

LEX MUNDI INTERNATIONAL TAX DESKBOOK

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AUSTRALIA TAX DESKBOOK

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AUSTRALIA

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The information on the taxing regime of the above country is intended to be accurate and current. Before relying on the information, however, please contact the above firm, which prepared and is responsible for revising the information to verify its accuracy.

Lex Mundi International Tax Deskbook

AUSTRALIAN CHAPTER Clayton Utz

[This commentary reflects the current state of the law as of 1 March 2006]

Introduction

Australia is a federation with three levels of government. The Federal government is the principal revenue raiser while the State and Territory governments are significantly dependent upon transfers of revenue from the Federal government. Finally, local governments raise revenue within their respective localities to fund the maintenance of community facilities.

The Federal government's tax base encompasses both direct and indirect taxes. Taxation of income provides the principal tax base (around 70 percent of total tax revenues). The laws governing the taxation of income are primarily found in the *Income Tax Assessment Act (Cth)* 1936 (the "**1936 Act**"). The Act is gradually being re-written into a clearer format, and provisions which have been re-written are contained in the *Income Tax Assessment Act (Cth)* 1997 (the "**1997 Act**"). Australia introduced a goods and services tax ("GST") on 1 July 2000. GST is a broad based consumption tax similar to GST/VAT in other jurisdictions. The basic rules in relation to the GST are contained in the *A New Tax System (Goods and Services Tax) Act 1999*. Customs and excise duties are levied on various goods. The Federal government also taxes employers on fringe benefits provided to employees (under the *Fringe Benefits Tax Assessment Act (Cth)* 1986). Other taxes include a petroleum resource rent tax.

State and Territory government taxes that may impact investment and business activities in Australia include: land tax, payroll tax, stamp duty and certain indirect taxes on petrol, alcohol and tobacco. State and Territory governments do not tax income. States also operate workers' compensation schemes which include imposing a levy on employers. Uniformity in laws between the States and Territories may not be assumed, and special revenue incentives may be offered by a State to encourage a particular business activity.

Australian governments do not require social security or pension contributions. However, employers must make superannuation contributions for employees at a prescribed minimum level or incur a tax if they fail to do so. Superannuation arrangements are generally managed by the private sector in compliance with Federal government laws. The Federal government also imposes a 1.5 percent "Medicare" levy on the taxable income of resident individuals to help fund Australia's public health system (there is an additional 1% levy surcharge if an individual's income exceeds a certain threshold and the individual does not have private patient hospital insurance).

Australian governments no longer impose death duties, inheritance taxes or gift duties.

The Department of Treasury of the Federal government is ultimately responsible for the creation and administration of Federal taxation laws. The Australian Taxation Office ("ATO") has day-to-day administrative responsibility for collecting taxes and ensuring general compliance with the taxation law. The ATO has various branch offices in each State and Territory. The ATO maintains a website at <http://www.ato.gov.au>.

Taxation is imposed in relation to an income year from 1 July to 30 June. An application may be made to the ATO for a "substituted accounting period" in certain circumstances, for example

when the income year of a foreign parent company is determined on a different basis. The income tax is administered primarily on a self-assessment basis combined with extensive auditing by the ATO.

From time to time the ATO produces public rulings and private rulings which seek to explain or illustrate the application of a particular tax law. The *Tax Laws Amendment (Improvements to Self Assessment) Act (No 1) 2005* and the *Tax Laws Amendment (Improvements to Self Assessment) Act (No 2) 2005* significantly expanded and clarified the regimes applicable to the tax ruling system, with effect from 1 January 2006. Both public rulings and private rulings are legally binding on the ATO. Reliance on a ruling entitles taxpayers to protection from additional primary tax, penalties and interest. Taxpayers may apply for "private rulings" on a range of tax liability and administration issues. They are currently confidential and only apply to the particular taxpayer concerned. Failure to follow a public or private ruling can have adverse consequences, including penalties.

Objections may be lodged in relation to decisions made by the ATO, including amendments to assessments and private rulings. Objections are initially re-considered internally by the ATO. Decisions disallowing objections may be challenged before the Australian Courts. The primary source of law in relation to the administration of tax in Australia is the *Taxation Administration Act (Cth) 1953* and Regulations. Taxpayers may also lodge objections to administrative actions of the ATO with the Commonwealth Ombudsman.

The *Inspector-General of Taxation Act 2003* established the office of Inspector-General of Taxation. The Inspector-General's role is to provide independent advice to government on tax matters, to identify systemic issues in tax administration and generally to improve the administration of the tax laws. For these purposes, the Inspector-General may compel production of taxpayer information by tax officials in appropriate circumstances.

Income Taxes as Applied to Business Entities and Individuals

I. CORPORATIONS

1. What Tax Returns Must be Filed

Resident companies and non-resident companies which have earned income from Australian sources are required to file or lodge Australian income tax returns. Agents of companies, including non-resident companies, must also lodge returns disclosing the income earned in the agent's representative capacity. The head company of a consolidated group is primarily responsible for the entire group's tax liability and for lodging a single return on behalf of the group.

Returns for companies are completed on a standard "*Form C*" and require the disclosure of income, including net capital gains or losses, credits, loss transfers, rebates and other information deemed necessary in the calculation of "taxable income" and "tax payable".

The current Pay As You Go ("PAYG") instalments system was introduced on 1 July 2000. This system does not affect the due date for lodgment of a taxpayer's income tax return. The system requires most taxpayers to pay quarterly instalments after the end of each quarter, based on income derived during the quarter. Some taxpayers pay annually but most pay quarterly. The Commissioner of Taxation (the "Commissioner") recommends finalizing PAYG withholding amounts before the income tax return is lodged (to ensure proper credit of PAYG instalment

payments), though ultimately it is the income tax return which determines the actual tax payable for the income year.

A. The Filing Dates

Taxable companies that are not part of a consolidated group and head companies of consolidated groups are both required to lodge their income tax return according to certain lodgment categories. Near the end of each financial year, the ATO issues a legislative instrument calling for the lodging of annual income tax returns.

The table below sets forth a very general guide to lodgment dates. The table does not include special lodgment dates for certain taxpayers, such as those with a substituted accounting period or with outstanding returns due.

Turnover/ Type of Taxpayer	Lodgment Date	Due Date for Payment
Non-taxable	3 June	----
\$2m to \$10m	31 March	31 March
\$10m or more	15 January	1 December (preceding year)
Taxable new companies	28 February	28 February
Balance of companies	15 May	15 May

Lodgment may be made on the next applicable business day if the lodgment due date is otherwise a weekend or a public holiday.

B. Where and With Whom Filed

Returns may be filed with the ATO branch which services the general area in which the taxpayer's principal place of business or administration is located. Non-residents (including companies) should lodge in the region where the principal Australian records are kept. If the returns are being lodged by a Registered Tax Agent, the place of lodgment will depend upon that particular tax agent's arrangements with the ATO.

C. When Taxes Must be Paid

As many taxpayers will find that the PAYG system is the primary method of tax payment, the following table sets out the dates on which PAYG instalments must be paid for most taxpayers. For the due date of the final payment, see the table of lodgment due dates in "The Filing Dates" above. This table includes a category for companies that pay their GST monthly. The determination whether a company pays GST monthly generally depends on the size of the company's annual turnover.

If the company...	...pays GST monthly	...is the head company of a consolidated group	...does not fall into the first two categories
Quarter	Instalment due by	Instalment due by	Instalment due by
July - September	21 October	21 October	28 October
October – December	21 January	21 January	28 February
January – March	21 April	21 April	28 April
April – June	21 July	21 July	28 July

If the due date falls on a Saturday, Sunday or public holiday, the due date will be the next business day.

2. Calculation of Income Taxes

A. Determination of the Tax Base

Income and deductions are determined separately, and then the allowable deductions are subtracted from the assessable income to arrive at "taxable income". The gross amount of tax payable is calculated by multiplying taxable income by the applicable tax rate (or rates).

Offsets, including rebates and credits, are amounts which may be deducted directly from tax payable. Credits that may be applied against the tax payable include, for example, those for foreign taxes. A variety of specific rebates are available. They are predominantly used as a form of social welfare.

(1) Revenues Included

The income tax base includes statutory income and ordinary income. The income tax base thus includes "income according to ordinary concepts and usages", with the addition of net capital gains. Income according to ordinary concepts is generally regarded as including three concepts; income from rendering personal services, income from property and income from carrying on a business. There are various categories of exempt income which are specifically excluded from assessable income, although these amounts may be relevant for other purposes, such as for the determination of the applicable rate of tax.

In determining the tax base, a distinction is drawn between gains of a revenue nature and gains of a capital nature. Generally, this exercise in characterisation will depend upon factors such as the regularity of the receipt, whether the receipt is in exchange for a right or asset which might be expected to produce revenue in the future, the ambit of the taxpayer's usual business operations and whether the taxpayer had an intention to generate profit. Ultimately, the question is decided in the light of precedent and all the circumstances.

If the gain is a capital receipt, it may be subject to special treatment under the "Capital Gains" provisions in the 1997 Act Pt 3-1, 3-3 and 3-5. In general, capital gains are only included in the tax base if they are realised on the disposal of an asset acquired (or deemed to have been acquired) after 19 September 1985. The amount of the capital gain to be included in the taxpayer's assessable income is calculated as the difference between the proceeds on disposal of the asset and the "costbase" of the asset. The costbase will generally include the acquisition consideration, incidental costs, non-deductible non-capital costs of ownership, capital expenditures to increase value and capital expenditures to establish or defend title to or right over the asset.

Where a taxpayer has held an asset for more than twelve months a discount may be available to the amount of the capital gain. For individuals and trustees this discount is 50% and for superannuation funds it is 33 1/3%. The discounted gain is then included in the calculation of the net capital gain. Capital losses must be offset against capital gains before the discount is applied. However, companies do not enjoy discount capital gains.

Net capital losses may not be offset against revenue gains. However, they may be carried forward indefinitely and offset against future net capital gains,. Companies and trusts must

satisfy certain tests relating to the continuity of ownership and the continuity of a same business. Foreign capital losses are not subject to the same quarantining provisions which apply to ordinary foreign losses (see below under "Deductions Allowed").

In Australia, there is movement towards accruals-based taxation of certain financial transactions and arrangements, particularly those in which receipt of gain is deferred. In December 2005, the government released draft legislation relating to the final stages of reforms of the taxation of financial arrangements. The draft Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2006 (sometimes referred to as "TOFA" legislation) sets forth various timing methods, including fair value, accruals, retranslation, realisation, applicable to the taxation of financial transactions. The rules also seek to conform the taxation of hedging instruments with the tax timing applicable to the relevant underlying item.

(2) *Deductions Allowed*

The deductions available may be categorised as either general or specific.

General deductions represent losses and outgoings to the extent they are incurred in the course of earning assessable income, or in the course of carrying on a business for the purpose of earning assessable income. Losses and outgoings that are of a capital, private or domestic nature, or relate to the earning of exempt income are not deductible.

Factors relevant to the issue of whether expenditure is of a capital nature include:

- the character of the advantage sought (and in this its lasting qualities may play a part);
- the manner in which it is to be used, relied upon or enjoyed (and in this and under the former head recurrence may play a part); and
- the means adopted to obtain it (that is by providing a periodic reward or by making a final provision or payment).

Specific deductible allowances apply to certain types of expenditure such as certain building expenditure, research and development expenditure, mining expenditure, environmental expenditure and expenditure incurred on the development or purchase of certain industrial property rights.

(3) *Timing and Quarantining*

Deductible expenditure need not be incurred in the same year in which it gives rise to assessable income. Furthermore, there is no requirement that expenditure be related to particular items of assessable income, provided that the expenditure satisfies the required connection with income production and is related or properly referable to a particular accounting period. Deductions in relation to a prepaid benefit may be apportioned over the period during which the benefit accrues. Existing tax timing rules will be significantly altered by the proposed new code relating to financial arrangements.

As an exception to these general rules, foreign losses are "quarantined", that is, an overall foreign loss in relation to a class of foreign source income may only be deducted from future foreign source income of that same class. Foreign losses may not be deducted against Australian-sourced income. Separate classes of foreign income include "interest income", "other passive income", "offshore banking income" and "other income". Foreign losses can be carried forward

indefinitely in relation to the same class of income. As a result of the New Business Tax System (Thin Capitalisation) Act 2001, debt deductions are no longer subject to foreign loss quarantining. Legislative proposals have been introduced that would remove quarantining of foreign losses and foreign tax credits.

(4) *Depreciation*

A deductible depreciation allowance ("capital allowance") applies to plant or articles owned and used, or installed ready for use, by the taxpayer in the course of producing assessable income.

A uniform capital allowances regime applies, consisting of a general set of rules to calculate the deduction for the notional decline in value of most depreciating assets.

The depreciation base generally comprises the cost of the relevant asset. The cost includes the purchase or construction price, plus the transport charges, import duties, GST and other installation charges. The depreciation base or "cost" of the asset is reduced by any GST input tax credits generated in acquiring or constructing the asset. When an asset is purchased its useful or "effective" life is estimated, either by the taxpayer or by reference to a ruling or determination by the ATO which sets out the estimated effective lives of various classes of assets. The depreciation base is then allowed as a progressive deduction over the course of the asset's estimated effective life.

In general, there are two methods of calculating the annual depreciation allowance; "prime cost" and "diminishing value". The prime cost method provides an equal deduction for each full year over the estimated effective life of the asset, based on a set percentage of its original cost. The diminishing value method applies a set percentage (higher than the prime cost rate) to the "written-down" value of the asset each year. In comparison with the prime cost method, the diminishing value method results in higher deductions early in the life of the asset, but lower deductions in later years.

Assets valued up to \$300 and used predominantly to produce non-business income, or with an effective life of less than three years, are fully deductible in the year of acquisition.

If a taxpayer disposes of the asset for an amount which exceeds its written-down value for tax, an assessable "balancing charge" will arise, equal to the difference between the written down value and the sale price. If the sale price exceeds what the taxpayer originally paid for the asset, a balancing charge will arise equal to the difference between the written-down value and the original purchase price, and a capital gain may also arise equal to the remaining difference between the original purchase price and the final sale price.

In general, intangible assets cannot be depreciated. There are, however, some important exceptions:

(i) *Intellectual Property*

A deduction is available for owners of patents, copyrights or designs (or licenses thereof), granted or registered under the laws of either Australia or any other foreign country, which are used in the production of assessable income. The amount of the deduction is calculated by dividing the residual value of the property with its effective life. The residual value is its total cost less consideration receivable for part disposals and other relevant deductions. The period of effective life commences from when the property is first used.

(ii) Australian Films

Capital expenditure incurred in the production of a film that is made wholly or substantially in Australia and has significant Australian content, is deductible at a rate of 100 percent.

For the 2001/2002 and later income years, there are provisions allowing film production companies to claim a refundable tax offset for Australian production expenditure incurred in relation to the making of a film, if the expenditure exceeds a specified amount.

(iii) Certain Licenses and Rights

Depreciation deductions are also available for certain licenses, including spectrum and datacasting transmitter licenses, over a period equal to the term of the license or, in some cases, 15 years. Additionally, depreciation deductions are available for mining, quarrying or prospecting rights which generally depend on the life of the proposed mine, quarry or field. Rights relating to telecommunications site access may be deductible over the term of the right.

(iv) Computer Software

Depreciation deductions are available for computer software, or the right to use computer software, which is "in-house software" and is to be used solely for a taxable purpose. "In-house software" is computer software which is acquired, developed or commissioned mainly for the taxpayer to use to perform the functions for which the software was developed. Such computer software has an effective life of 2.5 years and depreciation deductions may begin from the time the software is used or installed ready for use. Expenditure on commissioning or developing, though not of acquiring, in-house software may be pooled with other software development expenditure. Amounts allocated to a software development pool may be deducted at a rate of 40% in each of the first two years after the year the expenditure was incurred and 20% in the third year. The amount of the deductible expenditure does not include the value of the time the taxpayer spends developing the software.

(5) *Major Non-Deductible Expenses*

In general, expenditure which is capital in nature or which is related to a private or domestic purpose is not deductible. The distinction between a capital and revenue expense is somewhat difficult. However, it can be said generally that capital expenditure represents that which relates to establishing, replacing or enlarging the profit yielding structure, while expenditure of a revenue nature relates to the continual flow of working expenses which are paid continually from the returns of the business.

More specifically, major corporate expenses which are non-deductible include certain forms of entertainment, certain interest payments (see "Thin Capitalisation", below) and expenses relating to exempt income.

(6) *Assessable Income and Deductible Expenses Relating to Investment Abroad*

Most foreign source income received by residents is subject to income tax in Australia. Corresponding deductions for expenses incurred in deriving this income are also allowed. However, to the extent that these deductions exceed the assessable foreign income, the resulting foreign loss is "quarantined", in that it may not be offset against other domestic income. As noted above, legislative proposals have been introduced to limit the application of the quarantining rules.

A credit is allowed for both the direct and indirect foreign tax paid, up to the amount of the Australian income tax payable on the foreign income concerned, provided that the foreign tax paid was similar in nature to the Australian income tax (refer to "Treatment of Tax Credits", below).

Australian residents who have an interest in a "controlled foreign company", a transferor trust or a "foreign investment fund" are generally taxed on an accruals basis (see below, under "Anti-Deferral Regimes").

(7) *Anti-Avoidance*

Specific anti-avoidance provisions disallow deductions where expenditure is incurred and some advantage is obtained which is not assessable income, where expenditure and income are shifted between associated companies which effectively defers or avoids income tax or where deductions are claimed and expenditure is later recouped. In addition, the 1936 Act Pt IVA includes a general anti-avoidance section which may nullify a tax benefit and impose severe penalties where the taxpayer has structured their affairs with the dominant purpose of avoiding or reducing their tax liability.

B. The Applicable Rates

Company tax is levied by the Federal government at a flat rate of 30 percent. There is no special rate of tax on net capital gains included in assessable income for companies.

C. Company Losses

Both domestic revenue and net capital losses incurred by a company may be carried forward indefinitely. Revenue losses must be offset against both revenue and net capital gains. However, net capital losses may only be offset against future capital gains. If there is a change in the majority underlying ownership of a company then any carried forward losses will be lost, unless the company satisfies the applicable recoupment tests, including the continuation of the same business as it carried on before the change in ownership.

D. Transfer Pricing Rules

The Act provides the ATO with the power to reconstruct transactions which shift profit internationally where it is considered that the parties were not dealing on an arm's length basis. Income and expenditure may be reallocated to reflect the profit allocation which would have resulted from the transaction had the parties been dealing at arm's length. The ATO does not need to establish that the taxpayer had a tax avoidance motive before applying the provisions to reconstruct the transaction. The ATO has released a series of very detailed rulings in this area. In addition to these statutory provisions, most of Australia's double tax treaties contain articles which provide for an arm's length allocation of income and expenses between related entities and branches entering into cross-border transactions.

E. Consolidated Returns for Affiliated Corporations

Under Australia's consolidation regime, qualifying groups of entities that make a consolidation election are treated as single entities for income tax purposes and intragroup transactions are ignored. Wholly owned groups of resident entities may elect to form a consolidated group - a "one in all in" rule applies to group members. The head company of a consolidated group is

primarily responsible for the entire group's tax liability and for lodging a single return on behalf of the group. Members of a consolidated group are jointly and severally liable for the group's tax liability unless they enter into a valid tax sharing agreement to apportion liability among them.

3. Territorial Rules

A. Corporate Residence

The Act applies several tests to determine whether or not a company is to be treated as a resident of Australia for domestic tax purposes. A company will be considered resident in Australia if:

-it is incorporated in Australia; OR

-it carries on business in Australia and either:

- (i) has its central management and control located in Australia; or
- (ii) has its voting power controlled by shareholders who are residents of Australia.

A company may be resident both in Australia and in another country (*i.e.* a "dual-resident" company). In such circumstances various anti-avoidance provisions prevent the company from claiming the benefit of certain expenditure both in Australia and in the other country. Furthermore, a dual resident company will not be treated as resident in Australia for the purposes of certain specific anti-avoidance provisions and cannot be the head of a consolidated group.

B. Taxation of Worldwide Income

Where a company is resident in Australia, its assessable income will include the gross income derived from all sources, whether domestic or international. On the other hand, if a company is a non-resident, its assessable income in Australia will include only income which has an Australian source and capital gains made on assets with the "necessary connection" with Australia. Some capital gains may be protected under the business profits articles in some of Australia's double tax treaties.

Absent treaty protection, royalties are deemed to be sourced in Australia if they are paid as an expense of an Australian business. Furthermore, profit from the sale of imported goods in Australia is deemed to be sourced in Australia, even if the contract of sale, delivery and payment occurs outside Australia.

C. Treatment of Branch Income

In general, resident companies are exempt from income tax on profits derived from foreign branches which carry on business in particular "listed" countries, or which have a permanent establishment in those countries, provided that the branch income is subject to a comparable tax in that country. Generally, capital gains derived by a resident company are exempt if made on assets used mainly for the purpose of producing foreign income from a business through a foreign permanent establishment, provided that the asset does not have a "necessary connection" with Australia. Exceptions to this general rule apply in the case of gains derived from unlisted countries and certain tainted assets

Profit shifting between Australian branches of foreign enterprises is subject to the anti-avoidance provisions described above in relation to transfer pricing, provided the branch constitutes a

permanent establishment in Australia. Australian branches of non-resident companies are not subject to an additional branch profits tax. Under the New International Tax Arrangements (Foreign-owned Branches and Other Measures) Act 2005, dividends paid by an Australian company to a non-resident company that are attributable to an Australian branch of the non-resident are no longer subject to dividend withholding tax. Rather, such dividends are taxed in Australia on a net assessment basis. The non-resident company may be entitled to claim a tax offset where dividends are franked.

D. Controlled Foreign Companies, Transferor Trusts and Foreign Investment Funds

Income derived by Australian residents from a controlled foreign company ("CFC"), a transferor trust or a foreign investment fund ("FIF") is taxable on an accruals basis and as such is "attributed" to the income of the taxpayer in the year it is derived irrespective of when such income is repatriated to Australia. Attribution does not occur if the CFC has been taxed in the foreign jurisdiction in which it predominantly carries on business, and the tax system in that jurisdiction is comparable with the Australia system (see also "Anti-Deferral Regimes", below).

E. Treatment of Tax Credits

A "direct" tax credit may accrue to a domestic taxpayer in circumstances where foreign income is included in the taxpayer's assessable income and an amount of foreign tax has been paid on that income. Distributions of income received by resident taxpayers from a foreign entity may also attract an "indirect" tax credit for the foreign tax that has been paid by the foreign entity on its profits in its home jurisdiction.

The foreign tax credit is limited to the lesser of the amount of foreign tax paid or the amount of tax that would be payable in Australia on that foreign income. After 3 June 2003, excess foreign tax credits generated within a consolidated group accrue to the head company of the group. Outside the consolidated group context, excess foreign tax credits may only be used by the entity that generated them.

Excess tax credits in relation to a class of foreign income may be carried forward for a period of five years and offset against a future foreign tax credit shortfall in relation to the same class of foreign income and in the order in which they arose. In addition to these statutory provisions, most of Australia's double tax treaties contain articles which provide for a tax credit for foreign tax paid on foreign income.

4. Withholding Taxes

A. Dividends

In general, dividends are subject to withholding tax when they are paid by a domestic company to a non-resident shareholder. If the company has already paid company tax on the income being distributed, a "franking" credit is attached to the dividends and they are exempt from dividend withholding tax. To the extent that dividends are "unfranked", they are subject to a withholding tax at the rate of 30 percent. Australia's double tax treaties usually reduce this rate to 15 percent. Australia has a comprehensive network of double tax treaties (see "Tax Treaties", below).

The unfranked part of a franked distribution made by an Australian company that the company is entitled to declare to be "conduit foreign income" will not be assessable to a non-resident and will not be subject to dividend withholding tax. The declaration must be made on the company's distribution statement on or before the day the distribution is made. The amount that an

Australian company is permitted to declare as conduit foreign income is generally the entity's foreign source income with certain adjustments relating to non-assessable income and capital gains. Special rules also apply to prevent the duplication of benefits, such as where an amount qualifies as conduit foreign income but also for certain deductions available for non-portfolio dividends.

Dividends paid by non-resident companies to non-resident shareholders are subject to tax in Australia to the extent that the income is derived from an Australian source. However, Australia's double tax treaties generally exempt such income from tax.

B. Royalties

Withholding tax is payable on royalties paid or credited to non-residents at the rate of 30 percent of the gross royalty. Double tax treaties generally reduce this rate to 10 percent and in certain cases to 5 percent. Royalty withholding tax is payable when a royalty is paid by a resident to a non-resident provided that the royalty is an expense of the resident's business activities in Australia. Withholding tax is also payable where a non-resident, who carries on business in Australia through a permanent establishment, pays a royalty associated with its permanent establishment in Australia to another non-resident.

C. Interest

Interest derived by a non-resident may be subject to interest withholding tax when it is paid by a resident or by a non-resident who incurred the interest liability in the course of carrying on a business in Australia. Interest withholding tax may also be payable on interest paid to the foreign branch of a resident by another resident or by the Australian branch of a non-resident. An amount is required to be withheld at the rate of 10 percent on the gross amount of interest incurred. This rate is generally the same under the Australia's double tax treaties.

D. Withholding Tax on Profits of Non-Resident Corporations

While there are no specific provisions, apart from those explained above, which impose withholding tax on profits derived by foreign companies, each Australian resident (including a bank) holding money for non-residents is deemed to be the agent of that non-resident. As such, residents may be required by the ATO to withhold sufficient money to cover the tax liability of the non-resident. In relation to some forms of income (such as that derived from natural resources or employment) agents will be required to withhold such money as a matter of course.

5. Other Matters Impacting Upon Corporate Taxation

A. Imputation System

Australia has a dividend imputation system which is intended to prevent corporate profits being taxed twice. Australian resident companies can "frank" dividends to the extent that they have already paid tax on the distributed profits. The company must operate a franking account to record, on a rolling balance basis, franking credits (*e.g.* for paying income tax) and franking debits (*e.g.* for paying a franked distribution).

Dividends continue to be assessable in the hands of members. Franked distributions must be "grossed up" when included in assessable income (to equate to the portion of the pre-tax profit of the company that is distributed) and a credit known as a "tax offset" is available to the member for the corporate tax paid by the company.

B. Thin Capitalisation

Australia's thin capitalisation rules operate to deny allowable interest deductions for cross-border investments to the extent that the statutory debt/equity limits have been exceeded. Both inbound and outbound investors are subject to the rules, and this can have serious potential consequences both for foreign investors operating a business in Australia and for Australians operating a business offshore where interest is claimed against Australian assessable income. Deductions are limited by reference to the total debt (including related party debt, third party debt, foreign debt and domestic debt) of the Australian operations of investors. In the case of a consolidated group, the thin capitalisation rules apply to the head of the group.

In the case of inbound investors, a similar control test as that used in the controlled foreign companies rules applies for thin capitalisation purposes, so that only >50% foreign owned Australian companies are subject to the rules.

C. Capital Gains Tax Roll-overs

Where roll-over relief applies, an asset will be treated as if it had not been disposed of for capital gains tax purposes (but not for the purposes of income tax or stamp duty), in relation to the transfer for which the relief is available. Roll-overs may be automatic or elective, and are classified as either replacement asset roll-overs or same asset roll-overs. Typically, the relief is a form of tax deferral. The ability to qualify for roll-over relief is particularly important when reorganising a company structure. There are several different forms of roll-over relief, including interposed company roll-overs, scrip-for-scrip roll-overs, shareholder to company roll-overs, individual to trust roll-overs, partnership to company roll-overs and trust to company roll-overs.

There are also demerger relief provisions to allow certain restructures to result in a deferral of capital gains tax at both the investor and former company shareholder levels where companies are spin-off from corporate groups.

D. Accruals Taxation for Financial Institutions

Insurance companies, banks and other financial institutions are generally required to pay tax on interest earnings on an accruals basis. Financial arrangements are expected to be governed by a new general code.

II. PARTNERSHIPS

1. What Tax Returns Must be Filed

A partnership is not subject to tax as a separate entity. However, a partnership must lodge an annual return (a "*Form P*") specifying the annual net income of the partnership. The partnership itself is not liable to pay tax on such income. The return must set out a complete statement of the net income or loss of the partnership and the proportion allocated to each partner. Each partner must then include their portion of the net income or loss from the partnership in their personal return. Limited partnerships (other than certain limited partnerships involved in the venture capital industry and foreign hybrid partnerships) are not recognised as partnerships for Australian tax purposes and are treated as companies.

A. Filing Dates

The net income of the partnership is determined at the end of its particular accounting period, which will either be the common accounting period of the partners or the period of the majority partner. Partners do not derive their portion of partnership income until the net income of the partnership has been determined at year end. The filing dates for partnership returns are the same as those applicable to individual taxpayers (refer below). Note that as an entity not subject to tax, partnerships do not make PAYG instalments. However, a partnership calculates its income quarterly in order to provide its partners with the necessary information to pay their PAYG instalments.

B. Where and With Whom Filed

As with other tax returns, partnership returns must be filed with the nearest branch of the ATO.

2. Calculation of Partnership Income for Income Tax Purposes

The net income of a partnership is determined in accordance with the general income and deduction provisions of the Act. A partnership is generally unable to qualify for special allowances available only to companies. Franking credits, foreign tax credits and trust distributions generally flow through a partnership to the individual partners.

The net income of a partnership is allocated to the partners and is then included in their personal returns. Partnership losses are likewise allocated to the individual partners on an annual basis and may be carried forward by the individual partners rather than the partnership itself. Capital gains are also assessed from the perspective of the individual partners.

The Act recognises partnerships which limit the legal liability of certain partners to their capital contributions as "corporate limited partnerships." Limited partners are precluded from taking any part in the management of the business, and there must be at least one general partner who bears unlimited liability. In general, limited partnerships are taxed on the same basis as companies, and therefore tax losses cannot be taken into account in the personal returns of the partners. Certain types of limited partnerships that invest directly or indirectly in venture capital are treated as flow-through entities.

III. JOINT VENTURES AND TRUSTS

1. Joint Ventures

The taxation of parties involved in joint ventures will depend on the degree of association between the participants, which is in turn largely determined by the nature of their joint activities and the treatment of the product of the joint venture.

If the joint venture is conducted through a corporate entity, then the joint venture will be taxed as an ordinary company. At the other extreme, if the joint venture is merely contractual, and the participants have sufficiently distinct goals, and do not derive income jointly, then each participant will be taxed separately if and when they derive a profit. If the joint venture participants do not incorporate a company, but still carry on a business as partners or receive income jointly, then the joint venture will be taxed as a partnership.

2. Trust Estates

A. Ordinary Trusts

The net income of a trust estate may be either assessable in the hands of the trustee or in the hands of the relevant beneficiaries, depending on whether or not the beneficiaries have a present entitlement to the net income.

The beneficiary of a share of the net income of a trust is assessed whenever that beneficiary is entitled at law to demand their share of the income. In circumstances where the beneficiary's entitlement to the income is still contingent, the trust income may be taxed to the trustee. In various other circumstances, such as when a beneficiary is a minor or legally incapacitated, the trustee may also be taxed as a matter of practicality.

If a beneficiary is presently entitled to net income of the trust estate, such net income will be assessable in their hands in the year in which present entitlement is conferred, regardless of whether it is distributed in that same year. Subsequent distributions of amounts that have already been subject to tax in the hands of a beneficiary do not represent taxable income when received by that beneficiary. Net losses incurred by a trust cannot be distributed for the benefit of the beneficiaries. However, such losses may be carried forward by the trust and offset against future net profits, provided the trust satisfies various "loss carryforward tests".

Where a non-resident is a beneficiary of an Australian trust, the non-resident may or may not be immediately entitled to the income of the trust estate. Generally, the trustee is required to pay tax on that portion of the trust income to which the non-resident is entitled. However, the non-resident remains liable for the tax. Non-resident beneficiaries are entitled to a refund for tax paid by the trustee on income which was derived from non-Australian sources.

Where the non-resident has other Australian source income, and is therefore required to lodge a return, the non-resident will be liable to pay tax on its aggregate income, including its trust income, and will then receive a credit or refund for the tax paid by the trustee on the trust income. In addition, where the non-resident beneficiary is from one of a set of certain countries with which Australia has a double tax agreement and the non-resident is deemed to be carrying on business through a permanent establishment in Australia due to activities of the trustee, the beneficiary's share of the income derived from that permanent establishment is taxable in the hands of the beneficiary.

B. Trusts Taxed as Companies

Trusts which carry on business as "public trading trusts" are treated as companies for tax purposes. For an entity to be a public trading trust it must be a "trading trust", a "public unit trust" and a "resident unit trust".

For an entity to be a trading trust it must be involved in a trading activity. If the business of the trust is restricted to investing in land for the purpose of deriving rent, investing or trading in unsecured loans, securities, shares in a company, units in a unit trust, futures or forward contracts, interest rate or currency swap contracts, forward exchange or interest rate contracts, life assurance policies, a right or option in respect of such a loan, security, share, unit, contract or policy, or any similar financial instruments, it will not be considered a trading trust. An otherwise passive trust will be considered a trading trust if the trust obtains a controlling interest in an entity that carries on a trading business.

Public unit trusts are unit trusts which either are listed on an Australian or other stock exchange, offer units to the public or have at least 50 unit holders. If a trust is only a public unit trust it will not be taxed as a company. Public unit trusts are a common vehicle for real property investment, as they allow an effective flow-through of income and gains to the individual unitholders.

However, to the extent that the unitholders receive exempt income, the cost base of their units for capital gains tax purposes will be reduced (refer also to the commentary on "capital allowances", above).

A unit trust is considered resident in Australia, and therefore a "resident unit trust", if either the trust property or the trustee's business is situated in Australia. In addition, if more than 50 percent of the beneficial interests in the trust are held by non-residents, the central control and management of the trust must be situated in Australia before the trust will be considered resident in Australia.

Trustees of public trading trusts are taxed at the flat corporate rate of 30 percent. Distributions to beneficiaries are treated as dividends and are subject to the imputation regime. Corporate beneficiaries are entitled to a rebate in respect of the receipt of distributions from such trusts. Entities which are "corporate unit trusts" are treated in much the same way as are public trading trusts. A trust will be a corporate unit trust if it is as a public unit trust and the trust was formed by a prescribed arrangement whereby shareholders of a pre-existing company obtained units in the trust by virtue of their initial shareholdings, and the business of the pre-existing company was purchased by the trust.

C. Filing of Trust Returns

The trustee of a trust must prepare and lodge an income tax return in each income year, whether or not all the income of the trust has been distributed to the beneficiaries. There are no special lodgment procedures of particular importance which differ from those relating to individuals. A return on the standard "*Form T*" must generally be lodged for trusts by 31 October.

IV. INDIVIDUALS

1. Filing of Returns and Paying of Taxes

Returns for financial years ending 30 June must be lodged with the local ATO branch by 31 October of each year (or later if lodgment occurs through a Registered Tax Agent). The return must be filed on the standard "*Form I*". If the individual's year end is some date other than 30 June, lodgment must occur within four months of the substituted year end date. In contrast with the treatment of company income, individuals are assessed on income in the same year as the income is derived. Individuals are required to lodge a return if their taxable income exceeds the tax-free threshold, or where tax has been automatically deducted at source from wages or other earnings during the course of the financial year. Years in which losses have been incurred also require a return to be lodged. Individuals who carry on business in Australia must lodge returns which include details as to their business income. Non-residents are required to lodge returns for those financial years in which they derived any amount of assessable income from an Australian source.

In general, income from employment is taxed as it is earned, on the basis of an estimate of the taxpayer's taxable income derived during the year. Employers are required to withhold PAYG withholding amounts from the salary or wages of their employees. Any difference between the tax payable on the actual income of the employee at the end of the year and the withholding payments already made under the PAYG system will be accounted for when the taxpayer lodges his or her return for that year.

Individuals who earn non-salary and wages income (such as business income or consulting income, partnership income, trust distributions or other investment income) are required to pay instalments towards their expected income tax liability if the Commissioner has given them an

instalment rate. Generally, instalments are payable for each quarter of the individual's income year. The instalment may be based on the individual's previous year's income tax liability and notified to it by the Commissioner, or on the individual's estimate of its income tax liability for the current income year.

The individual's actual tax liability is worked out at the end of the income year when their annual income tax return is assessed. Any difference between the tax instalments paid during the year and the actual tax assessed in that year will either be refunded or require the taxpayer to make up the shortfall. A taxpayer who estimates that they will not earn similar income of a comparable amount may 'vary down' their tax instalments. If the actual tax exceeds the varied amount by a material margin, the taxpayer may be liable for penalties.

2. Calculation of Income Taxes

A. Determination of the Tax Base

(1) Revenue And Deductions

The tax base applicable to individuals is calculated in a similar manner to that described above in relation to companies, in respect of both income and deductions. However, individual taxpayers will not be able to qualify for certain allowances restricted to corporate taxpayers.

Specific receipts which are assessable income to the individual include: salaries and wages, share benefits granted in relation to employment, rents and royalties, gross-up amount of dividends, interest, shares in partnership or trust net income, and net taxable capital gains. Specific expenditures which are deductible to the individual include: expenses of carrying on a business, employee's expenses, property and investment income expenses, depreciation and gifts to certain charities and similar entities.

As a general principle, expenditure for personal rather than commercial use is not deductible. Specifically, expenditure relating to non-business travel, personal clothing, leisure, hobbies, child-minding, gambling and fines, is not deductible. In general, non-cash "fringe benefits" provided by employers to employees are not taxable to the employee, but are subject to a Fringe Benefits Tax assessable to the employer (refer "Fringe Benefits Tax", below).

(2) Exemptions

Income derived by individuals is exempt if it falls under one of the following categories:

- fringe benefits (employees are exempt from tax in relation to the receipt of benefits of this nature);
- pensions of various descriptions (either wholly or partially); and
- maintenance payments (unless the individual who made the payment did so by the disposal of an income-producing asset or by diverting income which would otherwise be taxable in the hands of the payer).

There are also a number of specific exemptions, mainly in relation to social security benefits.

B. Applicable Rates for 2005/06

Resident individuals are taxed on a progressive scale according to the following rates:

Taxable income	Tax payable
\$0 - \$6,000	Nil
\$6,001 - \$21,600	15c for each \$1 over \$6,000
\$21,601 - \$63,000	\$2,340 plus 30c for each \$1 over \$21,600
\$63,001 - \$95,000	\$14,760 plus 42c for each \$1 over \$63,000
Over \$95,000	\$28,200 plus 47c for each \$1 over \$95,000

A Medicare levy is also payable at the rate of 1.5% of taxable income, subject to relief for low income earners. An additional 1% levy surcharge, known as the "Medicare Levy Surcharge" may be imposed on certain high income earners. These are high income taxpayers without adequate private patient hospital insurance. The surcharge is levied on the taxpayer's taxable income and reportable fringe benefits.

A single taxpayer with no dependants is liable to the surcharge if the taxpayer's taxable income and reportable fringe benefits for the year total more than \$50,000. A taxpayer who is a member of a couple is liable to the surcharge if the combined taxable income and reportable fringe benefits of the couple is \$100,000 or more.

Tax offsets reduce the tax payable. Tax offsets based on taxable income levels apply to:

- individuals on low incomes (below \$27,475 in 2004/05);
- individuals who receive certain Australian government allowances and payments; and
- senior Australians.

Other tax offsets apply to people with dependants, those living in remote areas and those who receive particular types of income or incur particular expenses.

Non-residents are also taxed on a progressive scale. The rates are the same as for residents except there is no tax-free threshold and the first \$21,600 of taxable income is taxed at a rate of 29 percent. Non-residents are not subject to the Medicare levy.

Capital gains and losses are, in general, treated in the same way as they are in relation to companies: capital gains tax is not a separate tax, but a component of income tax. This means that the rate of tax you pay on a capital gain depends on your other income.

3. Territorial Rules Applying to Individuals

A. Residency

The determination of whether an individual is a resident or non-resident is different from the determination for companies and trusts. An individual will be treated as a resident if any of the following conditions apply:

- the individual is resident according to ordinary concepts;
- the individual's permanent place of abode is within Australia;

- the individual is present in Australia for over half of the year of income, (unless the individual's usual place of abode is outside Australia or the individual has no intention to settle in Australia); or
- the individual is a member of particular government superannuation schemes, or a spouse or child under 16 is such a member.

B. Taxation of Worldwide Income

A resident individual is subject to Australian tax on their worldwide income, while a non-resident individual is only subject to Australian tax on income derived from a source in Australia. Australian residents are generally exempt from taxation on income from a period of foreign employment, provided that the income was not exempt from tax in the source country. Tax is imposed on non-exempt, foreign-sourced income and is calculated according to a notional average rate. Foreign tax credits are allowed in a similar manner as they are for corporate taxpayers.

4. Withholding Taxes

As is the case with corporate taxpayers, the withholding tax system applies in respect of non-resident individuals in receipt of Australian-sourced dividends, interest and royalties. Non-resident withholding taxes are a final tax and therefore income paid to non-residents which is subject to withholding tax will not be included in the taxpayer's Australian taxable income. Income from employment is subject to withholding tax in so far as the taxpayer is subject to PAYG withholding. A withholding regime also applies to certain specific categories of payments to non-residents (*e.g.* certain sporting, gambling, construction contract payments).

All Other Taxes and Duties

I. GOODS AND SERVICES TAX

Goods and Services Tax ("GST") commenced in Australia on 1 July 2000 and is an indirect, broad-based consumption tax similar to GSTs and VATs in many jurisdictions throughout the world. It applies not just to goods and services as commonly understood but also to real estate and the creation of rights. GST is payable by an entity (defined to include individuals, companies, partnerships and trusts) if the entity makes a "taxable supply". In order for a supply to be taxable, the supply must be:

- made for consideration;
- made by an entity that is registered or required to be registered for GST purposes;
- made in the course or furtherance of an enterprise being carried on by that entity; and
- connected with Australia.

However, a supply will not be a taxable supply to the extent that it is a "GST-free" supply (known as *zero rated* supplies in other jurisdictions) or an "input taxed" supply (similar to *exempt* supplies in other jurisdictions). The GST payable on a taxable supply will be calculated as 10% of the value of the consideration that entity receives for making the supply (excluding GST). Entities that are registered for GST purposes may claim input tax credits for the GST

included in the price of goods and services acquired by that business for most business activities. However, where an acquisition relates to input taxed supplies, the registered entity may be restricted in its ability to claim input tax credits for that acquisition depending on the purpose of the acquisition and the supplies to which it relates.

Generally, an entity will be required to be registered for GST purposes if that entity is carrying on an enterprise and has an Australian turnover of more than \$50,000 per year or \$100,000 in the case of a non-profit body. Entities that are below the registration turnover threshold and are carrying on an enterprise may elect to be registered. Once registered for GST, an entity must remit GST to the ATO on all taxable supplies that it makes and can claim input tax credits arising from creditable acquisitions. Entities that are registered for GST are required to complete and lodge a GST return with the ATO either monthly, quarterly or in some cases annually. Entities are required to lodge GST returns monthly if their annual turnover is greater than A\$20 million or if the entity's enterprise will be carried on in Australia for a period of less than three months. Entities with a monthly tax period are required to lodge their GST return by the 21st day of the month following the end of the tax period. Entities with a quarterly tax period are required to lodge their GST return by the 28th day of the month following the end of the tax period (except the December quarter return which is due on 28 February). Where an entity's net GST amount is positive (i.e. GST payable on supplies exceeds input tax credits from acquisitions) an entity will be required to pay this amount to the ATO when lodging its return. Where an entity's net GST amount is negative, it may be entitled to a refund from the ATO.

GST is imposed on all goods imported into Australia, although an entity may be able to claim an input tax credit for the GST paid on importation. Exports from Australia in certain circumstances may be GST-free. The GST legislation also enables agents who are resident in Australia to assume the GST liabilities and the input tax credit entitlements of their principals who are non-resident in Australia. This may significantly reduce the compliance burden of the non-resident. However, even where these rules are applicable, the non-resident will nevertheless be required to register in Australia for GST purposes.

Luxury car tax ("LCT") and wine equalisation tax ("WET") are further indirect taxes payable on specific types of transactions. Supplies and importations of cars that are above the LCT threshold will be subject to LCT at a rate of 25% on the portion of the GST-inclusive price of the car above the LCT threshold. WET is levied at a rate of 29% on certain dealings in wine and wine products and is payable by wine manufacturers, wine wholesalers and wine importers.

II. CUSTOMS AND EXCISE DUTIES

Customs duty is a Federal tax which is levied on a range of imported goods. Excise duty is imposed by the Federal government on a narrow range of products, principally oil, petroleum products, beer, spirits and tobacco.

III. FRINGE BENEFITS TAX

The Federal Government applies a comprehensive Fringe Benefits Tax ("FBT") which is levied separately from general income taxation. FBT is imposed on employers in relation to the value of non-wage benefits which are provided to employees in their capacity as employees. Any associates of employers or employees involved in the provision or receipt of fringe benefits will also give rise to a liability on the employer for FBT. Fringe benefits are taxed at a flat rate equal to the top marginal personal income tax rate (plus the Medicare Levy). The tax is an allowable deduction to the employer. Benefits are divided into various categories for valuation and exemption purposes. A residual category catches miscellaneous benefits. Various benefits are

either exempt or subject to concessional treatment. The FBT year runs from 1 April to 31 March. Employers are required to lodge an annual FBT return and pay any FBT liability by 21 May following the end of the relevant FBT year although in certain circumstances the Commissioner may grant an extension. For employers with an FBT liability of \$3,000 or more, the employer is required to pay the tax in quarterly instalments throughout the year.

IV. SUPERANNUATION GUARANTEE CHARGE

Where employers provide less than a minimum level of superannuation support for employees they must pay a Superannuation Guarantee Charge. This charge is a penalty in the sense that it is not tax deductible. There are various exemptions, including an exemption for resident employees who are paid by non-resident employers solely for work undertaken outside Australia. Payments to non-resident employees for work solely undertaken outside Australia are also exempt. The prescribed level of superannuation support is currently 9 percent of the employer's annual national payroll.

V. HIGHER EDUCATION LOAN PROGRAMME

Prior to 1 January 2005, the Higher Education Contribution Scheme ("HECS"), which seeks to recoup tertiary education fees which have been deferred by the Federal government, was the primary governmental assistance for student loans. On 1 January 2005, the Higher Education Loan Programme ("HELP") replaced HECS and several other federal loan assistance schemes subject to some transitional arrangements. Under the new HELP-HECS legislation, the total amount to be recouped from the student is calculated according to the length of the course being studied and is indexed to inflation but is not subject to interest charges. If the contribution is paid by an employer, it is subject to fringe benefits tax and is tax deductible. Payments do not commence until the student's income has reached a threshold level. For 2005-2006, this minimum level is \$36,184. The repayment rates vary from 4% to 8% depending on income.

VI. PAYROLL TAX

Payroll tax is imposed by the States. It is levied on employers with total annual Australian wagebills which exceed various thresholds which are set by each State. There are significant differences between the States in this regard, particularly in relation to the applicable rates and thresholds. The average rates vary between 4.75 percent to 6.85 percent, while the exemption thresholds vary between \$504,000 and \$1,250,000 of total wages paid by an employer.

VII. LAND TAX

Land tax is imposed by the States. It is calculated annually on a progressive scale by reference to the value of land. The tax is imposed upon the owner of the land at a particular given time (although in the Australian Capital Territory the land tax is imposed on lessees). Methods of valuation differ between States. The owner's principal place of residence is exempt in most States. Land used for primary production in certain circumstances is similarly exempt. Rates generally range from 0.15 percent to 3.7 percent.

VIII. PETROLEUM RESOURCE RENT TAX

This tax is imposed on an accruals basis on certain off-shore petroleum projects except those in Australia's North West Shelf. It is levied at a rate of 40 percent on a unique measure of "taxable profit". Payments may be made by instalments. This tax is itself a deductible expense in relation to the calculation of ordinary income tax.

IX. STAMP DUTIES

Stamp duty is imposed by all the States. Historically, stamp duty has been a tax on instruments, however as part of a rewrite of the stamp duty legislation by many of the States over the past few years, stamp duty is now generally payable where there is "dutiabale property" and a "dutiabale transaction." The rate of stamp duty varies between States and according to the type of transaction involved. Instruments which have not been stamped are inadmissible as evidence in the courts in the relevant jurisdiction.

X. ASIC REGISTRATION DUTIES

Companies are charged registration duties and lodgment fees by the Australian Securities and Commission ("ASIC") under the *Corporations Act*. The ASIC is a Federal body which regulates corporate activity in Australia. Such duties and fees are payable at the time of lodgment of the relevant documents with the ASIC.

Relevant charges (in A\$) for 2006 include:

Application for registration of a company - with share capital:	\$800
Application for registration of a company - without share capital:	\$330
Application for registration as a foreign company:	\$800
Annual return of a public company:	\$1000
Annual return of a proprietary company:	\$212
Annual return of a foreign company:	\$1000
Prospectus (required whenever securities are offered):	\$2010

Various fees and duties are also payable under other statutory requirements which relate to such things as prescribed notices, resolutions, registration of charges, information searches, occupational licensing and fundraising.

Inheritance and Gift Duties

In general, there is no separate taxation of inheritances and gifts in Australia. In many instances, gifts to employees are likely to be characterized as fringe benefits and subject to the rules discussed above under "Fringe Benefits Tax".

Other Matters

I. PARTICULAR TAX INCENTIVES

1. Research and Development Expenditure

A number of tax incentives are available to companies that incur research and development ("R&D") expenditure:

- An accelerated rate of deduction (generally 125%), subject to a \$20,000 threshold, is allowed for wages, salaries, other labour costs and expenditure incurred directly on R&D activities and for certain payments to approved outside entities.

- An additional 50% deduction is available to certain companies that have increased their R&D expenditure above their average R&D expenditure over the previous 3 years.
- A refundable tax offset equivalent to the value of the R&D deduction is available for small companies.
- A 100% deduction is allowed for expenditure incurred in acquiring rights to pre-existing "core-technology", subject to limitations for expenditure incurred under a contract entered into after 23 July 1996.
- Expenditure on R&D plant is eligible for effective life depreciation at the rate of 125% if it was incurred after 29 January 2001.

These R&D tax incentives are administered jointly by the Industry Research and Development ("IR&D") Board (through AusIndustry) and the ATO.

2. Capital Works Expenditure

A taxpayer can claim a deduction for capital expenditure incurred in constructing capital works, including buildings and structural improvements. The deduction is either 2.5% or 4% of the construction expenditure, depending on when construction started and how the capital works are used. However, capital works deductions are not available until the construction of the capital works has been completed. The deduction is generally available if the capital works are used in a deductible way during the income year. It is generally the owner of the capital works who is entitled to claim the deduction for particular capital works, although in some cases a lessee that has incurred a capital works expenditure may claim the deduction.

3. Offshore Banking Units

Income derived by an offshore banking unit from certain offshore banking activities is taxed at an effective rate of 10 percent. The normal company rate of 30 percent applies to capital gains and other income. Furthermore, the offshore banking unit is exempt from interest withholding tax in relation to certain offshore borrowings.

4. Headquarters of Foreign Companies

In order to attract foreign companies' headquarters to Australia, various incentives are available. These include the removal of withholding taxes on certain foreign source dividends distributed through Australian companies to non-residents and tax deductibility of certain costs of relocation.

5. Pooled Development Funds

Pooled Development Funds ("PDFs") are designed to promote the channelling of investment funds into small and medium sized companies (*i.e.* total assets no greater than A\$50 million) by means of concessional tax treatment. In general, at least 65 percent of the funds raised by PDFs must be invested in small or medium sized companies within 5 years. PDFs are taxed in the same way as other companies, but income derived from investment in small or medium companies is taxed at a concessional rate of 15 percent rather than 30 percent. Other income is taxed at a rate of 25 percent.

As an additional incentive:

- shareholders of a PDF are exempt from tax on unfranked dividends;
- dividends paid by PDFs to foreign residents are exempt from dividend withholding tax;
- no capital gains or losses are incurred on the disposal of shares in a PDF; and
- any revenue gains on the disposal of shares in a PDF is exempt from income tax, though losses on disposal are not deductible.

6. Venture capital

A number of tax incentives exist to encourage venture capital investment in Australia, namely:

- Foreign exempt superannuation funds resident in the USA, UK, Canada, France, Germany, Japan or other prescribed country are not subject to tax on gains from the disposal of "venture capital equity" in resident investment vehicles in Australia.
- Venture capital limited partnerships ("VCLPs"), Australian venture capital funds of funds ("AFOFs") and venture capital management partnerships ("VCMPs") are treated as pass-through entities and non-resident partners of these entities are exempt from tax on their share of the profit or gain made on disposal by such entities of an eligible venture capital investment.

VCLPs and AFOFs must apply to the Pooled Development Funds Registration Board for registration. The Board will grant registration if the applicant meets the requirements set out in the Venture Capital Act. These requirements include maintained existence for a prescribed period of time and restrictions on the type of debt interests the entity can hold, among others.

II. EXCHANGE CONTROLS

Most specific exchange controls in Australia are no longer active. Under the Financial Services Reform Act 2001, which commenced on 11 March 2002, the licensing of all financial service providers (including foreign exchange dealers), when required by the Corporations Act 2001, is the responsibility of the Australian Securities and Investments Commission (ASIC). Purchase and sale of foreign currency outside Australia is unrestricted.

Transfers of Australian or foreign currency over A\$10,000 in value, in or out of Australia, must be reported to "AUSTRAC" (Australian Transaction Reports and Analysis Centre) which is a Federal body established to monitor significant cash and financial transactions involving Australians.

III. ANTI-DEFERRAL REGIMES

Accrual taxation regimes apply to controlled foreign companies ("CFCs"), transferor trusts (*i.e.* trusts to which property or services have been transferred by an Australian resident) and foreign investment funds ("FIFs").

Generally, a company is a CFC if it is (i) a non-resident company and (ii) either (A) a group of five or fewer Australian residents hold 50% or more of the interests in the company, (B) there is a single Australian resident whose direct and indirect interest in the company is not less than

40% and the company is not controlled by a group of entities that does not include the Australian resident or any of its associates, or (C) the company is in fact controlled by a group of five or fewer Australian residents (either alone or with their associates). Depending on which country the CFC is resident in, a proportion of certain "tainted" income of the CFC is attributable to the Australian resident shareholders at the time that income is derived by the CFC, instead of at the time the income is repatriated to the Australian shareholders. The "tainted income" of a CFC generally includes income likely to be manipulated through tax planning such as interest, royalties, dividends and payments from related parties. Concessions are available for CFCs that are resident in certain listed countries, such as Canada, New Zealand, France, the UK, Germany, the US and Japan.

If an Australian resident transfers property or provides services to a non-resident trust, the transferor trust rules attribute to that Australian resident a portion of the income of the transferor trust. The amount of income so attributable depends on the country in which the trust is resident and other factors but generally the whole of the trust's notional income may be taxed to the transferor. Where there are multiple transferors to a single trust, the Commissioner has discretion to reduce the amount of income attributable to each transferor. Certain *de minimis* exceptions apply to the transferor trust rules and the income that has been assessed in the hands of the transferor is not subject to further taxation when distributed to a beneficiary.

The FIF measures apply to an Australian resident who holds an interest in a foreign company or trust and operate to attribute to that resident a share of the foreign entity's income. There are a number of significant exceptions to the FIF rules, including exemptions for entities directly engaged in an active business, interests in certain US entities and certain insurance businesses.

Dividends or trust distributions out of income which has previously been subject to accruals taxation is exempt from further Australian tax on repatriation of that income. Comparably taxed branch profits derived by a branch of an Australian company may be exempt from accruals taxation on a similar basis.

IV. TAX TREATIES

Australia has entered into a number of double tax treaties with other countries. Additionally, Australia is also in the process of negotiating information exchange agreements to help combat offshore tax evasion. In November 2005, Australia signed such an information exchange agreement with Bermuda. The table below lists countries with which Australia has signed a tax treaty and sets out the source country limits applicable to dividends, interest and royalties. Please refer to the applicable treaty for alterations of the rates below in certain circumstances.

Country of residence or source	Dividends received by Australian residents from non-resident company	Interest received by Australian residents from external sources	Royalties received by Australian residents from external sources
	Percentage rate of tax on gross dividend	Percentage rate of tax on gross interest	Percentage rate of tax on gross royalties
Argentina	10-15	12	10-15
Austria	15	10	10
Belgium	15	10	10
Canada	5-15	10	10
China (excluding Hong Kong and	15	10	10

Macau)			
Czech Republic	5-15	10	10
Denmark	15	10	10
Fiji	20	10	15
Finland	15	10	10
France	15	10	10
Germany	15	10	10
Hungary	15	10	10
India	15	15	10-15
Indonesia	15	10	10-15
Ireland	15	10	10
Italy	15	10	10
Japan	15	10	10
Kiribati	20	10	15
Malaysia	nil-15	15	15
Malta	nil-15	15	10
Mexico	nil-32	10-15	10
Netherlands	15	10	10
New Zealand	15	10	10
Norway	15	10	10
Papua New Guinea	20	10	10
Philippines	15-25	15	15-25
Poland	15	10	10
Romania	5-15	10	10
Russia	5-15	10	10
Singapore	15	10	10
Slovak Republic	15	10	10
South Africa	nil-15	10	10
South Korea	15	15	15
Spain	15	10	10
Sri Lanka	15	10	10
Sweden	15	10	10
Switzerland	15	10	10
Taipei	10-15	10	12.5
Taiwan	10-15	10	12.5
Thailand	15-20	10-25	15
United Kingdom	5-15	10	5
United States	5-15	10	5
Vietnam	10	10	10