



Draft Taxation Ruling

Income tax: entitlement to foreign income tax offsets under section 770-10 of the *Income Tax Assessment Act 1997* where income is derived from investing in fiscally transparent foreign entities

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What this Ruling is about

1. This draft Ruling is concerned with the application of Division 770 of the *Income Tax Assessment Act 1997* (ITAA 1997)¹ (foreign income tax offsets) in circumstances where an Australian resident taxpayer invests in a fiscally transparent foreign entity. In particular, this draft Ruling deals with:

- the entitlement of a resident taxpayer to claim a foreign income tax offset under section 770-10 for foreign income tax imposed on the income of a fiscally transparent foreign entity in which the taxpayer holds an interest, depending on whether Division 830 applies to the foreign entity;
- the entitlement of a resident taxpayer to claim a foreign income tax offset for foreign income tax imposed on the notional income of a foreign investment fund (FIF) or the notional assessable income of a controlled foreign company (CFC) where the resident taxpayer invests indirectly in the FIF or CFC through a foreign hybrid which is treated as an interest in a partnership pursuant to Division 830; and

¹ All legislative references are to the ITAA 1997 unless otherwise indicated.

- whether the entitlement to claim a foreign income tax offset under section 770-10 in the circumstances outlined above will be affected by the operation of Australia's tax treaties.
2. This draft Ruling applies to taxpayers who have an interest in a fiscally transparent foreign entity as defined at paragraphs 5 to 6 of this draft Ruling.
3. The draft Ruling does not deal with taxpayers in relation to their:
- income which is non-assessable non-exempt income pursuant to section 23AH of the *Income Tax Assessment Act 1936* (ITAA 1936); or
 - income which is non-assessable non-exempt income pursuant to section 23AJ of the ITAA 1936.

Definitions

Australian income tax law

4. Australian income tax law means the ITAA 1936, the ITAA 1997, Schedule 1 to the *Taxation Administration Act 1953* (TAA) and Part IVC of the TAA to the extent that it relates to the aforementioned Acts.

Fiscally transparent foreign entity

5. A foreign entity is fiscally transparent if no foreign income tax is imposed on its income, either by effect of application of the laws of a foreign country or because of an election, but rather tax is imposed on such income at the level of the partner or member.

6. For the purposes of this draft Ruling an interest in a fiscally transparent foreign entity means:

- an interest in a foreign hybrid; or
- an interest in an entity which would be treated as a foreign hybrid but for the fact that it does not satisfy paragraph 830-10(1)(e) of the ITAA 1997 (if the entity is a limited partnership) or paragraph 830-15(1)(d) of the ITAA 1997 (if the entity is a company) and no election has been made to treat the interest as an interest in a foreign hybrid under section 485AA of the ITAA 1936.

Foreign hybrid

7. A foreign hybrid is an entity that is either a foreign hybrid limited partnership or a foreign hybrid company for the purposes of Division 830.

Foreign hybrid company

8. A foreign hybrid company means a company formed in a foreign country that satisfies the requirements in subsection 830-15(1) of the ITAA 1997. An interest in a foreign hybrid company also includes an interest in a FIF held by a taxpayer who makes an election under section 485AA of the ITAA 1936.

Foreign hybrid limited partnership

9. A foreign hybrid limited partnership means a limited partnership formed in a foreign country that satisfies the requirements in subsection 830-10(1) of the ITAA 1997. An interest in a foreign hybrid limited partnership also includes an interest in a FIF held by a taxpayer who makes an election under section 485AA of the ITAA 1936.

Foreign income tax

10. Foreign income tax means taxes imposed under a foreign law in accordance with section 770-15.

Ruling

Foreign income tax imposed on taxpayer's share of income of a foreign hybrid*The resident taxpayer pays the foreign income tax – offset allowed*

11. A resident taxpayer whose assessable income includes, under section 92 of the ITAA 1936, a share of the net income of a foreign hybrid is entitled to a foreign income tax offset under subsection 770-10(1) of the ITAA 1997 for foreign income tax the taxpayer paid under the law of a foreign country in respect of that income.

The foreign hybrid, or some other entity, pays the foreign income tax – offset allowed

12. If, rather than the resident taxpayer, the foreign hybrid or some other entity pays foreign income tax in respect of that income (being income included under section 92 of the ITAA 1936) under the law of a foreign country, the resident taxpayer is treated (under section 770-130 of the ITAA 1997) as if it had paid the foreign income tax for Australian income tax law purposes. Accordingly, the resident taxpayer is entitled to a foreign income tax offset under subsection 770-10(1) of the ITAA 1997 for that foreign income tax paid. (See explanation at paragraphs 72 to 73 of this draft Ruling.)

Foreign income tax imposed on taxpayer's share of income of a fiscally transparent foreign entity that is not a foreign hybrid

Foreign income tax paid on dividends and distributions from the foreign entity – offset allowed

13. A resident taxpayer that has an interest in a fiscally transparent foreign entity that is not a foreign hybrid is entitled to a foreign income tax offset under subsection 770-10(1) of the ITAA 1997 for foreign income tax imposed on a dividend or distribution from the foreign entity. This entitlement is only to the extent that the foreign income tax is paid in respect of so much of that dividend or distribution as is either:

- included in the taxpayer's assessable income; or
- non-assessable non-exempt income of the taxpayer under section 23AK of the ITAA 1936.

(See explanation at paragraphs 77 to 83 of this draft Ruling.)

Attributable FIF income from the foreign entity – no offset allowed

14. A resident taxpayer that, because it has an interest in an entity of that kind, includes an amount in its assessable income under section 529 of the ITAA 1936 is not entitled to a foreign income tax offset in respect of that amount. (See explanation at paragraphs 84 to 90 of this draft Ruling.)

Foreign income tax imposed on amounts included in the notional income of a CFC or a FIF in which a foreign hybrid has an interest

CFCs and FIF companies – no offset allowed

15. A resident taxpayer may have an interest in a foreign hybrid that, in turn, has an interest in a CFC or a foreign company FIF. In these cases, the resident taxpayer is not entitled to a foreign income tax offset for foreign income tax paid by the CFC or FIF in respect of amounts included in the CFC's notional assessable income or the FIF's notional income.

16. This is because, under Division 830, a foreign hybrid is not a company for Australian tax purposes. Only an attributable taxpayer that is a company can satisfy paragraph 770-135(2)(a). Therefore, the resident taxpayer cannot be treated as having paid the foreign income tax. (See explanation at paragraphs 91 to 99 of this draft Ruling.)

FIF trusts – offset allowed because hybrid is taken to have paid the foreign income tax

17. A resident taxpayer may have an interest in a foreign hybrid that, in turn, holds an interest in a foreign trust FIF. In this case, by contrast, the foreign hybrid is taken to have paid any foreign income tax paid by the foreign trust FIF in respect of an amount included in the FIF's notional income. This is because paragraph 770-135(2)(b) allows the section to apply to any entity with an interest in a foreign trust FIF.

18. Therefore if all the additional conditions in section 770-135 are met, the resident taxpayer is, in turn, entitled to a foreign income tax offset under subsection 770-10(1). This is because the taxpayer is taken under section 770-130 to have paid the foreign income tax that the hybrid is taken to have paid under section 770-135.

19. The offset is allowed to the extent that the foreign income tax is paid in respect of the taxpayer's share, under section 92 of the ITAA 1936, of so much of the foreign hybrid's net income as represents FIF income attributed to the foreign hybrid under section 529 of the ITAA 1936. (See explanation at paragraphs 100 to 106 of this draft Ruling.)

CFCs and FIFs – distributions to a foreign hybrid

20. The following paragraph applies to a resident taxpayer that has an interest in a foreign hybrid that, in turn, has an interest in a CFC or a FIF.

21. If foreign income tax is imposed on distributions the CFC or FIF makes to the foreign hybrid, then the resident taxpayer is entitled to a foreign income tax offset.

22. The offset is allowed to the extent that the foreign income tax is paid in respect of the taxpayer's share of so much of the foreign hybrid's net income as represents the distribution, where the taxpayer's share is either assessable income or non-assessable non-exempt income under section 23AI or 23AK of the ITAA 1936. (See explanation at paragraphs 107 to 115 of this draft Ruling.)

The impact of Australia's tax treaties on the availability of foreign income tax offsets

23. This section of the ruling applies in the case of countries with which Australia has a tax treaty.

24. A difference in treatment of income as between the State of source and Australia may arise because of differences between the countries' respective domestic tax laws. For example, the foreign entity may be treated as fiscally transparent under the law of the other State but as a company taxed in its own right under Australian tax law (that is, if it is not a foreign hybrid under Division 830).

25. In these cases, provided that the other State has taxed such income in accordance with the tax treaty, as interpreted and applied by it as the State of source, such tax is foreign income tax for the purposes of section 770-15. A foreign income tax offset may therefore be available under section 770-10.

26. However, if the foreign country imposes income tax in a manner other than in accordance with the tax treaty, relief under Australian income tax law from this category of double taxation (that is under Division 770) is only available to the extent consistent with the treaty. Accordingly, relief from this particular category of double taxation may only be obtained by seeking a refund of the foreign income tax from the foreign country. (See explanation at paragraphs 116 to 121 of this draft Ruling.)

Limit on the amount of the offset

27. If, in the above cases, a taxpayer is entitled to a foreign income tax offset, the amount of the foreign income tax offset is subject to the foreign income tax offset limit calculated in accordance with sections 770-75 and 770-80.

Examples

Example 1 – limited liability company a foreign hybrid

28. YZ LLC (YZ), a limited liability company formed in a foreign country that meets the requirements of subsection 830-15(1), derives \$100,000 income from real property investments during the 2008-09 income year and incurs expenses of \$20,000 in earning that income. A.B. See (AB), an Australian resident individual, is a shareholder in YZ with a membership interest of 50%.

29. Under the laws of YZ's country of residence, YZ is taxed as a partnership and is required to withhold tax of 30% from net real property income to which foreign resident shareholders are entitled, whether or not such income is distributed. YZ withholds and remits \$12,000 of foreign income tax in respect of AB's share of the net real property investment income.

30. Under Division 830, YZ is treated as a partnership for Australian income tax law purposes. Therefore, for the 2008-09 income year, AB is treated as a partner in YZ and his assessable income will include his share of the net income of YZ.

YZ LLC		A.B. See (2008-09 income year)	
Gross real property investment income	\$100,000		
Deductible expenses	\$20,000		
Net income (section 90 ITAA 1936)	\$80,000	50% share of net income (section 92 ITAA 1936)	\$40,000
AB See's share of net real property investment income	\$40,000		
Foreign income tax withheld at 30% (0.30 x \$40,000)	\$12,000	<i>Foreign income tax paid in respect of amount included in assessable income (section 770-10 ITAA 1997)</i>	\$12,000

31. AB is potentially subject to double taxation, as the amount in respect of which the foreign income tax has been paid is included in his assessable income. AB is taken to have paid that foreign income tax under section 770-130 and will be entitled to a foreign income tax offset for the 2008-09 income year for the \$12,000 foreign income tax withheld by YZ, subject to AB's foreign income tax offset limit calculated under section 770-75.

Example 2 – limited liability company not a foreign hybrid

32. The same facts apply as in example 1, except that AB's membership interest in YZ is 10% and the remaining 90% interests are held by unrelated foreign residents. YZ therefore does not meet the requirements of paragraph 830-10(1)(e) of the ITAA 1997. In addition AB has not elected to treat his interest in YZ as an interest in a foreign hybrid under section 485AA of the ITAA 1936.

33. YZ withholds and remits \$2,400 of foreign income tax in respect of AB's share of the net real property investment income (30% x (10% x \$80,000)).

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34. YZ is treated as a company for Australian income tax law purposes.² YZ does not pay any dividends to AB during the income year.

YZ LLC		A.B. See (2008-09 income year)	
Gross real property investment income	\$100,000		
Deductible expenses	\$20,000		
Net income	\$80,000	Amount included in assessable income (no distribution)	\$0
AB See's share of net real property investment income	\$8,000		
Foreign income tax withheld at 30% (0.30 x \$8,000)	\$2,400	<i>Foreign income tax paid in respect of amount included in assessable income (section 770-10 ITAA 1997)</i>	\$0

35. As YZ has not paid a dividend to AB in the 2008-09 income year, AB's assessable income for that year does not include an amount in respect of which foreign income tax has been paid. Therefore AB is not entitled to a foreign income tax offset during the 2008-09 income year.

Example 3 – distribution by limited liability company that is not a foreign hybrid

36. The facts are the same as in example 2. In the following year, that is the 2009-10 income year, YZ distributes AB's share of the net rental income to AB.

37. AB receives a dividend for the purposes of section 44 of the ITAA 1936. AB's assessable income for the 2009-10 income year therefore includes \$8,000 (the amount of the dividend grossed up to include the foreign income tax withheld).

YZ LLC		AB See (2009-10 income year)	
Net profits for distribution	\$80,000		
10% of net profits distributable to AB See	\$8,000	Amount included in assessable income (sections 44 ITAA 1936 and 6-10 ITAA 1997)	\$8,000
Less foreign income tax withheld at 30% in 2008-2009 income year	\$2,400		
Amount paid upon distribution	\$5,600	<i>Foreign income tax paid in respect of amount included in assessable income (section 770-10 ITAA 1997)</i>	\$2,400

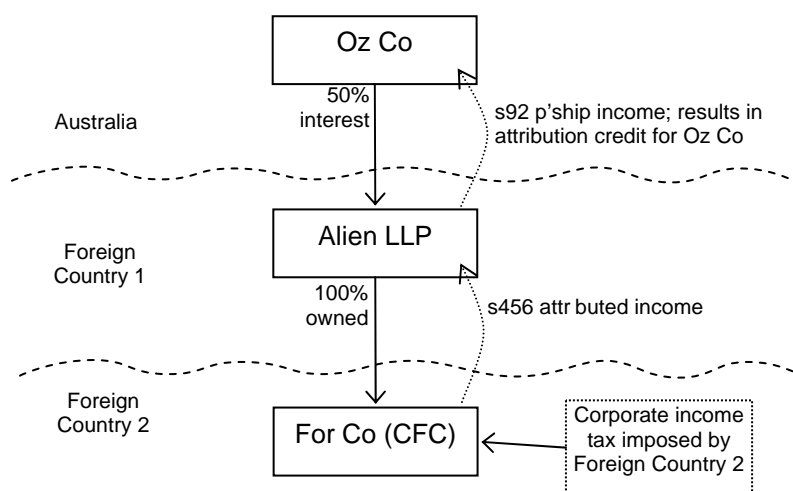
² For the purposes of example 2 and example 3, it is assumed that AB is exempt from taxation in respect any foreign investment fund income that may otherwise be taken to accrue from YZ.

38. The distribution was paid to AB during the 2009-10 income year out of income in respect of which YZ withheld foreign income tax during the 2008-09 income year. Therefore, the foreign income tax in the 2008-09 income year is taken to have been paid by AB in respect of the amount included in his assessable income in the 2009-10 income year. Accordingly, AB is entitled to claim a foreign income tax offset in that income year for the \$2,400 tax withheld by YZ, subject to AB's foreign income tax offset limit for that year calculated under section 770-75.

Example 4 – foreign hybrid invests in foreign company

39. Oz Co Pty Ltd, an Australian resident company, has a 50% interest in Alien LLP, a foreign hybrid limited partnership formed in Foreign Country 1. Alien in turn wholly owns For Co, a company that is resident in Foreign Country 2. For Co is a Controlled Foreign Company (CFC) for Australian tax purposes.

40. During the income year, For Co pays income tax under the laws of Foreign Country 2.

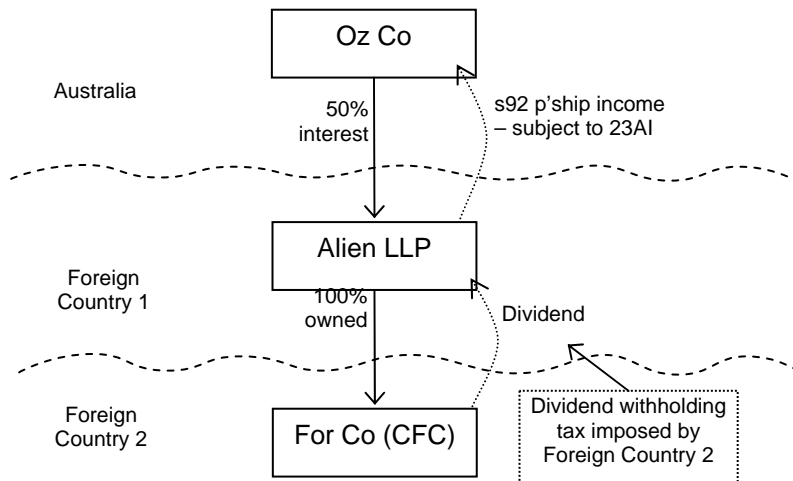


41. As Alien is treated as a partnership for Australian income tax law purposes, Oz Co's assessable income will include its share of the net income of Alien, calculated as if Alien was an Australian resident.

42. As For Co is a CFC and Alien is an attributable taxpayer by virtue of it being an Australian partnership for the purposes of Part X of the ITAA 1936, Alien's net partnership income includes attributed income under section 456 of the ITAA 1936. In calculating For Co's attributable income a notional allowable deduction is allowed for the foreign income tax paid. However, the foreign income tax paid by For Co does not count towards Oz Co's foreign income tax offset for the relevant income year, as Oz Co is not treated, pursuant to section 770-135 of the ITAA 1997, as having paid the foreign income tax for the purposes of section 770-10(1) of the ITAA 1997.

Example 5 – foreign hybrid receives dividend from foreign company

43. The facts are the same as in example 4, except that in the following income year For Co pays a dividend to Alien. Foreign Country 2 imposes withholding tax on the dividend.



44. As Alien is treated as a partnership for Australian income tax law purposes, Oz Co's assessable income would normally include its share of the net income of Alien, including the dividend payment from For Co. However, as a result of the earlier attribution of income from For Co to Alien (in Example 4) and the individual interest of Oz Co in the partnership net income of Alien, an attribution account credit exists for For Co in relation to Oz Co.

45. The share of the net income of Alien that would otherwise be included in Oz Co's assessable income will therefore be non-assessable non-exempt income pursuant to section 23AI of the ITAA 1936 to the extent of the attribution account debit. Although Oz Co did not directly pay the foreign income tax withheld from the dividend payment made from For Co to Alien, it is taken, by virtue of section 770-130 of the ITAA 1997, to have paid the relevant tax in respect of the non-assessable non-exempt income under section 23AI of the ITAA 1936. Oz Co will therefore be entitled to a foreign income tax offset pursuant to subsection 770-10(2) of the ITAA 1997 for the foreign income tax withheld from the dividend payment to the extent that the tax has been paid in respect of Oz Co's non-assessable non-exempt income.

Example 6 – Application of a tax treaty

46. Hank LP (Hank) is a limited partnership formed in the United States. Fozzie Pty Ltd is an Australian resident company with a membership interest in Hank of 10% (with the remaining 90% interests being held by unrelated foreign residents). Hank does not meet the requirements of paragraph 830-10(1)(e) of the ITAA 1997, and Fozzie has not made an election under section 485AA of the ITAA 1936 to treat its interest in Hank as an interest in a foreign hybrid.

47. During the 2008-09 income year, Hank derives \$1,000,000 of interest income.
48. Under United States income tax law, tax of 10% is withheld in respect of the interest income to which foreign resident partners are entitled.
49. During the same income year, Fozzie receives its 10% share of the distribution from Hank, which is \$100,000 less the \$10,000 tax withheld, that is \$90,000.
50. Hank is treated as a company for Australian income tax law purposes. Therefore, for the 2008-09 income year, pursuant to sections 94L and/or 94M of the ITAA 1936, the \$100,000 distribution to Fozzie will be treated as a dividend (grossed-up to include the tax withheld). Accordingly, Fozzie's assessable income will include the amount distributed or credited to him as a dividend.
51. As established in example 3 above, Fozzie will be entitled to a foreign income tax offset in the income year in which his assessable income includes the dividend deemed paid by Hank. However, the availability of a foreign income tax offset may also be subject to the USA Convention contained in Schedule 2 of the *International Tax Agreements Act 1953* (the Agreements Act).
52. Article 22(2) of the USA Convention provides a general principle that where US tax has been paid in respect of US source income under the law of the US and in accordance with the USA Convention, a credit against Australian tax payable on that income will be allowed subject to the provisions and limitations of the law of Australia in force at the relevant time.
53. As Hank is treated as fiscally transparent under US tax law, the treaty benefits are applied at the level of the partner and not the limited partnership by the US for the purposes of applying the USA Convention.
54. As the income that flows through Hank to Fozzie retains its character in the hands of Fozzie for the purposes of US tax law, the extent to which the US exercises its source country taxing right under the Convention will be determined in accordance with Article 11 of the Convention, which deals with interest income. This is the case notwithstanding Fozzie is taken to have received a dividend for the purposes of Australian income tax law.
55. As the US has taxed the income in accordance with the maximum rate allowable in respect of interest income under the Convention, Australia is obliged under the Convention to provide credit relief in respect of such tax, subject to the provisions and limitations of the law of Australia in force at the relevant time. This relief is provided in accordance with the provisions for the granting of a foreign income tax offset under section 770-10.

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Date of effect

56. It is proposed that when the final Ruling is issued, it will apply to years of income commencing on or after 1 July 2008. However, the final Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the final Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

25 March 2009

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Introduction

57. Division 830 was introduced to enable certain entities formed outside Australia (called foreign hybrids) that are treated as fiscally transparent for the purposes of foreign income tax, but as companies for Australian income tax law purposes, to be treated as partnerships under the Australian income tax law.³

58. Division 830 of the ITAA 1997 can apply to a fiscally transparent foreign entity in one of two ways:

- automatically where all of the requirements of subsection 830-10(1) of the ITAA 1997 (for a foreign hybrid limited partnership) or subsection 830-15(1) of the ITAA 1997 (for a foreign hybrid company) are satisfied; or
- by election where the requirements of paragraphs 830-10(1)(a) to (d) of the ITAA 1997 (for a foreign hybrid limited partnership) or paragraphs 830-15(1)(a) to (c) of the ITAA 1997 (for a foreign hybrid company) are met, and the taxpayer makes an election under section 485AA of the ITAA 1936.

59. The effect of an election under section 485AA of the ITAA 1936 is that the fiscally transparent foreign entity is a foreign hybrid only for the purpose of applying the Australian income tax law to that taxpayer’s interest in the entity. This election also prevents the FIF rules in Part XI of the ITAA 1936 from applying to the taxpayer’s interest in the entity.

60. Where Division 830 applies in relation to a taxpayer’s interest in a foreign hybrid, the Australian income tax law applies as if the foreign hybrid was a partnership, and the taxpayer was a partner in the partnership.⁴

³ In the case of a foreign hybrid company, the company is treated as a partnership for the purposes of the foreign hybrid tax provisions, which are defined in section 995-1 of the ITAA 1997 and essentially mean the ITAA 1997 and the ITAA 1936, except for Division 5A of Part III of the ITAA 1936, along with the other Acts administered by the Commissioner that deal with taxation administration and income tax rates.

⁴ There are also special rules in Subdivisions 830-C and 830-D that apply in addition to those that normally apply to partnerships.

61. Where Division 830 does not apply, the fiscally transparent foreign entity continues to be treated as a company for the purpose of Australian income tax law.⁵

62. Subsection 770-10(1) provides that a taxpayer is entitled to a foreign income tax offset for foreign income tax paid in respect of an amount that is included in their assessable income in a year of income.⁶

63. To be entitled to an offset under subsection 770-10(1), a taxpayer must have:

- included an amount in their assessable income for that income year; and
- paid foreign income tax (as defined by subsection 770-15(1)) in respect of that amount.

64. Where foreign income tax has effectively been paid on the taxpayer's behalf, section 770-130 may treat the taxpayer, for the purposes of the ITAA 1997, as having paid the foreign income tax: for example, where foreign income tax has been withheld by the payer from a payment made to the taxpayer.

65. Section 770-130 requires that:

- the foreign income tax was paid *in respect of* an amount included in the taxpayer's ordinary or statutory income; and
- that foreign income tax has been paid under an arrangement with the taxpayer or under the law relating to the foreign income tax.

66. Both sections 770-10 and 770-130 use the phrase 'in respect of' to link the foreign income tax with an amount included in the taxpayer's ordinary or statutory income. The meaning of the phrase 'in respect of' has been considered by the Courts in a number of contexts.

67. It is well settled by the Courts that the phrase 'in respect of' denotes a relationship or connection between two things: *State Government Insurance Office (Qld) v. Rees & Anor (Liquidators of KD Morris & Sons Pty Ltd)* (1979) 144 CLR 549. The Courts have also considered that the meaning of the phrase, although wide, must be determined by the context within which the words are used: *State Government Insurance Office (Qld) v. Rees & Anor* at CLR 553-554 and 560-561, *Technical Products Pty Ltd v. State Government Insurance Office* (1989) 167 CLR 45 at 47, 51 and 54, *Construction Industry Long Service Leave Board v. Irving* (1997) 74 FCR 587 at 595 and *FC of T v. Scully* (2000) 201 CLR 148 at 171; 2000 ATC 4111 at 4121; (2000) 43 ATR 718 at 729.

⁵ The fiscally transparent foreign entity is treated as a company because it either satisfies the definition of 'company' in section 995-1 of the ITAA 1997, or because it is a corporate limited partnership under Division 5A of Part III of the ITAA 1936.

⁶ A foreign income tax offset is also available under subsection 770-10(2) of the ITAA 1997 for foreign income tax paid in respect of an amount that is a taxpayer's non-assessable non-exempt income under section 23AI or 23AK of the ITAA 1936.

68. Applying the principles expressed in these cases, the phrase 'in respect of' should be construed within the context of Division 770, the intent of which can be found in the Object contained in section 770-5 and at paragraph 1.30 of the Explanatory Memorandum (the EM) to the Tax Laws Amendment (2007 Measures No. 4) Bill 2007, which provides:

1.30 Pursuant to Australia's tax laws, resident taxpayers may be assessed on both their foreign and domestic sourced income. To prevent the double taxation of worldwide income that has been taxed in another country, resident taxpayers will be entitled to a non-refundable tax offset for foreign income tax paid on an amount included in their assessable income (a 'double-taxed amount') **[Schedule 1, item 1, subsections 770-5(1) and (2)]**. This offset will extend to foreign residents where certain requirements are satisfied.

69. Within this context, it can be said that the phrase 'in respect of' is intended to draw a nexus between foreign income tax paid and an amount included in a taxpayer's assessable income, where the imposition of such foreign income tax would, apart from the application of Division 770, result in the taxpayer being exposed to double taxation in respect of that income.

Foreign income tax imposed on taxpayer's share of income of a fiscally transparent foreign entity

70. The key feature of a fiscally transparent foreign entity is that foreign income tax is not imposed on the income of that entity but rather on the partners. Such foreign income tax may be imposed by differing means, including directly on the partners by assessment, or indirectly by a payer withholding from the partner's share of the income of the fiscally transparent foreign entity. An Australian resident taxpayer with an interest in such an entity will therefore be exposed to foreign income tax in respect of their investment in the foreign entity.

71. The availability and timing of foreign income tax offsets depends on the treatment of the taxpayer's interest in the fiscally transparent foreign entity for Australian tax law purposes.

Fiscally transparent foreign entity treated as a foreign hybrid

72. Where a fiscally transparent foreign entity qualifies as a foreign hybrid, it is treated as a partnership for the purposes of both Australian income tax law and the law of the foreign country. A resident taxpayer with an interest in a foreign hybrid is therefore treated as a partner in a partnership under Australian income tax law and the law of the foreign country, and is subject to tax in relation to their share of the net income of the foreign hybrid.

73. In these situations, as both the foreign and Australian income tax are levied at the level of the partner, the core rules in Division 770 and, in particular, section 770-10(1) should apply in a straight-forward manner to work out the foreign income tax paid (or taken to be paid) in respect of the amount included in the taxpayer's assessable income.

Fiscally transparent foreign entity not treated as a foreign hybrid

74. However, where a fiscally transparent foreign entity is not treated as a foreign hybrid because it does not satisfy paragraph 830-10(1)(e) of the ITAA 1997 (if the entity is a corporate limited partnership) or paragraph 830-15(1)(d) of the ITAA 1997 (if the entity is a company), and the taxpayer does not make an election under section 485AA of the ITAA 1936, the foreign income tax offset implications for the resident taxpayer with an interest in such an entity are less straight-forward.

75. As the fiscally transparent foreign entity is treated as a company for Australian tax purposes, any distribution the taxpayer receives (or is taken to receive under section 94L or 94M of the ITAA 1936) from it is characterised as a dividend. Also, the taxpayer is treated as having an interest in a FIF which may result in income accruing to the taxpayer under section 529 of the ITAA 1936.⁷

76. In these circumstances, it is necessary to consider whether, for the purposes of subsection 770-10(1), the foreign income tax imposed on the taxpayer's share of the net income of the fiscally transparent foreign entity has been paid *in respect of* the amount included in the taxpayer's assessable income.

Taxpayer's assessable income includes dividend or deemed dividend payment

77. Where the taxpayer receives a distribution from the fiscally transparent foreign entity and foreign income tax has been imposed on the taxpayer's share of the profits, there will be a relevant connection between the foreign income tax paid and the distributed amount (characterised as a dividend and included in the taxpayer's assessable income under Australian tax law).

78. That connection exists because the foreign income tax is levied at the level of the partner on their share of the entity's net income, rather than on the profits of the fiscally transparent foreign entity. Accordingly, to the extent that a distribution made to the resident taxpayer is included in their assessable income as a dividend, it is considered that the relevant portion of foreign income tax is paid (or taken to have been paid) by the taxpayer *in respect of* the distributed amount: see discussion at paragraphs 67 to 69 of this draft Ruling.

⁷ Section 529 of the ITAA 1936 will not apply to the taxpayer's interest in the foreign entity if any of the exemptions in of Divisions 2 to 14 of Part XI of the ITAA 1936 apply.

79. Where the taxpayer does not pay the foreign income tax directly but rather an obligation is imposed on the fiscally transparent entity or another entity to withhold foreign income tax on the taxpayer's share of the net income of the fiscally transparent entity, it is accepted that such tax is paid in a representative capacity for the taxpayer. As such, the taxpayer is taken to have paid the relevant foreign income tax for the purposes of determining their entitlement to the foreign income tax offset under Division 770: see discussion in relation to section 770-130 at paragraphs 64 to 65 of this draft Ruling.⁸

80. This result is consistent with the legislative intent expressed in the EM to the foreign income tax offset measures contained in Tax Laws Amendment (2007 Measures No 4) Bill 2007, which discusses the necessary link between foreign income tax paid by someone else and amounts included in a taxpayer's assessable income, particularly in the context where a taxpayer has not elected foreign hybrid treatment. Paragraph 1.103 of the EM states:

Even where the Australian resident has not elected for the US limited liability company to be a foreign hybrid, the Australian resident will be entitled to a tax offset for the US withholding tax imposed on the distribution of the profits of the limited liability company. The tax offset will be in respect of the gross amount (pre-US tax) paid to the Australian resident. This is irrespective of the fact that the amount is regarded as a 'dividend' under Australian tax law and a 'distribution of partnership profits' under US law.

81. The use of the phrase 'in respect of an amount (a taxed amount) *that is all or part of an amount included in your ordinary income or statutory income...*' (emphasis added) in subsection 770-10(1) of the ITAA 1997 indicates that an apportionment should be made of the amount of foreign income tax paid to reflect the amount actually included in the taxpayer's assessable income.⁹ Accordingly, where the taxpayer receives a dividend, or a distribution deemed to be a dividend under section 94L or 94M of the ITAA 1936 from the fiscally transparent foreign entity, but the dividend does not represent all of the partner's share of the income of the foreign entity in respect of which foreign income tax has been paid, the taxpayer will only be entitled to a foreign income tax offset to the extent that the foreign income tax has been paid *in respect of* that dividend income.

⁸ See also paragraph 1.99 of the EM.

⁹ Support for an apportionment approach is also found in paragraph 1.107 of the EM.

82. If in an income year, the taxpayer is not taken, for the purposes of Australian income tax, to have received a dividend from the fiscally transparent foreign entity, the taxpayer's assessable income will not include any dividend income from the entity. Subsection 770-10(1) requires an amount to be included in the taxpayer's assessable income and that foreign income tax has been paid in respect of that income. Although foreign income tax may have been paid in a particular income year, if the income in respect of which that tax is paid is not included in the taxpayer's assessable income, then the taxpayer is not entitled to claim a foreign income tax offset in that income year. By corollary, the taxpayer will be entitled to a foreign income tax offset in the year of income in which the taxpayer's assessable income includes the amount in respect of which foreign income tax has been paid, even though the foreign income tax may have been paid in an earlier income year.¹⁰ Thus, where a taxpayer receives a dividend from a fiscally transparent foreign entity (that is not a foreign hybrid) which is included in their assessable income in a later year to the year of income during which the foreign income tax was paid on the amount, the entitlement to a foreign income tax offset will arise in the later year.

83. Where, under the law of the foreign country, tax is imposed on a withholding basis on the amount of the distribution or deemed distribution, the amount included in the taxpayer's assessable income will be grossed up by the amount of any foreign income tax withheld by the payer. This is because, as noted in the EM, the foreign income tax constitutes income according to ordinary concepts pursuant to general tax law principles.¹¹ Further, this income is derived in the relevant year of income by the taxpayer when it is applied or dealt with on the taxpayer's behalf: see subsection 6-5(4).

Taxpayer's assessable income includes attributed FIF income under section 529

84. Where a resident taxpayer holds an interest in a fiscally transparent foreign entity that is not treated as a foreign hybrid due to an election not having been made under section 485AA of the ITAA 1936, the taxpayer has a FIF interest which may give rise to an amount of FIF income being included in their assessable income under section 529 of the ITAA 1936. In such case, any foreign income tax imposed on the taxpayer's share of the profits of the fiscally transparent foreign entity will not be considered to have been paid *in respect of* the taxpayer's FIF income as the core rules in subsection 770-10(1) of the ITAA 1997 have not been met.

¹⁰ See Note 1 to subsection 770-10(1).

¹¹ See paragraphs 1.95-1.96 of the EM.

85. As a fiscally transparent foreign entity, the foreign income tax is imposed on the taxpayer's share of the profits (as a partner). However, for the purposes of Australian tax law, the amount included in the taxpayer's assessable income is not the taxpayer's share of the profits but is a notional amount of statutory income, being the attributed FIF income under section 529 of the ITAA 1936. As the taxpayer is an attributable taxpayer assessed on attributable income, rather than actual income, the extent to which the tax-paid deeming rules apply in respect of such income are governed by section 770-135 of the ITAA 1997.

86. Section 770-135 of the ITAA 1997 sets out all the rules for when foreign income tax will be taken to have been paid by a taxpayer in respect of an amount of attributable income included in that taxpayer's assessable income under section 529 of the ITAA 1936. One of the pre-conditions for the operation of section 770-135 of the ITAA 1997 is that the relevant foreign income tax be paid by the FIF (see subsection 770-135(3) of the ITAA 1997). As the FIF is a fiscally transparent foreign entity, it pays no foreign income tax (rather, tax is imposed at the level of the partner/member). Accordingly, section 770-135 of the ITAA 1997 cannot apply to treat the attributable taxpayer as having paid any foreign income tax in respect of the section 529 of the ITAA 1936 amount.¹²

87. If the FIF makes a distribution of income (characterised as a dividend under Australian tax law) to the attributable taxpayer during the notional accounting period of the FIF (that is, before any attribution is made for that year), the amount otherwise attributable under section 529 of the ITAA 1936 is generally reduced by the amount of the distribution under section 530 of the ITAA 1936. In effect, to the extent of the 'interim dividend', this results in the attributable taxpayer being taxed on a 'derivation' basis rather than on an 'attribution' basis, with the effect that any entitlement to a foreign income tax offset in relation to this income is subject to the core rules in section 770-10 of the ITAA 1997.

¹² This outcome was recognised by the Parliament when Division 830 of the ITAA 1997 was enacted. In particular, the explanatory memorandum to the Taxation Laws Amendment Bill (No. 7) 2003 noted that fiscally transparent FIFs are generally denied a deduction under section 573 of the ITAA 1936 because the foreign tax is not paid by the FIF and, as a consequence, a foreign tax credit would not be available to the taxpayer whose assessable income includes an amount under section 529 of the ITAA 1936: see paragraphs 9.123 to 9.131.

88. If a distribution of income (a FIF attribution account payment) is made by the FIF in a later notional accounting period (that is, after an amount of attributed income has already been included in the taxpayer's assessable income under section 529 of the ITAA 1936), that distribution will be non-assessable non-exempt (NANE) income of the taxpayer under section 23AK of the ITAA 1936 to the extent that it gives rise to a FIF attribution debit.¹³

89. Where section 23AK of the ITAA 1936 applies, subsection 770-10(2) of the ITAA 1997 allows for a foreign income tax offset to be claimed where the taxpayer has paid foreign income tax *in respect of* that income.¹⁴ Accordingly, where a distribution is made by the foreign entity out of previously attributed profits to the attributable taxpayer that is NANE income under section 23AK of the ITAA 1936, and such amount has been taxed on a withholding basis in the hands of the foreign entity, the attributable taxpayer will be entitled to an offset for the foreign income tax paid to the extent that it is paid *in respect of* the section 23AK income. Note that the 'tax-paid deeming' rules in section 770-130 of the ITAA 1997 also apply where the taxpayer derives ordinary or statutory income that is NANE income (see subsection 770-130(1) of the ITAA 1997).

90. The foreign income tax offset result, that is allowing an offset when the attributable taxpayer receives a distribution upon which foreign income tax has been paid rather than at the time of attribution (except as expressly provided for in section 770-135 of the ITAA 1997), is consistent with the policy intent of the measure which was designed to replicate the former foreign tax credit rules. Such rules, it is noted, also expressly prevented attributable taxpayers from claiming a foreign tax credit for foreign tax paid, except as provided for by the listed tax-paid deeming rules in former Division 18 of Part III of the ITAA 1936 (see former sub-section 6AB(3A) of the ITAA 1936). Although the new foreign income tax offset provisions have been drafted using different language to the former foreign tax credit rules, a combination of sections 770-10 and 770-135 of the ITAA 1997 gives interpretative effect to the same policy outcome, that is, an attributable taxpayer can only claim a foreign income tax offset for foreign tax paid in respect of attributed income where the conditions set out in section 770-135 of the ITAA 1997 have been met.

¹³ Division 19 of Part XI of the ITAA 1936 sets out the mechanism for recognising amounts that have previously been included in a taxpayer's assessable income under section 529 of the ITAA 1936 by using FIF attribution accounts. In particular, a dividend paid by a company to a shareholder is an attribution account payment pursuant to paragraph 603(1)(a) of the ITAA 1936.

¹⁴ Further, the foreign income tax offset limit is increased under section 770-80 by any amounts of foreign income tax that count towards the taxpayer's tax offset for the year because of subsection 770-10(2).

Foreign income tax imposed on amounts included in the notional income of a CFC or a FIF in which the foreign hybrid has an interest

91. As a foreign hybrid is treated as a partnership for Australian income tax law purposes, its net income, pursuant to section 90 of the ITAA 1936, is its assessable income less allowable deductions, calculated as if the foreign hybrid were a resident taxpayer.

92. Where that foreign hybrid (in which an Australian resident is a partner) holds an interest in a CFC, the definitions of 'Australian entity', 'Australian partnership' and 'Attributable taxpayer' in sections 336, 337 and 361 of the ITAA 1936 respectively, enable section 456 and section 457 of the ITAA 1936 to apply to include an amount of attributable income in the net income of the foreign hybrid for the purposes of Division 5 of the ITAA 1936.

93. Similarly, where a foreign hybrid holds an interest in a FIF section 529 of the ITAA 1936 can apply to include an amount in the partnership's net income for the purposes of Division 5 of the ITAA 1936 due to the operation of sections 485 and 485A of the ITAA 1936.

94. Accordingly, a foreign hybrid can have an interest in a CFC or a FIF, and have attributed CFC or FIF income included in its net income.

95. A foreign income tax offset may be available for foreign income tax, income tax or withholding tax paid by a CFC or FIF in which an entity has an interest, where the requirements of section 770-135 are met. The entity is taken to have paid the foreign income tax (as calculated under subsection 770-135(7)) only if:

- an amount is included in the entity's assessable income as described in subsection 770-135(2); and
- the conditions in subsections 770-135(3), (5) and (6) are satisfied.

96. Subsection 770-135(2) states:

An amount is included in an entity's assessable income as described in this subsection if:

- (a) the entity is a company and the amount is included under:
 - (i) section 456 (a **section 456 case**) of the 1936 Act in relation to a *CFC and a statutory accounting period; or
 - (ii) section 457 (a **section 457 case**) of that Act in relation to a CFC; or
 - (iii) section 529 of that Act in relation to a foreign company (within the meaning of Part XI of that Act) (a **foreign company case**) in respect of a notional accounting period (within the meaning of that Part) (a **notional accounting period**); or

- (b) the amount is included under section 529 of that Act in relation to a foreign trust (within the meaning of Part XI of that Act) (a **foreign trust case**) in respect of a notional accounting period.

97. A taxpayer that has an interest in a foreign hybrid that holds a CFC or FIF interest will not satisfy subsection 770-135(2) of the ITAA 1997 because the taxpayer's assessable income does not include an amount under section 456, 457 or 529 of the ITAA 1936. In these circumstances it is the foreign hybrid, not the partner, that is the relevant attributable taxpayer. Rather, the taxpayer's assessable income will include their share of the net income of the foreign hybrid under section 92 of the ITAA 1936.

98. Further, the taxpayer could not meet the association condition in subsection 770-135(5) in relation to the CFC or foreign company FIF. The association condition requires the taxpayer to have an 'attribution percentage' of 10% or more in relation to the CFC or the foreign company FIF and, because the taxpayer's interest is held indirectly via the foreign hybrid, the taxpayer will not have an attribution percentage in the CFC or foreign company FIF.¹⁵

99. As noted above (at paragraphs 92 and 93 of this draft Ruling), the net income of a foreign hybrid (for the purposes of Division 5 of the ITAA 1936) may include an amount under section 456, 457 or 529 of the ITAA 1936 in respect of an interest the foreign hybrid has in a CFC or a FIF. However, as paragraph 770-135(2)(a) of the ITAA 1997 is only satisfied where the attributable taxpayer is a company, a foreign hybrid, which is treated as a partnership, will not be taken to have paid foreign income tax which has been paid by a CFC or a foreign company FIF in which it holds an interest. Accordingly, a resident taxpayer that has an interest in such a foreign hybrid is not entitled to claim a foreign income tax offset for foreign income tax, income tax or withholding tax paid by a CFC in respect of an amount included in the CFC's notional assessable income or a foreign company FIF in respect of an amount included in the FIF's notional income.

100. On the other hand, where an amount is included in the net income of a foreign hybrid under section 529 of the ITAA 1936 in relation to a foreign trust FIF, paragraph 770-135(2)(b) of the ITAA 1997 is satisfied, regardless of whether the entity is a company. Accordingly, provided the additional conditions contained in subsections 770-135(3), (5) and (6) are satisfied the foreign hybrid will be taken under section 770-135 to have paid the foreign income tax paid by the foreign trust FIF, as calculated in accordance with subsection 770-135(7).

¹⁵ The taxpayer's attribution percentage in relation to a CFC is determined under section 362 of the ITAA 1936, and in relation to a FIF under section 581 of the ITAA 1936.

101. In these circumstances, subsection 770-135(8) also applies to increase the amount included in the net income of the foreign hybrid by the amount of tax calculated under subsection 770-135(7). This has the effect of grossing-up the amount of attributed income by the foreign income tax that has already been deducted.¹⁶

102. It should also be noted that subsection 770-135(1) states that '[Division 770] applies to an entity as if it had paid an amount of foreign income tax...'. Accordingly, if subsection 770-135 applies to treat a foreign hybrid as having paid the foreign income tax that has been paid by a foreign trust FIF in which the foreign hybrid has an interest, the foreign hybrid is taken to have paid that foreign income tax for all purposes of Division 770, including section 770-130.

103. As noted at paragraph 97 of this draft Ruling, a resident taxpayer that holds an interest in a foreign hybrid that in turn has an interest in a foreign trust FIF cannot be taken to have paid foreign income tax under section 770-135. However, because the foreign hybrid may be taken to have paid such foreign income tax, section 770-130 can apply to deem the resident taxpayer with an interest in the foreign hybrid to have paid that foreign income tax because it is treated as having been paid by the foreign hybrid *in respect of* the taxpayer's share of the net income.

104. In these circumstances, the resident taxpayer is taken to have paid the foreign income tax to the extent that the taxpayer's share of the net income relates to the attributed FIF income included in the net income of the foreign hybrid. This is because such foreign income tax is taken to have been paid by the foreign hybrid 'under an arrangement with the taxpayer' for the purposes of subsection 770-130(2). The example given in the legislation following 770-130(2) indicates that foreign income tax paid by a partnership should be deemed to have been paid by a partner. Paragraph 1.106 of the EM also provides support for the Commissioner's interpretation, in stating:

...This is distinguishable from the situation in which a partnership or trust paid foreign income tax on partnership or trust income that is taxed in the hands of the resident taxpayer under Australian tax law on a flow-through basis, thus reducing the amount distributed or credited to the taxpayer. In these cases, while the partnership or trust pays the foreign income tax, it is the resident partner or beneficiary that bears the economic burden (under Australian law) of that foreign income tax.

¹⁶ The gross-up under subsection 770-135(8) applies only where an amount is included in an entity's assessable income as described in subsection 770-135(2). In the case of a foreign hybrid, this means that amounts attributed from CFCs and foreign company FIFs are not grossed-up.

105. Further, if section 770-130 did not apply to deem the resident taxpayer to have paid the foreign income tax that has been paid in respect of its share of the attributed FIF income, the requirement to gross-up the foreign hybrid's net income under subsection 770-135(8) would result in the taxpayer being denied both a deduction and an offset for the foreign income tax imposed on the foreign trust FIF. This outcome would clearly be at odds with the intended operation of subsection 770-135(8), which should apply only in circumstances where a taxpayer is entitled to a foreign income tax offset: see paragraph 1.97 of the EM.

106. Therefore, a resident taxpayer that has an interest in a foreign hybrid, which in turn holds an interest in a foreign trust FIF, is entitled to claim a foreign income tax offset for foreign income tax, income tax or withholding tax paid by the foreign trust FIF in respect of an amount included in its notional income.

Tax imposed on distributions made by a CFC or a FIF to a foreign hybrid

107. Where a taxpayer holds an interest in a foreign hybrid which in turn holds an interest in a CFC, and the CFC makes a distribution or dividend payment to the foreign hybrid, the taxpayer may be entitled to a foreign income tax offset for any withholding tax imposed at source on the distribution.

108. As discussed at paragraph 64 of this draft Ruling, where the taxpayer's assessable income includes a share of the net income of a foreign hybrid which includes a distribution paid to the foreign hybrid upon which foreign income tax has been withheld at source, section 770-130 will treat the taxpayer as if it had paid foreign income tax in respect of an amount included in the taxpayer's assessable income, and thereby entitle the taxpayer to a foreign income tax offset under subsection 770-10(1).

109. However, where a CFC makes a distribution to the foreign hybrid in circumstances where an amount has previously been included in the net income of the foreign hybrid under section 456 or 457 of the ITAA 1936, the amount will be treated as NANE income of the taxpayer under section 23AI of the ITAA 1936, to the extent of the amount previously attributed. This is achieved through Division 4 of Part X of the ITAA 1936 which concerns attribution accounts.

110. The attribution account rules in Division 4 of Part X of the ITAA 1936 apply where an interest in a CFC is held by a partnership to ensure that a resident taxpayer with an interest in the partnership will obtain the benefit of section 23AI of the ITAA 1936. This is achieved through a combination of provisions that ensure that attribution credits and debits (which arise when income is attributed and when it is distributed respectively) arise for the resident taxpayer, rather than for the partnership that is the attributable taxpayer under Part X.

111. Similar rules in Division 19 of Part XI of the ITAA 1936 apply to interests in FIFs so that later distributions can be treated as NANE income under section 23AK of the ITAA 1936.

112. Accordingly, where a foreign hybrid includes an amount in its assessable income under section 456 or 457 of the ITAA 1936, an attribution credit arises for the resident taxpayer who holds an interest in the foreign hybrid: see subsection 371(6) of the ITAA 1936.¹⁷ As a consequence, when a subsequent distribution is paid to the foreign hybrid by the CFC, the taxpayer's share of that distribution that would be included in the taxpayer's assessable income under section 92 of the ITAA 1936 is NANE income of the taxpayer under section 23AI of the ITAA 1936: see paragraphs 23AI(1)(d), 365(1)(b), and 371(1)(d) and section 372 of the ITAA 1936.¹⁸

113. As the 'tax-paid deeming' rules in section 770-130 also apply where the taxpayer (that is the resident partner in the foreign hybrid) derives ordinary or statutory income that is NANE income (see subsection 770-130(1)), the taxpayer will be treated as having paid the foreign income tax imposed on the distribution to the extent that it give rise to such NANE income in the hands of the taxpayer.

114. In these circumstances, subsection 770-10(2) of the ITAA 1997 enables the taxpayer to claim a foreign income tax offset for foreign income tax taken to have been paid in respect of the taxpayer's section 23AI (of the ITAA 1936) amount which arises from distributions made by a CFC to a foreign hybrid in which the taxpayer holds an interest.

115. The same outcome arises for an interest held in a FIF via an interposed foreign hybrid.

The impact of Australia's tax treaties on the availability of foreign income tax offsets

116. The availability of a foreign income tax offset may be affected by the application of Australia's tax treaties contained in Schedules to the Agreements Act. Subsection 4(1) of the Agreements Act provides that the ITAA 1936 and the ITAA 1997 must be read as one with the Agreements Act.

117. The elimination of double taxation articles of Australia's tax treaties generally provide that where tax has been imposed by a foreign country in respect of income from sources in that country and in accordance with the particular tax treaty, a credit against tax payable in Australia on that income will be allowed under the law of Australia.

¹⁷ The same result is effected under section 23AK of the ITAA 1936 for a taxpayer who holds an interest in a foreign hybrid that includes an amount in its assessable income under section 529 of the ITAA 1936: see subsection 605(8) of the ITAA 1936.

¹⁸ For an interest in a FIF, see paragraphs 23AK(1)(d), 603(1)(c), and 605(1)(d) and section 606 of the ITAA 1936.

118. This includes situations where there is a difference in treatment of income derived from sources in the other country and Australia that arise because the foreign entity is treated as fiscally transparent under the law of the other State but as a company for Australian tax law purposes. This type of conflict which arises because of domestic law differences between the two countries to a tax treaty is commonly referred to as a Conflict of Qualification.

119. The Commissioner's view expressed at paragraph 104 of Taxation Ruling TR 2001/13 is that the OECD Model Tax Convention and Commentary may be considered in interpreting tax treaties. The 2008 OECD Commentary on Article 23A and 23B at paragraphs 32.1 to 32.7 discusses the concept of a Conflict of Qualification, concluding that where the difference in treatment is solely referable to differences in the respective domestic laws of the State of source and State of residence of the taxpayer, it is considered that the State of source has taxed the income in accordance with the Convention and accordingly the State of residence is obliged to provide relief in accordance with the relevant article of the Model Convention.¹⁹

120. Therefore, to the extent that the foreign country taxes income in accordance with the Convention, as interpreted by it as the State of source and gives rise to a Conflict of Qualification referable solely to differences in domestic tax laws, such tax will constitute foreign income tax within the meaning of section 770-15 and relief in the form of a foreign income tax offset may therefore be available in accordance with, and to the extent allowed, under section 770-10.

121. Conversely, where a resident taxpayer derives income that has borne foreign income tax in circumstances where the foreign country imposes the tax other than in accordance with a tax treaty with Australia, relief from double taxation is to be obtained by seeking a refund of the foreign income tax from the foreign country that imposed it. In these circumstances a foreign income tax offset under Division 770 of the ITAA 1997 is not available.

Application of former Division 18 of Part III of the ITAA 1936

122. The above explanation deals with the application of the foreign income tax offset rules in Division 770 to circumstances involving the imposition of foreign income tax on income derived from investing in foreign hybrid entities. These rules have effect for income years commencing on or after 1 July 2008.

123. For income years commencing before 1 July 2008, generally, equivalent relief from double taxation was achieved under the foreign tax credit rules in former Division 18 of Part III of the ITAA 1936.

¹⁹ In relation to the OECD Model Convention article 23 concerns the 'Methods for elimination of double taxation'.

124. To the extent that the rules in Division 770 of the ITAA 1997 effectively replicate the rules in former Division 18 of Part III of the ITAA 1936, then where, in the circumstances set out in this explanation, a taxpayer is entitled to a foreign income tax offset, it would normally be expected that the same set of circumstances arising in an income year commencing prior to 1 July 2008 would also lead to the taxpayer being entitled to a foreign tax credit under former Division 18 of Part III of the ITAA 1936.

Appendix 2 – Your comments

125. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

126. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

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