Attachment I

FOREIGN INVESTMENT IN AUSTRALIA

More comprehensive conduit income rules will be introduced to ensure that foreign source income passing through Australia to foreign investors is not double taxed.

A measure will be introduced to counter the avoidance by non-residents of Australian capital gains tax by disposing of an interposed entity holding Australian assets rather than the assets themselves.

The exemption from interest withholding tax (IWT) will not be extended to government securities issued in Australia.

Foreign Income Account

The current foreign dividend account will be replaced by a foreign income account that extends relief from Australian dividend withholding tax on non-portfolio dividends to all types of foreign source income passing to non-resident investors.

Key features

- The foreign income account will extend the relief from Australian dividend withholding tax when Australian companies receive non-portfolio foreign source dividends and subsequently pay unfranked dividends to non-resident investors to all types of foreign income, including portfolio dividends, foreign branch profits and capital gains.

- The foreign income account will include a refund mechanism for the company tax on inter-entity distributions paid by holding companies that are 100 per cent owned by a non-resident.

These measures are consistent with Recommendations 22.1 to 21.5 of *A Tax System Redesigned*.

Commencement date

The measures will apply from 1 July 2001.

Why the change is needed

The current tax treatment of foreign source income flowing through resident entities to non-resident investors can impact on the attractiveness of investments by non-residents in Australian entities. The foreign income account will ensure that foreign income is not double taxed where it flows through Australian entities to non-resident investors.

Gains on the disposal of interposed non-resident entities

The measures will be targeted at tax avoidance rather than commercial transactions.

The regime will not apply where the gain on the sale of an interposed entity is subject to tax in a broad exemption listed country or would have been subject to tax in such a country except for recognised rollover relief.

This measure is consistent with Recommendation 21.7 of *A Tax System Redesigned*.

Commencement date

The measure will apply from 1 July 2001.

Why the change is needed

Failure to address this issue would mean that, through relatively simple tax planning, non-residents would continue to be able to avoid capital gains tax.

Interest withholding tax on government securities

IWT is currently levied on interest paid to non-resident investors in relation to Commonwealth and State Government securities issued in Australia. This arrangement will be continued.