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Grant Thornton

Grant Thornton periodical reporting on taxation issues for business owners.

An often overlooked and misunderstood issue is that of withholding tax on international payments. A failure to apply the rules appropriately may lead to significant penalties or a denial of income tax deductions.

Withholding Tax

In an international context, Australia's withholding tax provisions impose a requirement to withhold and remit tax to the Australian Taxation Office ("ATO"), on certain prescribed payments to non-residents, including dividends, interest and royalties.

The rules operate such that the withholding tax requirement is imposed on the Australian resident, or an Australian branch of a non-resident, for payments made to non-residents or foreign branches of Australian residents. The tax is remitted to the ATO in accordance with your other PAYG withholding requirements, i.e. generally in accordance with your Business Activity Statement lodgements for the period in which the liability to withhold arises.

The liability to withhold tax generally arises when the respective dividend, interest or royalty amount has been paid, credited or otherwise dealt with. The mere accruing of interest or royalties does not necessarily give rise to a withholding tax liability. However, where the amount is credited to a loan account or another account whereby the recipient has legal claim over the monies, a withholding tax liability arises. The facts, circumstances and documentation need to be considered in each case to determine whether the liability to withhold has arisen.

Note, income tax deductions for payments of interest and royalties subject to withholding tax are not available until such time as the withholding tax has been remitted to the ATO.

Dividends

Non-resident withholding tax is imposed on gross unfranked dividends paid or credited to non-residents. To the extent that the dividend is franked (or is declared to be 'conduit foreign income' under new laws), no withholding tax applies.

The rate of withholding tax on dividends is 30%, generally reduced to 15% where the dividend is paid to a resident of a country with which Australia has a double tax treaty. Note a reduced rate of 0% or 5% can apply to certain US and UK recipients.

Interest

Interest withholding tax is imposed at the rate of 10% (regardless of in which foreign country the recipient is resident) when that interest is paid or credited.

Royalties

Royalty withholding tax is ordinarily imposed at the rate of 30% when that royalty is paid or credited. The withholding tax rate is reduced to 10% or 15% where a double tax treaty is in force.

The law also imposes withholding tax on certain industry specific payments including:

- Operating or promoting casino junket tours;
- Entertainment and sports activities; and
- Certain construction, installation and upgrading contracts.

Should these impact you, please do not hesitate to seek additional information from your local advisor.

Transitions to Retirement Pensions

There has recently been promotion of a salary sacrifice/retirement pension strategy whereby individuals were commencing transition into a retirement pension, and at the same time, were making salary sacrifice contributions to superannuation. This strategy can significantly reduce the tax liability of an individual.

In a media release (No Nat 2005/66) issued on 17 November 2005 the ATO has advised that the general anti-avoidance provisions, contained within the taxation laws, will not apply where taxpayers are merely commencing their transition to a retirement pension and making the additional salary sacrifice contributions to superannuation. In this regard, the Commissioner made the following comments:

"Arrangements entered into in a straight forward way are consistent with the operation of the law, and we do not see grounds for applying anti-avoidance rules.… We would only be concerned where accessing the pension or undertaking the salary sacrifice may be artificial or contrived."

Director liability of corporate trustee

The concern over the personal liability of directors of corporate trustees was brought to the forefront in the decision of the South Australian Supreme Court in Hanel v O'Neill [2003] SASC 409. In that case it was held that where the trust had insufficient assets to discharge its liabilities, the directors of the corporate trustee were personally liable.

This decision resulted from the poor drafting of Section 197(1) of the Corporations Act 2001. The Parliamentary Secretary to the Treasurer advised "This was never the intention of the relevant provision."

On 10 November 2005, the Senate passed the Corporations Amendment Bill (No. 1) 2005 (now awaiting Royal Assent), which contains measures to rectify the situation and again protect directors of corporate trustees.

Taxpayer Alert

On 30 November 2005 the Commissioner of Taxation issued a Taxpayer Alert 2005/3 'Income Tax - Consolidation: Application of the tax cost setting rules to copyright' regarding the pushing down of value to copyright within a tax consolidated group.

By way of background, tax consolidation seeks to tax corporate groups as a single entity. As a consequence of this, the head entity of the consolidated group is treated as owning all the assets and tax attributes of the corporate group. Accordingly, an appropriate tax cost must be ascribed to these assets and attributes that the head entity now owns for tax purposes. This cost reflects the cost of the shares held in the respective subsidiaries as adjusted for liabilities, retained profits and other economic attributes of the subsidiary. Such cost is allocated based on the market value of the assets introduced to the group by that subsidiary.

It is well known that many, if not all, businesses contain elements of copyright, which under the tax cost setting rules described above should be allocated a cost for tax consolidation purposes. The ATO does not dispute this issue.

However, to prove the market value of copyright, so as to allocate a new tax cost to it, a market valuation must be obtained. These valuations must be performed by a qualified valuer and must adopt reasonable and well-recognised valuation methodologies.

The ATO is concerned that groups are obtaining inflated valuations so as to push more cost to copyright, rather than other assets (more likely to be goodwill) so as to obtain higher capital allowance deductions.

At this stage the ATO has not finalised its views in relation to the valuation of copyright for these purposes. However, it is anticipated that a Public Ruling will issue in the near future. Until that Ruling issues, it is important that where you are valuing (or have valued) copyright for these purposes, you retain sufficient substantiation and ensure the valuation methodologies adopted are appropriate and the value ascribed is reasonable.

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