Treatment of foreign income tax offsets, attribution surpluses and conduit foreign income

Foreign income tax offset rules

The foreign income tax offset rules (in Division 770 of the *Income Tax Assessment Act 1997* – ITAA 1997) replace the foreign tax credit (FTC) rules and apply to income years starting on or after 1 July 2008. The application of the foreign income tax offset rules to consolidated and multiple entry consolidated (MEC) groups is dealt with in Subdivision 717-A of the ITAA 1997 (which replaces the previous provisions on FTCs and tax consolidation).

Transitional rules provide for the utilisation of an entity's excess FTCs, with specific rules for consolidated groups and MEC groups in Subdivision 770-E of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997).

The application of the FTC rules to consolidated groups is dealt with in this section from p. 4.

Entitlement to a foreign income tax offset

The foreign income tax offset rules provide a non-refundable tax offset for foreign income tax paid on an amount included in an entity's assessable income (a 'double-taxed amount'). The entity becomes entitled to a tax offset in the income year the amount is included in its assessable income, and the offset is determined on a whole-of-income basis, not on a class-of-income basis.

A head company's entitlement to foreign income tax offset is determined in accordance with the general foreign income tax offset rules in Division 770 of the ITAA 1997. The head company can only claim a foreign income tax offset for the income year in which the relevant amount is included in its assessable income, which may be different from the income year in which the foreign income tax on that amount is paid. If foreign income tax is paid after the year in which the relevant income amount is included in assessable income, the head company will need to lodge an amended return for that year to claim the foreign income tax offset.

Under the single entity rule, each subsidiary member of a consolidated or MEC group is treated as being part of the head company for income tax purposes. Therefore, amounts, including amounts on which foreign income tax has been paid, received by a subsidiary member of a consolidated or MEC group will be taken to be received by the head company and will be included in the head company's assessable income.

Where a subsidiary member pays foreign income tax on an amount included in the head company's assessable income, the head company rather than the subsidiary member is treated as having paid the tax. → section 717-10, ITAA 1997

Foreign income tax deemed to be paid

Foreign income tax is deemed to have been paid by an entity on an amount included in its assessable income where the tax has effectively been paid by another entity in certain circumstances, such as payments by a partnership or trust.

Under subsections 770-130(1) and (2) of the ITAA 1997 and the single entity rule, the head company is treated as having paid foreign income tax on an amount included in its assessable income where the tax has been paid by another entity under an arrangement or under the law relating to the tax.

For example, where a subsidiary member of a consolidated or MEC group is a partner in a partnership that is not a member of the group, and the partnership pays foreign income tax, on behalf of the subsidiary member under an arrangement with it, on an amount part of which is included in the head company's assessable income, the head company will be deemed to have paid the tax. The application of the deeming rule and the single entity rule allows the head company to claim a foreign income tax offset.

An entity is also deemed to have paid foreign income tax where it is presently entitled to a share of trust income that is attributable to income received by the trust on which foreign income tax has already been paid → Subsections 770-130(1) & (3), ITAA 1997. This rule applies in conjunction with section 6B of the ITAA 1936, which ensures that the character and source of income that flows through a trust is retained when received by a beneficiary. When applied together with the single entity rule, these rules ensure the head company is deemed to have paid the foreign income tax on an amount included in its assessable income where a subsidiary member is a beneficiary of a trust and the trust is not part of the consolidated or MEC group.

→ 'Calculating the foreign income tax offset', C6-2-130

Using pre-commencement excess foreign income tax

Excess FTCs from the five income years before the commencement of the foreign income tax offset rules are converted to pre-commencement excess foreign income tax.

At the commencement of the new foreign income tax offset rules, the head company of a consolidated or MEC group amalgamates and converts existing excess FTCs from the previous five income years into a classless bundle of pre-commencement excess foreign income tax. There is no requirement to maintain the four classes of assessable foreign income, as required under the previous FTC rules.

Subject to the transitional rules (→ p. 3 of this section), pre-commencement excess foreign income tax can be used for up to five years from the commencement of the new regime to top up the amount of foreign income tax paid if there is a foreign income tax shortfall (that is, where the foreign income tax paid is less than the foreign income tax offset limit). → section 770-230, IT(TP)A 1997

The foreign income tax offset limit is calculated as the amount of Australian tax payable on the double-taxed amounts and other assessable income that does not have an Australian source. Alternatively, the taxpayer can elect to use

$1,000 (the *de minimis* rule) as the foreign tax offset limit. → section 770-75, ITAA 1997

Where a head company has a foreign income tax shortfall, it can increase the foreign income tax paid up to the foreign income tax offset limit by using any pre-commencement excess foreign income tax it has or that has been transferred to it from a joining entity, subject to the transitional rules. → section 770-230, IT(TP)A 1997

Where the foreign income tax paid exceeds the foreign income tax offset limit, the excess foreign income tax cannot be carried forward to a subsequent year or transferred.

→ Subdivision 770-D, IT(TP)A 1997

Transitional rules

Transitional rules (in Subdivision 770-E of the IT(TP) Act 1997) allow a joining entity to transfer pre-commencement excess foreign income tax to the head company at the joining time. The rules apply in the same way to MEC groups and consolidated groups. → Subdivision 770-E, IT(TP) Act 1997

These transitional rules substantially replicate the previous FTC rules on the transfer of excess FTCs to the head company at the joining time (previously in Subdivision 717-A of the ITAA 1997).

Once an entity joins a consolidated or MEC group, the entity's pre-commencement excess foreign income tax is effectively transferred to the head company. The pre-commencement excess foreign income tax transferred from the joining entity is pooled with any other pre-commencement excess foreign income tax of the head company and any other subsidiary members. → section 770-290, IT(TP)A 1997

There is a five year limit on the utilisation of pre-commencement excess foreign income tax by the head company, and the pre-commencement excess foreign tax in the pool must be separately identified according to the income years in which it arose. The head company can apply pre-commencement excess foreign income tax transferred from a joining entity in an income year starting on or after joining time.

The worked example 'Foreign income tax offset – transitional rules' (→ C6-2-120) shows how the pre-commencement excess foreign income tax is transferred to the head company of the group and subsequently used.

Joining a consolidated group

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

A joining entity can use its pre-commencement excess foreign income tax where it has a foreign income tax shortfall in the non-membership period. It can also transfer unutilised pre-commencement excess foreign income tax to the head company at the joining time.

If the foreign income tax paid by the joining entity exceeds the foreign tax offset limit in the non-membership period, the excess foreign income tax paid cannot be transferred to the head company.

Leaving a consolidated group

An entity that leaves a consolidated group is not entitled to any pre-commencement excess foreign income tax it had before joining the group, or that arose in the group while it was a subsidiary member.

→ section 770-305, IT(TP)A 1997

The head company is entitled to an offset for foreign income tax paid by a leaving entity after it leaves the group on an amount included in the head company's assessable income.

Period to lodge amendments extended

To ensure an entity can claim an offset for foreign income tax paid after the year in which the amount on which the tax has been paid is included in its assessable income, section 770-190 of the ITAA 1997 modifies the usual amendment period to allow an amendment to be lodged within four years of the time the foreign income tax is paid. The amendment to claim the offset is made to the assessment for the income year in which the double-taxed amount was included in assessable income.

Foreign tax credit rules (pre 1 July 2008)

The FTC rules were replaced by the foreign income tax offset rules from 1 July 2008, subject to the transitional provisions.

Under the single entity rule, the head company of a consolidated group is assessed on the foreign income of all members of the group. Previously, the head company could claim an FTC against Australian tax payable on this income – using its own FTCs, FTCs of subsidiary members and excess FTCs transferred into the group from joining entities.

On consolidation, the excess FTCs of entities joining or forming a consolidated group were transferred to the head company. The excess FTCs were then pooled by the head company according to class of income and the income year in which they arose.

The head company generally could not use the excess FTCs of a subsidiary member until the end of the head company's income year following the one in which the member joined the group, unless the joining time was at the start of the head company's income year.

There were special rules for the transfer of excess FTCs where the income year of the joining entity ended before that of the head company – that is, where the joining entity was an early balancer relative to the head company.

The worked example 'Pooling of excess foreign tax credits' (→ C6-2-110) shows how the excess FTCs of a joining entity were transferred to and used by the head company.

Claiming FTCs

Section 160AF of the ITAA 1936 allowed an FTC to be claimed only by the entity that paid and was personally liable for the foreign tax. To ensure a head company could claim an FTC against Australian tax payable on a consolidated group's foreign income, the head company was deemed to have paid and been personally liable for the foreign tax on that foreign income rather than the subsidiary member. This also applied to foreign tax on certain overseas film income under Part III, Division 18A of the ITAA 1936 and certain shipping income under Division 18B.

Where the head company was assessed on foreign income, it could use its own FTCs, FTCs of subsidiary members and excess FTCs transferred into the group from joining entities. This applied even if the entity that paid the foreign tax was no longer a member of the group or if the foreign tax was paid by an entity after it left the group. However, if an entity was assessed on foreign income before joining the group but paid the foreign tax afterwards, the entity was still entitled to the FTC to offset the Australian tax payable by it on the foreign income.

Once transferred, FTCs were effectively pooled according to class of income and the year in which the credits arose. Any excess FTCs held by or arising for the head company (through subsidiary members in the consolidated group) remained with the head company when entities left the group. This was because the head company is the only entity recognised as having paid and been personally liable for the foreign tax that gives rise to the FTCs.

Transfer and carry-forward of FTCs

The rules for the carry-forward of excess FTCs were contained in section 160AFE of the ITAA 1936. Before its amendment[1] this section (the old section 160AFE) allowed:

- the carry-forward of excess foreign tax paid over the Australian tax payable on foreign income for up to five years (excess FTCs from the earliest year must be used first), and
- the transfer of excess FTCs between companies that have been members of the same wholly-owned group for the whole of an income year, subject to certain conditions.

The amended section 160AFE (the new section 160AFE) continued to allow all taxpayers to carry-forward excess FTCs for five years, but removed the provisions allowing transfer of excess FTCs between companies in a wholly-owned group.

Subject to certain variations and exceptions to its application in the transitional period, the new section 160AFE applied to any income years and any non-membership periods starting after 30 June 2003. This basic rule applied to an entity whether or not it was a member of a consolidated or MEC group, either as a head company or as a subsidiary member, and irrespective of whether the entity had a substituted accounting period (SAP). The old section 160AFE

[1] Section 160AFE was amended by Schedule 10 of the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002).

continued to operate until 30 June 2003 or until the time the new section 160AFE applied.

Where an entity with excess FTCs became a subsidiary member of a consolidated group, the excess FTCs were effectively transferred to the head company of that group. This was done by deeming the head company to have held the excess FTCs (referred to as transfer credits) rather than the subsidiary member. Once transferred, the excess FTCs remained with the head company.

The head company could not use the excess FTCs of a subsidiary entity until the end of the head company's income year following the one in which the entity joined the group, unless the transitional rule applied. This was the case whether or not the entity was still a member of the group at that time.

Where an entity was not currently a member of a consolidated group, it was entitled to any excess FTCs that arose under section 160AFE during that time. However, where the excess FTCs had been transferred to the head company of a consolidated group because the entity had joined the group, the entity relinquished any future entitlement to those excess FTCs in later non-membership periods or when it joined another group.

Joining part-way through an income year

If an entity is a subsidiary member of a consolidated group for part but not all of an income year, and there are one or more periods in that year where it is not a member of any consolidated group, each period is referred to as a non-membership period. This period is treated as if it were an income year.

→ former section 701-30, IT(TP)A 1997

Where a joining entity had a non-membership period and foreign income was included in its assessable income for that period, the entity could claim an FTC on any foreign tax it paid on that foreign income (even if it paid the tax after joining the group). The entity could also use any excess FTCs to which it was entitled (that is, FTCs that were not previously transferred to a head company), subject to the rules in section 160AFE. Any remaining excess FTCs were then transferred to the head company of the group it joined.

If an entity left a consolidated group part-way through an income year and foreign income was included in its assessable income, the leaving entity was entitled to claim an FTC only for the foreign tax paid on that foreign income. It could not claim a credit for excess FTCs of earlier income years or non-membership periods because those FTCs remained with the head company of the group the entity was leaving. → section 717-30, ITAA 1997

Attribution surpluses

Changes to attributed tax accounts

As part of the changes made under the foreign income tax offset rules, attribution tax accounts are no longer required to track underlying foreign tax paid. Under the foreign income tax offset rules, a resident taxpayer that receives non-assessable non-exempt income, under either section 23AI or 23AK of the ITAA 1936, may be entitled to a foreign income tax offset for the foreign income tax paid on the distribution. A taxpayer with previously attributed income will no longer be entitled to claim a credit for underlying foreign taxes paid on a distribution, and therefore attributed tax accounts are no longer necessary.

The legislative provisions dealing with the attributed tax accounts were repealed on 24 September 2007.

Attribution accounts

The foreign investment fund (FIF) rules were repealed with effect from the 2010-11 income year. Companies with interests in a FIF or foreign life policy (FLP) are no longer subject to the requirements of the attribution rules. Consequently, insofar as this section refers to FIFs and FLPs, it only applies in relation to income years before 2010-11. For the treatment of FIFs and FLPs in later years, see → 'FIF income (2010-11 onwards)', p. 12.

In keeping with the single entity principle, in a consolidated group only the head company is able to operate attribution accounts for the purposes of the controlled foreign company (CFC) and FIF provisions. The pre-consolidation surpluses of such accounts are transferred to the head company.

This section explains the rules for:

- dealing with attribution accounts at entry and exit, and
- calculating the appropriate amount of FIF income that should be assessed to an entity that joins or leaves a consolidated group with an interest in a FIF in order to determine the surplus to be transferred.

The worked example 'Transfer of attribution surpluses' (→ C6-2-210) shows how attribution account surpluses relating to interests in CFCs, FIFs and FLPs are transferred from a joining company to a head company at the joining time and from a head company to a leaving company at the leaving time.

Transfer of surpluses

These rules apply to surpluses in attribution accounts, attributed tax accounts, FIF attribution accounts and FIF attributed tax accounts – collectively referred to here as 'attribution accounts'.

At entry

A company that becomes a subsidiary member of a consolidated group may hold interests in a CFC, FIF or FLP. If the balance of any relevant attribution account kept by that company is in surplus immediately before the joining time, the surplus is transferred to the head company of that group.

This ensures that distributions from CFCs, FIFs and FLPs are not taxed to the head company where the joining company has already been taxed on the attributed income.

A surplus is transferred from the joining company to the head company in the following way:

1. The balance of the joining company's attribution account is calculated immediately before the joining time to determine the amount of the surplus to be transferred (if any).
2. At the joining time an attribution account credit equal to the amount of that surplus arises in the attribution account of the head company.
3. At the same time, a corresponding and equal attribution account debit arises in the attribution account of the joining company.

After the transfer of surpluses, the attribution accounts of the joining company become inoperative. Any attribution account debits or credits that would have arisen in the attribution accounts kept by the joining company during the time it is a member of the consolidated group will now arise in the attribution accounts kept by the head company.

At exit

When a company leaves a consolidated group it may take with it interests in a CFC, FIF or FLP. Where this happens, the head company transfers to the leaving company a proportion of the attribution account surplus that the head company has in relation to these interests.

The underlying rationale for transferring the surplus on exit is the same as that for transferring attribution account surpluses on entry, and the procedure is effectively a reversal of steps 1 to 3 above. The principal difference, however, is in the amount transferred.

Only a proportion of the head company's attribution account surplus, as it relates to the relevant CFC, FIF or FLP interests, is transferred. The proportion is calculated at the leaving time using the following formula:

$$\frac{\text{Leaving company's attribution account percentage}^{1}\text{ in relation to the attribution account entity}^{2}\text{ at the leaving time}}{\text{Head company's attribution account percentage in relation to the attribution account entity just before the leaving time}} \times \text{Attribution surplus for the attribution account entity in relation to the head company just before leaving time}$$

Notes:

[1] The term 'attribution account percentage' is defined in the ITAA 1936 – section 364 for CFCs and section 602 for FIFs.

[2] An 'attribution account entity' is defined in the ITAA 1936 – section 363 for CFCs and section 601 for FIFs.

Calculation of FIF income before the joining or leaving time

Special rules are required to ensure that the correct amount of FIF income is assessed to the correct taxpayer where a company joins or leaves a consolidated group during the notional accounting period of a FIF. To achieve this, where the FIF's notional accounting period does not actually end at the joining time or leaving time, it is taken to end immediately before the joining or leaving time. These rules are not required for interests held in CFCs (see note).

Note

Calculation of CFC income

Under the CFC rules, an attributable taxpayer includes its share of the CFC income for the whole statutory accounting period of the CFC when the statutory accounting period ends in the income year of the taxpayer. If the CFC's statutory accounting period ends in a non-membership period of a company that joins or leaves a group, that company is assessed on its attribution percentage of the whole of the CFC's attributable income for the CFC's statutory accounting period that ended in the company's income year. If the CFC's statutory accounting period ends while the company is a member of a group, the head company is assessed instead on the attributable income for the whole statutory accounting period.

At entry

If a joining company holds an interest in a FIF at a time immediately before the joining time and the notional accounting period of the FIF actually ends at the joining time, the joining company will calculate the FIF income according to the rules in Part XI of the ITAA 1936. If this is not the case, the notional accounting period of the FIF is taken to end immediately before the joining time and the joining company will need to calculate the FIF income relating to the shortened notional accounting period that ended at that time.

If the FIF income calculation results in an amount being assessable, a credit arises in the joining company's FIF attribution account. If the calculation results in a FIF loss and the FIF attribution account is in surplus, so much of the FIF loss as does not exceed that surplus is allowable as a deduction against the joining company's assessable income for that period. A debit will arise in the joining company's FIF attribution account to the extent of the allowable deduction. Any remaining FIF loss will be inherited by the head company under the entry history rule.

Thus, all possible credits and debits to the FIF attribution account and FIF attributed tax account are made before the surplus (calculated immediately before the joining time) is transferred to the head company.

The head company will have FIF income included in its assessable income from the joining time onwards in accordance with the FIF provisions. This is achieved by the head company being deemed to have acquired the FIF interests at the joining time. The deemed acquisition at the joining time means that the head company will only include in its assessable income an amount of FIF income relating to the period from the joining time until the end of the notional accounting period of the FIF.

At exit

When a company leaves a consolidated group taking FIF interests with it, the principles for calculating FIF income are effectively the same as those outlined above but in reverse.

Where the notional accounting period of the FIF is taken to end at the leaving time, the head company determines the FIF income and the FIF attribution and attributed tax account surpluses immediately before the leaving time as though the FIF interest held by the leaving company was held by the head company at the end of its income year. As in the entry case, this calculation is made to determine the FIF income where the notional accounting period of the FIF does not ordinarily end at the leaving time.

The head company will continue to determine the FIF income in relation to the interests in the FIF remaining in the group, from the leaving time until the actual end of that FIF's notional accounting period.

The leaving company will have FIF income included in its assessable income from the leaving time onwards in accordance with the FIF provisions. This is achieved by the leaving company being deemed to have acquired the FIF interests at the leaving time. The deemed acquisition at the leaving time means that the leaving company will only include in its assessable income an amount of FIF income relating to the period from the leaving time until the end of the notional accounting period of the FIF.

Deferred attribution credits

An attributable taxpayer joining a consolidated group may have elected to defer the timing of an attribution credit that relates to the attribution of an unrealised gain on assets (a notional gain) where a CFC changes residence from an unlisted country to a listed country. At the joining time, the joining company's deferred attribution credit is made available for the head company to use when the CFC pays a dividend from a gain derived from the actual disposal of an asset. → section 717-227 Schedule 8, *New Business Tax System (Consolidation and Other Measures) Act 2003*

A company that leaves a consolidated group with an interest in a CFC is able to take a proportion of the deferred attribution credit that relates to the attribution account percentage of the attribution account entity. The amount of the deferred attribution credit – referred to as the 'original credit' – is worked out using the following formula:

$$\frac{\text{Leaving company's attribution account percentage in relation to the attribution account entity at the leaving time}}{\text{Head company's attribution account percentage in relation to the attribution account entity just before the leaving time}} \times \text{Original credit}$$

The proportion taken by the leaving company reduces the amount of the attribution credit available for the head company to use when the CFC pays a dividend from gains derived from the actual disposal of an asset.

→ section 717-262 Schedule 8, *New Business Tax System (Consolidation and Other Measures) Act 2003*

Elections relating to CFCs, FIFs and FLPs

An entity can make irrevocable elections in relation to calculating the attributable income of CFCs, or FIF income in relation to FIFs or FLPs. If a subsidiary member makes irrevocable elections prior to the joining time, those elections are not taken to have been made by the head company for the head company core purposes. The head company is also not prevented from applying the calculation method to determine FIF income if an entity that became a subsidiary member would have been prevented from using the calculation method had it not joined the consolidated group.

However, any irrevocable elections made by a head company prior to consolidation continue to apply to interests in CFCs, FIFs and FLPs that the head company holds under the single entity principle. Also, if a head company is prevented from using the calculation method to determine FIF income, it continues to be bound by that restriction. → Subdivision 717-F Schedule 8, *New Business Tax System (Consolidation and Other Measures) Act 2003*

An entity that leaves a consolidated group is not bound by any elections made by the head company prior to the leaving time. After the leaving time, the leaving entity can make its own elections under Parts X and XI in calculating attributable income or FIF income. → Subdivision 717-G Schedule 8, *New Business Tax System (Consolidation and Other Measures) Act 2003*

A special rule ensures the entry history rule does not affect the time limit in which the head company can elect to value at market value FIF interests brought to the group by a joining entity that are treated as trading stock. → section 717-292

Example: election for FIF interests that are trading stock

In July 2001, Company A holds an interest in a FIF that is trading stock. It does not make an election under section 70-70 to value its FIF interest at market value.

Company A becomes a subsidiary member of a consolidated group on 1 July 2003. Prior to the joining time, the head company had not held any interests in FIFs that were trading stock.

If the entry history rule were to apply, the head company would not be able to satisfy the time limits imposed by subsection 70-70(3) and therefore would not be able to elect to value the FIF interests brought to the group by Company A at market value.

Section 717-292 overrides the application of the entry history rule for the purposes of satisfying the time limit requirement in subsection 70-70(3) for the head company. The head company can therefore elect to value the FIF interest at market value.

If Company A left the group with FIF interests as trading stock, Company A would not inherit the election made by the head company under subsection 70-70(2) by virtue of section 717-310. Further, Company A would not be able to

make the election after it left the group because it would still fail to satisfy the time limits required by subsection 70-70(3).

Had Company A made the election to value its FIF interests that were trading stock at market value before the joining time, it would be required to continue to value its FIF interests at market value after it left the group.

FIF income (2010-11 onwards)

From the 2010-11 income year onwards, any FIF attribution surpluses that previously arose for the head company of a consolidated group, including those transferred to it and those of its own, will become part of its post-FIF abolition surplus.

When a company becomes a subsidiary member of a consolidated group and it has a post-FIF abolition surplus, the surplus is transferred to the head company of that group. → section 717-220, ITAA 1997

When a company leaves a consolidated group and takes with it interests in a FIF or FLP, the head company transfers to the leaving company a proportion of the post-FIF abolition surplus that it has in relation to those interests. The proportion is based on the percentage of the group's interest in the FIF or FLP held by the leaving company. → section 717-255, ITAA 1997

Under section 23AK of the ITAA 1936, when the head company or the leaving company receives a distribution paid out of previously attributed FIF income, it will continue to be exempt from tax.

Under section 23B of the ITAA 1936 (which was introduced to preserve the effect of former section 613 of the ITAA 1936), when the head company or the leaving company disposes of an interest in a FIF or FLP where the FIF income has been attributed but not distributed before disposal, the head company or the leaving company may reduce its capital proceeds. The capital proceeds may be reduced by so much of the post-FIF abolition surplus that it has in relation to those interests, not exceeding the capital proceeds.

Therefore, on disposal of an interest in a FIF or FLP, the head company or the leaving company can continue to take advantage of the section 23AK exemption or the former section 613 reduction of capital proceeds.

From the 2010-11 income year onwards, taxpayers with interests in FIFs or FLPs are no longer subject to the attribution rules and are not required to make any elections in relation to calculating FIF income. Consequently, section 715-660 of the ITAA 1997 (about certain resettable elections) was amended to remove these elections from the list of elections that a head company can reset.

Conduit foreign income

The conduit foreign income rules replace the foreign dividend account rules with effect from an entity's first income year commencing on or after 1 July 2005. The specific application of the conduit foreign income rules to consolidated groups is contained in Subdivision 715-U. These rules have the same effect in relation to MEC groups.

Under the conduit foreign income rules, Australian corporate tax entities calculate their conduit foreign income at a particular time (the 'relevant time'),

usually before the time such entities declare a dividend or make a distribution, rather than keeping a rolling balance of conduit foreign income → section 802-25, ITAA 1997. Amounts that are included or excluded from the calculation of conduit foreign income at this relevant time are set out in sections 802-30 to 802-55 of the ITAA 1997.

For consolidated and MEC groups, the single entity rule means that conduit foreign income derived by subsidiary members of the consolidated or MEC group is taken to be derived by the head company or provisional head company respectively. → section 715-875, ITAA 1997

The head company of a consolidated group and the provisional head company of a MEC group are Australian corporate tax entities that, at the relevant time, calculate the conduit foreign income of the group. Subsidiary members of a consolidated or MEC group do not calculate their own amounts of conduit foreign income while they are members of the group.

To determine the basic conduit foreign income amount, it is the head company or provisional head company that is treated as a foreign resident when working out if an amount is included in the first step of the conduit foreign income calculation. However, the requirement that this amount is or will be included in an income statement does not mean the amount must be included in an income statement of the head company or provisional head company. The amount may be included in the income statement of the subsidiary member that received the amount. An income statement is broadly a statement prepared in accordance with Australian Accounting Standards.

→ subsection 802-30(1), ITAA 1997

Distributions between Australian corporate tax entities

The conduit foreign income rules allow conduit foreign income to be distributed through another Australian corporate tax entity under certain conditions. The provisions that deal with distributions between Australian corporate tax entities have no application where the distributions in question are made between members of the same consolidated or MEC group.

→ Explanatory Memorandum to Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005, paragraph 5.104

If declared conduit foreign income is distributed to a member of a consolidated or MEC group from an Australian corporate tax entity or entities outside the group, the receiving entity for the purposes of subsection 802-20(1) of the ITAA 1997 is the head company or provisional head company respectively. The declared conduit foreign income amount will be non-assessable, non-exempt income of the head company of the consolidated or MEC group provided the conduit foreign income is on-paid within the period commencing at the start of the income year and ending before the due date for lodging the head company's income tax return for that income year.

→ subsection 802-20(1), ITAA 1997

Joining a consolidated group part way through an income year

The entry history rule applies to treat any amounts of conduit foreign income received by an entity before it joins a consolidated or MEC group as amounts the head company can treat as conduit foreign income. → subsection 715-875(1), ITAA 1997

Leaving a consolidated group

If an entity leaves a consolidated or MEC group it cannot take an amount of conduit foreign income with it → section 715-880, ITAA 1997. Amounts of conduit foreign income received by the entity either before it joined the group or while it was a member of the group will remain with the head company.

→ 'Treatment of conduit foreign income', C6-2-410

Foreign dividend accounts

Repeal of foreign dividend account provisions

The provisions dealing with the foreign dividend account regime were repealed on 14 December 2005, subject to the transitional rules. Specifically, in relation to consolidated groups and MEC groups, Subdivisions 717-J and 719-X of the ITAA 1997 have no application after that date.

Previous foreign dividend accounts

Under the foreign dividend account measure which operated before the introduction of the conduit foreign income rules, a head company of a consolidated group operated a single foreign dividend account (FDA) by pooling any FDA surpluses or deficits transferred to it at the joining time. The head company was also able to aggregate the foreign investments of all its subsidiary members. The aggregation of the foreign investments held by the members enabled the head company to, for instance, credit the FDA for the total non-portfolio dividends received and debit the account for the FDA declaration amounts that relate to all dividends paid on a particular day.

The worked example 'Transfer of foreign dividend account balance' (→ C6-2-310) shows the transfer of a joining company's FDA balance to the head company of a consolidated group. It also shows how the head company uses the FDA surplus to pay non-resident shareholders unfranked dividends exempt from dividend withholding tax.

FDA surplus

An FDA surplus is an excess of FDA credits over FDA debits.

If a subsidiary member had an FDA surplus at the balance time (that is, a time just before the joining time), the FDA surplus was transferred to the head company by:

- entering an FDA debit in the subsidiary member's account equal to the FDA surplus at the balance time, and
- entering an FDA credit in the head company's account equal to the FDA surplus at the joining time.

FDA deficit

An FDA deficit is an excess of FDA debits over FDA credits.

If a subsidiary member had an FDA deficit at the balance time, the FDA deficit was transferred to the head company by:

- entering an FDA credit in the subsidiary member's account equal to the FDA deficit at the balance time, and
- entering an FDA debit in the head company's account equal to the FDA deficit at the joining time.

→ Section 717-510, ITAA 1997 (repealed)

The FDA of a subsidiary member was inoperative following the transfer of its FDA balances – no credit or debit entries were made to the subsidiary member's FDA while it was a member of a consolidated group.

Joining part-way through an income year

If a company joined a consolidated group part-way through its income year, and an FDA debit for an Australian taxable dividend amount would have arisen for that company had it not joined the consolidated group, an FDA debit was made to the account immediately before the balance time. The FDA debit amount for the Australian taxable dividend amount was calculated according to the formula in subsection 128TB(2) of the ITAA 1936 (repealed).

Leaving a consolidated group

When a company ceased to be a subsidiary member of a group it could not take an FDA balance with it on exit.

FDA declarations

During consolidation, the head company could utilise a pooled FDA surplus to pay non-resident shareholders unfranked dividends, free from dividend withholding tax. The head company was taken to make the FDA declarations for dividends paid to its shareholders and to the shareholders of its subsidiary members. If the head company made more than one FDA declaration on a particular day, the sum of the FDA declaration amounts must not have exceeded the FDA surplus at the beginning of the day.

If the total of the FDA declaration amounts exceeded the FDA surplus, the FDA declaration percentages specified by the head company were proportionally reduced so that the FDA declaration amounts did not exceed the FDA surplus available to the head company. The proportional reduction of the FDA declaration percentages, which in turn reduced the FDA declaration amounts, did not affect the dividend amount paid to non-resident shareholders. → sections 717-520 and 717-525, ITAA 1997 (repealed)

Repeal of the FDA grouping provision

The FDA grouping provision, which allowed resident companies of a wholly-owned group to transfer a proportion of the FDA surplus with the payment of unfranked dividends, generally ceased to apply from 1 July 2003.

MEC groups

The FDA rules that applied for a consolidated group also applied to MEC groups. In a MEC group, the provisional head company operated the FDA and made FDA declarations for dividends paid to its shareholders and shareholders of its subsidiary members.

The provisional head company was also taken to have paid foreign tax where that tax is actually paid by a subsidiary member of the group. This deemed payment of foreign tax enabled the provisional head company to claim an FDA credit under paragraph 128TA(1)(b) of the ITAA 1936.

Where a provisional head company is replaced by a new provisional head company, the FDA balance was transferred from the old provisional head company to the new one. → section 719-905, ITAA 1997 (repealed)

Where the provisional head company was paid a dividend at a particular time, and that entity was not the head company of the group for the income year, section 128TB of the ITAA 1936 operated in relation to the Australian-taxable dividend amount as if the dividend had been paid to the head company.

Offshore banking units

If a member of a consolidated group is a gazetted offshore banking unit (OBU), the consolidation rules deem the head company of the consolidated group to be an OBU for the period in which the subsidiary member has this status.

The OBU provisions in Division 9A of Part III of the ITAA 1936 will apply to the head company to ensure that the income arising from offshore banking activities of members of the group are effectively taxed at 10%. Division 9A will also apply in this way where the head company itself is an OBU. → Section 717-710 Schedule 10, *New Business Tax System (Consolidation and Other Measures) Act 2003*

However, the head company will not be taken to be an OBU for the purposes of determining whether a non-resident lender to the group is entitled to withholding tax exemptions under Division 11A of Part III of the ITAA 1936. This is because the withholding tax regime is not covered by the core purposes and therefore not subject to the single entity rule. In other words, for the exemptions under Division 11A to apply to an interest payment to a non-resident, the member of the group paying the interest must in itself be a gazetted OBU.

References

Income Tax Assessment Act 1936, sections 128TB, 128TC; Division 9A of Part III, Division 11A of Part III

Income Tax Assessment Act 1936, sections 160AF and 160AFE, Part III, Divisions 18A and 18B; as amended by:

- *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 10
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 15

Income Tax Assessment Act 1997, section 701-5

Income Tax Assessment Act 1997, Division 717, Subdivision 717-A; as amended by:

- *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 6
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 7
- *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedules 8, 9 and 10

Income Tax (Transitional Provisions) Act 1997, former section 701-30; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 7

Income Tax (Transitional Provisions) Act 1997, Division 717; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 9

Income Tax Assessment Act 1997, Division 717; as amended by *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (No. 83 of 2004), Schedule 2

Explanatory Memorandum to New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, Chapter 3

Explanatory Memorandum to New Business Tax System (Consolidation and Other Measures) Bill 2002, Chapter 9

Explanatory Memorandum to New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 7

Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006 (No. 101 of 2006), which repealed section 701-30 of the *Income Tax (Transitional Provisions) Act 1997*

Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005, which repealed Subdivisions 717-J and 719-X and inserted Subdivisions 715-U and 802-A in the *Income Tax Assessment Act 1997*

Explanatory Memorandum to Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005, Chapter 5

Tax Laws Amendment (2007 Measures No. 4) Act 2007 which repealed Divisions 18, 18A and 19 and sections 79D, 79DA, 424 and 430 of the *Income Tax Assessment Act 1936*

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

Revision history

Section C6-1 first published (excluding drafts) 2 December 2002 and updated 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
14.7.04	Note on recent changes to consolidation rules.	Legislative amendments.
3.11.04	Clarify timing of use of transferred FTCs. Example on election for FIF interests that are trading stock – an irrevocable election. Explain effects of repeal of FDA grouping provision in relation to FDA surplus. Clarify effects of FDA rules for MEC groups.	Reflect changes in *Taxation Laws Amendment (2004 Measures No. 2) Act 2004* (83 of 2004).
	Remove 14.7.04 note on recent changes to consolidation rules.	Text amended to reflect the changed rules.
15.11.06	Updated references to inoperative provisions.	Legislative amendment.
30.6.09	Extensively revised to take account of new rules for foreign income tax offsets, conduit foreign income and attributed tax accounts.	Amendments in *Tax Laws Amendment (2007 Measures No. 4) Act 2007* and *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005.*
6.5.11	Revised to take into account the repeal of Part XI of the ITAA 1936 in relation to the FIF and FLP rules.	Legislative amendments.