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6 November 2002

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Board of Taxation
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REVIEW OF INTERNATIONAL TAXATION ARRANGEMENTS

Following are comments regarding treatment of foreign source income of Australian companies and their Australian shareholders. They relate to options in the consultation paper prepared by Commonwealth Treasury. The comments are also relevant to 'conduit' foreign income passing through Australian companies and out to foreign shareholders.

Summary

2. In brief:

- Each of the three options in the consultation paper has shortcomings in addressing the current bias at Australian shareholder level between domestic and foreign source income – including the option that seeks to address the bias directly by providing domestic shareholders tax relief for one ninth of unfranked dividends paid out of exempt foreign source income. This option would add another set of income tax arrangements to existing imputation and foreign tax crediting systems.

- In contrast, a principle-based option built around the inclusion of foreign taxes in Australian companies' franking accounts and the general application of the current foreign tax credit system, FTCS, would strip away many complexities associated with the taxing of foreign source income by using existing franking credit arrangements.

- The 'Achilles' heel' of this 'franking credit' option is a feature included to reduce the cost to revenue of providing credits to Australian shareholders for foreign taxes on their Australian companies' income. That feature (tightening the FTCS) would add Australian tax at the company level even when foreign income had already been subject to 30 per cent tax offshore – though the benefits of foreign tax crediting would fall even-handedly on Australian companies and their Australian and foreign shareholders.

- The 'Achilles' heel' could be avoided by maintaining current exemption/foreign tax crediting arrangements at the company level and providing benefits of foreign tax crediting to shareholders in a principled way using separate accounts. Revenue costs would be reduced by directly limiting foreign taxes credited to Australian shareholders. These separate arrangements in 'pure' form would, however, be very complex from administration and compliance perspectives (they would have similarities to the 'one ninth' consultation paper option but would be based around authenticated foreign tax paid).

- An intermediate option, which would also avoid the Achilles' heel, would be to apply FTCS generally at the company level but reduce foreign tax credits in the hands of Australian shareholders. Administratively, this would involve minimal extra complexity.

- If the 'franking credit' option – or the associated intermediate option – is not considered feasible, doing nothing (apart from some 'tidying' of existing arrangements) becomes a more serious option.

3. The Business Income Taxation (BIT) Model, written by the author, enables the practical testing of different options. The attachment to this submission illustrates the 'franking credit' option using results from BIT.

Foreign Source Income: Background

4. Discussion in the consultation paper on foreign source income focuses on the bias at the shareholder level between domestic and foreign source income under Australia's full imputation company tax system. Contrary to the view of some, this bias is not a result of basic problems with full imputation systems. Full imputation systems, with their tax crediting arrangements for domestic shareholders, can achieve a single layer of tax on income flowing through domestic companies and out to shareholders regardless of whether the companies' income is sourced domestically or offshore.

5. More than one layer of tax often applies to foreign source income flowing through Australian companies and out to individual domestic shareholders. That arises because foreign taxes on the foreign source income are not included as imputation credits under Australia's imputation system. The foreign taxes are not included as imputation credits for obvious tax revenue reasons, however, not because of any fundamental design principle of imputation systems.

6. The inclusion of foreign taxes as imputation credits underpins the 'franking credit' option discussed below for the treatment of foreign source income.

Options to Address Shareholder Bias: Consultation Paper

7. Of the three options discussed in the consultation paper to address the shareholder bias between domestic and foreign source income:

- the relevance of the DWT option has been changed significantly by the recent Australia/US double tax protocol; and

- the dividend streaming option offends basic imputation and taxation principles (shareholders receiving something other than their share of a company's value) with *ad hoc* practical effects (for example, no benefits to domestic shareholders if there are no foreign shareholders).

8. The option of providing domestic shareholders tax relief for unfranked dividends paid out of exempt foreign source income seeks to address directly the bias between domestic and foreign source income. Limiting shareholder credits to one ninth of relevant unfranked dividends is necessarily arbitrary but has the practical advantage of not requiring any knowledge of the level of foreign tax paid on the foreign source income. But the option requires a new system to be established separate from existing imputation arrangements and the foreign tax credit system (FTCS) and is coupled with retention of a potentially extended foreign income account system. The new system would require ledgers to handle years of retention of foreign income before distribution to Australian individuals (as well as precedent rules when different forms of income are distributed) and to handle distribution of foreign source income down the company chain.

Franking Credit Option

9. With all options open for discussion, including doing nothing, another option worth considering is one that is principles-based (though in practice also has arbitrary features) and has a range of practical advantages. The main features of this 'franking credit' option are:

- Apply the foreign tax credit system, FTCS, uniformly to all domestic companies (removing the exemption arrangements applying to dividends from 'listed' countries) – for authenticated tax paid on foreign source income.

- Limit the annual amount of foreign tax credited at the company level to an amount obtained by applying the Australian company tax rate to the income (that is, no net refunds of foreign taxes), a limitation arrangement that already applies under FTCS.

- Add foreign tax paid (less the effect of any limitation) on offshore income to companies' franking accounts so that domestic shareholders receive the benefit of those credits when distributions occur.

  Shareholders would not be faced with any extra administrative requirements. All their dividends out of foreign source income would be franked through foreign taxes being added to franking credits and the operation of FTCS. The effect of the above limit on foreign credits would increase the amount of domestic tax paid through FTCS.

Illustration 1 in the attachment is from the computer model, Business Income Taxation (BIT), written by the author. The illustration is of an investment in an offshore company (subject to full imputation) by Australian individuals via an Australian company. It adds foreign company tax (30 per cent) and DWT (15 per cent) on foreign dividends received to the Australian company's franking account. Those credits flow out to the individual investors with their dividend receipts. All the foreign tax is added to the franking account because foreign tax crediting is limited in this illustration by Australia's 30 per cent company tax rate and the foreign income has been taxed at 30 per cent or below (when only DWT applies to unfranked foreign dividends). That results in a single layer of tax (both foreign and domestic) applying at investors' marginal tax rates ($1001 of tax in the illustration, $178 of that domestic) – consistent with the single layer of tax that applies to investments by Australian individuals in Australian companies that produce domestic income.

- Tighten the foreign tax credit limit further for both companies and their shareholders if reduced cost to tax revenue is required. This tightening could be made on the basis of a reduced tax rate (below our 30 per cent company tax rate) used to apply in the above FTCS limitation arrangements.

  Again, in administration/compliance terms, the effect of a tightened limit would only change the balance between domestic tax and foreign tax credits in fully franking dividends received out of foreign source income by domestic shareholders (or trust investors). This is shown in BIT Illustration 2 in the attachment where tightening at a 15 per cent rate means that more than a single layer of tax applies to the individual investing indirectly in offshore equities ($1011 rather than $1001, the extra collected domestically).

  Those individuals investing directly in foreign equities, however, would be required to apply the limitation themselves to authenticated underlying foreign company tax (and DWT).

  Applying this extra tightening through a lower tax rate limit would arbitrarily impact more on investments in countries with higher taxes. That is the same as the present FTCS limit and it would not impose additional tax beyond the effect of FTCS on conduit income from low tax countries. Nevertheless, an alternative basis of limitation could be used, if desired.

Advantages/Disadvantages of Franking Credit Option

10. The franking credit option would have the disadvantage of increased compliance associated with general applicability of FTCS at the company level. The general application of FTCS would also apply tax at the company tax rate to low taxed conduit income. As the consultation paper notes, however, this would remove an incentive for resident companies with foreign shareholders to shift profits from Australia to low taxed countries by physically shifting operations or through non-arm's length pricing arrangements and take pressure off anti-avoidance measures. Moreover, it is not clear that achieving zero Australian tax on conduit income passing through Australia is the benchmark to be sought in practice – any more than the taxing by each country of its own residents only (not foreign residents) should be sought in practice, even though this would achieve neutral tax treatment of investment regardless of its location worldwide.

- In practice, what underlies the taxation by Australia of the income of other countries' residents depends on such issues as net capital inflow/outflow, other countries taxing of our residents' income and the benefits to offshore investors of our stable investment environment.

- In these circumstances, the degree of neutrality in worldwide investment decision-making depends on the extent to which a country provides credits to its residents – including those at the end of the conduit chain – for tax paid on their income sourced in other countries.

11. Most importantly, however, with extra tightening of the foreign tax credit limit under the franking credit option, a company could pay more Australian tax the greater the extra tightening. That would be the case, for example, if the percentage of foreign tax were 30 per cent on income underlying foreign dividends received by the company. This effect might appear to put paid to the franking credit option completely but this 'Achilles' heel' is discussed further below.

12. Against these disadvantages is a range of advantages whereby the option would:

- remove the need for 'listed' and 'non-listed' countries for foreign tax crediting purposes;

- handle directly issues associated with foreign dividends passing down the domestic entity chain (through the inclusion of foreign taxes in the franking account).

  Domestic tax would not be paid on those foreign dividends 'franked' by foreign tax. It would not be paid either in the company initially receiving the dividends or as they pass down the Australian company chain (for example, in the context of an investment by an Australian company in a joint venture company with offshore activities).

  DWT would automatically not apply to such dividends that ultimately are distributed to foreign shareholders (that is, conduit income) again because they are franked as a result of foreign taxes paid on the foreign source income. In BIT Illustration 3 in the attachment, the overall domestic tax paid falls to $140 because half the domestic company's dividends flows to foreign owners and is not subject to the assumed 47 per cent domestic shareholders' tax rate or to DWT;

- remove, therefore, any requirement for separate foreign income accounts;
- remove the need to distinguish between foreign portfolio and non-portfolio dividends for foreign income account purposes;
- address the 'triangular' case, again by including foreign taxes (of all countries that are the source of foreign income) as franking credits, which the other country in the triangle can then identify and allow as credits to its individual shareholders if desired (see foreign owners' block in BIT Illustration 3 in the attachment) – thus avoiding the complexities of the alternative bilateral pro rata allocation method;
- allow neutral treatment of individuals investing directly offshore and those investing offshore via a domestic company;
- apply even-handedly to both foreign dividend income (the subject of the BIT illustrations) and foreign non-dividend income (for example, business income, interest income and capital gains from property sales).

13. This option strips away many complexities associated with the taxing of foreign source income by using existing franking credit arrangements, consistent with imputation principles. Attempts at providing foreign credits to individual shareholders in a principled way using separate accounts, while possible, would be administratively complex with associated compliance problems. BIT's modelling of these arrangements suggests that numerous ledgers would be required to operate them in 'pure' form.

The Achilles' Heel

14. It is the extra tightening of the foreign tax limit below our 30 per cent company tax rate, a tightening that presumably would be necessary initially for revenue protection, that is the 'Achilles' heel' of the franking credit option. It might seem unacceptable for a company to be required to pay Australian tax on foreign dividends that are currently exempt from Australian tax because they are from a 'listed' country with a 30 per cent company tax rate. Similarly, it might seem unacceptable for conduit dividend income passing through Australia from this listed country to face some additional component of domestic tax.

15. Arguments on the other side of this view include:

- The extra restriction on inclusion of foreign taxes in companies' franking accounts would be designed solely to reduce the revenue cost of the benefits to the shareholders of those companies.

- Despite the extra tightening, overall tax paid by the company plus its individual domestic shareholders (when the foreign income is distributed to them) presumably would be significantly less than under existing arrangements.

- The franking credit option would see even-handed benefits of foreign tax crediting arrangements applying to the company (receiving credits on its foreign income, potentially limited to some degree), its domestic shareholders (receiving the same credits) and its foreign shareholders (paying no DWT on distributed foreign income, at least in part because of foreign taxes being added to franking accounts).

  This even-handed treatment is in contrast to current arrangements where the company attracts full credit for foreign taxes through exemption or FTCS, the domestic shareholder attracts no foreign tax credits and the foreign shareholder attracts mixed benefits from, on the one hand, the interaction of exemption/FTCS and foreign income tax arrangements relating to foreign non-portfolio dividends and, on the other, whether or not the foreign income passes down the Australian company chain first.

  The even-handed treatment necessarily follows from the inclusion of foreign credits in the company's franking account, an inclusion which is only possible if the company, its domestic shareholders and its foreign shareholders are all to receive equivalent foreign tax benefits.

16. As noted, if either the company or foreign shareholders are not to receive equivalent benefits, delivering foreign tax credits in a principled way to domestic shareholders would involve complexities through the use of additional ledgers.

- For example, if the current exemption/FTCS foreign tax crediting arrangements were to be retained to avoid the 'Achilles' heel' of the franking credit option (with revenue costs reduced by directly limiting foreign taxes credited to Australian shareholders) much complexity would be involved through the use of numerous ledgers.

- However, an intermediate option, which would also avoid the 'Achilles' heel', would be the franking credit option with FTCS applying generally at the company level but with foreign tax credits limited, as required, in the hands of Australian shareholders. Because this option is built around the inclusion of foreign taxes in Australian companies' franking accounts, beyond the simplicity of the franking credit option it would only require accounts to track excess foreign credits when company profits are retained (with shareholders advised of excess credits associated with dividend pay-outs).

Conclusion

17. The franking credit option involves a trade-off involving, on the one hand, simpler arrangements based on fundamental design principles of imputation arrangements and, on the other, taxation effects at the company level that stem from the use of additional limiting arrangements to achieve the basic requirement to collect sufficient revenue. It is an empirical issue as to how close the additional limiting arrangements under this option could be brought to the effect of Australia's 30 per cent company tax rate, consistent with acceptable tax revenue reduction.

18. The closely related 'intermediate' option offers minimal additional administrative complexity to remove the need for additional limiting arrangements at the company level while maintaining a principle-based approach.

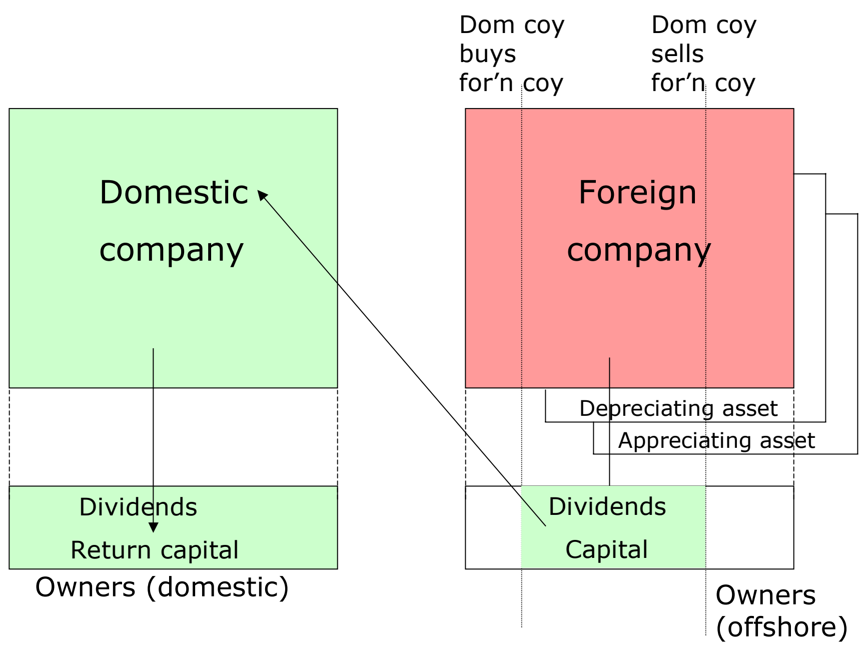
Wayne Mayo *

* Worked on business taxation issues over a number of years prior to, and during, employment at Treasury over the 1980s and 1990s, encompassing the tax reforms of 1985/86 and 1998/99, the latter including the Ralph Review of Business Taxation – currently a private consultant and software developer.

BIT ILLUSTRATION 1: FRANKING CREDITS INCLUDE FOREIGN TAXES, LIMITED BY 30% COMPANY TAX RATE

- Domestic company acquires foreign company in Year 2 and sells it Year 5
- Foreign company is the only asset that the domestic company holds
- Foreign company holds a depreciating asset and an appreciating asset
- Foreign and domestic company tax rate is 30% (DWT at 15%)
- Domestic individuals' marginal tax rate is 47%

Structure of BIT's 'Entity' and 'Asset' spreadsheets in following pages



BIT SUMMARY - TAX REVENUE

FOREIGN COMPANY			
Tax at entity level (F)	639	Entity income	2129
Foreign tax on non-dividend income	0	Entity tax rate	0.30
Total tax on company income	639	Income x entity tax rate	639
Tax at owner level	142	Domestic owner's tax rate	0.47
DWT (foreign company dividends)	42		
Total tax	823	Income x tax rate	1001

DOMESTIC COMPANY			
Tax at entity level	78	Entity income	0
Foreign tax on non-dividend income	0	Entity tax rate	0.30
Total tax on company income	78	Income x entity tax rate	0
Domestic tax at owner level	100	Domestic owner's tax rate	0.47
DWT (domestic company dividends)	0		
Total tax	178	Income x tax rate	0

TOTAL TAX PAID (DOMESTIC & FOR'N)	**1001**	**TOTAL INCOME x TAX RATE**	**1001**
TOTAL DOMESTIC TAX PAID	178		

From BIT's Front End which provides easy option selection and high level results

BIT's 'Entity' spreadsheet of domestic company

DOMESTIC COMPANY

Tax rate owner	0.47	Entity tax treatment	0	CGT on owner	1		
Total years	5	Measured income	0	CGT cost base adj	2		
Tax rate entity/bus	0.30	Reinvest retentions	1	CGT propn (entity)	1.00		
Full loss offset (1/0)	1	Dom dividends rec'd	0	CGT propn (owner)	1.00		
Gen entity tax rate	0.30	Unfranked div tax	0	Temp/perm prefs	0	'Ideal'	1
DWT	0.00	For'n tax on non-div	1	Dom own's for'n credit	3	Lt non-div	
DWT/tax switch		For'n dividends rec'd	3	For'n own's for'n credit	1	Limt divs	

Imputation

Foreign tax credit at company and owner level, limited on basis of company tax rate

DWT relief for any foreign owners

COMPANY

Year	0	1	2	3	4	5	6	7	8
Owned entity			1	1	1	1			
Propn owned	0%	0%	100%	100%	100%	100%	0%	0%	0%
Pre-tax									
Value net assets	0	0	1932	1945	1986	2054	0	0	0
Net receipts	0	0	0	0	0	0			
Net r'pts (for'n non-div)	0	0	0	0	0	0			
Net r'pts (for'n dividend)		0	0	143	121	103			
Cash flow	0	0	-1932	143	121	2157			
Pre-tax return %		0.0	0.0	0.0	0.0	8.3	0.0	0.0	0.0
Post-tax									
Tax value	0	0	1932	1932	1932	2054	0	0	0
Credit (dom/franked)		0	0	0	0	0	0		0
Foreign i/tax on div		0	0	22	18	16			
Foreign DWT		0	0	16	14	12			
CGT base (dom)		0	0	0	0	0			
CGT base (foreign)		0	0	0	0	122			
Taxable income (dom)		0	0	0	0	0	0	0	0
Taxable income (for)		0	0	181	154	252	0	0	0
Xs for'n tax credit div		0	0	0	0	0	0	0	0
Xs for'n tax cr non-div		0	0	0	0	0	0	0	0
Tax paid		0	0	16	14	48	0	0	0
Post-tax cash flow	0	0	-1932	126	107	2109	0	0	0
Acc tax paid		0	0	16	30	78	0	0	0
Post-tax return %		0.0	0.0	0.0	0.0	7.0	0.0	0.0	0.0

Franked and unfranked dividends from foreign company

Foreign taxes on income

CGT gain from sale of foreign company

DOMESTIC INDIVIDUAL OWNERS

	0	1	2	3	4	5	6	7	8
Retain entity/sell (0/1)		0	0	0	0	0	0	0	0
Retain/distribute		0	0	1	1	1			
Value (share)	0	0	1932	1945	1986	0	0	0	0
Tax value (share)	0	0	1932	1932	1932	0	0	0	0
Franked div (share)		0	0	126	107	177	0	0	0
Unfranked div (share)		0	0	0	0	0	0	0	0
Return of cap (share)	0	0	0	0	0	1932	0	0	0
Gross tax		0	0	85	72	119			
Credit		0	0	54	46	76			
Foreign tax credit		0	0	0	0	0			
Tax paid		0	0	31	26	43	0		0
CGT base		0	0	0	0	0	0	0	0
CGT		0	0	0	0	0	0	0	0
Post-tax cash flow	0	0	-1932	96	81	2066	0	0	0
Post-tax return		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
						5.33%			
Acc overall i/tax paid		0	0	47	87	178	0	0	0

Distribution of all cash each year

Foreign and domestic tax paid included in franking credits

BIT's 'Entity' spreadsheet of foreign company

FOREIGN COMPANY

Tax rate owner	0.47	Entity tax treatment	0	CGT on owner	1		
Total years	10	Measured income	0	CGT cost base adj	2		
Tax rate entity/bus	0.30	Reinvest retentions	1	CGT propn (entity)	1.00		
Full loss offset (1/0)	1	Dom dividends rec'd	0	CGT propn (owner)	1.00		
Gen entity tax rate	0.30	Unfranked div tax	0	Temp/perm prefs	0	'Ideal'	0
DWT	0.15	For'n tax on non-div	0	Dom own's for'n credit	0	Lt non-div	
DWT/tax switch		For'n dividends rec'd	2	For'n own's for'n credit	0	Limt divs	

Imputation

CGT cost base on owners' shares adjusted for returns of capital only

Liquidation in Year 10

DWT

COMPANY

Year	0	1	2	3	4	5	6	7	8
Pre-tax									
Value net assets	2000	1950	1932	1945	1986	2054	2149	2269	2416
Net receipts	0	250	213	181	154	131	111	94	80
Change in value	0	-50	-18	13	41	68	94	121	147
Income	0	200	195	193	195	199	205	215	227
Cash flow	-2000	250	213	181	154	131	111	94	80
Pre-tax return %		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Post-tax									
Tax value	2000	1850	1723	1614	1522	1444	1377	1321	1272
Change in tax value		-150	-128	-108	-92	-78	-67	-57	-48
Balancing adjustmt		0	0	0	0	0			0
CGT bal adj		0	0	0	0	0			0
Post-tax cash flow	-2000	220	187	159	135	115	98	83	71
Acc tax paid		30	56	77	96	111	125	136	146
Post-tax return %		0.0	0.0	0.0	0.0	0.0			

Net receipts from depreciating asset

Change in value/tax value of both assets

639 in Year 10 including CGT on sale of appreciating asset

COMPANY OWNERS

F

Coy in diff country to owners Yrs 3-5

Original owner sells to domestic company which then sells out in Year 5

Distributes each year

	0	1	2	3	4	5	6	7	8
Retain entity/sell (0/1)		0	1	0	0	1			
Retain/distribute		1	1	1	1	1	1	1	1
Value (share)	2000	1950	1932	1945	1986	2054	2149	2269	2416
Tax value (share)	2000	1950	1932	1932	1932	2054	2054	2054	2054
Franked div (share)		70	60	51	43	37	31	26	22
Unfranked div (share)		100	110	108	92	78	67	57	48
Return of cap (share)	-2000	50	18	0	0	0	0	0	0
DWT		15	16	16	14	12	10	8	7
I/tax to foreigners		30	26	22	18	16	13	11	10
Tax paid		64	66	63	54	46	39	33	28
CGT base		0	0	0	0	122	0		0
CGT		0	0	0	0	57	0		0
Post-tax cash flow	-2000	156	2053	96	81	2066	59	50	42
Post-tax return		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
			5.30%			5.33%			
Acc overall i/tax paid		94	186	224	256	283	335	380	417

823 in Year 10

High proportion of unfranked dividends because increasing value of appreciating asset included in profits for tax purposes. Option can be chosen not to revalue asset, but unfranked dividends useful to bring out DWT payments.

No CGT on sale of foreign company by original owners because value equals cost base (tax value).

Transactions in this block reflected in domestic company's tax assessment while that company owns the foreign company

CGT gain of 122 to domestic company = 2054 sale price - 1932 purchase price This ignores possibility of the country of the foreign company also taxing this gain.

Depreciating asset held by foreign company (summary of BIT's 'Asset' spreadsheet)

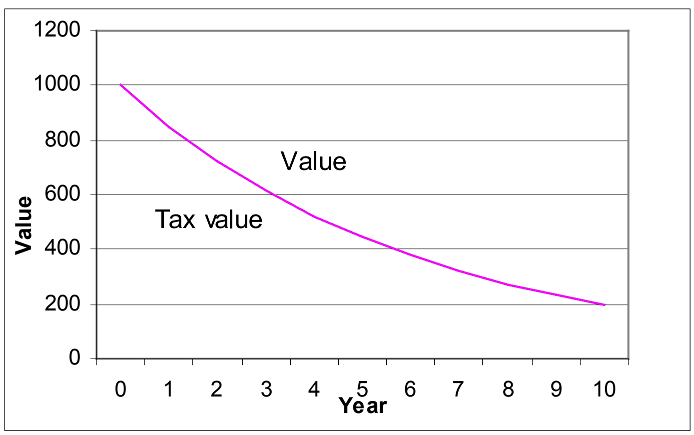
DEPRECIATING ASSET

Deterioration rate	0.15	Tax depreciation rate	0.15	Sheet type	0		Tot income
Pre-tax rate of return	0.1	Tax dep yr	0	Asset/liab	1		535.4
Inflation	0	First dep allowances	1	Lease/liab	0		Foreign tax
Annual net receipts	0	Tax deprec loading		Start year	0		0.0
Total years	10	Exempt recpts propn		End year	0		
Investment year	0	Tax rate	0.47	Paym't str	0		
Up-front cap amount	1000	Ec depn	0	Prp'n l'sed	0.0		
First net receipts	1	Full loss offset (1/0)	1	Tax t'ment	0	No revalue	0

Year	Investment	Net Receipts	Change in Value	Value	Income	Cash Flow	Tax Value	Tax Deprecn
0	1000	0	0	1000	0	-1000	1000	
1	0	250	-150	850	100	250	850	-150
2	0	213	-128	723	85	213	723	-128
3	0	181	-108	614	72	181	614	-108
4	0	154	-92	522	61	154	522	-92
5	0	131	-78	444	52	131	444	-78
6	0	111	-67	377	44	111	377	-67
7	0	94	-57	321	38	94	321	-57
8	0	80	-48	272	32	80	272	-48
9	0	68	-41	232	27	68	232	-41
10	-197	58	-35	197	23	255	197	-35
Pre-tax return						10.00%		

Value declining at 15% in line with declining value tax write-off

	Benchmark		Tax Treatment	
Year	Tax	Cash Flow	Tax	Cash Flow
0	0	-1000		-1000
1	47	203	47	203
2	40	173	40	173
3	34	147	34	147
4	29	125	29	125
5	25	106	25	106
6	21	90	21	90
7	18	77	18	77
8	15	65	15	65
9	13	55	13	55
10	11	244	11	244
Post-tax return	252	5.30%	252	5.30%



Because value changes in line with depreciated value (tax value), 10% pre-tax return reduced by the 47% tax rate to 5.3%

Appreciating asset held by foreign company (summary of BIT's 'Asset' spreadsheet)

APPRECIATING ASSET

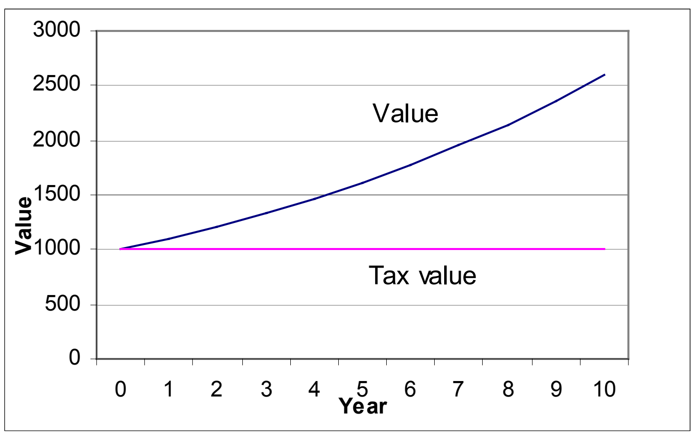
Physical apprec rate	0	Proportn dep asset		Sheet type	0	Tot income	
Pre-tax rate of return	0.1	Tax dep yr	40	Asset/liab	1	1593.7	
Inflation		First dep allowances	1	Lease/liab	0	Foreign tax	
Annual net receipts	0.0	CGT proportion	1.00	Start year	0	0.0	
Total years	10	Exempt recpts propn		End year	0		
Investment year	0	Tax rate	0.47	Paym't str	0		
Up-front cap amount	1000	Ec depn	0	Prp'n l'sed	0.0	Bal adj	
First net receipts	1	Full loss offset (1/0)	1	Tax t'ment	0	No revalue	0

Year	Investment	Net Receipts	Change in Value	Value	Income	Cash Flow	Tax Value	Tax Deprecn
0	1000	0	0	1000	0	-1000	1000	
1	0	0	100	1100	100	0	1000	0
2	0	0	110	1210	110	0	1000	0
3	0	0	121	1331	121	0	1000	0
4	0	0	133	1464	133	0	1000	0
5	0	0	146	1610	146	0	1000	0
6	0	0	161	1771	161	0	1000	0
7	0	0	177	1949	177	0	1000	0
8	0	0	195	2143	195	0	1000	0
9	0	0	214	2358	214	0	1000	0
10	-2594	0	236	2594	236	2594	1000	0
Pre-tax return						10.00%		

Value increasing 10% per year and asset is revalued

Cost base (tax value) unchanged at original cost

	Benchmark		Tax Treatment	
Year	Tax	Cash Flow	Tax	Cash Flow
0	0	-1000		-1000
1	47	-47	0	0
2	52	-52	0	0
3	57	-57	0	0
4	63	-63	0	0
5	69	-69	0	0
6	76	-76	0	0
7	83	-83	0	0
8	92	-92	0	0
9	101	-101	0	0
10	111	2483	749	1845
Post-tax return	749	5.30%	749	6.31%



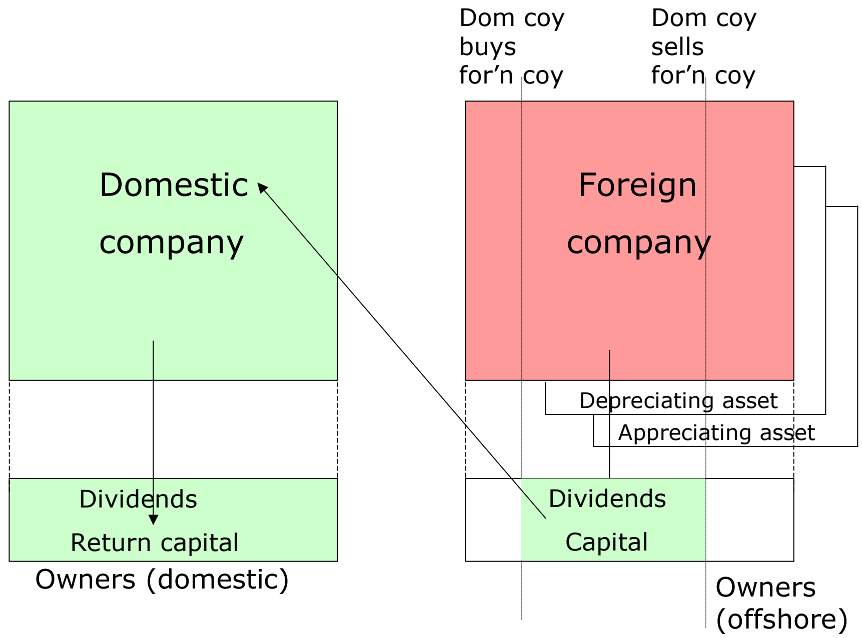
CGT applies on sale of asset

BIT ILLUSTRATION 2: FRANKING CREDITS INCLUDE FOREIGN TAXES, LIMITED BY A 15% RATE, DOMESTIC OWNERS ONLY

- Domestic company acquires foreign company in Year 2 and sells it Year 5

- Foreign company is the only asset that the domestic company holds
- Foreign company holds a depreciating asset and an appreciating asset
- Foreign and domestic company tax rate is 30% (DWT at 15%)
- Domestic individuals' marginal tax rate is 47%

Structure of BIT's 'Entity' and 'Asset' spreadsheets in illustration (domestic company on next page, others same as Illustration 1)



BIT SUMMARY - TAX REVENUE

FOREIGN COMPANY			
Tax at entity level (F)	639	Entity income	2129
Foreign tax on non-dividend income	0	Entity tax rate	0.30
Total tax on company income	639	Income x entity tax rate	639
Tax at owner level	142	Domestic owner's tax rate	0.47
DWT (foreign company dividends)	42		
Total tax	823	Income x tax rate	1001

DOMESTIC COMPANY			
Tax at entity level	92	Entity income	0
Foreign tax on non-dividend income	0	Entity tax rate	0.30
Total tax on company income	92	Income x entity tax rate	0
Domestic tax at owner level	96	Domestic owner's tax rate	0.47
DWT (domestic company dividends)	0		
Total tax	189	Income x tax rate	0

TOTAL TAX PAID (DOMESTIC & FOR'N)	**1011**	**TOTAL INCOME x TAX RATE**	**1001**
TOTAL DOMESTIC TAX PAID	189		

From BIT's Front End which provides easy option selection and high level results

BIT's 'Entity' spreadsheet of domestic company

DOMESTIC COMPANY

Tax rate owner	0.47	Entity tax treatment	0	CGT on owner	1		
Total years	5	Measured income	0	CGT cost base adj	2		
Tax rate entity/bus	0.30	Reinvest retentions	1	CGT propn (entity)	1.00		
Full loss offset (1/0)	1	Dom dividends rec'd	0	CGT propn (owner)	1.00		
Gen entity tax rate	0.30	Unfranked div tax	0	Temp/perm prefs	0	'Ideal'	1
DWT	0.00	For'n tax on non-div	1	Dom own's for'n credit	3	Lt non-div	
DWT/tax switch		For'n dividends rec'd	3	For'n own's for'n credit	1	Limt divs	0.15

Imputation

Foreign tax credit at company and owner level, limited on basis of lower than company tax rate

DWT relief for any foreign owners

COMPANY

Year	0	1	2	3	4	5	6	7	8
Owned entity			1	1	1	1			
Propn owned	0%	0%	100%	100%	100%	100%	0%	0%	0%
Pre-tax									
Value net assets	0	0	1932	1945	1986	2054	0	0	0
Net receipts	0	0	0	0	0	0			
Net r'pts (for'n non-div)	0	0	0	0	0	0			
Net r'pts (for'n dividend)		0	0	143	121	103			
Cash flow	0	0	-1932	143	121	2157			
Pre-tax return %		0.0	0.0	0.0	0.0	8.3	0.0	0.0	0.0
Post-tax									
Tax value	0	0	1932	1932	1932	2054	0	0	0
Credit (dom/franked)		0	0	0	0	0	0		0
Foreign i/tax on div		0	0	22	18	16			
Foreign DWT		0	0	16	14	12			
CGT base (dom)		0	0	0	0	0			
CGT base (foreign)		0	0	0	0	122			
Taxable income (dom)		0	0	0	0	0			
Taxable income (for)		0	0	170	144	252			
Xs for'n tax credit div		0	0	11	9	0			
Xs for'n tax cr non-div		0	0	0	0	0			
Tax paid		0	0	24	20	48			
Post-tax cash flow	0	0	-1932	119	101	2109			
Acc tax paid		0	0	24	44	92	0	0	0
Post-tax return %		0.0	0.0	0.0	0.0	6.8	0.0	0.0	0.0

Franked and unfranked dividends from foreign company

Foreign taxes on income

CGT gain from sale of foreign company

Excess foreign tax credits from extra tightening

More domestic tax because of tightening

DOMESTIC INDIVIDUAL OWNERS

Retain entity/sell (0/1)		0	0	0	0	0			
Retain/distribute		0	0	1	1	1			
Value (share)	0	0	1932	1945	1986	0			
Tax value (share)	0	0	1932	1932	1932	0	0	0	0
Franked div (share)		0	0	119	101	177	0	0	0
Unfranked div (share)		0	0	0	0	0	0	0	0
Return of cap (share)	0	0	0	0	0	1932	0	0	0
Gross tax		0	0	80	68	119			
Credit		0	0	51	43	76			
Foreign tax credit		0	0	0	0	0			
Tax paid		0	0	29	25	43			
CGT base		0	0	0	0	0	0		0
CGT		0	0	0	0	0	0	0	0
Post-tax cash flow	0	0	-1932	90	76	2066	0	0	0
Post-tax return		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
						5.14%			
Acc overall i/tax paid		0	0	53	98	189	0	0	0

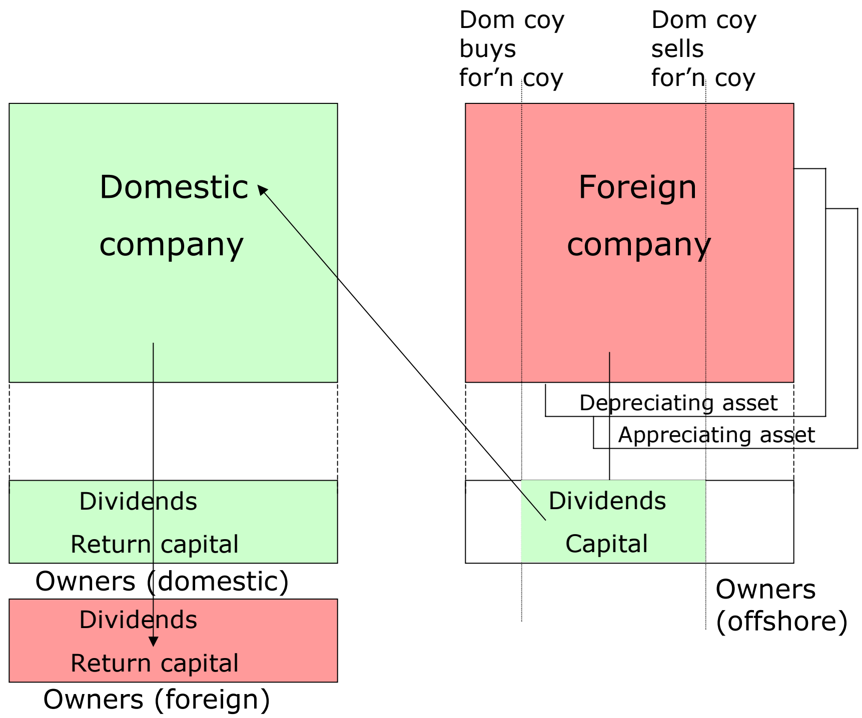
Distribution of all cash each year

Foreign (limited) and domestic tax paid included in franking credits

BIT ILLUSTRATION 3: FRANKING CREDITS INCLUDE FOREIGN TAXES, LIMITED BY A 15% RATE, DOMESTIC AND FOREIGN OWNERS

- Domestic company acquires foreign company in Year 2 and sells it Year 5
- Foreign company is the only asset that the domestic company holds
- Foreign company holds a depreciating asset and an appreciating asset
- Foreign and domestic company tax rate is 30% (DWT at 15%)
- Domestic individuals' marginal tax rate is 47%

Structure of BIT's 'Entity' and 'Asset' spreadsheets in illustration (domestic company on next page, others same as Illustration 2)



BIT SUMMARY - TAX REVENUE

FOREIGN COMPANY			
Tax at entity level (F)	639	Entity income	2129
Foreign tax on non-dividend income	0	Entity tax rate	0.30
Total tax on company income	639	Income x entity tax rate	639
Tax at owner level	142	Domestic owner's tax rate	0.47
DWT (foreign company dividends)	42		
Total tax	823	Income x tax rate	1001

DOMESTIC COMPANY			
Tax at entity level	92	Entity income	0
Foreign tax on non-dividend income	0	Entity tax rate	0.30
Total tax on company income	92	Income x entity tax rate	0
Domestic tax at owner level	48	Domestic owner's tax rate	0.47
DWT (domestic company dividends)	0		
Total tax	140	Income x tax rate	0

TOTAL TAX PAID (DOMESTIC & FOR'N)	**963**	**TOTAL INCOME x TAX RATE**	**1001**
TOTAL DOMESTIC TAX PAID	140		

From BIT's Front End which provides easy option selection and high level results

BIT's 'Entity' spreadsheet of domestic company

DOMESTIC COMPANY

Tax rate owner	0.47	Entity tax treatment	0	CGT on owner	1		
Total years	5	Measured income	0	CGT cost base adj	2		
Tax rate entity/bus	0.30	Reinvest retentions	1	CGT propn (entity)	1.00		
Full loss offset (1/0)	1	Dom dividends rec'd	0	CGT propn (owner)	1.00		
Gen entity tax rate	0.30	Unfranked div tax	0	Temp/perm prefs	0	'Ideal'	1
DWT	0.15	For'n tax on non-div	1	Dom own's for'n credit	3	Lt non-div	
DWT/tax switch		For'n dividends rec'd	3	For'n own's for'n credit	1	Limt divs	0.15

Imputation

Foreign tax credit at company and owner level, limited on basis of lower than company tax rate

DWT relief for any foreign owners

DWT

COMPANY

Year	0	1	2	3	4	5	6	7	8
Pre-tax									
Value net assets	0	0	1932	1945	1986	2054	0	0	0
Cash flow	0	0	-1932	143	121	2157	0	0	0
Pre-tax return %		0.0	0.0	0.0	0.0	8.3	0.0	0.0	0.0
Post-tax									
Tax value	0	0	1932	1932	1932	2054	0	0	0
Post-tax cash flow	0	0	-1932	119	101	2109			
Acc tax paid		0	0	24	44	92	0	0	0
Post-tax return %		0.0	0.0	0.0	0.0	6.8	0.0	0.0	0.0

Flows as with Illustration 2

DOMESTIC INDIVIDUAL OWNERS

	0	1	2	3	4	5	6	7	8
Retain entity/sell (0/1)		0	0	0	0	0	0	0	0
Retain/distribute		0	0	1	1	1	0	0	0
Value (share)	0	0	966	973	993	0	0	0	0
No shares/interests	400	400	400	400	400	400	0	0	0
%age for'n own'ship	50.00%	50.00%	50.00%	50.00%	50.00%	50.00%	0.00%	0.00%	0.00%
Tax value (share)	0	0	966	966	966	0	0	0	0
Franked div (share)		0	0	59	51	88	0	0	0
Unfranked div (share)		0	0	0	0	0	0	0	0
Return of cap (share)	0	0	0	0	0	966			
Tax paid		0	0	14	12	21			
CGT base		0	0	0	0	0			
CGT		0	0	0	0	0			
Post-tax cash flow	0	0	-966	45	38	1033			
Post-tax return		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
						5.14%			
Acc overall i/tax paid		0	0	38	71	140	0	0	0
F									
FOREIGN OWNERS									
Retain entity/sell (0/1)		0	0	0	0	0	0	0	0
Retain/distribute		0	0	1	1	1	0	0	0
No shares/interests	400	400	400	400	400	400	400	400	400
Franked div (share)		0	0	59	51	88			
Unfranked div (share)		0	0	0	0	0			
Return of cap (share)	0	0	0	0	0	966			
DWT		0	0	0	0	0			
I/tax to foreigners		0	0	25	22	38			

Flows half those of Illustration 2 as only 50% domestic owners here

Company in diff country to these owners

No DWT as all dividends franked either by foreign or domestic taxes

Underlying company tax