Attachment G

ALLOCATING INCOME BETWEEN COUNTRIES

To ensure that Australia receives its appropriate share of tax paid by multinational companies, measures will be introduced to improve the rules for allocating income between countries. The thin capitalisation rules will be strengthened to prevent multinationals (both foreign and Australian based) from reducing their Australian tax by allocating a disproportionate share of debt to their Australian operations.

Reform of the taxation of foreign expatriates and residents departing Australia will also be undertaken which will reduce tax on foreign investments acquired before expatriates take up residence in Australia but ensure that the appropriate tax on Australian income is collected.

Australia will seek to improve its Double Tax Agreements to assist the competitiveness of Australian businesses offshore.

Thin capitalisation provisions

Key features

- The new thin capitalisation measures will apply to the total debt of the Australian operations of multinational groups (including branches of those groups).
- They will cover inward investment of foreign multinationals and outward investment of Australian based multinationals, and include a safe harbour debt to equity ratio of 3:1 — interest deductions will be denied to the extent that gearing exceeds the safe harbour ratio.
- Where gearing exceeds the safe harbour ratio, multinationals will not be affected by the rules if they can satisfy the arm's length test (that the gearing could have been borne by an independent entity).
- Separate rules will apply to financial institutions.
- To facilitate their inclusion in the rules, branches will be required to prepare financial accounts for taxation purposes.

The measures are consistent with recommendations 22.1 to 22.9 of *A Tax System Redesigned.*

Commencement date

The measures will apply from 1 July 2001.

Why the change is needed

Australia's current thin capitalisation provisions are not fully effective at preventing an excessive allocation of debt for tax purposes to the Australian operations of multinationals. The new measures strike an appropriate balance between revenue protection and facilitating commercial arrangements.

Foreign expatriates and residents departing Australia

Key features

- Temporary residents will be exempt from tax on foreign source income relating to assets acquired before taking up residence (and associated liabilities).
- Share discounts given to employees under qualifying schemes will be taxed when the employee ceases to be a resident.
- Residents departing Australia will be required to provide security where capital gains tax liabilities are deferred.

The measures are consistent with recommendations 22.18 to 22.20 of *A Tax System Redesigned.*

Commencement date

The measures will apply from 1 July 2001.

Why the change is needed

The exemption from Australian tax on foreign source income derived from pre-existing assets ensures that Australian tax on that income does not make it difficult to recruit foreign executives to Australia. The tightening of other rules ensures that Australian tax is collected on income earned in Australia by foreign expatriates.

Double Taxation Agreements (DTAs)

Key features

- Australia will endeavour to reduce foreign dividend withholding tax on non-portfolio investment.
- Australia will agree to a non-discrimination article in future DTAs.
- Priority will be given to renegotiating aging DTAs with major trading partners.
- Australia will review its overall DTA policy.

The measures are consistent with recommendations 22.21 to 22.24 of *A Tax System Redesigned.*

Why the change is needed

Current DTA policy reflects that Australia has traditionally been a capital importer. However, the increasing amount of Australian investment abroad requires a greater focus in DTAs on the taxation of foreign source income.