

**DOING  
BUSINESS  
IN**

**Australia**



**HLB** Mann Judd

# DOING BUSINESS IN AUSTRALIA

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## FOREWORD

This booklet has been prepared for the use of clients, partners and staff of HLB International member firms. It is designed to give some general information to those contemplating doing business in Australia and is not intended to be a comprehensive document. You should consult us, therefore, before taking further action. HLB Mann Judd and HLB International cannot be held liable for any action or business decision taken on the basis of information in this booklet.

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# GENERAL INFORMATION

## 1. Location and Climate

Australia's land mass of 7,682,300 square kilometres has wide variations in climate and topography. There are rain forests and vast plains in the north (almost 40 per cent of the country lies in the tropics), snowfields in the south-east, desert in the centre and fertile croplands in the east, south and south-west. It is the world's sixth largest country in area and the only nation that occupies an entire continent.

Although geographically isolated from its major trading partners, Australia has a diversified economy characterised by large scale resource development, highly productive agriculture and a range of manufacturing industries.

## 2. Constitution and Population

Australia's political institutions and practices follow the Western democratic tradition, reflecting the British Westminster System.

Australia is a Constitutional Monarchy and has been a federation since 1 January 1901 with a Federal Government (Commonwealth) and separate Governments of each of the six sovereign States of New South Wales (whose capital is Sydney), Victoria (Melbourne), Western Australia (Perth), Queensland (Brisbane), South Australia (Adelaide) and Tasmania (Hobart). There are two mainland Territories within federal jurisdiction, the Australian Capital Territory where the Federal Parliament is located in Canberra, and the Northern Territory with Darwin as its capital city. There are also several offshore Territories.

There are two houses of the Federal Parliament, the House of Representatives being the Lower House and the Senate being the Upper House. The Head of the Government is the Prime Minister. Each State Parliament, with the exception of Queensland, also has two houses, the lower house being the Legislative Assembly and the Upper House being the Legislative Council. The head of each State Government is the Premier. Both the ACT and the Northern Territory have one house only, and the head of each Territory Government is the Chief Minister.

Australia has a Federal Constitution and similarly, each of the States has its own Constitution. The Federal Constitution vests certain exclusive legislative powers in the Federal Government and confers numerous other non-exclusive powers which may be exercised by the States until Federal legislation overrides them. Other legislative powers not vested in the Federal Government may be exercised exclusively by the State Governments. Where Federal law conflicts with State law the former takes precedence.

Foreign investment, exchange control, immigration, banking, taxation, life assurance, customs and excise, the media and communications, trade practices, patents, trademarks, copyright, shipping and overseas trade are examples of areas regulated by the Federal Government. Mining, land tenure, law enforcement, motor vehicle registrations, partnerships and certain special types of taxation, such as property transfer taxes, are examples of areas regulated by State Governments.

In addition, there is a third layer of government, Local Government, which operates under State laws in defined areas through elected local Councils which are responsible for regulating such things as building construction, road construction and maintenance and other local infrastructure services.

Australia is a multicultural country with a population of approximately 23 million.

The population is concentrated in capital and other major cities, mainly on the south and east coasts of the continent. This results from a variety of factors including climate, physical characteristics of the continent, changing agricultural practices, exploitation of mineral resources and personal preference.

### **3. Currency and Language(s)**

Australia has a decimal system of currency, the unit being the dollar, which is divided into 100 cents. Australia does not have exchange controls.

English is the official language but, as a result of considerable immigration in the last fifty years, many foreign languages are spoken by ethnic community groups.

Approximately one in four Australians speaks a language other than English at home, of which about 6% speak Italian, 5% Greek, 5% Cantonese, 7% Mandarin and many other Asian languages, including Vietnamese.

Australian English does not differ significantly from other forms of English, although many colloquial expressions are unique to Australia.

### **4. Legal System**

Australia's legal system is based on the English System. Depending upon the type of investment proposed, an overseas investor in Australia would need to have regard to the laws and regulations of one or more of the Federal, State, Territory or Local Governments.

### **5. Economy & Economic Arrangements**

Australia's prosperity is largely dependent on trade. It is geographically remote from most of its major markets and its traditional allies. It is a relatively affluent and resource rich country in a populous, developing and rapidly changing region.

Initially, Britain and the Commonwealth countries were a central element of Australia's foreign policy and economic activity. Close relations now exist with the USA and many Asian countries.

While links with Europe remain important factors to Australia in terms of cultural tradition, security, strategic interests and trade, the focus has shifted significantly to the Asia-Pacific region.

Awareness of the importance of neighbouring states in Asia and the South Pacific has led successive Australian Governments to promote and maintain friendly and co-operative relations with them to promote the stability and security of the region and to develop trade, investment and technology exchange.

Australia gives special attention to its relations with China, Indonesia, Japan, ASEAN (Association of South East Asian Nations) and its members, New Zealand, Papua New Guinea and the other South Pacific states. APEC (Asia Pacific Economic Co-operation Forum) has also been seen as a way of increasing Australia's trade with its Asian neighbours and has been actively promoted by Australia's Government.

Australia has been a member of the WTO (World Trade Organization) since 1 January 1995.

# INVESTMENT FACTORS

## 1. Foreign Investment Review Board (FIRB)

The Foreign Investment Review Board (the Board) is an advisory body which assists the Treasurer (the senior Federal Government finance minister) in the administration of foreign investment policy. The Chairman and Members of the Board have a wide range of business and other experience and provide the Government with a business-oriented and independent source of advice on foreign investment matters.

The main functions of the Board are:

- to advise the Government on foreign investment matters generally;
- to examine proposals by foreign interests for investment in Australia and to make recommendations to the Government on those proposals;
- to foster an awareness and understanding of the Government's policy in the community at large and in the business sector, both in Australia and abroad;
- to provide guidance, where necessary, to foreign investors on those aspects of their proposals that may not be in conformity with Government policy and suggest ways by which the proposals might be amended; and
- to maintain an awareness of the activities of foreign-controlled businesses operating in Australia.

Certain types of proposals by foreign interests to invest in Australia are subject to examination under foreign investment policy and the Foreign Acquisitions and Takeovers Act (1975).

For the purposes of foreign investment policy, a foreign interest is:

- a natural person not ordinarily resident in Australia;
- a foreign-controlled corporation or business;
- any corporation or business in which there is a substantial foreign interest regardless of whether the corporation or business is foreign-controlled. (A substantial foreign interest is defined as an interest of 15 per cent or more in the ownership or voting power of a corporation or business by a single foreign interest either alone or together with associates; or, an interest of 40 per cent or more in aggregate in the ownership or voting power of a corporation or business by foreign interests and their associates, if any.)

Proposals which require registration or approval of the Foreign Investment Review Board include:

- an acquisition or issue of shares (including an option to acquire shares) which would result in, increase, or alter the foreign ownership of a substantial interest in a corporation that carries on an Australian business subject to the corporation having total assets valued at greater than \$248 million (except for NZ / US investors);



- an acquisition or issue of shares (including an option to acquire shares) by a NZ / US investor which would result in, increase, or alter the foreign ownership of a substantial interest in a corporation that carries on an Australian business subject to the corporation having total assets valued at greater than \$248 million where involving *prescribed sensitive sectors* listed below (or \$1078 million for NZ / US investors where not involving prescribed sensitive sectors):
  - media;
  - telecommunications;
  - transport (including airports, port facilities, rail infrastructure, international and domestic aviation and shipping services provided within, or to or from, Australia);
  - the supply of training or human resources, or the manufacture or supply of military goods or equipment or technology, to the Australian Defence Force or other defence forces;
  - the manufacture or supply of goods, equipment or technology able to be used for a military purpose;
  - the development, manufacture or supply of, or the provision of services relating to, encryption and security technologies and communications systems;
  - the extraction of (or the holding of rights to extract) uranium or plutonium or the operation of nuclear facilities;
- direct investments by Foreign Governments or their agencies regardless of size;
- takeovers of offshore companies whose Australian subsidiaries or assets are valued at greater than \$248 million (or \$1078 million for NZ / US investors), or account for more than 50% of the target company's global assets;
- acquisitions of interests in urban land (including interests that arise via leases, financing and profit sharing arrangements and the acquisition of interests in urban land corporations and trusts) that involve the:
  - acquisition of developed non-residential commercial real estate valued at \$54 million or more, (where property is heritage listed, approval must be sought if property value exceeds \$5 million);
  - acquisitions of accommodation facilities irrespective of value;
  - acquisitions of vacant urban real estate irrespective of value; and
  - acquisitions of residential real estate irrespective of value.

## **2. Import and Export Controls**

### ***Import Controls***

The importation of goods into Australia is controlled primarily by regulations made under the Federal Customs Act and tariffs applicable under the Customs Tariff Act which are administered by the Australian Customs Service (ACS). The purposes of these regulations are, in essence, to protect Australian industry and consumers and to raise revenue.

Goods may be prohibited from importation either absolutely or by reference to their place of origin or, unless certain specified conditions or restrictions are complied with. The regulations also prohibit the importation of certain goods without a licence or governmental approval.

All goods imported into Australia must be cleared by Customs whether arriving by air, sea or post.

Customs duty and/or GST are levied on many items entering Australia.

### ***Import Documentation***

Customs does not require importers to hold an import licence. However, depending on the nature of the commodity and regardless of value, owners may need to obtain permits to clear the goods.

### ***Clearance of Commercial Consignments***

Fees apply to cargo reporting and import entry processing for goods. Commercial Customs clearances may be arranged by the owner or a customs broker who will usually charge a fee for the service. Brokers specialise in clearing imported goods and are licensed by Customs.

### ***Customs Valuation System***

Customs determines the value of goods imported into Australia based on the World Trade Organisation (WTO) Valuation Agreement.

The most common method used is the Transaction Value method, which is based on the price actually paid (or payable) for the imported goods. However, in applying the Transaction Value method the transaction must be at arm's length.

If the price paid (or payable) cannot be accepted as the basis for determining the Customs value, then Customs would consider the alternate methods provided by the WTO Agreement.

The "price", if not in Australian dollars will be converted to Australian dollars at the ruling rate of exchange on the day the goods were imported.

### ***Indirect Taxes***

The appropriate tariff classification for any goods imported must be supplied.

Imported goods may be subject to one or more indirect taxes. These indirect taxes include the goods and services tax, the wine equalisation tax and the luxury car tax.

### ***Tariff Advice***

Where importers are considering the importation of specific goods, they should obtain a Tariff Advice (TA).

### ***Import Prohibitions & Restrictions***

A range of legislation provides for the importation of certain goods into Australia to be prohibited absolutely or conditionally.

Goods that may be subject to import prohibitions and restrictions include:

- certain animal, marine and plant life and their products;
- goods bearing certain official emblems and designs;
- goods that may be hazardous to health (including chemicals, radioactive material and therapeutic substances);
- goods bearing incorrect or misleading markings and packaging;
- goods that infringe trademarks or copyright;
- certain goods relating to cultural heritage;
- goods subject to quarantine controls;
- ozone depleting substances;
- weapons;
- narcotic and psychotropic substances; and
- goods subject to censorship controls.

### ***Commerce Trade Descriptions***

Importers are required to ensure that goods entering the commerce of Australia are correctly marked.

Trade descriptions markings must be:

- in English;
- in prominent and legible characters;
- on a principal label or brand attached to the goods in a prominent position in a manner as permanent as is practicable;
- and, in certain circumstances, include the country of origin.

### ***Temporary Import/Export of Commercial Goods***

Goods may be brought into Australia on a temporary basis without the payment of Customs duty or taxes for a period of up to 12 months. These goods are referred to as Temporary Imports.

Another way goods can be brought into Australia on a temporary basis is under the cover of a “carnet” which is an international “passport for goods”. All temporary imports must be re-exported within the approved period.

### ***Rules of Origin***

Rules of Origin (ROO) are applied to determine which country goods originate from for international trade purposes as goods imported from certain countries attract a lower (preferential) rate of duty.

Trade between Australia and New Zealand, Fiji and the Pacific Forum Islands and other APEC members may be eligible for preferential rates of duty on imports.

### ***Exporting Goods***

Goods intended for export must be notified on an export entry. The exceptions are:

- personal or household effects of a passenger or crew of a ship or aircraft other than goods which are regarded as commercial consignments or are in commercial quantities;
- a postal consignment that has a Free On Board (FOB) value not exceeding \$2000 except for:
  - dutiable goods on which duty is unpaid;
  - excisable goods on which excise duty is unpaid;
  - goods on which a person intends to claim a drawback of customs duty or excise duty;
  - goods on which GST is payable but unpaid;
- those in a consignment to which a single Australian Harmonised Export Commodity Classification (AHECC) applies, and the consignment is one exported by ship or aircraft that has an FOB value not exceeding \$500 export for:
  - dutiable goods on which duty is unpaid;
  - excisable goods on which excise duty is unpaid;
  - goods on which a person intends to claim a drawback of customs duty or excise duty;
  - goods on which GST is payable but unpaid;

- containers, whether empty or loaded, that belong to a business in Australia and are exported on a temporary basis to be re-imported; and
- certain ships' stores.

### ***Goods Subject to Export Control***

An exporter must apply to the appropriate government department or agency for a permit or licence to export where goods are subject to export controls under Customs or any other Commonwealth legislation.

The following is a non-exhaustive list of categories of goods that are subject to export control:

- certain animal, marine and plant life and their products;
- certain drugs and goods containing those drugs;
- certain goods bound for certain countries subject to United Nations embargoes, chemical warfare precursors, biological agents and toxins;
- certain human products;
- fresh fruit and vegetables;
- hazardous waste and ozone-depleting substances;
- military goods, civilian arms and explosives and goods containing dual-use (military/civilian) technology;
- nuclear-related plants and materials;
- movable cultural heritage items like works of art, Aboriginal artefacts, precious stones and minerals, fossils and items of national significance; and
- wine, brandy and grape spirit.

### ***Commerce Trade Descriptions***

It is an offence for exporters to knowingly apply any false trade descriptions to goods destined for export or to export such goods.

### ***Export Concessions***

The Drawback scheme provides for a refund of import duty on goods that are subsequently exported. Excise duty may also be refunded on exported goods. Imported goods must be exported either unused since importation or exported in manufactured goods after further processing.

### *Indirect Taxes*

Overseas customers will not bear the cost of the GST as the supply of goods for export is generally GST free.

### **3. Australian Competition & Consumer Commission (ACCC)**

This regulatory body was formed in 1995 by merging the Trade Practices Commission and the Prices Surveillance Authority. The ACCC is responsible for administration of the *Trade Practices Act 1974* and covers consumer rights, anti-competition and unfair market practices, industry regulation and price monitoring.

### **4. Government Incentives**

#### *Federal Government*

Investment in Australia should be made on a sound commercial basis as no tax holidays or special tax free zones exist.

The Tax Act does however provide for certain capital allowances and increased deductions for Research & Development expenditure.

#### *State Government*

In recent years State Governments have provided significant incentives to investors who can develop industries resulting in significant employment opportunities. These incentives usually take the form of reduced state taxes such as Payroll Tax or interest free loans or grants.

#### *Export Market Development Grants*

Austrade administers the Export Development Grant Scheme which provides grants to subsidise the cost of developing export markets.

### **5. Sources of Finance**

#### *Banks*

The Australian banking system was deregulated in the 1980s and is now comprised of one Central Bank (Reserve Bank of Australia) and a number of private banks. Since deregulation many foreign banks have commenced operation in Australia. Sophisticated financial services are available from both traditional banking sectors and from the many merchant banks and finance companies now operating in Australia.

A major review into Australia's financial system was completed in 1997. The objective of the review was to make Australia's capital markets and financial sector more efficient and competitive, both domestically and internationally. The recommendations of the Wallis Committee of Inquiry resulted in the establishment of APRA (Australian Prudential Regulation Authority) to prudentially supervise deposit taking institutions, life and general insurance companies and superannuation (pension) funds.

The review also resulted in the strengthening of the Reserve Bank's powers with its role focused on the objectives of Australia's monetary policy, overall financial system stability and regulation of the payments systems (clearing systems).

Australian banks generally require significant levels of collateral, predominantly real estate, to secure advances. Security may also be taken over inventories and receivables.

#### *Other*

Funding in the form of equity may be raised from the public via listing on the Australian Stock Exchange (ASX).

A number of venture capital funds provide both debt and equity financing for start-up companies and management buy outs.

## **6. Foreign Exchange Control**

*Australia has no foreign exchange controls.*

The Financial Transaction Reports Act 1988 requires that any cash transaction of A\$10,000 or more involving the flow of funds to or from Australia be reported by cash dealers to AUSTRAC (the Australian Transaction Reports and Analysis Centre). Similarly, any cash transaction of \$10,000 or more within Australia must also be reported. There are exemptions available for certain transactions and certain businesses.

## **7. Employment Regulations**

### *Characterisation*

In general in Australia, if a relationship between a purchaser of labour and provider of labour is classified as one between an employer and an employee it is subject to statutory regulation. On the other hand, if the provider of labour is classified as a non-employee independent contractor then, subject to certain exceptions where statutes require particular groups of independent contractors to be treated as employees for particular purposes, contracting parties have a considerable degree of freedom in regulating their relationship.

In determining whether a person is an employee rather than an independent contractor, the courts examine the relationship as a whole, looking toward factors such as the degree of control which is exercised over that person's work, and the extent to which he or she is integrated into the business structure of the person to whom he or she provides labour.

It is not possible to contractually deem a person who is clearly an employee to be an independent contractor, but nevertheless in borderline situations appropriate contractual drafting may determine how a particular person is classified.

### *Superannuation*

A prescribed minimum level of superannuation support must be provided by employers for each of their employees. For further information, refer to "Superannuation" under the "Taxation" heading.

## ***Fair Work Australia***

On 1 January 2010 the Australian workplace relations system changed to the Fair Work system. The Fair Work laws cover all workplaces in the national workplace relations system. Most workplaces in Australia are in this system. The main changes are the National Employment Standards (NES), a set of 10 basic conditions that apply to employees in the national system and approximately 122 awards were to replace more than 2,000 awards that applied under the different State systems. There is also revised bargaining arrangements for enterprise agreements and streamlined rules on workplace rights (such as protection against discrimination and unfair dismissal) and industrial action.

New Fair Work bodies have been established to manage the new legislation namely The Fair Work Commission which is the national workplace relations tribunal. It is an independent body with power to carry out a range of functions relating to:

- the safety net of minimum wages and employment conditions
- enterprise bargaining
- industrial action
- dispute resolution
- termination of employment
- other workplace matters.

The Fair Work Ombudsman is an independent statutory agency created under the *Fair Work Act 2009*, and is responsible for promoting harmonious, productive and cooperative Australian workplaces. The Fair Work Ombudsman educates employers and employees about workplace rights and obligations to ensure compliance with workplace laws. Where appropriate, the Fair Work Ombudsman will commence proceedings against employers, employees, and/or their representatives who breach workplace laws.

## ***Hiring and Firing***

Apart from equal opportunity legislation aimed at preventing discrimination, an employer's right to hire labour as he sees fit is essentially unrestricted. However, an employer does not have a totally free hand with regard to dismissal of workers as an employer should not dismiss in a manner that is 'harsh, unjust or unreasonable'. If this occurs, this may constitute unfair dismissal and the employee may be eligible to make an application to the Fair Work Commission for assistance.

Termination of employment can occur for a number of reasons, including redundancy, resignation and dismissal. When the employment relationship ends, the employee is entitled to receive any outstanding employment entitlements. This may include outstanding wages, payment in lieu of notice, payment for accrued annual leave and long service leave, and any applicable redundancy payments.

It should be noted that Western Australia has not joined the national workplace relations system. Some employers (essentially incorporated entities) and their employees are covered by the national workplace relations system, but sole traders, partnerships, other unincorporated entities and non-trading corporations and their employees continue to operate under the WA state system.



### ***Controls on Foreigners Working In Australia***

Australia has established a Business Skills Migration programme which offers resident status to applicants who will use their skills and capital to actively engage in business of benefit to Australia.

Persons who have successful business records as either an owner or part-owner of a successful business (or in some cases senior executives employed in a major business) may apply.

To qualify under the Business Skills category a number of criteria are applied such as business attributes (recent history and skills), age, English language skills and net assets legally available for transfer to Australia.

## **TYPES OF BUSINESS ORGANISATIONS**

### **1. General**

In Australia various types of business organisations may be established. A foreign corporation may incorporate a local subsidiary or register itself as a foreign corporation and operate a branch office. The type of business organisation chosen is an important decision as each has advantages and disadvantages regarding liability, tax treatment, reporting, documentation and legal requirements.

### **2. Sole Proprietorship**

A sole trader is an individual who carries on business on his or her own behalf.

The individual may carry on business under his or her own name or adopt a business name which must be registered under the National Business Names Register. This is integrated with a register of company names to avoid name similarity.

The principal advantages of sole proprietorship are that it is comparatively easy to wind up or sell such a business; the costs of establishing and operating the business are generally less than those of other structures; and, apart from an individual tax return and Business / Instalment Activity Statements (where applicable), there are generally no other reporting or disclosure requirements. On the death of the sole proprietor, the business will cease although it may be sold by the deceased's personal representatives. The major disadvantage is that a sole proprietor has unlimited personal liability for his or her business obligations and debts. There may also be income tax disadvantages in operating this way. For example, there is at present a significant difference between the highest rate applicable to an individual's taxable income (46.5% including standard Medicare Levy) and that applicable to a company (30%).

### **3. Partnerships**

A partnership arises where two or more individuals or corporations agree to carry on business together or in common with a view to deriving profit jointly. A partnership is not a separate legal entity and the liability of the partners for the obligations of the partnership is joint and unlimited. The rights of the partners as between themselves are largely determined by the terms of the partnership agreement. What is not covered in that agreement is regulated by legislation in each State and Territory and at common law.

Partnerships (other than certain professional partnerships) are generally limited in size to twenty partners, with partners able to be corporations and non-Australian residents. The interest of a partner is not freely transferable in that the consent of the other partners is necessary before a partnership interest can be transferred.

The principal advantages of partnerships are that the arrangements need not be committed to writing, though, for taxation reasons and to avoid future disputes it is prudent to have the full terms of the partnership clearly set out; the degree of control among the partners can be agreed upon and management may be vested in a particular partner or a committee of partners; partnership losses can be offset against other income of individual partners for income tax purposes; and, subject to certain conditions, the partnership agreement is a flexible document which may be tailored to meet specific needs. For example, there may be differential profit sharing, unequal contribution of assets and labour and individual ownership of assets used for producing partnership income.

For taxation purposes, partnership accounts and income tax returns must be prepared on the basis that the partnership is a single independent entity. The partners' share of net income is taxed in their hands as part of their personal income. Conversely, the partners' share of net losses are subject to certain conditions deductible against any other income of those partners. Thus the partners must adopt and be bound by a uniform treatment of partnership expenses and revenue for tax purposes. Although a partnership does not itself pay tax, its taxable income is calculated as if a partnership were a taxpayer in its own right and certain deductions normally available to individuals and companies may not be available to the partners.

#### **4. Joint Ventures**

An unincorporated joint venture is often used for property development or in the mining, oil and gas or other natural resources sectors, where pre-production costs are likely to be high. The parties to a joint venture usually enter into a detailed agreement which specifies their respective rights and obligations and seeks to avoid the relationship being characterised as a partnership. If it were held to be a partnership each party would be liable for the debts incurred by the other in the joint venture and certain elections under income tax law could not be exercised by each party separately.

A joint venture is not required to lodge a separate income tax return. Each joint venturer incorporates its share of the income and expenses of the venture into its own accounts and income tax return.

#### **5. Corporations**

##### ***General***

Corporations, generally referred to as "companies" in Australia, are legal entities formed in accordance with the *Corporations Act 2001*. The Corporations Act governs the incorporation and management of companies and is administered by the Australian Securities & Investments Commission (ASIC). Foreign companies registered in Australia are also regulated by ASIC.

Most companies have limited liability with members' obligations to contribute further capital limited to the amount of any uncalled capital on their shares. Proprietary Companies, which have a limit of 50 members and restricted rights in relation to transfer of shares, are

distinguished from Public Companies. Proprietary Companies must add the suffix “Pty Limited” to their names and Public Companies must add “Limited” to their names. In each case “Limited” may be shortened to “Ltd”.

A Proprietary Company can be acquired “off the shelf” for about A\$1,200 (including company incorporator’s fee). Fees payable to ASIC may be as low as A\$230 a year.

The Corporations Act also provides for other types of companies, including Unlimited Companies (members’ obligations to contribute further capital are not limited), Companies limited by Guarantee (generally used by clubs, charities and other not-for-profit organisations) and No Liability Companies (generally used for oil and minerals exploration). Members of N.L. Companies may forfeit their shares instead of paying further capital calls.

Only shares in Public Companies and N.L. Companies may be listed on The Australian Stock Exchange (ASX).

Proprietary Companies are further classified as Large or Small with a company automatically being “large” if it meets two of the following three tests:

- Revenue greater than A\$25 million;
- Assets greater than A\$12.5 million (book amount, not current value); and
- More than 50 employees.

### ***Legal Requirements***

All companies are required to have a Constitution setting out the rules under which the Company should operate. Approval of at least 75% of members is generally required for the Constitution to be amended.

Directors and secretaries of companies must be natural persons. Public Companies must have a minimum of three directors, at least two of whom are Australian residents. Proprietary Companies may have only one director, who would need to be Australian based to meet a requirement that there be at least one resident director. Most have two or more directors. A public company must have at least one secretary who is an Australian resident. A proprietary company is not required to have a secretary.

Alternate directors may be appointed and directors’ meetings may be held anywhere in the world. The constitution of most companies allow for directors’ meetings by teleconference and for a circulated resolution signed by all directors to be used as a substitute for a directors’ meeting.

All companies must lodge an Annual Return with ASIC giving details of directors, secretaries and shareholders and the company’s business location and contact address. Changes in particulars generally require notification within a short period after they occur.

### ***Accounting and Audit Requirements***

Public Companies must prepare annual financial statements and file them, together with an independent audit report, with ASIC. Similar requirements apply to Large Proprietary

Companies unless they are part of a group that files audited group financial statements and has cross guarantees between all group companies for payment of liabilities.

Small Proprietary Companies are generally not required to appoint auditors and prepare annual financial statements unless they are controlled by a foreign corporation. Provided that they are not part of a “large” (same definition as above) group within Australia, foreign owned Small Proprietary Companies may apply annually to ASIC for relief from these requirements in each ensuing financial year.

### ***Corporate Governance & Directors’ Duties***

Through legal reform as a result of corporate collapses in the 1980s, the law now imposes more stringent requirements on directors’ duties in relation to companies. The duty to act bona fide in the best interests of the company, the duty to exercise reasonable care and diligence in the performance of their duties and the duty to prevent insolvent trading are all codified in the Corporations Act and also in that body of law handed down by the Courts through judgements made in the 1990s and 2000s. Additionally ASX imposes its own corporate governance rules for listed Public Companies.

## **6. Trusts**

Where a trust is established to carry on a business, the trustee holds the assets of the business and runs the business for the benefit of the trust’s beneficiaries. Generally, trustees are liable for their actions as trustee with a right of indemnity against the trust assets, provided they act within the scope of their authority. The trustee is liable for any debts that it incurs in connection with the business but, if the trustee is a company, liability will be limited to the assets of the company (if any) and the trust.

The operation of the trust is regulated by a deed, and the flexibility of available trust structures means that the deed can be drawn up to suit most applications and requirements. The beneficiaries’ entitlements may be in a fixed proportion or variable at the discretion of the trustee.

Discretionary trusts have become a popular structure for small business or family investment. A typical family trust gives the person establishing the trust, and the trustee, wide discretionary powers in relation to the distribution of income and capital among the beneficiaries. The trust deed typically includes a provision giving the person establishing the trust power to remove and replace the trustee. It generally provides the trustee with powers to acquire or dispose of property, carry on business, borrow money and offer security for such borrowing.

A unit trust structure may be adopted where a beneficiary’s entitlement to the income of the trust is dependent upon the number of units the beneficiary holds. In many respects, units are similar to shares in a company, although there are fundamental legal differences between the two. A unit trust may list its units on a stock exchange.

Unit trusts are commonly used as a vehicle for non-family businesses, for example where there are a number of separate families, individuals or companies involved. The beneficial ownership of the trust property is divided into a number of fixed units which may be further divided into income and capital units. The operation of unit trusts is governed by the same principles as other trusts. In unit trusts there is normally no discretion to distribute the beneficial interest in capital or income among unitholders.

The principal advantages of a trust structure are that trusts are relatively easy to form and are not subject to government controls on their formation or operation (except where a company acts as trustee, in which case, the requirements of the Corporations Act must be fulfilled). There may be significant taxation benefits in the use of a trust. A discretionary trust has considerable flexibility in terms of income distribution and in most cases the key figure can maintain a significant degree of control.

The principal disadvantages of a trust structure are that there are a number of formalities required to maintain a trust. There must be strict adherence to the terms of the trust deed and, in relation to a trustee company, there must be adherence to the provisions of its constituent documents and the Corporations Act. Also, there is legislation relating to the powers and duties of trustees to be adhered to and the courts have developed a complex set of rules relating to trusts. A trust structure will not enable beneficiaries to offset their share of trust losses against assessable income from other sources.

# TAXATION

## 1. Fiscal Year

The standard year end for all taxpayers is 30 June. Alternative balance dates are generally permitted for foreign owned organisations.

## 2. General Structure

Income tax in Australia is currently administered under the Income Tax Assessment Act, 1936 and 1997 (the Tax Act) together with associated legislation and regulations. The 1936 Tax Act has been partially redrafted. The aim of the rewrite was to improve the expression of the tax law, without actually changing it. Therefore the following comments are applicable to both the old and the new law, subject to changes in the section numbers.

The provisions of the Tax Act apply to income and capital gains derived by individuals, corporations, trusts and partnerships. A liability to tax arises in respect of taxable income, which is defined by the Tax Act to mean the amount remaining after deducting from assessable income all allowable deductions. The term assessable income includes not only income as that term is ordinarily understood (including, for example, salary and wages, business profits, rent, interest and dividends), but also a number of other items which are deemed by the Tax Act to constitute assessable income, including the whole or part of any net capital gains. Income tax is imposed on an annual basis, with the normal year of income being 1 July to 30 June following, although substituted accounting periods can be obtained in certain circumstances. Apart from the withholding tax provisions and the capital gains provisions of the Tax Act, which both contain their own special rules relating to non-residents of Australia, the two key elements which give rise to a liability to Australian tax are residence and source. Thus, the assessable income of a resident of Australia includes income derived from all sources whether in or out of Australia, whilst the assessable income of a non-resident of Australia includes only income derived from all sources within Australia.

Under Australian tax law, the source of income is largely a matter of fact to be determined by reference to principles developed by the courts. However, the Tax Act does deem certain types of income to have a source in Australia. For example, certain royalties paid by an Australian business to a non-resident are deemed by Section 6C of the Tax Act to have a source in Australia. Further, as will be discussed below under the heading Withholding Tax, the withholding tax provisions operate in such a way as to give, in effect, an Australian source to dividends and interest paid to non-residents.

The operation of the Tax Act in respect of both residents and non-residents is subject to the provisions of the various double taxation agreements which Australia has entered into with other countries which provide relief from double taxation, to which, reference is made below under the heading, Double Taxation Treaties. Such agreements often contain their own rules for determining the source of different types of income.

### **3. Corporate Taxation**

The Tax Act defines a company to include all bodies or associations incorporated or unincorporated, but specifically excludes partnerships from the definition.

It is necessary to determine whether or not a company is a resident of Australia for tax purposes. The Tax Act defines a resident of Australia to include any company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia. In relation to a company which is not incorporated in Australia, it should be noted that the Courts have held that a company which has its central management and control in Australia necessarily carries on business in Australia, thus constituting it a resident of Australia.

Central management and control is a concept which originates in English law and is one which has been developed by the courts in both England and Australia. The company's central management and control will usually be the place where the directors meet to do business of the company, although regard must always be had as to where real control of the company's operations is located.

A resident company is required to lodge an annual return of income covering the period 1 July to 30 June in each year, or any 12 months period which the Commissioner has agreed may be substituted in lieu thereof. A non-resident company which derives Australian source income is similarly required to lodge an annual return of income unless it derives only interest and dividend income to which the withholding tax provisions apply.

Companies pay a flat rate of tax on each dollar of taxable income. The current rate is 30%. However, companies may be entitled to a tax credit for tax payable in respect of franked dividends included in their assessable income. An explanation of the meaning of "unfranked" and a discussion on the taxation of dividends generally, is included under the heading "Dividend Imputation".

From 1 July 2002 wholly owned groups of companies may make an irrevocable election to lodge a consolidated income tax return for the group. The main advantages of such election are the ability to transfer tax losses between companies and the pooling of dividend imputation credits.

### **4. Personal Taxation**

Any person who resides in Australia within the ordinary meaning of that expression is a resident of Australia for tax purposes. In addition, the Tax Act extends the definition of resident to include a person:

- Whose domicile is in Australia, unless the Commissioner is satisfied that his/her permanent place of abode is outside Australia (the tests of domicile are complex and depend on the individual circumstances of each case);

- who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that his/her usual place of abode is outside Australia and that he/she does not intend to take up residence in Australia; or
- who is a member of certain Commonwealth Government Superannuation Schemes or is the spouse or a child under 16 years of age of such a member.

All persons, whether resident or non-resident, whose total assessable income (other than interest or dividend income to which the withholding tax provisions apply) exceeds the limit specified by the Commissioner of Taxation, are required to lodge an income tax return.

Taxation is imposed on individuals on a progressive basis, with higher rates applying to higher levels of taxable income (referred to as marginal rates).

Resident individual taxpayers are taxed at more favourable rates than non-residents, with further concessions accruing to resident families. The highest marginal tax rate is currently 45c in the dollar with a compulsory medical insurance (Medicare) levy adding a further 1.5%. Rates applicable to persons under the age of 18 years vary depending upon the nature of their income.

Employers are required to make tax instalment deductions from all payments of salary and wages paid to individual employees, with such deductions forwarded by the employers to the Commissioner. The total amount of the deductions are credited against an individual employee's liability as determined at the conclusion of the relevant year of income. Favourable tax treatment can apply to expatriate individuals who come to Australia on a temporary work visa, including certain fringe benefits tax exemptions (see section 9 below).

From 1 July 2006, temporary residents have also been exempt from Australian income tax on most of their foreign investment income and capital gains. Previously, as they are generally classified as residents for Australian tax purposes, any foreign income was taxed.

It is important to be aware, however, that as soon as expatriates decide to take up permanent residency in Australia, they can no longer utilize any of the expatriate tax concessions.

## **5. Partnerships**

At common law, a partnership is defined to mean the relationship that exists between persons carrying on a business in common with a view to profit. For the purpose of the Tax Act, the definition of partnership is extended to mean not only a partnership at common law but also any association of persons in receipt of income jointly. A partnership for tax purposes, therefore, includes any association of persons who jointly share in income or profits of an undertaking.

In conformity with the position at common law, a partnership is not regarded as a separate legal entity for tax purposes and no tax is payable by or on behalf of the partnership itself. However, a partnership return is required to be lodged with the Commissioner of Taxation on an annual basis, showing either the net income of the partnership (equivalent to taxable income) or the partnership loss of the partnership, as the case may be.



The Tax Act includes in the assessable income of each resident partner his or her individual share of the net income of the partnership and allows as a deduction to each resident partner his or her individual share of any partnership loss. In relation to non-resident partners, the Tax Act includes in the assessable income of each non-resident partner his or her individual share of the net income of the partnership which is attributable to Australian sources, and allows as a deduction his or her share of any partnership loss which is attributable to Australian sources.

## **6. Trusts**

A trust is not a separate legal entity but, in contrast, is a relationship which exists between a person who holds property or in whose name property is vested, being the trustee, and the person or persons on whose behalf the property is held, being the beneficiaries. If the trust property produces income, the trustee will, in accordance with the terms of the trust and the principles of equity, hold that income not on its own behalf but on behalf of one or more of the beneficiaries. Income of a trust estate is taxed only once, either in the hands of the trustee if not distributed to the beneficiaries or in the hands of the beneficiaries upon distribution.

Unlike losses of a partnership, trust losses are not allocated to beneficiaries and allowed as deductions. Instead the losses are accumulated for offset against future income of the trust. A number of tests have been introduced to counter trafficking in trust losses. An Australian resident who is a beneficiary of a non-resident trust is liable to Australian income tax in respect of any income or other property distributed to or applied for the benefit of the beneficiary by the non-resident trust.

## **7. Taxation of Capital Gains**

Prior to 20 September, 1985, the imposition of Australian income tax on capital profits was limited to profits arising from the sale of property purchased within 12 months of the date of sale, profits arising from the sale of property acquired for the purpose of profit-making by sale and profits arising from the carrying on or carrying out of any profit-making undertaking or scheme to the extent if any, that they were considered not to be income.

Australia taxes, either in whole or in part, most capital gains arising on the disposal of assets acquired by resident taxpayers on or after 20 September, 1985. In relation to non-resident taxpayers, from 12 December 2007 Australia taxes, either in whole or in part, capital gains arising on the disposal of certain assets (defined by the Tax Act to be taxable Australian property) acquired on or after 20 September, 1985.

Taxable Australian property includes:

- land or buildings situated in Australia (including mining rights);
- an asset that has at any time been used in carrying on a trade or business wholly or partly at or through a permanent establishment in Australia;
- shares, or an interest in shares, of a company whose assets comprise principally Australian real property;
- an interest in a trust whose assets comprise principally taxable Australian real property;  
and

- an option to acquire any of the above assets.

The process to determine the assessable net capital gain differs depending on who derives the capital gain.

### ***Individuals and Superannuation Funds***

For assets acquired before 21 September 1999 capital gains realised by individuals, trusts and superannuation funds may be determined by one of two methods:

#### ***Method 1 – Indexation Method***

Consideration received less the cost of the asset disposed of, after allowing for inflation. The result is included in assessable income.

#### ***Method 2 – Discount Method***

Consideration received less cost of asset disposed of. Half of the result (two thirds for superannuation funds) is included in assessable income.

For assets acquired *after* 21 September 1999 only Method 2 can be used.

The government has removed the eligibility for the 50% discount on capital gains earned after 8 May 2012 by non-residents on taxable Australian property, such as real estate and mining assets.

### ***Corporations***

For corporations assessable net capital gains are determined by deducting the cost of the asset disposed of, after allowing for inflation, from the consideration for sale. The allowance for inflation is frozen at the rate applicable as at 30 September 1999.

## **8. General Information Regarding Income Tax**

### **Debt & Equity Tests**

Legislation effective 1 July 2001 was enacted to codify the distinction between debt and equity interests. The distinction between debt and equity is important in determining whether returns on these interests are considered to be either deductible interest in the case of debt interests or frankable dividends in the case of equity interests. The test for debt interests revolves around whether the issuer has an effective obligation to return to the investor an amount at least equal to the amount invested.

The determination of whether an interest is one of debt is important in relation to Thin Capitalisation.

Equity interests are defined as interests providing returns that depend on the issuers' economic performance, the discretion of the issuer or an interest that will convert into a share. The distinction between debt and equity interest of non-residents also has ramifications with respect to the level of withholding tax that may apply.

## **Dividend Imputation**

An imputation system for the taxation of company dividends operates in Australia and applies to all dividends paid on or after 1 July 1987.

In broad terms, the imputation system operates to impute or allocate tax paid by a company in respect of the company's profits to shareholders in the company to whom dividends are paid. Dividends with an imputation credit attached are known as franked dividends.

Resident shareholders to whom franked dividends are paid are assessed to tax on the sum of the dividend received and the imputation credit, but are allowed a tax credit for an amount equal to the imputation credit. Where the credit exceeds tax payable, the excess is refundable to individuals, charities and superannuation funds.

When a company declares dividends out of profits which have not borne company tax (for example, because of the entitlement to a deduction for carry-forward losses), the dividends are normally unfranked dividends and do not carry an entitlement to an imputation credit. For resident individual shareholders, the amount of the dividend is included in the assessable income of the shareholder, who is taxable on the dividend in the normal manner.

Entitlement to imputation credits is subject to a 45 day holding rule, ie. shares must be held by the investor at risk for at least 45 days.

Where a taxpayer's tax liability is less than the value of imputation credits, a refund of the excess is available. Dividends may also be partly franked and partly unfranked. In such circumstances, the two components of the dividend are treated as if they were separate franked and unfranked dividends.

Dividends paid by resident companies to non-residents may also be subject to withholding tax, on the unfranked portion of the dividend.

## **Double Taxation Treaties**

Australia has entered into a number of double taxation agreements or treaties – the form of which is based on, but not identical with, the OECD Model Double Taxation Convention on Income and on Capital (1977). Australia currently has double taxation agreements with Argentina, Austria, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Fiji, Finland, France, Germany, Greece (limited to airline profits), Hungary, India, Indonesia, Ireland, Italy, Japan, Kiribati, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Norway, Papua New Guinea, the Philippines, Poland, Romania, Russia, Singapore, Slovakia, South Africa, South Korea, Spain, Sri Lanka, Sweden, Switzerland, Taipei, Thailand, the United Kingdom, the United States of America and Vietnam. New treaties are continually being negotiated.

The provisions of the treaties are given the force of law in Australia by virtue of the *Income Tax (International Agreements) Act, 1953*, which incorporates the provisions of both the treaties and the Tax Act. Subject to certain limited exceptions, to the extent to which any inconsistency exists between the Tax Act and a treaty, the provisions of the treaty prevail.

Australia's double taxation agreements apply to various types of income derived by residents of one country from sources in the other country. Each agreement adopts two alternative methods of avoiding or relieving double taxation, the applicable method depending upon the

nature of the income. The first method reserves to the country of residence of the taxpayer (generally) the right to tax the income. The second method permits the country of source to tax the income and, to the extent to which the country of residence also taxes the same income, the agreements require the country of residence to give a credit against its tax for any tax paid in the country of source.

Subject to Controlled Foreign Companies (CFC), Transferor Trust Rules and Foreign Investment Fund (FIF) measures / Foreign Accumulation Fund (FAF) integrity rules (all of which are currently under review, or in the case of the FIF legislation, repealed), business profits of an enterprise will be generally taxable only in a taxpayer's country of residence, except in circumstances where the business profits are attributable to a permanent establishment in the country of source through which an enterprise carries on business. Conversely, the country of source is permitted to tax business profits which are attributable to a permanent establishment in the country of source, through which the enterprise carries on business. In the latter circumstances, a credit will be available to the enterprise in its country of residence.

Each agreement defines extensively (but not necessarily in identical terms), what constitutes a permanent establishment. A permanent establishment usually includes, but is not limited to, a fixed place of business through which the business of the enterprise concerned is wholly or partly carried on, such as a place of management, a branch, an office, a factory, or a workshop. In addition, agents who habitually exercise an authority to conclude contracts on behalf of the enterprise usually constitute a permanent establishment.

Income which is taxable in the country of source also includes dividend, interest and royalty income. However, in relation to such income, all agreements limit the rate of tax which the country of source can impose on such income, except in circumstances where the income is effectively connected with a permanent establishment of the person beneficially entitled to the income in the country of source.

Other provisions of such agreements deal with income from real property, shipping and air transport profits, independent personal services, dependent personal services, income of entertainers, teachers and students, and pension income.

## **Foreign Income**

### ***Specific provisions providing relief from double taxation to Australian residents***

Australian residents are subject to tax on their worldwide income. Australia's domestic legislation employs both the "exemption" and "foreign tax credit" approaches to relieve a resident taxpayer from double taxation.

#### ***Exemption***

An Australian resident company is not assessed to tax to the extent it derives active business income through a foreign "permanent establishment". Similarly, tax is not imposed on capital gains derived by an Australian resident company from sale of capital assets used in connection with a foreign business permanent establishment or shares in a foreign company which has substantial foreign active assets.

Also, Australian resident companies are not taxable on dividends they receive from non-portfolio interests in foreign companies (i.e. holdings in foreign companies where a voting interest of more than 10% is held).

### ***Foreign Tax Credit***

Australian residents who do not qualify for a complete exemption under the above arrangements are taxable in Australia on gross foreign income or gains derived, but a tax offset is usually allowed for foreign tax paid on the income or gain to the extent of the Australian tax payable on the foreign income.

### ***Australia's Accruals Taxation Regimes***

Australia imposes a comprehensive system of accruals taxation for Australian residents' interests in foreign entities, covering both control and non-control interests.

The Foreign Investment Fund rules were effectively repealed as of 1 July 2010 (noting that the Foreign Accumulation Fund rules are still currently in draft), and as such, the only rules that currently operate are the Controlled Foreign Companies rules and the transferor trust rules.

The CFC rules have been undergoing review and re-development for a number of years. To date, no final version of any amending legislation is available. This is discussed below. The transferor trust rules are also under review, but primarily to simplify the rules rather than change policy.

### ***Controlled Foreign Companies (in operation, but under review)***

Part X of the Tax Act was introduced so that certain income of CFC will be attributed to Australian resident taxpayers on an accruals basis.

There are three tests in determining whether a foreign company is controlled by Australian resident taxpayers. These are:

- strict control – 5 or fewer residents, together with their associates, own, or are entitled or able to acquire, or are able to control, an interest of 50% or more in the foreign company; or
- assumed control – a single resident, together with associates, owns, or is entitled to acquire, an interest of at least 40% in the foreign company, unless the company is controlled by parties unrelated to the single resident or associates; or
- de facto control – 5 or fewer residents, together with their associates, effectively control the company.

It is both the direct and indirect interests that are taken into account in determining whether a foreign company is a CFC. An interest held in a CFC via an interposed entity will only be included when that interposed entity is either a CFC, a controlled foreign partnership or a controlled foreign trust.

Having established that the company is a CFC, income will only be attributed where the Australian taxpayer has a certain minimum interest in a CFC, the extent of which is to be determined by reference to the operative control test.

The CFC's income that may be attributable will be determined according to the residency of the CFC.

The residency of the CFC is categorised as follows:

- Listed (Comparable Tax) Country which includes Japan, New Zealand, United Kingdom, United States of America, Canada, France and Germany
- Unlisted Country.

CFC's which are resident in any Listed Country will not generally be subject to attribution.

In respect of all other countries, the accruals measures seek to tax tainted income of CFCs, which is basically passive income, such as interest and dividends, as well as business income derived from transactions with Australian associates.

Certain income, which would otherwise be subject to the accruals tax measures, would not be attributable if it satisfies the active income exemption. Thus, the tainted income of a CFC will not be attributed to Australian resident shareholders if the CFC derives more than 95% of its income from genuine business activities (active income). This is basically income that is not tainted.

Dividends paid by CFCs out of previously attributed income will be exempt from tax. A credit, however, is allowed for any withholding tax deducted in respect of dividends paid.

Dividends that are not sourced from previously attributed income may be exempt, where it is received by a resident company holding a non portfolio interest (i.e. greater than 10%) in the foreign company paying the dividend.

The Government's exposure draft was released on 17 February 2011 (with submissions closed on 18 March 2011). The key changes were expressed to be:

- Better targeting the CFC rules by:
  - Focusing the rules on single Australian controllers
  - Providing relief for intra-group transactions
  - Treating rent in respect of real property as being active income
  - Allowing royalty income to be treated as active where it has not originated from Australia
  - Removing the base company income rules
  - Retaining the existing listed country, active income de minimis, and AFI subsidiary exemptions.
- Rewriting the CFC laws using coherent principles, resulting in more streamlined and simpler legislation.
  - The proposed rules reduce the number of pages of CFC law from 181 to around 35 operative pages.
- Providing more access to dividend exemptions as well as methods to prevent the double taxation of previously attributed income.

- Improving the integrity of the Australian revenue base by:
  - Denying eligibility to dividend exemptions where they are paid in respect of debt interests
  - Introducing a FAF rule.

***Transferor Trust Rules (in operation, but under review)***

The transferor trust measures in Division 6AAA relate to the accruals taxation of income derived by non-resident trust estates.

The legislation was introduced to overcome the problem of the accumulation of foreign sourced income in a non-resident trust estate, which would not be subject to Australian tax until actually distributed to resident beneficiaries.

The circumstances in which a resident taxpayer will be attributed income of a non-resident trust estate depends upon whether the relevant trust is a discretionary or non-discretionary trust.

Exceptions to the rule apply where:

- the transfer was made in the ordinary course of carrying on a business and made on identical or similar terms to those that relate to transactions with ordinary clients or customers
- the transfer was made under an arm's length transaction not in the ordinary course of carrying on a business and the transferor was not in a position to control the trust at any time after the transfer and before the relevant year of income
- if the transfer was made before 12 April 1989, the taxpayer was not in a position to control the trust at any time after that date and before the end of the relevant year of income
- for a non-discretionary trust estate, a resident taxpayer may be an attributable taxpayer if the taxpayer transferred property or services to the trust after 12 April 1989 and the consideration for the transfer was nil or less than arm's length
- the attributable income of a non-resident trust is: where the trust is not resident in a broad exemption listed country, i.e. a low tax jurisdiction, the whole of the net income of the trust, determined according to the Australian tax law, with certain modifications
- where the trust is resident in a listed country, i.e. comparable tax jurisdiction, so much of the net income which benefits from concessional tax treatment.

The amount to be attributed is reduced by amounts already subject to tax in Australia or in a listed country. The attributed amount is also reduced by amounts already assessable to a resident beneficiary or to the trustee of a non-resident trust estate.

Distributions made by non-resident trusts out of income previously attributed, is exempt when received by the Australian beneficiary.

In the absence of a resident transferor to whom income may be attributed, the measures seek to apply an interest penalty to resident beneficiaries when they become presently entitled to the accumulated trust income.

***Foreign Investment Funds (repealed as of 1 July 2010, Foreign Accumulation Fund is the replacement but is still in draft)***

The Government's exposure draft was released on 17 February 2011 (with submissions closed on 18 March 2011). The summary of the new law was expressed to be:

- The amendments introduce a targeted anti-roll-up rule which applies where:
  - an investor holds an interest in a foreign accumulation fund;
  - the investor receives a tax deferral benefit as a result of the interest; and
  - the investor entered into the scheme with the dominant purpose of obtaining a tax deferral benefit.
- In instances where these rules apply, the Commissioner may make a determination to include the whole or part of the tax deferral benefit in the investor's assessable income for the relevant income year.
- Investors who have an amount attributed to their assessable income as a result of this rule will be protected from double taxation against future distributions from the foreign accumulation fund.

That this exposure draft is not law, the Australian Taxation Office has an administrative treatment:

The ATO will accept tax returns as lodged during the period up until the proposed law change is passed by Parliament. Past year assessments will not be reviewed until the outcome of the proposed amendment is known.

After the new law is enacted, taxpayers will need to review their position for the income year commencing 1 July 2011.

- Those taxpayers who returned income in accordance with the changes do not need to do anything more.
- Those taxpayers who returned more income than they were required to can seek an amendment and if a reduction in liability results, interest on overpayment will be paid.
- Those taxpayers who returned less income than required by the changes will need to seek amendments. No tax shortfall penalties will be applied and any interest accrued will be remitted to the base interest rate up to the date of enactment of the law change. In addition, any interest in excess of the base rate accruing after the date of enactment will be remitted where taxpayers actively seek to amend assessments within a reasonable timeframe after enactment.

## **Medicare Levy**

An individual who is a resident of Australia at any time during a year of income is liable to pay, in addition to income tax, Medicare levy based upon the individual's taxable income for



the year of income. The Medicare levy is also payable by some trustees. The rate of the Medicare levy is 1.5 per cent.

An additional surcharge of 1% will be imposed on high income earners who do not carry private health insurance.

### **Thin Capitalisation**

Thin capitalisation refers to the situation where an entity is financed from borrowing rather than equity.

The objective of this legislation is to ensure that multinationals do not allocate excessive amounts of debt to their Australian operations.

Thin capitalisation legislation was amended to apply from 1 July 2001 to include the following requirements:

- Australian Permanent Establishments to prepare financial statements from 1 July 2002
- Provisions that deal with the deductibility of interest expenses for Australian entities investing overseas.

The legislation acts to limit the allowance of debt deduction (interest expenses) on debt attributable to the Australian operation of multinationals (entities that are foreign controlled).

Control is usually considered to be 50% ownership by five or fewer entities, but can apply when one entity owns 40% or more and no other entity controls the entity.

Thin capitalisation legislation, which existed prior to 1 July 2001, was considered deficient as it only applied to foreign controlled Australian operations and non-residents deriving Australian assessable income, and only sought to limit debt borrowed from a foreign controller or their associates.

The rules apply to groups and they are considered as one consolidated entity for this purpose.

Deductions of less than \$250,000 are not affected by this legislation.

Debt deductions (debt interest) are the returns payable on debt capital. Reference is made to the debt and equity legislation to determine debt capital for thin capitalisation purposes.

The rules affect non-banks as follows:

- Debt deduction will be reduced where the amount of debt exceeds 75% of the entity's Australian assets.

The rules affect Banks or ADIs (Authorised Deposit Taking Institutions) as follows:

- Debt deductions will be reduced where equity used to fund the Australian operations is less than 4% of its Australian risk weighted assets.

## **Transfer Pricing**

Subdivision 815-A and Division 13 of the Tax Act deals with international transfer pricing or profit shifting. The provisions have effect only upon exercise of the Commissioner's discretion, directed in considering all international agreements resulting in loss of Australian revenue, even in the absence of a tax avoidance motive. It is the internationally accepted arm's length principle that is the basis for determining whether Australia has been denied its fair share of tax in the supply or acquisition of property or services across international boundaries defined as an international agreement.

The legislation is therefore concerned with under-pricing of goods and services supplied or overpricing of goods and services acquired by Australian resident taxpayers, or non-residents deriving Australian sourced income.

Thus, where a taxpayer supplies property or services under an international agreement in circumstances where the Commissioner is satisfied that the parties to the agreement are not dealing with each other at arm's length, and the taxpayer either fails to receive consideration or receives consideration which is less than the arm's length consideration, the Commissioner may determine to apply the provisions of Subdivision 815-A and Division 13. The consequences of the application of Subdivision 815-A and Division 13 in these circumstances, is that the taxpayer is deemed for all purposes of the Tax Act, to have received consideration equal to the arm's length consideration in respect of the supply of the property or services. In other words, the taxpayer's assessable income will be increased by the difference between the consideration received (if any) and the arm's length consideration.

Conversely, where a taxpayer acquires property and services under an international agreement in circumstances where the Commissioner is satisfied that the parties to the agreement are not dealing with each other at arm's length, and the taxpayer gives consideration which is greater than the arm's length consideration, the Commissioner may also determine to apply the provisions of Subdivision 815-A and Division 13. The consequences of the application of Subdivision 815-A and Division 13, in these circumstances, is that the taxpayer is deemed for all purposes of the Tax Act, to have given consideration equal to the arm's length consideration in respect of the acquisition of the property or services. In other words, the deduction claimed by the taxpayer in respect of the acquisition of the property or services will be reduced by the excess of the consideration paid over the arm's length consideration.

The Commissioner has also released guidelines where Subdivision 815-A and Division 13 may be applied to attribute income to a resident company on a loan made by it to a non-resident company, if there is no interest, or the interest on that loan is less than the amount that would have been received by an independent party dealing at arm's length with the borrower.

Where interest expense is claimed by a resident company, Subdivision 815-A and Division 13 may be applied to reduce the deduction for interest on a loan received by it from a non-resident company, if the interest expense is greater than the arm's length amount.

Where the Commissioner exercises the powers conferred upon him by Subdivision 815-A and Division 13, he is also empowered to make compensating adjustments to the returns of the other taxpayers where he considers it to be just and reasonable. Tax penalties may also be applied if Subdivision 815-A and Division 13 is determined to apply.

The provisions of a double tax treaty may also apply to permit transfer pricing adjustments to be made. This would be the case if the other party was resident in a country with which Australia had a double tax treaty. In general, the double tax treaty article and Subdivision 815-A and Division 13 of the Tax Act are applied in the same manner by the Commissioner.

### **Uniform Capital Allowances**

A Uniform Capital Allowance was introduced from 1 July 2001 which allows for deductions for the decline in value of business assets over their effective life.

### **Withholding Tax**

An unfranked dividend paid by a resident company to a non-resident is subject to withholding tax. The applicable rate is 30 per cent of the gross amount of the dividend, except where the person beneficially entitled to the dividend is a resident of a country with which Australia has entered into a double taxation agreement, and the holding in respect of which the dividend is paid is not effectively connected with an Australian permanent establishment. In this case the applicable rate is generally limited to 15% of the gross amount of the dividend or less (depending on the country). In contrast, to the extent to which a dividend paid to a non-resident is franked, no liability to withholding tax arises.

From 1 July 2005, the more limited Foreign Dividend Account (FDA) rules were replaced with a Conduit Foreign Income (CFI) exemption. This exemption allows foreign income to be passed through an Australian company to foreign shareholders without being taxed in Australia. By declaring an unfranked dividend that it pays to foreign shareholders to be CFI, the relevant foreign income will be treated as non-assessable, non-exempt income of the Australian company, and the dividend will not attract withholding tax. The exemption can also apply where foreign income is paid through one or more interposed Australian entities.

Interest derived by a non-resident, other than interest derived by a non-resident in carrying on business in Australia at or through an Australian permanent establishment, which is paid to the non-resident by either:

- a resident of Australia; or
- a non-resident of Australia carrying on business in Australia at or through an Australian permanent establishment, is subject to withholding tax.

The applicable rate is 10%.

Australian sourced interest derived by a non-resident in carrying on business in Australia at or through an Australian permanent establishment, is included in the assessable income of the non-resident and taxed in the normal manner.

Royalties paid to non-residents are also subject to withholding tax. A royalty withholding tax of 30% applies on royalties paid or credited to non-residents. The amount of withholding tax may be reduced where a royalty is paid from Australia to a resident of a treaty country. The amount applicable to a treaty country will usually be 10% but may be as high as 25%, depending on the treaty agreement.

Dividends, royalties and interest upon which withholding tax is payable, and franked or exempted dividends paid to a non-resident, are not included in the Australian assessable income of the non-resident concerned. Withholding tax is, therefore, a first and final tax in respect of such income. Withholding tax is required to be deducted by the person paying the dividend, interest or royalty.

Withholding tax at the rate of 30% has applied since 1 July 2007 to certain distributions from Australian managed funds to non-resident investors. The new withholding tax covers distributions of Australian source income other than interest, dividends and royalties (which are subject to withholding tax in their own right, usually at lower rates), but excludes capital gains that do not relate to taxable Australian property (see above).

## **9. Other Taxes and Levies**

### **Goods & Services Tax**

Goods and Services Tax (GST), similar to value added taxes (VAT), was introduced in Australia from 1 July 2000.

GST is levied at the rate of 10% on transactions relating to the provision of most goods and services supplied in Australia. There are two types of exemptions: “GST Free” and “Input Taxed” transactions.

#### ***GST Free***

GST Free transactions (generally referred to as “zero rated” in other jurisdictions) are ones which do not attract GST but entitle the producer of the supply to claim GST paid on the inputs that create the GST free supply. They include exports, food, health and education.

#### ***Input Taxed***

Input taxed transactions (generally referred to as “exempt” in other jurisdictions) do not attract GST and the producer of the supply is not entitled to claim GST paid on the inputs that create the Input Taxed Supply. Input Taxed supplies include financial supplies (e.g. interest) and residential property.

## ***Registration***

Registration is compulsory for enterprises whose turnover exceeds A\$75,000. Supplies which are input taxed are excluded from the definition of turnover.

## ***Returns***

Returns must be lodged monthly where annual turnover exceeds A\$20 million. For enterprises with lower annual turnovers returns may be lodged on a quarterly or monthly basis.

Enterprises whose annual turnover is less than \$2 million have the choice of adopting either a cash or accruals method for GST reporting purposes.

## **Fringe Benefits Tax**

By virtue of the operation of the Federal *Fringe Benefits Tax Assessment Act, 1986*, fringe benefits tax is payable by employers on the value of fringe benefits provided to either their employees or associates of their employees. Taxable fringe benefits may be provided either by the employer itself, by an associate of the employer or by any other person under an arrangement with the employer or an associate of the employer. In all cases, however, the benefit must be provided in respect of the employee's employment.

Fringe benefits tax is payable in respect of a wide range of benefits, including:

- motor vehicles which are available for private use by the employee;
- interest-free or low interest loans;
- certain residential accommodation provided by employees;
- discounted or free goods and other property provided to employees;
- entertainment; and
- discounted air travel for employees in the airline or travel industry.

The fringe benefits tax year is the 12 months period from 1 April to 31 March. An annual fringe benefits tax return showing the taxable value of all benefits must be lodged. Employers must pay quarterly fringe benefits tax instalments in anticipation of each year's liability where the liability exceeds \$3,000, with any balance payable at the time of lodgement of the annual return.

The rate of tax payable in respect of the value as calculated under the Fringe Benefits Tax Assessment Act of taxable fringe benefits is currently 46.5%. This rate is applied to a tax inclusive value by "grossing up" the benefit 2.0647 times (if GST applies to the benefit) or 1.8692 times (if GST does not apply).

Income tax deductions are allowed for the amount of fringe benefits tax paid by the employer.

When benefits provided exceed \$2,000, the value of benefits provided must be reported on Employees Payment Summaries.

This effectively means the benefit of the tax saving to an employee represented by the difference between the taxpayer's marginal rate and the company tax rate, will be negated for certain fringe benefits. However, fringe benefits that retain concessional status, such as motor vehicles, will remain an effective means of remuneration packaging.

### **Pay-roll Tax**

Each of the states and territories of Australia imposes pay-roll tax on employers in respect of wages paid to employees. Certain exemptions exist where the monthly or annual pay-roll does not exceed a specified limit.

### **Compulsory Workers Compensation Insurance**

Each state has laws requiring insurance cover to be provided for employees. The particular arrangements vary between states, but generally involve private-sector insurance companies underwriting the risks. Premium rates vary between states and industry groupings, reflecting various levels of risk.

### **Land Tax**

Land tax is levied by each of the states and is paid upon the value of all lands owned by a taxpayer, which are situated within the state concerned. Certain land is exempt from tax, including (as a general rule) the taxpayer's principal place of residence and primary production property.

### **Stamp Duty / Transfer Duty / Landholder Duty**

Whilst there are continuing endeavours to harmonise the respective duty regimes across Australia, the duty legislation and regulations are still not currently uniform, although duty rates are similar in some cases to avoid jurisdiction shopping.

Depending on the state, duty is a tax imposed on specified classes of written instruments or on the transactions affected by them.

In some cases where duty would otherwise be avoided by the parties to a transaction not bringing a dutiable written instrument into being, they are required to prepare a written record of the transaction and have duty paid on it.

Some of the main types of written instruments / transactions that attract stamp duty are transfers of shares in 'land holder' companies; conveyances of land and other property; motor vehicle registration and transfers.

The rate of duty payable, in the case of a transfer or conveyance of property, is typically calculated by reference to the higher of the amount or value of the consideration paid and the true unencumbered value of the item of property transferred or conveyed, and is payable at ad valorem rates on a sliding scale by reference to the result of that calculation. The duty authorities are empowered to require proof of independent arm's length values.

## Superannuation

A prescribed minimum level of superannuation support must be provided by employers for each of their employees. The minimum level is 9% of earnings currently but will increase over time to 12%.

Year commencing	Increase	Total
1 July 2013	0.25	9.25%
1 July 2014	0.25	9.5%
1 July 2015	0.50	10%
1 July 2016	0.50	10.5%
1 July 2017	0.50	11%
1 July 2018	0.50	11.5%
1 July 2019	0.50	12%

Superannuation support contributions must be made on a quarterly basis.

A superannuation guarantee charge will be imposed on employers failing to meet these requirements. An income tax deduction will not be allowed for this amount.

# DIRECTORY

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The HLB Mann Judd Australasian Association comprises a number of independent accounting firms with offices throughout Australia and New Zealand. Through their membership of the HLB International accounting network, HLB Mann Judd firms have access to accounting expertise throughout the world.

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