



**EMBARGO** Budget. Not for release before 7.30 pm AEST, 13 May 1997.

## INTERACTION OF CONTROLLED FOREIGN COMPANY MEASURES AND CAPITAL GAINS TAX PROVISIONS

### Financial Implications (\$m)

1997-98	1998-99	1999-00	2000-01
†	†	†	†

† The measure will protect the revenue base used for the forward estimates, by removing opportunities for significant future expansion of tax minimisation practices. In the absence of the measure, to the extent that the revenue base would not be protected, there would be a significant revenue loss compared to the forward estimates.

### Explanation

The Government intends to correct several anomalies that have been identified concerning the interaction of the controlled foreign company (CFC) measures and the capital gains tax (CGT) provisions. Three of the anomalies could, in combination, prevent the intended taxation in Australia of capital gains on the deemed disposal of tainted assets (assets held to derive tainted income such as interest and dividends) of a CFC. (A deemed disposal can occur, for example, when a CFC, which holds an asset which has been subject to rollover relief, ceases to be a member of a group.) A further anomaly which will be corrected is that shareholders of a CFC that holds a tainted asset and has taken advantage of the rollover provisions, may reduce their Australian tax liability by diluting their interest in the CFC between the time the rollover relief is obtained and when an asset disposal takes place.

Capital gains derived or deemed to be derived by a CFC on tainted assets are intended to be taxed in Australia (with a credit for foreign taxes paid) unless the CFC satisfies an active income test or the gains have been comparably taxed in another jurisdiction. Unless these anomalies are corrected, the interaction of the CFC measures and the CGT provisions will not operate as intended and companies could avoid the imposition of Australian tax by holding mobile assets through a CFC (rather than in Australia).

The Government proposes to amend the *Income Tax Assessment Act 1936* (ITAA) and the Income Tax Regulations to ensure that:

- tainted income consisting of capital gains on assets deemed to be disposed of by a CFC on its ceasing to be a member of a group, or ceasing to be a CFC, is included in the attributable income of the Australian resident controllers (as the ITAA is currently worded there is uncertainty as to whether this is the case);
- all capital gains accruing, for the purposes of Part IIIA of the ITAA, on the deemed disposal of an asset are taken into account in applying the active income test to a CFC;

- all capital gains accruing for the purposes of Part IIIA of the ITAA are included in the kinds of capital gains that are taken into account in determining whether the gains are designated concession income; and
- taxation of capital gains on the disposal of tainted assets is not avoided or minimised by arrangements designed to dilute the Australian taxpayer's attribution interest in the CFC that holds tainted assets that have received rollover relief.

Because this is an anti-avoidance measure, the amendments to the ITAA and the Income Tax Regulations will apply to disposals (including deemed disposals) of tainted assets occurring after Budget night (after 7.30 pm AEST, 13 May 1997).

**The above material is a full extract of the description of the measure as contained in *Budget Paper No 2: Budget Measures 1997-98*. This paper explains all outlays and revenue measures, and is available from Australian Government Bookshops or from the Treasury Internet site at <http://www.treasury.gov.au/budget>**

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