modify some ITAA97 provisions, include certain amounts in assessable income, and provide for certain deductions and exemptions: ¶13-125 – ¶13-170).

Step 3. Work out the entity's taxable income as if its trustee were an Australian resident or, in the case of a non-complying superannuation fund that is a foreign superannuation fund (¶13-250), not an Australian resident.

Step 4. Work out the entity's low tax component and non-arm's length component of the taxable income.

Step 5. Apply the applicable rates in the ITRA to the components, or to the taxable income of a non-complying superannuation fund or non-complying ADF.

Step 6. Subtract the entity's tax offsets from the step 5 amount or, for a superannuation fund, from the sum of the fund's step 1 and step 5 amounts (ITAA97 s 295-10(1)).

The taxable income of a complying superannuation fund, complying ADF or PST is made up of two components — a low tax component which is taxed at 15%, and a non-arm's length component which is taxed at 47% in 2014/15 to 2016/17. The non-arm's length component for an income year is the entity's non-arm's length income (¶13-170) for the year less any deduction attributable to that income, while the low tax component is any remaining part of the entity's taxable income for the income year (ITAA97 s 295-545). The no-TFN contributions income (if any) of a superannuation fund (see Step 1) is taxed at 34% for a complying fund and at 2% for a non-complying fund (¶13-180).

Complying funds and PSTs are eligible for a one-third discount on the capital gains that are included in assessable income or, in certain cases, a choice of the CGT discount or calculation of the cost base of assets with indexation frozen at 30 September 1999 (¶13-130).

By contrast, the whole taxable income of a non-complying superannuation fund or ADF is taxed at 47%, and none of the special concessions applicable to complying funds is available (¶13-220). A special tax regime applies to complying superannuation funds that become non-complying, or non-resident superannuation funds that become resident, in the year in which the fund's complying or residency status changes (¶13-200, ¶13-270).

If a fund has not received a notice under SISA about its complying status, the Commissioner can assess the fund as a complying fund or PST in anticipation that its status will be determined as such (ITAA97 s 295-25). Such an assessment is not allowed if the Commissioner is satisfied that the notice will not be given, or APRA does not receive an audit report on the fund (as required under the SISA prudential standards or former s 36(1)) before the end of 12 months after the assessment is made.

In each year, a superannuation fund is required to lodge an income tax return with the ATO (¶13-350), as well as a regulatory return with APRA (or with the ATO, if an SMSF).

The PAYG system as it applies to superannuation funds is discussed in Chapters 26 and 27.

Look-through tax treatment for assets acquired under limited recourse borrowing arrangements

Regulated superannuation funds which enter into a limited recourse borrowing arrangement (LRBA) to acquire assets with a trust holding the assets (in accordance with SISA s 67A or former s 67(4A)) are subject to a look-through tax treatment which ensures that most of the income tax consequences associated with the underlying asset of the trust flow through to the fund as if it had invested in the asset directly. The holding trust under the LRBA is effectively ignored and anything that happens to or results from being the owner of the asset (such as receiving franked dividends) affects the trustee of the superannuation fund, and not the trustee of the holding trust.

The look-through tax treatment, which applies to assets acquired in the 2007/08 or later income years, confirms the long-standing ATO and industry practice which has been to ignore the existence of the trust for CGT purposes (¶11-210) (ITAA97 Subdiv 235-I, s 235-810 to 235-845).

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ATO tax governance guide

The ATO has released a tax governance guide to assist SMSF trustees and professionals to develop an effective governance framework and identify ways to improve existing governance practices within their SMSF. Effective tax governance for SMSFs includes working collaboratively with the fund auditor, seeking advice when making decisions, documenting decisions and keeping good records, accurate and timely reporting, and managing risks to ensure the SMSF remains complying (www.ato.gov.au/Business/Privately-owned-and-wealthy-groups/Tax-governance/Retirement-planning/Self-managed-super-funds).

The ATO has stated that it focuses on the incorrect treatment of transactions in SMSFs, such as:

- significant management and administration expenses (¶13-150)
- incorrect calculation of exempt current pension income (¶13-140)
- incorrect treatment of related party transactions and non-arm's length income (¶13-170)
- certain non-arm's length transactions involving companies associated with members and SMSFs that may be intend to improperly redirect dividends to the SMSF (TA 2016/6: ¶13-800).

Taxpayer Alert TA 2016/6 covers arrangements where individuals (typically SMSF members at or approaching retirement age) purport to divert income earned from their personal services to an SMSF. The ATO is concerned that, in order to avoid paying tax at their personal marginal rate, these arrangements are being entered into by individuals in an attempt to divert their personal services income (PSI) to an SMSF, where the income is concessionally taxed or treated as exempt current pension income. The ATO's voluntary disclosure offer for PSI arrangements as described in *Taxpayer Alert* TA 2016/6 may be found at www.ato.gov.au/Super/Self-managed-super-funds/In-detail/News/Diverting-personal-services-income-to-an-SMSF.

[AMSG ¶7-000; FITR ¶270-010; SLP ¶43-000]

¶13-125 Assessable income and contributions

The assessable income of a superannuation fund in a year of income includes contributions or payments received by it in the income year (s 295-160) (¶13-120). These contributions are taxed at 15% in the year that they are received by the fund (commonly referred to as "contributions tax") (¶13-120).

TR 2010/1 sets out the Commissioner's views on the ordinary meaning of contribution, how a contribution can be made and when a contribution is made for the purposes of ITAA97 (¶13-705). Funds can only accept contributions in accordance with the SISR (¶13-790).

Subject to certain additions and exceptions, the three types of assessable contributions of a complying superannuation fund are:

- contributions made by a contributor (eg an employer) on behalf of someone else (eg an employee)
- personal contributions for which the contributor is entitled to a deduction, and
- amounts transferred from a foreign superannuation fund.

A complying superannuation fund may transfer its tax liability on assessable contributions to an eligible entity (eg a PST). Where applicable, a complying fund may also use its pre-1 July 1988 funding credits to exclude otherwise assessable contributions (see below).

Apart from contributions tax, a superannuation fund is also subject to tax for no-TFN contributions income received by it in each year (¶13-120, ¶13-180).

Superannuation contributions made to a fund for or by a person are "concessional contributions" or "non-concessional contributions" under the excess contributions tax and charge regimes in ITAA97 Div 291 and Div 292. An excess contributions charge or tax is payable by the person if those contributions exceed the concessional or non-concessional contributions cap for the year (¶13-775, ¶13-780).

Contributions on behalf of a person

The assessable income of a complying superannuation fund for a year of income includes the following:

- contributions to provide superannuation benefits for someone else, except a "roll-over superannuation benefit" (see below) and certain contributions expressly excluded (see "Contributions that are not assessable contributions" below)
- payments under s 65 of the SGAA (these are payments of the shortfall component of a superannuation guarantee charge to the fund: ¶39-600)
- payments under s 61 or 61A of the *Small Superannuation Accounts Act 1995* (these are amounts transferred to the fund from a person's individual account in the Superannuation Holding Accounts Special Account: ¶39-650) (ITAA97 s 295-160, table items 1, 3, 4).

Employers are generally required to make superannuation contributions for their employees under the SGAA (¶39-000). In addition, some employers make contributions for employees under an award or contractual obligation. These contributions are assessable income of the fund, regardless of whether the employer has claimed a tax deduction for the contributions.

A "roll-over superannuation benefit" is a lump sum superannuation member benefit that can be paid from, and to, a complying superannuation plan, or is paid to an entity to purchase a superannuation annuity (see below). A person may have more than one superannuation plan with a superannuation provider. A superannuation benefit may be rolled over from one plan to another plan held by the same provider. A plan may also contain more than one superannuation interest. If an amount is transferred from a superannuation interest in a plan to another interest in the same plan, the transfer is treated as a payment in determining whether it is a superannuation benefit or a roll-over superannuation benefit (s 307-5(8); TD 2013/10: using deceased member's benefits in a fund to start a pension for a beneficiary is not a transfer of an amount between superannuation interests in that fund).

A roll-over superannuation benefit is not assessable contributions of a complying fund under s 295-160, but is assessable income under s 295-190 in certain circumstances (see "Personal contributions and roll-over amounts" below).

Contributions that are not assessable contributions

The following contributions or payments received by a superannuation fund are not assessable contributions:

- contributions made on behalf of a spouse (¶13-770)
- government co-contributions (¶13-760)
- contributions for a person under 18 (¶13-775) that are not employer contributions
- payments from an FHSA under former s 22 or 34 of the *First Home Saver Accounts Act 2008* or government FHSA contributions (applicable until 1 July 2015)
- contributions made out of the complying superannuation assets or segregated exempt assets of a life insurance company, or contributions made by a complying superannuation fund, a complying ADF or a PST when the contribution was made
- a member's contributions for a non-member spouse in satisfaction of the non-member spouse's entitlement to a superannuation interest in the fund under the family law

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- a contribution made to a public sector superannuation scheme to the extent tha trustee chooses, with the agreement of the contributor, not to be include assessable income (note that the choice cannot exceed the amount covere notices given by the scheme under ITAA97 s 307-285. Making this ch effectively shifts the liability to pay the tax on those contributions to the recipien the benefit when it is paid by the scheme)
- contributions to a non-complying fund that is a foreign superannuation fund f person who is a temporary resident of Australia at the end of the income yea which the contribution relates (s 295-165; 295-170; former s 295-171; 295-1 295-175; 295-180; 295-185).

Amounts transferred from KiwiSaver schemes to a complying superannuation fu are not included as assessable income of the fund (¶13-380).

Personal contributions and roll-over amounts

The assessable income of a complying superannuation fund includes the followi amounts as assessable contributions:

- personal contributions for which the contributor has given the fund a valid notice intent to claim a deduction for the contributions (see "Member contributions below)
- a roll-over superannuation benefit that a person is taken to receive under s 307- to the extent that it consists of an element untaxed in the fund and is not an exce untaxed roll-over amount for that person (see "Assessable roll-over superannuati benefits" below)
- the taxable component of a "directed termination payment" within the meaning ITTPA s 82-10F (s 295-190(1)).

Member contributions

A complying superannuation fund will include a member's personal contributions its assessable income only if the member gives the fund a notice under ITAA97 s 290-170 (before the fund lodges its tax return for the year that the contributions are made) that a tax deduction will be claimed for the contributions (s 295-190(2)). Tax deductions for personal contributions are discussed at ¶13-730. If the notice is received after lodgment of its return, the fund will include the contributions covered by the notice as assessable contributions in the year in which the notice is received (s 295-190(3)).

If a member's contributions have been included as assessable contributions by the fund before its tax return for the year is lodged, and the fund receives a later notice from the member reducing the amount covered by the earlier notice, the fund can reduce its assessable contributions for the year accordingly (ITAA97 s 295-195(1)).

If the fund is notified of the reduction after it has lodged its return, the fund is entitled to a deduction in the income year in which it is notified (s 295-490(1), table item 2). Alternatively, the fund has the option to amend that tax return to exclude the reduction amount, but only if that would result in a greater reduction in tax for that year than the reduction that would occur for the income year in which the notice is received (s 295-195(3)).

Assessable roll-over superannuation benefits

A "roll-over superannuation benefit" is a lump sum superannuation member benefit (¶14-120) that can be paid to or from a complying superannuation fund (see "Contributions on behalf of a person" above) (ITAA97 s 306-10: ¶14-450).

A person is taken to have received a superannuation benefit when a payment is made for the person's benefit, or payment has been made to another person at the person's direction or request (ITAA97 s 307-15).

A roll-over superannuation benefit taken to be received is not assessable income and not exempt income of the person for whom the roll-over is made, but the payment will be included as assessable contributions of the recipient roll-over fund in the income year in which the roll-over occurs to the extent that the benefit consists of an element untaxed in the fund (ie an untaxed roll-over amount) and is not an "excess untaxed roll-over amount" for that person (s 295-190(1), item 2).

An excess untaxed roll-over amount arises if the untaxed roll-over amount exceeds the person's untaxed plan cap amount ($1.415m in 2016/17). Tax is payable by the person on the excess amount at 49% in 2014/15 to 2016/17 (ITAA97 s 306-15: ¶14-450). The overall effect is that the untaxed roll-over amount is taxed at 15% as assessable contributions in the roll-over fund while the excess amount which has already been subject to tax, as noted above, is not subject to further tax in the fund. When the person's entitlements are subsequently paid as a benefit from the fund, the excess amount remains tax-free (¶14-140).

A roll-over superannuation benefit that is a departing Australia superannuation payment made under s 20H of the *Superannuation (Unclaimed Money and Lost Members) Act 1999* (¶14-340) is not assessable contributions of the recipient fund (s 295-190(1A)).

Roll-over of employment termination payments

Employment termination payments to employees cannot be rolled over into the superannuation system from 1 July 2007 so as to defer tax on the payments. Before 1 July 2012, "directed termination payments" were permitted to be rolled-over under a transitional arrangement and the taxable component of such roll-over payments were assessable contributions in the roll-over fund (s 295-190(1), item 3).

Pre-1 July 1988 funding credits

Certain employer contributions that would otherwise be assessable contributions in the hands of a complying superannuation fund are excluded from assessable income if they are made in respect of unfunded liabilities for member benefits accrued up to 30 June 1988. This exemption is available to funds that were exempt from tax up to 30 June 1988. A fund may apply for approval of a pre-1 July 1988 funding credit as provided by s 342 of the SISA.

A superannuation fund with approved pre-1 July 1988 funding credits may choose to apply an amount of the credits (subject to limits) each year to reduce the fund's assessable contributions relating to the unfunded liabilities (ITAA97 s 295-265). The trustees must make a choice before the fund's tax return for the relevant year is lodged, subject to any extension of time by the Commissioner.

A complying superannuation fund can also reduce the contributions otherwise included in its assessable income in anticipation of APRA confirming the amount of credits available as at 1 July 1988. However, the credits will not be considered available for the income year to the extent that the notice received differs from the amount anticipated (ITAA97 s 295-270).

Transfer of assessable contributions

A complying superannuation fund or a complying ADF (transferor) that has investments in the form of superannuation policies with a life assurance company or units in a PST may transfer its tax liability on assessable contributions to that entity (transferee) by written agreement between the transferor and transferee. The agreement, which is irrevocable, must be made on or before lodgment of the fund's tax return for the year to which the agreement relates (ITAA97 s 295-260). The transferor may make one agreement only for an income year with a particular transferee. The effect of the transfer is that the relevant contributions are excluded from the transferor's assessable income and included in the transferee's assessable income for the relevant year.

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The total amount of contributions covered by the agreements cannot exceed the total amount otherwise included as assessable contributions of the transferor for the income year. The amount covered by an agreement with a particular transferee is limited to the amount calculated by dividing the greatest equity value of the transferor's investments in the transferee in the income year by the transferor's low tax component tax rate for the income year.

Transfers from foreign superannuation funds

The following amounts transferred from a foreign superannuation fund (¶13-250) are assessable income of the transferee fund in the income year in which the transfer happens (ITAA97 s 295-200):

- where the transferee is an Australian superannuation fund — an amount transferred from a foreign superannuation fund in relation to a member of the foreign fund to the extent that the amount transferred exceeds amounts vested in the member at the time of the transfer, or
- where the transferee is a complying superannuation fund — so much of an amount transferred from a foreign superannuation fund as specified in a choice made by a former member of the foreign fund under ITAA97 s 305-80 (¶14-420; ID 2012/27; *Baker*: IRA not a foreign superannuation fund).

The above treatment also applies to transfers from a superannuation scheme that is not, and has never been, an Australian superannuation fund or foreign superannuation fund, was not established in Australia, and is not centrally managed or controlled in Australia (s 295-200(4)). However, amounts transferred from KiwiSaver schemes to a complying superannuation fund are not included as assessable income of the fund (¶13-380).

[AMSG ¶7-120; FITR ¶270-010ff; SLP ¶45-140ff]

¶13-130 Superannuation funds — capital gains

The CGT provisions in Pt 3-1 and 3-3 (see Chapters 11 and 12) apply to a complying superannuation fund in the same way as any other taxpayer, subject to the modifications in ITAA97 s 295-85 (see "CGT primary code" below) and s 295-90 (see "30 June 1988 asset and cost base" below). The modifications do not apply to non-complying superannuation funds or non-complying ADFs.

A look-through tax treatment applies where superannuation funds acquire an asset under a limited recourse borrowing arrangement as permitted by the SISA (¶13-120).

CGT primary code

If a CGT event happens involving a CGT asset owned by a complying superannuation fund (or a complying ADF or a PST), the provisions below do not apply to the CGT event:

- ITAA97 s 6-5 (about ordinary income), s 8-1 (about amounts that are deductible), and s 15-15 and 25-40 (about profit-making undertakings or plans)
- ITAA97 s 230-15 (about financial arrangements)
- ITAA36 s 25A and 52 (about profit-making undertakings or schemes) (s 295-85(2)).

The modifications in s 295-85(2) do not apply to the CGT event if:

- a capital gain or loss from the event is attributable to currency exchange rate fluctuations, or
- the CGT asset is a debenture stock, bond, debenture, promissory note, certificate of entitlement, bill of exchange, promissory note or other security, a bank deposit or a loan (secured or not), or other loan contract (s 295-85(3)).

The modifications can also apply to the CGT event if a capital gain or loss is disregarded because of certain ITAA97 provisions (eg for cars, shares in a pooled development fund, collectables, trading stock, insurance policies, etc) (s 295-85(4)).

The above modifications have the effect that the CGT provisions are the primary code for determining the capital gain or capital loss arising from a CGT event happening to a CGT asset of a complying superannuation fund except for the CGT assets and transactions specified in s 295-85(3). For example, the capital loss realised by a superannuation fund from its investment activities is determined under the CGT provisions, not as a deduction under s 8-1 (ID 2009/92: a share does not come within the meaning of "security" (see 2nd dot point above); ID 2009/110, ID 2009/111: exchange traded options; ID 2010/7: futures contracts).

The s 295-85(2) modifications can apply to a venture capital limited partnership when a complying superannuation fund is a partner in the partnership such that gains flowing to the fund by reason of being a partner are taxed as capital gains (ID 2011/7).

Trading stock

For CGT assets owned by a fund on or after 7.30 pm on 10 May 2011, the trading stock exception provided in s 295-85(4) item 5 is not available in relation to assets covered by ITAA97 s 275-105 (ie shares, units in a trust, and land) (ITAA97 s 70-10(2)(b)). Complying superannuation entities may only access the trading stock exception to the CGT primary code rule for assets other than those covered by s 275-105 where such assets can appropriately be treated as trading stock.

▶ Example

An SMSF buys and sells shares during a year pursuant to the fund's investment objectives and strategy.

The fund must determine whether a capital gain or a capital loss arises for each share transaction during the year under the normal CGT rules.

The fund does not need to consider whether the buying and selling of shares would qualify as being in the business of share trading, or whether the shares bought and sold during the year would be trading stock. The normal CGT consequences will apply to the fund's share transactions.

Insurance policies

For CGT events in the 2005/06 and later income years, a capital gain or capital loss is disregarded if it is made when a CGT event happens to an interest in a policy of insurance for an individual's illness or injury and it is made by the trustee of a complying superannuation entity for the income year in which the CGT event happened (ITAA97 s 118-300(1), item 7).

▶ Example

The ABC Superannuation Fund holds total and permanent disability insurance cover for its members, through Safe Insurance Co. Samantha, a fund member, is injured at work and applies to be paid a total and permanent incapacity benefit from the Fund. Safe Insurance Co is satisfied it must pay the insured amount to the Fund in respect of Samatha's injury.

Any capital gain made by the Fund on the payment from Safe Insurance Co is disregarded under the insurance CGT exemption in s 118-300(1).

For the Fund, the disregarded capital gain is governed by the CGT primary code rule in s 295-85(2) and is not subject to treatment on revenue account.

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CGT assets subject to the asset roll-over as being transferred (or disposed of) to the receiving entity by treating the assets that would otherwise realise a capital gain as being transferred at their cost base and assets that would otherwise realise a capital loss as being transferred at their reduced cost base (s 310-60(1) to (3)). The consequences are:

- the transferred CGT assets will have neither a capital gain nor a capital loss on their transfer, and
- for the receiving entity, the first element of the cost base and reduced cost base of the transferred assets in its hands is taken to be equal to the cost base and the reduced cost base, respectively, of the asset just before its transfer (when it was still held by the transferring entity) (s 310-60(5)).

Likewise, under the individual asset approach for revenue assets, the transferring entity has the option to disregard all revenue gains or losses it realises, or it may choose to disregard some or none of its revenue gains or losses. This approach for revenue assets will treat the transferring entity's gross proceeds for the transfer of each revenue asset to be the amount, the deemed proceeds, it would need to have received to have no profit or loss from the transfer. This rule means that there is no gain or loss for the transferring entity (ITAA97 s 310-70(1)). The receiving entity will be taken to have paid an amount equal to the deemed proceeds for the transferring entity for each revenue asset received.

Division 311 tax relief for transfers of accrued default members

Tax relief is available under ITAA97 Div 311 where there is a mandatory transfer of default members' account balances in a complying superannuation fund to a MySuper product in another superannuation fund (see proposed extension of the relief below). The relief ensures that these members are not adversely affected as a consequence of the accrued default amounts being compulsorily transferred, as required by the SISA. Division 311 applies to the income year of the fund that includes 1 July 2013 and the following income years if the accrued default amounts of members are transferred between 1 July 2013 and 1 July 2017 (the period specified in SISA for the transfer of members' accrued default amounts to a MySuper product).

Where the conditions in ITAA97 s 311-10 are met, a complying superannuation fund can choose to transfer a loss or choose an asset roll-over, or both. If the superannuation fund invests in a life insurance company or a pooled superannuation trust (PST) to support its default members, the same relief is provided to those entities.

A transferring entity that is eligible for relief under Div 311 and under the Div 310 merger relief provisions (see above) can choose which Division to apply to its particular transaction, as it will have access to the same income tax relief.

The transferring entity can choose to transfer any or all of its losses (set out in s 311-20), in whole or in part, to one or more of the following entities (a receiving entity):

- the continuing fund for the choice
- a PST in which units are held by the continuing fund for the choice just after the completion time, or
- a life insurance company with which a complying superannuation life insurance policy is held by the continuing fund for the choice just after the completion time (s 311-15).

The effects of transferring a net capital loss and tax loss are set out in s 311-25 and 311-30, respectively.

A transferring entity can choose an asset roll-over for an asset where the asset is reasonably attributable to the accrued default amount of the members and a CGT event happens to the asset with the result that the asset becomes an asset of one of the receiving entities (see above) as a result of the event (ITAA97 s 311-40). Where the transferring entity is a PST or life company, the asset must be reasonably attributable to the accrued default amount of the member and the units in the PST or life policy issued by the entity

(as the case may be) which are held by the fund. The consequences of the roll-over for CGT assets, revenue assets and further consequences for roll-overs involving life insurance companies are set out in ITAA97 s 311-45 to 311-55.

A choice under Div 311 must be made by the day the transferring entity's income tax return is lodged for the transfer year for the entity (or within a further time allowed by the Commissioner). The way the transferring entity's tax return is prepared is sufficient evidence of the making of the choice (ITAA97 s 311-60).

Proposed extension of relief to transfers within the same fund

The government has announced that it would amend ITAA97, effective from 29 June 2015, to ensure that the existing MySuper tax relief covers the consequences of transfers within a superannuation fund, where the transfer is required under the law. SMSFs are not affected as the MySuper requirements do not apply to them.

To access this relief, the relevant MySuper product will need to be offered through the same type of structure as the default product. Where the fund invests in a life insurance company or a PST to support its default members, the same relief will apply. The asset roll-over will apply:

- at the membership interest level and to the interposed entities that dispose of assets pursuant to the transfer, and
- to the initial transfer of members' account balances from default products to MySuper products, and will not extend to any rebalancing which may occur after the initial transfer.

The relief will not extend to the transfer of losses (*Assistant Treasurer's media release*, 29 June 2015: jaf.ministers.treasury.gov.au/media-release/035-2015). The ATO has advised on the administrative treatment of tax returns lodged during the period up until the outcome of the proposed amendment is known (www.ato.gov.au/General/New-legislation/In-detail/Direct-taxes/Income-tax-for-businesses/Income-tax-relief-for-MySuper-transfers-within-a-fund).

CGT exemption for funds paying current pensions

A superannuation fund paying current pensions is entitled to a tax exemption for the normal assessable income derived from the assets of the fund supporting its current pension liabilities (¶13-140).

Any capital gain or loss that a complying superannuation fund makes from a CGT event happening to a ''segregated current pension asset'' (¶13-140) is disregarded (ITAA97 s 118-320). In addition, when a CGT event happens to assets used solely to produce exempt current pension income, any capital gain or capital loss is disregarded (ITAA97 s 118-12).

The CGT exemptions are not available if the superannuation fund no longer has current pension liabilities. This may happen, for example, when a current pension has ceased to be payable because it is fully commuted, or the annual pension payment rules are breached. TR 2013/5 provides guidelines on when a pension commences and ceases (¶14-120).

Avoiding double taxation

The capital gain calculated under the CGT provisions may be reduced or extinguished if the trustee of a superannuation fund disposes of an asset (and makes a notional capital gain) and the market value of the asset has been taken into account in determining the fund's net previous income in respect of previous years of income under ITAA97 s 295-325 (where a complying fund becomes non-complying: ¶13-200) or ITAA97 s 295-330 (where a non-resident fund becomes a resident fund: ¶13-270).

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If the notional capital gain exceeds the amount that would have been included in assessable income as a capital gain if the asset had been disposed of for its market value at the time of calculating the fund's net previous income, the excess is assessable under the CGT provisions. If the notional capital gain does not exceed that amount, no amount is included in assessable income under the CGT provisions (ITAA97 s 118-20(4A)).

[AMSG ¶7-130 – ¶7-140; FITR ¶151-500ff; FITR ¶270-100ff; SLP ¶45-1

¶13-140 Superannuation funds providing pensions

A complying superannuation fund is entitled to an exemption for so much of its income as is attributable to its liability to pay current superannuation income stream benefits (ITAA97 s 295-385(3), (4); 295-390). The exemption applies to the ordinary and statutory income (other than assessable contributions or non-arm's length income) derived by the fund from its segregated current pension assets or as calculated as a proportion of the fund's superannuation liabilities (see below) (former ID 2004/19; specified roll-over amount from untaxed fund is not exempt income; *SCCASP Holdings as trustee for the H&R Super Fund*, meaning of arm's length income: ¶13-170).

A CGT exemption applies when a CGT event happens to the assets supporting a superannuation fund's current pension liabilities (see "CGT exemption for funds paying current pensions" in ¶13-130).

A "superannuation income stream benefit" is a benefit that is paid from a superannuation income stream, ie annuities and pensions which meet the prescribed standards in the SISR or RSAR (ITAA97 s 307-70; ITR97 reg 995-1.01). A pension may cease to be paid in various circumstances, such as the death of a pensioner, or where the pension is fully commuted, or the SISR or RSAR pension standards are breached (TR 2013/5 in ¶14-120). The current pension income exemption does not continue when a superannuation income stream benefit has ceased to be payable because a pensioner has died, subject to a limited exception as noted below.

To provide tax certainty for deceased estates, the term "superannuation income stream benefit" has an expanded meaning for the purposes of the current pension income exemption, applicable to the 2012/13 and later income years (ITR97 reg 295-385.01(b)). The effect of the expanded meaning is that where a fund member (pensioner) was receiving a superannuation income stream immediately before his/her death, and that income stream did not automatically revert to another person on the pensioner's death, an amount that is either paid as a death benefit lump sum using only an amount from the superannuation interest that was supporting the deceased pensioner's income stream immediately before the death, or that is applied from that interest to commence a new income stream, is taken to be a superannuation income stream benefit payable by the fund for a specified period. The specified period is from the pensioner's death until as soon as it was practicable to pay the death benefit lump sum or commence the new income stream. This effectively allows the superannuation fund to continue to be entitled to the current pension income exemption in relation to such an amount during that period.

The deemed superannuation income stream benefit is reduced by any amount, other than investment earnings, that was added to the superannuation interest on or after the pensioner's death. "Investment earnings" does not include an amount paid under a policy of insurance on the life of the deceased or an amount arising from self-insurance. This ensures that the level of the exemption for the relevant period after the pensioner's death is no greater than it was before his/her death (allowing only for investment earnings after the person's death).

Method of determining exempt current pension income

There are two methods of determining the exempt current pension income amount — the segregated current pension assets method and the attributable proportion method — either or both of which may apply.

Under the *segregated current pension assets* method, the fund segregates its assets for the sole purpose of enabling the fund to discharge the liabilities payable in respect of superannuation income stream benefits (the relevant sole purpose), as certified in an actuary's certificate (see below) or prescribed by regulations (s 295-385(3), (4)). The prescribed benefits are allocated pensions, market linked pensions or account-based pensions, as defined in the SISR (ITR97 reg 295-385.01(a)).

The assets held by a fund that can be classed as segregated current pension assets may not exceed the value placed on the fund's current pension liabilities by the actuary as determined on a "best estimate" basis (former ID 2002/368).

The assets supporting a superannuation income stream benefit which is being paid as an allocated pension, a market linked pension or an account-based pension are not considered segregated current pension assets to the extent that the market value of those assets exceeds the value of the account balance supporting the income stream benefit (s 295-385(6)). In this case, none of the income derived from the assets which contributed to the excess of the market value over the account balance will be exempt under s 295-385.

Section 295-385 only requires the segregation of current pension assets as a whole from the other assets of the fund. There is no requirement to segregate assets in respect of each individual member who is receiving a superannuation income stream benefit although funds may choose to do so where permitted by the fund's trust deed.

TD 2014/7 sets out the circumstances in which a bank account (or sub-account) of a complying superannuation fund is a segregated current pension asset. That is, when the account is considered to be invested, held in reserve or otherwise being dealt with for the sole purpose of enabling the fund to discharge liabilities payable in respect of superannuation income stream benefits for the purposes of s 295-385(3)(a) or (4).

Under the *attributable proportion* method, the exemption is based on the proportion of unsegregated current pension liabilities of the fund to its total unsegregated superannuation liabilities (ITAA97 s 295-390). That proportion of the fund's ordinary and statutory income (other than assessable contributions, non-arm's length income, income exempt under s 295-385 or income derived from assets that are segregated non-current pension assets of the fund) is exempt from tax.

A superannuation fund's "segregated non-current pension assets" are assets relating to the fund's superannuation liabilities *other than* current pension liabilities (as certified by an actuary), ie assets invested or held by the fund for its non-current pension liabilities (s 295-390). No tax exemption is available for income derived from segregated non-current pension assets.

Actuarial certificates

A superannuation fund paying a pension may need to obtain an actuarial certificate each year in order to claim the exemption on the income earned on the assets used to provide for current pension liabilities under s 295-385 or s 295-390.

An actuary's certificate is not required if a fund is claiming the exemption using the segregated current pension assets method and is only paying allocated pensions, market linked pensions or account-based pensions (ITAA97 s 295-385(4); ITR97 reg 295-385.01). A fund that uses the segregated assets method and pays other types of pensions will need to obtain a certificate covering all pensions that the fund pays.

Funds using the proportional (unsegregated assets) method will need an actuarial certificate for each year that it claims a tax exemption, regardless of the type of pension being paid (s 295-390(4) to (7)).

Funds paying pensions may also require additional actuarial certifications as part of the SISA prudential requirements (SISR Pt 9).

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ATO guidelines — powers of general administration

The ATO has provided guidelines for funds claiming the exemption for exempt current pension income (ECPI), the actuarial certificate requirements, the annual return requirements for a fund in both the pension and accumulation phase, the effect of tax losses or capital gains and losses on a fund's claim for ECPI, and the reporting labels in an SMSF's tax return (Fact Sheet "Self-managed super funds and tax exemptions on pension assets": www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/Self-managed-super-funds-and-tax-exemptions-on-pension-assets).

In certain circumstances (eg honest mistakes and matters beyond the fund trustee's control), the Commissioner may allow superannuation funds to continue to claim ECPI even though the SISR minimum pension standards (¶14-120) have not been met under his powers of general administration (www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/SMSFs--Minimum-pension-payment-requirements---frequently-asked-questions).

Changes from 1 July 2017

The SIS Regulations and the Retirement Savings Accounts Regulations 1997 (RSAR) currently permit individuals who have reached preservation age, but not retired from the workforce or attained age 65, to access their superannuation by commencing a transition to retirement income stream (TRIS), a transition to retirement income pension (TRIP), or a non-commutable allocated pension or non-commutable allocated annuity (this is a form of TRIS offered by superannuation funds between 1 July 2005 and 20 September 2007).

Some individuals have used TRISs for the sole purpose of achieving tax advantages. For example, they can enliven the earnings tax exemption by commencing a TRIS, thus saving up to 15% on earnings, or they can participate in superannuation salary sacrifice and draw down their account balance by commencing a TRIS to receive income taxed at a concessional rate while not reducing their working hours. Also, individuals may elect to treat superannuation income stream benefits as superannuation lump sums, which are tax-free up to the low rate cap of $195,000. (The government will remove this election which is provided in ITR97 reg 995-1.03: ¶14-130.)

Earnings tax exemption

From 1 July 2017, the earnings tax exemption will be extended to new innovative retirement income products that are deferred superannuation income streams (including guaranteed annuities and group self-annuities) and will no longer be available for TRISs. The relevant earnings tax exemption provisions from that date will no longer refer to "superannuation income stream benefits that are payable at the time" but will instead apply when a superannuation income stream is in the "retirement phase" at the time (s 295-385(3)(a), (4)(a), (5)).

A superannuation income stream will be in the retirement phase at a time if:

- a superannuation income stream benefit is payable from it at the time, or
- in the case of a deferred superannuation income stream — a superannuation income stream benefit is payable at a later time and the person who will receive the benefit has satisfied a relevant nil condition of release.

A superannuation income stream will not be in the retirement phase if:

- it is a TRIS, or
- a superannuation income stream provider has failed to comply with a commutation authority in respect of a member's transfer balance cap.

SMSFs and small APRA funds

SMSFs and small APRA funds will not be able to use the segregated method to determine their earnings tax exemption for an income year if:

- at a time during the income year, there is at least one superannuation interest in the fund that is in the retirement phase, and
- just before the start of the income year:
  - a person has a total superannuation balance that exceeds $1.6m, and
  - the person is the retirement phase recipient of a superannuation income stream (whether or not the fund is the superannuation income stream provider for the superannuation income stream) (s 295-385(7); 295-387).

Assets of funds covered by s 295-387 are known as "disregarded small fund assets" which cannot be segregated current pension assets for the purposes of s 295-385 or segregated non-current assets for the purposes of s 295-395. These funds will now be required to use the proportioning method under s 295-390 to determine their earnings tax exemption.

A regulation will be made for the purposes of s 295-390(7) to determine liabilities in respect of account-based income stream benefits for the proportionate method. This means that funds which use the proportionate method but whose only superannuation income stream benefit liabilities arise from account-based superannuation income stream products will not be required to obtain an actuary's certificate for the purpose of determining their exempt current pension income.

The above is an integrity measure as a consequence of the introduction of the transfer balance cap from 1 July 2017 (¶14-320). This is because some individuals will be required to reduce the value of their interests in the retirement phase to $1.6m. If funds with members in both the pension and accumulation phase can use the segregated assets method to determine their earnings tax exemption, assets can be cycled between the segregated pools for each phase to avoid CGT.

[AMSG ¶7-150ff; FITR ¶270-390; SLP ¶45-200]

¶13-150 Superannuation funds — allowable deductions

The deductibility of expenditure incurred by a complying superannuation fund is determined under the general deduction provision in ITAA97 s 8-1, unless a specific provision applies (eg ITAA97 s 25-5 dealing with tax-related expenses). Expenditure must be "incurred" in order to qualify for a deduction (see ¶16-040 and TR 97/7 for guidelines on the meaning of "incurred").

Expenditure is deductible under s 8-1(1) to the extent that:

- it has the essential character of an outgoing incurred in gaining or producing assessable income, or
- it has the character of an operating or working expense of a business or is an essential part of the cost of the fund's business operations.

A loss or outgoing is not deductible under s 8-1 to the extent that it is of a capital, private or domestic nature, or is incurred in relation to gaining or producing exempt income or non-assessable non-exempt income, or deduction is specifically prohibited by a provision of the tax Acts (s 8-1(2)).

The specific deduction rule in s 8-5 is subject to any provision that may prevent or limit the deduction of the amount. Where two or more provisions allow a superannuation entity deductions in respect of the same amount, the superannuation entity can deduct only under the most appropriate provision to ensure that there is no double deduction (s 8-10).

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General and specific deductions

The general principles governing deductibility of expenditure for superannuation funds, ADFs and PSTs (superannuation entity) under s 8-1 and other specific provisions are discussed in TR 93/17.

Subject to the need for apportionment, expenses that are ordinarily deductible under s 8-1 include: (a) administration fees; (b) actuarial costs; (c) accountancy and audit fees; (d) non-capital costs of complying with relevant legislation; (e) trustee fees and premiums under an indemnity insurance policy; (f) costs in connection with the calculation and payment of benefits to members (but not the cost of the benefit itself), eg interest on money borrowed to secure temporary finance for the payment of benefits and medical costs in assessing invalidity benefit claims; (g) investment adviser fees and costs in providing pre-retirement services to members; (h) membership subscriptions paid to professional associations; and (i) other administrative costs incurred in managing the fund (TD 2004/1: costs of subscriptions to share market information services and journals).

General expenses of managing a superannuation fund (such as those above) which are incurred partly in producing assessable income and partly in gaining exempt income must be apportioned. The two generally accepted apportionment methods are set out in TR 93/17, but other methods are acceptable provided they give a fair and reasonable assessment of the extent to which the outlay relates to assessable income (see "Draft guidelines on apportionment of expenses" below). The apportionment ensures that expenditure is deductible only to the extent to which it is incurred in producing assessable income. The exempt income of a fund includes non-reversionary bonuses and exempt current pension income (¶13-140). Apportionment is not required for non-capital expenditure incurred solely in gaining contributions made to the fund (see "Cost of collecting contributions" below).

Fees paid to a commercial superannuation provider in respect of a product purchased by the superannuation fund (eg investment or administration charges levied by a life assurance company or PST) will generally not be deductible. Investment-related expenses (eg commissions and ongoing management fees) would ordinarily be deductible, but up-front fees incurred in investing money are of a capital nature and are not deductible (TD 95/60 at ¶16-660; ID 2004/968: management fees and allocated pension fund).

Costs incurred in amending a superannuation fund's trust deed are deductible if they are not of a capital nature. An example is where the deed amendments are necessitated by changes in government regulations and are made to ensure that the fund's day-to-day operations continue to satisfy the requirements for a complying superannuation fund or where the amendments make administration of the fund more efficient and do not amount to a restructuring of the fund (IT 2672; TR 93/17, para 23). In contrast, amendment costs incurred by an employer-sponsor of a superannuation fund are deductible, regardless of whether the amendments are necessitated by changes in government regulations.

A complying superannuation fund can claim a deduction under ITAA36 s 70B for the full amount of a loss it incurs on the disposal or redemption of a "traditional security" (as defined in ITAA36 s 26BB: ¶23-340) which is not a segregated current pension asset (as defined in ITAA97 s 295-385(3)) and where ITAA97 s 295-390 applies to exempt some of the income of the fund (¶13-140). The deduction for a loss on the disposal or redemption of a traditional security is limited by certain exceptions (eg s 70B(2A) denies a deduction for a loss on disposal or redemption of a traditional security made by a complying fund where the traditional security was a segregated current pension asset). As s 70B does not provide for any particular treatment of such losses in respect of traditional securities held by funds which do not segregate their assets, these funds can claim a deduction for the full amount of the loss on the disposal or redemption of the traditional security in the year in which the disposal or redemption takes place if

the s 70B conditions are satisfied and no exceptions apply to the loss. This is the case even if s 295-390 applies to exempt some of the income of the fund in that income year (ID 2014/26).

The deductibility of legal expenses depends on whether the expenses are of a capital or revenue nature, but certain legal expenses are specifically made deductible (¶16-830).

Capital expenditure incurred in establishing a structure for a regulated superannuation fund (eg purchase of a trust deed) is not deductible under ITAA97 s 40-880(2A) (¶16-156; former ID 2003/524; former ID 2003/525).

A deduction was not available under ITAA97 s 25-45 (loss by theft) for misappropriation by one of two trustees of an SMSF as the loss was not caused by the misappropriation of an employee or agent (*Shail*).

TA 2008/3 and TA 2008/4 set out the ATO's concerns about non-arm's length arrangements under which a fund uses borrowed funds to acquire an interest in an investment vehicle, and certain non-arm's length arrangements under which a superannuation fund derives income through a direct or indirect interest in a closely-held trust. The concerns include the deductibility of expenses, and whether income derived by the fund from the trust is non-arm's length income (¶13-170).

Cost of collecting contributions

In determining deductions under s 8-1, a contribution made to a complying superannuation fund is taken to be assessable income, whether or not it is an assessable contribution (ITAA97 s 295-95; TR 93/17). That is, the receipt of non-assessable contributions does not reduce the extent to which a fund can deduct expenditure incurred in obtaining contributions. Accordingly, losses or outgoings directly incurred by a fund in obtaining contributions do not need to be apportioned for s 8-1 purposes where they are incurred in obtaining both assessable and non-assessable contributions (including a single contribution that has both an assessable and non-assessable portion). This modification also applies to a non-complying superannuation fund that is an Australian superannuation fund, a complying or non-complying ADF, and an RSA provider.

A roll-over superannuation benefit (¶13-125) to a fund is a "contribution" for s 295-95(1) purposes. For example, the full roll-over amount is treated as if it were included in the fund's assessable income when working out the deductible portion of an administrative fee under s 8-1. This is consistent with the policy intention underpinning s 295-95(1) that a fund can deduct losses and outgoings incurred in obtaining a roll-over superannuation benefit in its entirety (not just the assessable part) (ID 2012/47).

Cost of insurance premiums for death or disability benefits

A complying superannuation fund which provides death and disability benefits that are specified in ITAA97 s 295-460 can claim a deduction related to the cost of providing these benefits. The quantum of the deduction is calculated either on a premiums basis or by using a formula based on actual costs under ITAA97 s 295-465. Alternatively, the fund may choose not to claim deductions under s 295-465 for an income year and to deduct amounts instead under ITAA97 s 295-470 based on the fund's future liability to pay the benefits (see "Deduction based on actual cost of providing benefits" below) (s 295-465(4)). An RSA provider can claim a deduction relating to the provision of these benefits on a premiums basis (ITAA97 s 295-475).

The benefits under s 295-460 are superannuation death benefits, disability superannuation benefits, temporary income protection benefits and, for benefits provided on or after 16 February 2008, terminal medical condition benefits (see below). A "superannuation death benefit" means a lump sum or pension benefit paid after the death of a member (¶14-270). A "disability superannuation benefit" means a lump sum or pension benefit paid to an individual because he or she suffers from ill-health (whether physical or mental) and two legally qualified medical practitioners have certified that, because of the ill-health, it is unlikely that the individual can ever be gainfully employed in a capacity for which he or she is reasonably qualified because of education, experience

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or training (ITAA97 s 995-1(1)). A superannuation lump sum can be a disability superannuation benefit even if it is not paid under the "permanent incapacity" condition of release of the SISR (ID 2009/109).

An income protection benefit covers an income stream payable to a member due to his/her temporary incapacity to engage in gainful employment that is payable for no longer than two years, or such longer period as allowed by APRA or the Commissioner (see TD 2007/3 below).

A deduction under s 295-465 is available for premiums on insurance policies where the income payments under the policy are made to members during periods of temporary incapacity which last longer than two years, provided the benefits payable under the policy comply with the SISA requirements. The provision of temporary disability benefits is an approved ancillary purpose under the sole purpose test in the SISA and such benefits may potentially be paid for a period of more than two years but not exceeding the period of incapacity (TD 2007/3).

Before 1 July 2014, a fund could purchase a trauma insurance policy in respect of members and still satisfy the sole purpose test in SISA s 62 if certain conditions were met (former SMSFD 2010/1). The purchase of such insurance is not allowed from that date, but funds may continue to provide this insured benefit to pre-1 July 2014 members who were previously covered by such insurance policies (SISR reg 4.07D(2)). A deduction is not available under s 295-465 for premiums for a trauma policy (former ID 2002/371).

If a fund receives a rebate or refund of premiums paid, for which a deduction has previously been allowed, that amount is included in the fund's assessable income for the year in which it is received (ITAA97 s 295-320, item 4).

Deduction on premiums basis

The deduction for insurance premiums under s 295-465(1) is as follows:

(1) 30% of the premium for a whole of life policy — a "whole of life policy" is an insurance policy that satisfies the following conditions: (a) the policy includes an investment component; (b) the premium is not dissected; and (c) the proceeds are payable only on death or on attaining an age of 85 years or more (deduction not allowed where the premium is dissected between an entry fee and the investment component of the policy: see ID 2009/100)

(2) 10% of the premium for an endowment policy — an "endowment policy" is an insurance policy that satisfies the following conditions: (a) the policy is not a whole of life policy; (b) the policy includes an investment component; (c) the premium is not dissected; and (d) the proceeds are payable only on death or on attaining an age specified in the policy

(3) 30% of that part of the premium for a non-whole of life policy that is specified in the policy as being for a distinct part of the policy, if that part would have been a whole of life policy had it been a separate policy

(4) 10% of that part of the premium for a non-endowment policy that is specified in the policy as being for a distinct part of the policy, if that part would have been an endowment policy had it been a separate policy

(5) that part of the premium as specified in the policy as being wholly for the liability to provide the benefits referred to in s 295-460

(6) so much of other insurance policy premiums as are attributable to provide the benefits referred to in s 295-460 (supported by an actuary's certificate) (s 295-465(1) items 1–6, (3)).

For deductions under item (6) from the 2011/12 income year, the deductible proportion of premiums for certain prescribed TPD policies that are treated as being attributable to a liability to provide the benefits in s 295-460 is set out in ITR97 reg 295-465.01. This means that funds may deduct the specified proportion of the premium in reg 295-465.01(1) provided those policies are more restrictive or have substantially the same meaning as the conditions specified in reg 295-465.01(5). In such cases, an actuary's certificate is not required (s 295-465(1B), (3A)). A fund can still deduct an amount under item (6) without recourse to the regulations, but will need to obtain an actuary's certificate in that case.

A deduction can be claimed under item (6) for the remaining part of an insurance premium for which a partial deduction has been claimed under item (5) (because part of the premium is specified in the policy as being wholly for the liability to provide benefits referred to in s 295-460). For example, if only part of an insurance premium is specified in the policy as being wholly for the liability to provide superannuation death benefits (s 295-460), the fund may be able to claim a deduction under item (6) for the part of the remainder of the premium attributable to a liability to provide benefits referred to in s 295-460 by reference to reg 295-465.01 or by obtaining an actuary's certificate (s 295-465(1A)).

Self-insuring funds

Superannuation funds which self-insure their liability to provide the benefits referred to in s 295-460 may deduct the amount the fund could reasonably be expected to pay in an arm's length transaction to obtain insurance to cover the liability. An actuary's certificate is required to claim the deduction (s 295-465(2), (3)).

Self-insuring funds may determine the deductible amount under s 295-465(2) using the percentages in reg 295-465.01, for example, where an actuary has calculated the arm's length cost of an insurance policy which covers a broader class of benefits than is referred to in s 295-460 and the policy is of a kind specified in reg 295-465.01 (s 295-465(2A), (2B), (3)).

Deduction based on actual cost of providing benefits

A fund that elects under s 295-465(4) not to claim deductions on the above premiums basis may claim a deduction based on the actual cost of providing the death or disability benefits which arise each year under s 295-470. The election must be made by the fund's tax return lodgment date for the year in which the election is to apply. Once made, the election also applies for all later years unless the Commissioner decides otherwise (s 295-465(5)). An election is not required to be in writing or lodged with the Commissioner. The deductible amount is the future service element of the lump sum or pension death or disability benefits during the year, as calculated using the formula in s 295-470(2). A choice can be made under s 295-465(4) to claim a deduction under s 295-470 before or after the death of an insured fund member (ID 2015/17).

Terminal medical condition benefits

A terminal medical condition (TMC) exists in relation to a person at a particular time if the following circumstances exist:

- two registered medical practitioners have certified, jointly or separately, that the person suffers from an illness, or has incurred an injury, that is likely to result in the death of the person within a period (the certification period) that ends not more than 24 months (or 12 months before 1 July 2015) after the date of the certification
- at least one of the registered medical practitioners is a specialist practising in an area related to the illness or injury suffered by the person, and
- for each of the certificates, the certification period has not ended (ITR97 reg 303-10.01).

¶13-160 Superannuation funds — offsets, losses and other concessions

Other tax offsets (rebates and credits) and taxation concessions which may be relevant to superannuation entities are outlined below.

Franking credits

A complying superannuation fund that receives franked distributions will have assessable income grossed up to include the amount of franking credits attached (ie reflecting the company tax paid attributable to the distributions) in the same manner as other recipients of franked distributions (¶4-800). Distributions where no tax has been paid by the resident payer entities are treated as unfranked distributions.

A complying superannuation fund is entitled to a franking tax offset of the full amount of franking credits, even though its primary tax rate as a complying fund is 15% or its income is exempt (such as income relating to current pension liabilities), except on dividends paid as part of a dividend stripping operation. The offset may be set off against tax on other fund income.

A venture capital franking tax offset is similarly available if the fund receives a venture capital franked dividend paid by a pooled development fund (PDF) even though the dividend is exempt.

A superannuation fund must therefore include the total franked and unfranked amount of distributions received, as well as the franking credits attached, to determine its net income or loss.

To the extent that family trust distribution tax has been paid on a distribution that was paid or credited to a superannuation fund by a company that has made an interposed entity election, the distribution is excluded from the fund's assessable income (ITAA36 Sch 2F s 271-105). Any loss or outgoing incurred in deriving such excluded distributions is not deductible and the fund cannot claim a credit or tax offset for any franking credit attached to the whole or a portion of the exempt income.

A complying superannuation fund (or a complying ADF or PST) is entitled to a refund of excess franking credits where they exceed the fund's tax liability after taking into account other tax offsets to which the fund is entitled (ITAA97 s 63-10(1), item 40; s 67-25; ¶4-820). A claim for excess franking credits is made as part of the assessment process in the fund's income tax return. Supporting documents must be retained by the fund.

From 1 July 2013, an entity's ability to obtain the benefits of additional franking credits received as a result of ''distribution washing'' is restricted (ITAA97 s 207-157) (¶4-920). In *The Trustees of the WT and A Norman Superannuation Fund*, the AAT confirmed that the ITAA36 Pt IVA determination process and anti-avoidance rule in s 177EA (¶30-195) could apply to certain benefits arising from dividend washing transactions entered into before s 207-157 was enacted and operative. The ATO considers that the AAT's reasoning was consistent with its view in TD 2014/10 on the law relating to ''dividend washing'' transactions. The commencement of s 207-157 from 1 July 2013 will remove the need for the Commissioner to make determinations under s 177EA to deny imputation benefits arising under dividend washing transactions for distributions which are made on or after 1 July 2013 (ATO *Decision Impact Statement* VRN 6023 of 2014 and 6090 of 2014). The imputation system and integrity rules are discussed in detail in Chapter 4.

Anti-avoidance and regulatory issues

TA 2015/1 covers arrangements where a private company with accumulated profits channels franked dividends to an SMSF instead of the company's original shareholders. As a result, the original shareholders escape tax on the dividends and the original shareholders or individuals associated with the original shareholders benefit as members of the SMSF from franking credit refunds to the SMSF.

The ATO is concerned that contrived arrangements are being entered into by individuals (typically SMSF members approaching retirement) so that dividends subsequently flow to, and are purportedly treated as exempt from income tax in, the SMSF because the relevant shares are supporting pensions. The intention is for the original shareholders of the private company and/or their associates to avoid ''top-up'' income tax on the dividend income; and for the SMSF to receive a refund of the unused franking credit tax offset, which is available for tax free distribution to its members. This arrangement has features of dividend stripping which could lead to the ATO cancelling any tax benefit for the transferring shareholder and/or denying the SMSF the franking credit tax offset.

The ATO stated that, since March 2014, it had issued private rulings on arrangements with features similar to those described in TA 2015/1 and had applied the anti-avoidance provisions to determine whether:

- the franked dividends received by the SMSF may be part of a dividend stripping operation under ITAA97 s 207-145(1)(d) (¶4-920)
- the arrangement may be a scheme by way of, or in the nature of, or have substantially the effect of, dividend stripping to which ITAA36 s 177E applies (¶30-190)
- the arrangement may be a scheme to obtain imputation benefits to which ITAA36 s 177EA applies (¶30-195).

In addition, the ATO has applied the non-arm's length income provision for arrangements of this type, including the views expressed in TR 2006/7 (¶13-170).

The ATO further states that other compliance issues for arrangements described in TA 2015/1 may include: (i) CGT consequences, such as transfers below market value; (ii) ordinary dividend or deemed dividend consequences; (iii) superannuation regulatory issues, including non-arm's length dealings between members or associates and the SMSF; and/or (iv) excess contributions tax consequences.

Investments in PSTs, life assurance policies

If a complying superannuation fund invests in a PST or a life assurance policy:

- the income derived and capital gains realised by the PST or life assurance company are not taxable to the investing fund, and
- the gains on disposal or redemption of units in the PST or of the life assurance policy are not taxable under the CGT provisions and realised losses cannot be used to offset other capital gains (ITAA97 s 118-300; 118-350).

A non-reversionary bonus (ie cash bonus) received by a complying superannuation fund on its investment in a life assurance policy is excluded from assessable income as the relevant income would have already been taxed in the hands of the life assurance company (ITAA97 s 295-335, item 1).

Complying superannuation funds may claim a deduction for expenses relating to investments in PSTs and in life assurance policies (¶13-150).

Reversionary bonus rebate

A complying superannuation fund is entitled to a rebate of tax under ITAA36 s 160AAB(5A) where an ''eligible 26AH amount'' is included in its assessable income under ITAA36 s 26AH (¶10-240). These amounts are reversionary bonuses (ie bonuses paid on maturity, forfeiture or surrender of a life assurance policy) received under short-term life assurance policies issued by a life office whose investment income was not tax-exempt, or by a friendly society. The rebate can be offset against tax payable from any source (IT 2499), but excess rebates are not refundable. For the ATO's warnings on investments in life insurance bonds issued by tax haven entities, see TA 2009/17 (¶13-150).

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Other proposed innovation incentives

Changes to same business test

The "same business test" (¶3-120) will be relaxed to allow businesses to access prior year losses even if minor changes are made to their operations. The test will be replaced by a "predominantly similar business test" that allows companies receiving new equity injections or that diversify revenue streams to still access company losses. The new test is to apply to losses made in the 2015/16 and later income years. Comments on the Exposure Draft of the legislation closed on 22 April 2016.

Depreciation on intangibles

Businesses will be able to self-assess the tax effective life (¶17-270) of acquired intangible assets (¶17-015) where it is currently fixed by statute, allowing for faster depreciation claims. There will also be an option to use existing statutory effective lives. The proposal will apply to intangible assets acquired from 1 July 2016. Comments on this Exposure Draft also closed on 22 April 2016.

FinTech investments

The government has sought submissions on the best way to ensure investors into financial technology (FinTech) startup activities can be eligible for the venture capital tax concessions (see further treasury.gov.au).

Chapter 21 Residence • Source • Foreign Tax Offsets • Accruals Taxation

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¶21-000 Residence and source as criteria for liability

There are two main criteria for liability to Australian tax: *residence* and *source of income*. In general, it is necessary to determine whether or not the taxpayer concerned is a resident of Australia and then to determine the source of the income concerned.

A taxpayer, whether an individual or a company, who is a resident of Australia is generally assessable on ordinary and statutory income derived from all sources whether in or out of Australia (ITAA97 s 6-5; 6-10). There are some exceptions to this rule, eg for limited types of overseas employment income (¶10-860), approved overseas projects (¶10-870) and certain temporary residents (¶22-125). See generally Chapter 10.

Income earned by some foreign companies and non-resident trusts is attributed to resident taxpayers and taxed on an accruals basis, ie it is taxed in the hands of resident taxpayers when it is derived, not when it is remitted to Australia. Income earned by resident taxpayers from certain other foreign investments may also be taxed on an accruals basis (¶21-105).

In contrast, a non-resident is generally liable to Australian tax only on ordinary and statutory income from Australian sources. This general rule is subject to a number of exceptions. For example, the liability of non-residents to withholding tax on dividends, interest and royalties is not dependent on the source of the amounts received. For the special CGT rules applying to non-residents, see ¶12-720 onwards.

Non-resident individuals are also subject to higher rates of tax than residents (¶42-015). A special rate of income tax applies to income earned on or after 1 January 2017 by a working holiday maker (¶21-033).

Where the taxing powers of the source country and of the country of residence of the taxpayer are governed by a double taxation agreement, residence and source as determined according to Australian domestic law may be overridden by the provisions of the particular agreement (¶22-140).

The ATO is examining certain tax schemes involving non-disclosure of foreign source income by residents (TA 2012/1).

Meaning of Australia

The geographical definition of ''Australia'' is a key factor for liability to Australian tax. It is important in working out whether an entity is a resident of Australia and whether an income or a gain has an Australian source. In summary, Australia, for the purposes of the income tax law, includes the States and internal Territories (the Australian Capital Territory and the Northern Territory), Australia's territorial waters, all of Australia's external Territories including the territorial waters surrounding them and much of the waters contained in Australia's exclusive economic zone (EEZ). It also includes the airspace above and the seabed and subsoil beneath Australia's waters.

Provisions in the tax law relating to the definition of Australia were rewritten and simplified, with effect for tax years or quarters starting on or after 1 July 2015. ITAA97 s 960-505(1) and (2) name the external territories and offshore areas that are part of Australia as:

- Norfolk Island
- the Coral Sea Islands Territory
- the Territory of Ashmore and Cartier Islands
- the Territory of Christmas Island
- the Territory of Cocos (Keeling) Islands
- the Territory of Heard Island and the McDonald Islands
- an offshore area for the purpose of the *Offshore Petroleum and Greenhouse Gas Storage Act 2006*, and
- the Joint Petroleum Development Area (within the meaning of the *Petroleum (Timor Sea Treaty) Act 2003*).

The EEZ is a marine area off Australia and its remote external territories, extending to a distance of not more than 200 nautical miles from the territorial sea baseline. Within its EEZ Australia has jurisdiction over the water column, seabed and subsoil and certain sovereign rights to the natural resources. Australia does not include the Australian Antarctic Territory.

The GST and some other indirect taxes do not operate in Australia's external territories and in certain offshore areas. From 1 July 2015, those taxes are referred to as operating in the ''indirect tax zone'', not Australia, to reflect their more limited geographic operation (¶34-000).

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Review of international tax rules

In recent years, Australia's international tax regime has been undergoing significant change. Many of the changes are intended to improve the competitiveness of Australian companies with offshore operations, and to encourage the establishment in Australia of regional headquarters for foreign groups. Particular attention has been paid to transfer pricing and profit shifting (¶22-580). Other areas of change have involved the accruals system (¶21-105); increased activity on double tax agreements (¶22-140); non-portfolio interests (¶21-095); foreign branch income (¶21-098); conduit foreign income (¶21-100); foreign tax offsets (¶21-670); dividend withholding tax (¶22-010); interest withholding tax (¶22-020, ¶22-022); royalty withholding tax (¶22-030); managed investment trust withholding (¶22-045); non-resident capital gains (¶12-720, ¶22-072); offshore banking units (¶21-080); thin capitalisation (¶22-700) and the Investment Manager Regime for foreign funds (¶22-122).

[FITR ¶28-500, ¶29-002]

¶21-005 Foreign investment approval: tax conditions

The Foreign Investment Review Board (FIRB) is a non-statutory body that advises the government on foreign investment policy and its administration. The Board examines proposals by foreign interests to undertake direct investment in Australia and makes recommendations to the government on whether the proposals are suitable for approval.

Foreign investment proposals are reviewed on a case-by-case basis to ensure that they are not contrary to the national interest. In general, national interest considerations can include: national security, competition, other Australian Government policies (including tax), impact on the economy and the community and the investor's character.

The government announced that new conditions regarding compliance with Australian tax laws would apply to foreign investment applications from 22 February 2016 (*Source: Treasurer's media release, 22 February 2016*). The applicant and its associates must:

- comply with Australian tax laws in relation to assets acquired
- provide documents or information to the ATO within the timeframe specified
- advise the ATO of any material transactions where the transfer pricing or anti-avoidance rules might apply and engage with the ATO in good faith to resolve tax issues
- pay any outstanding tax debt due at the time of the proposed investment
- where a significant tax risk is identified, periodically provide a forecast of tax payable and explain significant variations from the forecast, and
- report annually to the FIRB on compliance with the conditions.

[FTR ¶979-800]

Residence

¶21-010 Residence of individuals generally

An individual is an "Australian resident" if he/she either:

- resides in Australia (this is the primary or "ordinary concepts" test of residence): see below, or
- satisfies one of three statutory residence tests (ITAA36 s 6(1)): see ¶21-020.

Ordinary concept of residence

Residence according to ordinary concepts is quite different from domicile, nationality and citizenship.

Whether a person "resides" in Australia is essentially a question of fact and degree and there is no one rule which will determine the issue in every case. The dictionary definition of "reside" is "have one's settled abode, dwell permanently or for a considerable time, live in or at a particular place". It is not necessary for a person to reside in a particular structure such as a house. While physical presence alone may be insufficient evidence of residence, it does seem to be a prerequisite to a finding of residence in a particular place.

A person may be resident in more than one place (¶21-050). An individual may be held to be resident in Australia, even though living permanently abroad, if the individual visits Australia for part of the year as part of the regular order of his/her life. Conversely a sailor, for example, will be resident in Australia if he/she maintains a family home in Australia at which the sailor spends time while in Australia, even though absent from the country for most of the year.

Members of the Defence Forces serving abroad retain their residency, but may also be held to reside in the country in which they are serving. A person need not intend to remain permanently in a place to be found to reside there, but it seems that, where the duration of the stay is not decisive, the circumstances under which the person moved to that location should be considered.

The circumstances under which an individual entering Australia will be treated as "residing" here are considered in TR 98/17. The ruling is relevant to most persons entering Australia, including migrants (see below), academics teaching or studying in Australia, students, tourists and those on pre-arranged employment contracts.

Individuals are considered to be residing in Australia when their behaviour over a considerable time has the degree of continuity, routine or habit that is consistent with residing here. The Commissioner considers that six months is a "considerable time" for these purposes. When behaviour consistent with residing in Australia is demonstrated over a considerable time, an individual is regarded as a resident from when that behaviour commences. While each case must be considered on its facts, the following factors are useful in describing the quality and character of an individual's behaviour:

- the intention or purpose of the person's presence in Australia
- the extent of the person's family or business/employment ties with Australia
- the maintenance and location of the person's assets
- the person's social and living arrangements.

As recent examples, an engineer who took up a 2+ year appointment overseas, but maintained his Australian family home and ties in Australia to which he ultimately returned, was held to be a resident according to ordinary concepts (*Iyengar*). A similar result was reached where a doctor who worked in East Timor for many years returned to Australia each year for six to eight weeks (*Pillay*); and where an Australian citizen was hired to work in Qatar for a total period of nearly two and a half years, but continued to maintain a residence in Australia, garaged a car there, maintained internet and telephone accounts, bank accounts and membership of an Australian superannuation fund (*Sneddon*; see also *Ellwood*, where the taxpayer was a New Zealand citizen). The fact that a taxpayer had acquired a residential property overseas was not considered sufficient to establish that he was no longer a resident of Australia in *Mulherin*. On the other hand, a person who had left Australia to live permanently in Bali, where he had personal and financial ties, was held to have ceased to be a resident, despite lengthy subsequent visits to Australia, his indication on the immigration cards that he was an Australian resident, and his receipt of Medicare benefits (*Murray*). An unmarried French citizen who visited

Australia on a working holiday for just over a year, doing casual jobs and living in various residential premises, was held to have established Australian residency (*Guissouma*).

Individuals who migrate to Australia are regarded as residents as soon as they arrive. The factors which the Commissioner regards as relevant to determining whether a business migrant is a resident according to ordinary concepts are set out in IT 2681.

The fact that a person comes to Australia under a business skills program is a strong indication that the person intends to reside in Australia. In addition, successful applicants under such programs are normally given permanent resident status on arrival in Australia under migration law and this fact should be given due weight. For an article discussing the relevance of details recorded by taxpayers on their incoming and outgoing passenger cards, see the CCH *Tax Week* at ¶692 (2013); see also *Murray* and *Guissouma*.

[FITR ¶29-010; FTR ¶3-850]

¶21-020 Residence: three statutory tests

Even if a person does not reside in Australia within the ordinary meaning of "reside" (¶21-010), that person may nevertheless be a resident of Australia for tax purposes if any one of three additional statutory tests in the definition of "resident" in ITAA36 s 6(1) is satisfied.

(1) Domicile/permanent place of abode test

Under the first of these tests, a person whose *domicile* is in Australia is deemed to be a resident of Australia unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia (the "domicile/permanent place of abode" test).

The term "permanent" is not used in the sense of everlasting, but is used in contrast to temporary or transitory. It means something less than a place of abode in which the taxpayer subjectively intends to live for the rest of the taxpayer's life. Thus, in *Applegate's case*, an employed solicitor who was transferred to a Pacific island to open up a branch office, but returned 21 months later because of ill health, was held to have a permanent place of abode outside Australia during the period of his stay. This was so even though he always intended to return eventually to Australia after an indefinite, but lengthy, absence.

In *Applegate's case*, the taxpayer's overseas stay was intended to be indefinite. However, the absence of this element will not necessarily preclude a finding that the taxpayer has a permanent place of abode outside Australia. For example, in *Jenkins' case*, a bank officer who, at the bank's request, agreed to go abroad for three years and had not given any consideration to prolonging his stay there beyond that period, had a permanent place of abode outside Australia. In *Case W13*, Australian source rental income was taxed on the basis that the taxpayers were non-residents. They had returned to Greece in 1979 to care for their ageing relatives but maintained a family home in Australia for nine years pending their return in 1988. It was held that, although they were domiciled in Australia, their permanent place of abode was in Greece.

IT 2650 examines the factors to be taken into account in determining whether a person who leaves Australia temporarily to live overseas acquires a permanent overseas place of abode there. These factors include the intended and actual length of the stay overseas (as a rule of thumb, a period of about two years would normally be considered to be a minimum), whether a fixed home has been established outside Australia and the durability of the person's continuing association with a place inside Australia. However, none of these factors is conclusive by itself.

In *Case 2/98*, a physiotherapist who worked in Canada for more than two years, and who was present in Australia for only four weeks during 1995 and 1996, was nevertheless held to be a resident of Australia throughout her stay abroad because she had not established a permanent place of abode outside Australia. Similar results were

reached in *Boer* (oil field worker who worked on short-term contracts in Oman); *Sully* (marine engineer who worked on ocean-going vessels based in various parts of the world); *Bezuidenhout* (pilot who worked overseas but had house, family, private health insurance, bank account and an investment property in Australia); and *Case 5/2013* (Indian citizen with Australian permanent residence and a family home in Australia who spent most of two income years working either in Singapore or India). On the other hand, a New Zealand citizen with a long history of taking overseas postings, who left his home in Australia to take up a job in Abu Dhabi, was held to have established a permanent place of abode there (*Mayhew*). Although he retained some links with Australia, his actions were consistent with a person who had resolved to permanently leave. For an article discussing some of these cases, see CCH *Tax Week* at ¶998 (2012). Similarly, a project manager domiciled in Australia who went to Saudi Arabia in 2007 to work under a contract of indefinite duration was held to have established a permanent place of abode there by the start of the 2009 income year. He was able to demonstrate that he had a genuine intention to live there for the duration of the project and beyond, even though he had maintained significant links with Australia (*Dempsey*; *Agius*).

(2) The 183 day test

Under the second statutory test, *constructive residence* in Australia is attributed to a person who is actually present in Australia for a total period of more than half the year of income, unless it can be established that the person's usual place of abode is outside Australia and that there is no intention to take up residence here. This is called the "183 day" test. The test applies in relation to the relevant income year rather than a calendar year. The person's presence in Australia need not be continuous for these purposes, ie all the days the person is present in Australia during the income year will be counted (IT 2681).

However, the fact that the taxpayer spends more than 183 days *outside* Australia does not necessarily mean that they are not resident in Australia (*Gunawan*). The fact that a taxpayer does not have a usual place of abode in Australia does not necessarily mean that the taxpayer must have a usual place of abode somewhere else (*Subrahmanyam*).

(3) Commonwealth superannuation fund test

An individual is a resident under the third statutory test if he/she is a contributing member (or is the spouse or child under 16 of a person who is a contributing member) of the superannuation fund for Commonwealth government officers. The taxpayer in *Case 11/94* was held to be a resident under this test as he remained an "eligible employee" for the purposes of the *Superannuation Act 1976* throughout his period of service in the Solomon Islands. A taxpayer who had actually ceased to reside in Australia, but had retained membership of an Australian government superannuation scheme, was held to be resident within this test even though he had ceased contributing to the fund (*Baker*).

[FITR ¶29-085, ¶29-105, ¶29-120]

¶21-030 Part-year resident

Where a person resides in Australia within the ordinary meaning of that expression for less than one-half of the year of income, that person would be treated as a resident of Australia only during the actual time he/she is present in Australia. This means that the person would not be assessable to ordinary Australian tax on foreign source income derived during the period he/she was not actually in Australia.

Where, however, the individual has been present in Australia for more than half of any income year and is constructively a resident of Australia within the 183 day test, the position is not clear. In early cases, such an individual was treated as a resident of Australia *throughout* the year. However, a different view was expressed in *Case S19*. In that case, a bank officer departed from Australia in April 1978 for a posting in the Pacific. The Board of Review rejected the Commissioner's contention that the taxpayer could be deemed to be a resident for the whole of the 1977/78 income year because more

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than six months of that year had elapsed before his departure and he had no definite intention of not returning to Australia. The Board said that the 183 day test cannot deem a person who comes to Australia during an income year, and is here for more than six months of the year, to be a resident from the beginning of that year, nor can it deem a person who leaves Australia after being here for more than six months of an income year to be a resident from the time of departure until the end of that year.

Where a person is a resident of Australia for only part of the year, the tax-free threshold which applies to residents is only available on a pro-rated basis (¶2-130).

[FTR ¶29-130]

¶21-032 Temporary residents

Individuals with temporary visas who qualify as "temporary residents" are not assessable on most of their foreign source income, even if they qualify as residents under the normal tax rules. For details, see ¶22-125.

¶21-033 Working holiday makers

A special rate of income tax applies to income earned on or after 1 January 2017 by a working holiday maker (also known as the "backpacker tax"). A working holiday maker is an individual who holds a Subclass 417 (Working Holiday) visa, a Subclass 462 (Work and Holiday) visa or a bridging visa granted in relation to an application for one of the above visas.

A 15% income tax rate applies to working holiday maker taxable income on amounts up to $37,000, with ordinary tax rates applying to taxable income exceeding this amount. Working holiday maker taxable income is assessable income earned by a working holiday maker from Australian sources, less relevant deductions.

For a table with the working holiday maker income tax rates, see ¶42-018.

The special rate was considered necessary to ensure that all working holiday makers are taxed on a consistent basis. Before the enactment of the new rate, some working holiday makers were taxed on the basis of being a non-resident of Australia for tax purposes and some were taxed as a resident. The new rate applies regardless of the residency status of the individual.

The special rate is accompanied by the following measures:

- the rate of departing Australia superannuation payments tax for working holiday makers is 95% for those components of the payment that are subject to the tax (¶26-260)
- employers of working holiday makers must register with the Commissioner to be able to apply reduced rates of PAYG withholding on payments
- the Commissioner will provide an annual report to parliament and has been given expanded scope to disclose information to the Fair Work Ombudsman
- certain visa application charges will be reduced and the passenger movement charge will be increased.

Any income earned by an individual from sources in Australia while a working holiday maker and which forms part of their taxable income is taxed as working holiday maker taxable income. That may include, for example, income other than employment income. The individual may claim tax deductions for expenses of earning the income, under the ordinary rules.

Where a person is a working holiday maker for part of an income year, the working holiday maker tax rates only apply to income derived during that period. For the other part of the year, the person must assess their residency status, determined on a whole of year basis, and the relevant rates of tax will apply.

▶ Example (based on the explanatory memorandum)

Fabio is a non-resident for income tax purposes. He earns $50,000 while a working holiday maker in Australia from 1 July 2017 to 31 March 2018 and has $1,000 of deductions that relate to this income. His working holiday taxable income is therefore $49,000. He also earns a $39,000 salary in Australia while holding a different class of visa from 1 April 2018 to 30 June 2018. In this period he is not a working holiday maker.

Fabio pays tax at the rate of 15% on the working holiday taxable income from $0 to the tax threshold of $37,000 and 32.5% for the remaining $12,000 of his total of $49,000 of working holiday taxable income.

On his taxable income of $39,000 that is not working holiday taxable income, he pays income tax at the 32.5% non-resident rates for the first $38,000. The remaining $1,000 is taxed at 37%, as his overall income for the year is higher than $87,000 so he moves into the next tax bracket.

The new measures apply to income earned on or after 1 January 2017. The explanatory information accompanying the measures does not address how the working holiday maker income tax rates apply in the 2016/17 income year. It would appear that working holiday maker taxable income earned in the 2016/17 income year should be treated as being in the bottom slice of income when applying the relevant income tax rates.

¶21-035 Residents of Australia's territories

For income tax purposes, Australia's external territories are treated as if they were part of Australia (ITAA97 s 960-505: ¶21-000). Residents of these Islands are therefore generally treated as residents of Australia and are subject to tax on that basis. This means, for example, that income from sources within the Islands is treated as Australian-source income and withholding tax can apply to outgoing dividend, interest and royalty payments. In addition, the tax rules governing shipping freights and insurance contracts (¶22-110) apply as they do to Australia. After 1 July 2016, some special exemptions from paying personal and business taxes (but not the GST) for "genuine" residents of Norfolk Island ceased (¶10-640).

The Islands are included in Zone A (special area) for the purpose of the zone tax offsets (¶15-160).

The Joint Petroleum Development Area in the Timor Sea is treated by Australia as part of Australia and by East Timor as part of East Timor (ID 2009/95).

[FTR ¶5-726]

¶21-040 Residence of companies

Under the statutory definition, a company is resident in Australia if:

- it is incorporated in Australia, or
- although not incorporated in Australia, it carries on business in Australia and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia (ITAA36 s 6(1)).

The place of central management and control will usually be where the directors meet to do the business of the company, but it is a question of fact and degree to be decided in each case by a scrutiny of the course of business and trading (*De Beers Consolidated Mines v Howe*).

The central management and control of a company may be divided between two places, in which case the company will be resident in both places (*North Australian Pastoral Co*). For example, a company's head office may be in one country and its main business office in another.

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The *Esquire Nominees case* involved a company incorporated in Norfolk Island with its voting shares and directorships in Norfolk Island hands. The High Court found that it was carrying on business as a trustee in Norfolk Island and, notwithstanding the influence and power of the Australian accountants who masterminded the scheme it was pursuing, doing so properly in the interests of its business. Its central management and control was therefore in Norfolk Island alone and it was not a resident of Australia. In *Bywater Investments Pty Ltd*, however, the High Court found that various offshore companies and their directors were controlled by a person in Australia and, therefore, the companies' central management and control was in Australia.

The Commissioner considers that: (i) a company may be "carrying on business" under the statutory test even if its main activity is the management of its investment assets; (ii) the place of business of a large industrial concern is wherever its offices, factories or mines are situated. In contrast, if a company's income-earning outcomes are dependent on the investment decisions made in respect of its assets, it carries on its business where these decisions are made; (iii) central management and control involves the high level decision-making processes, including general policies and strategic directions, major agreements and significant financial matters; and (iv) as a matter of practical compliance, if the central management and control is exercised by a board of directors at board meetings, it generally will be taken to be in Australia if the majority of the board meetings are held in Australia (TR 2004/15).

Tax benefits denied to certain dual resident companies

"Prescribed dual residents" are denied access to certain tax advantages available to ordinary resident companies. Prescribed dual residents are companies resident both in Australia and another country which:

- are treated as resident solely in another country for the purposes of one of Australia's double taxation agreements (¶22-140), or
- qualify as resident in Australia solely because their central management and control is in Australia, and which also have their central management or control in another country (s 6(1)). Effectively, this applies where there is a division of central management and control between the two countries.

Prescribed dual residents are denied CGT roll-over relief for certain assets (¶12-490) and the group transfer of income and capital losses (¶3-090, ¶11-110). Dual resident companies are also deemed to be non-residents for the purposes of the thin capitalisation (¶22-700) and other anti-avoidance provisions.

These deeming rules also apply to dual resident entities that are treated as companies under Australian income tax law (ie public trading trusts and corporate limited partnerships) even if they are not so treated under the relevant foreign law.

[FITR ¶29-205]

¶21-050 Residence for tax agreement purposes

In determining liability to Australian tax on the basis of residence or non-residence in Australia, it is necessary to consider not only the income tax laws, but also any applicable double taxation agreement (DTA).

Australia has concluded DTAs with over 40 countries to avoid the incidence of double taxation (see ¶22-140 and following for details of their operation). Most DTAs include a "tie-breaker" test under which a dual resident is deemed, for double taxation purposes, to be a resident solely of one of the two contracting countries.

For discussion of the residence of trusts and trustees in the DTA context, see TR 2005/14; see also ¶6-060.

[FITR ¶29-005]

Source of Income

¶21-060 Source of income generally

The operation of the rules governing the taxation of foreign source income and the fact that non-residents are generally assessable only on income sourced in Australia make the identification of the source of a particular item of income fundamentally important.

Personal exertion — acts done by the taxpayer or the taxpayer's employees or agents — is one possible source of income. Property or rights over, or in relation to, property is another. The making of the contract or agreement, pursuant to which acts are done or moneys are paid and received, is also a possible source of income.

Often income may be the result of a combination of several factors occurring in different places. For example, the immediate source of income may be the sale of goods in Australia. The fact that the goods were purchased, produced or manufactured outside Australia would also be relevant in determining the source of the income. In cases where income has multiple sources, the dominant factor or factors must be determined. If necessary, the income must be apportioned among the various sources.

The source of income for tax purposes is determined according to the law of the country seeking to tax the recipient. Thus, while payments made by an Australian company for US "know-how" supplied in the US under a contract made in the US would probably have a US source according to generally accepted concepts of source, they are specifically deemed, for Australian tax purposes, to have an Australian source (ITAA36 s 6C, ¶22-030).

Under Australia's double taxation agreements, certain classes of income are deemed to be sourced in one or other country (¶22-150). In other cases, the source is undefined and falls to be determined under the laws of each country, which may or may not be the same.

[FITR ¶28-500]

¶21-070 Source of particular classes of income

Except where there is a specific statutory provision, determining the dominant source of an item of income is a practical, hard matter of fact to be determined separately in each case — the general comments below are intended merely as a guide.

Wages or salary, professional fees

The source of remuneration under a normal contract of employment or contract for services is generally the place where the duties or services are performed (*French*). If, however, creative powers or special knowledge is involved to such a high degree that the place where those powers or knowledge are utilised is relatively unimportant, the dominant source may be the place where the contract was made (*Mitchum*). In *Efstathakis' case*, salary paid by the Greek Government to a Greek national working in Sydney at the Greek Press and Information Service was taken to have an Australian source. Although the circumstances under which the taxpayer's employment was obtained, and the remuneration paid, included some factors occurring outside Australia, they were not significant enough to outweigh the importance of other factors relating to the employment which took place in Australia. In *Case X78*, a US resident was assessed on a payment made by his US employer of the tax payable on the salary he had received while working in Australia on secondment in the previous year of income. The AAT held that the payment was exempt income on the basis that the taxpayer derived the income at a time when he was a non-resident, and the source of the income was the US because the legal liability to make the payment arose from the taxpayer's employment contract which was entered into in the US.

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An employment termination payment is more similar to a payment of compensation than a payment for services. Therefore, the most relevant factors in determining its source are where the liability to make the payment arose and where it was paid from, rather than where the services were performed (ID 2010/110).

Trading or business profits

The source of trading or business profits is generally determined by reference to the place where the trader (or its employees or agents) trades or renders services. Where the relevant acts consist largely of the making of contracts, and the place of their performance is unimportant, the place where the contracts are made may be the only significant determinant of source. Conversely, if the making of the contract is of little importance and the chief factor is its performance, then the place where the contract is performed may be the only relevant factor in determining source (*Thorpe Nominees*). The ATO considers that it is important to consider the substance of the transaction as a whole, particularly where it is plain that a transaction has been structured so as to avoid tax in Australia. In the case of a leveraged buyout arrangement, for example, the ATO does not consider the place of execution of the contracts to be determinative (TD 2011/24). For an article discussing this determination, see CCH *Tax Week* at ¶997 (2011).

On this basis, income received by a Vanuatu-based insurance company was held *not* to have an Australian source where the insurance contracts were made and performed in Vanuatu, notwithstanding the taxpayer's close links to Australian companies (*Crown Insurance Services Ltd*; note that the ATO's *Decision Impact Statement* treats this decision as being confined to its own facts). In contrast, income from trading in Australian-listed shares by a Vanuatu-based trader was held to have an Australian source, even where the transactions were conducted off-market, where the trading contracts were completed in Australia (*Picton Finance*).

Prize moneys derived by a non-resident from racing their horse in Australia were considered to have an Australian source, even though the horse was from overseas and the contract for the training of the horse was made outside Australia (ID 2012/30).

Interest

The source is generally the place where the obligation to pay the interest arose, ie where the loan contract was made or the credit was given. The place where payment is to be made is also relevant. In *Spotless Services*, interest was paid to an Australian resident company by a Cook Islands bank on funds deposited against a certificate of deposit issued by the bank in the Cook Islands. However, the deposit was preceded by, and was dependent on, security being obtained for the deposit from a bank in Australia in the form of an irrevocable letter of credit. The Commissioner argued that the interest had its source in Australia from where all of the dealings between the parties originated and the contract for the letter of credit was made. However, the Full Federal Court identified the certificate of deposit as the crucial document and concluded that the interest had its source in the Cook Islands.

The source of tax indemnification payments made by a borrower to a non-resident lender will depend on where the contract is made and performed, the residence of the payer, the place and source of the payments and the reason the payment is made (TR 2002/4).

Dividends

The source of a dividend is not the location of the share register on which the shares giving rise to the dividend are effectively registered, but where the company paying the dividend made the profits out of which the dividend is paid (*Esquire Nominees*).

Royalties

If royalties are received in respect of property, such as a patent, trade mark, design, etc, or mine, owned by the recipient in the country from which the royalty flows, the source of those royalties will generally be that country. If received for technical know-how and services supplied outside that country under an agreement made outside that country, the source of those royalties would generally be outside that country. Note, however, that all "royalty" income derived by non-residents is deemed to have an Australian source to the extent that the payment is an outgoing of an Australian business (ITAA36 s 6C) and may therefore be subject to withholding tax when paid by a resident (¶22-030).

Pensions and annuities

The ATO treats the location of the fund from which a pension is paid as the source of the pension. On the other hand, it regards the source of an annuity payable under a contract to be the place where the contract was executed.

Income derived by residents of Norfolk Island

"Genuine" residents of Norfolk Island and companies wholly owned and controlled by such persons are exempt from tax on Norfolk Island and foreign source income (¶10-640). From 1 July 2016, the special exemptions from paying personal and business taxes (but not the GST) ended.

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Natural resource payments to non-residents

Income derived by non-residents which is directly related to the development and exploitation of Australia's natural resources is treated as having a source in Australia where the payments of natural resource income are based on the level of production and recovery of natural resources (ITAA36 s 6CA).

The provisional views of the ATO on the application of s 6CA and the real property tax treaty articles to "override royalties" (payments made by the holder of a mining right based on the value of natural resources produced and/or sold) are given in *Draft* TR 2016/D3.

[FITR ¶28-520 – ¶28-620]

Offshore Banking Units

¶21-080 OBUs concessional income tax treatment

Income (other than capital gains) derived by an offshore banking unit (OBU) from offshore banking activities is taxed at an effective rate of 10%. The other income and capital gains of an OBU are taxed at normal company rates. Interest paid by an OBU on qualifying offshore borrowings and gold fees paid by an OBU on certain offshore gold borrowings are exempt from withholding tax.

OBUs are banks subject to the *Banking Act 1959*, state banks, fully-owned subsidiary companies of such banks, and other financial institutions authorised to deal in foreign exchange which have been given operational approval by the Treasurer. They can also include: (i) funds managers which are money market corporations or fully owned subsidiaries of such corporations; (ii) holders of a securities dealer's licence or investment adviser's licence; (iii) life insurance companies; and (iv) other companies, including providers of custodial services, determined by the Treasurer to be OBUs (ITAA36 s 128AE; ID 2008/8). Under the consolidation regime (¶8-000), the head company of a consolidated group may be treated as an OBU when a subsidiary member of the group is an OBU.

A special tax regime applies to Australian branches of foreign banks (ITAA36 Pt IIIB).

OBU regime modernised from 1 July 2015

The OBU regime was amended in a number of ways to modernise it with effect from 1 July 2015. Some of the changes were recommended by the Johnson Report (the *Australia as a Financial Centre — Building on Our Strengths* report by the Australian Financial Centre Forum). The reforms also include targeted amendments to address a number of integrity concerns with the existing regime.

The most significant changes include:

- limiting the availability of the OBU concession in certain circumstances where it could otherwise be used to convert an ineligible activity into an eligible OB activity
- codifying the choice principle to remove uncertainty for taxpayers
- introducing a new method of allocating certain expenses between the operations of a taxpayer's domestic banking unit (DBU) and the OBU
- modernising the list of eligible OB activities, and
- treating internal financial dealings (for example, between an entity's DBU and OBU) as if they were on an arm's length basis.

Offshore banking activity

To be an offshore banking activity (OB activity) the following conditions must be satisfied:

- the activity undertaken by the OBU must be one of the defined types of activity (see below)
- in relation to some kinds of activity, the other party to the transaction must be an ''offshore person''
- the activity must be undertaken by a resident OBU (not being part of the offshore business of its overseas permanent establishment) or by a non-resident OBU (being part of the Australian business of its Australian permanent establishment) (ITAA36 s 121EA).

Eligible OB activities are listed in ITAA36 s 121D and include specified types of borrowing or lending, providing a guarantee or letter of credit, trading, investment, giving investment or other financial advice, hedging activities and leasing.

In income years starting on or after 1 July 2015, eligible trading activities do not include trading in subsidiaries or other entities where the OBU holds an interest of 10% or more. They also exclude trading in interests the OBU holds that are not held for trading according to the OBU's accounting records.

Broadly defined, an ''offshore person'' is: (a) a non-resident entity excluding its Australian operations; (b) the overseas branches of a resident entity; or (c) another OBU (ITAA36 s 121E).

Record-keeping

An OBU is required to keep separate accounts for money used in its OB activities. Internal dealings of the OBU between units which carry on OB activities and those which do not carry on OB activities are treated as dealings by the OBU with separate entities. If the OB activities are not accounted for separately, the 10% effective tax rate does not apply. An OBU is not required to maintain a separate nostro account or vostro account for its OBU activities.

The choice to treat a transaction falling within the definition of offshore banking activity as a transaction of the domestic banking unit (DBU) and not an OB activity was sanctioned by TD 93/135. However, for income years starting on or after 1 July 2015, the choice principle has been enacted in legislation (in s 121EAA).

[FTR ¶59-250]

¶21-090 Calculation of OBU tax concession

A 10% effective tax rate on the income of an OBU is achieved by applying the general company tax rate to only a fraction (the ''eligible fraction'') of the OBU's ''assessable OB income'', less the eligible fraction of the OBU's ''allowable OB deductions''. The eligible fraction is 10 divided by the number of percent in the general company tax rate.

Assessable OB income

The assessable OB income of an OBU is so much of the OBU's assessable income as is derived from its OB activities except to the extent that the money used in carrying on those activities is ''non-OB money''. In this calculation the following are excluded from OBU assessable income: capital gains, income from managing the Australian asset component of its portfolio investment for a non-resident and income from managing a portfolio investment for an overseas charitable institution.

Allowable OB deductions

The deductions of an OBU may be classified into five mutually exclusive types, three of which are wholly or partly ''allowable OB deductions'' (ITAA36 s 121EF):

(1) *Exclusive OB deductions* are deductions (other than loss deductions) that relate exclusively to assessable OB income and are allowable OB deductions.

(2) *Exclusive non-OB deductions* are deductions (other than loss deductions) that relate exclusively to non-OB income and are not allowable OB deductions.

(3) *Apportionable deductions* are deductions (eg for gifts) which are apportioned by a formula as OB and non-OB deductions.

(4) *Loss deductions* are deductions allowable under ITAA97 Div 36 for carry-forward losses, and are not allowable OB deductions.

(5) *General deductions* are deductions which are not any of the other four types. An example would be rent and utilities for an office building which is used for both OB and non-OB activities. These are allocated as OB or non-OB deductions on an adjusted income basis.

For income years starting on or after 1 July 2015, a deduction that relates to both OB and non-OB income is allocated to the taxpayer's OBU to the extent that it relates to ''OB income''. As a result, the allocation rule applies to deductions that relate to expenses incurred in deriving non-assessable, non-exempt NANE income, as well as assessable income.

Foreign tax offsets

For the calculation of an OBU's foreign tax offsets, see ¶21-710.

Loss of concession where non-OB money used

Income derived from the use of ''non-OB money'' is taxed at normal company rates. Broadly defined, ''non-OB money'' consists of domestic funding and funding generated in non-OB dealings (ITAA36 s 121EE).

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- capital gains made by a resident company on assets used wholly or mainly for the purpose of producing foreign income in carrying on a business at or through a foreign PE of the company, where the asset is not one that would expose a non-resident to CGT (¶12-720). In the case of PEs in listed countries, the exemption does not apply if the gain is from a tainted asset and is eligible designated concession income in relation to a listed country. In the case of PEs in unlisted countries, the exemption does not apply where the gain is from a tainted asset. Corresponding provisions apply to capital losses.

A "PE" has its ordinary meaning, as modified by any applicable double tax agreement (¶22-150). The "active income" test and "adjusted tainted income" referred to above are based on the corresponding concepts that apply under the CFC rules (¶21-180). A "tainted asset" is, broadly, an asset that produces passive income. It does not include trading stock or other assets used solely in carrying on a business (ITAA36 s 317), such as business goodwill (ID 2006/17; ID 2006/181).

The exemption also applies correspondingly where a resident company has an indirect interest, through one or more partnerships or trusts, in:

- foreign income derived by the partnership or trustee through a foreign PE (eg ID 2011/35)
- capital gains or losses made on an asset of the partnership or trust in carrying on business through a foreign PE.

▶ Example

An Australian resident company (X) has a 50% interest in a partnership that carries on business through a PE in an unlisted country. In the income year, the income from the business is $1m, and another $150,000 is net tainted rental income from equipment leases. This equipment is sold during the income year for a capital gain of $20,000.

The amount included in X's assessable income is 50% of the net tainted income, and 50% of the capital gain, ie $75,000 + $10,000 = $85,000.

The Commissioner considers that a debt interest cost is not deductible under s 25-90 or, alternatively, s 230-15(3) of ITAA97 where the amount is incurred in earning income that meets the requirements of both s 23AH of ITAA36 and s 768-5 of ITAA97 because such income is not non-assessable non-exempt income under s 768-5 for the purposes of s 25-90 (TD 2016/6).

The exemption does not apply to foreign branch income and capital gains from the operation of ships or aircraft in international traffic.

For the application of the exemption where the company has a PE on "substantial equipment" grounds (¶22-150), see TR 2014/3.

[FTR ¶9-970]

¶21-100 Conduit foreign income

Any part of an unfranked distribution made by an Australian corporate tax entity that it declares to be "conduit foreign income" (CFI) is not assessable to a foreign resident, and is not subject to dividend withholding tax (ITAA97 s 802-15). The general aim of this measure is to reduce tax impediments for foreign investors who structure their foreign investments through Australian entities, instead of holding them directly. It replaces the more limited foreign dividend account rules (¶22-010).

An Australian corporate tax entity means a corporate tax entity (¶4-440) that is a resident or, in the case of a public trading trust, a resident unit trust (¶4-600) for the relevant income year. The entity must make its declaration in its distribution statement (¶4-690) on or before the day that the distribution is made.

Associated measures ensure that tax will not be attracted where the distribution declared to be CFI:

(1) flows through a trust to non-resident beneficiaries (ITAA97 s 802-17). In this situation, a presently entitled non-resident beneficiary is not assessed on its share of the net income of the trust to the extent that the share is reasonably attributable to all or part of the unfranked distribution. The trustee is also not liable to pay tax in relation to that beneficiary's share, or

(2) flows through interposed Australian entities to other Australian corporate tax entities (ITAA97 s 802-20). This concession applies where: (i) an Australian corporate tax entity receives an unfranked distribution from another Australian corporate tax entity that declares an amount of the unfranked distribution to be CFI; and (ii) the recipient entity itself makes an unfranked distribution and declares that part of it is CFI. This must be done after the start of the income year and before the due date for lodging its tax return for that year. The effect of this concession is that an amount calculated as follows will not be assessable to the recipient entity:

$$\text{total received CFI amounts*} \times \frac{\text{total declared CFI amounts**}}{\text{total received CFI amounts** − related expenses}}$$

* ie the total amounts of CFI received during the income year

** ie the total amounts declared to be CFI by the recipient entity before the due date for lodging its tax return for that year, excluding declared CFI amounts already taken into account for a previous income year.

The amount cannot exceed the total received CFI amounts. If the related expenses exceed that amount, none of the received CFI amounts is assessable.

▶ Example

Companies A, B and C are Australian corporate tax entities.

Company A pays an unfranked dividend of $1,000 to Company C and declares the whole amount to be conduit foreign income. Company C has $50 of expenses relating to the dividend.

Company B pays an unfranked dividend of $2,000 to Company C and declares $1,600 to be conduit foreign income. Company C has $150 of related expenses.

Company C itself pays an unfranked dividend of $1,800 and declares $1,200 to be conduit foreign income.

The amount that is not assessable to Company C is:

$$\$1{,}000 + \$1{,}600 \times \frac{\$1{,}200}{\$1{,}000 + \$1{,}600 - \$200}$$

$$= \$1{,}300$$

The balance ($2,600 – $1,300) = $1,300 is assessable to Company C. It can deduct $100 of its total $200 expenses.

If, instead, Company C had made a dividend that declared $2,400 as conduit foreign income, the whole of the $2,600 received CFI amounts would have been non-assessable.

The CFI in a distribution that flows through an interposed partnership or trust is worked out in the same way as would be the share of a franking credit on a franked distribution (¶4-860).

CFI is technically described as non-assessable non-exempt income (¶10-890), with the effect that it will not reduce Australian foreign tax losses of the foreign resident.

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Controlled Foreign Companies

¶21-110 Scope of CFC rules

The broad purpose of the controlled foreign company (CFC) rules is to tax Australian shareholders on their share of a CFC's "tainted income" as it is earned, unless that income is comparably taxed offshore or the CFC derives its income almost exclusively from active business activities. This result is achieved by "attributing" tainted income to the Australian resident controllers of the CFC. "Tainted income" is generally income from investments or arrangements that are likely to be significantly affected by taxation considerations, eg interest, dividends, royalties or amounts arising from related party transactions (¶21-180).

The CFC rules generally apply accruals taxation to: (i) tainted income derived by CFCs resident in "unlisted" countries (¶21-130); and (ii) "eligible designated concession income" derived by CFCs resident in one of seven "listed" countries (¶21-170). Accruals taxation will generally not apply, however, to income derived by CFCs which pass the "active income test", ie which derive more than 95% of their income from genuine business activities (¶21-180).

[FTR ¶795-250, ¶795-253]

¶21-130 "Listed" countries

"Listed" countries comprise the seven countries below (ITAA36 s 320; ITR15 reg 19). These are countries that are considered to have tax systems closely comparable to Australia's. These countries were formerly classified as "broad-exemption listed countries" (BELCs). All other countries are "unlisted countries" (s 320).

Canada	New Zealand
France	United Kingdom
Germany	United States of America
Japan	

[FTR ¶795-380]

¶21-140 Attributable taxpayer

The controlled foreign company (CFC) rules operate under the self-assessment regime. Therefore, the taxpayer bears the responsibility for determining whether, in a particular year of income, the taxpayer is required to include income derived by a CFC in the taxpayer's assessable income. For this purpose, the threshold question for each taxpayer is whether there is a CFC in relation to which the taxpayer is an "attributable taxpayer".

A taxpayer will be an attributable taxpayer in relation to a CFC where the taxpayer (ITAA36 s 361):

- has a minimum 10% associate inclusive control interest in the CFC, or
- has a minimum 1% associate inclusive control interest in the CFC and is one of five or fewer Australian entities that controls the CFC.

"Associate inclusive control interest" is the aggregate of the direct and indirect control interests held by the taxpayer and the taxpayer's associates. The definition of "associate" in ITAA36 s 318 covers a very wide range of entities who are associates of natural persons, companies and trustees. Direct control interests are determined using criteria based on interests, or entitlements to acquire interests, in issued capital (measured in terms of the paid-up value), voting rights and rights to distributions of capital (ITAA36 s 350). For these purposes, the ATO considers that Australian entities that are members

of a foreign company limited by guarantee may be treated as shareholders (TD 2007/20). Entitlements to acquire include absolute and contingent entitlements (ITAA36 s 322). The ATO considers that this includes call options, but not put options, and does not include pre-emptive rights until such time as they are able to be exercised (TR 2002/3).

Indirect control interests are only traced through "controlled foreign entities" (CFCs, controlled foreign partnerships (ITAA36 s 341) and controlled foreign trusts (ITAA36 s 342)). Tracing of control interests stops where a foreign entity either has no interests in other entities or is not a controlled foreign entity. Indirect control interests are calculated by multiplying the control interest held by an Australian entity in the interposed entity by the control interest that the interposed entity has in the company being tested as a CFC. Where there is more than one interposed entity, the respective control interests are multiplied down the chain. For the purpose of determining whether a company is controlled, a resident or an interposed CFC with a majority interest in a non-resident company will be treated as having a 100% control interest.

Temporary residents

Individuals with temporary visas who qualify as "temporary residents" are not attributable taxpayers (¶22-125).

[FTR ¶795-710, ¶795-850]

¶21-150 What is a CFC?

A company is a CFC if it satisfies any one of the following three "control tests" in ITAA36 s 340:

(1) The company is a company in respect of which five or fewer Australian residents (each of which has at least a 1% control interest) have or are entitled to acquire at least a 50% associate inclusive control interest.

(2) A single Australian entity (and its associates) has at least a 40% control interest in the foreign company. There is a rebuttable presumption that such a shareholder controls the foreign company and the company is therefore a CFC. The presumption can be rebutted if the shareholder can demonstrate that the company is in fact controlled by another, unassociated, entity. For example, although an Australian entity may have a 45% control interest, the control test will not be satisfied where there is a single unassociated foreign entity holding a 55% control interest.

(3) Irrespective of the interests in a foreign company, a group of five or fewer Australian entities (either alone or together with associates) has *actual control* of the company.

For the purpose of applying the control tests, (1), (2) and (3) above are tested sequentially, ie it is first necessary to test whether situation (1) applies; if it does, no further testing is required.

For the treatment of foreign hybrid business structures, see ¶21-105. Individual cells in a Guernsey protected cell company are not CFCs (ID 2008/23).

Statutory accounting period

The control tests are to be applied at the *end* of the statutory accounting period of the relevant foreign company or another foreign company further up a chain of foreign companies. If a company ceases to exist before the end of its statutory accounting period, its statutory accounting period will be deemed to have ended immediately before it ceased to exist (¶21-200). In addition, the calculation of a CFC's attributable income and the application of the active income test to a CFC (¶21-180) are both done in relation to the period covered by the company's statutory accounting period.

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There are also anti-avoidance measures intended to ensure that services provided indirectly through interposed entities are treated as if they were provided directly.

The ATO has issued *Taxpayer Alert* TA 2015/5 concerning arrangements involving the use of offshore procurement hubs by Australian resident multinational enterprises. The ATO is concerned that the arrangements as described are being used to minimise "tainted income" under s 447 and 448. Part IVA potentially applies and the ATO says the pricing of the arrangements raises transfer pricing issues.

Other aspects

The Commissioner can make adjustments to amounts included in a CFC's recognised accounts to reflect the application of arm's length transfer pricing principles to the CFC's transactions with related parties not covered by ITAA36 s 440. Under s 440, arm's length principles are used in applying the active income test to the calculation of gains and losses on the disposal of assets other than trading stock.

Where a CFC resident in an unlisted country passes the active income test, its attributable income will not include its "adjusted tainted income". This is its tainted income (ie passive income and tainted sales and services income) subject to certain modifications. These modifications essentially include gross amounts instead of net gains from the disposal of tainted assets and tainted commodity investments, and from currency exchange rate fluctuations.

Where a CFC resident in a listed country satisfies the test, there will be no attribution in respect of its designated concession income.

Special rules apply to the keeping of records needed to substantiate claims that the active income test has been passed (ITAA36 s 451 to 453).

[FTR ¶795-298, ¶796-670, ¶796-890]

¶21-190 Attribution of CFC income to attributable taxpayers

The assessable income of a taxpayer who is an "attributable taxpayer" in relation to a CFC will include the taxpayer's share of the CFC's "attributable income" for the CFC's statutory accounting period that ended during the taxpayer's year of income.

Attribution percentage

The share of a CFC's attributable income that is attributable to a particular attributable taxpayer is called the "attribution percentage".

The attribution percentage is the sum of the taxpayer's direct and indirect "attribution interests" in the CFC. A direct attribution interest is calculated in the same manner as the taxpayer's direct control interest in the CFC (¶21-140). Indirect attribution interests can only be traced through controlled foreign entities. They are calculated by multiplying attribution tracing interests through interposed entities. Attribution does not apply where the taxpayer simply has de facto control, without either a direct or indirect attribution interest (ID 2008/5).

Attributable income provisions

The basic provision under which the attributable income of a CFC will be included in a resident taxpayer's assessable income is ITAA36 s 456. Special relief from double taxation is available under ITAA36 s 456A to ensure that there is no attribution under s 456 where an attributable taxpayer holds an interest in a CFC through an entity that is a resident of a listed country in which foreign tax is payable by the entity under an "accruals taxation law" of that country. The relevant accruals taxation laws are specified in ITR15 reg 18. The Commissioner will treat foreign tax as being payable in situations where no tax is paid due to the availability of a tax rebate, credit or deduction in the listed country (TD 96/37).

Attribution to resident attributable taxpayers will also occur where a CFC changes its country of residence from an unlisted country to a listed country or to Australia (ITAA36 s 457). The operation of this provision is modified where an unlisted country CFC is treated as having changed residence to a listed country as a result of the unlisted country becoming listed. In such a case, s 457 will not apply if the CFC was a resident of the newly listed country for three or more years prior to the country becoming listed. If the CFC has been a resident of a newly listed country for less than three years, s 457 will apply, but only to tax gains on the disposal of assets held at the residence-change time. However, effective from 27 June 2005, this three-year requirement will not apply, so there will be no attribution under s 457 simply because an unlisted country CFC becomes a listed country CFC due to its country of residence becoming listed.

Section 457 does not attribute adjusted distributable profits of past statutory accounting periods.

Attribution may also occur where ITAA36 s 459A is triggered to combat avoidance of attribution of income by the use of interposed Australian trusts or partnerships in conjunction with a CFC or a controlled foreign trust.

[FTR ¶796-980ff]

¶21-200 Attributable income of a CFC

The attributable income of a foreign company must be calculated where, at the end of the company's statutory accounting period:

- the company was a CFC (¶21-150). Where a CFC ceases to exist before the end of its statutory accounting period, its statutory accounting period will be deemed to have ended immediately before the CFC ceased to exist (ITAA36 s 319(6)), and
- there was at least one attributable taxpayer in relation to the CFC (¶21-140).

Where these conditions are satisfied, the attributable income of the CFC for that statutory period must be calculated separately for each attributable taxpayer.

A CFC's attributable income will be calculated on a *notional* basis using, in a modified form, the rules that apply for the calculation of the taxable income of a resident company (ITAA36 s 381 to 431). The most important modifications relate to the application of the CGT provisions (see below), the treatment of depreciating assets and trading stock, currency translation and the deductibility of taxes paid. The commercial debt forgiveness provisions (¶16-910) do not apply for the purpose of attributing income derived by a CFC to resident taxpayers and neither do the thin capitalisation or debt creation rules.

The types of income that will be included in the attributable income of a CFC depend on whether it is resident in a listed or unlisted country and whether it passes the active income test (¶21-180).

The ATO considers that amounts deemed to be dividends under ITAA36 s 47A (¶21-250) are not included in the notional assessable income of either a listed or unlisted country CFC (TD 2007/16).

Unlisted country CFCs

Where a CFC that is a resident of an unlisted country does not pass the active income test, its attributable income is the amount that would have been its taxable income if the CFC was a resident of Australia and its only income (including income derived through a partnership) was: (i) adjusted tainted income (ie passive income and tainted sales and services income); and (ii) trust income (including trust income attributed under the transferor trust measures (¶21-300)). Where a CFC resident in an unlisted country passes the active income test, its attributable income will include the same forms of income as those listed above except for its adjusted tainted income (s 384).

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Listed country CFCs

The attributable income of a CFC resident in a listed country which fails the active income test is calculated on the assumption that its income (including income derived through a partnership) consists of:

- adjusted tainted income that is eligible designated concession income (¶21-170)
- income that is not eligible designated concession income, is not derived from sources in the listed country and is adjusted tainted income not taxed in a listed country
- income derived as a beneficiary of a trust that is not taxed in a listed country or Australia or, being subject to tax in a listed country, is eligible designated concession income in relation to a listed country
- income attributed to the CFC under the transferor trust measures.

The attributable income of a listed country CFC that passes the active income test will include the same forms of income except for eligible designated concession income (s 385(2)).

Income excluded from attributable income

The attributable income of a CFC resident in an unlisted or a listed country does not include the following "notional exempt income" (s 402 to 404):

- income of the CFC assessable for Australian tax purposes independently of the operation of the CFC measures
- dividends to the extent that they have been franked
- certain excluded insurance premiums.

For a CFC resident in an unlisted country, attributable income also does not include income derived in carrying on a business in a listed country, at or through a permanent establishment in that country, where the income is not eligible designated concession income (s 403).

Where a CFC is resident in a listed country at the end of the income year, a dividend paid to it by a company also resident in a listed country is also notional exempt income (s 404). For the purposes of this rule, the following countries are, in effect, treated as listed countries (ITAA36 s 320; ITR15 reg 19): Argentina, Austria, Bangladesh, Belgium, Brazil, Brunei, Bulgaria, China (except the Hong Kong Special Administrative Region), Czech Republic, Denmark, Fiji, Finland, French Polynesia, Greece, Hungary, Iceland, India, Indonesia, Iran, Ireland, Israel, Italy, Kenya, Kiribati, Republic of Korea, Luxembourg, Malaysia, Malta, Mexico, Myanmar, Netherlands, New Caledonia, Norway, Pakistan, Papua New Guinea, Philippines, Poland, Portugal, Romania, Russian Federation, Saudi Arabia, Singapore, Slovak Republic, Solomon Islands, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Taiwan, Thailand, Tokelau, Tonga, Turkey, Tuvalu, Vietnam, Western Samoa and Zimbabwe. As a result of the changes to the rules on foreign dividend exemption (¶21-095), together with concerns about exploitation, s 404 was replaced with a new rule designed to ensure that CFCs would continue to have access to the foreign dividend exemption.

De minimis exemption for listed country CFCs

A *de minimis* exemption applies so that where the combined amount of: (i) eligible designated concession income; and (ii) income from sources outside the listed country that is *either* not taxed in a listed country or adjusted tainted income not taxed in a listed country, does not exceed certain levels (see below), such income is not included in the attributable income of a listed country CFC (s 385(4)). There is no similar exemption for CFCs that are residents of unlisted countries.

For a listed country CFC with a gross turnover of less than $1m, the exemption applies where the sum of the three amounts does not exceed 5% of the gross turnover. Where a listed country CFC has a gross turnover of more than $1m, it applies where the sum of the three amounts does not exceed $50,000.

Prior year losses

A CFC's attributable income may be reduced by prior year losses. A loss from a previous year can only be taken into account as a notional deduction if the CFC was a CFC during the year in which the loss was incurred and in all intervening years. In addition, a notional deduction is not generally available for prior year losses where a CFC changes its country of residence from a listed country to an unlisted country (or vice versa). A CFC's prior year losses will generally be reduced by the CFC's "sometimes-exempt income", ie broadly, an amount which was not included in the CFC's attributable income because the CFC passed the active income test or it fell within the *de minimis* exemption (see above) (s 425 to 431).

Currency translation rules

For the rules governing the conversion of amounts expressed in a foreign currency into Australian or functional currency, see ¶23-070 and TD 2006/6.

Modified application of CGT provisions

A number of modifications to the operation of the CGT provisions apply for the purposes of calculating the attributable income of a CFC.

- When calculating the capital gain or loss in relation to a CGT event involving a CFC or the disposal of an asset by a CFC, all assets owned by the CFC immediately before it became a CFC which are not of a type that would expose a non-resident to CGT (¶12-720) (referred to as "commencing day assets") are treated as having been acquired by the CFC on its "commencing day". The cost base of the asset is deemed to be the greater of the asset's cost base or market value at the end of the commencing day; the first element of the reduced cost base of each such asset is the lesser of its market value or its cost base at the end of that day. For a CFC in existence as at 30 June 1990, its commencing day is 30 June 1990; for any other CFC, its commencing day is the first day after 30 June 1990 at the end of which it was a CFC. This means that, in relation to a post-30 June 1995 CGT event affecting an asset which is not of a type that would expose a non-resident to CGT (¶12-720), the attributable income of a CFC will include only the gain or loss accruing from the time the asset was acquired or its commencing day, whichever is later (s 406; 411; 412). Where a company becomes a CFC after 30 June 1995, CGT events or asset disposals made before its commencing day will not be taken into account in the calculation of its attributable income. Note that, with general effect from 1 July 2005, the definition of "commencing day" is eased so that it will be the later of: (i) the last day of the most recent period during which there was not an attributable taxpayer with a positive attribution percentage in relation to the CFC; and (ii) 30 June 1990.
- Where the commencing day assets of a CFC include shares or units in a unit trust and, during the time from when they were acquired up to the CFC's commencing day, a payment representing a return of capital is made on those shares or units, their cost base as at the commencing day is reduced by the amount of the payment (s 413).
- Capital gains or losses on CGT events affecting assets which are of a type that would expose a non-resident to CGT (¶12-720) are not taken into account for attribution purposes. The usual CGT provisions applying to non-residents will, of course, apply to such assets in the calculation of the assessable income of the CFC in its own right.

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