

# HOW THE AUSTRALIAN COMPANY TAX SYSTEM WORKS



## What this booklet is about

The corporate tax system and the laws underpinning it are extremely complex. Without understanding how our system works can inevitably lead to misunderstandings around how the tax system operates and whether it is collecting the right amount of tax from large corporates.

This booklet is aimed at explaining at a high level how the Australian corporate income tax rules operate by outlining some of the key building blocks of the corporate tax system. Its aim is to explain some of the more misunderstood concepts underpinning the corporate income tax system and how corporates operate within it.

By its nature, this booklet is a general summary and doesn't deal with the many thousands of pages of tax law. It probably goes without saying readers should always seek professional advice on how the tax rules may apply to their specific circumstances.

## About the CTA

The Corporate Tax Association (CTA) is the peak representative body on tax issues for over 150 large corporates operating in Australia.

The CTA serves as the collective voice for its members, playing a vital role in fostering collaboration between tax professionals, corporations, policymakers and the government to ensure the development of sound and effective tax laws (in particular, those applying to large corporates) and ensuring these laws are administered efficiently and effectively.

A list of the CTA's members and more information on the CTA can be found here: [www.corptax.com.au](http://www.corptax.com.au).

## Acknowledgement of Country

The CTA acknowledges the Traditional Custodians of the Country throughout Australia and their knowledge in caring for land, sea and community. We pay our respects to their Elders past and present.

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# The building blocks of the Australian company tax system

## 1. Tax is payable on taxable income not total income

Income tax is payable on taxable income. Taxable income is defined as:

***Taxable income = Assessable income less allowable deductions.***

Assessable income, gross income, total income, revenue or gross turnover are terms used interchangeably but they essentially describe the gross amount derived from selling goods and services before taking into account the expenses (or allowable deductions) incurred in deriving that amount.

Simply applying 30% to this gross amount and concluding this is the amount of tax a company should pay is very misleading as it doesn't take into account costs such as wages, the cost of goods sold or other expenses that are incurred to derive that gross amount.

It is more sensible to talk about an income tax rate applying to accounting profit as a 'guide' to the amount of tax that may be payable.

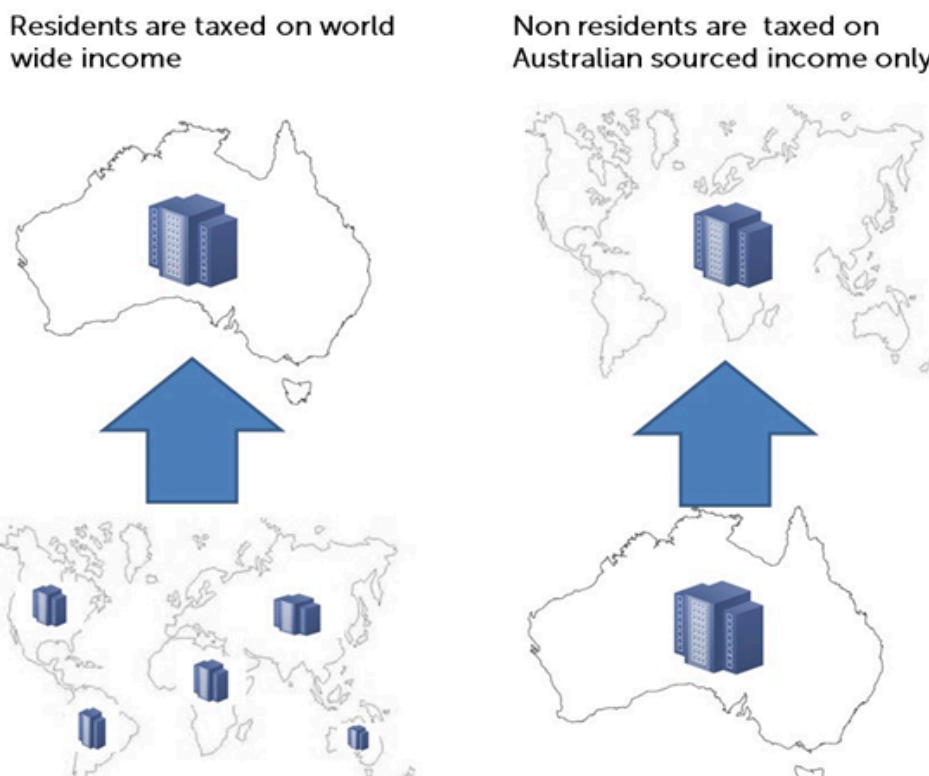
Although there are similarities between how accounting profit and taxable income are determined, they are different concepts and should not be confused. The different treatments between the tax system and accounting principles also mean effective tax rates calculated will likely differ from the 30% statutory rate. These differences can result in effective tax rates both above and below 30%.

We have produced a document, Public Tax Transparency - What the numbers do and don't mean, which provides more detail on the differences between accounting profit and taxable income.<sup>1</sup> The ATO also provide some detailed information.<sup>2</sup>

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## 2. Tax is payable where profits are earned or income is sourced

Australia, like many countries, generally taxes its residents on their worldwide income and non-residents on their Australian-sourced income.<sup>3</sup> This rule applies to companies as well as individuals.



Although this all sounds quite sensible, it can result in tax being paid in two countries on the same income without other rules setting out how taxing rights are allocated between them.

For example, an Australian resident company may have a branch operating in New Zealand (NZ) which generates \$100 of NZ-sourced profits. This profit could be taxed both in Australia (as the company is an Australian resident) and in NZ (as the company is a non-resident but with NZ-sourced income) if there were no rules to prevent the same income being taxed twice (ie 'double taxation'). Most domestic tax laws and tax treaties allocate taxing rights to either one country or the other by either exempting income from tax in the home country where it has already been taxed in a foreign country or giving tax offsets (or tax credits) for taxes paid in the other country to offset tax otherwise payable at home.

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In our example, NZ would have primary taxing rights on the \$100 business profits, as Australia exempts such profits from Australian tax. This rule is an example of the “territorial system” of tax adopted by the vast majority of economies around the world.<sup>4</sup> In essence, a territorial system subjects business profits earned in a particular country to tax in that country, and generally does not tax them again in the home jurisdiction. The exemption from further tax in the home jurisdiction is generally only available for income from active business activity. Income from controlled passive activity (such as interest on a related party loan) is generally taxable in the home jurisdiction as it accrues with tax offsets given for any foreign taxes paid.

In the simple case of a company with immovable property, such as a factory or a mine operating solely in one country, it is generally not that difficult to determine where business profits are earned, as the source of profits would generally be where the factory or mine and/or staff are physically located. However, where supply chains are disaggregated (meaning they are spread over different countries and thus business activity, assets and risk are geographically dispersed), it can be more complex to determine where profit is earned, and which country has taxing rights, and then how much it can tax. Take the example of a company that is headquartered in the UK, develops an Internet platform to conduct sales to final consumers in Ireland, but sources products sold from all over the world - determining the source of this company's business profits and what component of those profits should be taxed won't necessarily be a straightforward task.

These issues are generally solved for companies by rules that essentially say that if a company has a “permanent establishment” (or a taxable presence) in a country, it can be subject to tax in that country.<sup>5</sup> Once a permanent establishment exists, other globally accepted transfer pricing rules operate to determine how much profit can be taxed in that country.

## **Taxation of business profits**

As mentioned above, residency and physical location of activity are key determinants of the allocation of taxing rights between countries on business profits.

### Residence

A company's residence is generally determined by its place of incorporation or if not incorporated in Australia, where it carries on business and where its central management and control abides. It is also considered a resident if it carries on business in Australia and the company's voting power is controlled by shareholders who are residents of Australia. Once a company is considered a resident, it is generally taxed on its worldwide income, whereas a non-resident of Australia is taxed on its Australian source income only.

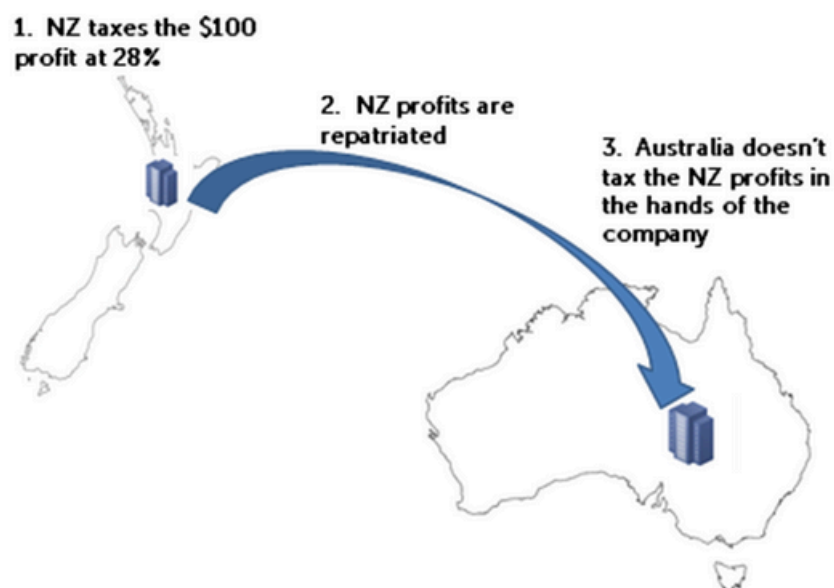
# The building blocks of the Australian company tax system

## Permanent Establishments

Where a company has its effective management and control in one country but has a physical location or substantial activity (a permanent establishment or PE) in another country, it is generally taxed on the business profits (income less expenses) accruing in that country that are effectively connected to that permanent establishment.

For example, if an Australian incorporated company which is centrally managed and controlled in Australia operates a factory in New Zealand that produces widgets and sells them in NZ and generates a profit of \$100, NZ will retain the right to tax \$100 profit as the Australian company has a PE in NZ. However, as the Australian company is also an Australian resident, it is subject to Australian tax on its worldwide income and could also be taxed in Australia on the same \$100. To avoid double tax, Australian rules exempt the \$100 NZ profits from Australian tax and also prevent the Australian company claiming Australian tax deductions (such as interest) for expenses incurred in generating that exempt income.

Similarly, if the Australian company was to establish a subsidiary in NZ rather than operate through a branch (PE), NZ would retain the right to tax the subsidiary's \$100 profit and Australia would not tax the \$100 earned or when the NZ subsidiary pays a dividend to it.



# The building blocks of the Australian company tax system

The simple case of a factory producing and selling widgets wholly in one country can be contrasted to an internet based company with a disaggregated value chain, such as one headquartered in the UK, with sales to Australian and other customers, having a sales support team based in Singapore, with a server in the US, with staff cutting code in India, dealing with customers via a marketing function in Switzerland, with intellectual property owned in Ireland and where final sales contracts are concluded in the Netherlands.

Who has taxing rights here - the UK, Singapore, US, India, Switzerland, Ireland, the Netherlands or Australia?

A rule that says income tax should be paid on income where the customer is located might sound like a solution. In fact, this is exactly what a consumption tax (such as GST) is all about and what Australia, the OECD and Inclusive Framework are currently considering as a potential change to international tax rules to deal with the impact of digitalisation through Pillar One of the BEPS project.<sup>6</sup> Currently, however, income tax has different rules that essentially tax profits (sales less expenses) attributed to the functions, assets and risks attributed to a country.

Thus, in our example, it is most likely all countries in the value chain will have the right to tax a slice of the value generated where there is a PE in that country. The next question is how much.





# The building blocks of the Australian company tax system

## How much of the value chain activity is taxed in each country?

Once a PE status is determined, how much that can be taxed is generally determined by understanding the functions, assets, and risks that are attributed to the particular country.

To reduce the chance of fiscal evasion (and to also avoid double tax), the amount of profit that can be taxed by each country relies on transfer pricing rules and international tax treaties which determine the amount of business profits that should be taxed. This requires an analysis of what functions are undertaken, the assets employed, and risks assumed in each country by the PE and then determining a value on the assumption of what would be the outcome if the related parties were at arm's length and arm's length conditions applied.

Some further detail of how Australia applies the arm's length standard (or our transfer pricing rules) is provided in Section 3.

## **Taxes on income flows that are not business profits**

Although the general rule is tax is only determined by reference to whether there is a PE, certain types of income can be taxed in a host jurisdiction regardless of whether a PE exists.

This is generally accomplished by the host country imposing withholding taxes on certain income flows paid to non-residents. The most common forms of cross-border flows subject to withholding tax include interest, royalties and dividends. Similar to business profits, in order to prevent these income flows from being subject to double tax, a tax offset (or foreign tax credit) is generally given in the home country for the withholding tax paid to the host country.

As a general rule, Australia imposes a 30% withholding tax on payments made to non-residents. However, where the recipient of any payment is a resident of a country with which Australia has a tax treaty, the rate of withholding Australia applies is generally reduced to 15% for unfranked dividends and 10% for interest and royalties.<sup>7</sup>

# The building blocks of the Australian company tax system

## 3. Transfer pricing rules

Australian transfer pricing rules are effectively the codification of globally accepted OECD transfer pricing standards and require all related party transactions between Australian and related foreign entities to be priced in accordance with what is known as the 'arm's length principle'. The arm's length principle seeks to determine the conditions at which comparable transactions by unrelated parties occur and then price the related party transaction based on those arm's length conditions, taking into account the functions undertaken, assets employed, and risk assumed. Substantial penalties are imposed if the price charged, or income received, is not arm's length and detailed transfer pricing documentation is not prepared to support the dealing.

In some cases, practical difficulties can arise in determining an arm's length price as it is not always possible to find a comparable, uncontrolled price, or views on the basis by which the price is determined may differ between a taxpayer and the ATO. The fact that a taxpayer and the ATO do not agree on the transfer price is not necessarily a sign that a taxpayer is involved in tax minimisation activity. There are inherent complexities associated with determining a price where components of the value chain are located in different countries and involve pricing goods or services that may not have a third party comparable.

Detailed globally accepted transfer pricing guidelines exist which assist in the task of determining the arm's length price.<sup>8</sup> Many countries, such as Australia, also allow a taxpayer and a tax authority to enter into Advance Pricing Agreements (APA). APAs allow a taxpayer and a tax authority to agree in advance the price for a related party transaction and have procedures in place to resolve potential disagreements on transfer pricing where treaty partner countries are involved. Many countries also allow bilateral or multilateral APAs which involve agreement being reached by a taxpayer and more than one tax authority on the same matter, as a means of ensuring the chance of dispute and double taxation is minimised. Of course, in cases where there is no agreement between a taxpayer and the ATO, these matters can be resolved by the judicial process, and where there is disagreement between treaty partners via mutual agreement procedures contained in tax treaties.

It is worth noting that an Australian headquartered company with a subsidiary in a low tax jurisdiction, where that subsidiary receives passive income (such as interest or rent) from a related party (such as from its Australian parent) will be subject to Australian tax under Australian Controlled Foreign Corporation rules (see Section 5 below). Thus, where the price is equivalent to an arm's length one, the income is fully taxed in Australia as it accrues.

# The building blocks of the Australian company tax system

As most other jurisdictions adopt the same transfer pricing standard, the potential for transfer pricing being a source of tax evasion or avoidance only really arises from those that deliberately misprice international related party transactions. In such cases, Australia's General Anti-Avoidance Rule, the Multinational Anti Avoidance Rule (the MAAL), the Diverted Profits Tax and penalty regime also operate as a significant deterrent for those that wish to inappropriately take advantage of such mismatches.

We have outlined how the General Anti-Avoidance Rule operates in section 9 below.

## 4. Interest limitation rules

The general rule is that interest incurred in carrying on a business is tax deductible as it is incurred unless the interest is of a capital nature or incurred in the derivation of certain exempt income. So as to not disadvantage Australian companies who may need to access debt funding to finance overseas expansion, interest is also generally deductible, subject to a limit, if it is incurred in generating certain exempt foreign source dividends.

However, as interest is deductible, there is a risk to the tax base if taxpayers fund their operations with excessive amounts of debt. To deal with this risk, Australia has recently amended its “thin capitalisation” rules from 1 July 2023, which place a limit on the level of debt deductions by reference to taxpayers Australian earnings before interest, tax, depreciation and amortisation (EBITDA) other than for approved deposit-taking institutions (banks).

The Australian rules provide that after applying the transfer pricing rules, a taxpayer (with interest expenses over \$2 million) has interest deductions capped at either:

- 30% of EBITDA
- the Worldwide Group EBITDA ratio, or
- via a third party debt test.

Any interest denied can be carried forward and deducted in the next 15 years.

Special rules apply for banks that limit debt funding to 94% of their risk weighted Australian assets.<sup>9</sup>

The Australian rules also limit the interest rate that can be charged by reference to the arm's length interest rate that would be charged in such cases. Furthermore, interest is only deductible in Australia if withholding tax that may be payable has been paid to the ATO.<sup>10</sup>

# The building blocks of the Australian company tax system

## 5. Controlled foreign corporation rules

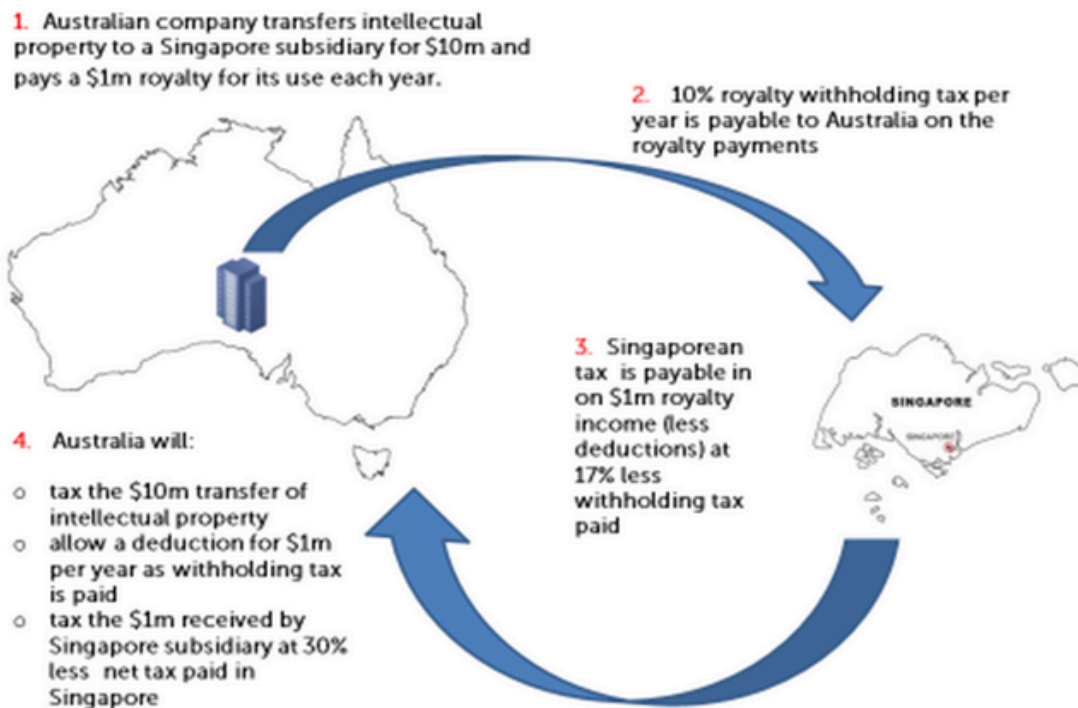
As mentioned in Section 2, Australia, like most countries, adopts a territorial basis of taxation, subjecting Australian sourced profits to Australian tax and exempting from Australian tax dividends derived from active foreign sourced income. The policy behind exempting certain foreign profits from Australian tax is similar in concept to imputation as it is aimed to ensure that there is no (or minimal amounts of) double taxation of those profits when received by an Australian parent.

However, it is possible that by exempting some foreign profits from Australian tax, there could be an erosion of the Australian tax base by simply placing movable sources of income into a low or no tax jurisdiction and never repatriating the profit. For example, placing money on deposit in a subsidiary in a low tax jurisdiction, rather than having that money on deposit in Australia could lead to the interest earned not being subject to tax. To ensure that the Australian tax base is protected, tax integrity rules called the controlled foreign corporations (CFC) rules operate to subject certain types of foreign passive income to Australian tax as that income accrues in the foreign subsidiary rather than when the dividend is received.

Essentially, the CFC rules operate to tax foreign sourced income from a controlled passive source (such as interest on an intercompany loan or royalties from intellectual property) as it accrues. For example, if an Australian company has a subsidiary in a low tax jurisdiction with equity funding of \$100 and that subsidiary lends \$100 to a related foreign subsidiary generating interest income of \$5, the Australian parent would be subject to Australian tax on the \$5, less any tax the company paid in the low tax jurisdiction each year as it accrues. These rules effectively place the Australian company in the same position it would have been if it had lent the money directly to its foreign subsidiary and paid 30% tax on the \$5 interest income.

These rules ensure there is no tax advantage for an Australian company transferring intellectual property (IP) to a lower tax jurisdiction, such as Singapore, and charging a royalty back to Australia for its use. Although the royalty paid by the Australian company would be tax deductible in Australia, the income received by the Singapore company would also be subject to Australian tax. The end result is the Australian tax saved from the royalty deduction equals the Australian tax paid (less any Singapore tax paid on that income) on the equivalent royalty income. And tax would generally be payable on the gain made from the sale of the IP to Singapore.

# The building blocks of the Australian company tax system



Australian CFC rules do not tax the profits derived by a non-resident entity that is not controlled by an Australian parent. However, in such cases, the amount of any payment to a non-resident would generally be subject to Australian withholding tax and not be tax deductible in Australia until the withholding tax is paid. Furthermore, the amount of any payment to the non-resident must not be greater than the amount that would be payable had it been paid to an unrelated party under arm's length conditions as required by Australian transfer pricing rules (see Section 3 above).

# The building blocks of the Australian company tax system

## 6. Tax Consolidation

As a general rule, companies in Australia are taxed on a standalone basis. Thus, if one company makes a taxable profit of \$200 and the other a loss of \$100, our rules operate so that even if the companies are owned by the same person, you cannot offset the \$100 loss in one company against the \$200 taxable profits in the other. Thus \$60 tax (30% of \$200) would be payable by the profitable company and the loss company can carry forward the \$100 loss for use by it in future years.

However, a resident Australian head company, and its wholly owned Australian resident subsidiaries can make an election to be taxed as a single consolidated group as if the head company and its 100% subsidiaries were all part of the same single entity. Under these rules, transactions between members of the consolidated group (such as dividend payments, asset and liability transfers, and liquidations) are generally ignored for income tax purposes. The head company of the consolidated group lodges one tax return and pays tax instalments for the consolidated group, maintains one franking account and pools tax losses and other tax attributes.<sup>11</sup> If the consolidation election is made, the \$100 loss company and the \$200 profitable company could be treated as a single consolidated entity and would pay tax of \$30 on a \$100 consolidated taxable profits (\$200 profit less the \$100 loss), but would not have any carry forward losses.

## 7. Tax losses

Not all companies make profits every year. In fact, the ATO indicates that over the last 10 years about 20% to 30% of companies listed on the ASX 500 generate net losses each year.<sup>12</sup> Overtime, however it is expected companies will make profit and pay tax, otherwise they would go out of business.

Australian tax rules distinguish between the treatment of income losses and capital losses. Capital losses are only available to offset capital gains (not income gains). However, income losses can offset either income or capital gains.

Unlike individuals and superannuation funds, companies do not get the benefit of a capital gains discount but instead pay tax on the full net capital gain. Some gains derived on the disposal of foreign assets can be exempt from Australian income tax.

# The building blocks of the Australian company tax system

Where income losses or capital losses are generated in a year but are not fully utilised in that year, they can be carried forward to future income years and will be available to be offset against future income or capital gains. Carry forward capital losses can only be used to offset capital gains.

Integrity rules ensure that losses can only be used if there is sufficient continuity of ownership of the company that incurred the loss when the loss is recouped by that company or where the company meets a very rigid 'same business' test or the more flexible 'similar business' test where there has been a change in ownership.<sup>13</sup> Other integrity rules operate where a consolidated group acquires another consolidated group with losses.<sup>14</sup>

## 8. Dividend imputation

Australia's dividend imputation system is aimed at ensuring there is no double tax on underlying Australian company profits by providing a tax (or imputation) credit to resident Australian shareholders<sup>15</sup> who receive a dividend from the company (ie a franked distribution). Where a resident company receives a franked distribution from another Australian company, it also does not pay additional income tax on those dividends to the extent they are franked. This ensures there is no double tax on Australian-sourced profits. Imputation also removes the bias that would otherwise exist to fund with debt rather than equity for Australian companies.<sup>16</sup>

As the imputation system creates a bias towards paying franked dividends to Australian shareholders and unfranked dividends to non-resident shareholders, very tight tax integrity rules exist to ensure companies cannot "stream" the benefits of franked dividends to resident shareholders and unfranked dividends to those that don't benefit from the franking credit. As mentioned in Section 2, unfranked dividends paid to residents are generally subject to Australian withholding tax.

It is worth noting that if an Australian company received dividends from abroad and these profits are distributed as a dividend to its Australian resident shareholders, they will generally be received by the shareholder as an unfranked dividend at some point in time. This means the resident shareholder eventually pays tax on those dividends at their marginal tax rate. This can result in the underlying profits from overseas operations being taxed at rates that are higher than an individual shareholder's marginal tax rate if tax is paid on underlying profits in the country where the underlying profits are generated.<sup>17</sup>

# The building blocks of the Australian company tax system

## 9. General anti-avoidance rules

Apart from the specific tax integrity rules such as transfer pricing, thin capitalisation and the CFC rules described above, Australia also has a myriad of specific anti-avoidance rules which are aimed at protecting the Australian tax base. To list all the specific rules is beyond the scope of this booklet. However, overarching these specific rules is a General Anti-Avoidance Rule (GAAR) which is aimed at striking down tax avoidance schemes that have been that have a dominant purpose of generating a tax benefit.<sup>18</sup>

The policy behind the GAAR is to ensure tax benefits are cancelled for schemes that are blatant, artificial and contrived. The rules are aimed at striking a balance between ensuring ordinary family and commercial dealings are not impacted by legitimate tax planning whereas schemes that have a dominant tax driven purpose result in the denial of any tax benefit.

As you can imagine, there can be a spectrum of activity that could potentially fall foul of this rule. Along this spectrum, it becomes a question of fact. as to whether the GAAR should apply.

Some cases have reached the courts, including the High Court, where the GAAR rules have been held to apply (and to not apply) to certain arrangements.

The ATO has published many rulings where it outlines instances it believes the GAAR can apply. It has also established administrative arrangements, including a panel consisting of eminent internal and external tax experts to assist ATO officers in cases where they seek to apply the GAAR. Where the GAAR applies, the tax benefit generated is cancelled and non-deductible tax penalties of up to 100% of the tax benefit can also be imposed.

It is worth noting that in the area of transfer pricing, where there is a potential avoidance of a taxable presence in Australia or in franking streaming arrangements, there is no requirement for a dominant purpose of avoiding tax to be present before the GAAR rules can apply.



# The building blocks of the Australian company tax system

## 10. Proposed international rules applying to certain multinationals

Over the last few years, Australia, along with 136 other countries, has been negotiating<sup>19</sup> a new set of international tax rules that will apply in addition to current domestic tax integrity rules.

There are two rules currently being considered - Pillar One and Pillar Two.

**Pillar One** (when the global details of the measure are finalised) will ensure a fairer distribution of profits and taxing rights among countries with respect to the largest and most profitable multinational enterprises (MNE). It will reallocate some taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether firms have a physical presence there. Specifically, MNEs with global sales above EUR 20 billion and profitability above 10% - that can be considered as winners of globalisation - will be covered by the new rules, with 25% of profit above the 10% threshold to be reallocated to market jurisdictions.

**Pillar Two** introduces a global minimum corporate tax rate set at 15% with Australia's new rules applying from 1 July 2024. The new minimum tax rate will apply to global groups with revenue above \$1 billion dollars and is estimated to generate around USD 150 billion in additional global tax revenues annually. Australia has estimated Pillar Two may generate receipts of \$370 million (and increase payments of \$111 million) over the 5 years from 2022-23.<sup>20</sup> Further benefits will also arise from the stabilisation of the international tax system and the increased tax certainty for taxpayers and tax administrations.

Details of the final rules have yet to be confirmed, but an explanation of them can be found [here](#) and [here](#).

## 11. Tax assessments and the settlement of disputes

Australia operates a self-assessment tax regime whereby the lodging of a tax return is seen as an assessment to income tax. The ATO and companies have four years to amend an assessment of tax, or in cases involving transfer pricing, six years.

For many large corporates, the ATO conducts reviews of tax returns before they are lodged as part of the ATO's Justified Trust initiative in relation to the Top 100 and Top 1000 largest corporate groups.<sup>21</sup> Apart from ensuring that the ATO is across the company's positions on significant tax issues, it also has the added advantage of enabling the ATO and companies to resolve any differences of view in real time, so there is no disagreement down the track and no need for amended assessments to issue.

# The building blocks of the Australian company tax system

There can be, in some cases, a genuine difference of view between the ATO and a company on how the income tax law applies to a particular transaction. Just because a company's view differs from that taken by the ATO does not mean that the company has been involved in tax avoidance.

Where there is a difference of view that can't be resolved before amended assessments are issued (for example, the evidence may show the arm's length range of interest on a related party loan should be between 5% and 6%, but the taxpayer may have lodged its tax return based on 6% and the ATO's position is it should be 5%), the ATO may issue an amended assessment for the 1% difference and impose penalties and interest. Normally, when tax is due on an amended assessment and the taxpayer objects to that assessment, the ATO and the taxpayer will enter into a 50% payment arrangement pending the outcome of the resolution of the matter by the courts or via some other form of dispute resolution. This may lead to a settlement deed being entered into between the ATO and the taxpayer.

As the outcomes can be uncertain for both the ATO and the taxpayer, and court processes can be long and expensive for both parties, there can be instances where the parties may wish to consider settling a matter. That being said, not every matter will result in the ATO or taxpayer wishing to settle before the issue is heard by a Tribunal or Court. Some issues may have precedential value, meaning the outcome will have an impact beyond the facts of the particular case or it may involve a question of law that requires a Court to decide what the law means.

Although settlements may to some be seen as giving rise to the potential for "sweetheart" deals between the ATO and taxpayers, this is far from the reality of what happens in practice. The ATO has a Code of Settlement<sup>22</sup> that sets out the principles on which it will settle matters, with settlements for large matters having to undergo an independent review before they are agreed to by the ATO.

The ATO does not do settlement "package deals" but looks at each matter on a case-by-case basis as well as the impact the settlement may have on the wider community to ensure consistency. The ATO also has an obligation to administer the taxation system in an efficient and effective way, balancing competing considerations (such as the precedential value of the issue at hand) and applying discretion and good sense. The ATO also has an independent panel of four former Federal Court judges that review large settlement cases.

# The building blocks of the Australian company tax system

Inevitably there will be cases where the amount due on the amended assessment differs from the amount finally agreed to by the ATO on settlement. For example, it may be that the interest rate difference in our example is resolved at a figure of 5.5%, subject to the taxpayer agreeing to this figure for future years. The fact that there is a difference between what the ATO had issued in the amended assessment and the final settled amount does not mean that the ATO has waived or “split the difference”- rather it is recognition that there is uncertainty of outcome for both parties. It is important to recognise that in any dispute, whether it be in the tax or commercial world, the final settlement figure is rarely all that either party had hoped to achieve.

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## End Notes

1. The ATO has also produced some explanatory material as well. See [ATO | Tax is not simply 30% of profit](#).
2. [Publicly available data to help understand tax compliance | Australian Taxation Office](#)
3. Some countries only tax income sourced from that country or tax based on citizenship (such as the US) regardless of source.
4. 28 of the 34 OECD countries have adopted some form of territorial tax system. Other countries, notably the US, adopt a foreign tax credit system to avoid double tax, although recent changes adopt an effective territorial tax system.
5. The definition of permanent establishment varies slightly depending on the relevant tax treaty but generally does not treat the physical warehousing of stock in a country as a permanent establishment unless other factors are present. Recently the definition of permanent establishment has been changed by the OECD's Multilateral instrument. Australia is a signatory to the MLI and will incorporate changes to the PE definition in most of Australia's Double Tax Agreements
6. See [OECD | OECD invites public input on the Secretariat proposal for a Unified Approach under Pillar One](#)
7. Australia has 46 tax treaties currently in place. The details of Australia's treaty network can be found at the Treasury website at: [Tax treaties](#)
8. See the OECD's [Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators](#)
9. Australia's thin capitalisation rules were tightened from 1 July 2014. Previously the rules allowed debt to the level of 75% of Australian assets for non-banks and 96% of Australian risk-weighted assets for banks or up to 110% of worldwide gearing. For the 2013-2014 year, ATO data shows that debt deductions of approximately \$1.6 billion were denied. Further changes to thin capitalisation rules were announced in the October 2022-23 Federal Budget to introduce an earnings-based test. See further below.
10. To assist taxpayers to access foreign debt markets, rules exist that can exempt interest paid to non-residents from Australian withholding tax on certain debt instruments issued to the public.
11. The consolidation rules also allow 'Multiple Entry Consolidation' (MEC) groups to be formed. MECs are tax groups that may have more than one entry point into Australia.
12. See [Tax is not simply 30% of profit | Australian Taxation Office \(ato.gov.au\)](#).
13. The “similar business” test for losses incurred after 1 July 2015 was [enacted](#) in 2019 with retrospective effect.
14. Losses can only be used according to a formula known as the Available Fraction.
15. The franking credit received reduces the amount of tax payable by an individual shareholder who pays tax on the dividends received up to their marginal tax rate.
16. Interest tax deductible and dividends paid are not. Assume a company makes \$100 profit and is equity funded with \$100. It would make more pre-tax profit than a company that is debt funded by \$100 equal to the amount of the interest expense on the \$100 borrowed and could pay a bigger dividend. However, the company would also pay more tax but passes on this tax as a franked dividend.
17. Special rules do not tax certain “conduit foreign income”. These rules are aimed at making Australia an international holding company locale for non-residents who invest in non-resident companies via an Australian holding company by not subjecting the foreign income received by the Australian company to further Australian tax.
18. The General Anti-Avoidance Rules were recently amended to deal with cases where one of the principal purposes of a tax arrangement is the avoidance of a permanent establishment in Australia, the Multinational Anti Avoidance Law (the MAAL) and the 40% Diverted Profits Tax (the DPT) that can be applied if a taxpayer pays or receives an amount from a country with a tax rate 80% of the Australian rate (i.e. 24%) and there is no economic substance supporting that payment. The ATO have indicated that over \$100 million in extra income tax per annum has been generated under the MAAL.
19. See [OECD | Statement on Two Pillar Solution](#)
20. See [Implementation of a global minimum tax and a domestic minimum tax measure](#) at p20 of Budget Paper No. 2 of the 2023-24 Federal Budget
21. See the ATO's explanation of the Top 100 and Top 1000 Justified Trust programs at [ATO | Justified Trust](#)
22. See [ATO | Code of Settlement](#)