TAX MANAGEMENT
PORTFOLIOS™

FOREIGN INCOME

Business Operations in Australia

by

John Walker
Partner
Jones Day
Sydney, Australia

John Walker, Bachelor of Economics (Macq); Bachelor of Laws (Macq); Masters of Law (Syd); Chartered Tax Advisor of Taxation Institute of Australia.

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TAX MANAGEMENT PORTFOLIOS™

FOREIGN INCOME

Business Operations in Australia

PORTFOLIO DESCRIPTION

Tax Management Portfolio, *Business Operations in Australia*, No. 7010, provides basic information relating to the tax and general legal problems affecting a foreign business conducting its operations in Australia.

The Portfolio contains a detailed analysis of the Australian system of taxation applying to business operations in Australia. The withholding tax provisions on dividends, interest and royalties, the taxation considerations of differing methods of doing business in Australia, the foreign investment guidelines, tax incentive legislation, and restrictive trade practices legislation are discussed.

The Worksheets contain regulations for management of a limited company, relevant income tax forms, and related matters.

This Portfolio may be cited as Walker, 7010 T.M., *Business Operations in Australia*.

This Bloomberg Tax Portfolio is not intended to provide legal, accounting, or tax advice for any purpose and does not apply to any particular person or factual situation. Neither the author nor the publisher assumes responsibility for the reader's reliance on information or opinions expressed in it, and the reader is encouraged to verify all items by reviewing the original sources.

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DETAILED ANALYSIS

I. Australia — General Background

A. Tax Systems Overview

1. General

Revenue authority	Australian Tax Office (Section I.B.3.)
Type of tax system	Residents: Worldwide system. (Corporations: Section V.B.1.; Individuals: Section X.A.) Nonresidents: Generally, only Australian-source income is subject to tax. (Corporations: Section VI.B.; Individuals: XI.A.)
Residence	A company is tax resident in Australia if: • It is incorporated in Australia; or • It carries on business in Australia and: (i) it is centrally managed and controlled from Australia; or (ii) its voting power is controlled by Australian resident shareholders. (Section V.A.) An individual is tax resident in Australia if he or she generally resides in Australia or: • He or she is physically present (intermittently or continuously) in Australia for at least 183 days in the tax year concerned; • He or she is domiciled in Australia; or • He or she is an 'eligible employee' (or is a spouse or child of such an employee) under Australian labor law. (Section X.A.)
Basic domestic nexus rule for foreign corporations	A company not resident in Australia located in a treaty country is subject to Australian taxation on its business income derived through an Australian permanent establishment (PE). A nonresident company without an Australian PE located in a treaty country is subject to Australian taxation only on Australian-source investment income, including non-franked dividends and certain payments of interest, royalties, capital gains on disposals of taxable Australian property, including real property and business assets, and certain other categories of income. (Section VI.B.) Where there is no applicable treaty, a company not resident in Australia can also be subject to tax in Australia on all Australian-source income (irrespective of whether a PE exists).
Treaty network	Australia has tax treaties with nearly 50 countries, including the United States, and generally follows the OECD Model Tax Convention. (Section XV.B.) MLI signatory: Yes. (Section XV.D.) For the texts and status of Australia's tax treaties, see International Tax Treaties.

2. Corporations

Corporate income tax rate	The standard rate is 30%. A reduced rate of 25% applies to smaller corporations, 80% or less of whose income is passive income. (Section V.B.8.)
Withholding tax rates on payments to non-resident companies	Dividends: 30%/0% for franked dividends. (Section VI.B.3.b.) Interest: 10% on interest (subject to certain concessions, e.g., an exemption for interest paid on publicly issued debentures); 0% on various other payments. (Section VI.B.3.a. and Section VI.B.3.) Royalties: 30% (Section VI.B.3.c.) For the rates of source country taxation applying under Australian domestic law and tax treaties and the context for their application, see the Withholding Tax Chart.
Net operating losses carryback/forward	Carryback: No. Carryforward: Indefinitely, subject to the satisfaction of the continuity of ownership or similar business test. (Section V.B.6.)
Restrictions on deductibility of interest expenses	There are thin capitalization rules, generally limiting interest deductions to 30% of EBITDA or, in the case of financial entities, a 15:1 gearing ratio. (Section XIV.C.)
Anti-hybrid mismatch rules	Yes. (Section XVII.D.)
Incentives (major)	• R&D: Yes. (Section II.A.1.c.) • Enhanced depreciation/capital allowance: Yes, specific to minerals and

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	petroleum exploration. (Section V.B.5.f.) • Environmental: Yes. (Section V.B.5.) • Other: Various special concessions to encourage inward investment. (Section II.A.1.)
Participation exemption (or similar regime)	A tax exemption is available for foreign dividends and certain other distributions for 10% participating interests and active foreign branch income carried on through a PE. (Section V.B.3.d.)
Tax consolidation	Yes. (Section V.B.11.)
M&A regime	• Tax-free or tax-privileged transaction: Yes. (Section V.B.12.) • Stamp duty/share transfer taxes: Share deals do not attract duty or transfer tax, unless interests in Australian real estate are involved; asset deals ordinarily are subject to stamp duty. (Section VII.D.) • Limitation on pre-deal NOL carryforwards: similar business test restrictions on losses acquired in share deals. (Section V.B.6. and Section V.B.12.)
OECD Pillars One and Two	Legislation adopted implementing Pillar Two. (Section XIV.D.)
Controlled foreign company regime	Yes. (Section XIV.A.)
Transfer pricing regime	Yes. (Section XIII.) Country-by-country report: Yes. (Section XIII.C.) See also Chapter 10 of 6940 T.M., *Transfer Pricing: Rules and Practice in Selected Countries (A–B)*.
General anti-avoidance rule	Yes. (Section XVII.A.) For diverted profits regime, see Section XVII.C.
Mandatory disclosure regime	Yes, with a new Public Country-by-Country regime (Section XIII.D.). Plus there are various rules addressing the promotion of tax avoidance schemes. (Section XVII.H.)
Foreign tax relief	Relief may be granted unilaterally by way of exemption or credit, or under the terms of a tax treaty by way of a credit. (Section V.B.7. and Section XV.A.)

3. *Individuals*

Personal income tax rates	• AUD 0–18,200: 0% • AUD 18,201–45,000: 16% on excess above 18,200 • AUD 45,001–135,000: 4,288 plus 30% on excess above 45,000 • AUD 135,001–190,000: 31,288 plus 37% on excess above 135,000 • AUD 190,001 and above: 51,638 plus 45% on excess (Section XVI.A.)
Equity incentives	Yes. (Section V.B.3.e.)
Foreign tax relief	Yes, exemption or credit. (Section V.B.7. and Section XV.A.)
Wealth tax/estate or inheritance taxes/gift tax	• No estate or inheritance tax. (Section XII.) • No wealth tax. • No gift tax. (Section XII.)
Exit tax	Yes. (Section XV.B.3.d.(2))

4. *Other Taxes*

VAT/GST/Sales tax	The standard GST rate is 10% on most goods and services. (Section IV.B.13.) Registration threshold: AUD 75,000 (annual turnover). (Section IV.B.13.a.)
Digital services tax	No, but 10% GST applies to the sale of all imported digital services.
Local taxes	No, but almost all Australian States/Territories levy a property tax with rates of up to 2.75% on the unimproved capital value of land. (Section IV.B.5. and Section V.C.)

5. *Administrative*

Standard tax return filing dates	By October 31 after the year of assessment for both corporations and individuals. The tax year runs from July 1 to June 30. (Section IV.C.6.)
Limitations period for assessment	• Generally, up to two years from the date of the assessment; • Up to four years for taxpayers with complex affairs; • Inapplicable where fraud or evasion is involved. (Section V.B.10.)
Advance tax rulings	Yes. (Section IV.A.2.)

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B. Government/Political Organization

Australia adopted a federal system of government under the name "Commonwealth of Australia" in 1901. The federal (or commonwealth) government is of the parliamentary type with a House of Representatives and a Senate. Each state has an equal number (12) and each main territory has an equal number (two) of representatives in the Senate. State and Territory representation in the House of Representatives correlates to population. Both Houses are elected by a system of universal suffrage. The federal government controls customs, excise, defense, social services, immigration, telegraphic and postal services and income tax. The federal government also administers various small trust territories adjacent to the Australian mainland. Most powers exercised on an Australia-wide basis are under the federal government's control.

The state governments are also of a parliamentary type and are autonomous. In contrast to the federal system, members of the state senates (the Legislative Council) are elected by the members of each state's senate (the Legislative Assembly) and the Legislative Council, except in the case of Queensland, which has only one house. The states are generally responsible for police functions, transport, education, health and other intrastate activities. The six federated Australian states and two main territories are:

- Australian Capital Territory (federal capital: Canberra);
- New South Wales (capital: Sydney);
- Northern Territory (capital: Darwin);
- Queensland (capital: Brisbane);
- South Australia (capital: Adelaide);
- Tasmania (capital: Hobart);
- Victoria (capital: Melbourne);
- Western Australia (capital: Perth).

Canberra is the seat of the federal government of the Commonwealth of Australia and is comparable in function to Washington, D.C., in the United States.

Since 1942, income tax has been levied only by the federal government, which makes grants to the states to compensate them for vacating the field of income tax. Under an arrangement entered into in 1985, the federal government grants the states each year an amount calculated by reference to the amount granted in 1984–85 (A$9,058.40 million) increased by the change in the All Groups Consumer Price Index. Increases in the financial grants, based on real terms, also may be given and are determined from year to year. Once the level of grants to the states is determined for a particular year, this amount is shared on a weighted per capita basis among the states.

The revenue sharing arrangements with the states were altered as a result of the Tax Reform Program and the introduction of the goods and services tax (GST) from July 1, 2000. GST revenue is made available to the states in exchange for the elimination of certain state taxes. This allocation process is under the direction of the Commonwealth Grants Commission.

Municipal, shire and county councils provide local government, and levy rates and various license fees. (Local government taxes are not dealt with in this portfolio.)

C. Legal System

Australia adopted a federal constitutional framework in 1901. Within this constitutional framework, Australia's legal institutions are split into the legislative, judicial and executive arms of government. Each is intended to operate independently of one another.

1. Legislature

The legislative powers of the Federal, or Commonwealth, Parliament are listed in the Australian Constitution. Very broadly, the Commonwealth Parliament is responsible for a specified list of issues of national importance (and the States retain responsibility for all other areas). The process for the enactment of legislation at the federal level of government (which includes income tax legislation) is as follows:

(i) Proposed legislation (referred to as a "bill") is introduced and read in the House of Representatives.

(ii) The bill is then sent to the Senate. If the Senate either rejects the bill or proposes amendments to its contents, it is sent back to the House of Representatives for reconsideration. This process by which a bill can be sent back and forth between both Houses of Parliament is quite common when different political parties control each House.

(iii) Once approved by the Senate, bills are sent to the Governor General for Royal Assent. Royal Assent is invariably given as a matter of course.

(iv) While it is possible to enact retrospective legislation, new legislation usually applies from when it is first proposed or from when it receives Royal Assent.

Each state is also divided into local government districts, which receive their delegated authority from their respective state governments. Local governments usually enact regulations relevant to community issues such as residential waste disposal, residential building developments and similar issues.

2. Judiciary

The judiciary is empowered with the interpretation of the legislation and regulations enacted by the various legislative bodies referred to above. The judicial system includes the High Court of Australia, the Federal Court of Australia, the Supreme Courts of the states, the minor state and district courts, and the Industrial Relations Commission. There are no specialized tax courts.

3. Executive

The administration of the legal system rests with the executive arm of government — which includes services such as the police force and the Australian Tax Office (ATO). Administration of income tax is vested in the Commissioner of Taxation and his several Deputy Commissioners. The Commissioner is head of the ATO, which is a branch of the Australian Treasury. The Executive also provides the source of various proposals for changes in legislative policy. It is common, especially in the context of taxation, for the ATO or Treasury to recommend changes in law, which may be taken up by the Government and enacted as legislation via the process set out above. The Executive branch also oversees a range of administrative

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tribunals. The largest of these, the Administrative Appeals Tribunal (AAT), has the jurisdiction to review decisions of the Commissioner of Taxation. In the majority of cases, a taxpayer may choose between commencing income tax proceedings in the AAT or the in Federal Court of Australia. The AAT conducts merits-based review but does not exercise judicial power.

4. Arbitration and Mediation

a. Arbitration System

Australia's arbitration system is well-established and closely aligned with international standards, particularly the UNCITRAL Model Law on International Commercial Arbitration. The system is designed to provide an efficient, neutral, and enforceable method for resolving commercial disputes, both domestically and internationally.

The cornerstone of Australia's international arbitration regime is the International Arbitration Act 1974 (Cth) (IAA). This Act gives effect to the UNCITRAL Model Law, which is incorporated as Schedule 2 of the IAA. The Model Law provides a comprehensive framework for the conduct of international arbitrations, ensuring consistency with global best practices. For domestic arbitrations, each Australian state and territory has enacted legislation based on the Commercial Arbitration Act, which is also harmonized with the Model Law.

Arbitration in Australia is generally conducted by private arbitral tribunals, which are constituted by agreement between the parties. The parties have significant autonomy in selecting arbitrators, determining procedural rules, and choosing the seat of arbitration.

The courts play a supportive and supervisory role. The Federal Court of Australia and the Supreme Courts of the states and territories have jurisdiction over matters arising under the IAA, such as applications to enforce or set aside arbitral awards, grant interim measures, or determine questions of law. However, judicial intervention is limited to circumstances expressly provided for in the legislation, in line with the pro-arbitration stance of the Model Law.

The key rules for arbitration in Australia include:

• Party autonomy: Parties are free to agree on the procedure, the seat, and the language of arbitration;

• Neutrality and impartiality: Arbitrators must be impartial and independent;

• Confidentiality: Arbitration proceedings are generally private and confidential, unless the parties agree otherwise;

• Finality: Arbitral awards are final and binding, with limited grounds for challenge or appeal;

• Enforceability of awards.

Australia is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. As such, arbitral awards made in Australia or in other Convention countries are readily enforceable in Australian courts, subject to limited exceptions (such as incapacity, invalidity of the agreement, or public policy considerations). The IAA and state/territory legislation provide mechanisms for the recognition and enforcement of both domestic and international awards.

b. Mediation System

Mediation is another prominent form of alternative dispute resolution (ADR) in Australia. Unlike arbitration, mediation is a non-binding process in which a neutral third party (the mediator) facilitates negotiations between the parties to help them reach a mutually acceptable settlement. The mediator does not make a decision or impose an outcome.

In contrast, whereas arbitration is more formal and structured and results in a binding and enforceable award, mediation is the more flexible and informal option and only produces a binding outcome if the parties reach and formalize a settlement agreement. Accordingly, arbitrators decide the dispute, whereas mediators facilitate the negotiation. Both processes are generally confidential, but mediation is often perceived as being more private.

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II. Operating a Business in Australia

A. *Foreign Investment Regulation*

Since World War II, Australia has been involved in a period of rapid industrial and commercial expansion that has placed a very heavy demand on risk capital. Because Australia has continuously encouraged immigration on a large scale and has pursued a high rate of economic growth and a high standard of living, it has been necessary to draw heavily on foreign resources. Accordingly, there has always been (and continues to be) a high rate of capital inflow into Australia.

1. Incentives

A number of state governments provide decentralization incentives to encourage the establishment of industries that will provide employment in areas distant from the major cities. Under these schemes, investors may be entitled to transport, loans and grants, industrial land, and essential services at subsidized or below-market-value prices.

Export grants are provided by the Australian government to encourage Australian businesses to seek export markets for their goods and services. Expenditures incurred in creating or developing an export market will be rewarded by a grant of up to 50% of eligible costs — over a minimum threshold of $10,000 and a maximum number of seven grants per applicant.

However, Australia's relatively high corporate tax rate (30%) continues to be a significant disadvantage to multinational companies employing staff in Australia for specific functions beyond sales and marketing that require focus on the local market (and possibly New Zealand and other South Pacific markets located near Australia), and research and development (R&D) teams for intellectual property (IP) development. Other countries within the region with low tax rates, such as Singapore, generally attract more of the manufacturing and middle office and back-office functions required for Asia Pacific.

With that said, there are various tax concessions available designed to encourage foreign investment in Australia. The key tax concessions are set out briefly below.

a. Australia Regional Headquarter Provisions

Business profits from offshore subsidiaries and branches derived by an Australian company are typically not taxed in Australia. This is due to the fact that Australia has a comprehensive foreign branch income exemption (contained in section 23AH and discussed at V.B.3.d.(1), below) and participation exemption for income from foreign subsidiaries (contained in Division 768-A and discussed at V.B.3.d.(2), below). Furthermore, when this exempt foreign income is distributed by the Australian company, the dividends will not be subject to either an Australian income tax or dividend withholding tax liability on receipt in Australia by the Australian or foreign holding company/shareholder. The objective of these concessions, often referred to as the "conduit foreign income rules," is to encourage the use of Australian companies as holding companies for regional business activity.[1]

Furthermore, an Australian company is entitled to a deduction for interest on debt funding borrowed for the purpose of investing in the shares of a foreign subsidiary, even though the dividend income from the foreign subsidiary may be tax exempt in Australia as described above. This entitlement to a deduction is subject to the various limitations to interest deductions found elsewhere in Australia's tax legislation, such as the thin capitalization rules discussed at X.C., below.

There are also very limited concessions entitling companies to upfront deductions for relocation expenditure moving regional headquarters to Australia.

A possible disadvantage in the use of Australia as a regional holding company relates to the fact that Australia's controlled foreign company (CFC) rules are, by international standards, reasonably broad in application. This can undermine the benefits of using an Australia company as a regional holding company if the profits from its subsidiaries are attributed back to Australia and taxed on an accruals basis at 30%. The CFC rules are discussed in detail in X.A., below.

b. Patent Box Regime

Australia does not have a patent box regime but does encourage R&D expenditure (see II.A.1.c., below).

c. Research and Development

Companies undertaking R&D activities in Australia may be eligible for the Australian Government's R&D tax incentive. The incentive is structured as a tax offset which reduces income tax payable. It is intended to stimulate productivity growth and competition for the Australian economy by encouraging investment in R&D, where the risk of technical uncertainty might otherwise mean that R&D activities do not take place. The rationale is that it ultimately produces a public benefit in the form of spillover benefits to other firms or the wider Australian economy. The R&D tax incentive is not intended as a subsidy for innovation in general.

The main features of the tax incentive are as follows:

(i) The taxpayer must be undertaking eligible R&D activities, broadly experimental activities conducted for the purpose of generating new knowledge whose outcome cannot be known or determined in advance on the basis of current knowledge, information or experience, but can only be determined by applying a systematic progression of work that is based on principles of established science, and proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusions;

(ii) Entities with aggregated turnover of less than A$20 million in an income year are entitled to a refundable tax offset calculated at 43.5% of eligible R&D expenditure (note the proposed changes to the R&D tax incentive discussed further below).[2] The refundable tax offset means that once tax payable is reduced to nil, any remaining amount of the offset is refunded; and

---

[1] Income Tax Assessment Act, 1936 (ITAA 1936), Sec. 23AH and Income Tax Assessment Act, 1997 (ITAA 1997), Divisions 768 and 802.

[2] Aggregated turnover is calculated taking into account the turnover of all entities connected to or affiliated with the taxpayer. See ITAA 1997, Division 328.

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(iii) Entities with aggregated turnover of A$20 million or more, or where more than 50% of the company is owned or controlled directly or indirectly by exempt entities, are entitled to a non-refundable tax offset calculated at 38.5% of eligible R&D expenditure. As the offset is non-refundable, once tax payable is reduced to nil, any unused offset amounts may be carried forward to future income years (subject to satisfying certain integrity rules).

Eligible R&D expenditure is currently capped at A$100 million per annum.

The R&D tax incentive is available to Australian resident companies (whether or not incorporated in Australia), companies resident in a country with which Australia has a tax treaty that are carrying on business in Australia though a PE, and body corporates acting in their capacity as trustee of a public trading trust (R&D Entities). It does not apply to exempt entities.

Eligible R&D activities are divided into core R&D activities, i.e., the core experimental activity, and supporting R&D activities. Certain activities are excluded from being core R&D activities, for example, market research, management studies, prospecting, exploring or drilling for minerals or petroleum to discover deposits, and research in social sciences, arts, or humanities. However, some of these excluded activities may be eligible supporting R&D activities if undertaken for the dominant purpose of supporting core R&D activities. Supporting R&D activities are otherwise activities that are directly related to core R&D activities. If the activity produces goods or services, or is directly related to producing goods or services, it must also meet the dominant purpose test to be a supporting R&D activity.

Software development is subject to the same eligibility tests as other forms of R&D, with the exception of certain in-house software where the software is developed for the dominant purpose of internal business administration. However, it may still qualify as supporting R&D if it is directly related to eligible core activities (i.e., it satisfies the "dominant purpose" test). It should be noted that in Taxpayer Alert 2017/5, the ATO highlighted its concerns that some R&D tax incentive claims for software development projects do not meet the criteria for eligible R&D activities (e.g., where the project involves acquiring and modifying off-the-shelf software).

Taxpayer Alerts have also been released in relation to claims for certain construction activities,[3] agricultural activities,[4] and ordinary business activities.[5]

Expenditure on eligible R&D activities is only eligible for the R&D tax incentive if it has been incurred by the R&D Entity on R&D activities conducted "for" the entity. An entity cannot claim expenditure if it conducts the associated R&D activities to a significant extent for another entity — i.e., another entity receives the major benefit from the activities. For example, another entity owns the results of the activities, bears the financial risk of the activities, and/or controls the activities.[6]

In general, R&D expenditure is only eligible to the extent it has been incurred by an R&D Entity on R&D activities conducted solely within Australia. However, expenditure incurred on R&D activities conducted overseas may also be eligible if certain requirements are met and an advance finding is obtained from Innovation and Science Australia which determines that the activities are eligible.[7]

The tax offset does not apply to expenditure incurred for interest, expenditure on core technology and expenditure that is not at risk (i.e., when expenditure is incurred, the R&D Entity or an associate could reasonably expect to receive an amount of consideration as a result of the expenditure being incurred and irrespective of the results of the activities on which the entity incurs the expenditure). The expenditure-not-at-risk provisions do not apply to activities undertaken in Australia for foreign related companies.

Companies are also entitled to deductions with respect to the decline in value of depreciating assets used for R&D activities and for any balancing adjustments occurring with respect to an asset used for R&D activities.

The receipt of R&D-related government grants do not affect the availability of the R&D tax offset; however an extra tax liability applies to negate the tax benefit received from the grant-related R&D tax offset.

To be eligible for the R&D tax incentive, the R&D Entity must apply online with Innovation and Science Australia to register its R&D activities under section 27A of the Industry Research and Development Act 1986. The R&D Entity must register each income year within 10 months of the end of its income year.

Note: At the time of writing, these changes were not yet enacted and were being reviewed by the Senate Economics Committee following a large number of submissions to the Committee, most of which were critical of the proposed changes.

The key proposed changes to the R&D tax incentive broadly involve the following:

- For companies with aggregated turnover of less than A$20 million, the refundable tax offset rate will be equal to the company's tax rate plus 13.5% (replacing the previous refundable offset rate of 43.5%). Based on the current corporate tax rate of 26% which is available for smaller entities, this results in an offset rate of 42.5%;

- Cash refunds under the refundable tax offset will also be capped at A$4 million annually — however, the cap will not apply to R&D tax offsets for R&D activities which are clinical trials; and

- The non-refundable offset rate for companies with aggregated turnover of A$20 million or more will be tied to the company's "R&D intensity," replacing the previous non-refundable offset rate of 38.5%. R&D intensity is the company's annual R&D expenditure as a proportion of total

[3] Taxpayer Alert 2017/2.

[4] Taxpayer Alert 2017/4.

[5] Taxpayer Alert 2017/3.

[6] *Note:* There are specific requirements which must be met for a foreign-owned R&D Entity conducting R&D activities for a foreign corporation, or a foreign corporation carrying on R&D activities through a PE, to be eligible for the R&D tax incentive — see ITAA 1997, secs. 355-210 to 355-220.

[7] Innovation and Science Australia and the ATO are jointly responsible for administering the R&D tax incentive. AusIndustry (on behalf of Innovation and Science Australia) oversees the eligibility of R&D activities while the ATO manages the rules for eligible entities and expenditure.

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annual expenditure. The offset available increases as R&D intensity increases, as set out in the table below:

Amount of R&D Expenditure Within an R&D Intensity Range of:	Is Eligible for a Non-refundable Tax Offset of the Company's Tax Rate, Plus:
Between 0% and 4%	4.5%
Above 4% to 9%	8.5%
Above 9%	12.5%

d. Digital Tax Offset

The previous Federal Government announced the Digital Economy Strategy in the 2021–22 Federal Budget. The strategy targets investment in emerging technologies, building digital skills, encouraging business investment and enhancing Federal Government service delivery. The Digital Tax Offset is part of this strategy and is aimed at promoting the growth of the digital games industry in Australia and attracting games development.

The legislation to enact the offset, included in the *Treasury Laws Amendment (2022 Measures No. 4) Bill 2022*, received Royal Assent on June 23, 2023, and it applies to qualifying Australian development expenditure incurred in relation to eligible game development from July 1, 2022.

Australian companies (and foreign companies operating through an Australian permanent establishment (PE)) are entitled to a 30% refundable tax offset for expenditure in excess of A$500,000 on qualifying Australian game development expenditure. Certification will be required from the Arts Minister. The offset can be for the completion of a new game, the porting of a digital game to a new platform or the ongoing development of one or more existing digital games during an income year. Because the offset is refundable, a refund will occur where the total offsets exceed the Australian tax liabilities the company otherwise would have if it had not received those tax offsets. The offset is capped at A$20 million per company, per income year: the equivalent of A$66.7 million of qualifying expenditure per annum.

A digital game is defined in Section 378-20 of the ITAA 1997 as a game in electronic form that is capable of generating a display on a portable electronic device, computer monitor, television screen, liquid crystal or similar medium that allows the playing of an interactive game. An interactive game is not defined in the Act, but it is generally understood to be a game where the sequence of events is determined in response to the decisions, inputs and direct involvement of the player(s). An eligible game must be:

(i) Primarily developed to be made available to the public;

(ii) For entertainment or education purposes (not gambling, advertising, industrial, corporate or institutional purposes);

(iii) Available for use over the internet; primarily played through the internet; or operational when a player is connected to the internet; and

(iv) In electronic form capable of generating a display on a computer monitor, television screen, liquid crystal or similar medium that allows the playing of an interactive game.

A company is eligible if it is primarily responsible for the actual development of the game. This would be a company that owns or controls the rights to develop the digital game and that itself undertakes the development of the game. A company that has been engaged to develop the game by the entity that own or controls the rights to develop the game is also eligible, if it is primarily responsible for undertaking activities that are necessary for the development of the digital game in Australia.

e. Tax-Exempt Debt Investments

There is a general rule that, *prima facie*, interest paid from Australia to an offshore counterparty is subject to an Australian interest withholding tax of 10% (see VI.B.3., below). However, there are various exemptions from this general rule which reduce the interest withholding tax rate on various types of debt investments to nil. Most borrowing activities by Australian residents — which seek to raise funds from offshore — would be structured in a manner that qualifies for one of these concessions (discussed at VI.B.3., below) such that the interest withholding tax rate on most offshore borrowings from unrelated offshore counterparties is, typically, nil. (By contrast, the rate of withholding on money raised from offshore associates is generally caught by the 10% interest withholding tax.)

f. Venture Capital

The Venture Capital provisions of Division 118-F of Part 3-3 of the Income Tax Assessment Act 1997 (ITAA 1997) entitle nonresidents to an exemption from income tax on capital gains derived from investments in Venture Capital Limited Partnerships (VCLPs) and certain other entities set up for the purposes of investing into the Australian venture capital market. VCLPs must have a minimum of A$10 million in total committed capital and their investments must satisfy the requirements of the Venture Capital Act 2002 and be registered with the Innovation Australia. (See IX.D., below.)

g. Australian Films

The tax concessions for the Australian screen media industry consist of three refundable tax offsets, namely a location offset, producer offset and PDV (post, digital and visual effects) offset in Division 376 of ITAA 1997. These offsets are only available for companies.

The producer offset is available for the making of an Australian film where a certificate has been issued for the film by the Australian film authority. For a feature film, the offset is 40% of the total of the company's qualifying Australian production expenditure. For all other films the amount of the offset is 20%.

The location and PDV offsets require a certificate to be issued by the Arts Minister. The location and PDV offsets are each 15% and the focus of these offsets is on certain types of qualifying Australian production expenditure to which the producer offset does not apply.

The Producer Offset Rules 2007 (Legislative Instrument F2007L4553), Location Offset Rules 2008 (Legislative Instrument F2008L00352) and PDV Offset Rules 2008 (Legislative

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Instrument F2008L00353) provide guidance as to the way in which certificates will be issued.

h. Foreign Resident Superannuation Funds

Income that comprises interest, dividends or non-share dividends (broadly, distributions in respect of non-share interests which are classed as equity) that is derived by a foreign resident superannuation fund has generally been exempt from Australian withholding tax where the fund caters to nonresidents and the income is exempt from income tax in the country in which the fund is a resident.[8]

In light of the fact that foreign superannuation funds represent a significant portion of foreign investment into Australia, this concession has been extremely valuable for foreign investors in Australia, especially in infrastructure, energy, and resource sectors. The exemption from dividend and interest withholding tax has historically made it very attractive for these superannuation funds to gear their Australian equity investments using investor debt to lower their overall Australian tax on the investments.

More recently, appreciating the tax advantages these concessions gave foreign investors (and arguably making it difficult for domestic funds to compete for large projects), the withholding tax exemptions for superannuation funds has been limited to portfolio-like investments only. For investments acquired after March 27, 2018; and (ii) income derived on or after July 1, 2026, dividends and interest earned by a foreign superannuation fund is exempt from withholding tax if, and only if:[9]

(i) The income derived by the superannuation fund is exempt from income tax in the country in which it resides;

(ii) The superannuation fund has a portfolio like interest in the entity that pays the dividends, non-share dividends or interest to it at the time the income was derived and throughout any 12-month period that began no earlier than 24 months before that time and ended no later than that time (the Portfolio Interest Test); and

(iii) The superannuation fund does not, at the time the income was derived, have influence (either directly or indirectly) over decisions that comprise the control and direction of the operations of the entity that pays the dividends, non-share dividends or interest to it (the Influence Test).

A superannuation fund satisfies the Portfolio Interest Test if it has an interest of less than 10% in the entity (or trust estate) which paid the interest, dividend, or non-share dividend (referred to as the "test entity"). The fund's interest is broadly worked out by reference to the percentage of capital, rights to vote, and rights to distributions of income and capital held by the fund directly or indirectly in the relevant entity.

The Influence Test will be satisfied if the superannuation fund:[10]

(i) Acting alone or in concert with others, is directly or indirectly able to determine the identity of at least one of the persons who, individually or together with others, make (or might reasonably be expected to make) the decisions that comprise the control and direction of the test entity's operations; or

(ii) At least one of those persons is accustomed or obliged to act, or might reasonably be expected to act, in accordance with the directions, instructions or wishes of the superannuation fund (whether those directions, instructions or wishes are expressed directly or indirectly, or through the superannuation fund acting in concert with others).

The Explanatory Memorandum to the *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2019* (which introduced the limitation to the exemption to portfolio-like investments) states that a superannuation fund will indirectly have influence within this definition where, for example, the influence or ability to influence the test entity is held by an Australian resident entity that is controlled by the superannuation fund. However, in determining whether a superannuation fund has sufficient influence, any breach of terms of a debt interest by any entity is disregarded.

The following example is provided in paragraph 3.19 of the Explanatory Memorandum setting out how these rules may be applied in practice. In this example (3.4), despite the fact that the investor satisfies the Portfolio Interest Test (as the investor holds less than 10% of the equity in the test entity), the fund's level of influence means the Influence Test is not satisfied and the withholding tax concession is not available.

Example 3.4 from the Explanatory Memorandum

SFFR is a superannuation fund for foreign residents. SFFR holds 8 per cent of the ordinary share capital of Aus Co.

Under Aus Co's constitution, any investor with an equity interest of 8 per cent or more is entitled to appoint an individual to an Advisory Board of Aus Co. The Board of Directors of Aus Co cannot make certain decisions in relation to the control and direction of Aus Co's operations without the Advisory Board's approval.

In these circumstances, SFFR has influence in relation to Aus Co of the kind described in the influence test.

Therefore, any dividends paid by Aus Co to SFFR will not be entitled to a dividend withholding tax exemption.

The ATO has released draft guidance in relation to the application of the Influence Test in Draft Law Companion Ruling 2019/D4.

i. Managed Investment Trusts

The preferred collective investment vehicle in Australia is, by a significant margin, a trust. This is because limited partnerships are (with very few exceptions) taxed as companies and subject to the corporate tax rate of (usually) 30% on taxable income (very broadly, the partnership's profits). While there

[8] ITAA 1936, Subsec. 128B(3)(jb).

[9] ITAA 1936, Subsec. 128B(3CA). Note that the income must also not be non-assessable, non-exempt income of the foreign superannuation fund because of ITAA 1997, Subdivision 880-C (or its equivalent transitional provision). This refers to the sovereign immunity provisions.

[10] ITAA 1936, Sec.128B(3CD).

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have been attempts over the years to enact regimes to make prescribed types of companies and limited partnerships more effective structures for tax purposes, the rules have had limited application and have often been impractical solutions for pooled investment. A trust remains the most effective multipurpose pooling structure. While there are rules limiting the use of a widely-held trust to carry on an operating business (where the business operations go beyond "eligible investments"), a trust will invariably be the best option where it can be used (see the limitations set out in IX.A.2., below).

The Managed Investment Trust (MIT) rules apply to a specific type of trust. The MIT tax concessions are designed to encourage the growth of the Australian funds management industry and foreign investment into Australia. Under this regime, where a substantial portion of the investment management activities carried out in relation to the MIT's Australian assets are carried on in Australia, foreign investors that are residents of Exchange of Information jurisdictions (being most of Australia's trading partners) are subject to a rate of withholding tax of 15% on the taxable income of the MIT which is distributed to them. Therefore, as a general rule, the total amount of tax payable by a foreign investor on its Australian investments held through an MIT is limited to 15% of the taxable income derived from the investment. There is no additional tax payable in Australia at either MIT or underlying foreign investor level. This is a favorable outcome when compared to the corporate tax rate of 30% generally associated with profits taxable in Australia.

The final withholding tax rate is reduced 15% to 10% for MIT's which own newly constructed energy efficient/environmentally sustainable commercial buildings.

An additional advantage of an MIT is that it is entitled to deem capital gains tax (CGT) treatment for capital gains made by an MIT (see (9) below). Appreciating the fact that non-residents are generally only taxable on capital gains made from the disposal of taxable Australian property, this can entitle foreign investors to dispose of their Australian non-land investments without incurring an exit charge when held through an MIT (assuming it is not a direct or indirect interest in land). Importantly, there are time limits within which the trustee of a MIT must elect to deem CGT treatment of its assets. Very broadly, this election must be made on or before the day the MIT is required to lodge an income tax return for the income year on which it became a MIT (or a later time at the Commissioner's discretion).

An MIT is also an attractive investment vehicle for Australian residents. As such, an MIT is effectively the collective investment "vehicle of choice" for transactions involving either nonresidents, residents or both.

The rules can be found in Subdivision 12-H of Schedule 1 of the Tax Administration Act 1953 and Division 275 of the Income Tax Assessment Act 1997.

(1) What Is a Managed Investment Trust?

Broadly speaking, a trust with the following attributes is an MIT:

• *Item 1* — It has an Australian resident trustee or it is centrally managed and controlled from Australia.

• *Item 2* — It is a managed investment scheme (MIS) as defined by section 9 of the Corporations Act 2001 (Corps Act).

• *Item 3* — either (A) retail clients are no more than 21 and hold no more than 10% of the rights to income, membership interests or value in the MIT and the scheme is not required to be registered with the Australian Securities and Investments Commission (ASIC) (wholesale trusts); or (B) the scheme is not covered by (A) above and is registered with ASIC (retail trusts).

• *Item 4* — The trust is widely held.

There are various definitions of this widely held test depending on the type of trust.

If it is an unregistered wholesale trust, the trust needs 25 members to be widely held.

If it is a registered wholesale trust, either (1) the trust has at least 25 members; or (2) a Qualified Investor has at least a 25% interest (and at no time does an investor that is not a Qualified Investor hold a 60% interest).

If it is a registered retail trust, either: (1) a Qualified Investor has at least a 25% interest (and at no time does an investor that is not a Qualified Investor hold a 60% interest); (2) the units are listed for quotation on an approved stock exchange in Australia; or (3) the trust has at least 50 members.

For the purpose of determining interests held, it is important to look at what rights to income, membership interests or value in the MIT an entity holds or has the right to acquire or control (directly or indirectly). This is referred to as the "MIT participation interest."

In applying the 25-member and 50-member tests: (1) a Qualified Investor is deemed to represent a multiple number of members. The deemed number is determined by multiplying by 50 the MIT participation interest that the Qualified Investor holds in the MIT; and (2) the MIT must look through any interposed trusts that are not Qualified Investors, a wholesale trust or a discretionary trust.

A "Qualified Investor" is:

(a) An Australian or foreign life insurance company;

(b) A complying superannuation fund, complying approved deposit fund or foreign superannuation fund with at least 50 members;

(c) A pooled superannuation trust that has at least one member that is a complying superannuation fund with more than 50 members;

(d) Another MIT;

(e) An entity recognized under foreign law as being used for collective investment by means of pooling the contributions of at least 50 members of the entity as consideration to acquire the rights to benefits produced by the entity, if the members of the entity do not have day to day control over the operations of the entity;

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(f) Foreign pension funds established for the principal purpose of funding pensions for the citizens or other contributors of the foreign country by exempt foreign government agencies;

(g) Investment entities wholly owned by foreign government agencies established using public funds where all of the economic benefits obtained by the entity pass to the foreign government concerned;

(h) Entities established and wholly owned by an Australian government agency if the capital and returns are used for the primary purpose of meeting statutory government liabilities or obligations;

(i) The Future Fund Board of Guardians (Future Fund Board) (an Australian body corporate responsible for deciding how to invest the Future Fund, which is Australia's sovereign wealth fund established in 2006 to strengthen the Australian Government's long-term economic position.);

(j) Limited partnerships where at least 95% of the interests are held by entities mentioned in the preceding paragraphs (and the remaining 5% is owned by the general partner habitually exercising management authority);

(k) Entities wholly owned by entities mentioned in the preceding paragraphs (or this paragraph); and

(l) Entities of a similar kind to an entity mentioned in (a) to (h), above, as specified in the regulations. At present, there are no regulations extending the categories of Qualified Investors.

• *Item 5* — the trust is not closely held.

This is an anti-avoidance test, focused on excluding from the scope of the definition of an MIT certain trusts that are not truly widely held — even though they satisfy item 3, above.

A trust is closely held if a foreign resident individual has an MIT participation interest of 10% or more.

There are additional requirements depending on whether the trust is a wholesale or retail trust. If the trust is a wholesale trust, the trust is closely held if 10 or fewer persons (excluding Qualified Investors) hold an MIT participation interest of 75% or more. If the trust is a retail trust, the trust is closely held if 20 or fewer persons (excluding Qualified Investors) hold an MIT participation interest of 75% or more.

• *Item 6* — the trust does not carry on a trading business or control the affairs or operations of another person that carries on a trading business. The definition of a trading business is also relevant to the application of Division 6C of the 1996 Act and is discussed in more detail at IX.A.2., below.

• *Item 7* — a "substantial proportion" of the investment management activities relating to assets of the trust that are relevantly connected with Australia are carried out in Australia.

Assets that have a relevant connection with Australia are, broadly speaking, assets of the trust that are situated in Australia, taxable Australian property and shares, units and interests traded on a qualifying Australian stock exchange. This test allows trusts that have a mix of Australian and offshore assets to remain eligible to be an MIT where the investment management activities are located where the assets are located.

(2) Licensing Requirement for Wholesale Trusts

In addition to the requirements above, wholesale trusts must be operated or managed by a financial services licensee holding an Australian Financial Services License (AFSL), which would cover it providing financial services to wholesale clients (or an authorized representative of such a financial services licensee). Alternatively, it may be operated or managed by an entity that would be required to be a financial services licensee but for the specific exemption available for the Crown.

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(3) MIT Checklist

A checklist of the various types of MITs is summarized in the following table.

	REGISTERED		**UNREGISTERED**	
Requirements	**Wholesale**	**Non-wholesale**	**Wholesale**	**Non-wholesale**
Widely-held requirement				
At least 25 members	√	X	√	N/A
Qualifying investors with more than 25% interest in the trust, and no one other entity holding 60% of the relevant interests of the trust	√	√	X	N/A
Units listed on the official list of an approved stock exchange in Australia	X	√	X	N/A
At least 50 members	X	√	X	N/A
Closely-held requirement				
Number of investors that cannot own more than 75%	10	20	10	N/A
Foreign resident individual can own 10% or more	X	X	X	N/A
Licensing requirement				
License required	Registered under s. 601EB of the Corporations Act 2001	Registered under s. 601EB of the Corporations Act 2001	Must be either operated or managed by a holder of an Australian Financial Services License	N/A
Investment management requirement				
Invest management requirement	√	√	√	N/A

(4) Tax Treatment of Distributions by an MIT Offshore

A MIT is required to withhold tax from "fund payments" distributed by an MIT to an investor that has a relevant connection outside Australia (see discussion below for more on this concept).[11]

In summary, a fund payment refers to distributions of the net income of the trust subject to a number of modifications. The key modifications exclude certain amounts (called excluded amounts), including:

- Dividends, interest and royalties (which remain subject to the existing withholding tax rules);
- Capital gains (and capital losses) on assets which are not assessable to a nonresident (i.e., capital gains (and capital losses) made in respect of assets that are not "taxable Australian property"); and
- Amounts not from an Australian source.[12]

The determination of the amount of a fund payment involves the application of a three-step approach (provided below), which requires an MIT to make a reasonable estimate of its net income for the relevant income year.[13]

Further, to constitute a fund payment, the rules generally require that the payment is made during or within three months after the relevant year of income (i.e., September 30 if the trust has a June 30 year-end) (the Commissioner of Taxation (the Commissioner) can allow a longer period of up to six months in some circumstances).[14] If the three-month period is not complied with, the MIT withholding rules do not apply and the trustee is liable to tax at the top marginal rate plus the 2% Medicare levy (currently 47%) on the amount that would have been a fund payment if it had been paid to a nonresident beneficiary within the three-month period. That is, as opposed to the Attribution MIT regime discussed below at (i), the MIT regime relies on the distribution of all of the income of the trust to the underlying beneficiaries on an annual basis (which may then be reinvested in the MIT by the beneficiaries on a voluntary basis by way of the acquisition of additional interests in the MIT).

[11] TAA, Sec. 12-385(1).
[12] TAA, Sec. 12-405.
[13] TAA, Sec. 12-405(2).
[14] TAA, Sec. 12-405(4) and (5). The Commissioner's power to provide an extension of time is exercised when he is of the opinion that the trustee of the MIT was unable to make the fund payment within the three-month period because of circumstances beyond the influence or control of the trustee.

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(5) Connection Outside Australia

A MIT trustee is obliged to withhold tax from a fund payment if (according to the trustee's records) the beneficiary's address is outside of Australia or the trustee is authorized to make the payment to a place outside of Australia and:

(a) Where the foreign beneficiary is not investing in the capacity of a trustee of another trust:

(i) the beneficiary is a foreign resident when the fund payment is made; and

(ii) the payment is not made to the beneficiary in the course of the beneficiary carrying on business through an Australian permanent establishment; or

(b) Where the foreign beneficiary is investing in the capacity of a trustee of another trust, the underlying non-trustee beneficiary satisfies (a)(i) and (ii) at the time the underlying non-trustee beneficiary is presently entitled to the fund payment.

The rate of tax varies depending on where the foreign beneficiary is located. The MIT withholding tax rate is 15% (reduced to 10% for MIT's which own newly constructed energy efficient/environmentally sustainable commercial buildings) where the address or place for payment is in an Exchange of Information jurisdiction and 30% for other countries.

The information referred to above may not be readily available to the trustee at the time it makes the fund payment. If the trustee withholds in circumstances where these requirements are not satisfied (e.g., the investor is an Australian resident that provided an offshore bank account) the investor may claim a credit for the tax withheld against its own Australian income tax liability (discussed in more detail below).[15]

(6) Exchange of Information Countries

The reduced MIT withholding tax rates will apply to a nonresident investor located in a jurisdiction with which Australia has effective exchange of information arrangements on tax matters.[16] The relevant countries are set out in the regulations to the measures.[17] In addition, some countries that do not have comprehensive double taxation agreements with Australia, such as Bermuda and the Netherlands Antilles, are included.

An entity is considered a resident of an Exchange of Information country only if:

(a) The entity is a resident of that country for the purposes of the tax laws of that country; or

(b) If there are no such tax laws applicable to the entity or the entity's residency status cannot be determined under those laws, then:

(i) for an entity which is an individual — the individual is ordinarily resident in that country; or

(ii) for an entity (other than an individual) — the entity is incorporated or formed in that country and is carrying on a business in that country.[18]

(7) Taxation of Offshore MIT Beneficiaries

Fund payments from a managed investment trust to a nonresident (not operating from an Australian permanent establishment) are withheld at either a rate of 10%, 15% or 30%, depending on whether the country is an "Exchange of Information" country and/or whether clean building requirements are satisfied.[19]

As such, where a nonresident investor (that is not a trustee of a trust) provides to the MIT an address/place of payment that is located in the investor's country of residence, the tax withheld should match the nonresident investor's tax liability. On this basis, this MIT withholding tax regime is effectively a final tax. This, however, may not always be the case. For example, if the beneficiary provides an address or place for payment that is an Exchange of Information country, but the beneficiary is a resident of a foreign country that is not an Exchange of Information country, the beneficiary may have an income tax liability, which will not have been satisfied by withholding and will need to be paid by the beneficiary directly, equal to the deficit (e.g., 15% (30%−15%) of the fund payment assuming the clean building requirements are not satisfied).

Where a foreign investor's MIT liability exceeds the MIT withholding tax withheld, then they are required to pay top-up tax (equal to the difference) to the Australian Taxation Office (ATO) within 21 days of the end of the month when they first became entitled to the fund payment.[20]

Regarding the collection of any top-up tax from a foreign investor, where the investor is a resident of a country with which Australia has a tax treaty, then the ATO may seek to use the "Assistance in the Collection of Taxes" Article in the relevant treaty. Broadly, this article gives the ATO the power to seek assistance from the other country's revenue authority in relation to the collection of certain Australian taxes (this includes the MIT liability tax). Not all the treaties that Australia has entered into have such an article and it will be necessary to check the relevant treaty to see if the Article is applicable to a foreign investor.

The clean building MIT withholding tax concession is being extended to include eligible data centers and warehouses. To qualify, construction must have commenced after 7:30 pm (AEST) on May 9, 2023. The start date for this extension is the first of January, April, July, or October, after the amending legislation receives assent. Key points of the extension include:

- The concessional final withholding tax rate of 10% will apply to fund payments from eligible clean building MITs

[15] TAA, Sec. 18-32 of Schedule 1.

[16] TAA, Sec. 12-385.

[17] Taxation Administration Regulations 2017, Sec. 34. For a complete list of the countries with which Australia has an exchange of information agreement on tax matters, among other tax-related agreements, including the texts and information on signature, entry into force and effective dates, see *Bloomberg Tax International Tax Treaties.*

[18] Income Tax (Managed Investment Trust Withholding Tax) Act 2008, Sec. 4(3).

[19] Income Tax (Managed Investment Trust Withholding Tax) Act 2008, Sec. 4(3).

[20] Where the foreign investor's MIT liability is less than the amount withheld, the investor may write to the Commissioner requesting a refund of the excess amount withheld.

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to non-residents in countries with which Australia has an information exchange agreement in place;

- Eligibility is extended to data centers and warehouses that meet the relevant energy efficiency standards;

- The minimum energy efficiency requirements for both existing and new clean buildings will be raised to a 6-star rating from the Green Building Council Australia (previously 5-star) or a 6-star rating under the National Australian Built Environment Rating System (previously 5.5-star);

- Consultation will occur regarding transitional arrangements for existing buildings.

A clean building MIT must not derive assessable income from any taxable Australian property other than its clean buildings and assets reasonably incidental to those buildings.

The measure (if enacted) also raises the minimum energy efficiency requirements for clean buildings.

(8) No Deduction for Related Expenses

A foreign investor will not be able to deduct expenses related to their derivation of the fund payment. This arises because the tax law deems the fund payment to be non-assessable non-exempt income of the investor.[21] This deeming ensures that not only is an investor not liable to ordinary Australian income tax on the fund payment, but also that the investor will not be able to claim deductions for expenses related to their derivation of the fund payment.

There may be circumstances where this results in an investor incurring losses (capital or revenue) that cannot be offset against the tax paid on fund payments. This may produce an outcome where the tax payable by the offshore investor is more than it would have been if the investor had directly acquired the underlying Australian asset. This result may also affect how the debt funding of cross-border investments into Australia is structured.

(9) Capital Gains Tax (CGT) Concessions

In addition to the withholding tax concession referred to above, the trustee of an eligible MIT can elect for gains and losses from certain types of assets to be held on capital account. The main benefits of deemed CGT treatment are:

- For resident investors — CGT discount treatment of capital gains; and

- For nonresident investors — clarity as to jurisdictional scope of the Australian tax system (as the CGT rules, which set out when a nonresident is taxed in Australia on capital gains, are relatively clear in comparison to revenue account assets).

It is not necessary for a trust wishing to qualify for deemed CGT treatment to satisfy the investment management activities requirement or the trading trust requirement set out as items 6 and 7, above.

Corporate unit trusts and trading trusts are excluded from the CGT deeming rules. A trading trust is a trust that carries on a trading business or controls the affairs or operations of another person that carries on a trading business.

These trusts can elect into the regime as they can still qualify as an MIT, albeit their assets do not qualify for the CGT deeming while they are corporate unit trusts and trading trusts. This is relevant to the timing of the election for deemed CGT treatment discussed below.

Division 230 Financial Arrangements (as defined in the TOFA legislation) and debt interests are also excluded from the CGT deeming rules.

Land and interests to acquire or dispose of land (including an interest in land) will not qualify for the deemed CGT treatment if the asset is trading stock of the MIT. (There are other minor exclusions — such as profit-making plans involving land acquired prior to September 20, 1985 and (for non-land assets) trading stock acquired prior to electing into this regime.)

The trustee needs to elect into this deemed CGT regime. The election is irrevocable. The trustee must make the election on or before the day it is required to lodge its tax return for the year the trust becomes an MIT (or a later day as allowed by the Commissioner).

If a trustee qualifies to make an election due to the fact that the trust is an MIT, but does not do so, there is a general rule that the assets referred to above will be deemed to be held on revenue account. However, this rule does not apply where the asset is land or a right to acquire or dispose of land. That is, even if the election is not made, the land could be held on capital account (if it is a capital asset under the existing law).

As discussed earlier, a corporate unit trust and trading trust can be an MIT, despite the fact that the trust's assets do not qualify for deemed CGT treatment. As such, the election period can lapse during the period an entity is a corporate unit trust or trading trust. Importantly, if a corporate unit trust or trading trust fails to elect during the relevant election period, the assets of the trust will be deemed to be a revenue amount both during and after the period the trust is a corporate unit trust or trading trust.

(10) Carried Interests

Gains made from, in general terms, carried interests in an MIT are included in assessable income and consequently do not qualify for the CGT discount concessions in Division 115 of the 1997 Act.

j. Attribution Managed Investment Trusts

The Attribution MIT Regime modifies the application of the MIT Regime such that the income of the trust is taxable to underlying investors under an accruals regime (rather than by reference to the income of the trust to which they are presently entitled — see i., above). Investors are provided with an AMIT Member Annual Statement (AMMA Statement) within three months of the end of the income year setting out the amount and character of the income of the trust which has been allocated to the member for tax purposes (even if the amount is not actually distributed to the investor). The Attribution MIT regime entitles the trustee to retain income of the trust (albeit allocated to the underlying investors for tax purposes) without incurring the highest marginal tax rate (which is otherwise applicable to income of the trust where a beneficiary is not presently entitled by year end).

[21] ITAA 1997, Sec. 840-815.

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k. Investment Managers

The objective of the Investment Manager Regime (IMR) is to exempt foreign funds with a presence in Australia from income tax in Australia on certain activities.

Under the IMR, to the extent the "IMR income" or "IMR capital gain" of a nonresident is taxed only because an "IMR foreign fund" is taken to have a PE in Australia solely as a result of engaging an Australian agent, manager or service provider that habitually exercises an authority to negotiate and conclude contracts on its behalf, such income or capital gain will be exempt from income tax. Broadly, this means that for a fund satisfying these requirements, Australia will only tax the arm's-length fee for services provided by the Australian intermediary.

The ensures that a foreign managed fund will not have a permanent establishment (PE) in Australia because of an Australian intermediary that was a dependent agent. In such a case, part or all of the investment income (including capital gains) of the foreign fund may have become attributable to the PE and been subject to Australian tax.

The definition of an "IMR foreign fund" draws parallels with the definition of a "managed investment trust" (MIT). Broadly, it requires a fund that:

- Is not an Australian tax resident;
- Is recognized under a foreign law as a collective investment vehicle;
- Does not allow its members to have control of the day-to-day operations of the fund;
- Is widely held, and not closely held, under the existing MIT rules (the Act also provides that if a fund would satisfy the widely held test in the year before it is wound up, it will satisfy the test for the "winding up year"); and
- Does not carry on or control a trading business in Australia (i.e., it undertakes passive investment).

IMR income refers to revenue earned by an IMR foreign fund that is attributable to a return or gain on a "financial arrangement" covered by the IMR regime that is taxable in Australia solely because of rules that deem an item to have an Australian source. An item can have an Australian source if an Australian PE exists solely as a result of the item engaging an Australian agent, manager or service provider that habitually exercises an authority to negotiate and conclude contracts on its behalf, or because the financial arrangement is a CGT asset used in carrying on business through an Australian PE or is an option or right to acquire such an asset. Such financial arrangements comprise:

- Interests of less than 10% in the debt or equity (or derivatives related to such debt or equity) of an entity, except to the extent the amount gives rise to a withholding tax liability;
- Derivative financial arrangements, except to the extent they are in respect of an underlying interest that is otherwise taxable (e.g., taxable Australian real property); and
- Financial arrangements in an entity that gives a right to vote on the board of directors, the ability to participate in management decisions, or to deal with assets (to the extent that such rights only arise when the issuer breaches the terms of the financial arrangement but not otherwise).

Similarly, an IMR capital gain is a capital gain that has arisen solely because of the presence of a PE in Australia and is made in relation to a CGT asset which is used in carrying on an Australian PE or an option or right to acquire such an asset.

In addition, certain deductions and capital losses will be disregarded.

The IMR has been extended to financial arrangements with entities in which an IMR foreign fund holds a non-portfolio interest. The permanent establishment test remains in respect of financial arrangements with entities in which an IMR foreign fund holds a non-portfolio interest.

l. Sovereign Wealth Funds

In April 2019, new rules were introduced that codified (and materially tightened) Australia's existing practice of exempting investment income and gains derived by foreign governments and foreign government agencies from income tax and withholding tax (the *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2019*). The new legislative framework limits the tax exemption to portfolio-like investments in certain assets and introduces a range of new conditions which must be met for the exemption to be available.

Broadly, certain sovereign wealth funds may be exempt from Australian income tax (including withholding taxes) on returns on interests of less than 10% in Australian companies and managed investment trusts, provided that the fund has no influence over decisions that comprise the control and direction of the operations of the Australian entity. The ownership threshold and influence test are judged by reference to the sovereign entity group, rather than just the investing entity.

The sovereign entity must also meet a range of requirements to be eligible for this exemption, including that it is funded solely by public monies and all returns on its investments are public monies. Although this test appears relatively straightforward, there is also some complexity to satisfying these requirements as a result of recent draft guidance from the ATO (Draft Law Companion Ruling 2019/D4). Among other things, the ATO's preliminary view is that this test will not be satisfied where a sovereign entity obtains third-party debt funding. The public monies test will also not be satisfied where the pension fund obtains contributions from employees or employers.

2. Restrictions

Foreign investments in Australian entities, businesses and land are regulated by the Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA) and related legislation and Australia's Foreign Investment Policy (Policy). The objective of FATA is to stop or limit foreign investment into Australia determined to be "contrary to the national interest."

The Foreign Investment Review Board (FIRB) administers the legislation and Policy and assists the Treasurer of the Commonwealth of Australia and its department (Treasurer) to make decisions on foreign investment proposals submitted for approval. FIRB's functions are advisory only. Decisions regarding any proposed foreign investment are ultimately the re-

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sponsibility of the Treasurer. The Treasurer determines what is contrary to the national interest by having regard to the widely held community concerns of Australians.

Under the FATA, there are two categories of transactions:

- "notifiable actions;" and
- "significant actions."

Only notifiable actions must be mandatorily notified to the Treasurer and failure to do so constitutes an offence. It is not compulsory to notify the Treasurer of significant actions. However, if the Treasurer is not notified, the Treasurer may block, unwind or place conditions on a significant action if it is considered contrary to the national interest.

a. Notifiable Actions

Subject to the threshold tests being met (see c., below), the following transactions must be mandatorily notified to FIRB for approval:

- the acquisition by a foreign person of a "direct interest" in an Australian corporation, Australian unit trust or holding entity of an Australian corporation or unit trust, that carries on an agribusiness;
- the acquisition by a foreign person of a "substantial interest" in an Australian corporation, Australian unit trust or holding entity of an Australian corporation or unit trust (which is not an agribusiness); or
- the acquisition by a foreign person of an interest in Australian land, subject to certain exemptions (see below).

(1) Direct Interest

A person acquires a "direct interest" in an Australian entity or business if it acquires:

- an interest of at least 10% in the entity or business;
- an interest of at least 5% in the entity or business and has also entered into a legal arrangement relating to the person's business and the entity or business (such as an agreement to secure the offtake of commodities); or
- an interest of any percentage in the entity or business if the person is in a position to influence or participate in the central management and control of the entity or business, or influence, participate in, or determine the policy of the entity or business.

(2) Substantial Interest

A person holds a "substantial interest" in an entity, business or trust if the person (and its associates) holds an interest of at least 20% in the entity or business, or for a trust (including a unit trust) if the person (and its associates) holds a beneficial interest in at least 20% of the income or property of the trust.

(3) Interests in Australian Land

The definition of an "interest" in Australian land is extremely wide and includes options over freehold land, leases with a term exceeding five years (including any option for a further term) and any financing or other arrangements for the sharing of profits from investment in Australian land.

Proposals involving the acquisition of interests in Australian land by foreign persons that fall within specific exemptions do not require FIRB approval. Some of the major exemptions relate to new dwelling developments, multiple acquisitions by foreign investors with high volume acquisitions, passive investments in land entities, acquisition of residential property by permanent visa holders, aged care facilities, retirement villages or certain student accommodation.

b. Significant Actions

Subject to the threshold tests being met (see c., below), the following will be a significant action for the purpose of FIRB assessment:

- Acquiring (including by way of issue) an interest in securities of an entity with a relevant Australian nexus (broadly, an Australian entity, a foreign corporation that holds Australian land or securities in an Australian entity, or a holding entity of such an entity), even if the interest acquired is less than a substantial interest of 20%;
- Entering into or terminating significant agreements with an Australian entity or business (i.e., agreements relating to using the assets of the business or participating in its profits or management and control);
- Acquiring interests in assets of an Australian business; or
- Entering into certain agreements or altering the constituent documents of an Australian entity which enables a foreign person to control senior officers of the entity.

For actions in relation to Australian entities, there must generally be a "change of control" involving a foreign person as a result of the transaction. This requirement, however, does not apply to the acquisition of an Australian agribusiness so that, subject to the threshold test being met, the acquisition by a foreign person of a direct interest in an Australian agribusiness is a significant action.

c. Threshold Tests

Under present temporary emergency changes announced by the Australian Government in response to COVID 19 pandemic, the threshold for all proposed foreign investments into Australia is zero dollars.

The imposition of a zero-dollar investment threshold will apply for all foreign investments in a new category of "sensitive national security business." "Sensitive national security businesses" include assets in technology, energy, communications, water, ports, data and other sectors considered crucial to national security.

Under the framework, prior to the existing temporary framework, for non-government foreign investors, even if a transaction is within one of the categories of actions discussed above, it will only be a notifiable action or significant action if the value of the transaction, entity or business exceeds the monetary thresholds in the table below, subject to any exemption that may apply.

In some instances, higher thresholds apply for investments (except investments by foreign government investors) in sectors other than sensitive sectors (e.g., defense and media) for "agreement country investors" such as from certain countries

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with which Australia has a Free Trade Agreement, which includes the Australian-United States Free Trade Agreement.

These thresholds do not apply to foreign government investors (which have a zero-dollar threshold) so they will have to notify and obtain approval from FIRB for such investments and actions regardless of their value.

Type of Investment or Action	Thresholds for Foreign Persons (Other Than Foreign Government Investors)	Thresholds for Agreement Country Investors (Other Than Foreign Government Investors)[1]
Entities/Businesses		
Acquisition of interest in an Australian business or entity which is non-sensitive	• 275 million Calculated on the higher of: — total asset value of the entity or business; or — total issued securities value of the entity or business (based on consideration for the acquisition)	• 1,192 million
Acquisition of interest in an Australian business or entity which is sensitive	• 275 million Calculated on the higher of: — total asset value of the entity or business; or — total issued securities value of the entity or business (based on consideration for the acquisition)	• 275 million
Acquisition of a direct interest in an agribusiness	• 60 million (cumulative, i.e., based on value of the consideration for the acquisition and the total value of other interests held by the foreign person in the entity or business)	• 1,192 million for investors from the United States, New Zealand and Chile • 60 million for investors from China, Japan, South Korea and Singapore[2] (cumulative, i.e., based on value of the consideration for the acquisition and the total value of other interests held by the foreign person in the entity or business)
Acquisition of 5% or more in an entity or business in the media sector	Must notify of all acquisitions regardless of value	Must notify of all acquisitions regardless of value
Land		
Agricultural land	• 15 million (cumulative, i.e., based on value of the consideration for the acquisition and the total value of other interests held by the foreign person in agricultural land)	• 1,192 million for investors from the United States, New Zealand, and Chile • 50 million for investors from Thailand • 15 million for investors from China, Japan, South Korea, and Singapore[3] (cumulative, i.e., based on value of the consideration for the acquisition and the total value of other interests held by the foreign person in agricultural land)
Non-sensitive developed commercial land	• 275 million	• 1,192 million
Sensitive developed commercial land (e.g., mines or critical infrastructure)	• 60 million	• 1,192 million
Residential land or vacant land (both commercial and residential)	Must notify of all acquisitions regardless of value	Must notify of all acquisitions regardless of value
Acquisition of mining or production tenement	Must notify of all acquisitions regardless of value	• 1,192 million for investors from the United States, Chile, and New Zealand Investors from China, Japan, South Korea, and Singapore must notify of all acquisitions regardless of value[4]
Exploration tenement	Approval generally not required	Approval generally not required

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[1] "Agreement country investors" are non-government investors from the United States, New Zealand, Chile, Japan, South Korea, China, Singapore and pursuant to the Trans-Pacific Partnership, Canada, Mexico, Vietnam, and the region of Hong Kong, China.
[2] This threshold will also apply to non-government investors from Brunei Darussalam, Malaysia, and Peru, once the Trans-Pacific Partnership is implemented.
[3] This threshold will also apply to non-government investors from Brunei Darussalam, Malaysia, and Peru, once the Trans-Pacific Partnership is implemented.
[4] It is expected that this threshold will also apply to non-government investors from Brunei Darussalam, Malaysia, and Peru, once the Trans-Pacific Partnership is implemented.

(1) Agribusiness

An "agribusiness" is defined by reference to specified and well recognized industry classifications as set out in the Australian and New Zealand Standard Industrial Classification Codes. These industry classifications include agriculture, forestry, fishing and also most food manufacturing or what has been described as "first stage downstream manufacturing."

A business or entity will be considered an agribusiness if the business or entity (or a subsidiary of the entity) carries on such activities and where at least 25% by value of the assets of the business/entity are used in, or at least 25% of its earnings are derived from, carrying on such activities.

(2) Australian Land

Under the FATA, "Australian land" is divided into four categories:

(i) "Agricultural land" refers to land that is used, or could reasonably be used, for a primary production business (for example, a business of cultivating or propagating plants, maintaining animals for purposes of selling them or their bodily produce, or planting or tending trees that are intended to be felled). The ATO maintains an agricultural land register to track foreign ownership of agricultural land. Regardless of whether approval is required, the ATO must be notified within 30 days of the acquisition by foreign persons of all freehold interests, and leasehold interests likely to exceed five years, in agricultural land.

(ii) "Commercial land" means land in Australia other than residential land or land used wholly and exclusively for a primary production business.

(iii) "Vacant land" means land with no substantive permanent building on it that can be lawfully occupied by persons, goods or livestock, unless a wind or solar power station is located on its surface.

(iv) "Residential land" means land in Australia that has at least one dwelling on it but is not commercial land or agricultural land. As with agricultural land, foreign persons that acquire residential real estate are required to register their purchase with the ATO.

d. Critical Infrastructure

Some acquisitions by non-government foreign investors from state and territory governments are not subject to FIRB review. However, FIRB review and approval is required for acquisitions by all foreign investors of "critical infrastructure assets" sold by state and territory governments, with a focus on national security.

Critical infrastructure assets include:

(i) Public infrastructure (such as airports or airport sites, ports, infrastructure for public transport, electricity, gas, water and sewerage systems);

(ii) Existing and proposed roads, railways and inter-modal transfer facilities that are part of the National Land Transport Network or are designated by a state or territory government as significant or controlled by the government;

(iii) Telecommunications infrastructure; and

(iv) Nuclear facilities.

FIRB approval will also be required for acquisitions of Australian entities and businesses which hold interests in such critical infrastructure assets.

e. Register of Foreign Ownership of Australian Assets

Foreign investors are required to report certain investments in Australian assets and other related matters to the ATO, which the Commissioner of Taxation records in the Register. The Commissioner is the Registrar responsible for administering the Register, under the *Commonwealth Registers (Appointment of Registers) Instrument 2021.*

The Register enhances the Australian Government's visibility of foreign ownership of Australian assets. The Register is confidential (however, the Commissioner provides a report to the Treasurer each financial year, for presentation to Parliament, including aggregated statistics).

The Register is primarily focused on enhancing available information regarding Australian assets in: (i) land, (ii) water interests, (iii) mining, production and exploration tenements, and (iv) specified business and entity related interests for which foreign investment approval has been obtained. It includes not only the acquisition and disposal of certain interests but also changes in the levels of interest held in assets and changes in investors' circumstances (for example, where an investor ceases to be a foreign person).

Notification is typically required within 30 days of the date of the action or event. Additional guidance, including the ATO portal through which foreign residents can register.[22]

[22] See Register of Foreign Ownership of Australian Assets, https://foreigninvestment.gov.au/guidance/conditions-and-reporting/register-foreign-ownership-australian-assets.

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B. Currency and Exchange Control

1. Currency

The Australian dollar (A$) is the unit of currency and has been floating (on a very limited government managed basis) since December 8, 1983.

2. Banking System

The banking system consists of the Reserve Bank of Australia (the Banker of the Commonwealth Government) and private trading banks. The approval of the Treasurer is required for the establishment of any additional trading banks to operate in Australia. In addition, there are a number of investment banks throughout Australia, many of which have associations with or are branches of overseas entities.

Banks require identification of customers when an account is opened. Suitable identification includes references from an acceptable referee, a birth certificate, a passport or a citizenship certificate.

3. Exchange Control

There is no limit on the amount of Australian notes and coins that can be taken or sent overseas. However, exports and imports of Australian and foreign cash, in amounts of A$10,000 or more, must be reported to the Australian Transaction Reports and Analysis Centre. Reporting forms may be obtained from the Australian Customs Service at ports and airports and from the Centre itself.[23]

The objective of this information gathering process is to provide information to other authorities, including the Commissioner of Taxation.

C. Trade and Commerce Regulation

1. General Regulation of Companies

The control and supervision of companies was originally administered by state legislation. In the 1950s, a need for uniform law and practice on a national basis was recognized. In the early 1960s, the States cooperated by passing uniform companies legislation. In December 1978, a Formal Agreement between the Commonwealth and all states was made whereby Commonwealth legislation would be applied in each of the states and the National Companies and Securities Commission would regulate the application by the states of the Commonwealth laws.

The national legislation had a difficult introduction involving problems and differences at the implementation level, a parliamentary committee enquiry, and a High Court constitutional challenge. This resulted in the states agreeing to the introduction of the Corporations Legislation Amendment Bill 1990, which brought about a national scheme that became effective as of January 1, 1991.

The main administrative body is the Australian Securities and Investments Commission (ASIC), which replaced both the National Companies and Securities Commission and the Corporate Affairs Commission.

Changes to company law introduced by the Second Corporate Law Simplification Act applying from January 1, 1998, were designed to modernize and streamline procedures and included:

(i) The introduction of simpler procedures for the formation of a company;

(ii) Replacing the memorandum of association with a standard constitution;

(iii) Eliminating the need for a common seal;

(iv) Reducing the minimum number of members and directors to one;

(v) Allowing the use of electronic means to give notice of and to hold meetings; and

(vi) No longer requiring shares to have a par value.

The Corporate Law Economic Reform Program Act, 1999 was enacted with the aim of easing the establishment of new enterprises and reducing the costs of business complying with the law. The principal areas of change were:

(i) Pushing for international harmonization of Australian accounting standards;

(ii) Easing requirements for fundraising by small business, reducing the volume of material in prospectuses and liberalizing the advertising of listed securities;

(iii) Introducing a "business judgment rule" for directors, permitting shareholders and directors to commence proceedings on behalf of a company and permitting directors to rely on the advice of experts or to delegate their powers; and

(iv) Enhancing the role of the Corporations and Securities Panel in resolving takeover disputes.

a. Formation and Administration

A company is formed by filing with the Australian Securities and Investments Commission (ASIC) an application for registration that includes the company's constitution, the proposed name, share capital details, a list of persons that have consented to be directors and the location of the company's registered office. The ASIC issues a Certificate of Registration.[24]

(1) Shares

Shares can be issued for a nominal value. There is no minimal or par value required under the Corporations Law.

(2) Constitution

Every company has a constitution that governs the internal management of the company and regulates such matters as the appointment, powers and duties of directors and the secretary, the declaration of dividends and the provision of reserves, the allotment of shares, the calling and conduct of general meetings, and the alteration of capital.

[23] See Banking Act, 1959 and Banking (Foreign Exchange) Regulations and Financial Transaction Reports Act, 1988.

[24] Corporations Act, 2001, Part 2A.2.

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Prior to the entry into effect of the Company Law Review Act, 1998, all companies were required to have a memorandum and articles of association. These documents have been replaced with the concept of a constitution. Companies in existence in July 1998 continue to use their existing memorandum and articles of association as their constitution or may adopt a new constitution or the "replaceable rules" contained within the Corporations Law (see Worksheet 1). The replaceable rules do not apply to a proprietary company that has the same person as both the sole director and the sole shareholder.

(3) Control

The business of a company is usually controlled by the board of directors. The division of powers between the directors and the general meeting is governed by the company's constitution. Certain duties are required to be carried out only by directors while the law also provides that certain powers are to be exercised only by a general meeting. Companies with a large spread of shareholders (especially public companies) usually adopt a clause that provides the board of directors with the powers of management.

(4) Shareholder Meetings

Companies are required to hold the shareholders' meetings described in (a) and (b), below.[25]

(a) Statutory Meeting

A statutory meeting is required in the case of limited public companies with share capital and no-liability companies that issue a prospectus for the first time. The statutory meeting must be held soon after the company is formed. The purpose of the statutory meeting is to inform shareholders of details as to the company's formation, capitalization and prospects.

(b) Annual General Meeting

The annual general meeting (AGM) generally must be held at least once every calendar year. The business to be conducted at the AGM is governed by the constitution. There are also statutory requirements providing that certain items are to be laid before the AGM, for example, a copy of the accounts, a directors' report, a statement by the directors in relation to the accounts, and an auditor's report. Shareholders may be entitled to require additional meetings requesting that a particular problem or aspect of the company's affairs be discussed. Proprietary companies are exempt from holding an AGM under the Corporations Law, but their constitution may require them to do so.

b. Winding up a Company

A company may be wound up voluntarily by the members (i.e., shareholders) if it is solvent, or by creditors if it is insolvent. In either case, the winding up is brought about by a special resolution of the members. Alternatively, compulsory liquidation may be undertaken by a creditor or other applicant to a court if the company is insolvent or has breached certain regulatory requirements such as those set out below. A winding-up by the court may be ordered in the following circumstances:

(i) If a special resolution was passed by the members of the company resolving that it be wound up by the court;

(ii) If the company has defaulted in filing the statutory report or in holding the statutory meeting;

(iii) If the company is insolvent;

(iv) If the company's affairs are being carried out in a manner that is oppressive, unfairly prejudicial to, or unfairly discriminatory against a member or members, or in a manner that is not in the interest of the members as a whole; or

(v) On other general grounds under the Corporations Law.

An application for winding-up by the court may be brought by any of the following persons:

(i) The company;

(ii) A creditor of the company (including a contingent or prospective creditor);

(iii) The liquidator; or

(iv) The ASIC as a result of a special investigation in relation to the company's affairs or following the termination of the company.

A members' voluntary winding-up is a winding-up in which a majority of the company's directors files a declaration to the effect that the company will be able to pay its debts in full within 12 months after the winding-up has commenced. Where such a declaration is not filed, a voluntary winding-up can be instituted only at the instance of the creditors.

A company that has become insolvent or is likely to become insolvent may appoint an administrator for purposes of Voluntary Administration. The object of Voluntary Administration is to provide for the business property and affairs of an insolvent company to be administered in a way that maximizes the chances of the company or as much as possible of its business continuing or, if not, results in a better return to the company's creditors and members than would result from an immediate liquidation of the company.

Voluntary Administration commences with the appointment of the administrator, who must be a registered liquidator. The appointment may be made by the company's directors or, less commonly, by a liquidator, provisional liquidator, or a secured creditor. On appointment, the administrator assumes powers and responsibilities similar in nature to those of a Receiver and Manager. These include personal liability for any debt that the company may incur for services rendered, goods bought, or property used, leased or owned during the administration. The administrator has a lien on the company's assets for payment of his fees.

Once an administrator has been appointed, the company remains in Voluntary Administration, other than by leave of the Court, until the main meeting of creditors is held. This meeting must be scheduled within 28 days of the administrator's appointment.

During the moratorium period, the company cannot be wound up, nor can any civil proceedings be started, and Court enforcement processes are suspended, except with the leave of the Court.

[25] *Id.*, Part 2.3.

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On the appointment of an administrator, a secured creditor that has security over the "whole or substantially the whole" of the property of the company has 14 days in which to enforce its charge. Should such a charge holder not enforce its charge during this period, it is unable to enforce its charge during the moratorium period, which extends at least until the meeting of creditors.

The administration continues until the creditors decide to execute a Deed of Company Arrangement or terminate the administration to wind the company up.

The following processes, which do not necessarily lead to a company being wound up, also are available to creditors that believe their loans are unsafe:

(i) A compromise or arrangement may be entered into with the company's creditors;[26] and

(ii) Receivers and managers may be appointed to protect the rights of secured creditors.[27]

c. Reorganizations

A company may reduce its share capital, provided the reduction is fair and reasonable to all shareholders and is approved by them, and does not materially prejudice the company's ability to pay its creditors.

A company is prohibited from giving financial assistance for the purpose of, or in connection with, the acquisition by any person of shares in the company or in its holding company. The acquiring or lending of money by a company on the security of its shares or those of its holding company is also prohibited (except in the case of a company the ordinary business of which is that of money lending).[28]

The Corporations Law permits the following types of share buy-back schemes:

(i) Equal access buy-back. This is restricted to ordinary shares and the company must offer to buy back an equal percentage of each shareholder's holding.

(ii) On market buy-back. This is undertaken by listed companies during normal stock exchange trading.

(iii) Employee share buy-back. The company may buy-back shares held by directors or employees.

(iv) Selective buy-back. A general meeting or special resolution of members may approve offers being made to specific shareholders to buy back shares under certain conditions.

(v) Odd-lot buy-back. A listed company may purchase its shares where the number of shares is less than a marketable parcel.

In alternatives (i) to (iii) inclusive, approval of an ordinary resolution of members is required where 10% or more of the voting shares are purchased within the previous 12 months (generally referred to as the 10/12 limit).

[26] *Id.*, Part 5.1.
[27] *Id.*, Part 5.2.
[28] *Id.*, Sec. 205.

2. Trade Regulations

Trade regulation in Australia is controlled by both the state and federal governments.

a. Price Controls

Price control is a power that can be exercised only by the states. However, in all states (except to a very limited extent in South Australia), price control is not exercised.[29]

In December 1973, the Australian government sought approval (via a referendum) to alter the Australian Constitution to enable it to make laws with regard to prices and incomes and was decisively rejected by the electorate.

The Australian Government has established the Prices Surveillance Authority (PSA), which has the statutory power to examine and inquire into the prices charged for certain goods and services. The selection of goods and services subject to surveillance is based on the degree of effective competition and the pervasive effects throughout the economy of the price changes.

The Australian government has also established the Petroleum Products Pricing Authority, which operates to monitor the pricing of petroleum products in Australia.

b. Trade Practices

Restrictive trade practices are controlled by Federal legislation. The Trade Practices Act (1974) has two main purposes:

(i) To control restrictive trade practices and monopolization; and

(ii) To provide a national basis of protection for consumers against a wide range of unfair practices.

The Trade Practices Act provides for the appointment of a Commissioner of Trade Practices and for a specially constituted Trade Practices Tribunal. The effects of the Act are far reaching. Basically, the following activities are prohibited:

(i) Agreements reducing competition, restrictive covenants, etc.;[30]

(ii) Resale price maintenance;[31]

(iii) Exclusive dealing;[32]

(iv) Monopolization;[33]

(v) Company takeovers resulting in a substantial reduction of competition;[34] and

(vi) Price discrimination.[35]

Although the provisions of the Trade Practices Act 1974 apply primarily to corporations, they also apply to individuals where the subject transaction involves interstate trade or commerce, the Australian Capital Territory, the Northern Territory,

[29] Except in times of war or national emergency, when the federal government may exercise control.
[30] Trade Practices Act, 1974, Secs. 45–45D.
[31] *Id.*, Sec. 48.
[32] *Id.*, Sec. 47.
[33] *Id.*, Sec. 46.
[34] *Id.*, Sec. 50.
[35] *Id.*, Sec. 49.

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or dealings with the Australian government or any of its authorities or instrumentalities.[36]

An individual (or corporation) that engages in a prohibited restrictive trade practice may be liable for both a penalty under the Trade Practices Act and to civil action by an injured party (i.e., private persons also are able to take court action against a person that engages in prohibited practices).

Where there is sufficient justification, there is scope under the Trade Practices Act for practices that would normally be prohibited.[37] Any conduct covered by an authorization under the appropriate provisions is protected from enforcement action.

There also are specific provisions of the Trade Practices Act that prohibit commercial practices that are detrimental or unfair to the interests of consumers. In this area, there can be no special authorization for practices that are prohibited. The types of practices that are prohibited are as follows:

(i) Misleading or deceptive conduct;[38]

(ii) False representations or advertising;[39]

(iii) The deceptive offering of prizes in conjunction with the promotion of goods or services;[40]

(iv) "Bait-type" advertising;[41]

(v) Referral selling;[42]

(vi) Taking payment without intention to supply;[43]

(vii) Misleading or false statements in connection with home business operations;[44]

(viii) Coercion at a consumer's place of residence;[45]

(ix) Pyramid-type selling;[46]

(x) The supply of products not meeting safety standards;[47] and

(xi) Inertia-type (for example, unsolicited) selling, etc.[48]

The Trade Practices Act of 1974 established a Trade Practices Commission charged with a range of responsibilities that include enforcement of the Act's provisions, the granting of authorizations as provided for by the Act, and general administration of the Act.

In August 1993, the National Competition Policy Review, known as the Hilmer Committee, recommended the extension of the Trade Practices Act to encourage the application of a uniform competition policy throughout Australia. At a September 1994 meeting of the Council of Australian Governments, it was agreed that competition is a key stimulus to the higher productivity levels that are essential to Australia's growth and competitiveness, and it was further agreed that an effective national competition and legal framework is crucial to underpinning enhanced economic performance. As a result, the Commonwealth government legislated to:

(i) Amend Part IV of the Trade Practices Act and the application of the Act to all persons within state jurisdictions;

(ii) Establish the Australian Competition Commission, the National Competitions Council, and pricing and access arrangements;

(iii) Put in place an Intergovernmental Conduct Code Agreement; and

(iv) Create an Intergovernmental Competition Principles Agreement that includes procedures and principles relating to the structural reform of public monopolies, legislation review, competitive neutrality, prices oversight and access to essential facilities.

c. Financial Institutions

The Financial Corporations Act (1974) provides for the examination of the business activities of certain financial and trading corporations, and for the regulation of the activities of those corporations.[49] Broadly, the legislation applies to foreign corporations, and Australian trading or financial corporations that have:[50]

(i) The borrowing of money and the provision of finance as their sole or principal business activity;

(ii) 50% of their assets consisting of debts arising from transactions entered into in the course of the provision of finance; or

(iii) Debts of more than A$5 million arising from the provision of finance with respect to their carrying on of a business of selling goods at retail in Australia.

The legislation applies to finance companies, permanent building societies, merchant banks, money market groups, "pastoral finance companies" (i.e., companies specializing in the lending of money for primary production purposes) and credit unions; it does not apply to statutory bodies, banks subject to the Banking Act, terminating building societies, friendly and benevolent societies, medical health insurance organizations, life insurance or tariff insurance corporations, trustee corporations and the like.[51]

Corporations subject to the legislation are required to register with the Reserve Bank of Australia and to furnish extensive information to the Bank concerning their activities. The Financial Corporations Act does not specify the controls within the range provided for in the Act by way of the making of subsequent regulations. The Treasurer has stated that cooperation in the future may enable the government to achieve its objectives without the need to bring down detailed regulations concerning the activities of institutions.

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[36] *Id.*, Sec. 5.
[37] *Id.*, Sec. 88.
[38] *Id.*, Sec. 52.
[39] *Id.*, Secs. 53 and 53A.
[40] *Id.*, Sec. 54.
[41] *Id.*, Sec. 56.
[42] *Id.*, Sec. 57.
[43] *Id.*, Sec. 58.
[44] *Id.*, Sec. 59.
[45] *Id.*, Sec. 60.
[46] *Id.*, Sec. 61.
[47] *Id.*, Sec. 62.
[48] *Id.*, Sec. 64.

[49] Financial Corporations Act, 1974, Sec. 3.
[50] Financial Corporations Act, 1974, Sec. 8.
[51] Financial Corporations Act, 1974, Sec. 8.

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Where the total assets of a registered corporation and its related corporations exceed A$5 million, the corporation is subject to the regulation and control provided for in the legislation, including control of:

(i) The asset ratios of the corporation in relation to the type of assets held;[52]

(ii) The lending policies of the corporation;[53] and

(iii) The rates of interest receivable or payable by the corporation.[54]

d. Foreign Takeover Restrictions

Foreign takeovers are restricted by the Foreign Takeovers and Acquisitions Act 1975 (see A.2., above).

e. U.S. Tariffs

This continues to be an area of significant volatility and change. Most goods originating in Australia entering the United States face a baseline 10% "reciprocal" tariff, with a number of sector-specific rates that are higher; some categories are exempted by policy or later guidance.

Low-value *de minimis* treatment has been suspended, meaning all parcels are dutiable and subject to full customs entry and charges, materially affecting e-commerce flows and small consignments from Australia to U.S. consumers.

Key sector tariffs are as follows: 50% on steel and aluminum (and certain derivatives), 25% on automobiles and many parts, 50% on certain copper products, 25% on specified furniture and cabinets (with some planned escalations later paused), 10% on softwood timber/lumber, and a targeted 25% on certain advanced computing chips with enumerated exemptions for particular uses.

(1) What This Means for a U.S. Company Operating in Australia?

Selling into Australia remains largely unchanged: under the Australia-United States Free Trade Agreement (AUSFTA), qualifying U.S.-origin goods imported into Australia are generally duty-free, so exports from the United States to Australian customers should continue to receive tariff preferences if rules of origin are met.

Exporting from Australia to the United States has become costlier and more complex: an Australian subsidiary's shipments to the United States are now typically subject to a 10% baseline tariff, plus any applicable sector-specific rates.

E-commerce and small parcel flows face new frictions: every shipment to U.S. consumers must clear formal entry and incur applicable duties/fees. Since Australian postal/courier operations have adjusted processes following the change, it is important to plan for added cost, documentation and potential delays.

Country-of-origin and supply chain structure matter: under U.S. rules, U.S. duties are assessed by origin not shipping point.

It is worth watching for scope creep from ongoing national security probes: if pharmaceuticals, aircraft/parts, medical device, or other investigated categories move into tariffable territory, affected Australian-origin exports to the U.S. could begin to incur tariffs.

(2) Practical Actions for U.S. Companies with Australian Operations

U.S. companies with Australian operations should:

(i) Re-map product classifications and origin: HTS codes and U.S. non-preferential origin for goods shipped from Australia to the United States should be verified; where possible, sourcing/manufacturing should be redesigned to retain AUSFTA benefits for imports into Australia and to minimize exposure to U.S. tariffs;

(ii) Model landed costs and pricing: the baseline 10%, any sector-specific tariffs, and administrative fees should be incorporated for all U.S.-bound flows; Incoterms (for example, DDP vs DAP) and customer pricing should be revisited with a view to allocating tariff and customs costs transparently;

(iii) Strengthen compliance and documentation: companies should ensure they have robust proofs of origin, bills of materials, and routing records; routing patterns that could be viewed as transshipment to evade duties should be avoided, given the 40% penalty risk for findings of evasion;

(iv) Consider U.S. customs programs where relevant: FTZ usage, duty deferral, valuation strategies, and drawback for qualifying re-exports should be evaluated to optimize cash flow, noting FTZ entries may require privileged foreign status under some recent measures; and

(v) Monitor scope/exemptions and agency notices: Federal Register/CBP updates and DFAT/Austrade guidance should be followed for HTS-level adjustments, exclusions and sector developments that could change their exposure.

(3) Consequences of Learning Resources, Inc. et al. v. Trump, President of the United States, et al. (No. 24-1287)

On February 20, 2026, the U.S. Supreme Court held that the relevant legislation relied on by the Trump Administration to enact the tariffs, the *International Emergency Economic Powers Act (IEEPA)*, does not authorize the U.S. President to impose such sweeping, unilateral tariffs, the power to do so being reserved for Congress. At first glance, the decision has invalidated significant tariffs imposed by the U.S. Administration and opened the door for potentially billions in refunds for companies that paid them. However, following the ruling, the administration immediately initiated new, separate tariffs under different, limited authority. These new tariffs will no doubt be similarly tested in the Courts in the near future. The Australian Government has not changed its policy settings as a consequence of this case (or the U.S. Government's response).

3. Securities Regulations

a. In General

Under a Commonwealth state cooperative scheme, the Commonwealth enacted the Securities Industry Act (1980),

[52] Financial Corporations Act, 1974, Sec. 13.
[53] Financial Corporations Act, 1974, Sec. 14.
[54] Financial Corporations Act, 1974, Sec. 15.

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which was subsequently enacted by all states through their various state Securities Industry (Application of Laws) Acts passed in 1981. Such legislation makes provisions with respect to the stock exchanges, stockbrokers and other persons dealing in securities, and imposes penalties for certain offenses made punishable by the Acts.

The Securities Industry (Application of Laws) Acts provide for the licensing of dealers in securities, investment advisors, and certain representatives of dealers and investment advisors. A person that is a dealer, a dealer's representative, an investment advisor, an investment representative or a financial journalist is required to maintain a register of any securities in which he has an interest.

These laws are now part of the Corporations Law.

b. Stock Exchanges

A company, or unit trust that is a registered investment scheme, may list its shares (or units in the case of a unit trust) on the Main Board of the Australian Stock Exchange Limited (ASX) to allow access to equity capital and to establish a secondary market in the entity's securities. The ASX has a branch in each state capital, but the principal office is located in Sydney.

The Listing Rules of the ASX set out the requirements for entry to the Official List of the ASX and for the official quotation of securities. The rules impose continuing reporting and disclosure obligations and are aimed at maintaining efficient, fair and informed trading of securities. In the case of a failure to comply with the Listing Rules, the ASX can suspend quotation of securities or remove or suspend the company or trust concerned from the List.

The ASX refers to the Australian Securities and Investments Commission (ASIC) any matters detected by the ASX that could constitute breaches of the Corporations Law or the rules of the ASX.

There are various requirements that must be satisfied before the ASX will list an entity. These requirements are called the "minimum admission criteria." The most important minimum admission criteria are set out below:

(i) A Prospectus, Product Disclosure Statement or other type of complying offer document must be issued and lodged with the Australian Securities and Investment Commission setting out the entity's business and the types of securities to be listed;

(ii) A company must have at least 300 non-affiliated shareholders with share holdings worth A$2,000 or more;

(iii) Either:

- The entity's aggregate operating profits before tax must have been at least A$1 million for the last three full financial years and at least A$500,000 for the most recent year; and

- The entity must be a going concern, or a successor of a going concern, and the nature of its business must have been the same for the last three years; or

- The entity's net tangible assets must exceed A$4 million, or A$15 in market capitalization, and in the case of an investment entity, its net tangible assets must exceed A$15 million.

4. Intellectual Property

Federal legislation provides for the registration and protection of IP, such as trademarks, patents and industrial designs. Copyright is also protected under Federal law, without requiring registration. The registration of company and business names is available under the Corporations Act.

a. Patents

Australia's Patents Act 1990 confers upon the owners of standard patents the exclusive right to make, use, sell, hire and otherwise exploit a patented invention for a period of 20 years from the date of filing the patent. "Invention" in this context means any manner of new manufacture. As in the United States and Europe, extensions to the terms of patents are allowed for pharmaceutical substances by up to five years provided the patent claims an active ingredient.

Australia is a party to the Paris Convention for the Protection of Industrial Property and an application may be made claiming the priority date of a convention country application, as long as the Australian application is made within 12 months. As Australia is a subscriber to the Patent Co-operation Treaty (PCT), a PCT international application can be filed in Australia with the priority date of the Australian patent application.

To sustain a valid patent, an invention must be novel, not obvious when compared with the prior art base that existed before the "priority date" of the patent, and useful. For purposes of determining whether a patent is novel and inventive, it must be compared to information made publicly available anywhere in the world, either by publication of a document or by the doing of the applicant.

b. Innovation Patents

An innovation patent, which is for a term of eight years, is an alternative form of protection to that given by the standard patent. The purpose of the innovation patent system is to ensure easy and inexpensive short-term monopoly protection for lower level or incremental inventions. This system facilitates the grant of patents without substantive examination. Generally, an innovation patent is granted after it passes a formalities check, usually within one to three months. No opposition proceedings are permitted at this stage. Substantive examination only occurs if required by the Commissioner or specifically requested by the patentee or a third party.

c. Trademarks

Distinctive signs used or intended to be used in relation to particular goods and/or services are readily protectable under the Trade Marks Act, 1995. "Signs" are broadly defined, and include amongst others, words, numbers, logos, names colors, shapes, sounds and smells. The benefits of registration include:

(i) In enforcement (infringement) proceedings there is no need for the registered owner to establish a reputation in the trademark or that use of the offending mark is likely to deceive or confuse the public;

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(ii) The rights of the registered owner extend throughout the Commonwealth of Australia, not merely to those regions in which reputation can be established;

(iii) A trademark registration acts as a deterrent on the public record to others who may be considering adopting the same or a similar mark;

(iv) A trademark registration is a readily identifiable IP right that can be sold or used as security; and

(v) Registration provides a defense against a third party's claim of infringement if the mark is used.

The basic requirements for registration are that the sign:

(i) Is not identical or deceptively similar to a sign that is already being used by a third party or that is the subject of a prior registration or application in respect of the same goods or services; and

(ii) Is distinctive or capable of becoming distinctive. There is no need to show that the mark has been used provided the mark is sufficiently distinctive.

The registered owner of a trademark can bring an action for infringement if another person uses a sign that is substantially identical with, or deceptively similar to, the trademark in relation to goods or services in respect of which the trademark is registered, or on similar goods or closely related services. "Well known" registered trademarks are given protection against use even on unrelated goods and services.

Registered trademarks can be licensed or assigned and are renewable every 10 years. They can be removed for non-use. Thus, if a mark has been registered for more than five years but has not been used during the last three years, either by the owner or an authorized user, the registration can be removed on the application of an "aggrieved" third party.

d. Trade Names

Business names and company names are allocated on a first come-first served basis, so no search is conducted for prior rights already on the trademarks register. Also, the fact that a company has a well-known trading name or trademark overseas does not, in itself, entitle it to register that name or mark as a company or business name in Australia. An application may be made to the appropriate authority by any person for the registration of a business or corporate name. That application will not be rejected unless it is determined that:

(i) In the case of a business name, the name is the same as, or would be confused with, other existing company names registered in Australia or existing business names registered in the same state;

(ii) In the case of a company name, the name is identical to an existing company or registered business name; or

(iii) The name is offensive or otherwise prohibited.

Internet domain names within the Australian top-level country-code ".au" are administered by an industry self-regulatory organization named the .au Domain Administration (auDA). The ".au" domain is divided into a number of sub-domains ("second-level domains" or "2LDs"). The most popular is ".com.au" — which is intended for use by commercial entities. The current eligibility requirements or a registration of a ".com.au" domain are set out in auDA's Domain Name Eligibility and Allocation Policy.[55]

e. Registered Designs

Design features of products, such as shape, configuration, pattern or ornamentation may be protected from initiation by registration of those features as "designs" under the Designs Act 2003. This Act confers upon the registered owner/s of a design proprietary and monopoly rights in that design. To be valid, a design registration must be for a design, which is new and distinctive. Prior use or publication in Australia or elsewhere will destroy registrability.

Where an artistic work is industrially applied as a design and articles made to this three-dimensional design are put on the market in Australia, copyright protection is unlikely to be available and design registration would be the only protection possible (if the design were still new and distinctive).

Since the Trade Marks Act 1995, there has been some overlap between trademark and design legislation. It is now possible to register shapes as trademarks. Traders may potentially register their product as both a design and a trademark and obtain protection under both regimes.

f. Know-How

"Know-how" or "trade secrets" refers broadly to information, which is of commercial value to the holder of the information and is known only by the holder or others to whom the holder has disclosed the information subject to an obligation to maintain its confidentiality (e.g., customer lists, marketing techniques, software, product specifications and manufacturing processes).

Although the Copyright Act may protect the particular form in which information is embodied, and the Patents Act may protect the subject matter of information (which discloses a patentable invention, i.e., the subject of a patent registration), there is no federal or state legislation, which specifically protects secret information as such.

Such information may be protected either by express contractual obligations to maintain the secrecy of confidential information or by application of the general principle that anyone to whom information, which is confidential, is communicated in circumstances of confidence has an obligation of good faith to maintain the confidentiality of the information. Such obligations can be included in employment contracts.

g. Copyright

Owners of certain original works and other copyright subject matter (such as artistic works, sound recordings and computer programs) have various rights under the Copyright Act 1968. The owner of a copyright that has been infringed can bring an action to seek an injunction and obtain damages or an account of profits.

In relation to computer software programs, copyright protection as a literary work extends not only to computer programs written in source code, but also to object code programs.

Australian copyright law reflects "digital agenda" reforms at the international level, aimed at ensuring that copyright laws

[55] For further information, refer to www.auda.org.au.

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can be enforced in a digital environment, and are centered around a new technology-neutral right of communication to the public.

Australia is a member of Trade-Related Aspects of Intellectual Property (TRIPS) and the Berne and Universal Copyright Conventions. Works and other copyright subject matter created by the citizens of member countries or first published in the relevant member country are entitled to the same protection in Australia as if they had been created and first published in Australia.

Moral rights held by individuals in relation to literary, dramatic, musical, artistic and cinematographic works are given protection. These rights include the right of attribution of authorship, the right not to have authorship of a work falsely attributed, and the right of integrity of a work. Copyright generally lasts for 70 years following the death of the author, with the exception of the right of integrity, which ceases on the death of the author.

D. Immigration

1. In General

Since October 1945, more than 7.5 million people have migrated to Australia. In 2019, 29.7% of Australia's 25.37 million people were born outside Australia, Furthermore, New Zealand has been the major source country for settlers since 2009.

From 1945 to 1972, Australian governments pursued a policy of actively encouraging the immigration of individuals and families of European race by the maintenance of immigration offices in a number of countries and the provision of assisted passages to Australia. During 1972 to 1996 the government commenced a review of Australia's immigration requirements and made interim reductions in the annual immigrant targets. Preference was given to immigrants that were close family relatives (defined as spouses or children) of individuals that had already settled in Australia, while second preference was given to individuals that possess a skill, trade or profession of which there is a shortage in Australia. The third preference was to immigrants that are more distant relatives of persons already settled in Australia. Immigrants were also allowed to settle in Australia on humanitarian grounds (for example, because they were refugees). From 1996, there was a growing emphasis on individuals that have a skill, trade or profession of value to the Australian economy.

The number of permanent settlers arriving in Australia between 2018 and 2019 totaled 157,560. Migrants, including temporary migrants, came from over 180 countries, with South and Central Asia being the highest region for immigration. Most were born in one of the following four countries: India, China, the United Kingdom, and New Zealand.[56]

Today, applications for migration to Australia are assessed against requirements set out in the Migration Act and Regulations. There are different criteria for different categories of visas, with the criteria established in order to meet Australia's national interests and needs. Currently, permanent migrants enter Australia via one of two distinct programs — the Migration Program for skilled and family migrants or the Humanitarian Program for refugees and those in refugee-like situations. The government determines the criteria and sets the number of people who can enter under these programs on an annual basis. This is informed following broad public consultations with stakeholders, including business and community groups from all states and territories.

Australia's Migration Program is separated into three streams: the Skill stream; the State Specific Eligibility stream; and the Family stream.

Different visas are available under the Skill Stream in the form of points tested migration for skilled workers who have and who do not have an employer sponsoring them. There is also a separate business skills migration subcategory which seeks to attract migrants with a proven track record of success in business innovation or investment who will use their skills and experience to engage in business innovation or investment activities in Australia. Business skills migrants are required to obtain an ownership interest in an eligible business and actively manage that business or maintain a specified level of investment activity in Australia.

The Family stream allows for the migration of immediate family members of Australian citizens, permanent residents or eligible New Zealand citizens, such as partners or fiancés and dependent children. Places are also available for other family members, including parents, orphan relatives, aged dependent relatives, carers and remaining relatives.

The Special Eligibility stream is the smallest stream, covering those in special circumstances that do not fit into the other stream. This may include permanent residents returning to the country after a period away.

Australian states and territories are also able to offer visas to skilled workers under the Regional Sponsored Migration Scheme in order to address skill shortages in regional Australia and attract overseas businesspeople in different areas of the country.

2. Significant Investor Visas

The Significant Investor Visa provides a pathway for migrants who invest more than A$5 million in certain Australian investments and opening the door to more investment opportunities for Australian businesses.[57] The new visa falls within the business innovation and investment class of visas and seeks to provide a boost to the Australian economy and to compete effectively for high-net-worth individuals seeking investment migration. For migrants, the Significant Investor Visa has a number of advantages over other types of visas including that they do not need to satisfy the innovation test and there are no upper age limits. There are also no English language threshold requirements for applicants of the new visa. The visa provides work, travel and study rights to the applicant as well as to their immediate family.

Applicants with a successful business and/or investment career, may be eligible to obtain the visa by investing A$5 mil-

[56] 3412.0 — Migration, Australia, 2018–19, https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/3412.0Main+Features12018-19?OpenDocument.

[57] Australia in the Asian Century White Paper 2012, The Australian Government, http://asiancentury.dpmc.gov.au/White-paper.

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lion into complying investments for a continuous period of four years from the grant of the visa. Complying investments are:

(i) Australian government bonds;

(ii) Australian Securities and Investment Commission regulated managed funds with a mandate for investing in Australia (this includes wholesale unregistered schemes); and

(iii) Direct investment into Australian proprietary companies.

For an ASIC regulated managed fund to qualify as a complying investment, it must be limited to categories of investments specified by the Minister in a legislative instrument in writing. These categories include:

(i) Infrastructure projects in Australia;

(ii) Cash held by Australian authorized deposit taking institutions;

(iii) Bonds issued by the Commonwealth Government or a State or Territory government;

(iv) Bonds, equity, hybrids or other corporate debt in companies and trusts listed on an Australian stock exchange (this includes shares in ASX listed entities);

(v) Bonds or term deposits issued by Australian financial institutions;

(vi) Real estate in Australia; and

(vii) Australian agribusiness.

Each successful applicant must be nominated by an Australian State. Queensland has indicated that, for it to nominate an applicant, the applicant must invest 30% of the A$5 million (i.e., A$1.5 million) Queensland Treasury Corporate Bonds. By contrast, states like New South Wales and South Australia have announced themselves as having no investment requirement, with the latter requiring applicants to commit to living in that state.

The Significant Investor Visa provides an invaluable investment pipeline that will enable Australian businesses to benefit from the immense wealth that has accumulated in Asia over recent decades. The new class of visa presents exciting opportunities for Australian fund managers, in particular those investing in infrastructure, real estate and agribusinesses. It will also benefit the providers of the underlying investments of the managed funds and private wealth management businesses.

E. Labor Relations

1. Fair Work Act

The Fair Work Act 2009 (the "FW Act") is the primary piece of Federal legislation relating to labor relations in Australia. The FW Act regulates the employment of employees who are employed by incorporated entities (whether Australian or foreign registered entities) that carry on trade or commerce in Australia. The FW Act establishes regulatory authorities and minimum conditions of employment, provides for negotiation of industrial instruments, and provides for rights and obligations with respect to dismissal.

2. Oversight and Enforcement Bodies

The FW Act establishes a tribunal called Fair Work Australia (FWA), which oversees the operation and enforcement of the FW Act. FWA also has broad powers under the FW Act to become involved in collective bargaining to assist parties in the process of agreement-making. FWA will also be responsible for setting minimum wages, which, apart from the federal minimum wage, are contained in Modern Awards. Enforcement duties with respect to minimum entitlements are carried out by the Office of the Fair Work Ombudsman.

3. Minimum Conditions of Employment

The FW Act sets out the 10 minimum terms and conditions of employment, called the National Employment Standards (NES), for all employees covered by the federal system. The NES protect the following entitlements:

(i) Maximum weekly hours of work;

(ii) Parental leave;

(iii) Personal/carer's leave;

(iv) Long service leave;

(v) Notice of termination and redundancy;

(vi) Requests for flexible working arrangements;

(vii) Annual leave;

(viii) Community service leave;

(ix) Public holidays; and

(x) Provision of a fair work information statement.

The FW Act also establishes an industry-based system of Modern Awards, which establish a further safety net of entitlements for employees. There are currently 122 Modern Awards in operation, which apply to employees engaged in a wide variety of roles in different industries. An employee whose employment is otherwise covered by a Modern Award, may be excluded from the effect of the award if he/she is a "high income" employee with a written guarantee of earnings in a prescribed form of over the high income threshold, which is currently A$175,000 per annum (as of July 1, 2024) and is indexed annually. Guaranteed income for the purposes of classifying a "high income" employee does not include superannuation, commissions, incentives, overtime (unless the overtime is guaranteed) or expense reimbursements.

4. Enterprise Agreements

The FW Act focuses on collective bargaining at the workplace level and provides for three types of enterprise agreements: single enterprise, multi-enterprise and green-fields. There is no distinction between union and non-union agreements.

Enterprise Agreements may be entered into between one or more related employers and their employees to provide flexibility around minimum entitlements at the enterprise level. Enterprise Agreements may have a nominal term of up to four years.

The FW Act introduces a number of new procedural obligations and timeframes that employers need to comply with

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when negotiating Enterprise Agreements. For example, employers must take reasonable steps to advise employees of their right to have a bargaining representative in the bargaining process.

In the event that an employer and/or its employees wish to enter into an Enterprise Agreement, the FW Act requires both sides to bargain in good faith, for example, by:

(i) Attending, and participating in, meetings at reasonable times;

(ii) Disclosing relevant information to other bargaining representatives (other than confidential or commercially sensitive information) in a timely manner;

(iii) Responding to proposals made by other bargaining representatives for the agreement in a timely manner;

(iv) Giving genuine consideration to the proposals of other bargaining representatives for the agreement, and giving reasons for the bargaining representative's responses to those proposals;

(v) Refraining from capricious or unfair conduct that undermines freedom of association or collective bargaining; and

(vi) Recognizing and bargaining with the other bargaining representatives for the agreement.

These requirements can be enforced upon application to FWA.

Where employees are members of a union, the employee has a right to be represented by that union in any negotiations or nominate another bargaining representative including themselves.

Employers, employees and their unions have a right to engage in protected and lawful industrial action (such as strikes and lockouts) during any bargaining period in relation to a new agreement.

All employees who are to be subject to the Enterprise Agreement are entitled to vote on it. The Enterprise Agreement will be approved if more than 50% of employees who cast a valid vote, vote in favor of it.

If an agreement is the subject of a successful vote, then it must be lodged with FWA within fourteen days. FWA will then conduct the "better off overall test" and ensure that the terms and conditions contained in the Enterprise Agreement are at least as beneficial as those contained in any Modern Award which is otherwise be applicable.

Once an agreement is approved, the Enterprise Agreement applies to all employees who are stated to be covered by the agreement, whether or not that employee voted for the agreement, as well as all new employees who fall within the agreement's terms. The Enterprise Agreement will operate to the exclusion of any otherwise applicable Modern Award.

5. Employment Termination

Certain employees have the ability to challenge the termination of their employment pursuant to the FW Act. The primary legislative requirement is that an employer may not terminate the services of an employee in circumstances where the termination is harsh, unjust or unreasonable.

Employees who are employed by an employer who employs fewer than 15 employees will have unfair dismissal rights after completing 12 months of service, and employees who are engaged by an employer with 15 or more employees will have rights of action after completing six months of service.

A "high income" employee who is not covered by a Modern Award is excluded from the unfair dismissal jurisdiction.

The time for making an unfair dismissal claim is 14 days from the date of termination. However, the FWA may allow a late application on certain express grounds.

The FW Act also provides that it is unlawful to terminate an employee's employment for reasons which include one or more of the following reasons:

(i) Temporary absence from work because of illness or injury of a kind prescribed by the regulations (generally an absence of less than three months in any 12-month period);

(ii) Trade union membership or participation in trade union activities outside working hours or, with the employer's consent, during working hours;

(iii) Non-membership in a trade union;

(iv) Seeking office as, or acting or having acted in the capacity of, a representative of employees;

(v) The filing of a complaint, or the participation in proceedings, against an employer involving alleged violation of laws or regulations or recourse to competent administrative authorities;

(vi) Race, color, sex, sexual preference, age, physical or mental disability, marital status, family or carer's responsibilities, pregnancy, religion, political opinion, national extraction or social origin;

(vii) Absence from work during maternity leave or other parental leave; and

(viii) Temporary absence from work for the purpose of engaging in a voluntary emergency management activity, where the absence is reasonable having regard to all the circumstances.

If an employer terminates an employee for one of these reasons, the employee can apply to FWA and then to the Federal Court or Federal Magistrates Court for legal remedies. There are no exclusions from this jurisdiction as in the unfair dismissal jurisdiction.

The "general protections" provisions in the FW Act also permit an employee, potential employee or an independent contractor to commence legal action where they have been subjected to any "adverse action" by an employer (such as termination, failure to hire, demotion or alteration of the employee's position) based on:

(i) The person's exercise of, or right to exercise, a workplace right, such as any benefit under a workplace law or a right to initiate legal proceedings or make a complaint;

(ii) The person engaging in, or not engaging in, lawful industrial activity; and

(iii) The person's race, color, sex, sexual preference, age, physical or mental disability, marital status, family or car-

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er's responsibilities, pregnancy, religion, political opinion, national extraction or social origin.

F. Accounting

1. In General

The Corporations Law details reporting and disclosure requirements that must be adhered to by all companies governed by the Law. Companies also must keep accounting records detailing their transactions and enabling the determination of their financial position. Companies must generally retain such records for seven years.

2. Accounting Periods

A company's financial year for purposes of the preparation of financial statements can be any period of up to 18 months in duration. Most companies use a financial year ending on June 30 although a substituted accounting period may be used where the company is a subsidiary of a foreign company, to align the year-end of both companies.

3. Accounting Standards

The Corporations Law requires that company financial statements (except for small proprietary companies) be prepared and presented in such a way that they show a true and fair view of the company's financial position. The financial statements must be prepared in accordance with Approved Accounting Standards. These accounting standards comply with International Accounting Standards.

G. Resources and Energy Policy

The government attaches high priority to the research and development of energy resources. To this end, the government has set up a National Energy Advisory Committee to examine and advise on aspects of energy conservation, assessment of energy resources and proposed programs for the research and development of the nation's existing and potential energy resources. The development and processing of uranium is substantially within the domain of the Australian Atomic Energy Commission.

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III. Forms of Doing Business in Australia

A business in Australia may be conducted by a sole trader, a partnership (with partners that have either limited or general liability), a company (with either limited or no liability), a branch or a trust. The regulation of partnerships, trusts and companies is controlled by the various state governments and territories.

A. *Sole Trader (Proprietor)*

A person may carry on a business under either his own name or a business name that is required to be registered in the states in which the business is conducted. All assets, both business and personal, may be attached for the payment of business debts.

B. *Partnerships*

Each Australian state and territory has a Partnership Act, which provides that each partner is an agent for his co-partners and that the liability of partners to outside parties is unlimited. In the states of Tasmania, Western Australia, Queensland and New South Wales there is legislation for limited partnerships, in which at least one partner must be fully and personally liable for all debts of the partnership. There is no provision for limited partnerships under the laws of the other states.

The general law as to partnerships is to be found in the rules of common law and equity, which continue in force, except to the extent they are inconsistent with the express provisions of the state Partnership Acts. The Partnership Acts provide rules governing the relationship of partners to each other and of partners to persons dealing with them. A partnership may include a company or companies as partners.

A partnership is not required to be registered unless it is a limited partnership. A partnership operating under a business name is required to register the business name in the relevant state.

C. *Corporate Structures*

Every Australian company is issued with a single 11 digit identifying number (Australian Business Number or ABN). This number is required to be included on the company's common seal, every public document signed by the company (e.g., business letters, invoices) and all negotiable instruments signed (e.g., checks, letters of credit).

1. Limited Liability Company

The Corporations Law provides for companies limited by shares and also for companies limited by guarantee. The usual form adopted is a company limited by shares. Companies that offer shares for sale to the public and/or invite loans from the public are commonly referred to as public companies. These may or may not be listed on a stock exchange. A proprietary company is a company with fewer than 50 non-employee shareholders that does not invite subscription from the public. A proprietary company is normally adopted as the form for a subsidiary whether of an Australian or overseas company (public or proprietary), as it is simpler to incorporate and administer than a public company. Approximately 90% of the companies operating in Australia are proprietary companies.

A proprietary company is classified as "small" or "large" determined by whether:

(i) The annual consolidated gross operating revenue of the company and entities controlled by it is less than A$50 million;

(ii) The consolidated gross assets at year-end of the company and its controlled entities are less than A$25 million; and

(iii) The company and its controlled entities employ less than 100 persons at year-end.

If two of the criteria above at (i) to (iii) are satisfied, the company is a "small" proprietary company. This results in reduced financial reporting requirements.

"Large" proprietary companies are required to prepare audited group and parent company financial reports and file them with the Australian Securities and Investment Commission (ASIC).

Companies limited by guarantee are a special form of company without share capital, in which the members agree to pay their share of the liabilities of the company in the event of a winding-up, to the extent of the amount specified in the memorandum of association. This form of company is usually used as the legal form for nonprofit organizations, foundations and charitable institutions.

Except where a prospectus indicates a minimum amount of capital that must be subscribed, there is no minimum amount of capital required before a company may commence business.

Shares may be issued either for cash, or in consideration of property transferred or services rendered to the company. Except in the case of certain employee share plans, a company may not deal in its own shares or give financial assistance for the purchase of its shares.

A proprietary company that has either an overseas corporation or a public company as a shareholder, is required to file each year, for public inspection with the Australian Securities Commission (ASC), in addition to an annual return (giving details of shareholders, directors and registered charges), a copy of its balance sheet, and a profit and loss statement in the same form as is required from a public company.

The liability of a member of a company is limited to the amount uncalled on his shares or guarantee.

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2. Unlimited Company

An unlimited company is a company formed on the principle that no limit is placed on the liability of its members.[58]

3. No Liability Company

A no liability company is a company in which the acceptance of a share does not constitute a contract to pay calls or to make any contribution towards the debts and liabilities of the company. Australian mining companies are often incorporated as no liability companies. Shares are forfeited if a call is not paid by a specified date.[59]

4. Foreign Company

A company incorporated outside Australia must register under the Corporations Law as a "foreign company" to carry on business in any state or territory of Australia. The foreign company must appoint a local agent to enable registration with the ASC. The foreign company must file its annual accounts with the Australian Securities and Investments Commission (ASIC).[60]

5. Management

Any alteration to the constitution requires the consent of a general meeting of members.

The members appoint directors whose powers are normally specified in the company's constitution. Companies must have at least one director that is a resident of Australia.

Similarly, the members appoint an auditor (unless the company is a small proprietary company and all members vote that an auditor need not be appointed) to audit the accounts and records of the company, and to report on the company's balance sheet, and profit and loss account.

Most companies are also required to have at least one secretary. The secretary must be a natural person resident of Australia. If a secretary is not required, a resident director may take on the secretarial obligations.

The members at a general meeting will declare dividends, but most constitutions provide for the directors to declare an interim dividend. Typically, the members approve a director's motion for a dividend. The constitution normally provides that a motion for a dividend may be amended to reduce the dividend proposed, but not to increase it.

D. Branch of a Foreign Corporation

A foreign company may operate in Australia as a branch, rather than through a subsidiary.

One month from beginning branch operations in Australia, the company must register as a "foreign company" with the Australian Securities and Investments Commission (ASIC) in the state where it has started operations. At the time of registration, the following documents must be submitted:

(i) The company's constitution;

(ii) The company's current certificate of incorporation in its home jurisdiction;

(iii) A reservation of name;

(iv) The name, private address, place and date of birth of each director; and

(v) The name of an agent.[61]

E. Trusts

Business and investments may also be undertaken by a trustee of a trust, which holds the assets of the trust on behalf of the trust's beneficiaries. A trust is a common structure for investment in the funds management and superannuation industry and is the entity of choice in the context of closely held family investment structures due to the favorable tax treatment of income derived by these types of entities (see IX.A., below).

Three forms of trusts are commonly referred to in Australia: discretionary trusts; unit trusts; and fixed trusts.

A trustee of a discretionary trust has powers to determine which object of the trust will benefit from the trust income and capital. The trustee may provide that, where a trustee fails to exercise his discretion, the income and/or capital is distributed to specified beneficiaries in fixed proportions.

In what is generally referred to as a unit trust, unitholders are allotted (or acquire) units in the trust in a similar fashion to shares in a company. Those units provide the unitholders with a fixed right to the income and corpus of the unit trust. The unit trust also may allow the trustee to determine whether any part of the income of the unit trust for a particular year should be accumulated rather than distributed to the unitholders. The units in a unit trust are normally capable of being sold or redeemed for consideration.

Under a fixed trust, the trustee has no discretion as to how the income or capital of the trust is distributed or as to whether any part of the income of the trust is accumulated. The beneficiaries have rights to the corpus and income in fixed percentages. These types of trusts are commonly found in dealing with bequests. Unlike the unit trust, rights under a fixed trust are typically not readily transferable.

The regulatory requirements relating to a trust are generally very limited. Two exceptions of note are widely offered retail unit trusts (which are subject to corporations law and certain ASIC requirements — see II.C., above) and superannuation funds (see IX.B., below).

F. Joint Ventures

Technically, joint ventures are not a separate business form. They are merely a contractual arrangement between other parties (each of which must be one of the types of entities referred to above). As such, joint ventures are not discussed as a separate type of investment entity — although some contractual arrangements that may be considered a joint venture by reference to overseas concepts are in fact taxed as partnerships in Australia due to the breadth of the partnership definition for tax purposes (see VIII., below).

[58] Corporations Law, Parts 2.4 and 5.6, Div. 2.

[59] *Id.*, Part 4.3.

[60] *Id.*, Part 4.1, Div. 2.

[61] *Id.*, Secs. 341, 345, and 346.

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G. Business Registration

Firms, individuals and corporations must register in each state in which they have a place of business and carry on business under a business name. The Business Names Act provides that, without registration, a person must not, either alone or in association with other persons, carry on a business unless the name under which he does so consists of the full name of the person and each other person in association with whom that person is carrying on the business, including his or their Christian names or initials, without any addition. A person or firm not resident in a state is not regarded as carrying on business within that state if it merely employs travelers in that state that have no authority to make contracts on behalf of their employer.

To register a business name, a formal application is required, and a fee is charged. The registration is then current for three years and may be renewed for further terms of three years on payment of the renewal fee. Where all persons registering a business name reside outside a state, an agent resident in the state must be appointed.

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IV. Principal Taxes

A. *Sources of Authority in Tax*

The Australian Constitution prescribes the federal power to tax and includes priority in the collection of federal taxes. Customs and excise duties are exclusively federal taxes, the states being debarred by the Constitution from levying such imposts. The states have the power to levy any other residual types of taxes.

The main federal taxes are income tax, goods and services tax, fringe benefits tax, and excise duty. The main state taxes are stamp duties, motor taxes and licenses, payroll tax, land tax, racing and betting taxes, and liquor and poker machine licenses.

Taxation on various forms of income represents the majority of Australia's taxation revenue. Personal income tax is the largest component of Australia's tax revenue, at around 47% for 2019–20, followed by corporate income tax at 18% of total tax revenue in 2019–2020.[62]

1. Legislative Process

a. In General

A federal constitutional framework was adopted in 1901 (see I.B., above).

Within this constitutional framework, Australia's legal institutions are split into the legislative, judicial and executive arms of government. Each is intended to operate independently of one another.

The legislative powers of the Federal, or Commonwealth, Parliament are listed in the Australian Constitution. Very broadly, the Commonwealth Parliament is responsible for a specified list of issues of national importance (and the States retain responsibility for all other areas). The process for the enactment of legislation at the federal level of government (which includes income tax legislation) is as follows:

(i) Proposed legislation (referred to as a "bill") is introduced and read in the House of Representatives.

(ii) If it is passed by the House of Representatives, the bill is then sent to the Senate. If the Senate either rejects the bill or proposes amendments to its contents, it is sent back to the House of Representatives for reconsideration. This process by which a bill can be sent back and forth between both Houses of Parliament is quite common when different political parties control each House. The Coalition currently controls both Houses of Parliament by way of allegiances with various parties.

(iii) Once approved by the Senate, a bill is sent to the Governor General for Royal Assent. Royal Assent is invariably given as a matter of course.

(iv) While it is possible to enact retrospective legislation, new legislation usually applies from when it is first proposed or from when it receives Royal Assent.

[62] See Parliament of Australian website: aph.gov.au/About Parliament.

Each state is also divided into local government districts, which receive their delegated authority from their respective state governments. Local governments usually enact regulations relevant to community issues.

Reflecting the multiple taxes, at both the federal and state level, there are multiple taxing statutes. However, as a rule, for each tax there is one principal legislative instrument operating as a single code for the relevant tax. Each of these are referred to in B., below.

b. Legislative Documents Used to Interpret the Law

The purpose of statutory interpretation is to *"give to the words of a statutory provision the meaning which the legislature is taken to have intended them to have."*[63] When legislation is introduced as a Bill into the relevant lower house of parliament (e.g., House of Representatives for federal legislation like income tax), it is accompanied by an Explanatory Memorandum (EM) that can be used for the purposes of interpreting the legislation, to the extent it is not clear from the legislation itself. The EM does not replace the legislation but can be used as an aide for the purpose of understanding its purpose. In addition, reference can be made to the speech made by the Minister of Parliament when moving the motion that the Bill be read for the second time and any relevant report or other document laid before Parliament before a provision is enacted.[64]

c. Constitutional Challenges

The Federal Government's power to raise revenue is found in section 51(ii) of the Constitution. Constitutional appeals by taxpayers are possible, but rarely successful. Section 55 provides that laws imposing taxation *"shall deal only with the imposition of taxation, and any other provision … shall have no effect."* With the objective of complying with this constitutional requirement, one Act has been enacted to impose tax, and another Act sets the rate (see IV.B. below.)

2. Administrative

The administration of the legal system rests with the executive arm of government, which includes services such as the police force and the Australian Tax Office (ATO). The administration of the income tax is vested in the Commissioner of Taxation and his or her Deputy Commissioners. The Commissioner is head of the ATO, which is a branch of the Australian Treasury. The Executive also provides the source of various proposals for changes in legislative policy. It is common, especially in the context of taxation, for the ATO or Treasury to recommend changes in law, which may be taken up by the Government and enacted as legislation via the process set out above. The Executive branch also oversees a range of administrative tribunals. The largest of these, the Administrative Appeals Tribunal (AAT), has the jurisdiction to review decisions of the Commissioner of Taxation. In most cases, a taxpayer may choose between commencing income tax proceedings in the AAT or in the Federal Court of Australia. The AAT conducts merits-based review but does not exercise judicial power.

[63] *Project Blue Sky v. ABA* (1998) 194 CLR 355.
[64] Acts Interpretation Act 1901, sec. 15AB.

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a. Rulings

There are three types of legally binding rulings issued by the Commissioner of Taxation: (i) Public Rulings (which includes Tax Rulings (TR), Tax Determinations (TD), Product Rulings and Class Rulings); (ii) Private Rulings; and (iii) Oral Rulings.

(1) Public Rulings

The Commissioner publishes general rulings and determinations, described as "public rulings" (the TR and TD series), that represent the considered and decided ATO position on the interpretation of income tax and fringe benefits tax laws. A public ruling must be published in the *Commonwealth Gazette*.

A public ruling may be issued to explain how an income tax law (including withholding tax, mining withholding tax, franking deficit tax, and the Medicare levy) or a fringe benefits tax law applies to a person or class of persons in relation to an arrangement or class of arrangements. It may be a ruling on the way in which a discretion of the Commissioner will be exercised. Although the large number of rulings and determinations published by the Commissioner before July 1992 are not legally binding, the ATO is seen as being "administratively bound" by them. The Commissioner has indicated in Practice Statement Law Administration PS LA 2008/3 that, where he stands by his administratively binding advice, then a taxpayer who relies on it will be protected from having to pay the primary tax, shortfall penalties and interest charges which may otherwise apply. Where the Commissioner does not stand by his administratively binding advice, then a taxpayer who relies on it in good faith will be protected against the shortfall penalty and interest charge but remains liable for the primary tax due.

The Commissioner may withdraw a public ruling, in whole or in part, at any time by publishing a notice of withdrawal in the *Commonwealth Gazette*. If a new public ruling is inconsistent with an earlier public ruling, the earlier ruling is taken to be withdrawn to the extent of the inconsistency. If a public ruling is withdrawn, it continues to apply to arrangements entered into before the withdrawal, but it does not apply to arrangements entered into after the withdrawal.

Product rulings are another typical form of binding public ruling. They deal with the availability of tax benefits (income tax or fringe benefits tax) from so-called tax-effective investments such as timber, vineyard, olive, and film projects. A product ruling is binding only to the extent the arrangement is implemented as proposed in the application for the ruling. The ATO accepts no responsibility in relation to the commercial viability of a project, whether charges are reasonable or represent industry norms, or whether project returns will be achieved or are reasonably based.

Class rulings are another "niche" type of public ruling that allow the Commissioner to provide legally binding advice in response to a request from an entity seeking advice about the application of a tax law to a specific class of persons in relation to a particular arrangement. Situations where a class ruling may be given include where an employer seeks advice about the tax consequences of an employee share acquisition plan for individual employees or of a bona fide redundancy scheme for a class of employees, or where a company seeks advice about the tax consequences for its shareholders of a restructure of the company or a split or consolidation of its shares.

A public ruling must be applied by the Commissioner, the AAT and the courts so as to give a taxpayer the benefit of the treatment provided for in the ruling if that treatment produces less final tax under the assessment. On the other hand, if the law (apart from the public ruling) is found to be more favorable to a taxpayer in the determination of final tax, the law will prevail.

Taxpayers who fail to follow a public ruling may face penalties for a failure to take "reasonable care" in discharging their tax obligations and be subject to a 25% penalty, computed by reference to the tax underpaid. Further, a failure to follow a public ruling may be relevant in determining whether a taxpayer has a "reasonably arguable position." A public ruling will be treated as "authority" that must be weighed against the authority of decisions of courts and the AAT.

Note that public rulings are usually first issued in draft form but that draft rulings are not binding on the Commissioner.

(2) Private Rulings

Taxpayers may apply for binding private rulings. The effect of such a ruling is much the same as a public ruling. However, only the person named in the private ruling can rely on the ruling (and that person has review rights of objection and appeal in relation to the ruling). Furthermore, failure to follow a private ruling unfavorable to a taxpayer will give rise to a 25% penalty whereas failure to follow a public ruling is merely one of the grounds to be weighed in the assessment of penalties.

(3) Oral Rulings

Individuals may apply for an oral ruling on the way in which a relevant provision applies to a particular scheme. The Commissioner of Taxation has provided guidance in PS LA 2008/3 as to the manner in which a taxpayer may apply for an oral ruling.

b. Advice

The Commissioner is also able to provide non-binding advice as to the tax treatment of a particular transaction. The relevant provisions are set out in Division 361 of Schedule 1 of the Taxation Administration Act 1953. The consequences of relying on "non-binding advice" provided under this Division is that, although the Commissioner is not legally bound by it, if the Commissioner were to change its opinion on an issue on which advice was relied upon, the taxpayer would not be liable to penalties or late payment interest for any additional tax due.

Comment: Clearly, advice that is not in the form of a binding ruling is not as "valuable" to a taxpayer. However, as there are various issues on which the Commissioner of Tax will not/cannot rule, this can be an appropriate "next best" course of action for certain issues for which some comfort from the Commissioner of Taxation is sought.

3. Courts

There are no specific "tax courts."

The judiciary is empowered with the interpretation of the legislation and regulations enacted by the various legislative bodies referred to above. The judicial system includes the High

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Court of Australia, the Federal Court of Australia, the Supreme Courts of the states, the minor state and district courts, and the Industrial Relations Commission.

An appeal from the administrative process referred to in 2. above would generally be dealt with by the Federal Court (single judge), with a possible appeal to the Full Federal Court and then to the High Court. One exception is where the issue requires a merits-based review/is a matter of fact (rather than law) in which case it may be referred to the Administrative Appeals Tribunal (AAT) for a determination before the issue is considered by the Federal Court (should there remain a question of law to be considered).

B. Main Taxes

1. Income Tax (Which Includes Capital Gains Tax)

Income tax was first imposed by the federal Parliament with respect to income derived during the year ended June 30, 1915. Before that year, and up until the year ended June 20, 1941, the states had imposed income taxes. For income derived subsequent to July 1, 1941, legislation was enacted that had the effect of making the federal government the only income taxing authority in Australia. Income taxes imposed by the states were suspended from June 30, 1941, conditional on the Commonwealth making grants to the states to compensate the states for vacating the income tax field. Subsequent state legal challenges to the federal government's sole taxing authority were unsuccessful.[65] The most comprehensive inquiries and reports on the taxation system operative in Australia were commissioned in 1972 and presented to Parliament in 1975.[66]

The statutes comprising the income tax law in Australia are federal enactments.

The Income Tax (Rates) Act 1986 declares the rates of income tax payable on "taxable income." Taxable income is calculated according to the principles set in the Income Tax Assessment Act 1936 (ITAA 1936) and Income Tax Assessment Act 1997 (ITAA 1997). These Acts effectively include a capital gains tax — bringing to tax various gains from various defined events happening to (e.g., the disposal of) capital assets. ITAA 1997 was enacted as part of a "Tax Simplification Project" to rewrite the old income tax code of ITAA 1936 into simpler language. Unfortunately, this process is taking longer than expected. ITAA 1936 and ITAA 1997 will continue to operate together until the rewrite of ITAA 1936 is completed.

In general terms, taxable income consists of "assessable income" (other than income specifically exempted) less "allowable deductions."

There is no separate corporate tax. Income tax applies to (resident and nonresident) individuals, companies, partnerships and trusts.

Generally, a resident of Australia is assessable on income derived directly or indirectly from all sources, whether in or out of Australia. Nonresidents are generally assessable on gross income derived directly or indirectly from a source in Australia. A detailed consideration of income tax is set out in section V., below.

The Medicare Levy Act, 1986, imposes a Medicare levy on the taxable income of Australian resident individuals (and certain trustees). It does not apply to companies. The purpose of the levy is to finance the public health system, although there is no relationship between the amount of the Medicare levy that a person pays and services received. The levy is purely a general funding mechanism. Most taxpayers pay a Medicare levy of 2% of their taxable income. For 2024–5, this levy is not payable by single individuals on taxable income of A$27,222 or less. It is also not payable by families (including sole parent families) with taxable income of A$45,907 or less (increased by A$4,216 for each dependent child).

To encourage the use of private health insurance, an additional surcharge of between 1% and 1.5% applies to taxpayers who do not have private health insurance. The surcharge is levied on individuals with a taxable income of more than A$97,000 and families (including sole parent families) with a combined taxable income of more than A$194,000 (increasing by A$1,500 for each dependent child after the first child (if the taxpayer has two or more children)) who do not hold the required level of private health insurance. The surcharge rates are:

- 1% for Tier 1 ($97,001–$113,000 for singles; $194,001–$226,000 for families);
- 1.25% for Tier 2 ($113,001–$151,000 for singles; $226,001–$302,000 for families);
- 1.5% for Tier 3 (over $151,000 for singles; over $302,000 for families).

The Income Tax (Dividends, Interest, and Royalties Withholding Tax) Act 1974 imposes tax on certain dividends, interest and royalties derived by nonresidents and certain other persons. (See VI.B.3., below.)

The International Tax Agreements Act 1953 incorporates within Australian domestic law international tax agreements entered into by Australia with other jurisdictions (referred to as "Double Taxation Agreements" or "tax treaties"). For the texts and status of Australia's tax treaties, see International Tax Treaties. With the exception of Australia's general anti-avoidance provisions, these rules override the operation of Australia's domestic tax legislation contained in ITAA 1936 and ITAA 1997. (See XV., below.)

The Taxation Administration Act 1953 provides for the administration of Acts relating to taxation and for purposes connected therewith.

2. Customs Duty

Customs duty is levied by the federal government on many goods imported into Australia.

Customs duty serves the dual purpose of raising revenue, and of affording protection to Australia's secondary industries. Where goods similar to the goods imported are not produced in Australia, it is sometimes possible to obtain a by-law ruling to allow the duty-free importation of goods.

The duties are payable at the time of clearance of the goods through Customs and are normally *ad valorem* duties.

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[65] See *New South Wales (State) v. Commonwealth* (1957) 6 AITR 440.

[66] These reports were: (i) The Mathews Committee Report — the effect of inflation on taxation (chairman: Professor R.L. Mathews), May 22, 1975; and (ii) The Asprey Report — public enquiry into the Australian Taxation System (chairman: Justice Asprey), Jan. 31, 1975.

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Special duties may be imposed on a quantity basis to curtail "dumping" activities.

To establish closer economic ties, Australia and New Zealand have reached an agreement whereby many goods traded between the two countries are free of customs duty or subject to duty at a reduced rate.

The international harmonized commodity description and coding system allows for international conformity in the description of goods and applies to all parties involved in international trade, including importers, exporters, and shipping and insurance companies.

The Canberra Customs Service has made an administrative decision whereby importing companies paying royalties to related parties in relation to goods bearing a trademark are required to add the royalty payment to the invoice value of the imported goods to the extent it is excluded.

It should be noted that the Customs Service is very active in undertaking audits; penalties, where applied, may be as high as 200% of the duty avoided.

3. *Excise Duty*

Excise duty is levied by the federal government on the production in Australia of certain "luxury" items (e.g., liquor, tobacco, cigarettes and petroleum). The duty is levied at a fixed rate per proof liter, kilogram or liter, where applicable. Similar goods imported into Australia bear a corresponding impost (customs duty).

4. *Payroll Tax*

Payroll tax is levied by all states. Each state has an exemption level below which the total salaries, wages, fringe benefits, superannuation contributions, commissions and allowances paid by an employer are not subject to payroll tax. Amounts above the exemption level are liable for payroll tax at rates from 0.025% to 6.85%, subject to a tapering allowance that ceases after a ceiling limit.

In addition, each state has complex provisions that may apply to an employer that is a member of a group.

In the state of New South Wales, for the income years covering July 1, 2020 to June 30, 2022, annual payrolls of A$1,200,000 or less are exempt and payrolls above this limit are subject to a rate of 4.85%.[67]

The New South Wales Payroll Tax Act includes in the amount of wages subject to payroll tax certain payments made to employment agents interposed between employers and employees, and contractors.

The use of an interposed family trust, company, or partnership may be disregarded for payroll tax purposes; payments to that entity are subject to payroll tax.

Fringe benefits paid by an employer, to or on behalf of an employee, are to be treated as wages and are subject to payroll tax.

As an anti-avoidance measure, New South Wales, Victoria, South Australia, Queensland, Tasmania, Northern Territory and the Australian Capital Territory impose tax on remuneration paid to various contractors and subcontractors under contracts for the provision of services, which do not constitute an employee/employer relationship. However there are some exemptions to ensure that remuneration paid to an independent party who genuinely offers its services to the public is exempt from payroll tax. Relevantly, contracts to perform work are exempt from payroll tax if:

(i) The performance of the work is ancillary to the supply of goods;

(ii) The services are not ordinarily required by the business and are rendered by a person that ordinarily renders such services to the public;

(iii) The services are of a kind ordinarily required for less than 180 days per year;

(iv) The services are supplied by a person for a period that does not exceed 90 days per year;

(v) The services are rendered by a person to the general public; or

(vi) A contractor employs other persons to perform the work.

Payroll tax is collected monthly and is subject to an annual adjustment at the end of each financial year.

5. *Land Tax*

Land tax is levied by the state governments and the Australian Capital Territory at varying rates of up to 2.75% on the unimproved capital value of land. Land tax is levied annually in all states, and quarterly in the Australian Capital Territory, and is payable by the owner of the land or, in the case of the Australian Capital Territory, by the lessee. Where the land is the owner's principal place of residence, an exemption from land tax may be available. Exemptions from land tax may also be available in some jurisdictions where the land is used primarily for primary production or land being used by not-for-profit organizations, hospitals or religious organizations.

Land held by trusts in certain circumstances may be subject to different land tax rates from normal rates. For instance, in New South Wales, trusts which are classed as special trusts (e.g., discretionary trusts and certain unit trusts) do not qualify for the general rate tax-free threshold. A special trust is assessed at the rate of 1.6% on the combined taxable value of the land up to the premium land tax threshold of A$4,616,000 (with the premium land tax threshold rising to A$5,026,000 in 2022) and then 2% thereafter. In Victoria there is a surcharge tax rate that applies to certain trusts with landholdings in Victoria with a value of at least A$25,000.

Jointly owned land or, in the case of a corporation, land owned by another corporation owned or controlled by the first corporation, is subject to special grouping provisions and tax may be payable on an aggregate value.

6. *Land Tax Surcharge for Foreigners*

Some states charge surcharge land tax on land owned by a foreign person.

In Victoria, an absentee owner surcharge applies to Victorian land owned by an absentee owner. This surcharge is 2%. The absentee owner surcharge is an additional amount that ap-

[67] See rates at: https://www.revenue.nsw.gov.au/taxes-duties-levies-royalties/payroll-tax/rates-and-thresholds.

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plies over the general land tax and trust surcharge rates. In Victoria an absentee owner includes:

(i) An absentee individual: a person who is not an Australian or New Zealand citizen with a Special Category Visa (Subclass 444), or a permanent resident of Australia, who does not ordinarily reside in Australia, and was absent from Australia on either the December 31 of the year prior to the land tax year or for at least six months in the calendar year preceding the land tax year;

(ii) An absentee corporation: a corporation incorporated outside Australia or a corporation in which an absentee person, or that absentee person together with another absentee person, has a controlling interest; or

(iii) A trustee of an absentee trust: a trust that has at least one absentee beneficiary.

An exemption from absentee owner surcharge may be available for absentee corporations or trusts that are Australian based, make a make a significant contribution to the economy and community (by conducting a commercial operation in Victoria that engages local labor and uses local materials and services) and exhibit good corporate behavior.

Foreign person surcharges also apply in the following instances:

(i) A foreign person who owns residential land in New South Wales must pay a surcharge of 2% p.a. The surcharge must be paid on the taxable value of all residential land owned as of December 31 each year including the person's principal place of residence. The surcharge is in addition to any land tax already paid. Individuals are taken to be a foreign person in New South Wales if they are not an Australian citizen or ordinarily resident in Australia. New Zealand citizens who hold a special category visa will not be taken to be a foreign person if they were present in Australia for 200 or more days of the calendar year preceding the relevant land tax year. A foreign person can be an individual, corporation, trustee of a discretionary trust with a foreign person beneficiary, trustee of a trust in which foreign persons (individually or in aggregate) hold a substantial interest, beneficiary of a land tax fixed trust, government, government investor or a partner in a limited partnership.

(ii) An absentee (foreign) individual, a foreign company and a trustee of a foreign trust that owns land exceeding a total taxable value of A$350,000 in Queensland must pay a surcharge of 2%.[68] The surcharge is not paid on the total taxable value of the land, but only that amount exceeding A$350,000 which is owned as of June 30 each year. From the 2020–21 tax assessment year, the Queensland Revenue Office may consider ex gratia relief from the surcharge for foreign entities that make a significant contribution to the Queensland economy and community. The surcharge is in addition to any land tax already paid. An individual is considered to be an absentee[69] individual when they are not an Australian citizen, holder of a permanent Australian visa, or ordinarily resident in Australia, and were either outside of Australia on June 30 prior to the land tax year or have been away for more than six months over the preceding 12 months to the land tax year. A company is considered a foreign company where it is incorporated outside Australia or foreign persons or related persons have at least a 50% controlling interest in the company. A trust is taken to be a foreign trust where at least 50% of the interests are held by any of the following or a related person to any of the following: a foreign company, a trustee of a foreign trust, or an individual who is neither an Australian citizen nor a permanent resident.

(iii) A foreign person who owns residential land in the Australian Capital Territory must pay a surcharge of 0.75% p.a. The surcharge must be paid on the average unimproved value of all residential land owned on the first day of each land tax quarter, excluding the person's principal place of residence. The surcharge is in addition to any land tax already paid. A foreign person can be an individual, company or a trustee of a foreign trust. Individuals are deemed to be a foreign person provided they are not any of the following: an Australian citizen or permanent resident, a New Zealand citizen with a special category visa, or a person ordinarily resident in Australia. A company is taken to be a foreign corporation where it is incorporated outside Australia or where one or more foreign persons hold at least a 50% controlling interest in the company. A trust is taken to be a foreign trust where at least 50% of the interests are held by foreign persons or their associates. However, for a discretionary trust, a foreign person can only be taken to hold a controlling interest if the person is specifically identified in the trust deed as a person to whom distributions may be made.

A trustee of a trust that owns land in South Australia must pay a surcharge rate of land tax of up to 0.5% more than the general land tax rates from July 1, 2020. The surcharge land tax rate is not paid on the total taxable value of the land, but only that amount exceeding A$25,000 that is owned as of June 30 each year, except for land that is otherwise exempt from land tax (i.e., principal place of residence and primary production land). Certain trusts are excluded from the surcharged trust

[68] See, https://www.qld.gov.au/environment/land/tax/calculation/absentees.

[69] Land Tax Act, 2010, Sec. 31: "**Meaning of absentee**

(1) An *absentee* is a person who does not ordinarily reside in Australia.

(2) An *absentee* includes a person who —

(a) can not satisfy the commissioner that he or she ordinarily resides in Australia; and

(b) when ownership of the person's land is decided for this Act — (i) is absent from Australia; or (ii) has been absent from Australia for more than half of the 12-month period ending when the ownership is decided.

(3) An *absentee* does not include —

(a) a public officer of the Commonwealth or of a State who is absent in the performance of the officer's duty; or

(b) an individual (the *employee*) employed by an employer in Australia for a continuous period of 1 year immediately before the employee's absence, if the commissioner is satisfied that — (i) the employee is absent in the performance of the employee's duty for his or her employer; and (ii) the employee's absence will not be longer than 5 years; or

(c) an Australian citizen; or

(d) the holder of a permanent visa under the Migration Act 1958 (Cwlth), section 30(1).

(4) Subsection (3)(b) stops applying, for that absence, as soon as it is longer than 5 years.

(5) In this section — Australia includes an external Territory."

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land tax rates, including concessional trusts and superannuation trusts.

7. Transfer Duty

Transfer duty is imposed by the States and Territories on a considerable number of legal and commercial instruments and transactions. Tax imposts vary according to the type of document, transaction and jurisdiction concerned, but can be up to effectively 6.5% of the higher of the consideration and the property's unencumbered market value. In New South Wales, a premium transfer duty rate of 7% applies in respect of a transfer of residential property with a value exceeding A$3,194,000. Transfer duty is usually payable by the purchaser of property at law (with the exception of certain jurisdictions, e.g., Queensland, where the parties to the transaction/instrument are jointly liable). Acquisitions of property other than through purchase, where a change in beneficial ownership of the property is effected such as through a trust, lease or gift, will also be subject to transfer duty. These transactions may attract a flat rate duty. In most cases, transfer duty is imposed at *ad valorem* rates on the transfer of real property, certain business assets, transfers of motor vehicles and insurance contracts. All states and territories also impose duty at *ad valorem* rates on certain changes in legal or beneficial ownership in entities (including certain corporations and unit trust schemes) where these entities hold land or land interests (including fixtures and fixed assets). Some states (i.e., New South Wales, Western Australia, and Tasmania) also take into account the value of moveable plant and equipment. This is commonly referred to as landholder duty.

The transfer duty legislation varies between the States and Territories and reference must be made to the statute of the relevant jurisdiction to determine whether duty is payable, the rate of duty and whether an exemption applies. There are specific exemptions/concessions from duty where the relevant transaction is one between members of the same corporate group (where specific criteria are met). With that said, in the last decade, many of the Australian states and territories have enacted changes to their respective duty regimes to create greater uniformity in stamp duty legislation. Significant changes occurred during 2011, when Queensland and South Australia replaced existing land-rich regimes with a new landholder duty model more in line with other jurisdictions.

There has been considerable negotiation between the State, Territory and Federal governments regarding the abolition of a number of duties. These negotiations have resulted in various announcements regarding the staged abolition of various duties such as lease duty, hire of goods duty, mortgage duty, share transfer duty and duties on intangible business assets.

8. Foreign Purchaser Surcharge Duty

With the exception of the Northern Territory and the Australian Capital Territory, each Australian state has introduced a foreign investor stamp duty surcharge for transactions involving direct and indirect acquisitions of residential property.

In all states, the surcharge is imposed on a "foreign person," which generally includes a foreign natural person, corporation or trustee of a foreign trust. However, exactly who is included in this definition varies. For foreign natural persons all States (except for New South Wales) are consistent, applying to persons other than Australian citizens or certain New Zealand citizens (with special category visas) and other holders of certain types of permanent resident visas. In New South Wales, a person is taken to be a foreign person where they are a person other than an Australian Citizen, or an Australian permanent resident or New Zealand citizen with a subclass 444 visa who lived in Australia for more than 200 days in the 12-months period prior to the purchase date. For foreign corporations and trusts there is more variation, with New South Wales referring directly to the definitions in the Foreign Acquisitions and Takeovers Act 1975 (Cth) and other states providing their own tests.

The definition of what constitutes residential property also varies between the States. The type of property affected in each jurisdiction can be summarized as follows:

Jurisdiction	Type of Property Affected
New South Wales	Residential land which includes: • Land on which there are dwelling(s) or building(s) under construction that, when completed, will constitute one or more dwellings; • Strata lots, utility lots, or land use entitlements that relate to a separate dwelling; or • Substantially vacant land that is zoned or otherwise designated for residential or principally residential purposes.
Queensland	Residential land is land that is or will be solely or primarily used for residential purposes, where the building or part of the building that is or will be used for the residential purposes is designed or approved by a local government for human habitation by a single-family unit, which includes: • Homes and apartments (including chattels); • Vacant land on which a home or apartment will be built; • Land for residential development, such as: ◦ Smaller unit blocks, ◦ Housing subdivisions, ◦ Major developments with a residential component, and ◦ Buildings refurbished, renovated or extended for residential use.

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	Note: Residential property does NOT include land used for hotels and motels. Retirement villages and student accommodation are assessed on a case-by-case basis.
Victoria	Residential property is as follows and may be lawfully used in that way: • Land capable of being used solely or primarily for residential purposes; • Land which includes a building, or part of a building, that a person intends to refurbish or extend so the land is capable of being used solely or primarily for residential purposes; • Land: ◦ On which a person intends to construct a building so the land is capable of being used solely or primarily for residential purposes and may be lawfully used in that way, or ◦ In respect of which a person has undertaken or intends to undertake land development for the following allowed purposes: — Constructing a building so the land is capable of being used solely or primarily for residential purposes, or — Enabling another person to construct a building so the land is capable of being used solely or primarily for residential purposes.
	Note: Residential property does NOT include commercial residential premises, a residential care facility, a supported residential service or a retirement village.
South Australia	Residential land is land which the Commissioner determines, after taking into account information provided by the Valuer-General, is: • Being predominantly used for residential purposes; • Not being used for any particular purpose due to improvements that are residential in character having been made to the land; • Vacant, or vacant with only minor improvements, and the land is within a zone established under South Australian planning and development law that envisages the use, or potential use, of the land as residential.
	Note 1: The Commissioner will generally rely on Land Use Codes (LUC) to determine whether the land is residential. Land with the following LUCs will generally be residential land: • Residential (with some exceptions) (LUC 1100–1999); • Vacant Land — Urban (LUC 4100); • Vacant Land with minor improvements — Urban (LUC 4101); • Vacant Land — Rural Residential (LUC 4150); • Vacant Land with minor improvements — Rural Living (LUC 4151).
	Note 2: The Commissioner may consider land, although coded as residential, to be commercial land. Examples include hotels or other holiday accommodation.
Western Australia	Residential Property is land that is in Western Australia, and is: • Currently, or capable of being, or is intended to be, used solely or dominantly for residential purposes; • Vacant or substantially vacant, and is zoned for residential purposes; • Any estate or interest in the land described above or anything that is part of the land as a fixture.
	Note: Residential property does not include commercial residential premises, an aged care facility or a retirement village.
Tasmania	Residential property is as follows and may be lawfully used in that way: • Vacant land on which a building may be lawfully built and occupied as a place of residence; • Land capable of being used solely or primarily for residential purposes; • Land which includes a building, or part of a building, that a person intends to refurbish or extend so the land is capable of being used solely or primarily for residential purposes; • Land: ◦ On which a person intends to construct a building so the land is capable of being used solely or primarily for residential purposes and may be lawfully used in that way, or ◦ In respect of which a person has undertaken or intends to undertake land development for the following allowed purposes: — Constructing a building so the land is capable of being used solely or primarily for residential purposes, or — Enabling another person to construct a building so the land is capable of being used solely or primarily for residential purposes.

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The foreign surcharge rates in each state are 8% in Victoria, 7% in Queensland, 8% in New South Wales, 7% in South Australia, 7% in Western Australia, and 8% in Tasmania.

9. Local Taxes

Local government, or municipal and shire taxes are normally levied on the unimproved capital value of land (i.e., the land excluding any structural improvements). Water supply authorities also levy rates based on either the unimproved capital value of land or the fair average rental value of property. These values are assessed by the state valuation authorities.

10. Fringe Benefits Tax

Employers are liable for fringe benefits tax[70] (FBT) on the taxable value of noncash fringe benefits provided to employees. The benefits subject to FBT include cars, low interest loans, free or subsidized residential accommodation, goods or services sold at a discount, expenses paid on behalf of an employee, living away from home allowances, car parking, and other benefits provided to employees.

The rate of FBT is 47% for the year ending March 31, 2026. The payment of FBT is a deductible outgoing of the employer.

Determinations issued by the ATO deal with the calculation of the benefit and the record keeping requirements.

Employers are required to file annual returns for the year ended March 31. FBT is payable by quarterly installments in April, July, October, and January, based on the tax paid in the previous year. The FBT payable is the taxable value of all benefits — which is grossed up at the top marginal tax rate to account for the fact that the employee effectively receives the benefit on an after-tax basis (the taxable value is also grossed-up to account for any 10% GST tax credit entitlement that arises as a consequence of the supply of the fringe benefit — see 13., below regarding GST).

Calculation of FBT gross-up formulae

As a result of the introduction of GST, there are effectively two gross-up formulae for calculation of FBT. This is to ensure neutrality of treatment between cash salary and fringe benefits.

A 1.8868 gross-up applies to benefits, which do not benefit from a GST tax credit. This being:

$$\frac{1}{1\text{–FBT rate}} = \frac{1}{1\text{–}47\%} = 1.8868$$

This ensures the FBT is calculated on the after-tax value of the benefit to the employee.

A higher gross-up rate applies to GST-creditable fringe benefits for which the employer will receive an input tax credit of 10% of the value of the supply. For this type of fringe benefit, the gross-up rate is:

$$\frac{\text{FBT rate} + \text{GST rate}}{(1 - \text{FBT rate}) \times (1 + \text{GST rate}) \times \text{FBT rate}} = \frac{.47 + .1}{(1 - .47)(1+.1) \times .47} = 2.0802$$

The scope of the statute includes items such as private entertainment, club fees, leisure facilities and excess travel allowances. As taxable items, such items will, accordingly, become tax deductible. The tax deductibility of business travel expenses is restricted to certain prescribed rates.

Exemptions include exemptions for employee share acquisition schemes, contributions to superannuation funds, employers that are immune from income tax under international agreements, consular and diplomatic privileges and immunities statutes, motor vehicles with a load capacity in excess of one ton or designed to carry not less than nine passengers, the private use of unregistered motor vehicles, the use of an employer's equipment, benefits provided to public hospital employees, travel costs of attending job interviews, relocation costs, newspapers and periodicals, compensation for work-related injuries, work site medical facilities, occupational health and counseling benefits provided in emergencies, minor benefits, long service awards, accommodation and food provided under Australian traineeship schemes, various compassionate benefits, food provided to domestic employees, costs in traveling from a prescribed developing country for medical treatment, and staff accommodation and meals provided in religious houses. There is also a general exemption of up to A$1,000 for "in-house" benefits provided by an employer to an employee. "In-house" benefits are basically goods or services of the type that the employer is customarily in the business of providing to the public. Remote area housing benefits for employees in the primary production business area are exempt.

Employers must record and report on group certificates issued to employees the grossed-up value of fringe benefits. This reported value is included in the calculation of income tests used to determine liability for various levies, surcharges and concessions.

Small businesses (i.e., businesses with a gross income of less than A$10 million) are exempt with regard to car parking provided on the business premises subject to meeting certain parking conditions. Businesses whose aggregate fringe benefits are below an exemption threshold (A$10,664 for the year ending March 31, 2026) are exempt from recordkeeping requirements for fringe benefits and calculate their FBT liability differently, based on a base year as opposed to current year fringe benefits.

The taxable value of a fringe benefit can be reduced by:

(i) "The otherwise deductible rule," which is the hypothetical income tax deduction that would have been allowable if the employee had incurred the expenditure, provided the employer obtains documentary evidence and a declaration from the employee; and

(ii) A contribution made by the employee recipient towards the cost of the fringe benefit.

The provision of motor vehicles for private use and reimbursement for food and drink are both taxable fringe benefits.

[70] Fringe Benefits Tax Assessment Act, 1986.

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For the year ending March 31, 2026, the ATO has issued Taxation Determinations TD 2025/1 and TD 2025/2 for the purpose of determining the value of a benefit provided:

- TD 2025/1 sets the cents per kilometre rates for private use of a motor vehicle other than a car:
  - Up to 2,500cc: 69 cents/km
  - Over 2,500cc: 80 cents/km
  - Motorcycles: 20 cents/km
- TD 2025/2 sets the reasonable amounts for food and drink expenses for employees receiving a living away from home allowance. Where total food and drink expenses for an employee (including eligible family members) do not exceed the reasonable amount, substantiation is not required.

Exemptions and reductions in taxable value continue to apply as previously outlined, including the "otherwise deductible rule" and employee contributions. Employers must report the grossed-up value of fringe benefits on employee income statements, which is used for various income tests.

The recent Federal Court decision in *FC of T v. SEPL Pty. Ltd. ATF SFT Trust*[71] provides important clarification on the application of FBT to non-cash benefits provided to directors who perform active roles in the carrying on of a business. The case confirmed that directors can be considered "employees" for FBT purposes, and non-cash benefits provided to such directors were found to be "in respect of" their employment, making those benefits subject to FBT.

The case involved three brothers, directors and shareholders of the trustee company, who received exclusive use of over 40 luxury vehicles without drawing salaries. The Court found that the benefits provided to them were clearly linked to their roles as directors and their active involvement in the business, and thus fell within the scope of FBT.

This decision reinforces that the range of benefits subject to FBT remains broad, covering cars, loans, accommodation, discounted goods or services, expense payments, living away from home allowances, car parking, and other non-cash benefits. The case also confirms the connection between the benefit and employment is critical: if a benefit is provided "in respect of" employment, FBT will generally apply, regardless of whether the recipient is remunerated by salary or other means.

A general anti-avoidance provision, similar to Part IVA of the Income Tax Assessment Act, 1936 (as amended) (ITAA 1936), is included in the FBT legislation.[72]

11. Petroleum Resource Rent Tax

A resource rent tax[73] is imposed at a rate of 40% on taxable profits derived from the recovery of petroleum, but not from the Joint Petroleum Development Area in the Timor Sea. The tax assessed and paid is an allowable deduction for income tax purposes in the year of payment.[74] The tax applies to areas subject to the Petroleum (Submerged Lands) Act, except where production licenses were granted prior to July 1, 1984, and the relevant permit areas have been drawn up.

In recognition of the unique features of onshore petroleum projects:

(i) All Federal, state and territory resource taxes are able to be credited against current and future PRRT liabilities for a petroleum project;

(ii) Environmental expenditure and native title payments are deductible if they have a sufficient nexus to a petroleum project; and

(iii) Revenue generated from the sale of incidental products or from providing carbon capture and storage services are assessable if the products arise from the activities of a petroleum project.

In calculating the taxable profit, exploration expenditure incurred in relation to "designated offshore frontier areas" (prescribed remote locations) is deductible at 150% of the actual amount of the expenditure. These designated offshore frontier areas have been identified by the Government.

Petroleum subject to the resource rent tax is not subject to: (i) excise duty; or (ii) royalties.

Assessable income includes any refund of resource rent tax.[75] Interest is paid on certain refunds of resource rent tax.

12. Compulsory Superannuation and the Superannuation Guarantee Charge

The superannuation guarantee charge[76] legislates a prescribed minimum level of superannuation (retirement pension) support that employers are required to provide for their employees. Employers failing to comply with the prescribed minimum standard are required to pay a charge based on the shortfall in their superannuation support, plus an additional amount for ATO administration charges, plus a proxy for superannuation fund earnings. Any charge payable is not deductible for income tax purposes.

The prescribed level of employers' superannuation support is 12%.

An amount equal to the charge, less the ATO administrative charge, is redistributed to employees whose employers did not provide the prescribed minimum level of support. Employers are required to make the minimum level of superannuation payments for employees not later than 28 days after the relevant quarter (being October 28, January 28, April 28 and July 28 each year). Employers are also required to provide employees with a choice as to which superannuation fund they wish their superannuation guarantee contributions to be made to. Broadly, an employer is required to provide an employee with an approved choice of superannuation fund form within 28 days of the employee commencing work with the employer. Failure to provide such choice can result in a financial penalty which forms part of a superannuation guarantee charge payable by the employer.

[71] 2025 FCA 581.

[72] *Id.*, Sec. 67.

[73] Petroleum Resource Rent Tax Assessment Act, 1987 and Petroleum Resource Rent Tax Assessment Regulations 2024, registered by Treasury on August 6, 2024 and applicable years of tax beginning on or after July 1, 2024.

[74] ITAA 1997, Sec. 40-750(1).

[75] *Id.*, Sec. 40-750(3).

[76] Superannuation Guarantee (Administration) Act, 1992 and Superannuation Guarantee Charge Act, 1992.

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13. *Goods and Services Tax*

a. *In General*

Goods and services tax (GST) is a broad-based indirect tax on consumption in Australia.[77] It is imposed by the Federal Government and is conceptually similar to VAT taxes. For further research on Australia's GST system, see also the VAT Navigator.

GST at a rate of 10% applies to all goods and services that are not GST-free, input taxed or outside of the scope of the GST legislation. GST is effectively collected by enterprises on behalf of the Government. That is, it is imposed on various supplies made by registered entities (or those required to register) and must be paid over by those entities making any such taxable supply to the Government (the Australian Taxation Office). However, GST is effectively a tax on consumption in the sense that liability to GST can be passed onto consumers by way of higher prices (i.e., prices are "grossed-up" for the 10% GST). There is no gross-up at law. It is a matter for negotiation between the parties and is commonly dealt with contractually.

The concepts of "supply" and "consideration" are defined very broadly in the GST law, and have also been interpreted very broadly by the courts.

Namely, a "supply" is defined as "any form of supply whatsoever," and includes (non-exhaustive) the following:

- A supply of goods or services;
- A provision of advice or information;
- A creation, grant, transfer, assignment or surrender of any right;
- An entry into, or release from, an obligation:
  - to do anything;
  - to refrain from an act; or
  - to tolerate an act or situation.

In relation to "consideration," this includes any payment, or any act or forbearance, in connection with, in response to, or for the inducement of, a supply of anything. It does not matter whether the payment, act or forbearance was voluntary, or whether it was by the recipient of the supply (e.g., third party consideration).

Enterprises involved in supplying goods and services also prima facie pay the cost of GST on their inputs (where they had to reimburse their supplier of the GST arising from the taxable supply of the input). However, enterprises are generally entitled to claim back the GST paid on inputs where it is a creditable acquisition (commonly referred to as input tax credits).[78] Generally, to obtain an input tax credit for the GST paid on inputs, the acquisition must have been made for a creditable purpose (which includes confirming that the input is used in the taxpayer's enterprise, and was not acquired for a private or domestic purpose or for the purpose of making an input-taxed supply). The input tax credit available to an enterprise for any particular acquisition will be reduced to the extent that the enterprise did not acquire it for such creditable purposes. With the exception of input tax supplies, the overall effect of the GST paid on the inputs required to make a supply should be washed out and will only have a cash-flow impact on the enterprise.

Certain goods and services are "GST-free," which means the entity making the supply is not required to pay GST on the supply (but can still claim input tax credits). The following are examples of items and activities that may be GST-free (which do not necessarily automatically enliven, but can require the parties to satisfy a number of conditions such as agreeing in writing):

(i) Certain exports of goods and services;

(ii) International air and sea travel;

(iii) Certain health services;

(iv) Certain menstrual products;

(v) Certain educational services;

(vi) Certain childcare services;

(vii) Non-commercial activities of charitable institutions;

(viii) Religious services;

(ix) Taxes and charges imposed at all levels of government (including local government rates, water and sewerage rates, and charges);[79]

(x) Supplies of going concerns;

(xi) Food;

(xii) Certain supplies of precious metals;

(xiii) Cars for use by disabled people;

(xiv) Supplies through inward duty-free shops;

(xv) International mail;

(xvi) Telecommunication supplies made under arrangements for global roaming in the indirect tax zone;

(xvii) Eligible emissions units;

(xviii) Inbound intangible consumer supplies;

(xix) Grants of land by governments; and

(xx) Farm land.

Input-taxed supplies are also not subject to GST. However, the GST costs incurred on its inputs are "trapped," i.e., the enterprise making input tax supplies is not entitled to any input tax credits.

GST input taxed[80] supplies include financial supplies and residential rents.

b. *Registration*

Registration is compulsory for any entity that carries on an enterprise with an annual turnover (that is, supplies for consideration of goods or services (among others), whether in cash or kind) in excess of A$75,000, or A$150,000 in the case of a non-profit organization. All taxi operators (including ride-sourcing)

[77] A New Tax System (Goods and Services Tax) Act, 1999 ("GST Act").
[78] GST Act, Div. 11.
[79] GST Act, Div. 38.
[80] GST Act, Div. 40.

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must register regardless of turnover size. An entity for GST purposes includes individuals, companies, partnerships, joint ventures, trusts (and others).

You may also be required to register for GST even if you do not carry on an enterprise in Australia (i.e., very broadly, do not have an Australian GST permanent establishment). For example, a non-Australian resident that makes inbound supplies to Australian consumers for consideration can also be required to register for GST if they meet the registration turnover threshold. Similarly, a non-Australian resident with no GST permanent establishment that supplies low value goods for consideration can also be required to GST register. There are also deeming provisions for operators of an electronic distribution platform, which can make the platform operator responsible for the GST consequences instead of the underlying supplier (including GST-registering and returning GST to the ATO on the underlying supply). For discussion, see IV.B.13.s., t., and u., below.

The definition of "enterprise" is broad and includes a business, profession, trade, and start-up activities of a business (among others). It can also include isolated transactions that have a business purpose. Employees will not be required to register in their personal capacity where such activities are carried on as part of their employment. Subcontractors, however, can be required to. It is not limited to an enterprise of the entity within Australia.

Registration is optional where an entity is carrying on an enterprise and has GST turnover less than the above-mentioned thresholds (other than a taxi operator). Persons that wish to be registered must submit an application to the ATO that is in the approved form. An entity will be registered for GST on application, provided the ATO is satisfied that the relevant criteria are met. The ATO can also register enterprises that have not applied for registration.

Registration must occur within 21 days of an enterprise becoming required to be registered either in the instance of reaching the relevant GST turnover threshold, or in anticipation of its reaching the threshold within the first year of operation. Application can also be made before starting an enterprise, provided the ATO is satisfied there exists a genuine intention to start the enterprise in the future. It is important to apply to register for GST when required to do so as penalties may otherwise be incurred. Increased penalties can apply for significant global entities (groups with annual global income of at least A$1 billion).

The GST concept of "carrying on an enterprise in Australia," that is, to have a GST permanent establishment, is broader than the income tax permanent establishment test. Namely, the GST permanent establishment test does not require a determination as to whether the supplier has any "fixed place". Broadly, an entity is likely to have a GST permanent establishment where it has any employee(s), officer(s) and/or dependent agent(s) inside Australia for more than 183 days in any 12-month rolling period. In certain circumstances, it will be relevant if an entity has a GST permanent establishment, and if so, has made "through" that GST permanent establishment, as it may disengage certain exemptions that may otherwise be available (see, for example, the discussion at IV.B.13.s., below).

Also, a simplified GST registration regime may be available for certain non-Australian resident entities that also do not have any GST permanent establishment, which broadly, does not require the non-resident to obtain an Australian Business Number (ABN).

c. GST Groups

Certain companies are allowed to form a GST group if they are members of the same 90%-owned group (where other criteria are also satisfied).[81] Partnerships, trusts or individuals may also be members of a GST group (but are subject to additional membership criteria). Two companies are members of the same 90%-owned group if one of the companies has at least a 90% stake in the other company or a third company has at least a 90% stake in each of the two companies. Formation of a GST group is not compulsory.

Some of the features of a GST group are:

(i) A GST group is treated as a single taxpayer;

(ii) One company (referred to as the representative member) will be responsible for meeting the group's GST obligations (for example, filing GST returns (also known as Business Activity Statements), remitting any GST, collecting/claiming input tax credits); and

(iii) There will be no liability to account for GST on intragroup transactions (subject to certain exceptions).

In relation to supplies between associates (who are not part of a GST group, subject to certain exceptions), there is a market value deeming provision which can apply for supplies without consideration or for inadequate consideration.

d. Branches and Joint Ventures

The branches or divisions of entities may be separately registered for GST (where certain criteria are met), in which case they may account for GST separately from the parent entity, and make separate GST returns and payments of GST.

Certain joint ventures may be separately registered for GST purposes.[82] One participant (referred to as the joint venture operator) is responsible for lodging Business Activity Statements, paying GST and claiming input tax credits. Supplies made by the joint venture operator to another participant in the GST joint venture are generally not subject to GST.

e. Determination of Annual Turnover

In the context of GST, annual turnover is important in determining whether or not certain statutory thresholds are exceeded. This, in turn, can affect how an enterprise accounts for GST, whether the enterprise is required to be registered and the methods by which GST payments are to be made.

There are seven thresholds for which annual turnover is important:

(i) The registration turnover threshold — A$75,000;

(ii) The tax period turnover threshold — A$20 million;

(iii) The cash accounting turnover threshold — A$2 million;

[81] GST Act, Div. 48.

[82] GST Act, Div. 51.

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(iv) The electronic filing turnover threshold — A$20 million;

(v) The annual apportionment turnover threshold — A$2 million;

(vi) The small enterprise turnover threshold — A$2 million; and

(vii) The instalment turnover threshold — A$2 million.

An entity's GST turnover meets a particular turnover threshold if the entity's:

(i) Current GST turnover is at or above the turnover threshold and the Commissioner of Taxation is not satisfied that its projected GST turnover is below the turnover threshold; or

(ii) Projected GST turnover is at or above the turnover threshold.[83]

(1) Current Annual Turnover

This is the sum of the values of all sales made or likely to be made, during the month concerned and the preceding 11 months, excluding sales that are input taxed, sales that are not for consideration and sales not connected with the enterprise.

(2) Projected Annual Turnover

Consideration of the projected turnover is relevant in determining the GST obligations. If an enterprise believes that current annual turnover is not a true reflection of projected turnover, it may use the projected turnover. The projected GST turnover is the sum of the supplies that the entity makes, has made or is likely to make during that month and the next 11 months (excluding input taxed sales, sales for no consideration and sales that are not made in connection with that enterprise).

(3) Australian Tax Office Discretion as to Turnover

The ATO has wide discretion in determining whether or not the thresholds are met. Even though current turnover is below the threshold, the ATO may state that the projected turnover will be above the threshold so that GST will have to be accounted for.

f. GST Returns

A taxpayer registered for GST must file a GST return with the ATO for each tax period (other than a quarterly tax period) on or before the 21st day of the month following the end of the tax period to which the return relates.[84]

A return must be filed even if an enterprise has not made any taxable supplies in that tax period and even if the net amount for the tax period is zero.[85]

The return must be filed electronically if the enterprise's annual turnover exceeds A$20 million. Electronic filing is optional for all other taxpayers.

[83] GST Act, Sec. 188-10.
[84] GST Act, Sec. 31-10.
[85] GST Act, Sec. 31-5.

g. Payments and Refunds

A payment of GST is required to be made to the ATO when the net amount for a tax period is greater than zero. The net amount must be paid on or before the 21st day of the month following the end of the tax period to which the payment relates (other than a quarterly reporter). Alternatively, if the tax period ends during the first seven days of a month, the net amount must be paid to the ATO on or before the 21st day of that month. If the return is required to be filed electronically, the payment must be made electronically. All other taxpayers may pay electronically, by check or by providing direct debit authority.

Where the net amount for a tax period is payable to the taxpayer, the ATO will pay the amount directly into a nominated bank, building society or credit union account. The ATO has 14 days to pay the refund. If a refund is not received within 14 days, interest is payable on the amount owing.[86] The ATO may elect to offset a refund against other tax debts that the taxpayer may have.

h. Interest and Penalties

(1) Administrative Penalties

General interest charge (GIC) will be imposed on any late payments of GST. GIC is currently applied at an annual rate of 11.42% GIC is calculated on a compounding daily basis from the date that the payment was due. The ATO has the discretion to remit all or part of the GIC.

The ATO may also seek to impose penalties on a taxpayer where it considers that it has failed to comply with its GST obligations. Penalties include: tax shortfall penalties; penalties for failing to lodge documents on time; and miscellaneous civil penalties.

(a) Tax Shortfall Penalties

If the ATO relies on information provided by a taxpayer to assess its GST obligations and as a result less tax was paid than was properly payable, a tax shortfall is said to arise. Where a taxpayer or its agent makes a false or misleading statement to the ATO in respect of the GST law and a tax shortfall arises, a penalty will be imposed to the value of:

(i) 25% of the tax shortfall amount where there has been a failure to take reasonable care;

(ii) 25% where the taxpayer has taken a position that is not reasonably arguable;

(iii) 50% where the tax shortfall is caused by the recklessness of the taxpayer in relation to the operation of a GST law; and

(iv) 75% where the shortfall was caused by the intentional disregard by the taxpayer of the GST law.

This penalty can be increased or reduced in certain circumstances.

[86] Taxation (Interest on Overpayments and Early Payments) Act 1983.

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(b) "Failure to Lodge" Penalties

Where a taxpayer fails to lodge its GST returns, a penalty of 1 penalty unit will be applied for each period of 28 days, starting on the day the GST return is due up to a maximum of five penalty units. This penalty may be increased depending on the size of the business (multiplied by two for medium Pay As You Go (PAYG) withholders, by five for large PAYG withholders and by 500 for significant global entities).

A penalty unit is currently A$313.

(c) Miscellaneous Penalties

Other administrative penalties that may be imposed include the following:

(i) Failure to lodge a GST return electronically when required (five penalty units);

(ii) Failure to make a payment of GST in another form if required to make electronic payments (five penalty units);

(iii) Failure to keep a record in the manner required by the GST law (20 penalty units); and

(iv) Failure to issue tax invoices or adjustment notes when required (20 penalty units).

(2) Tax Offenses

There are also a number of taxation offenses prescribed by the Taxation Administration Act 1953. Where appropriate, a court may be satisfied that it is reasonable for the ATO to prosecute a taxpayer under these offenses rather than merely applying the administrative penalties referred to above.

Taxation offenses that could apply in a GST context include:

(i) Making a false or misleading statement to a taxation office (penalties imposed may be A$6,269 (A$313 × 20 penalty units) for the first offense, A$12,520 (A$313 × 40 penalty units) for the second offense or 12 months imprisonment for subsequent offenses);

(ii) Keeping incorrect records and accounts;[87] and

(iii) Recklessly making false or misleading statements.[88]

i. Assessments

GST payments and refunds will ordinarily be made without any formal assessment of liability by the ATO. In some situations, it will be necessary for the ATO to issue an assessment of the net amount for a tax period.

An assessment may be made if an entity fails to provide a GST return to the ATO by the due date, or if the ATO has reason to believe that the amounts stated in the GST return are incorrect.

j. Objections and Appeals

An entity that is dissatisfied with a GST assessment may object to the GST assessment. Objections must be filed with the ATO within (the later of):

(i) Four years and one day from the date the assessment was issued; or

(ii) Four years after the end of the relevant tax period or after the importation of goods to which the assessment relates.

The ATO, on receiving a valid objection, will then make a decision to either allow or disallow the objection, whether in whole or part. If the entity disputes the ATO's decision, it may seek a review of the ATO's decision in either the Administrative Appeals Tribunal or Federal Court of Australia.

k. Tax Invoices

Tax invoices play a very important part in the GST system and must be provided on request for businesses to meet their GST obligations. Tax invoices in the required format are necessary to substantiate claims for input tax credits.

A tax invoice must (among other things):

(i) Show the identity and ABN (registration number) of the entity issuing it;

(ii) Identify the supplier (if the price is above A$1,000);

(iii) Show the price and quantity (if applicable) of the supply;

(iv) Show the amount of GST (if any) payable on the supply;

(v) Show the date on which the document is issued;

(vi) Contain such information as the regulations require; and

(vii) Be in the form approved by the Commissioner.[89]

l. Adjustment Notes

An adjustment event arises when there is a cancellation of a supply or acquisition, a change in the consideration for a supply or acquisition, or a change in the extent to which the supply or acquisition was taxable or for a creditable purpose respectively. The adjusting event may increase or decrease the liability for payment of GST on a supply or may increase or decrease the input tax credit entitlement on an acquisition.

Any adjustment is to be reflected in the GST return for the tax period in which the adjustment event takes place. An adjustment note is to be prepared for the recipient if a tax invoice was previously issued. The adjustment is to be attributed to the tax period in which the person became aware of the adjustment event. A recipient of a supply that receives an adjustment note which affects the amount of input tax credit it claimed for its original acquisition must show the adjustment in its next GST return. The supplier is required to issue an adjustment note within 28 days of becoming aware of the adjustment, even if the recipient has not requested an adjustment note.

m. Tax Periods

A tax period is each quarter ending March 31, June 30, September 30 and December 31.

[87] TAA, Sec. 8L.
[88] TAA, Sec. 8N.
[89] GST Act, Sec. 29-70.

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However, a one-month tax period will apply in any of the following three circumstances:

(i) When GST turnover of the enterprise exceeds A$20 million (in any rolling 12-month period);

(ii) When the ATO is satisfied that the person has a history of failing to comply with tax obligations; or

(iii) When the ATO is satisfied that the period for which the person concerned will be carrying on an enterprise in Australia is less than three months.

An election may also be made to file returns monthly.

n. Tax Accounting Basis

GST can be accounted for on either a cash basis or an accruals (non-cash) basis. Generally speaking, entities with an annual turnover of less than A$2 million (and which do not carry on a business) may choose to use either the cash basis or the accruals basis. Other exceptions apply. Other entities must use the accruals basis.[90]

The two rules determine the timing of GST liability on a supply:

(i) In the case of accounting on a cash basis, the liability arises on the date on which consideration is received or paid for the supply concerned; or

(ii) In the case of accounting on an accruals (non-cash) basis, the liability arises on the earlier of the date on which the consideration (or any part thereof) is received or paid for the supply concerned, or an invoice is raised or received for the supply concerned.

o. Input Tax Credits

An entity is entitled to input tax credits for any "creditable acquisitions" that they make. That is, they are entitled to claim back the cost of GST incurred on the acquisition of goods or services for any creditable purpose which relates to the making of certain supplies by the entity. Input tax credits are available for acquisitions to the extent that they relate to an entity making supplies that would be GST-free or taxable; i.e., they are not available for acquisitions of a private or domestic nature, or acquisitions which relate to an entity's input taxed supplies.

If an enterprise is involved in a mixture of taxable and input taxed supplies, and the value of the input taxed supplies exceeds the "Financial Acquisitions Threshold" ("FAT"), then the enterprise would be required to deny itself a portion of its input tax credits. The FAT could be exceeded even from one-off events, such as M&A activity. You exceed the FAT for a particular month if the input tax credits you could claim for current or future financial acquisitions are more than <u>either</u> of the following:

- A$150,000 (on and after July 1, 2012) in the relevant 12-month period; or

- 10% of the total amount of GST credits you could claim for all your purchases (including financial acquisitions) during the relevant 12-month period.

[90] GST Act, Sec. 29-40.

p. Imports

(1) Imported Goods

Goods imported into Australia are subject to GST at the time of importation, regardless of whether or not the person that imports the goods is registered for GST purposes (unless it is a nontaxable importation, such as certain goods covered by the Customs Tariff Act 1995 (Cth) and certain goods returned to Australia).[91] Import GST is separate to any customs duty liability that may also be payable.

GST is payable at the rate of 10% on the sum of:

(i) The customs value of the goods;

(ii) The amount paid or payable to transport the goods to their place of consignment in Australia and insure them for that transportation;

(iii) Any customs duty payable on importation of the goods; and

(iv) Any wine tax payable with respect to the local entry of the goods (where applicable).

(2) Creditable Imports

The input tax credit paid on importation is available only to the person who makes the importation, provided that the importation is for a creditable purpose (i.e., for use in its enterprise), and the person is registered or required to be registered for GST.

(3) GST Deferral Scheme

The GST Deferral Scheme provides a cash flow advantage to importers of goods into Australia. The GST Deferral Scheme allows an entity to defer the GST payable on importation until the entity's first Business Activity Statement is lodged after the goods are imported into Australia (at which time the entity may claim an input tax credit for the import GST payable). To be part of the GST Deferral Scheme, an entity must submit an application to the ATO and satisfy certain requirements which, among other things, require that the entity lodge its Business Activity Statements electronically.

q. Transitional Arrangements for Second-Hand Goods

As GST was introduced on July 1, 2000, some transitional rules remain. One of the key transitional measures relate to the supply of second-hand goods.

The GST legislation allows an entity to claim input tax credits on second-hand goods it acquires in the ordinary course of business (for the purposes of sale or exchange but not for manufacture), even though GST was not payable by the supplier on the supply of the second-hand goods. This occurs if a second-hand dealer buys goods from an unregistered person. The original supplier would have paid GST on the goods when it acquired them (and therefore could not claim an input tax credit). Allowing an input tax credit to the entity acquiring the second-hand goods prevents GST from being charged twice on the same goods.

[91] GST Act, Part 2-3 and Part 3-2.

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The transitional provisions allow for an Input tax credit for second-hand goods acquired before July 1, 2000, where the goods were held on July 1, 2000, for sale or exchange (but not for manufacture), i.e., as inventory. This provision ensures that second-hand dealers pay GST on the difference between the selling and purchase price of the goods.

r. Reverse Charge

In certain circumstances, the GST law in Australia provides that a recipient of supplies should charge itself GST on certain acquisitions it makes. As a practical consequence, the supply is treated as if it was made by the consumer and not the supplier. Very broadly, there are two scenarios where reverse charge rules may operate. Firstly, the reverse charge rule may operate in respect of supplies by non-residents to Australian residents (if both parties agree to the reverse charge)[92] and, secondly, to certain offshore intangible supplies.[93]

s. Supplies of Things Other than Goods or Real Property

From July 1, 2017, supplies of anything other than goods or real property (such as services, digital products or other intangible supplies) that are made to an "Australian consumer" (broadly, unregistered recipients) are subject to Australian GST. The rules have extra-territorial effect and therefore can apply to suppliers who are not Australian resident and have no Australian GST permanent establishment.

For such inbound supplies made by a non-Australian, there is no default exemption for B2B supplies. For the B2B supply to enliven, among other things, the supplier must collect both the customer's ABN and a declaration from the customer that they are currently Australian GST-registered. Both pieces of information must be collected by the supplier at the time of the supply, and this carve out cannot be applied by the supplier retrospectively.

t. Offshore Supplies of Low Value Goods

An offshore supply of a low value good with a customs value of A$1,000 or less will be subject to Australian GST if, broadly, the supply involves goods being brought to Australia and the supplier delivers the goods into Australia, or procures, arranges or facilitates the delivery of the goods into Australia.

u. Electronic Distribution Platforms

From July 1, 2017, a deeming rule makes the operator of an electronic distribution platform ("EDP") liable for the GST on a supply made by a third-party through the operator's EDP, instead of the underlying third-party supplier. Very broadly, the rules only intend to capture inbound intangible supplies to Australian consumers, where the EDP allows "entities to make supplies available to end-users." Broadly, and practically speaking, this refers to transactions which are facilitated by the platform operator, rather than where the platform operator makes the supply themselves in the capacity of a principal/reseller. There are certain supplies which can be exempted from this deeming provision.

The operator of the EDP can also agree in writing with an underlying supplier to extend the effect of the deeming rule in certain circumstances, so that the EDP operator is liable for the GST instead of the underlying supplier for a broader subset of supplies.

Similar deeming rules are also in place for supplies of offshore supplies of low value goods made through an EDP.

v. Supplementary Annual GST Return

As part of a pilot program, businesses that have received a GST assurance rating through a top 100 or top 1,000 assurance review are required to lodge a supplementary annual GST return for the 2024–25 financial year if one of the following was received on or before June 30, 2024 (and so on for future years):

- Top 100 GST Assurance Report;
- Top 1,000 Combined Assurance Review report with a GST assurance rating; or
- Top 1,000 GST Streamlined Assurance Review.

Taxpayers required to lodge a supplementary return will receive a notice setting out the specified due date.

The ATO will initially ask a small number of top 100 and top 1,000 taxpayers to respond to the return questions as part of their assurance reviews.

The return covers:

- How ATO recommendations, areas of low assurance or red flags outlined in your most recent GST assurance review have been implemented;
- Maintainance of GST governance, material business or systems changes that impact the GST control framework since the last ATO review;
- Reconciliation between audited financial statements and business activity statements;
- Any material uncertain GST positions;
- Material GST errors and how these have been rectified, and whether you claimed any material amounts of credits in the period that were referable to earlier periods.

C. Tax Administration

1. Payment of Tax

a. Pay As You Go

The PAYG system has two components: PAYG withholding;[94] and PAYG installments.[95]

The PAYG withholding system of Part 2-5 includes the mechanics for the withholding of tax at source. Typically, this covers withholding obligations regarding salary and wages paid to employees (and other forms of remuneration for services rendered), as well as withholdings for dividend, interest and royalties paid to nonresidents. More specifically, it covers the following types of payment:

[92] GST Act, Division 83.
[93] GST Act, Division 84.
[94] Tax Administration Act, 1953, Part 2-5 of Schedule 1.
[95] Tax Administration Act, 1953, Part 2-10 of Schedule 1.

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(i) Payments for work and services — Subdivision 12-B of Part 2-5;

(ii) Superannuation Payments, employment termination payments, and unused leave payments — Subdivision 12-C;

(iii) Benefit and compensation payments — Subdivision 12-D;

(iv) Payments arising from investment where the recipient does not quote a tax file number (TFN) or an ABN — Subdivision 12-E;

(v) Interest, dividend and royalty payments to nonresidents — Subdivision 12-F;

(vi) Departing Australia superannuation payments — Subdivision 12-FA;

(vii) Excess untaxed roll over amounts (that relate to payments rolled over between superannuation funds in excess of certain tax-free caps) — Subdivision 12-FAA;

(viii) Payments to nonresidents specified in the Regulations — Subdivision 12-FB;

(ix) Payments with respect to mining on aboriginal land and natural resources — Subdivision 12-G; and

(x) Distributions of Australian-source income from managed investment trusts (MITs) to foreign residents (and deemed payments through Attribution MITs) — Subdivision 12-H (and Division 12A in the case of an Attribution MIT).

The concept of what constitutes an employee, especially in the context of a growing gig economy, is another key issue that needs to be monitored. ATO guidance can be found in TR 2023/4 and PCG 2023/2. Both documents take a broad substance-based approach to determining when an employee-employer relationship exists, despite the fact that recent case law has generally focused on the contractual terms of any relevant services agreement as setting out the relationship between the parties. The leading decision is *Construction, Forestry, Maritime, Mining and Energy Union v. Personnel Contracting Pty. Ltd.*[96] In that case, the majority of the High Court confirmed that in determining whether a relationship between a worker and engaging entity is one of employment, an examination of the totality of the relationship must be undertaken by reference solely to the legal rights and obligations which constitute that relationship. This examination of the established contractual relationship is undertaken through the focusing question of whether the worker is working in the business of the engaging entity.

The amount of tax that must be withheld from each category is specified in income tax regulations to the Taxation Administration Act, 1953. Subdivision 12-B, 12-E and 12-H have important subcategories and are discussed in greater detail below. Subdivision 12-F is the topic of XI., below.

[96] [2020] FCAFC 122.

b. Subdivision 12-B

Regarding Subdivision 12-B, the following types of payments for work and services are included and require additional comment.

(1) Voluntary Agreement to Withhold

A business and a worker that has an ABN can enter into a voluntary agreement to bring the payments for work into the withholding system, if the payments are not subject to any other PAYG withholding. It should be noted that this category only applies to individuals. If the contract worker is an entity such as a company, a voluntary agreement cannot be entered into.

The agreement must be in writing and identify and be signed by both parties. It must show their contractual relationship, identify the payments subject to withholding and state the rate of withholding. Both parties must keep a copy of the agreement for five years after the agreement ends.

Generally, where a voluntary agreement is in place, under which withholding of tax is being made, the contract worker will be excluded from GST. However, where the payer makes input taxed supplies, (e.g., a bank or insurance company), there will continue to be a GST liability on any payments made under the agreement by the contract worker. Consequently, payees should ensure that, where they are required to be registered for GST purposes, they determine the GST status of the payer and, where appropriate, take the GST liability into account in determining the amount to be charged to the payer.

(2) Payment Under Labor Hire Arrangements or Payment Specified by Regulations

Under this category, withholding is required where a payment is made to an individual performing work or services for a client of the payer. This category applies only if the individual is not an employee of either the payer or the end user of the work or services. It also applies only if the payer is an entity carrying on an enterprise.

Although this category is described as "payment under labor hire arrangements," it is not limited to the general understanding of "labor hire arrangements" and potentially applies to a far wider range of transactions.

c. Subdivision 12-E — Australian Business Number Withholding

This category applies regardless of whether the individual has quoted an Australian Business Number (ABN). The ABN is a single business identifier for all Commonwealth purposes that replaces all other numbers required to deal with the government at different levels. Companies are automatically entitled to obtain an ABN. ABNs are issued to entities carrying on an "enterprise" as defined in the GST legislation. The Commissioner has the authority to issue ABNs.

Regarding Subdivision 12-E, it should be noted that there is a close correlation between withholding requirements, the ABN and the goods and services tax (GST). A withholding obligation is imposed on payers on account of GST where a payment is made to another entity (payee) that is carrying on an enterprise, where that entity does not quote an ABN.

An "enterprise" is defined in the GST legislation as including:

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(i) Any activity conducted in the form of a business;

(ii) An adventure or concern in the nature of trade; and

(iii) A lease, license or other grant of real property on a regular or continuous basis.

It specifically excludes activities:

(i) Conducted as a hobby, or as a private or recreational pursuit; or

(ii) Carried on by a person as an employee or that relate to any of the withholding payments covered under the withholding provisions contained in the Act.

The payer must withhold from a payment if the payment is in relation to a supply made in the course of an enterprise by the payee (whether an individual, partnership, company or trust) where the payee does not quote its ABN. "Supply" has the same meaning as under the GST Act. The exceptions are where:

(i) The payment is made otherwise than in the course or furtherance of an enterprise carried on in Australia by the payer;

(ii) The payment does not exceed A$50;

(iii) The payment relates to an input tax supply; or

(iv) The payee (who is an individual) has made a written, signed statement that the supply is private or domestic in nature or relates to a hobby and the payer can accept such a statement unless the payer believes that it is false or misleading.

Where no ABN is quoted, the payer must withhold tax at the top marginal income tax rate plus the Medicare levy. Where withholding is effected, the payment may not be subject to GST.

The stated reason for this category of withholding is to remove the difficulties under the PAYE provisions involved in a business determining whether a service provider is a contractor or an employee.

The PAYG installment system contains various rules for the payment on a regular basis (usually quarterly) of an estimate of the tax payable on taxable income, which falls outside the scope of the PAYG withholding provisions. Each estimate is based on the taxable income of the taxpayer for the previous income year. PAYG also implements running balance accounts (RBAs) where taxpayers receive statements detailing their net tax position for a reporting period with respect to their goods and services tax (GST), income tax withholding, income tax installment and fringe benefits tax liabilities. The information recorded on such accounts will come from a taxpayer's single business activity statement, which will be filed on a monthly or quarterly basis.

d. *Managed Investment Trust Withholding Tax*

(1) In General

As discussed above at II.A.1.h., payments from an MIT to nonresidents are subject to a "final" withholding tax at the rate of either 30%, 15%, or 10%.

The Trustee is not obliged to withhold MIT withholding tax from payments to beneficiaries if (according to the Trustee's records) the beneficiary's address and place of payment is in Australia. In these circumstances, the trustee will (as required by law), either before or at the time the fund payment is made, give a written notice or place information on an appropriate website (in a way that is readily accessible to the recipient for not less than five continuous years) setting out the constituent elements of the payment, including the income year to which it relates and the part of the payment from which MIT withholding tax would have been withheld if paid offshore.[97]

(2) Other Entities to Which Managed Investment Trust Withholding Rules Apply

The MIT withholding rules also apply to:

(i) Certain Australian entities carrying on a business of providing custodial or depository services (i.e., custodians);[98] and

(ii) Other non-custodian entities (such as trustees and agents)[99] that hold interests in MITs on behalf of foreign investors (that are not operating through an Australian PE).

Generally, a custodian or other interposed entity will need to withhold from a fund that is covered (in whole or in part) by a written notice or information made available on a website (refer to above) where the underlying investor entitled to this amount is offshore (i.e., foreign investors (that are not operating through an Australian PE)).

An MIT or a custodian is required to withhold at the time it makes its fund payment. Whereas for other entities (i.e., non-custodians), the obligation to withhold arises when the foreign resident (the investor) is, or becomes, entitled to receive an amount of the fund payment. In essence, while an MIT's or custodian's obligation to withhold is determined by reference to the address/place of payment if offshore, the test for other interposed entities is the tax residency of the investor.[100]

It is noted that the requirement to withhold does not apply where no MIT withholding tax is payable in respect of the payment or an amount reasonably attributable to the payment.

If a nonresident beneficiary holds its trust units through a resident custodian, trustee or otherwise through an Australian resident on behalf of a nonresident, the eventual distribution of the fund payment by the onshore party to the nonresident may be subject to withholding tax in accordance with the rates set out above (and the notice statement referred to above should be used by the onshore party for the purposes of determining the extent to which the payment is a fund payment and subject to withholding tax).

To the extent to which the trust distribution is not assessable in the hands of the beneficiary and is not subject to the MIT withholding tax (say, the trust law income exceeds the net income of the trust), the distribution will reduce the beneficiary's cost base in the units.

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[97] TAA, Sec. 12-395(3).

[98] TAA, Secs. 12-390 and 12-395.

[99] TAA, Sec. 12-390(4).

[100] *id.*

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(3) Payment Summary

The entities that are required to withhold under the MIT rules must provide a payment summary in each year to an investor that specifies the following:

(i) The names of the payer and the recipient;

(ii) The recipient's tax file number or Australian business number (if provided);

(iii) The total of the withholding payments that the summary covers, and the total of the amounts withheld by the payer from those withholding payments; and

(iv) The income year of the relevant MIT to which the summary relates.[101]

The format of the payment summary is not prescribed by the Commissioner, but it must contain at a minimum the elements mentioned above.

(4) Penalties

There are administrative penalties that apply for not providing the required notices or information requirements. The amount of the penalty is the amount that would have been withheld from the payment had the notice or information requirements been satisfied.[102]

(5) Reporting Requirements

Broadly, an entity (MIT, custodian or other entity) that is required to withhold, must provide, on an annual basis, a report to the Commissioner on the amounts withheld.[103] This annual report must be provided to the Commissioner in the approved form (i.e., the Annual investment income report) and is due within 14 days after the end of six months following the end of the MIT's income year.[104]

(6) Attribution Managed Investment Trusts

The attribution MIT regime modifies the application of the MIT regime such that the obligation to withhold (and the rate) is determined by reference to the amount allocated to the investor in its AMIT Member Annual Statement (AMMA Statement), provided by the trustee to the underlying investors within three months of the end of the income year. The trustee will withhold tax at the appropriate rate by reference to the amount set out in the AMMA statement, as opposed to by reference to the amount actually paid.

(7) Disclosure of Subsidiaries

Schedule 1 to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share — Integrity and Transparency) Bill 2023* (the Bill) introduced new rules on the disclosure of information about subsidiaries. For financial years commencing on or after July 1, 2023, Australian public companies (listed and unlisted) must disclose information about subsidiaries in their annual financial reports. The intent is that increased public disclosures will lead to enhanced scrutiny of companies' arrangements and how they structure their subsidiaries and operate in different jurisdictions, including for tax purposes.

Under the amendments, if the accounting standards require the public company to prepare financial statements in relation to a consolidated entity, the 'consolidated entity disclosure statement' (to be included as part of the company's annual financial reports) must provide the following information in relation to entities within the consolidated entity:

- The name of each entity at the end of the financial year;
- Whether each entity was a body corporate, partnership or trust at the end of the financial year;
- Whether at the end of the financial year, each entity was any of the following:
  - A trustee of a trust within the consolidated entity;
  - A partner in a partnership within the consolidated entity; or
  - A participant in a joint venture within the consolidated entity;
- If any entity is a body corporate, where the entity was incorporated or formed;
- If any entity is a body corporate, the public company's percentage ownership (whether directly or indirectly) at the end of the financial year; and
- The tax residency of each entity during the financial year.

If, however, accounting standards do not require the public company to prepare financial statements in relation to a consolidated entity, the public company's annual financial report must include a 'consolidated entity disclosure statement' for such a company.

Directors, chief executive officers and chief financial officers must also declare that the consolidated entity disclosure statement is, in their opinion, 'true and correct' at the end of the financial year.

2. Tax File Number

Each taxpayer is required to obtain a TFN from the ATO. This unique number is quoted on income tax returns, assessments, notices and correspondence with the Taxation Office. It is also quoted to banks, financial institutions and employers. Failure to so quote results in tax being withheld at the maximum rate.

TFNs are required to be quoted in certain circumstances. The main rules concerning TFNs are as follows:

(i) Employers are required to include employees' TFNs on group certificates.

(ii) Employees who do not quote their TFNs when commencing new employment will have tax deducted at the highest marginal rate plus Medicare levy.

(iii) Taxpayers should quote their TFNs when opening bank accounts or making investments. Shareholders with investments held in public company shares are required to quote their TFNs.

[101] TAA, Sec. 16-170(1AA) of Schedule 1.
[102] TAA, Sec. 12-415.
[103] TAA, Sec. 16-153(4) of Schedule 1.
[104] TAA, Sec. 16-153(4A).

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(iv) If a TFN is not quoted, the payer will be required to withhold tax at the top marginal rate plus Medicare levy. The withholding of tax is not to be regarded as the final tax on the income. The gross income should be reported in the taxpayer's return and a credit claimed for the tax overpaid.

(v) Children under 16 years of age who do not receive interest in excess of A$420 per annum are exempted from the obligation to quote a TFN.

(vi) Information stored on a computer by employers and investment bodies is required to be provided to the ATO in a form that is readily processed. An exemption from this requirement is available, where fulfilling it would lead to substantial difficulties.

(vii) Persons applying for, or receiving, unemployment and sickness benefits must quote their TFNs or benefits will not be paid.[105]

3. Objections, Appeals and Reviews

A uniform code of procedures applies for all objections, review and appeals including income tax, GST, FBT and certain other Commonwealth taxing statutes. This uniform code is in Part IVC of the Tax Administration Act 1953.

A taxpayer dissatisfied with an assessment issued by the Commissioner is provided with avenues for contesting the assessment. A taxpayer's first action is to object within the required time frame of four years (or two years in the context of certain small taxpayers with simple tax returns).[106] The Commissioner is required to consider each objection filed and to give written notice of his decision to allow, partly allow or disallow the taxpayer's objection. If the Commissioner has not made a decision on the objection within 60 days of the filing of the objection, the taxpayer may, by notice in writing, require the Commissioner to make a decision on the objection within a further 60 days.

If the Commissioner fails to make a decision within the further 60 days, the objection is deemed to be disallowed. This is to allow the objector to pursue further remedies without added delay.

A taxpayer dissatisfied with the Commissioner's decision on an objection may (within 60 days of being served with a notice of the decision) file an application for review or appeal directly to the Administrative Appeals Tribunal (AAT) or the Federal Court. The form of an application is set out in the Administration Appeals Tribunal Regulations 1976 and the Federal Court Rules. The application fee to the AAT is A$682 (or A$68 if the matter is to be heard by the Small Taxation Claims Tribunal). The application fee to the Federal Court is A$1,881 for companies or A$785 for other applicants.[107]

Where a decision involves a question of law, an appeal may be made from the Federal Court to the High Court by special leave of that Court. The Federal Court of Australia was established to take over the appellate jurisdiction of the High Court. The Supreme Courts of the Australian Capital Territory and the Northern Territory have jurisdiction in income tax matters, but this jurisdiction is limited to residents of the respective territories.

4. Registration of Tax Agents

Any person or firm that prepares income tax returns and objections, or that transacts any business on behalf of a taxpayer in income tax matters must be registered with the Tax Agents Board as a tax agent. Persons that are not registered tax agents may not charge fees for the taxation services described above.

A Code of Practice defining the role and ethical standards expected of tax agents applies. A national Tax Agents Board administers the code and applications for registration.

5. Tax Year

Tax returns are furnished for the fiscal year ending on June 30 unless special approval has been obtained from the Commissioner of Taxation to adopt a substituted accounting period. Approval is granted only in special circumstances and is usually restricted to taxpayers carrying on a business, particularly company taxpayers, but only where there is a substantial business need. Companies in a group are most commonly granted approval so they may adopt the same accounting period as the parent company.

6. Tax Return Forms

There are five income tax return forms: I, C, F, P, and T.

The regulations provide that Form I (individuals) must be filed by October 31 each year. If an individual lodges his or her own tax return and it results in a tax bill, payment is due by November 21 of the same year (irrespective of when the return is lodged — this can be relevant to the determination of penalties in the context of late payment of tax). Registered tax agents are able to obtain extensions of time to at least January 31 of the following year to file returns/pay tax. Income tax returns are filed at the office of the state in which the taxpayer resides.

A company (corporation) return must be signed by the public officer (a resident of Australia) of the company, while a partnership return must be signed by one of the partners, and trust or superannuation returns by a trustee.

Company returns must be lodged by October 31.

The only schedules that must accompany return forms of companies and superannuation funds are details of overseas transactions or any requests for rulings. The public officer must sign a declaration that states the company will have available, and will retain for five years, a full set of records and a reconciliation statement.

All companies must also provide a statement giving full details of all dividends and interest paid by the company, including the names and addresses of the payees, by October 31 following the financial year-end.

Most election notices are no longer required to be filed with tax returns. Taxpayers are advised to check the filing requirements for each election when it is made.

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[105] ITAA 1936, Secs. 202 to 202G.
[106] TAA 1953, Sec. 14ZW and ITAA 1936, Sec. 170.
[107] AAT Regs. and Federal Court Rules.

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V. Taxation of Domestic Corporations

A. *What Is a Domestic Corporation?*

A "company" is defined under Australian law as any body or association, incorporated or unincorporated, but does not include a partnership or a non-entity joint venture.[108] A body or association does not need to be incorporated under corporation law to be a company for income tax purposes. An unincorporated sporting association or a cooperative can also be a company for income tax purposes.[109] (There are special rules for cooperatives; see IX.F., below.)

However, Australia does not use the term "domestic company". The preferred term (both in terms of how the legislation is drafted and commercial language) is to refer to a company that is a "resident", "Australian resident" or "resident of Australia."

A company is a resident of Australia if it:

(i) Is incorporated in Australia;

(ii) Carries on business in Australia and is centrally managed and controlled from Australia (the "CMC test"); or

(iii) Carries on business in Australia and has its voting power controlled by Australian resident shareholders.

The scope of the residence test has significantly expanded in recent years as a result of the broad interpretation of the CMC test applied by the High Court in *Bywater Investments Limited & Ors v. Commissioner of Taxation*; *Hua Wang Bank Berhad v. Commissioner of Taxation*.[110] The CMC test is normally determined by the location in which a company's directors execute their duties and comply with the standards expected of directors under the applicable Australian or foreign company law. This will normally be where its directors make their decisions. The *Bywater Hua Wang Bank* case illustrated the importance of focusing on the substance of these types of arrangements. Having directors located offshore will not be effective in ensuring a company is a nonresident of Australia if it merely "rubber stamps" a decision-making process undertaken in Australia. The Commissioner has provided additional guidance on this issue in Practical Compliance Guideline PCG 2018/9 and Tax Ruling TR 2018/5. A relevant example (see below) is provided for in PCG 2018/9:

> *Example 7 — Decision making by a subsidiary of a corporate group:*
>
> 41. Sub Co is a company incorporated in Foreignland and is a wholly-owned subsidiary of Aust Co, an Australian listed company. Aust Co requires Sub Co to comply with its policies where lawful in conducting its business.
>
> ***Possibility A — Sub Co's directors make decisions in line with its parent's policies:***
>
> 42. Sub Co's board meets in Foreignland where it makes all its high-level decisions. The board considers the business activities and financial position of Sub Co in addition to any consequences of the transactions. There is a process of discussion and consultation before any decisions are made.
>
> 43. The decisions of Sub Co's board comply with Aust Co's policies. However, the Board exercises central management and control, as it makes independent decisions within Aust Co's policy framework only after deciding it is in the best interests of Sub Co to do so. Sub Co is not a resident of Australia under the central management and control test of residency.
>
> ***Possibility B — Sub Co's Chief Financial Officer is an employee of its parent:***
>
> 44. Assume the same facts as Possibility A. However, one of Sub Co's directors is the Chief Financial Officer (CFO) of Aust Co and an Australian resident. The CFO travels to Foreignland to attend board meetings. The board considers the business activities and financial position of Sub Co in addition to any consequences of the transactions. There is a process of discussion and consultation before any decisions are made.
>
> 45. Aust Co's CFO does not control the decisions of Sub Co or exercise its central management and control independently of the other directors. No instance or pattern of decision making exists where the CFO exercises central management and control to the exclusion of the other directors. There is no evidence of the parent otherwise usurping the board and exercising central management and control. Sub Co is not a resident of Australia under the central management and control test of residency.
>
> ***Possibility C — Sub Co's board merely implements the decisions of its parent, Aust Co***
>
> 46. Aust Co's board sets global policies containing highly detailed operational and trading policies that Sub Co's board must follow. These policies cover the entirety of Sub Co's activities. Sub Co must also comply with any directions received from Aust Co's board.
>
> 47. Sub Co's board holds meetings where it mechanically follows directions from Aust Co's board on what decisions it is to make and policies to adopt. Its directors do so without giving any consideration as to the merits of those directions. It does not make any independent decisions regarding Sub Co's business or affairs. Sub Co's board is merely rubberstamping the decisions made by Aust Co's board. Aust Co's board is the real decision maker and makes the decisions as to what decisions Sub Co is to make and what policies to adopt in Australia. Aust Co's board therefore exercises central management and control of Sub Co in Australia. Sub Co is therefore a resident of Australia under the central management and control test of company residency.

Comment: For U.S. multinational groups, APAC subsidiaries (incorporated outside of Australia) may have an Aus-

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[108] ITAA 1997, Sec. 995-1; *Leonard v. FCT* (1919) 26 CLR 178.

[109] 11 CTBR Case 86.

[110] [2016] HCA 45.

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tralian director without becoming an Australian resident, even if they are set up under an Australian regional holding company. Specifically, this is often done by ensuring one director is located in the United States (providing an overall strategic direction for the operations of the foreign entity), one of the directors is located in Australia with a third director located within the country in which the company is incorporated. With this pattern, merely having one Australian director is not enough for the entity to become resident in Australia.

Legislative Note: In the 2020–21 Federal Budget, the Australian Government announced technical amendments to clarify the corporate residency test, providing that a company incorporated offshore will be treated as an Australian tax resident if it has a 'significant economic connection to Australia.' This measure, if enacted, is intended to have effect from the first income year after the date of royal assent of the enabling legislation (but possibly allowing taxpayers the option of applying the new law retrospectively from March 15, 2017). In the 2021–22 Federal Budget, the Government also announced that it will consult on broadening the proposed amendments to the corporate residency test to include trusts and corporate limited partnerships. Legislation to implement these announced measures has to yet be enacted.

Resident companies are divided into two main categories: public and private.

1. *Public Companies*

Broadly, a company is a public company if:

(i) Shares in the company that do not entitle the holder to a fixed rate of dividend were listed for quotation on the official list of a stock exchange in Australia or elsewhere on the last day of the year of income;

(ii) At all times during the year of income, the company was a cooperative company as defined in the Act;

(iii) The company has not, at any time since its formation, operated for the purpose of profit or gain to its individual members, and is prohibited by the terms of its enabling document from making any distribution to its members or relatives of members;

(iv) The company is a "mutual life assurance society" or a "friendly society dispensary" as defined in the Act;

(v) The company is government-owned; or

(vi) The company is a subsidiary of a public company.[111]

A company that would be public in accordance with either (i) or (ii), above will not be treated as a public company if:

(i) At any time during the year, 20 or fewer persons held (or had the right to acquire) three-quarters or more of the paid-up capital of the company, excluding shares entitled to a fixed rate of dividend only;

(ii) At any time during the year of income, three-quarters or more of the voting power was capable of being exercised by 20 or fewer persons;

(iii) Three-quarters or more of any dividend paid during the year was paid to 20 or fewer persons; or

(iv) No dividend was paid and the Commissioner of Taxation is of the opinion that, had a dividend been paid, three-quarters or more of it would have been paid to 20 or fewer shareholders.[112]

A company is a subsidiary of a public company in relation to a year of income if, at all times during that year of income, all of its shares were beneficially owned by a company or companies each of which is a public company.[113] Notwithstanding that a company may pass this test, the Commissioner has discretion to treat a company as not being a subsidiary of a public company where the affairs of the company were not fully controlled by the public company, or were conducted in the interest of persons other than the holding company.[114] Conversely, the Commissioner may treat a company as being a public company even if it does not meet the tests laid down.[115]

Comment: A public company for Australian tax purposes differs from the test under Corporation Act 2001. A public company for Australian corporate law purposes is referred to as a "Ltd" or "Limited" as opposed to a private company which uses the phrase "Pty Ltd" or "Proprietary Company" at the end of its name. Importantly, an Australian (corporate law) public company (i.e., an "Ltd") cannot be treated as a disregarded entity for U.S. tax purposes. For this reason, most Australian public companies are converted into private companies when they are acquired by a U.S. multinational (such that it can elect to be disregarded post acquisition).

2. *Private Companies*

All companies that are not public companies for income tax purposes are private companies for income tax purposes.

B. *Corporate Income Tax*

1. *Taxation of Worldwide Income*

Resident corporations are liable to pay income tax on their worldwide taxable income.

A company is treated as a separate taxable entity for income tax purposes. It is required to calculate its taxable income, and pay income tax on that taxable income, according to the general provisions set out in ITAA 1936 and ITAA 1997. The corporate income tax rate on taxable income is 30%, reduced to 25% for base rate entities. Base rate entities are a subset of companies with an "aggregate turnover" of less than $50 million — a test which includes the revenue earned by group companies (meaning that Australian subsidiaries of multinationals generally do not qualify for the lower 25% tax rate).

Taxable income is calculated by reference to assessable income less allowable deductions for each year of income. This taxable income amount is included in an annual income tax return provided by the taxpayer to the Commissioner of Taxation on which the taxable income and income tax liability of the taxpayer is assessed. This is the normal basis of taxation of resi-

[111] ITAA 1936, Sec. 103A(2).

[112] *Id.*, Sec. 103A(3).

[113] *Id.*, Sec. 103A(4).

[114] *Id.*, Sec. 103A(4D).

[115] *Id.*, Sec. 103A(5).

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dents of Australia. The calculation process is conceptually the same whether the income is derived by a company, individual, partnership or trust.

2. *Accounting*

a. *In General*

Accounting rules and corporate accounting profits of the company are generally of no relevance to the calculation of taxable income. Items that are particular to the calculation of the taxable income of an Australian resident company are set out below.

A company also keeps a record of the tax paid on its corporate profits (because there are various differences between the manner in which corporate profits and taxable income are calculated, the effective tax rate payable by a company on its corporate profits will typically not equal the corporate tax rate). This account is referred to as the company's franking account. Dividends paid by a company can be "franked" with a tax credit from this franking account. The effect of this system is to provide shareholders in a company with a tax credit for the tax paid on the corporate profits from which the dividend is sourced. This tax credit can generally be offset against the taxpayer's own liability for tax on the dividend income. (See 3.c., below, for a detailed discussion of the imputation system.).

b. *Accounting Periods*

The standard year of income for taxpayers is July 1 to June 30. Typically, this is also the year of income for general accounting purposes.

Australian resident companies, trusts and partnerships that are wholly owned by nonresidents may request a substituted accounting period from the Australian Tax Office (ATO) to change their year-end to that of its parent. The ATO will generally accept such a request. This means that for most Australian subsidiaries of foreign companies, the income year is something other than June 30, to align its reporting obligations in Australia with those of its offshore parent.

c. *Accounting Methods*

Income must be derived by the taxpayer during the income year before it is included in assessable income. There are two methods of tax accounting that may be used to determine the amount of income derived during the year: (1) the cash receipts basis (i.e., income is not derived until it has been received by the taxpayer, which includes constructive receipt such that a taxpayer is taken to have received the amount as soon as it is applied or dealt with in any way on the taxpayer's behalf or as the taxpayer directs); and (2) the accruals basis (whereby the income is recognized as it accrues, when it becomes "due" to the taxpayer).

The accruals method is likely to be the most appropriate to determine business income.

By contrast, the cash receipts method is likely to be appropriate to determine income derived by an employee (i.e., salary and wages), non-business income (fees for a service outside of a business context) and income from passive investments. An amount of back-pay or any kind of retrospective adjustment of salary or wages is assessable in the year of its receipt and cannot be apportioned over the period in which the services were performed by the recipient. As an example of distinction between business and non-business income, except in the case of banks or finance companies, interest is not assessable until it has been received or the debt for the interest has been in some way discharged (by contrast, for a bank interest income is earned as the interest accrues irrespective of when the interest is paid).

d. *Inventories*

Inventory is generally referred to as trading stock in Australia.

Very broadly, any gain or loss from the sale of trading stock is assessable/deductible.

Division 70 of Part 2–5 of the 1997 Act contains extensive provisions dealing with the manner in which inventory is to be taken into account for income tax purposes and the values to be used for inventory in certain specified circumstances. Although the provisions are very detailed, they do not affect the normal accounting treatment of inventory in the majority of cases. Rather, they are intended to protect the Revenue from the effect of unusual or unconventional accounting treatments. In general, inventory may be valued at cost, or at market, selling or replacement value, and, except in the case of livestock, a taxpayer may value part of the stock at cost, part at market and part at replacement value.

Where inventory is transferred between parties at prices in excess of arm's-length prices, the Commissioner may substitute the lower arm's-length price under section 70-20 of ITAA 1997. This provision was inserted to combat the transfer of taxable income by means of selling inventory at excessive prices in non-arm's-length transactions.

Taxation Ruling TR93/64 requires consumables, labels, packing, and other materials to be included in trading stock if the materials form part of the product or are provided to the customer as an incidental part of the goods sold.

Special rules apply in calculating the opening and closing values of livestock used in a business of primary production. Taxpayers can elect (on an annual basis) to use one of four methods i.e., cost price, market value, replacement cost or a special valuation (e.g., for obsolescence). The method chosen must be used for all stock and can be changed only with ATO approval. An "average cost" method is used in calculating cost price and this involves using the following minimum prescribed values for natural increase.

	A$
Sheep	4
Cattle	20
Pigs	12
Horses	20
Goats	4
Deer	20
Emus	8
Poultry	0.35

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Concessions to horse breeders provide a further valuation option to breeders in relation to horses:[116]

(i) Stallions: cost price, reduced by up to 25% per annum on a prime cost basis; and

(ii) Mares: cost price reduced by 33.3% per annum on a cost price basis or cost price reduced by annual installments reducing the value to A$1 by the end of the year in which the horse is aged 12 years, to a maximum of 33.3% of the cost price.

The above options are available only with respect to horses that have attained three years of age before the end of the year of income. Once a livestock valuation basis is established, it cannot be changed without the Commissioner's consent.

Service fees on the acquisition of horses by natural increase are to be taken into account in determining the cost of a horse for trading stock purposes.

e. Reserves

Where an amount has been received in advance of the supply of goods or services, the general rule is that the amount has not been derived while there is still the possibility that the amount, or part of it, would have to be repaid due to the services to which the income relates have not been provided.

3. Calculation of Gross Income

a. In General

The first step in calculating taxable income is to ascertain assessable income.

Assessable income includes both income according to ordinary concepts (i.e., what the case law has determined over the years to be income) and other amounts determined by reference to specified statutory provisions (e.g., certain types of capital gains). The latter category is often referred to as "statutory income."[117]

Australian residents are subject to tax on their worldwide income. Nonresidents are taxed only on their ordinary income with an Australian source and other amounts that have the requisite statutory connection with Australia.[118] Section 10-5 of the 1997 Act provides a detailed checklist of items of statutory income included in both ITAA 1936 and ITAA 1997, and Section 11–15 provides a detailed checklist of income that is exempt from tax.

The concept of "ordinary income" is a product of case law and over many decades the Courts have developed a range of attributes and tests to identify ordinary income amounts.[119]

Income from property and income from carrying on a business are typical examples of gains that will be classified as income under ordinary income tax principles. Also included with the definition of ordinary income are gains made from the disposal of property acquired as part of a profit-making scheme for the purpose of profit-making by sale, even if it is an isolated transaction.[120]

The calculation of gross income, generally referred to in Australia as "income according to ordinary concepts" is not a term of art but rather "must be determined in accordance with the ordinary concepts and usages of mankind."[121] In *FC of T v. The Myer Emporium Ltd*, 87 ATC 4363, the Full High Court (in a joint judgment) said (at page 4370): "The *periodicity, regularity and recurrence* of a receipt has been considered to be a hallmark of its character as income in accordance with the ordinary concepts and usages of mankind" (emphasis added). The meaning of "income" was noted as relevant by the Full High Court in *Arthur Murray (NSW) Pty Ltd v. FC of T* (1965) 14 ATD 98 where their Honours stated (at page 101): "used without relevant definition, is left to be understood in the sense which it has in the vocabulary of business affairs."

Over time, the concept of what can constitute income has broadened beyond notions of periodic, regular and recurrent receipts. The High Court's decision in *FC of T v. The Myer Emporium Ltd* 87 ATC 4363 establishes that the profit arising from an isolated business transaction will be of an income nature if the taxpayer's purpose in entering into the transaction was to make a profit, notwithstanding that the transaction was extraordinary judged by reference to the ordinary course of the taxpayer's business.

However, there are limits on the types of receipts that can constitute ordinary income. In *Westfield Ltd v. FC of T* 91 ATC 4234, the Court held that where a transaction is outside the taxpayer's ordinary business activity or a necessary incident thereof, it will be necessary to find, not merely that the transaction was "commercial" but also that there was, at the time the transaction was entered into, the intention or purpose of making a profit by reference to a transaction contemplated when the asset was acquired. The profit-making purpose must exist in relation to the particular operation by which the profit was in fact made and not simply in a temporal sense. Merely disposing of an asset (for consideration) in the most advantageous way will not, in itself, be income if it not in the course of carrying on the ordinary business operations of the taxpayer.

b. Capital Gains

The capital gains provisions are in Parts 3-1 and 3-3 of ITAA 1997. Under these rules, capital gains are crystallized by a taxpayer when a "CGT Event" occurs to a "CGT Asset."

The definition of a CGT Asset is extremely broad. It includes all types of property and any legal or equitable rights.

The definition of a CGT Event is also extremely broad. A complete list of CGT Events is set out in Division 104 of Part 3-1 of ITAA 1997 and is included in Worksheet 4. The most common CGT Event is the legal transfer of an item of property (referred to as a CGT Event A1), but other CGT Events are potentially wide enough to literally catch any "act, transaction or event" occurring to a CGT asset held by a taxpayer (subject to various exemptions found within the capital gains provisions).

The capital gain from a CGT Event is calculated by reference to the capital proceeds from the CGT Event less the cost

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[116] ITAA 1997, Sec. 70-60.

[117] ITAA 1997, Secs. 6-5 and 6-10.

[118] ITAA 1997, Secs. 6-5 and 6-10(3).

[119] See Jordon, C.J. in *Scott v. C. of T* (NSW) (1935) 35 SR (NSW) 215 at 219.

[120] See *FCT v. Myer Emporium Ltd.* (1987) 18 ATR 693 and *Westfield Ltd v. FCT* (1991) 21 ATR 1398.

[121] See Jordan J of the NSW Supreme Court in *Scott v. C of T* (NSW) (1935) 3 ATD 142 and *FC of T v. Cooke & Sherden* 80 ATC 4140, Brennan, Deane and Toohey JJ, at pp 4147–4148.

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base of the CGT Asset. Capital losses can be offset only against capital gains. If capital losses exceed capital gains for a particular year of income, the excess loss can be carried forward and offset against capital gains from future years.

Concessions are available for assessable net capital gains that relate to CGT Assets held for more than one year. Resident individuals and trusts are entitled to discount the assessable portion of such capital gains by 50%. Compliant superannuation entities and certain assets of life insurance companies qualify for a 33.33% discount. Companies do not qualify for a discount.

In the context of CGT Event A1 (legal transfer), the time of disposal is when the contract for sale is executed. A similar test (focusing on contract execution) applies for determining when property is acquired. This timing rule is important for determining the year of income in which the CGT Event occurs and determining whether the CGT Event qualifies for the CGT discount set out above for assets held for more than one year.

> *Example:* On July 1, 2010, Max enters into a contract for the acquisition of land. The contract is settled on August 1, 2010. On June 25, 2011, Max enters into a contract to sell the land. The contract is settled on September 1, 2011. In this example, because the contract for sale is entered into on June 25, 2011, the taxable CGT Event (transfer) occurs in the June 30, 2011, income year. Furthermore, because the period from when the contract for acquisition and the contract for sale were entered into is less than one year, any gain on sale does not qualify for the 50% CGT discount.

There are various exemptions from the CGT rules. The most important are:

(i) For any gain from the sale of the principal place of residence of an individual;

(ii) For the transfer of assets on death;

(iii) The rollover relief in connection with certain asset reorganizations (see below); and

(iv) For an interest in a Venture Capital Limited Partnership (see IX.D., below).

Relief from CGT is sometimes available in the form of a rollover relief. A rollover may require the taxpayer to elect or choose its operation or it may apply automatically. The various forms of rollover relief available to taxpayers can be found in:

(i) Division 122 of Part 3-3 of ITAA 1997, which contains rollover relief for the transfer of assets by individuals, trusts and partnerships to wholly owned companies. The shares received as consideration of the transfer of the asset must not be redeemable and the market value of these shares must equal the value of the assets transferred (and, in the case of a partnership, must reflect the proportionate interest of each of the partners in the asset rolled over into the company).

(ii) Division 124 of Part 3-3 of ITAA 1997, which contains replacement asset rollover relief concessions. These include:

- Share exchange. Where a shareholder's shares are redeemed or cancelled in exchange for (only) other shares of the same class, and of the same value, in the same company.

- Corporate interposition. Where a resident company is interposed between shareholders and an existing resident company, the rollover will be available provided (a) immediately after the reorganization the interposed company is the only shareholder in the original company; (b) the shareholders of the original company receive no consideration for the disposal of their shares in the original company other than nonredeemable shares in the interposed company; (c) the former shareholders in the original company have the same proportionate interest in the interposed company as they held in the original company and are the sole shareholders in the interposed company; and (d) the market value of the shares received in the interposed company is equal to the market value of the shares in the original company.

- Rollover relief. This is available for asset replacement in specified circumstances, for example: compulsory acquisition, loss or destruction, statutory license expiry, surrender or renewal of strata title conversion.

- Rollover relief. This is available where a split or consolidation takes place with respect to company-issued rights or options to acquire shares or rights or options to acquire units issued by unit trusts.

Rollover relief is also provided for scrip-for-scrip takeovers. That is, where a share in a company (Target) is exchanged with a share in another company (Purchaser), if Purchaser acquires more than 80% of the voting shares in Target, the original shareholder will be able to roll over any gain on exchange until the new shares in Purchaser are sold. These tax concessions have been drafted to align the regime with the Corporations Act treatment of bids and schemes of arrangements. Similar relief is available for scrip-for-scrip takeovers of trusts.

(iii) Division 125 of Part 3-3, which contains the demerger rollover relief (see 12., below).

(iv) Division 126 of Part 3-3, which contains various same asset rollovers. These concessions allow for the rollover of gains on the transfer of assets between husband and wife on marriage breakdown, between a resident company to an Australian branch of a nonresident parent (or vice versa), the amendment and restructuring of certain types of complying superannuation funds, and the transfer of assets between fixed trusts where both trusts have the same beneficiaries with the same rights to income and capital and the transferee trust is (effectively) a new trust with nominal assets just before the transfer time.

(v) Division 152 of Part 3-3, which contains various exemptions and rollover in respect of capital gains made by small business entities and entities whose maximum net asset value is less than A$6 million with respect to CGT assets used in active businesses.

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c. Dividends

Dividends are generally assessable income in the hand of a shareholder (including corporate shareholders). This can include liquidation distributions from a company to the extent to which they are not a return of the capital invested.

Australia uses an imputation system of company taxation. Under this system, corporate income tax paid by a company can be distributed to shareholders through a system of imputation credits (to eliminate the risk of double taxation on the income of a company in the hands of the shareholder). Dividends carrying an imputation credit are known as franked dividends. The system requires companies to establish and maintain a "franking account" to record the tax that has been paid by the company (and tax credits on franked dividends received from other Australian companies). The balance of the franking account must be reconciled at the end of each year of income. If a company's franking amount is in deficit as at the end of a year of income, the company may be liable to pay franking deficit tax to compensate for the deficit.

A company is obliged to issue shareholders with a statement setting out details of the franked and unfranked dividends (i.e., dividends that do not carry an imputation credit) paid, and the imputed tax.

This system is based on a "gross-up and credit" methodology. That is, shareholders must include in their assessable income an amount equal to both any dividend received and the amount of any company tax allocated to the franked dividend (i.e., the imputed tax). The shareholder is then allowed a credit against tax payable for the amount of the tax credit.

The calculation of the imputed tax on a franked dividend is based on the applicable rate of company tax. With the current rate of company tax being 30% the imputed tax is calculated as:

Franked amount of dividend × 30/70

If the imputation credit exceeds the tax assessed on the dividend income of a resident shareholder, the excess credit can be offset against tax assessed on other income. Resident individuals and superannuation funds receive a cash refund for any excess credits. A tax return must be lodged for the refund of excess credits to be received.

Assuming a cash dividend of A$70 is received by a resident individual taxpayer subject to the following marginal tax rates, the tax calculations are:

	Marginal Tax Rates		
	15%	30%	47%
Dividend received	70	70	70
Imputation credit	30	30	30
Assessable dividend	100	100	100
Tax on A$100	15	30	47
Less: Imputation credit	(30)	(30)	(30)
Tax Payable/(Excess credit)	15	NIL	(17)

Excess imputation credits cannot be applied to reduce any Medicare levy liability.

Various provisions are in place to combat the "streaming" and trading of tax credits attached to franked dividends. Among other things, most companies are required to frank all dividends within the same "benchmark" period by the same rate (there is a limited exemption for public listed companies with one class of share capital). For most companies each benchmark period is six months (splitting each year of income into two). For private companies, this period is extended to 12 months.

A franking account tax return must be completed by companies that are liable to pay franking deficit tax or over-franking tax or are required to disclose information regarding a significant variation in benchmark franking percentages. The return is required to be lodged by the last day of the month following the end of the income year. That lodgment date is also the date by which any franking deficit tax and/or over-franking tax is payable.

Nonresident shareholders are generally subject to withholding taxes (see VI.B.3.b., below.)

Dividends paid to corporate shareholders by a nonresident company may be exempt (see d.(2), below.)

d. Income from Foreign Sources

As a rule, an Australian resident taxpayer is assessed on income from both Australia and overseas. Double taxation is generally managed through a comprehensive foreign tax offset regime that ensures that Australian residents generally receive a credit for foreign tax paid on foreign sourced income.

There are three main exceptions available for Australian resident companies, where foreign income qualifies for an exemption from Australian tax (rather than a credit). These are set out in (1) to (3), below.

(1) Foreign Branch Income

Where a resident company carries on business in a foreign country through a permanent establishment (PE) in that foreign country, the income derived from those business operations may be exempt from tax in Australia under section 23AH of ITAA 1936. The exemption applies to both income from the conduct of business carried on by the branch and capital gains from the disposal of the business assets of the branch.

The application of this exemption depends upon the foreign country in which the branch is situated. As a rule, income derived through a PE in Canada, France, Germany, Japan, New Zealand, the United Kingdom and the United States will qualify for tax-exempt status. Income from these countries can only fall outside the scope of the section 23AH exemption if the income is concessionally taxed in the other country *and* it is a type of income specifically referred to in a table in the Income Tax Regulations as "designated concession income." A copy of the table is set out in the Working Papers.

For other jurisdictions, the income will generally qualify for this exemption if it is *not* "adjusted tainted income." The components of adjusted tainted income are set out in Worksheet 3.

(2) Foreign Dividends

Division 768-A of ITAA 1997 provides that a dividend received by a resident company from a nonresident company will be exempt where the resident corporate shareholder has a 10%

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voting interest in the foreign company, and the shares are equity for Australian purposes. See generally the discussion of the debt/equity rules at 4.q., below.

This exemption is based on the premise that the income from a foreign subsidiary has most likely been taxed in a foreign jurisdiction before being paid back to Australia. To stop companies abusing this concession by way of parking income offshore in foreign companies, Australia has a comprehensive set of accrual rules designed to attribute back to Australia (and tax) income held offshore in companies in tax havens (see XIV.A., below).

(3) Disposals of Non-portfolio Interests in Foreign Companies

Gains from the sale of foreign subsidiaries by Australian resident companies may also qualify for a concessional tax benefit. Very broadly, where an Australian corporate shareholder sells a specified non-portfolio interest (10% or more) in a foreign company (that has not undertaken certain activities), the gain on the sale may be exempt from taxation under Australia's CGT rules.

Comment: This can also be an important concession for multinationals with an Australian resident regional holding company wishing to restructure their global operations. As an example, if foreign subsidiaries are held by an Australian resident regional holding company, it should be possible to move these foreign subsidiaries out from under the Australian group without incurring any Australian tax on disposal of the shares. Noting the broad scope of Australia's Controlled Foreign Company (CFC) provisions, this may be an attractive avenue for multinational groups with material foreign income otherwise caught by Australia's CFC rules. This can be important where foreign subsidiaries of the Australian subgroup have material IP — as royalty income earned by CFCs from the use of IP by related entities is typically caught by the CFC regime. Naturally, in undertaking such a restructure, it would be important to consider the potential application of Australia's Diverted Profits Tax (DPT) and General Anti Avoidance Rules (GAAR).

e. Equity Incentives

Under Division 83A of ITAA 1997, the tax treatment of shares or rights acquired under an employee share scheme depends upon the structure of the scheme.

The general rule under Division 83A is that a taxpayer who acquires an Employee Share Scheme (ESS) interest is taxed on any discount at the time of acquisition.

However, this general rule is subject to various exceptions. In particular, deferral is possible where the ESS interests are at "real risk of forfeiture." Employees may also defer where the ESS interests are acquired by salary sacrificing (to a maximum of A$5,000). In these circumstances, the deferred taxing point is the earliest of: (i) the time at which there is no longer any real risk of forfeiture of the shares/rights, or any genuine restrictions (present at the time of acquisition) on the sale of the shares/rights are lifted; (ii) when the taxpayer ceases employment with the relevant employer; or (iii) seven years after the shares/rights were acquired.

There will be a real risk of forfeiture if, for example:

(i) The employee will lose the share or right if he/she does not satisfy meaningful performance hurdles or a minimum term of employment is not completed;

(ii) The reasons for forfeiture are beyond the employee's control; and

(iii) The risk of forfeiture is not contrived.

Refunds of tax paid on ESS interests that are later forfeited are available where the taxpayer had no choice but to forfeit the ESS interests, or where the taxpayer made a choice to resign from employment.

Refunds are not available where the scheme is structured to protect employees from market risk, or where the forfeiture is intentional due to market conditions (e.g., the taxpayer chooses not to exercise rights because the exercise price exceeds the prevailing share price).

Where the employment benefits are initially granted in a form that leaves doubt whether the benefit will finally comprise ESS interests, or where the number of ESS interests is uncertain, if and when it becomes clear, Div. 83A applies as though the benefit had always comprised those ESS interests.

(1) Common Types of Plans

(a) A$1,000 Tax-exempt Plans (Not Subject to Tax in the Hands of Employees at Any Time)

The conditions for A$1,000 exempt plans include the following:

(i) The employee's taxable income (after adjustments (increases) for reportable fringe benefits, reportable superannuation contributions and any total net investment loss) is A$180,000 or less;

(ii) The shares or rights is not subject to a real risk of forfeiture;

(iii) At the time the ESS interest is acquired, the employee is employed by either the company providing the ESS interest or one of its subsidiaries;

(iv) The particular scheme (including any financial assistance with respect to the scheme) is operated on a nondiscriminatory basis in relation to at least 75% of permanent employees who have completed at least three years of service;

(v) The ESS interests offered under the scheme relate to ordinary shares;

(vi) The shares or rights are required to be held by the employee for three years or until the employee ceases employment; and

(vii) Immediately after the employee acquires the ESS interest, the employee (together with their associates) does not hold a beneficial interest in more than 10% of the shares in the company and is not in a position to cast, or to control the casting of, more than 10% of the maximum number of votes that might be cast at a general meeting of the company.

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(b) Deferred Plans — Shares

Under such plans:

(i) Deferral is available only if there is a real risk of forfeiture or shares are acquired under a salary sacrifice arrangement and a number of other requirements are met (including that schemes are broadly available);

(ii) The discount is calculated as the market value at the deferred taxing point (or the market value at the time of sale if the shares are sold within 30 days) less anything paid to acquire the shares; and

(iii) The deferred taxing point is very broadly the earliest of the following times:

- When there is no longer a real risk of forfeiture or genuine restrictions on disposal (that were present from the outset) are no longer present;
- When the employment ceases; or
- 15 years after the employee acquired the share.

(c) Option Plans

Under such plans:

(i) There is upfront taxation unless there is a real risk of forfeiture or the options are subject to genuine restrictions on disposal and there is a statement in the plan or accompanying documents that tax deferral is to apply;

(ii) The discount is calculated as the market value of the ESS interest at the deferred taxing point (or the market value at the time of sale if sold within 30 days) less the cost base (which should include the exercise price where an option has been exercised);

(iii) The deferred taxing point is the earliest of:

- When there ceases to be a real risk of forfeiture and any genuine restrictions on disposal of the option cease to exist;
- When the relevant employment ceases;
- When the option has been exercised and no further restrictions exist; or
- The end of the 15th year after acquisition; and

(iv) Most options will be taxed once exercised unless the employees cease employment prior to and do not forfeit their options, in which case they will be taxed on the date of cessation of employment.

(d) Performance Rights and Restricted Stock Unit Plans

Under such plans:

(i) If the employee acquires a right to acquire a specific number of shares, the issues are the same as for option plans;

(ii) If there is no right to acquire shares, the payment is likely to be salary or wages when it is paid; and

(iii) If a benefit is provided that does not constitute a right to acquire a specific number of shares at the outset, but the benefit later constitutes an ESS interest, the benefit is treated as an ESS interest from the time the original benefit was provided.

For example, where a Restricted Stock Unit (RSU) is granted and the employer has the choice of whether to issue shares or rights or pay cash on vesting and the employer ultimately decides to issue shares or rights at a discount, an ESS interest will be considered to have been acquired at the time of the original grant of the RSU. Employees will be required to amend a prior year's income tax return if a taxing point has occurred in a prior year in relation to such shares or rights. For these purposes, the Commissioner is given the power to amend an assessment at any time for the purpose of taxing a right which later becomes an ESS interest. This could result in significant implications for employees including shortfall interest charges. The employer will also need to ensure that it meets its reporting obligations for the particular year.

(e) Loan Plans

If a loan is provided to an employee and the employee pays full market value for the shares or rights, Division 83A should not apply. If the employee receives a discount to market value, the rules in relation to shares or options should apply as discussed above. A loan plan should be carefully structured to prevent the loan giving rise to a taxable fringe benefit or a deemed dividend.

(2) Employer Reporting Obligations and Tax Treatment

Providers/employers are required to:

(i) Provide a statement (containing a range of information including the market value of interests at relevant times) to the ATO and to the employee if a taxing point has occurred in relation to an ESS interest during an income year; and

(ii) Withhold tax if an employee has not provided his or her TFN. A TFN declaration given by an employee to an employer who is a subsidiary of the provider of the ESS interest authorizes the employer to inform the provider of the ESS interest of the employee's TFN. This should make it easier to comply with the new TFN withholding tax regime.

Employers can deduct an amount for ESS interests provided under schemes subject to upfront taxation or deferral provided the ESS interest has been acquired by an employee.

Discounts or gains on ESS interests that relate to employment outside Australia are treated as income from sources outside Australia, whether subject to upfront taxation or deferred taxation.

The tax consequences for resident, nonresident and temporary resident taxpayers who receive such discounts or gains are then determined by the core residence and source rules relating to statutory income.

(3) Refunds When Rights Lapse

No refund is available if a lapse of options was the result of a choice by the employee (except a choice to cease employment, not exercise an option or allow it to lapse) or a condition of the plan that protects the employee from market risk.

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(4) Relationships Similar to Employment

The rules in Division 83A will apply to directors, office holders and independent contractors.

(5) Stapled Securities

Stapled securities will be treated in the same way as shares provided at least one of the elements of the stapled security is a share in a company. To obtain any tax concessions the share must be an ordinary share.

(6) Nonresidents and Temporary Residents

To the extent that a discount on an ESS interest relates to employment outside Australia, the discount is taken to be from a foreign source and the normal source rules will apply.

(7) Employee Share Trusts

In limited circumstances, capital gains tax may apply to trustees of employee share trusts on the allocation and transfer of an ESS interest. If a trust qualifies as an employee share trust, certain capital gains tax exemptions may apply. The market value of shares or rights less any consideration given by the employee should be included in the calculation of taxable wages for payroll tax purposes in all Australian States and Territories. Where the total taxable wages in the relevant State or Territory exceeds the applicable threshold, the employer company will be liable to pay payroll tax in that State or Territory.

(8) Payroll Tax

The market value of shares or rights less any consideration given by the employee should be included in the calculation of taxable wages for payroll tax purposes in all Australian States and Territories. Where the total taxable wages in the relevant State or Territory exceeds the applicable threshold, the employer company will be liable to pay payroll tax in that State or Territory.

(9) Australian Taxation Office Guidance

The ATO has released some further guidance in relation to the application of the ESS provisions. Specifically, the ATO has released guidelines on the following:

(i) Employer reporting requirements for ESSs;

(ii) Market value of listed shares and stapled securities;

(iii) Market value of unlisted rights to acquire listed shares and stapled securities;

(iv) Real risk of forfeiture;

(v) Indeterminate rights;

(vi) Deferred taxing points — genuine disposal restrictions; and

(vii) Lapsed and forfeited ESS interests.

The discussion in (10) to (17) below covers notable points in relation to the guidelines.

(10) Reporting Requirements

An ESS statement is required to be provided to an employee by July 14 after the end of a financial year if:

(i) The employee (or an associate of the employee) has acquired ESS interests under a taxed upfront ESS at a discount during the financial year; or

(ii) A deferred taxing point for ESS interests acquired under a tax-deferred ESS has arisen or could have arisen in the financial year.

An ESS annual report must be provided to the ATO by August 14 after the end of the financial year if an ESS deferred taxing point occurred for at least one employee during that year. The ESS annual report must be in an approved ESS annual report form, which must include certain information about each employee participating in an ESS and for each ESS that the employee is participating in. The report can be lodged earlier if all activities for that ESS plan have ceased for the financial year. A separate ESS annual report must be lodged for each provider and for each financial year.

(11) Tax-deferred Interests

The guidelines indicate that there is no requirement to provide information about ESS interests acquired under a tax-deferred ESS in respect of the year of grant (although the legislation provides that such information may be required).

(12) Amendments

Where the employer becomes aware of any material change or omission in any information given to an employee or the ATO, the employer must use the pro-forma amended ESS statement (for the employee) or the ESS annual report form (for the ATO) to provide them with the corrected information within 30 days of becoming aware of the change or omission.

(13) Annual Reports

The guidelines set out the information that must be provided in an ESS annual report to be provided to the ATO for each employee participating in an ESS and for each ESS that the employee is participating in.

When determining and reporting the discount at the deferred taxing point, if the employer knows that the ESS interests were disposed of by the employee within 30 days of the original deferred taxing point, the employer must take account of the 30-day rule. In some cases, this may move the deferred taxing point from one year into the next and may require the amendment of an ESS statement or ESS annual report issued in respect of the earlier year.

(14) Indeterminate Rights

The guidelines contain a discussion and a number of examples in relation to the reporting requirements where a right is provided to an employee, but the entitlement to a share or a specific number of shares is uncertain at the time of grant. If, ultimately, the employee receives a certain number of shares, the employee is taken to have acquired an ESS interest at the time the original right was provided. The guidelines indicate that in some cases it will be necessary to provide an amended ESS statement to the employee and an amended ESS annual report to the ATO within 30 days of the indeterminate right becoming an ESS interest (see also Income Taxation Determination TD 2016/17).

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(15) Market Value

Under Division 83A, "market value" of unlisted rights is determined according to ordinary principles or using the statutory valuation table set out in the Regulations.

The Assistant Treasurer commissioned and released the Board of Taxation's review into elements of the taxation of ESS arrangements on April 23, 2010. Four out of the five Board of Taxation's recommendations relate to the valuation rules (see below) and these recommendations were accepted by the Government.

In response to the four recommendations relating to the valuation rules, the ATO has released some guidance in the form of fact sheets and an online calculator tool to assist providers of ESS in preparing statements for employees and for the Commissioner.

The ATO has indicated that it will accept any reasonable method for determining the value of listed shares in particular circumstances and provides examples of methods it considers reasonable.

The guidelines indicate that it is reasonable to use the methods prescribed under the old ESS rules (for example, seven-day weighted average).

Other methods that may be reasonable in particular circumstances are:

(i) Average cost of shares actually purchased by a trustee or administrator;

(ii) Weighted average closing price based on the closing market prices over the five trading days before the particular day. This may be acceptable:

- For valuing newly issued shares on the day on which they were issued; or
- For valuing listed shares at the deferred taxing point where the shares are not sold within 30 days.

(iii) Retail offer price for new shares issued to employees as part of a public float (provided shares are issued to employees within five days either side of the shares being issued under the float) or public offer;

(iv) Closing price of the particular stock. This may be acceptable for valuing listed shares at the deferred taxing point where the stock is relatively liquid and does not exhibit significant price volatility.

(16) Risk of Forfeiture

The guidelines reinforce the guidance provided in the Explanatory Memorandum (EM) and ATO Interpretative Decision 2010/61 (ID 2010/61).

The ATO reiterates that whether there is a real risk of forfeiture depends upon the facts and circumstances of the scheme and the individual circumstances of the employee. This is particularly the case where the ESS features performance hurdles as it requires a judgment at the time of grant of the likelihood of the company meeting the specified targets.

The ATO has confirmed the position outlined in ID 2010/61 that it accepts that there will be a real risk of forfeiture where the minimum term of employment is at least six months and the maximum deferral is no more than three years; or where the minimum term of employment is at least 12 months. Although, depending on the facts, an ESS interest can be subject to a real risk of forfeiture even if it falls outside these parameters.

A number of examples are provided to illustrate when there will be a real risk of forfeiture — the following are worth noting:

(i) Early vesting on takeover — where there is a minimum term of employment condition, a discretion to vest rights early in the event of a takeover does not prevent there being a real risk of forfeiture; and

(ii) Retirement — the examples indicate that whether there is a real risk of forfeiture will depend on the employee's intention at the time of grant. If the employee has no intention of retiring during the standard forfeiture period, there will be a real risk of forfeiture. The examples in the new guidelines seem different to the example in the EM which does not take into account the employee's intention.

(17) Deferred Taxing Point: Genuine Disposal Restrictions

Genuine disposal restrictions:

(i) Must be in the conditions of the ESS when the employee acquires the ESS interest; and

(ii) Can be:

- A condition of the scheme that prohibits an employee from disposing of a share for a fixed period of time — where the disposal restriction is enforced by a holding lock or by the shares being held in a trust;
- A condition of the scheme (including documented company policy) that prohibits disposal of the shares or rights or exercise of the rights where that disposal would be in breach of insider trading prohibitions; or
- A contractual condition of the scheme that prohibits the employee from disposing of the ESS interests, provided there are some serious and enforced consequences for breaching the condition.

Restrictions that can be lifted in special circumstances or cases of financial hardship can still be genuine.

There is no genuine disposal restriction if:

(i) The employee can take action to dispose of the ESS interest; or

(ii) A disposal is subject to a request for approval by the board of directors of the company or a delegate, but such requests are routinely approved.

Disposal restrictions are lifted when the employee has the first opportunity to dispose of his/her ESS interest — whether or not the employee chooses to do so; for example, there is a trading window, even if the employee does not actually sell his/her ESS interest.

(18) Employee Share Scheme Regulations

Regulations have been issued for the purposes of valuing unlisted rights acquired under an employee share scheme.

Under the Regulations, a participant who receives unlisted rights (i.e., rights not quoted on an approved stock exchange) under an employee share scheme can value such rights in accor-

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dance with ordinary principles or using the valuation methodology set out in the Regulations.

The valuation methodology set out in the Regulations essentially replicates the valuation tables in the former employee share scheme rules.

It is noted that the valuation tables can only be used by a participant who has acquired unlisted rights that:

(i) Are included in a participant's assessable income on or after July 1, 2009;

(ii) Have an exercise period of 10 years or less; and

(iii) Have a taxing point that is not the date of disposal of the rights or the underlying shares (because of the operation of the "30-day rule").

Where a participant's rights have an exercise period of greater than 10 years, or where the taxing point is aligned with time of disposal of the right or underlying share, the market value of the rights must be determined using ordinary principles.

(19) Employer Deductions

In the context of qualifying shares or options provided to employees, the employer may qualify for a A$1,000 deduction per employee for the benefits provided. In all other circumstances, shares or options issued by a company over its own share capital as part of an ESS would not be deductible.

f. Debt Defeasance

In a common defeasance arrangement, a third party receives from the borrower consideration equal to the present value of the loan. The third party then assumes responsibility to repay the loan when it becomes due for payment. The borrower's liability for interest continues unaffected.

The income tax consequences arising from a defeasance arrangement are complex and there is a diversity of judicial opinion on the treatment of such arrangements. In *FCT v. Orica Ltd*,[122] the High Court held that the benefit that the taxpayer received under the debt defeasance arrangement was neither income according to ordinary concepts nor was it a profit of any description. The High Court applied the capital gains tax (CGT) provisions as the rights acquired to have the liabilities discharged were assets for CGT purposes.

In contrast, Spender J. in the Federal Court decision of *Unilever Australia Securities Limited v. FCT*[123] held that the taxpayer had not derived a profit or gain from a debt defeasance transaction. On appeal,[124] the Federal Court ruled that the amount was assessable.

g. Foreign Exchange Gains and Losses

Division 775 of ITAA 1997 provides a comprehensive framework for the taxation of realized gains and losses arising from currency movements.

Banks and other financial institutions were excluded from this regime on the basis that a comprehensive regime for the taxation of these types of entities would be introduced in the near future. This regime has now been enacted (see Division 230 of ITAA 1997 discussed at h., below). As a practical matter, it is questionable whether there are any significant consequences of this carve-out as these entities are simply subject to a more complicated regime that predated Division 775.

Under Division 775:

(i) Forex gains and losses are treated on revenue account, so that a forex gain is treated as assessable income and a forex loss is deductible (short-term gains/losses are an exception in certain circumstances); and

(ii) A forex gain or loss occurs if a "forex realization event" occurs. There are eight events in total: five main ones, two related to the financing facilities and one associated with the limited balance exemption. They are discussed in (1) to (8), below.

(1) Forex Realization Rules

The forex realization rules will apply regardless of whether there is actual conversion of the foreign currency into Australian dollars. Under the realization rules, a currency gain or loss will be treated as realized if any of the following "forex realization events" (FRE) occur:

(i) FRE 1 — an entity disposes of foreign currency or a right to it.

(ii) FRE 2 — an entity ceases to have a right to receive foreign currency. (For example, the receipt of foreign currency by a vendor of property from the purchaser under a sale contract denominated in a foreign currency with payment obligations on deferred terms.)

(iii) FRE 3 — an entity ceases to have an obligation to receive foreign currency. (An example is where the entity writes a put option over foreign currency.)

(iv) FRE 4 — an entity ceases to have an obligation to pay foreign currency. (Such an FRE would arise, for instance, if an entity discharges by payment an amount borrowed under a Euronote facility.)

(v) FRE 5 — an entity ceases to have a right to pay foreign currency. (A right to sell foreign currency under an option may cease because the option expires without being exercised or because it is cancelled, released or abandoned.)

A forex realization gain or loss is disregarded to the extent it represents exempt income or is made in gaining exempt income.

Another example of disregarded gain or loss would be where a foreign currency denominated loan is repaid to the creditor.

If more than one FRE applies to a transaction, the event that best reflects economic and accounting practice in the circumstances is preferred.

(2) Ordering Rule for Fungible Currency

Division 775 provides an "ordering" rule, which in effect requires that if any of the forex realization events under the general forex realization rules happens to foreign currency or a fungible right or obligation to receive or pay foreign currency, the event is applied on a first-in-first-out basis. An option to

[122] (1998) 39 ATR 66.
[123] (1994) 28 ATR.
[124] *FCT v. Unilever Australia Securities Ltd.*, 30 ATR.

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use a weighted average basis instead may be prescribed in the Income Tax Regulations at a later date.

Set out below are three typical examples of when these rules would apply in practice.

(a) Borrowings

An exchange gain or loss may arise on repayment of a foreign currency loan where the amount of Australian dollars required to repay that loan is more or less than the amount of the liability originally recorded in the taxpayer's accounts in respect of the loan.

(b) Investments

In its own accounts, a taxpayer that purchases an overseas asset would reflect the amount paid for the asset in Australian dollars. Part of any gain or loss arising on disposal of the asset may be due to movements in the exchange rate, rather than variations in value of the asset. That gain/loss relating to the foreign exchange movement may need to be recognized as a separate revenue item in the accounts of the taxpayer.

(c) Hedging Transactions

Taxpayers involved in foreign currency transactions often enter into hedging contracts to protect themselves against the effect of adverse currency fluctuations. These hedging transactions can take a variety of forms including swaps, options or forward purchases or sales of currencies. Under a hedging arrangement, any exchange gain or loss made by a taxpayer on a primary transaction is usually offset, either partly or wholly, by the loss or profit on the related hedging contract to the extent that the contract is hedged.

(3) Rollover Relief for Facility Agreements

FRE 6 and FRE 7 provide an exemption from the general FRE rules discussed above. The issuer of an eligible security under a facility agreement may choose to defer the taxation of forex gains and losses and rollover of any security. A facility agreement that involves the rolling over of bills of exchange or promissory notes would currently qualify for this treatment. Other securities may subsequently be specified in the income tax regulations. A material variation to the terms and conditions of the facility agreement, or to the types of security issued under it, may disqualify an arrangement from the rollover relief concession.

(4) Foreign Currency Bank Accounts

Under the new measures, taxpayers may elect either to:

(i) Have forex realization gains and losses arising under FRE 2 and 4 for particular accounts disregarded under a de minimis exempting provision; or

(ii) Adopt the retranslation basis for their "qualifying" foreign currency-denominated bank accounts.

The retranslation option enables an entity to account for forex gains and losses arising in respect of such accounts on an annual basis under a newly introduced FRE 8. Under the retranslation option, forex realization gains and losses arising under FRE 2 and 4 are disregarded. An election to apply the retranslation basis must be in writing. The entity may elect in writing to withdraw the election. A withdrawal does not prevent the entity from making a new choice.

(5) Short-term Forex Realization

An exception to the core rule deeming forex gains and losses to be on revenue account applies to forex gains and losses made in respect of the acquisition and disposal of capital assets where the time between the acquisition or disposal and the due date for payment is within 12 months. However, in the case of a depreciating asset the time period is 24 months beginning 12 months before the time the asset begins to be held. In such cases, the foreign currency gains or losses will not be assessable or deductible but will be treated as an adjustment to the cost base, cost or adjustable value for capital gains tax or depreciation purposes, as appropriate.

An entity can choose not to apply the short-term rules. To do so, the entity is required to make a once-off, irrevocable written election to that effect.

(6) Currency Derivatives

Division 775 contains comprehensive rules for currency derivatives, options and other hedging instruments relating to forex gains and losses. The rules deal with the differences between contracted exchange rates and actual future rates to cover synthetic currency exchange gains even if the actual exchange rate does not fluctuate. Various rules are adjusted to deal with derivatives contracts involving the economic setting-off of amounts. Such contracts are deemed to give rise to a legal set-off.

FRE calculation formulas (generally) capture the cost of derivatives in the calculation of the gains or losses.

The choice, which is irrevocable and must be in writing, is required to be made within 90 days after either the first time a bill is issued under the security or the applicable commencement date.

The choice applies immediately before the first time a security is issued under the facility agreement or the "applicable commencement date."

(7) Currency Translation

A core translation rule of the Australian income tax system is that an amount of foreign currency must be expressed in Australian currency for the purpose of calculating taxable income. There are a number of specific translation rules designed to support this objective. These rules specify the timing of the translation as well as the rate at which the amounts are translated into Australian currency. Very broadly, these rules require an amount to be translated into Australian dollars at the time any particular amount is derived/deductible.

(8) Functional Currency

There are also concessions that allow certain taxpayers to rely upon a "functional currency." Under the functional currency rules, an entity that functions predominantly in a particular foreign currency may elect to determine its income and expenses in that currency, with the net result being converted into Australian currency at year-end for the purposes of calculating the entity's Australian income tax liability.

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The functional currency rules are relevant for tax calculations for:

(i) PEs of nonresidents;

(ii) Offshore banking units (OBUs);

(iii) Certain foreign trusts; and

(iv) CFCs (see XIV.A., below).

h. Financial Arrangements

Division 230 of ITAA 97 deals with the taxation of "financial arrangements." Very broadly, this division seeks to match the recognition of gains and losses for tax purposes over the life of a financial arrangement to prevent tax-timing mismatches which may currently occur under the Australian income tax rules.

(1) Applicable Entities

The following entities are generally exempt from the operation of Division 230:

(i) An individual;

(ii) A superannuation entity or Managed Investment Scheme (MIS) (or an entity with a status similar to such a scheme under a foreign law relating to corporate regulation) with assets of less than A$100 million;

(iii) An authorized deposit-taking institution, a securitization vehicle or an entity that is required to register under the Financial Sector (Collection of Data) Act 2001 with an aggregated turnover of less than A$20 million; and

(iv) Any other entity whose aggregated turnover is less than A$100 million, and that has financial assets worth more than A$100 million and assets (including both financial and non-financial assets) worth less than A$300 million.

(2) Definition of "Financial Arrangement"

There is a "financial arrangement" if, under an arrangement, there is:

(i) A cash settleable legal or equitable right to receive a financial benefit;

(ii) A cash settleable legal or equitable right to provide a financial benefit; or

(iii) A combination of one or more such rights and/or one or more obligations.

However, there is no "financial arrangement" where the following are not insignificant compared to the rights/obligations listed above:

(i) Non-cash settleable rights/obligations; or

(ii) Non-financial benefit rights/obligations.

A "financial benefit" is broadly defined as anything of economic value (including property and services), and anything prescribed in the Regulations.

(3) Exempt Arrangements

Subject to the satisfaction of certain requirements, the following types of "financial arrangements" are exempted from the operation of Division 230:

(i) Short-term arrangements where amounts that are not money are involved;

(ii) Leasing or property arrangements;

(iii) Partnership and trust interests;

(iv) Life and general insurance policies;

(v) Worker's compensation arrangements;

(vi) Guarantees and indemnities;

(vii) Personal and personal injury arrangements;

(viii) Superannuation and pension income;

(ix) Interests in FIFs, FLPs or CFCs;

(x) Proceeds from business sales;

(xi) Infrastructure borrowings;

(xii) Farm management deposits;

(xiii) Deemed interest of owners of OBU units;

(xiv) Forestry MISs;

(xv) Ceasing to hold financial arrangements in certain circumstances;

(xvi) Commercial debt forgiveness; and

(xvii) Franked distributions.

(4) Tax Accounting Methods

Under Division 230, certain tax accounting methods are prescribed to allow a particular entity to recognize gains and losses from a financial arrangement. These methods are:

(i) Compound accruals;

(ii) Realization;

(iii) Hedging;

(iv) Fair value;

(v) Foreign exchange retranslation; and

(vi) Financial reports.

i. Other Inclusions in Gross Income

(1) Profits on Sales of Depreciated Property

Where property with respect to which depreciation (other than depreciation on buildings) has been allowed as a deduction is sold, any excess (to the extent of the sum of the amounts allowed and allowable as depreciation) of the net sale price over the depreciated value of the property is assessable income of the taxpayer.

(2) Insurance Recoveries

Assessable income includes insurance recoveries or indemnities received with respect to a loss of inventory taken into account in computing taxable income, a loss of income that

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would have been assessable income,[125] or a loss through fraud or embezzlement for which a deduction was allowed or is allowable.[126]

(3) Annuities

Amounts received by way of an annuity, subject to the allowance of a deduction calculated actuarially with respect to the undeducted portion of the purchase price of the annuity, are assessable income.[127]

(4) Interest, Premiums and Discounts on Debt Securities

Interest is assessable income in the hands of a resident lender. As a rule, the interest is assessable at the time of receipt.

Any gain derived on sale or redemption of a debt security is also assessable income. For certain discounted, deferred interest and discounted securities with a term greater than one year (referred to as "qualifying securities"), any such gain is assessable on an accruals basis over the term of the security — even if this is before the gain is recognized on sale or redemption.[128]

(5) Lease Incentives

Incentives to enter into a lease of business premises can in certain circumstances be income in the hands of a taxpayer.[129] The Taxation Office has ruled that: (i) Noncash benefits (e.g., cars or paintings) that can be converted into cash are taxable at their full money value; (ii) rent-free periods are effectively tax-free; (iii) free fit-outs are tax-free if owned by the landlord but assessable if owned by the tenant; (iv) payment for removal costs is assessable, except to the extent they relate to revenue items, such as trading stock; and (v) payment of the surrender value of an existing lease is fully assessable.

(6) Non-Cash Business Benefits

A non-cash business benefit may be treated as assessable income even if it is not convertible into cash, provided it is otherwise of an income nature.[130] The amount to be included in assessable income is the arm's-length value of the benefit, less any unreimbursed amount contributed by the recipient in acquiring the benefit. Any conditions that prevent, or restrict, the conversion of the benefit to cash are disregarded in determining the arm's-length value.[131]

(7) Transfers of Right to Receive Income

Consideration received for transferring to another person rights to receive income from property without also transferring the interest in the property is assessable income.

[125] ITAA 1997, Subdivision 20-A. See *McLaurin v. FCT* 3 (1961) 104 CLR 381, 8 AITR 180.
[126] ITAA 1997, Subdivision 20-A.
[127] ITAA 1936, Subdivision 27H.
[128] ITAA 1936, Sec. 26B and Div. 16E.
[129] *FCT v. Cooling* (1990) 21 ATR 13.
[130] *FCT v. Cooke and Sherden* (1980) 10 ATR 696.
[131] ITAA 1936, Sec. 21A.

j. Long-term Construction Contracts

Taxation Ruling IT2450 provides guidelines for determining when income is derived and when deductions are to be allowed, for taxation purposes, under long-term construction contracts.

Two methods of accounting for such contracts are accepted. The first method, "the basic approach," includes in assessable income all payments received in a year (as well as amounts billed) and allows as a deduction losses and expenditures to the extent permitted by the income tax law. The second method, "the estimated profits basis," allows a taxpayer to spread the profit or loss on a long-term construction project over the life of the contract. The completion-of-contract method, whereby profits or losses are brought to account only on the completion of the contract, is not accepted.

Where the taxpayer chooses a particular method, it must be used consistently over the life of the contract and with respect to all similar contracts.

k. Futures and Hedging Transactions

Income Tax Ruling IT2228 states the Commissioner's policy in applying the income tax law to futures transactions and hedging arrangements. Where a taxpayer entered into hedging transactions as an integral part of the business (i.e., the quantity of goods covered by futures transactions corresponds to estimated production of the business and there is a subsequent sale of goods of the kind covered by the transaction), any realized profit or loss on the futures transaction is taken into account in determining the gross income of the business. Where the quantity covered by the futures transaction is significantly more than the estimated production, it is outside the scope of the business activity. Tax treatment, then, depends upon whether the futures transaction represents an income activity in its own right.

Profits derived by traders in futures contracts are to be treated as assessable income and realized losses as allowable deductions.

Gains or losses on speculative transactions may or may not be regarded as assessable income or allowable deductions. The overall result of "straddle" transactions, rather than the effect in each income year, is to be taken into account for tax purposes.

l. Contractors on U.S. Government Projects

Profits and remuneration derived by a contractor or subcontractor, or an employee of a contractor or a subcontractor from the performance, in Australia, of a prescribed contract with the U.S. Government[132] is exempt income, provided the income is not exempt from U.S. income tax. The exemption applies if the contractor, subcontractor or employee is in Australia, or is carrying on business in Australia, solely for purposes of a prescribed contract. The exemption is not available to Australian companies, citizens or residents. The projects prescribed are the North West Cape Naval Communication Station, the Joint Defense Space Communications Station, the Sparta Project, and the Joint Defense Space Research Facility.

The prescribed person or dependent is deemed not to have been a resident of Australia during the relevant period and the

[132] ITAA 1936, Sec. 23AA.

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income derived under the specified conditions from the performance in Australia of prescribed contracts is deemed to have been derived from sources out of Australia. The effect of these deeming provisions is that the income referred to is exempt from Australian income tax.

4. *Business Expenses*

Once the assessable income of a taxpayer is calculated, the second step is to determine the allowable deductions that can be offset against that assessable income.

a. *In General*

Expenses necessarily incurred in gaining or producing assessable income, or in carrying on a business, are allowable deductions for all taxpayers, whether resident or nonresident, except to the extent the expenses are of a capital, private or domestic nature, or were incurred in gaining or producing exempt income.[133] A deduction is allowed for "incurred" losses and expenses. It is not necessary that payment be made. However, a legal liability must have accrued. As such, no deduction is allowable for general provisions, for instance, for doubtful debts, provisions for employee leave entitlements, etc. The phrase "private or domestic" is a combined phrase, which relates to "losses or outgoings that relate solely to the house, home or family organization of the person incurring them."[134] Arguably, the phrase "private or domestic" adds nothing to the threshold requirements of section 8-1. That is, most commentators argue that for an amount to be incurred in gaining or producing assessable income it cannot, by definition, be private or domestic in nature.

The effect of the word "necessarily" is to require a connection between the expenditure and the carrying on of the business. The expenditure must be dictated by the business ends to which it is directed, those ends forming part of or being truly incidental to the business. However, there is no need for the outgoing to produce income in the year in which the outgoing is incurred. For instance, an interest cost incurred on money borrowed to buy an asset that will not produce income for many years is deductible in the year the outgoing is incurred, as opposed to when the income is produced. As a rule, excess deductions regarding a particular investment or business can be offset against income from other activities.

As with the determination of assessable income, the determination of whether an outgoing payment is deductible is based on the same general rules irrespective of the legal form of the taxpayer. Important exceptions to this rule are noted where relevant below.

b. *Organization Costs*

Organization expenses are usually deductible, including recharged global expenses incurred by an offshore holding company of which an Australian company is a subsidiary member, and required to pay (in whole or in part). Such expenses may be subject to a mark-up, in accordance with OECD compliant transfer pricing policies (noting Australia's general compliance with the OECD standards).

[133] ITAA 1997, Sec. 8-1.
[134] (1955) 5 CRBR (NS) Case 50.

c. *Travel and Entertainment*

Entertainment and travel allowances (i.e., an amount provided with the expectation, but not an obligation, to incur relevant expenditure) may be deductible, provided that the allowance is included in the employee's assessable income and it satisfies the requirements of the general deduction provisions. That is, allowances are generally treated as being merely another form of remuneration derived by an employee.

Travel expenses incidental and relevant to a taxpayer's derivation of assessable income are deductible. As a rule, a company incurring expenditure relevant to an employee performing their duties as an employee will be deductible. If there is a material element that does not relate to the employee's role with the company, such that it can be characterized as a payment made for the purpose of reimbursing a personal non-business expense of the employee, the reimbursement may be subject to Fringe Benefit's Tax (FBT). FBT is discussed in more detail at IV.B.12.

Entertainment expenses are generally not deductible except where: (1) the taxpayer is in the business of providing entertainment and the entertainment has been provided in the ordinary course of the taxpayer's business, (2) the entertainment is at a seminar that satisfies certain conditions; or (3) the expenditure constitutes a fringe benefit subject to FBT. An exemption to this rule exists for relatively inexpensive Christmas gifts (e.g., a bottle of alcohol or a food hamper), morning and afternoon teas, and basic lunches provided by an employer to employees during the working day.

d. *Interest and Royalties*

Royalties and interest expenses incurred in the course of carrying on a business or gaining assessable income are generally deductible. The timing of the deduction is generally as the liability accrues (as opposed to at the time of payment). In the case of a discount on a short-term bill of exchange or promissory note, this cost should be claimed on an accruals basis over the term of the security to which the discount relates. In the case of a financing cost on a security issued at a premium or a discount, this cost should generally be claimed on a six-month compounding accruals basis.

The two limitations relevant to both expenses are: (i) when the amounts are incurred for purposes of deriving foreign branch income that is not assessable in Australia (see 3.d.(1), above); or (ii) where withholding tax, if required to be withheld, has not (yet) been withheld from the payment of interest or royalty to an offshore recipient (see VI.B.3., below). In both cases, the relevant interest or royalty expense would not be deductible. The primary limitation on the deductibility of interest expenses incurred by a business are the thin capitalization rules (see XIV.C., below).

(1) *Interest Cost to Acquire Foreign Shares*

Despite the general rule that interest is deductible if, and only if, it is incurred in the course of carrying on a business for gaining or producing assessable income, a company is entitled to a deduction for the interest cost on money borrowed to acquire shares in an offshore subsidiary. This is despite the fact

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that the dividend income from such a subsidiary is exempt.[135] This is based on the underlying policy objective that, for an Australian resident company, as long as the level of debt falls below the thin capitalization limits applicable to the company (see XIV.C.), the fact that borrowed funds are used to capitalize a foreign subsidiary should not limit the ability to claim a deduction for the interest expense.

(2) Return on Share Capital Classified as Debt

Australia has debt/equity tax rules designed to tax share capital and debt finance by reference to economic substance rather than legal form. A consequence of these rules is that in certain circumstances, corporates may be able to structure share capital as debt interests and claim a deduction for the dividends and other returns paid on the shares to the shareholders. An additional consequence of these rules is that interest incurred on debt finance that is classified as equity for tax purposes will not be deductible. These debt/equity rules are discussed generally at V.B.4.q., below.

e. Taxes

Companies are allowed a deduction for expenses incurred in managing one's own tax affairs or in complying with a legal obligation in relation to another entity's tax affairs. Such expenditure includes the costs of preparing returns and objections to assessments.

Payments of income tax are not deductible, and interest on money borrowed to pay personal income tax is not deductible. However, where a company has a general overdraft/lending facility available to it, direct tracing (to disallow that part of the interest on the overdraft or loan that is attributable to the payment of tax) is not required and the interest is deductible. The Commissioner generally accepts that, where a business taxpayer borrows money to pay income tax, the interest incurred on those borrowings is deductible provided the borrowings are connected with the carrying on of the business.

Payments of general interest charge (GIC) and shortfall interest charge (SIC) payable to the Australian Tax Office in respect of late lodgment, late payment, and underpayments, as well as for failure to make deductions under the PAYG system, incurred on or after July 1, 2025, are not deductible. Payments for such charges incurred prior to this date were deductible.

SIC applies to shortfalls of tax liabilities that are revealed when the Commissioner amends an assessment of an amount of tax payable, whereas GIC is generally imposed on unpaid tax liabilities. Both GIC and SIC apply on a daily compounding basis and are charged at uniform rates for all taxpayers that are adjusted to reflect movements in the Commonwealth's cost of borrowing.

SIC is intended to ensure that taxpayers who understate their liability in returns that incorrectly self-assess a liability do not receive an advantage, in the form of a 'free loan', over those taxpayers who report and meet their tax liabilities in full by the due date, whereas GIC is also intended to encourage taxpayers to pay their taxes on time.

Denying the deductibility of GIC and SIC will further penalize individuals and businesses who incorrectly self-assess their tax liabilities or pat their tax late and assist in lowering the amount of collectable debt owed to the ATO.

Employers can claim a tax deduction for the cost of providing a fringe benefit and for any FBT incurred. Most employers can deduct their actual FBT liability for the current FBT year ended March 31, less the FBT instalment for the first (June) FBT quarter of the current FBT year plus the FBT instalment for the first (June) FBT quarter of the next FBT year.

Most other taxes, such as payroll, municipal, water, sewerage and drainage rates, land tax incurred in respect of land or premises, where the relevant asset is used or activity occurs in the course of a business, are deductible.

f. Depreciation and Amortization

The depreciation provisions are in Division 40 of Part 2–10 of the 1997 Act. Under these rules, a taxpayer is entitled to deduct over the effective life of an asset the capital cost incurred on its acquisition.

Effective lives of assets may be varied, either up or down, to allow for market or technological developments or usage factors.

As a compliance measure, a low-asset value pool for all assets costing less than A$1,000 is provided for. Assets in that pool must be depreciated in the year of acquisition at a rate of 18.75% p.a. and in subsequent years at a rate of 37.5% p.a. on a diminishing value basis. If an asset is disposed of, the closing pool balance is reduced by the disposal proceeds. If the pool balance becomes negative, that amount is to be included in the taxpayer's assessable income of that year.

(1) Depreciable Assets

A depreciable asset is an asset that has a limited effective life and can reasonably be expected to reduce the value over the period it is used.[136] The depreciation may be taken on either a cost (straight line) or a diminishing value basis. It should be noted that plant, as defined, does not include buildings, except where the building forms an integral part of a manufacturing plant and machinery (for example, a bacon factory, butter factory, or freezing works).

The effective life of a depreciating asset is determined by estimating the period (in years, including fractions of years) the asset can be used by any entity for a specified purpose. Effective life of a depreciating asset is applicable provided taxpayers first use a depreciating asset or have it installed ready for use within five years of the time (the relevant time): they entered into the contract to acquire it, they started to construct it, or they otherwise acquired it.[137]

If taxpayers do not start to use a depreciating asset or have it installed ready for use within the five-year period, the effective life that applies is the one in force at the date you first use the depreciating asset or have it installed ready for use for any purpose.[138]

In determining an effective life, the following factors are considered:

- Physical life;

[135] See ITAA 1997, Sec. 25-90.

[136] ITAA 1997, Sec. 40-30.

[137] *Ibid.*

[138] ITAA 1997, Sec. 40-95.

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- Manufacturing specifications and engineering information;
- Use of the asset in a particular industry;
- Use of the asset in different industries, industry standards;
- Repairs and maintenance;
- Retention period;
- Obsolescence;
- Scrapping or abandonment practices;
- Lease periods;
- Financial analysis;
- Market value.

Where appropriate, each factor is considered based on historical information and future expectations. No single factor is necessarily conclusive and the relative importance of each varies depending on the asset. The Australian Tax Office provides guidelines as to what it considers is the effective life of an asset.[139] Taxpayers are not required to follow the ATO guidelines.

Taxpayers that choose not to use the ATO determinations of effective life may use their own estimates of effective life. Taxpayers who choose to self-assess can take account of their own particular circumstances of use.[140] Taxpayers can recalculate the effective life of a depreciating asset if the effective life used is no longer relevant because of changed circumstances relating to the use of the asset.[141] An example could be unpredicted obsolescence or more or less rigorous use than anticipated.

(2) Motor Vehicles

The depreciation of motor vehicles is subject to a cost base limitation that is indexed each year. For a taxpayer that starts to hold a car, the limit is A$59,136. Vehicles that cost more than the cost base limit are classified as “luxury cars.” Leases of such luxury cars are treated as loan transactions for tax purposes to prevent attempts to overcome the depreciation limit. The effective life of a new car is eight years (future prime cost depreciation rate of 12.5% p.a.).

(3) Anti-avoidance

The ability to claim deductions for depreciation are subject to specific anti-avoidance provisions in Division 250 of ITAA 1997. These are discussed at XVI., below.

g. Charitable Contributions

Gifts to charitable benevolent funds, authorities and institutions in Australia, and certain amounts paid as pensions, retiring allowances or gratuities to persons that are, or have been, employees or dependents of employees, in consideration of the past services of the employees in the taxpayer’s business, are an allowable deduction.[142]

Deductions are allowed for donations of assets purchased during the 12-month period prior to the gift being made. The deductibility of donations of works of art to prescribed funds, museums and art galleries is subject to one of three valuation methods being used. Deductions are allowed for donations of property, regardless of when the property was purchased, provided the market value of the property exceeds A$5,000.

Donations are deductible in the year they are made and any resultant loss cannot be included in a carried forward loss.

h. Losses Caused by Employee Malfeasance

Losses incurred by a taxpayer as a result of embezzlement, larceny, defalcation or misappropriation by a person employed by the taxpayer (but not a person employed for private or domestic purposes) of money that is or has been included in the taxpayer’s assessable income are an allowable deduction.[143]

Taxpayers can also deduct amounts which are misappropriated by their employee or agent from proceeds received on the sale of a depreciating asset of the taxpayers.[144]

i. Capital Losses

Capital losses can be offset only against capital gains. If capital losses exceed capital gains for a particular year of income, the excess loss can be carried forward and offset against capital gains from future years.

The loss carryforward rules applicable to tax losses apply equally to capital losses and are discussed below at 6.

j. Bad Debts

Bad debts that have been physically written off as such during the year of income are allowable deductions, provided they have been previously brought to account by the taxpayer as assessable income or are with respect to money lent by the taxpayer in the ordinary course of business as a money lender.[145] Bad debts written off by a company are allowable as a deduction only if the company satisfies certain tests as regards the continuity of beneficial shareholdings or the continuity of the same business.[146]

Taxation Ruling TR 92/18 clarifies the circumstances in which a deduction for bad debts will be allowable and explains the operation of these rules in relation to taxpayers in the business of lending money.

Where an entity makes a bona fide commercial decision that it is unlikely a portion of a debt will be recovered from a borrower, the lender will be entitled to a deduction for the portion of the loan that is “bad” and has been written off (evidenced in writing).[147] This means more than “doubtful.”[148]

[139] Taxation Ruling 2022/1 — Income tax: effective life of depreciating assets (applicable from July 1, 2022). See Worksheet 16.

[140] ITAA 1977, Sec. 40-105.

[141] ITAA 1997, Sec. 40-11.

[142] ITAA 1997, Division 30. See Maughan v. FCT (1942) 66 CLR 388, 2 AITR 365.

[143] ITAA 1997, Sec. 25-45. *Levy v. FCT* (1966) 106 CLR 448, 8 AITR 377.

[144] ITAA 1997, Sec. 25-47.

[145] ITAA 1997, Sec. 25-35. See G. E. Crane Sales Pty. Ltd. v. FCT (1971) 2 ATR 692.

[146] ITAA 1997, Sec. 25-35.

[147] ITAA 1997, Sec. 25.

[148] Income Tax Ruling TR92/18 sets out the circumstances in which the Commissioner considers a debt is bad.

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In the context of a limited recourse loan, where a lender's recourse is limited to a specified item of underlying secured property, if the borrower's obligations under the loan are satisfied by delivery of the secured property to the lender before the lender writes off any deficit (i.e., equal to the difference between the market value of the secured property and the amount due), a deduction will not be available under section 25-35. This is because section 25-35 deductions are limited to debts in existence at the time they are written off. The practical consequences of a lender failing to write off an amount lent before it is extinguished should not be material where the loan is made in the ordinary course of lending money. That is, in these circumstances, the losses made by the lender that do not satisfy the requirements of section 25-35 should be deductible under section 8-1 at the time the debt is extinguished as an ordinary business loss. However, for a lender that does not lend in the ordinary course of its business, the loss may be on capital account and may crystallize a capital loss that can only be taken into account under the capital gains provisions.

If any amount that has been written off is ever recovered, the recovered amount is assessable income.

k. Rents

Rent incurred for the purpose of leasing property for the purpose of carrying on a business or otherwise deriving assessable income is a deductible outgoing.

l. Salary and Wages

Salaries, wages, bonuses and allowances paid to employees are generally deductible, assuming the company has complied with its withholding obligations. As a compliance measure, where a company has not satisfied its withholding obligations, the deductions for the expenses are denied.

Fundamental to the scope of a company's withholding obligations regarding salary and wages is a determination of the individuals providing services that fall within the scope of the employee/employer relationship. This is a substance-based test and cannot be determined merely by reference to individuals labelled as employees. In the context of a growing gig economy, this is a key issue for companies to monitor.

Comment: Fortunately, as a rule, non-compliance in this area, if voluntarily disclosed to the ATO (on discovery), is typically manageable. The ATO has shown a willingness to exercise its discretion where appropriate to assist companies in rectifying historic mistakes without material penalties.

m. Property-related Deductions

Investors in rental property (both residential and commercial) are able to deduct expenditure according to the general rules set out in section 8-1. Typically, this includes an entitlement to:

(i) A deduction for interest on borrowings to finance the investment;

(ii) Depreciation deductions (at the various rates) on fixtures and fittings (based on the life of the asset); and

(iii) A capital allowance at a rate of 2.5% p.a. on various types of construction expenditure (in certain limited circumstances this rate can be 4% p.a.).

Often, property investments in Australia are "negatively geared" during early stages of the investment, such that the allowable deductions exceed the income produced from the investment. These losses can be offset against income from other activities (e.g., salary and wages).

Tax deductions that otherwise would be allowable to an owner of property (e.g., depreciation, interest, investment allowance, repairs) are denied to the owner in circumstances where the property is subject to certain leveraged leasing or similar arrangements, and the lessor is a tax-exempt government authority, or where the plant involved is an overseas plant used by nonresidents. These provisions can also encompass non-leveraged finance leases of property by nonresidents.[149]

n. Prepaid Expenses

Prepaid expenditure incurred by companies can usually only be claimed as a deduction on a pro rata basis over the term of the period to which the prepayment relates. In the case of small businesses and individuals, there are various limitations on the application of this rule where the prepayment relates to a period of more than 12 months.[150]

o. Audit Fees

Income Tax Ruling IT 2625 considers the deductibility of audit fees, particularly fees accrued but unpaid at balance date. It is necessary to determine whether, under the relevant contract, there is presently existing a pecuniary obligation that has become due. Thus, a deduction for an accrual is generally allowed only with respect to an amount billed before the relevant year-end or otherwise due under the contract for such services.

p. Repairs

Expenditure incurred on repairs to any item of property used by a taxpayer for the purpose of producing assessable income is allowable, except to the extent the expenditure is of a capital nature.[151] There is a great deal of judicial comment as to what is a repair of a capital nature and, as a general rule, repairs incurred during the earlier years of ownership of real property can be considered to be of a capital nature (on the basis that the need for the repair would be evident at the time of acquisition), as are repairs carried out with substantially different materials or that effect substantial improvement to the unit of property.[152]

q. Debt-Equity Provisions

Australia has introduced a complex set of debt/equity hybrid provisions designed to ensure that:

(i) Legal form debt that is economically the equivalent to equity is taxed in the same manner as share capital; and

(ii) Legal form equity that is economically the equivalent to debt is taxed in the same manner as debt.

Share capital will be taxed as a "debt interest" if the share satisfies the debt test. Share capital will satisfy the debt test if,

[149] ITAA 1997, Div. 250.
[150] ITAA 1997, Subdivision H of Div. 3 of Part III.
[151] ITAA 1997, Sec. 25-10.
[152] *FCT v. Western Suburbs Cinemas Ltd.* (1952) 5 AITR 300; the U.K. case is *Odeon Associated Theatres Ltd. v. Jones (Inspector of Taxes)* (1972) 1 All ER 681.

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broadly, the company issuing the shares has an effectively non-contingent obligation to provide to the holder of the share capital financial benefits with a value at least equal to the issue price of the shares. This valuation test is undertaken on a nominal basis for shares with a term of less than 10 years. For arrangements with a term in excess of 10 years, the test is undertaken by way of a discounted net present value formula.

A scheme that does not satisfy the debt test will be treated as equity for tax purpose if it satisfies the "equity test." A financial arrangement satisfies the equity test if it involves any of the following:

(i) An interest in a company as a member or shareholder;

(ii) An interest that accrues a right to a return from a company that is at the discretion of the company or determined by reference to the economic performance of the company or connected entity of the company;

(iii) An interest that gives the holder (or a connected entity of the holder) a right to be issued with an equity interest in the company or a connected entity of the holder; or

(iv) An interest that will or may convert into an equity interest in the company or a connected entity of the company.

The principal consequence for a share of being characterized as a debt interest is that the dividends paid are unfrankable. Instead, the dividends are deductible outgoings of the company and are assessable as income in the hands of the shareholder. Conversely, loans and other legal form of debt classified as equity interests will not be deductible to a company. Instead, returns on equity interests are frankable distributions and benefit from the imputation system of taxation.

r. Intellectual Property

A deduction is allowable for expenditure of a capital nature incurred in the development or purchase of an Australian patent, registered design or copyright, or in the purchase of a license to use a patent, registered design or copyright. Taxpayers are entitled to write off such expenditure over the period of the right, commencing in the year of income in which the right is first used for the purpose of producing assessable income. Where the right is used outside Australia, the Commissioner may reduce the deduction allowable in consideration of the benefit obtained by the taxpayer from his ex-Australian use. Provision is made for the making of a balancing adjustment when the right is disposed of or lapses.[153] The balancing adjustment allows a taxpayer to offset any assessable income derived on the disposal of a right against expenditure incurred on any right not written off at that time.

In January 2024, the ATO updated and finalized Practical Compliance Guide PCG 2024/1 Intangibles migration arrangements. The PCG sets out where the ATO is likely to apply resources to consider the potential application of the general anti-avoidance rules (GAARs) or the transfer pricing rules to cross-border related party "intangibles migration arrangements" (defined as cross-border arrangements involving the migration of intangible assets, or arrangements with similar effect).

The Australian Government has been concerned about the leakage of Australian revenue offshore from the offshore migration of valuable IP for some time. Often this occurs in the context of the post-acquisition integration of an Australian target's intangible assets with the broader supply chain of a foreign multinational (with centralized IP ownership outside of Australia). The PCG highlights the ATO's focus on the migration of Australian IP and the non-recognition of Australian activities connected with intangible assets held offshore. The ATO's expectations around holding documentation for such transactions are very high.

Comment: To defend IP migration, it is important to have a global intangible asset strategy, within a broader corporate framework, to ensure an alignment of IP portfolio management with long-term business objectives and to help drive overall value. The need for an intangible asset strategy that considers tax, transfer pricing, legal, and governance issues is imperative.

5. Capital Expenditure

a. Primary Producers

Expenditure incurred on structural improvements is subject to the normal depreciation allowances with respect to plant and equipment.

Expenditure incurred by a taxpayer carrying on a business of primary production[154] on various "landcare" measures is deductible in the year it is incurred. The deduction is reduced to the extent it is eligible for reimbursement, unless the reimbursement is assessable. Landcare measures include:

(i) The eradication or extermination of animal or vegetable pests from the land; the destruction of weed or plant growth detrimental to the land; and preventing or combating land degradation otherwise than by the erection of fences on the land;

(ii) The erection of fences (including any extension, alteration or addition to fences) on the land, primarily and principally for purposes of excluding livestock or vermin from areas affected by land degradation to prevent or limit any extension or aggravation of land degradation in those areas and to assist in the reclamation of those areas; also the erection of fences for purposes of preventing land degradation carried out in accordance with a whole farm plan;

(iii) The construction of levee banks or similar improvements having like uses; or

(iv) An operation (not including the draining of swamp or low-lying land) consisting of construction on the land, primarily and principally for purposes of controlling salinity, or assisting in drainage control, surface drainage works, or subsurface drainage works.

Capital expenditures incurred on the establishment of grape vines, including the costs of the vines, planting and land preparation, are deductible over a period of four years.

The capital costs of works designed to convey or conserve water, including dams, irrigation channels, bores, pumps,

[153] ITAA 1997, Sec. 104-235.

[154] ITTA 1997, Subdivision 40-G.

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pipes, windmills and power connections, are deductible over a period of three years.

The capital costs of establishing horticultural operations, including plants or seeds, planting and land preparation, tree grafting, pots and potting mixtures, are allowable over a period determined by the effective life of the plantation. Individuals and trusts carrying on business as primary producers are entitled to average their income for tax purposes. Averaging is available to both residents and nonresidents. The system allows a rebate where the taxable income of a particular year is greater than the average income (usually calculated as the average over a five-year period) and, correspondingly, requires the taxpayer to pay extra tax where the income of a particular year is less than average.

b. Environmental Protection

An immediate deduction is allowed for capital expenditure incurred for the sole or dominant purpose of preventing, combating or rectifying pollution of the environment by a taxpayer's business or on the site of that business.[155]

The costs of environmental impact studies are deductible in the year incurred if the project is completed or abandoned during the year. If the project life cannot be established, the deduction is allowable over 10 years or, in other cases, is amortized over the term of the project up to a maximum of 10 years.

Costs on carbon sink forests are also deductible.

c. Start-up Costs

Costs incurred with respect to the establishment of business operations may be capitalized and included in the cost base of the assets at that time.

There are two specific exceptions to this rule, as follows:

(1) Regional Headquarters

Subdivision CB of Division 3 of Part III of ITAA 1936 provides a deduction in the year of expenditure for costs incurred in setting up a Regional Headquarter Company (RHC) in Australia. A company may apply, in writing, to the Federal Treasurer to become a RHC if the company intends to establish facilities in Australia mainly for the purpose of providing "regional headquarter support" — being management, data or software support to associated companies located outside of Australia. These concessions have limited application in practice. They do not apply to costs relating to feasibility studies, depreciating assets, equipment, land or buildings.

(2) Organizational Start-up Costs

Section 40-880 of Part 2-10 of ITAA 1997 provides that taxpayers are entitled to a deduction for capital expenditure incurred in a business that is proposed to be, is or was previously, carried on or is in the course of being wound up.

The scope of this provision is potentially very broad, but it is limited to expenditure incurred for a taxable purpose that would not otherwise be recognized for income tax purposes. These provisions do not apply to amounts that are otherwise deductible under another provision, can be depreciated as part of another depreciable asset or would form part of the cost base of another asset for income tax purposes (say, a capital gains tax asset). For this reason, expenditure that falls within the scope of this provision is typically referred to as "black hole" business expenditure. Three examples that would fall within the scope of this concession are costs incurred in incorporating a company to carry on business in Australia, costs incurred in preparing/issuing a prospectus and the costs of feasibility studies incurred before a business is established.

The amount of the deduction is 20% of the expenditure in the year it is incurred and each of the next four income years.

d. Forestry Operations

Commercial reforestation projects qualify as primary production activities and enjoy the concessions available to primary producers generally. The particular types of commercial reforestation included in primary production are:

(i) Planting or tending trees in a plantation or forest that are intended to be felled;

(ii) Felling trees in a plantation or forest; or

(iii) Transporting trees, or parts of trees, felled in a plantation or forest, directly to the place where they are first to be milled or processed, or transporting them to the place from which they are to be transported to be milled or processed.

(1) Depreciation

Under the uniform capital allowance system, a deduction is available for the decline in value of such assets over their effective lives and for construction costs over a specified period (4% or 2.5% on a yearly basis for 25 years or 40 years, respectively).[156]

(2) General Deductibility: Forestry Management Investment Schemes

A typical debt finance retail MIS is shown below, involving a loan from a debt provider (typically a bank) which is used to invest in the scheme.

For income tax purposes, this can produce an attractive upfront tax result (subject to the potential application of any tax anti-avoidance rules). Under this arrangement, the loan from the bank to the investor is not assessable income (i.e., not subject to income tax) while the management fee paid to the MIS is deductible. In this ideal scenario, the MIS receives the required funding from the investor and the investor receives a deduction equivalent to the investment (which has been debt funded).

(3) Specific Deductibility: Forestry Management Investment Schemes

Under Division 394 of ITAA97, a specific deduction is provided to initial investors (i.e., those who obtained their interest directly) for 100% of their payments under the scheme, provided that there is a reasonable expectation on June 30 in the year in which an amount is first paid under the scheme that at least 70% of that expenditure (using market value) is attributable to establishing, tending and felling trees for harvest. There is no requirement for taxpayers to demonstrate that they are

[155] ITAA 1997, Secs. 40-755 and 43-140.

[156] ITTA 1997, Divisions 40 and 43.

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"carrying on a business" in order to access the deduction, or that the amount paid is revenue in nature.

Initial investors are able to trade their interest after they have held the interest for four years. Where the initial investors do not hold their interest for four years prior to trading, they will be required to unwind any deductions claimed.

Secondary investors (i.e., those who obtained their interest in a secondary market) are not able to claim a statutory deduction for acquisition costs, as the interest will be held on capital account. Any ancillary costs such as lease fees, annual management fees or costs of felling will be deductible expenses. However, these deductions will affect the calculation in relation to capital gains tax events that occur in relation to that interest.

Interest and borrowing costs paid by initial and secondary investors will not be covered by the specific deduction provisions and will continue to be subject to deductibility under general provisions, provided the relevant tests are met.

The ATO, through Practice Statement PS LA 2008/2, provides guidance on the application of Division 394. Importantly, it states the documentation requirements for the various tests and calculations taxpayers are required to undertake.

e. Carbon Sink Forests

Tax concessions for the cost of establishing carbon sink forests form part of the Government's drive to meet the greenhouse gas emissions target set for Australia under the Kyoto Protocol to the United Nations Framework Convention on Climate Change, which the Government ratified on December 3, 2007.

(1) Background

As discussed in V.B.5.b., above, taxpayers are currently entitled to an upfront deduction for expenditure incurred for the sole or dominant purpose of carrying on activities:

(i) Preventing, fighting or remedying pollution; or

(ii) Treating, cleaning up, removing or storing waste resulting from the taxpayer's earning activities.

This does not include expenditure on acquiring land or capital expenditure on constructing or improving buildings or structural improvements (although in certain circumstances such expenditure can be depreciated over the life of the project). The cost of planting trees for carbon sequestration typically does not fall within the scope of these existing concessions. This is based on the view that the dominant purpose of a carbon sink is not limited to these purposes and includes the generation of income from the carbon sequestered in the trees. There is an alternate view, but this issue has not been tested in the courts in an income tax context. As such, under the current law, the cost of establishing a carbon sink is typically capitalized and included in the cost base of the relevant land — effectively deferring the deduction for the cost until the land is sold (as the cost reduces the assessable gain on sale).

(2) Capital Expenditure for the Establishment of Carbon Sink Forests

Australia has two specific concessions relating to environmental activities, namely the pollution concessions and the carbon sink forest concession, which will assist in reducing Australia's national greenhouse emissions and preventing climate change. Subdivision 40-J provides that taxpayers who carry on a business can claim a deduction for certain expenditure incurred on establishing trees in carbon sink forests, specifically, for trees established for the primary and principal purpose of carbon sequestration. After June 30, 2012, such costs are deductible over 14 years and 105 days (i.e., at a rate of 7% p.a.).

The taxpayer must own, lease or license the land on which the expenditure is incurred and no other holder of an interest in the land must use the land for the primary and principal purpose of carbon sequestration.

(3) Conditions

To qualify for the concessions described above:

(i) The trees must occupy a continuous land area in Australia of at least 0.2 hectares;

(ii) At the time the trees are established it must be more likely than not that they will attain a crown cover of at least 20% and reach a height of at least two meters;

(iii) On January 1, 1990, the area must have been clear of trees that did, or were likely to, attain a crown cover of at least 20% and reach a height of at least two meters;

(iv) The establishment of the trees must meet the environmental and natural resource guidelines to be made by the Minister administering the National Greenhouse and Energy Reporting Act 2007 (referred to as the "Climate Change Minister" in the 2008 Bill); and

(v) The taxpayer must give to the Commissioner a statement that includes all information relevant to determining whether these preconditions have been satisfied on the earlier of the filing of the income tax return or within five months of the end of the relevant income year. The first three preconditions align with the criteria for carbon sink forest activities that can contribute to Australia's greenhouse gas emissions target under the Kyoto Protocol.

Very broadly, the environmental and natural resource guidelines set out three broad outcomes that must be met:

(i) Use of regionally applicable best practice approaches for achieving multiple land and water environmental benefits;

(ii) Consistency with regional natural resource management plans and water sharing plans and potential cumulative environmental impacts are assessed at a catchment scale; and

(iii) Adherence to government regulatory requirements.

(4) Eligible Costs

The types of qualifying expenditure that can be deducted under these rules include the costs:

(i) Of acquiring and planting the trees or seeds;

(ii) Of pots and potting mixtures;

(iii) Of grafting trees and germinating seedlings; and

(iv) Incurred in preparing to plant (surveying, ploughing, scarifying, contouring, top dressing, fertilizing, weed spraying, stone removal, etc.).

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Also included is companion planting for the purpose of carbon sequestration.

(5) Ineligible Costs

The above concessions are not available if:

(i) One of the purposes of establishing the trees was commercial horticulture or felling;

(ii) The expenditure is incurred under a MIS (being an entity with 20 members that is a MIS for purposes of the Corporations Act 2001) or forestry MIS (being a scheme for felling trees);

(iii) The expenditure is incurred in draining swamp or low-lying land, or in clearing land; or

(iv) The Climate Change Minister has given the Commissioner a notice to the effect that one of the preconditions set out above has not been satisfied. Expenditure on water facilities, roads, fire breaks fencing, draining swamps or low-lying land or clearing land should not qualify for these concessions.

f. Infrastructure, Mining and Environmental Incentives

In addition to the provisions that apply for depreciating assets and the concessions for primary producers, the uniform capital allowance system in Division 40 contains specific provisions for project infrastructure costs and environmental protection costs incurred by taxpayers generally, as well as special concessions for taxpayers engaged in the mining industries.

Special tax concessions are available to taxpayers engaged in mining (including petroleum mining) and quarrying operations for the following types of expenditure:

(i) Exploration or prospecting expenditure;

(ii) "Pooled project expenditure" incurred in the working of mine sites, petroleum fields and quarries;

(iii) Expenditure incurred in rehabilitating former mine sites, petroleum fields and quarries; and

(iv) Environmental protection activities.

These deductions are in addition to the deductions allowable for general operating expenses. The general deduction provisions apply to assets used for taxable purposes (i.e., the purpose of producing assessable income, mining site rehabilitation, exploration or prospecting and environmental protection activities). Such depreciating assets include mining, quarrying or prospecting rights or information. Where expenditure is deductible under both specific and general deduction provisions, the general rule against double deductions applies whereby the most applicable provision is utilized.

(1) Non-Arm's-Length Dealings

Where capital expenditure is incurred in a "non-arm's-length dealing" and the expenditure is greater than the "market value" of what the expenditure is for, the expenditure is taken to be that market value. This rule applies to exploration or prospecting expenditure, mining capital expenditure, transport capital expenditure, mining site rehabilitation expenditure, project infrastructure expenditure and environmental protection expenditure.

(2) Mining, Quarrying, and Prospecting Rights

A mining, quarrying or prospecting right is:

(i) An authority, license, permit or right (or interest therein) under Australian law to mine, quarry or prospect for minerals, petroleum or quarry materials;

(ii) A lease of land (or interest in such lease) allowing the lessee to mine, quarry or prospect on the land; or

(iii) A right with respect to a building or other improvement on the land concerned or used in connection with operations on it, where the right is acquired with one of the rights referred to in (i) or (ii).

Rights with respect to a housing and welfare facility relating to a quarrying site are excluded.[157]

A mining, quarrying or prospecting right is a depreciating asset and its decline in value is deductible over its effective life. Conversions of such rights are treated as a continuation of the existing right if the right ends and the new right relates to the same area.

Mining, quarrying or prospecting information is geological, geophysical or technical information relating to, or likely to help determine, the presence, absence or extent of deposits of minerals or quarry materials in an area. Such information is also a depreciating asset and its decline in value is deductible over its effective life from when the taxpayer first uses it for income-producing purposes. Where the information or rights are first used for exploration or prospecting for minerals, petroleum or quarry materials, the deduction is available in full in the year in which the taxpayer first uses the asset, provided the taxpayer satisfied certain activity tests.

The treatment of mining rights and mining information as depreciating assets has the consequence that the balancing adjustment provisions apply if a balancing adjustment event, e.g., sale or other disposal, occurs and that certain costs can be claimed as second element costs. However, mining, quarrying and prospecting rights held before July 1, 2001, remain subject to the CGT provisions rather than being subject to the balancing adjustment provisions for depreciating assets.[158]

An amount received by a taxpayer for providing mining, quarrying or prospecting information to another entity is assessable income if it is not otherwise assessable as ordinary income and if the taxpayer continues to hold that information. If the taxpayer held the information before July 1, 2001, the assessable amount (or any assessable balancing adjustment) is reduced by the cost of the information incurred before that day that was not deductible under the former law.[159]

(3) Exploration Costs

Expenditure on exploration or prospecting for minerals (including petroleum) or quarry materials obtainable by "mining or quarrying operations" is deductible outright in the year in which it is incurred.[160] The mining property may be located in or outside Australia. Exploration or prospecting expenditure

[157] ITAA 1997, Division 995.
[158] Income Tax (Transitional Provisions) Act, Sec. 40-77.
[159] ITAA 1997, Sec. 15-40 and former Sec. 40-77.
[160] ITAA 1997, Sec. 40-730.

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is deductible from income derived from any source. The deduction is available for the expenditure reduced by any GST input tax credits (decreasing adjustments are assessable and increasing adjustments are deductible).[161]

The deduction applies to both capital and revenue expenditure but is not available for the cost of depreciating assets (e.g., transport, materials, labor, administrative costs) incurred in carrying out exploration or prospecting activities. Where deductible under two or more separate provisions, the amount may only be deducted once, under the most appropriate provision.

Exploration or prospecting expenditure is deductible provided that at least one of the following "activity tests" is satisfied during the year of income:

(i) The taxpayer carried on general mining operations, petroleum mining operations or quarrying operations;

(ii) It would be reasonable to conclude that the taxpayer proposed to carry on such operations; or

(iii) The taxpayer carried on a business of, or a business that included, exploration or prospecting for minerals (including petroleum) or quarry materials obtainable by such operations and the expenditure was necessarily incurred in carrying on that business.

A deduction is available under the exploration and prospecting provisions only if, when it is first used by the taxpayer, the asset is not used for development drilling for petroleum or operations in the course of working a mining or quarrying property or petroleum field.

(4) Pooled Costs

Certain project expenditure that is not the cost of a "depreciating asset" may be deductible over the estimated life of the project.[162] The deduction is not limited to expenditure related to mining projects.

(5) Rehabilitation

An outright deduction is available for current and capital expenditure on rehabilitation of sites (Australian and foreign) that have been used by the taxpayer for "mining, quarrying or petroleum operations" or ancillary activities.[163] Sites on which "exploration or prospecting" was conducted also qualify, as do sites on which there are depreciating assets used in mining, quarrying or petroleum operations. "Ancillary activities" include preparing a site for mining, quarrying or petroleum operations, providing infrastructure for such a site, treating minerals or quarry materials, storing minerals and quarry materials (before or after treatment), and liquefying natural gas. "Rehabilitation" involves the restoration (or partial restoration) of the site to a reasonable approximation of its pre-mining condition.

(6) Environmental Protection

Expenditure, whether capital or revenue, that is incurred for the sole or dominant purpose of carrying on an environmental protection activity is deductible in the income year in which it is incurred.[164] No deduction is available if protection of the environment is only a residual or subsidiary purpose of the taxpayer. If the expenditure is incurred for two or more purposes, it is necessary to establish what is the dominant purpose. This does not include expenditure on acquiring land or capital expenditure on constructing or improving buildings or structural improvements (although in certain circumstances such expenditure can be depreciated over the life of the project).

g. Industrial Production of Hydrogen and Critical Minerals

The Future Made in Australia (Production Tax Credits and Other Measures) Act 2025 introduced significant new tax incentives for the industrial production of hydrogen and the processing of critical minerals, with measures effective from July 1, 2027. The Act establishes two key refundable tax offsets: the Hydrogen Production Tax Incentive (HPTI) and the Critical Minerals Production Tax Incentive (CMPTI).

The HPTI provides a refundable tax offset of A$2 per kilogram of eligible hydrogen produced in Australia, available for up to 10 years per eligible facility, for hydrogen produced between July 1, 2027 and June 30, 2040. To qualify, companies must hold a certified production profile and comply with community benefit principles as set by the Treasurer. The hydrogen must be produced at a single Australian site with a minimum production capacity equivalent to a 10-megawatt electrolyser, with a final investment decision made before July 1, 2030. The hydrogen must also be certified by the Clean Energy Regulator (CER) under the Guarantee of Origin scheme, demonstrating an emissions intensity not exceeding 0.6 kilograms of carbon dioxide per kilogram of hydrogen, and, if grid electricity is used, meeting grid matching requirements. There is no annual cap on the incentive, and companies may file claims for multiple facilities. The HPTI is co-administered by the CER and the ATO.

The CMPTI offers a refundable tax offset equal to 10% of eligible expenditure incurred on downstream refining and processing of critical minerals in Australia, also available for up to 10 consecutive income years for activities conducted between July 1, 2027 and June 30, 2040. Eligible companies must be registered for relevant processing activities and meet residency requirements. Processing activities must substantially transform feedstock containing critical minerals into purer or more refined forms that are chemically distinct. The Industry Secretary is responsible for registering eligible activities, while the ATO administers the offset. The legislation specifically excludes uranium

These measures are part of Australia's broader strategy to support renewable energy industries and strengthen supply chain resilience for critical minerals.

6. Loss Carryforward and Carryback

Generally, tax losses are only allowed to be carried forward.

However, the Federal Government introduced loss carry back provisions in 2020 as a temporary COVID-19 measure to support cash flow in small businesses with an aggregated an-

[161] ITAA 1997, Sec. 27-105.
[162] ITAA 1997, Sec. 40-830 to 40-885.
[163] ITAA 1997, Sec. 40-735 to 40-745.
[164] ITAA 1997, Sec. 40-755 to 40-765.

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nual turnover of less than $5 billion. As of February 22, 2022, these provisions have now been implemented in legislation (the *Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021*) to allow losses to be carried back from the 2022–23 income year.

Eligible entities (those with an aggregated turnover of less than A$5 billion in the year of the loss) may apply to the ATO to carry back tax losses from the 2019–2020, 2020–21, 2021–22 and 2022–23 tax years. These losses can be used to offset profits and tax paid in previous income years, as early as the 2018–19 tax year. The offset effectively represents the tax the eligible entity would save if it were able to deduct the loss in the earlier year using the loss year tax rate. As it is a refundable tax offset, the carry back may result in a cash refund, a reduced tax liability or a reduction of a debt owed to the ATO.

Similar rules apply to the carry forward of tax losses and capital losses (noting capital losses can only be used to offset capital gains).

A deduction is allowed to a taxpayer with respect to losses incurred in previous years in carrying on a business or undertaking an income-producing activity. Losses may be carried forward for an indefinite period. Where losses are to be carried forward by a company, certain stringent continuity of ownership or business tests must be met before a deduction is allowed.[165]

Under these rules, a company can only offset a prior year's loss against its current year income if (with one exception) it has the same owners and the same control throughout the loss year and the income year.

The exception, which is available in limited circumstances, is based on a "continuity of business test." This test provides that a company is entitled to claim a deduction for carry-forward losses if for each year from the change of ownership up to (and including) the income year, the company has carried on the same business, entered no new types of transaction and conducted no additional business.[166]

The "same owner" test requires shares carrying more than 50% of all voting, dividend and capital rights to be beneficially owned by one or more persons who, individually or together, held shares carrying similar rights at all times during the year in which the loss is to be used and at all times during the year in which the loss arose. Further, there must be no substantial change in the composition of ownership within a group of continuing owners, and this majority ownership is maintained for the loss to the claim year inclusive.

> *Example:* Two majority shareholders hold 52% (26% each). One shareholder purchased a further 20% holding from the other majority shareholder in the period after a loss was incurred and before the utilization of the loss. This would breach the "same share" test.

Ownership may be traced through interposed companies back to the ultimate natural persons in whom underlying ownership rests. In the case of a listed public company, it is only necessary to satisfy the Commissioner that it is reasonable to assume that the continuity of ownership test has been satisfied.

Anti-avoidance provisions deal with arrangements relating to the beneficial ownership of shares or to variation in share rights or share capital, if one of the purposes of the arrangements is to enable a company to continue to satisfy the continuity of ownership test.

The "continuity of business" test requires the company to carry on at all times during the year in which the loss is to be used, the same business as it carried on immediately before what would otherwise be a disqualifying change in ownership. The continuity of business test also requires that the company must not, at any time during the year in which the loss is to be used, derive income from a business of a kind that it did not carry on or derive income from a transaction of a kind that it had not entered into in the course of its business operations, before the disqualifying change in ownership took place.

Anti-avoidance provisions prevent a company from relying on the "continuity of business" test being satisfied, if it commenced business operations or undertook transactions before the disqualifying change in ownership, for the purpose of enabling carryforward of losses to be preserved.

Revenue losses made in respect of foreign income (i.e., a foreign loss) are treated in the same way as domestic losses. Foreign losses incurred in these income years can be used to offset domestic income.

Foreign losses can be carried forward indefinitely. However, a company must satisfy the loss carryover rules described above before it can deduct a foreign loss, in the same way that these rules must be satisfied in respect of domestic losses.

To overcome trafficking in trust losses, similar restrictions apply to the carryover of trust losses. In the context of closely held trusts, tests are designed to ensure that parties outside the family designated as principal objects of the trust do not benefit from the use of the trust losses. The tests are difficult to satisfy and, generally, a trust will adopt a simpler alternative test whereby it can elect to be a "family trust." This restricts the trust beneficiaries to a nominated individual and relatives and related entities that fall within the definition of a "family group." The family group definition includes more persons such as lineal descendants of nieces and nephews, former spouses, widowers and step-children.

Under the current framework introduced in 2017, the stringency of the "continuity of business" test was relaxed to allow for companies that utilize tax losses made from carrying on a business, to carry on similar businesses following an otherwise disqualifying change in ownership and control.

The effect of this flexible test will allow new businesses to more easily derive assessable income from new business activities and enter into new transactions without automatically failing the business continuity test. This will encourage innovation and business development.

Four factors are important in determining whether a business is sufficiently similar:

(i) The extent to which *assets* (including goodwill) were used in carryover from the former business to generate assessable income in the current business;

[165] ITAA 1997, Div. 165. *See FCT v. Brian Hatch Timber Co. (Sales) Pty. Ltd.* (1972) 2 ATR 658.

[166] ITAA 1997, Sec. 165-10.

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(ii) The extent to which *activities and operations* were carried over from the former business to generate assessable income in the current business;

(iii) A comparison of the current and former *identities* of the business; and

(iv) Whether changes to the business were attributable to innovative reasons such as the *development of commercialization* of assets, products, processes and organizational methods.

For purposes of satisfying the similar business test to access losses, the term 'similar' is restricted in its meaning to emphasize businesses that exhibit a core element of continuity in its identity from the original business activities and assets used to generate assessable income. This excludes relying on similar 'kinds' or 'types' of businesses. Accordingly, for substantial new business activities and transactions, a higher threshold will need to be met to show that the new business has evolved or complements the original business carried on before the test time.

a. Claiming Tax Offsets

The claiming of a tax offset is optional. The ATO released guidance on June 9, 2022 to help taxpayers correctly claim loss carry back refundable tax offsets. The ATO guidance states that taxpayers need to include the following in their tax return to ensure that the claim gets processed correctly:

- Complete the loss carry back labels in item 13;
- Provide the opening and closing franking account balance labels in item 8; and
- The refundable tax offsets label (Label E) in the calculation statement, where you add the loss carry back tax offset amount from label 13S.

Taxpayers must complete these labels to receive a refund. The franking account balance, previous year's tax liability, and net exempt income for the current income year all affect and limit the entitlement to the carry back (as losses are required to be offset against net exempt income in priority of taxable income certain circumstances).

7. Foreign Tax Credits (or Foreign Income Tax Offset)

Taxpayers will be entitled to a nonrefundable tax offset for foreign income tax paid on an amount included in assessable income (a "double-taxed amount"). This offset effectively reduces the potential Australian tax that would be payable on double-taxed amounts. The potential Australian tax will be reduced by the amount of the foreign income tax already paid on those double-taxed amounts or reduced to zero where the foreign income tax paid exceeds the potential Australian tax payable. Foreign tax paid is converted to Australian dollars at the exchange rate prevailing when the tax is paid, which is then used to calculate the foreign income tax offset (FITO). (For more on the conversion of foreign income to Australian currency, see V.B.3.g., above).

A FITO will be available for those foreign income taxes that are substantially equivalent to Australian income tax. That is, the foreign income tax must be levied on the taxpayer's income, profits or gains of an income or capital nature, or be similar to Australian withholding tax that is imposed in place of a tax on the net amount of income.

The FITO is limited to the lesser of foreign income tax paid or the foreign income tax offset cap. In the event that the total foreign income tax paid exceeds the foreign income tax offset cap, no offset or deduction is allowed for the extra foreign income tax. The FITO cap is based on the Australian tax that would be payable on the double-taxed amounts and other assessable amounts that do not have an Australian source. The taxpayer may refrain from calculating the cap and instead choose to use the A$1,000 *de minimis* cap.

Entitlement to a FITO will arise for taxpayers in the year in which an amount on which foreign income tax has been paid is included in their assessable income. It is not necessary for the taxpayer to pay the foreign income tax in the same income year that the amount is included in assessable income. Taxpayers have four years from the time foreign income tax is paid in which to claim an offset.

In ascertaining the amount of foreign income tax offset, taxpayers can combine all assessable foreign income amounts. Taxpayers cannot carry forward excess foreign tax offsets.

Comment: It is important to note that the ability to claim a tax credit in Australia is limited to the tax paid on the amount included in the assessable income of a resident taxpayer. This can become an issue where only a portion of a gain is assessable — for example, in the case of a long-term capital gain.

> *Example:* An Australian resident individual owns property in a foreign country. The property was acquired for AUD 150, and then sold for AUD 250 three years later, creating an AUD 100 gain on sale. The foreign tax on the gain is (say, purely as an example to illustrate the issue) AUD 30. Only half of the foreign tax (i.e., AUD 15) can be claimed as a credit in Australia. This is because, under the Australian CGT rules, only 50% of the capital gain made on the sale of an asset held by an Australian individual for more than 12 months is assessable. That is, the net capital gain included in the Australian resident individual's assessable income is only AUD 50 (not AUD 100). The FITO is similarly limited to 50% of the foreign tax, i.e., AUD 15 (half of AUD 30). This means that, in the case of long-term capital gains made by individuals, only a portion of the foreign tax can be claimed as a credit in Australia. In this case, if the Australian resident individual was subject to the top Australian marginal tax rate of 47% (including Medicare), the total tax payable would be AUD 30 (in the foreign country) plus AUD 8.5 (i.e., AUD 23.50 less AUD 15) in Australia.

Australian companies with foreign subsidiaries face similar issues. Dividends paid by foreign subsidiaries to an Australian parent generally qualify for the participation exemption (i.e., the dividends are not assessable in the hands of the Australian parent), as discussed at V.B.3.d.(2), above. Where this is the case, the Australian corporate will not be entitled to a FITO for foreign dividend withholding tax paid on the dividends.

Both outcomes discussed above are based on the policy position that if income/gain is not assessable, a taxpayer should not be entitled to a FITO for foreign tax paid on that income/gain.

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8. *Tax Rates and Calculation of Taxable Income*

Taxable income is determined by reference to assessable income (see 3., above) less allowable deductions (see 4., 5. and 6., above). The corporate tax rate for most companies is 30%, less foreign tax offsets (see 7., above).

The rate is reduced to 25% for base rate entities. A base rate entity is a company that both has an aggregated turnover of less than A$50 million and 80% or less of its assessable income is "base rate entity passive income," which is income consisting of dividends, royalties, rent, most interest income (with some exceptions), and a net capital gains earned either directly or indirectly through a partnership or trust.

9. *Assessment and Filings*

The Australian income tax system is a self-assessment system. Companies (and superannuation funds) pay the balance of tax due as per the return lodged on specified dates according to the level of total tax assessed. The income tax return lodged is deemed to constitute an assessment.

Individuals receive a notice of assessment after lodging an income tax return and the tax payable thereby is normally due 21 days from the date of issue of the assessment.

All taxpayers are subject to the PAYG system, which requires the filing of monthly or quarterly activity statements with payment of withholdings and/or installments, or the payment of an annual installment.

The legislation also requires companies (and funds) to operate under a full self-assessment system, whereby they calculate their tax payable and are responsible for the payment of tax, by way of either installments or a single payment. Income tax returns must be filed by the date the final payment is due, although no supporting schedules or financial statements of any kind are to be filed with the return. The ATO requires records to be maintained by the taxpayer or its agent for five years.

10. *Audits and Limitations Period for Assessment*

Apart from the provisions for deduction at source, ITAA 1936 provides the Commissioner with the machinery to collect income tax assessed and withholding taxes that for some reason may not have been retained.[167]

ITAA 1936 provides for the issue of an assessment based on the return furnished by the taxpayer. Any adjustments made by the Commissioner are shown on an adjustment sheet, which reconciles the taxable income as assessed with the income shown on the taxpayer's return. If no return is filed, or the Commissioner is dissatisfied with the return as furnished, the Commissioner has the power to arbitrarily assess the taxable income of the taxpayer.[168] An assessment notice specifies the date on which tax will become due and payable, normally 21 days after service of the assessment notice.

Tax refunded to a taxpayer as a result of a successful objection or appeal made against an assessment or other specified decision of the Commissioner carries interest at 4 percentage points below the 13-week Treasury Note rate and accrues for the period during which the tax was found to have been overpaid. Such interest received by a taxpayer is included in assessable income.

Late payment of tax carries a general interest charge (GIC) calculated by reference to general market variable interest rates, plus a margin. This penalty is deductible. It is calculated daily on a compounding basis.

Generally, for assessments a standard two-year amendment period applies to most taxpayers. However, a four-year amendment period applies to large business taxpayers with complex tax affairs, certain high-risk taxpayers, and where the Commissioner relies on an anti-avoidance provision. Where the Commissioner considers that there has been an avoidance of tax by fraud or evasion, an assessment may be amended at any time. There are also a limited number of specific provisions that provide unlimited amendment periods for the Commissioner.[169]

However, the list of circumstances in which the standard two-fourth year period can be extended is reasonably short and relates to circumstances where the nature of the taxing provisions requires a longer period before an amendment can be made to an assessment.

Guidelines for the conduct of auditors and taxpayers in complex and large case audits have been developed by the ATO. The overall approach is to achieve the objectives of an audit program in an open and responsible manner that is considerate of the taxpayers' needs.

The ATO also has released a set of guidelines under which it will negotiate with taxpayers and their representatives for the settlement of issues arising during, or as a result of, an audit. Such settlements are not to be treated as a process of bargaining between the parties.

Penalties are imposed by the ATO and fines are imposed by the judicial system. Penalty tax and interest are generally payable where a taxpayer fails to satisfy the requirements of the income tax legislation. Such penalties will be imposed for matters such as: late filing of returns, refusal or failure to provide requested information, failure to maintain records, late payment of tax, and avoidance or evasion of tax.

The ATO has issued numerous guidelines regarding the imposition and remission of penalties. These are ordinarily in the form of a *Practice Statement Law Administration* (referred to as a "PS LA") or a *Miscellaneous Taxation Ruling* (referred to as a "MT"). The most important of these are:

- PS LA 2008/13 — Australian Taxation Office Receivables Policy.
- PS LA 2006/8 — Remission of shortfall interest charge and general interest charge for shortfall amounts.
- PS LA 2008/3 — Provision of advice and guidance by the Australian Taxation Office.
- PS LA 2006/2 — Administration of shortfall penalty for false or misleading statement.
- MT 2008/1 — Reasonable care, recklessness and intentional disregard.

[167] ITAA 1936, Part VI, Div. 1.

[168] ITAA 1936, Sec. 167. See *George v. FCT* (1952) 86 CLR 183, 5 AITR 360; *Trautewin v. FCT* (1936) 56 CLR 63.

[169] ITAA 1936, Sec. 170. See *Lee v. FCT* (1962) 107 CLR 329, 8 AITR 557.

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• PS LA 2007/11 — Administrative treatment of taxpayers affected by announced but unenacted legislative measure which will apply retrospectively when enacted.

• PS LA 2000/9 — Remission of penalties under the new tax system.

• PS LA 2002/8 — Administration of penalties under the new tax system.

• PS LA 2007/22 — Remission of penalty for failure to withhold as required by Division 12 of Schedule 1 of the Taxation Administration Act 1953 (Pay As You Go Withholding).

• PS LA 2005/2 — Penalty for failure to keep or retain records.

Where an offense could lead to prosecution, the decision to prosecute is made by the Director of Public Prosecutions.

In association with the full system of self-assessment, the penalty provisions contain the concept of "reasonable care" and, for items involving tax of more than A$10,000, the requirement that a "reasonably arguable position" exists.

In determining whether a taxpayer's tax treatment of an item is reasonably arguable for purposes of the penalty provisions, the Commissioner is required to have regard for relevant authorities, which include public rulings, cases, acts and explanatory memoranda to bills.

11. Consolidated Returns

Part 3-90 of ITAA 1997 provides that resident companies, trusts and partnerships that are wholly owned by an Australian resident "head company" are entitled to consolidate as one entity for income tax purposes and be taxed as part of the head company, rather than as a separate taxpayer. A consolidatable group consists of a resident head company (or trust taxed like a company; see IX.A.2., below) and all partnerships, trusts and companies that are wholly owned. Ownership is determined by reference to legal ownership of share capital (or similar interests in the case of trusts or partnerships) that is not deemed to be debt under the "debt/equity provisions" (see 4.q., above).

Entry into the consolidation regime by way of election is optional. However, once made, the election is irrevocable. Due to the advantages of consolidation, it would be unusual for an Australian consolidatable group not to elect to consolidate.

A foreign-owned group of Australian-resident subsidiaries that do not have a single Australian-resident head company (i.e. enters Australia via two sister companies) may also be able to consolidate by forming a multiple entry consolidated (MEC) group if the ultimate parent of the Australian entities is the same. Broadly, within a consolidated group:

(i) Intra-group transactions are ignored and are not taxable;

(ii) Losses, franking credits and foreign tax credits and other tax attributes are all held by the head company of the group; and

(iii) Multiple reporting requirements are replaced with a single income tax return and PAYG installments for the entire group.

The group's cost bases for shares in each subsidiary company are preserved by allocating these cost bases to the assets the subsidiary brings into the group. This replaces the cost bases the subsidiary had for its assets. These values provide a cost base for calculating capital gains and losses on assets that are later disposed of outside the group, either directly or as a consequence of the disposal of equity in a member (which leads to deconsolidation of that member from the consolidated group).

For most purposes, a consolidated group inherits the tax history of its joining subsidiaries. Specifically, the entry history rule ensures that everything that happened in relation to the subsidiary member before joining the consolidated group that could affect its taxable income is taken to have happened in relation to the head company.

12. Reorganizations

a. Change of Legal Form

Australia corporate law does not accommodate the flexibility found in various other countries regarding an ability to change the legal form of a company. There is no concept of corporate merger. While it is possible for corporate groups to lodge a consolidated tax return, this is a pure tax fiction: as a matter of corporate law each entity continues to exist as a standalone legal entity.

Australian incorporated entities cannot migrate their place of incorporation offshore (as a matter of Australian corporate law). Noting the breadth of Australia's corporate residency test, and the tie breaker provisions in various double tax treaties, companies may be able to change their tax residency by way of the change in the location of the central management and control of the company, as opposed to changing the place of incorporation.

b. Mergers and Spin-offs

Capital gains derived by a company are assessable under Part 3-1 and Part 3-3 of ITAA 1997. These rules are discussed at V.B.3.b., above. Various concessions are provided for in the Australian CGT rules providing for corporate re-organizations that are not taxable. Noting Australia has a comprehensive consolidation regime for wholly-owned groups, specific concessions for transactions between wholly-owned Australia resident group entities are not required.

(1) Demerger Relief

Demerger relief provisions in Division 125 of Part 3-3 of ITAA 1997 apply where a company ("head company") restructures by passing ownership of one of its subsidiary entities ("demerged entity") to its underlying shareholders.

Relief is provided by deferring any capital gain or loss made by the head company from the transfer of ownership of the demerged entity. The cost base of the original interest held by the underlying shareholders in the head company is apportioned over the interests in the head company and the demerged entity by reference to their relative values post-merger.

Conditions for obtaining demerger relief include:

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(i) The owners of the head entity must acquire at least 80% of the head company's ownership interest in the demerged entity; and

(ii) All underlying shareholders must receive the same proportion of shares in the new demerged entity as their interests in the head entity determined as of immediately before the demerger.

Example: Shareholder acquired 500 ordinary shares (out of 50,000) in Head Co. for $3 per share. Head Co. owns 100% of the shares in Sub Co. Head Co. announces that it will demerge Sub Co. by way of a disposal of all of its shares in Sub Co. The demerger is proportional and is offered to all Head Co. shareholders.

To obtain rollover relief, the sum of the market value of Shareholder's shares in Head Co. and new shares in Sub Co. must equal to or exceed the market value of Shareholder's shares in Head Co. immediately prior to the demerger.

As a result of the demerger, Shareholder must recalculate the cost base of his interests in Head Co. and Sub Co. In the case of a public company demerging to a wide list of shareholders, a Head Co. would typically advise Shareholders of the relative value of the two interests post-merger (e.g., Sub Co. represented 20% of the value).

The cost base of shareholders shares in Head Co. prior to the demerger was $1,500. This cost base must now be spread between the new shares in Sub Co. and the remaining shares in Head Co.

(i) Cost base of shares in Sub Co. = 20% × $1,500 = $300 divided by 100 shares = $3 per share; and

(ii) Cost base of shares in Head Co. = 80% × $1,500 = $1,200 divided by 500 shares = $2.40 per share. Capital gains or capital losses made by Head Co. in relation to its shares in Sub Co. are disregarded.

(2) Share Buybacks

When a company undertakes a share buyback, the source of the buy-back proceeds (i.e., whether the proceeds are debited to share capital or retained earnings) is important for tax purposes. The tax consequences of a share buyback by a company also vary depending on whether the acquisition is "on-market" or "off market" and whether the company is a public listed company.

(a) On-market Buyback

In the case of an on-market buyback, the shareholder treats the proceeds for sale like it would any share disposal. As such, any gain on sale will be taxable, most likely as a capital gain. (See, generally, 3.b., above.) By comparison, the company undertaking the buy-back must effectively treat the buyback proceeds in the same way it would have if the buy-back had been off-market. The company may be required (for its own purposes) to deem a portion of the buy-back amount to be a dividend and (possibly) debit its franking amount (see, generally, V.B.3.c., above).

(b) Off-market Buyback

In the case of an off-market share buy-back, if the company is a listed public company, the shareholder treats the sale proceeds like it would any share disposal (as is the case for an on-market buy-back). However, if the company is not a listed public company, the buy-back proceeds are deemed to be a dividend to the extent to which the buy-back proceeds are debited against the company's retained profits. As opposed to an on-market buy-back, this deemed dividend is assessable income of the shareholder according to the same principles that apply to dividends generally (see 3.c., above). To ensure the same gain is not taxed twice, the buy-back proceeds for CGT purposes are then reduced by the dividend portion of the buy-back price.

Very broadly, for both an on-market and off-market buy-back, the deemed dividend portion of the buy-back proceeds may result in a debit to the company's franking amount (see V.B.3.c., above).

13. Cryptocurrency

Australia is yet to provide comprehensive framework on the tax treatment of cryptocurrency.

A review was undertaken by the Board of Taxation (the Board), with its report released in August 2022.

For Australian tax purposes, cryptocurrency is not foreign currency as defined under the ITAA 1997. Division 775 of the ITAA 1997, which provides rules for recognizing foreign currency gains and losses for income tax purposes, does not apply.[170]

Crypto assets including cryptocurrencies, such as bitcoin, generally fall under the Capital Gains Tax (CGT) provisions. Where crypto assets are held as an investment, a CGT event can occur for a variety of reasons, the most common being the disposal of crypto assets at the time the asset is sold. However, a disposal can include:

- Gifting crypto assets;
- Exchanging crypto assets (including the disposal of one crypto asset for another crypto asset);
- Converting crypto assets to fiat currency such as Australian dollars; or
- Using crypto assets to obtain goods or services or to remunerate employees.

If a capital gain is made on the disposal of crypto assets, some or all of the gain may be taxed.

Crypto assets held by entities carrying on a business of mining and trading crypto assets or carrying on a crypto asset exchange business will generally be treated as trading stock. Further, crypto assets received as a form of payment in the ordinary course of business will also be treated as trading stock where the crypto asset is held for the purpose of sale or exchange. As such, proceeds from the sale of crypto assets held as

[170] Section 995-1 of the ITAA 1997, as amended by Tax Laws Amendment (2022 Measures No. 4) Act 2023 which legislatively enforced what was previously contained in Taxation Determination TD 2014/25: Income tax: is bitcoin a 'foreign currency' for the purposes of Division 775 of the Income Tax Assessment Act 1997.

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trading stock in a business are considered ordinary income for the entity (rather than taxed under CGT rules).

If an employer uses crypto assets to satisfy an obligation to pay salary or wages to an employee, the employer will be subject to Pay as You Go (PAYG) withholding obligations and the amount will be subject to income tax in the hands of the employee. Where there is a valid "salary sacrifice" agreement in place, cryptocurrencies provided to employees will be a 'property benefit' for fringe benefits tax (FBT) purposes under the Fringe Benefits Tax Assessment Act 1986 (Cth), in which case the employer may be subject to FBT.

"Digital currency" is defined in the A New Tax System (Goods and Services Tax) Act 1999 (Cth.), and the goods and services tax (GST) consequences of using it as a method of payment are the same as the consequences of using money as payment. When a business sells digital currency and is paid with Australian, foreign, or digital currency, it makes an input taxed supply of digital currency. The buyer, if they are a business, also makes an input taxed supply of Australian, foreign, or digital currency.

An entity may be eligible for a deduction for a gift or donation of a crypto asset where the donation is made to a deductible gift recipient and the relevant gift conditions and rules are met. A donation of a crypto asset will be a CGT event as it represents a disposal of property and may result in CGT consequences. The crypto assets are valued at market value at the time of the CGT event for the purposes of calculating any capital gain or loss. Generally, the disposal of crypto assets gifted under a will, donated under the Cultural Gifts Program or personal use assets will not result in a CGT liability.

The income tax treatment of non-fungible tokens (NFTs) depends on how the NFT is held and used and follows the same general principles as cryptocurrencies. Transactions relating to NFTs may be subject to income tax on revenue account as trading stock, as part of a business or profit-making scheme; or under the CGT regime. For GST purposes, an NFT is not a form of digital currency. The GST treatment of an NFT depends on whether the transaction meets the requirements of being either a taxable or GST-free supply under the GST rules.

C. *Other Taxes*

All the taxes discussed in IV., above, apply to Australian companies. Other than corporate income tax, there are no taxes applicable to a company that are not relevant to other taxpayers.

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VI. Taxation of Foreign Corporations

A. *What Is a Foreign Corporation?*

All companies that are not residents of Australia and intend to do business in Australia are foreign companies. In contrast to the U.S. federal tax system, the Australian tax system does not allow a company to elect to be treated as a pass-through entity. Where a foreign company has elected pass-through treatment in its home country, it is still characterized as a foreign company for Australia tax purposes (other than in the context of the application of treaty relief, where look-through treatment may be available).

B. *Determination of Taxable Income*

1. *Taxation by Assessment*

Nonresident companies that derive Australian taxable income (other than dividends, interest, royalty income or Managed Investment Trust (MIT) distributions subject to a final withholding tax (see VI.B.3., below)) are required to lodge an Australian tax return.

The general jurisdictional limit as to what can constitute Australia taxable income for a foreign corporation is based on source. Thus, nonresidents can be taxed only on Australian-sourced income. The source of income is generally a question of fact.

In certain areas, specific rules are provided to assist in the determination of the jurisdictional limits of Australia's ability to tax (for example, when capital assets held by a nonresident are taxable Australian property). Specifically, a capital gain derived by a nonresident company will only be subject to tax in Australia under Australian capital gains tax provisions if it is one of the categories of assets set out below.

a. *Taxable Australian Assets*

Capital gains and losses made by a nonresident are taxable if, and only if, the relevant capital (CGT) asset is "taxable Australian property." Taxable Australian property means:

(i) Real property situated in Australia.[171]

(ii) A mining, quarrying or prospecting right — if the minerals, petroleum or quarry materials are situated in Australia.

(iii) An interest held by a shareholder beneficiary or partner in a (resident or nonresident) company, partnership or trust where:

- The shareholder-beneficiary or partner (alone or together with associates) holds 10% or more of the voting rights or the rights to income or capital in the company, partnership or trust either:
  - — At the time of the CGT event; or
  - — Throughout a 12-month period over the last 24 months; and
- — More than half of the entity's assets consist of real property and mining, quarrying, or prospecting rights of the type mentioned in (ii) and (iii), above (by reference to market value). For the purpose of this market value test, it is necessary to look through to the underlying assets of interposed companies, partnerships or trusts in which an entity holds 10% or more of the voting, income or capital rights.

(iv) An asset that has been used at any time by the nonresident in carrying on a business through an Australian permanent establishment (PE) (where the asset has been used in this way for only a portion of the time since the asset was acquired, only that portion of the capital gain is assessable in Australia).

(v) An option to acquire an asset referred to in (i), (ii), (iii) or (iv), above.

(vi) An asset held by a resident individual taxpayer at the time of becoming a nonresident, where the taxpayer chooses to defer the recognition of any gain on migration offshore (see below regarding a change of residence).

The above exhaustive list of "Australian taxable property" can be broadly summarized as covering Australian real property and business assets of Australian PEs. The list also has an integrity measure that subjects foreign residents to Australian CGT where they use a foreign entity to hold Australian assets. Foreign residents are affected by this integrity measure where they hold a non-portfolio interest (10% or more) in a foreign entity and more than half the value of the entity's assets is attributable to underlying Australian real property.

In addition to these CGT rules applying to foreign residents, a purchaser is required to withhold and remit to the Australian Tax Office 15% of the gross proceeds from the sale of certain types of Australian real property, other than disposals by Australian residents. As opposed to the withholding taxes referred to 2., below, this is not a final tax but merely assists with the collection of tax from nonresidents.

Legislative Note: On May 14, 2024, as part of the 2024–25 Budget, the Australian Government announced it will strengthen the integrity of the CGT regime as it applies to non-residents to ensure foreign residents pay their fair share of tax in Australia and to provide greater certainty about the operation of the rules. As of this writing, we are yet to see a draft bill for these proposed measures. While the amendments were originally intended to apply to CGT events starting on or after July 1, 2025, they have been deferred with a start date to arise the later of October 1, 2025 or the first day of the quarter after the amending legislation receives royal assent. The amendments will:

1. Clarify and broaden the types of assets that foreign residents are subject to CGT on amend the point-in-time principal asset test to a 365-day testing period;

2. Require foreign residents disposing of shares and other membership interests exceeding A$20 million in value to notify the ATO, prior to the transaction being executed.

This measure is intended to ensure that Australia can tax foreign residents on direct and indirect sales of assets with a close economic connection to Australian land, more in line with the tax treatment that already applies to Australian resi-

[171] This includes a lease of land if the land is situated in Australia.

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dents. The new ATO notification process will improve oversight and compliance with the foreign resident CGT withholding rules, where a vendor self-assesses their sale is not taxable real property.

These reforms will also improve certainty for foreign investors by aligning Australia's tax law for foreign resident capital gains more closely with OECD standards and international best practice.

The following rules apply in case of a change of residency.

Subject to the election to defer referred to in the following paragraph, when Australian residents become nonresidents they are generally deemed to have disposed of all of their assets that are not taxable Australian property at that time. Where the taxable Australian property is an interest in a company, trust or partnership or trust referred to in paragraph (iii) above, the interest is deemed to have been disposed of at the time of the change in residency — in the same way as all other assets that are not taxable Australian property — despite the fact that this asset class remains within the scope of Australia's jurisdiction to tax (these assets are then deemed to have been reacquired with a market value cost base).

A resident individual who becomes a nonresident can elect to defer this deemed disposal CGT event to when the assets are actually sold (or some other CGT event occurs). In this case, these assets are deemed to be a taxable Australian property until the relevant CGT event occurs.

b. Natural Resources Income

Income derived by nonresidents of Australia that is directly related to the exploitation of Australia's natural resources is deemed to have a source in Australia and is subject to Australian income tax. The tax is withheld by the person making the payment and remitted to the Commissioner within 14 days of the end of the month in which the payment is made. In Income Tax Ruling 2669, the Commissioner states his opinion that royalty and natural resource income is derived when a nonresident receives the royalties.

c. Offshore Commercial Activities

Income derived by nonresidents from commercial activities, such as tourism operations, conducted in certain island territories and from fixed tourist and other installations in the waters surrounding Australia and those islands is assessable income. An exemption from Australian income tax applies for bona fide residents of Norfolk Island.[172]

d. Insurance Provisions

Division 15 of the Income Tax Assessment Act 1936 (ITAA 1936) levies tax on certain premiums derived by nonresident insurance companies and other entities that do not have a principal office or branch in Australia under contracts of insurance. The two classes of income to which Division 15 can apply are (1) premiums derived by nonresident insurers; and (2) reinsurance premiums paid out of Australia by a person carrying on a business of insurance in Australia.

However, as the definition of contracts of insurance specifically excludes contracts of life assurance, Division 15 should have no application to the life insurance products.

e. Shipping Activities

Where a ship belonging to or chartered by a person whose principal place of business is outside Australia, carries passengers, livestock, mail or goods shipped in Australia, 5% of the amount payable with respect to such carriage is deemed to be taxable income derived in Australia.[173] Guidance from the Commissioner as to the scope of these provisions can be found in income tax ruling TR 2006/1. In particular:

(i) The section is principally applicable to nonresident shipping operators who "ship" goods in Australia. However, the section is equally applicable to a resident of Australia that has its principal place of business out of Australia.

(ii) Taxation is based on an arbitrary amount of profit made with respect to the carriage of passengers, livestock, mail or goods shipped in Australia by a shipowner or "charterer."

(iii) Division 12 of Part III of the section is not concerned with the actual profit made or how it is to be divided, form of carriage or the nature of the rights and obligations arising.

(iv) The amounts referred to in the section are the amounts paid or payable under the particular contractual arrangement used to carry passengers, livestock, mails or goods "shipped" in Australia.

(v) The applicability of Division 12 may vary depending on the type of shipping (i.e., bill of lading, voyage charterparty, time charterparty or a chain of charterparties).

The above comments are qualified by the fact that profits from the operation of ships in international traffic are generally the subject of specific articles in Australia's tax treaties. The general rule is that shipping profits derived by a resident of another country are exempt from tax in Australia, except where the profit relates to traffic wholly within Australia.[174]

f. Tax Treaties

Nonresidents also need to consider whether a tax treaty applies (see XV.B., below.) Typically, tax treaties limit the amount of tax payable in Australia (i.e., protect nonresidents from Australian taxation) but can on occasion result in providing the Australian Government with an opportunity to tax income that would otherwise not be caught under domestic law.

A nonresident not taxed in Australia as a result of the protection provided by a tax treaty is not required to lodge an income tax return (even if registered in Australia for GST purposes or registered with Australian Securities and Investments Commission (ASIC) as a foreign company carrying on business in Australia).

[172] ITAA 1997, Secs. 24B to 24P.

[173] Income Tax Determination TD93/89.

[174] Income Tax Determination TD93/89.

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2. Income from Casinos, Entertainment, Sports and Construction Activities

Australia has a comprehensive withholding tax regime that applies to dividends, interest, royalties, and MIT fund payments (as defined) paid from Australia. Dividend, interest and royalty withholding tax are discussed below, and withholding taxes from fund payments are discussed at II.A.1.h., above. For the rates of source country taxation applying to investment income, services income and capital gains under Australia's domestic law and tax treaties and the context for the application of those rates, see the Withholding Tax Chart.

There is also a small set of "industry-based" withholding tax rules for certain types of income derived by nonresidents. Under these rules, an Australian resident is required to withhold tax from certain types of income included in a list in the Income Tax Regulations (if the income is paid to a nonresident). This list is a simple mechanism to ensure collection of a tax from these taxpayers who would otherwise be assessed by way of a tax return. At present, this list is limited to payments for:

(i) Operating or promoting a gaming junket;

(ii) Certain entertainment or sport; and

(iii) Contracts for certain construction and other activities.

3. Investment Income

Australia has a detailed PAYG withholding system for the collection of tax on cross-border flows of interest, dividends, and royalties. Below is a detailed review of these provisions and various exemptions from their application.

a. Interest Withholding Tax

Division 11 and Division 11A of Part III of ITAA 1936 set out the two complementary regimes for the taxation of interest at source by way of withholding (IWT). Division 11A imposes a 10% IWT on cross border gross interest flows from Australia offshore (subject to the various exemptions discussed below). Division 11 imposes a 45% withholding liability upon corporate payers of interest on bearer debentures where the appropriate information requirements (regarding the name and address of the payee) have not been collected. Division 11 has very little practical application in Australia. Division 11A is the more common set of provisions in the context of cross border interest flows and is discussed in greater detail below.

There are four types of cross border interest payments subject to Division 11A, all of which are variations of the same theme — the payment of interest from Australia offshore. Division 11A applies to the payment of interest from either:

(i) An Australian resident taxpayer operating from Australia; or

(ii) An Australian PE of a nonresident to either:

- A nonresident operating from an offshore office; or
- An offshore PE of an Australian resident.

(1) Definition of Interest

Interest for these purposes is defined by section 128A(1AB) of ITAA 1936 and includes:

(i) Common law interest;

(ii) An amount in the nature of interest (including, for example, bill discount and premium);

(iii) Amounts converted into a form that is in substitution for interest;

(iv) Profits from bond washing arrangements — defined to include the profit on the sale, shortly before interest payment date, of an interest-bearing security (so as to economically realize the interest as a profit rather than as interest as otherwise defined) with the dominant purpose of reducing withholding tax; and

(v) Dividends paid on a non-equity share — which ties in the debt/equity hybrid tax rules of Division 974 of ITAA 1997 (see V.B.4.q., above).

The following *bona fide* payments are not caught:

(i) Returns on an "equity interest" (again, this ties in the debt/equity hybrid tax rules, and can include interest on debt securities classified as equity for tax purposes);

(ii) Payment of "interest equivalence payments" under interest rate swaps (see the Commissioner comments in Income Tax Ruling IT 2050);

(iii) Cross-currency swaps (by analogy to IT 2050);

(iv) Profits under repurchase agreements not caught by bond washing anti-avoidance provisions;

(v) Profits under forward purchase agreements;

(vi) Guarantees;

(vii) Certain perpetual income notes (see Income Tax Ruling TR2002/15); and

(viii) Interest derived by a foreign bank from a "nostro account" (i.e., an account that an authorized deposit-taking institution (ADI) or non-ADI financial institution holds with the foreign bank for the purposes of settling (within 10 days) international transactions).

(2) Consequences of Lender Having an Interest Withholding Tax Liability

The lender is liable to tax at 10% of gross interest. The payer is required to withhold that amount. Tax is due and payable to the Commissioner 21 days after the end of the month in which the income was derived by the nonresident.

IWT is a final Australian tax. If the interest is caught by the IWT regime, the interest is not also subject to Australia's general income tax regime. This is the case even if the interest payment falls within one of the IWT concessions discussed below.

(3) Exclusions from Interest Withholding Tax

The four principal IWT concessions expressly provided for in the tax law are discussed below. Each is driven by a desire to ensure that Australian entities are competitive in the international money markets and are able to access offshore funding without a 10% tax cost, which invariably leads to the gross-up of the interest payment offshore.

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(a) Sections 128F and 128FA of the Income Tax Assessment Act 1936

Sections 128F and 128FA provide an IWT exemption for interest paid on certain debentures and debt interests that satisfy the public offer test. This is the principal means by which corporations and widely held trusts operating in Australia raise money from offshore IWT free.

A debenture is defined for the purposes of sections 128F and 128FA to include debentures stock, bonds, promissory and other notes, bills of exchange and any other securities issued by the company or trustee of the eligible unit trust. Some offshore fundraisings are done in a manner that does not fall within this concept of a debenture. For this reason, section 128F also incorporates debt interests, being a more generic concept of debt.

The requirements that must be satisfied for an interest payment to fall within the scope of this exemption are set out below:

(i) The entity that issues the debenture or debt interest and pays the interest must be, at both the time of issue and interest payment:

• An Australian resident company;

• A nonresident company carrying on business through an Australian PE; or

• A trustee of an eligible unit trust. An "eligible unit trust" is:

— A unit trust whose units are listed, otherwise offered to the public or held by more than 50 persons (subject to a carve out for unit trusts where a group of 20 persons (or less) hold more than 75% of the rights to income or capital from the trust); and

— All of whose units are held by two or more eligible unit holders — being public companies, complying superannuation funds with at least 50 members, life insurance companies, pooled superannuation trusts or other public unit trusts.

(ii) In the case of a debt interest (other than a debenture), the debt interest is:

• A "non-equity share"; or

• A syndicated loan — which is defined as a loan or other form of financial accommodation that is provided under a syndicated loan facility where that facility has two or more lenders.

(iii) Either the debentures/debt interests must be offered, or invitations to become a lender under the syndicated loan facility must be made, in a manner that satisfies the public offer test. The issue of a debenture or a debt interest (other than a syndicated loan) satisfies the public offer test if the issue resulted from the debenture being offered for issue:

• To at least 10 persons (none of whom are associates) each of whom carry on a business of providing finance, or investing or dealing in securities, in the course of operating in the financial markets;

• To at least 100 persons with respect to whom it is was reasonable for the issuer to have regarded as either having acquired debentures in the past or being likely to be interested in acquiring debentures;

• As a result of being listed on a stock exchange, where the company had previously entered into an arrangement with a dealer, manager or underwriter, in relation to the placement of debentures, requiring the company to seek such a listing;

• As a result of negotiations being initiated publicly in electronic form, or in another form, that was used by financial markets for dealing with securities; or

• To a dealer, manager or underwriter, in relation to the placement of debentures, who, under an agreement with the issuer, offered the debentures for sale within 30 days in a way covered by the four options above.

In the case of a syndicated loan, an invitation to become a lender under a syndicated loan facility satisfies the public offer test if the invitation was made, broadly, in a manner that complies with the first or fourth bullet above or to a dealer, manager or underwriter, in relation to the placement of debentures, who, under an agreement with the issuer, made the invitation to become a lender under the facility within 30 days in a way covered by the first or fourth bullet above.

(iv) It must not be the case that, at the time the debenture or debt interest is issued, the issuer knowns or has reasonable grounds to suspect, that:

• The debenture or debt interest was being, or would be, directly or indirectly, acquired by an associate of the issuer;

• Either: the associate is a nonresident (operating from offshore); or the associate is a resident and the acquisition is carrying on a business in a country outside Australia at or through a PE in that other country; and

• The debenture or debt interest was not acquired by the associate in the capacity of:

— A dealer, manager or underwriter in relation to the placement of the debenture; or

— A clearing house, custodian, funds manager or responsible entity of a registered scheme.

(v) It must not be the case that, at the time of payment of the interest, the issuer knows, or has reasonable grounds to suspect that the recipient is an associate of the issuer, and:

• It is either: a nonresident (operating from offshore); or a resident and the payment is received by the associate with respect to a debenture or debt interest that the associate acquired in carrying on a business in a country outside Australia at or through a PE of the associate in that country; and

• The associate does not receive the payment in its capacity of a clearinghouse, paying agent, custodian, funds manager or responsible entity of a registered scheme.

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(b) Tax Treaties

Many of Australia's newer tax treaties, including those with Finland, France, Japan, New Zealand, Norway, the United Kingdom, and the United States provide an exemption from withholding tax for interest paid to financial institutions that are unrelated to and wholly independent from the payer. A financial institution is a bank or other enterprise substantially deriving its profits by raising debt finance in the financial market or by taking deposits at interest and using the funds in carrying on a business of providing finance. The ATO has provided some guidance as to the interpretation of these provisions in the Australia-U.K. and Australia-U.S. tax treaties in TR2005/5 (this ruling was finalized before the other treaties were enacted). The tax treaties Australia has with Austria, Italy, South Korea and Switzerland include a "most favored nation" (MFN) clause and will therefore require re-negotiation to include a similar provision in the near future.

(c) Branch Banking Rules

Part IIIB of the 1936 Act provides special rules for nonresidents operating in Australia through an Australian branch. Under these rules, interest payable from the Australian branch offshore to its offshore parent is subject to a 5% withholding cost.

(d) Section 128B(3)(jb) of the Income Tax Assessment Act 1936

Section 128B(3)(jb) exempts from withholding tax interest, dividend or non-share dividend income derived by a nonresident superannuation fund with portfolio (non-controlling) investments in Australian entities. These rules are discussed in detail in II.A.1.g., above.

b. Dividend Withholding Tax

Nonresident shareholders receiving dividends from Australian companies are subject to dividend withholding tax to the extent the dividends are:

(i) Not "franked" (see the discussion of franking in V.B.3.c., above); and

(ii) Not paid from foreign profits that were exempt (as either foreign branch income, dividends from foreign subsidiaries or gains from the sale of shares in foreign subsidiaries that qualify for the benefit of the participation exemption available for non-portfolio investments in foreign subsidiaries).

In very broad terms, dividend withholding tax is limited to the distribution offshore of Australian profits of an Australian corporate that has not been subject to Australian corporate income tax.

As a general rule, the rate of withholding tax on such unfranked dividend paid to a nonresident is 30%. This 30% rate may be reduced under a double tax treaty, if one exists between Australia and the shareholders' country of residence. Under the double tax treaties, the rate of withholding is usually limited to 15%, although it can be reduced to 10%, 5% or even 0% in some situations.

Dividend withholding tax is deducted either by the paying company, or by an agent acting for the nonresident, from dividends payable to a nonresident.

c. Royalties

(1) In General

Cross-border royalty payments are also subject to PAYG withholding in similar threshold circumstances as for interest (as discussed in a. above). The meaning of a royalty at common law is more limited than the statutory definition in section 6(1) of ITAA 1936, which generally applies for tax purposes. Broadly, the ordinary meaning of royalty is a payment made in return for the right to exercise a beneficial privilege or right where the consideration payable is determined on the basis of the amount of use made of the right acquired.[175]

Section 6(1) of ITAA 1936 extends to certain amounts which may not be royalties within the ordinary meaning of that term. It states a royalty includes any amount paid or credited, however calculated and whether periodical or not, to the extent the amount is paid or credited as consideration for:

(i) The use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trademark, or other like property or right;

(ii) The use of, or the right to use, any industrial, commercial or scientific equipment;

(iii) The supply of scientific, technical, industrial or commercial knowledge or information (generally read as a reference to know-how);

(iv) The supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right mentioned above;

(v) The reception of, or the right to receive, visual images or sounds transmitted by satellite/cable/optic fiber or similar technology;

(vi) The use of, or right to use, visual images and/or sounds in connection with television or radio broadcasting which are transmitted by satellite, cable, optic fiber or similar technology;

(vii) The use of, or right to use, spectrum specified in a spectrum license, or films or video tapes in connection with television or radio broadcasting; or

(viii) An agreement by another party to not make the above rights available to third parties.

The expansive drafting of this provision means that it can potentially capture lump sum payments, amounts of a capital nature (in the hands of the payee), and furthermore, that it is not necessary for the right to be actually used; it is sufficient that consideration is paid for a grant of a right falling within the above definition.

[175] See IT 2660, which sets out the key characteristics of a common law royalty.

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Australia's tax treaties generally define the term royalty consistently with the definition in Section 6(1), although not always identically.[176]

Tax Ruling IT2660 confirms the general proposition that the provision of services is not included in the definition of "royalty." Where a payment for services is part of enabling those items included in the definition of "royalty" to be supplied, such a payment for services will be treated as a royalty.

Whether the payment is a royalty payment or a payment for services depends on the nature and purpose of the agreement giving rise to the payment. In Tax Ruling IT2660, the Commissioner states that a contract for the supply or use of a "product" which is already in existence (or substantially in existence) is more likely to be a contract for the supply of know-how and will give rise to a royalty. On the other hand, where the contract requires the contractor to apply special skills and knowledge for his own purposes in order to bring the "product" into existence for the buyer, the contract will be a contract for services rendered.

It should be noted that amounts paid as consideration for an assignment of copyright generally qualify as royalties, unless the assignment is appropriately characterized as an outright sale of the copyright. In Taxation Ruling 2008/7, the Commissioner states that an assignment of copyright amounts to an outright sale if:

(i) It is for the full remaining life of the copyright;

(ii) It extends geographically over an entire country or several entire countries;

(iii) It is not limited as to the class of acts over which the copyright assignee has exclusive rights; and

(iv) The amount and the timing of the payment(s) or the assignment are not dependent on the extent of exploitation of the copyright.

Where a contract provides for the supply of multiple things, some of which may constitute rights or supplies for which a royalty is payable (e.g., a contract for both the supply of know-how and the provision of services), an apportionment of the payments under the contract will be necessary. Apportionment must be done in a fair and reasonable manner — for example, the value of the IP rights granted compared to the value of the other rights provided under the contract. Both the ATO (in Income Tax Ruling 2660) and the OECD Commentary (at paragraph 11.6 of the OECD Model Convention Commentary on Article 12) take the view that if one part of what is being provided under the contract constitutes the principal purpose of the contract, and the other parts are only ancillary to that, then the tax treatment applicable to the principal part should be applied to the whole amount of the consideration. Conversely, if there is sufficient evidence and contemporaneous documentation to support that the provision of any IP is only incidental and ancillary to the main purpose of the contract, then under the same principle there may be arguments that no part of the payment should be treated as a royalty.

[176] See also International Tax Agreements Act 1953, Sec. 3(8).

(2) Software Payments

(a) In General

The characterization of payments for software in the royalty context has become of increasing importance in recent years with the advent of cloud computing and distribution models such as software-as-a-service and platform-as-a-service.

The Commissioner's views on the income tax implications arising from the development and marketing of computer software were previously set out in Taxation Ruling 93/12 (withdrawn from July 1, 2021). According to this ruling, the Australian tax treatment of a software payment depends on the terms of the particular agreement between the parties, having regard to all the circumstances of the case and the rights, property, and information granted or supplied to the customer. The way in which the software is delivered (whether via the cloud or otherwise) is generally not determinative of the analysis. An intellectual property (IP) law analysis will generally be critical to the royalty analysis to accurately delineate the nature and value of the IP rights granted. Because a licensee typically lacks the right to exercise the IP right in the absence of a license, remuneration is ordinarily payable in circumstances in which the exercise of that right confers on the licensee something of commercial value. The quantum of the royalty ordinarily reflects the nature and extent of that commercial value. It is therefore important to understand how IP statutes govern ownership of IP is determined, set out the monopoly rights enjoyed by owners, and make provision for the licensing of those rights to third parties. In *FCT v. Seven Network Limited*,[177] the Full Federal Court analyzed the provisions of the Copyright Act 1968 in detail in holding that the subject matter of the payment in that case, an ITVR signal, was neither a cinematograph film, a copyright or other like property or right.

In TR 93/12, the Commissioner accepted, consistent with the OECD Model Convention Commentary on royalties, that a payment for software will generally not be characterized as a royalty where the payment is only for simple use of the software as an end-user, not permitting any exploitation of the underlying copyright or other IP rights embedded in the program. Although it is arguable that some part of the amount paid for the acquisition of computer software under a licensing arrangement may be attributable to an express or implied license to use the copyright in the program, which is strictly a royalty, the Commissioner accepted that the amount, if quantifiable, is likely to be minimal, and no apportionment of the license fee paid in respect of the software is necessary.

The royalty analysis is more complex in the context of distributors or resellers of software. Following the introduction of the Multinational Anti-Avoidance Law (see further at XVI.B., below), many large global companies restructured their Australian operations into reseller arrangements,[178] including software providers. It is crucial that the payment from the Australian distributor or reseller to the related foreign entity (which generally also owns the IP) is characterized correctly for Australian tax purposes. In TR 93/12, the Commissioner took the view that payments for a license for simple use only of comput-

[177] [2016] FCAFC 70.

[178] ATO Statement on Corporate Tax, released February 14, 2018.

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er software are not royalties, irrespective of whether the software is acquired by a distributor for sub-licensing to end-users or by end-users directly (at paragraph 28). However, to the extent the terms of the agreement give the distributor or reseller rights to exploit the copyright in the software that go beyond the rights required by an end-user, or where know-how is supplied to the distributor, there is a risk that payments under the agreement should be characterized as royalties. TR 93/12 gave the example of rights which allow the licensee to modify, adapt or copy, or otherwise do what would ordinarily be the exclusive right of the copyright owner. In *International Business Machines Corporation v. FCT*,[179] the Federal Court held that payments under a distribution agreement were royalties on the basis that the agreement clearly granted to the distributor IP rights, related knowledge and technical know-how necessary for the distributor to use, distribute and market programs in Australia, rather than conferring distribution rights independently of the grant of IP rights.

The terms of the agreement must also accurately reflect the substance of the activities and dealings between the parties. In Taxpayer Alert 2018/2, the ATO highlighted its continuing focus on arrangements that mischaracterize intangible assets and/or activities or conditions connected with intangible assets. More specifically, the concern is whether intangible assets have been appropriately recognized for Australian tax purposes and whether Australian royalty withholding tax implications have been analyzed. Importantly, the Alert states that it does not apply to resellers of finished tangible goods where the activity of reselling the goods involves incidental use of a brand name that appears on the goods and related packaging. Under current law and guidance, where an Australian taxpayer obtains no rights to use a trade name other than to market and distribute a branded product, the taxpayer would generally not be expected to be charged a royalty in addition to the price of the product. This is also consistent with the commentary in the OECD/G20's Base Erosion and Profit Shifting Project Action 8-10 2015 Final Reports on Transfer Pricing Outcomes (released October 5, 2015), which sets out eight examples involving reseller agreements. In none of these examples does the OECD flag a risk that the payments made by the local reseller subsidiary to the offshore parent to acquire the relevant product should be wholly or partially characterized as a royalty. However, the concept of marketing intangibles (for example, the trademarks and other brand rights which may be used in conjunction with performing the functions of a distributor or reseller) may evolve further.

Finally, it should be noted that the ATO may approach a royalty characterization dispute in a number of ways. As discussed elsewhere, the ATO has broad powers which allow it to reconstruct transactions under the General Anti-Avoidance Rules, the Diverted Profits Tax, and the transfer pricing rules. In addition, the ATO could also simply take the view as a matter of legal analysis that a payment is in the nature of a royalty based on the substance of the rights and obligations under a contract, regardless of how the parties have chosen to describe that payment in the contract.

[179] [2011] FCA 335.

(b) Draft Taxation Ruling TR 2024/D1

On January 17, 2024, the ATO issued updated Draft Taxation Ruling TR 2024/D1, which addresses the circumstances in which receipts from the licensing and distribution of software will be royalties under Australian domestic law. As it is only draft guidance, it is important to retain the historical analysis set out in the previously well accepted (and generally in alignment with OECD commentary) ATO Tax Ruling TR93/12. TR93/12 remains relevant to the extent it covers issues specific to a taxpayer's facts for previous income years. The Draft Ruling provides guidance to software owners, software distributors and end users of software, and reviews three software distribution models: (1) packaged software; (2) digital downloading of software, and (3) cloud computing arrangements.

Consistent with TR93/12, it concludes that consideration for 'simple use' of software, where a licensee's use of copyright is restricted to no more than is necessary to facilitate the use of the software, is not a royalty. However, for the remaining two categories, new guidance is provided — expanding the potential scope of the Australian withholding tax provisions. Specifically, where an intermediary entity (e.g., a local 'software distributor') has paid for the right to redistribute the software — potentially using the rights reserved to the software owner (as owner of the relevant copyright) — those payments may be royalties. This places the focus on whether the relevant distribution agreement has conferred exclusive rights of a copyright owner on the distributor. If it has, then payments made under that agreement may be considered royalties. Subject to further ATO clarification, the ruling could have a significant effect on existing software distribution arrangements, noting that many foreign company supply chains into Australia were restructured post introduction of the Multinational Anti-Avoidance Law (MAAL) to ensure that Australian customers were contracting directly with local distributers (as opposed to an offshore principal) to manage the risk of a deemed PE arising post the introduction of the MAAL.

Comment: The progress of this draft ruling, and the ATO's views regarding the breadth of Australia's royalty withholding tax provisions, will need to be monitored closely until this ruling is finalized. In light of the industry feedback on the ruling to date, it is unsurprising that the proposed finalization date for this ruling was for some time (officially) "To be advised". Due to the appeal of the Full Federal Court judgment in *Pepsi* to the High Court (see VI.B.3.c., below), the ATO has sensibly deferred the timing of the finalization of the draft ruling until the High Court's decision on the appeal.

(3) Assessment of Withholding Tax

Royalty withholding tax is payable in the following circumstances set out in section 128B(2B) of ITAA 1936:

(i) Where a royalty is paid to a nonresident by an Australian resident, and is not incurred in carrying on business in a foreign country or through a PE in a foreign country; and

(ii) Where a royalty is paid to a nonresident by a nonresident who has incurred the expense in carrying on business in Australia or through a PE in Australia — accordingly, upstream royalties may potentially be attributed (in whole

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or in part) to an Australian branch and subject to royalty withholding tax in Australia, although this will ultimately depend on the functional analysis of the branch and undertaking an attribution consistent with the relevant business activity approach applied in Australia.

Royalties paid to nonresidents are subject to royalty withholding tax at the rate of 30%. Where the royalty recipient is a resident of a country with which Australia has a double taxation agreement, the rate of withholding tax specified in the agreement applies.

Any royalty paid by a resident of Australia to a nonresident is deemed by Section 6C of ITAA 1936, to be derived from a source in Australia. Accordingly, a nonresident is assessable in Australia on any royalty income received from an Australian resident, as the source of the income is deemed to be from a source in Australia. Before this enactment, to assess a nonresident for Australian tax, it was necessary for the Commissioner to establish that the nonresident was deriving income from a source in Australia, i.e., from property in Australia (e.g., a patent, registered trademark, etc.), or with respect to services performed in Australia.

The Commissioner may therefore seek to recover unpaid royalty withholding tax from a nonresident by issuing a nonresident with a default income tax assessment or alternatively issuing a withholding tax notice. The Commissioner may also choose to impose a penalty on the payer equal to the amount failed to be withheld. There is generally no time limit on the Commissioner of Taxation's power to undertake these actions, broadly because there has been no assessment of the withholding tax liabilities within the meaning of section 170 of ITAA 1936. Where the Commissioner issues an income tax assessment to the nonresident, the nonresident should be able to avail itself to the tax objection and appeal procedures in Part IVC of the Taxation Administration Act 1953. However, where the Commissioner issues a withholding tax notice to a nonresident, this falls outside the ambit of Part IVC. In this instance, the nonresident generally needs to seek declaratory relief in Federal Court proceedings in Australia. This can provide certain advantages compared to the Part IVC process.

Finally, it should be noted that no deduction is available for a payment of interest or royalty unless the taxpayer has met all withholding tax obligations in relation to that amount.[180]

(4) Penalties

Legislative Note: On May 14, 2024, as part of the 2024–25 Budget, the Australian Government announced from July 1, 2026, it will introduce a new penalty for taxpayers with more than A$1 billion in global turnover annually, who have mischaracterized or undervalued royalty payments to which withholding tax would normally apply. This measure is not yet law, but it reflects the ATO's continued focus on royalty withholding tax as a key area for collecting revenue from foreign multinationals with Australian operations.

(5) The PepsiCo Case and Royalty-Free Use of Intangible Assets

PepsiCo[181] deals with the tax treatment of cross-border supply chains and the use of U.S. intellectual property by Australian companies. The path to the High Court has provided a win for the ATO at first instance and a win to the taxpayer on appeal to the Full Federal Court and the High Court. The case covers the ground on many issues relevant to the use of intellectual property by U.S. multinationals.

(a) Summary

The case involves the use of the PepsiCo Group's trademarks (and related intellectual property) by the independent Australian bottler for the Australian market (Schweppes Australia Pty. Ltd. (Schweppes)). The PepsiCo/Schweppes arrangement was structured such that Schweppes simply paid PepsiCo's Australian subsidiary (PBS) for the tangible ingredients (concentrate) necessary to make and bottle Pepsi, Mountain Dew, Gatorade, and similar products. (PBS on-paid this amount offshore to PepsiCo's Singapore subsidiary as the cost of the concentrate sold, retaining a small reseller margin). The related trademarks were owned by PepsiCo, Inc. (PepsiCo) in the U.S. PepsiCo granted Schweppes a royalty free right to use the necessary intellectual property to perform this role.

The Commissioner relied on two alternative contentions:

1. *Primary Contention:* PepsiCo was liable to royalty withholding tax on a portion of the consideration paid by Schweppes, as a portion of the payment was actually a royalty paid to PepsiCo; or

2. *Alternative Contention:* If incorrect on the Primary Contention, Australia's anti-avoidance rules, specifically the Diverted Profits Tax (DPT) would apply to deem a royalty (with consequential royalty withholding tax implications).

At first instance, Justice Moshinsky found for the Commissioner on the Primary Contention, characterising a portion of the consideration paid by Schweppes as a royalty paid to PepsiCo, subject to a 5% royalty withholding tax charge. The portion of the consideration paid by Schweppes characterized as a royalty paid to PepsiCo was approximately 5.88% of the net sales revenue of Schweppes. Justice Moshinsky also commented that, if he had been required to consider the Alternative Contention, he would have concluded the scheme was subject to the DPT.

On appeal to the Full Federal Court, the decision was reversed in favour of Pepsi. Giving primacy to the terms of the contractual arrangements, the majority held that no portion of the consideration was for the use of intellectual property. The Commissioner's submission that PepsiCo was giving away the right to use the trademarks for nothing ignored the limited nature of the intellectual rights granted (incidental and necessary in light of the services provided by Schweppes) and also ignored the benefits to PepsiCo in Schweppes promoting the brand in the Australian market. Regarding the DPT, the majority held that since there was no reasonable alternative to the scheme entered into, the DPT did not apply. Put simply, there

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[180] ITAA 1997, Sec. 26-25.

[181] *FCT v. PepsiCo, Inc.* [2025] HCA 30.

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was no reasonable alternative to the transaction entered into, under which Schweppes would pay a royalty and pay that royalty offshore.

On appeal to the High Court, the decision was again in favor of Pepsi.

Comment: PepsiCo demonstrates the ATO's continuing pursuit of arrangements that it perceives as contravening Taxpayer Alert TA 2018/2 (in which the ATO expressed concerns about arrangements involving payments in relation to intangible assets). Despite the High Court decision, the ATO is continuing to pursue this area by way of audits in upcoming cases.

(b) Case Background

The PepsiCo group of companies (PepsiCo Group) operates a global beverage business. PepsiCo was the owner of a world-wide portfolio of trademarks, designs and other rights and assets relating to the Pepsi and Mountain Dew brands, and Stokely-Van Camp, Inc. (SVC) was the owner of a world-wide portfolio of trademarks, designs and other rights and assets relating to the Gatorade brand. The facts for both the PepsiCo and SVC supply chains during the relevant years of income are very similar. (And we refer in this summary solely to PepsiCo).

Justice Moshinsky explained the history of the PepsiCo franchising model in the U.S., going all the way back to the early 1900's. The variation relevant to Australia during the 2018 and 2019 income years was the "FOBO" (short for "franchise-owned bottling operation") model, an arrangement in which the PepsiCo Group sells concentrate that is then "finished off" by a bottler with local equipment and distribution capabilities.

The central document for this modern variation is the Exclusive Bottling Agreement (EBA). PepsiCo entered into an EBA with Schweppes in 2009 whereby:

1. PepsiCo agreed to sell, or cause a related entity (called the "Seller") to sell, concentrate to Schweppes;

2. The concentrate was mixed by Schweppes in accordance with specifications provided by PepsiCo to produce finished beverages for retail sale in Australia; and

3. PepsiCo remained the registered proprietor of the trademarks. While the Schweppes 2009 EBAs did not expressly confer on Schweppes any right or interest in the trademarks or related IP, it was accepted that for Schweppes to perform its role the EBA must contain an implied licence (and various amendments to the EBA (and other EBAs) did in fact provide an express royalty free license for particular products).

Schweppes paid for the concentrate and the right to use the intellectual property was ostensibly granted for free.

The supply chain to Australia evolved over time. With the establishment of manufacturing operations in Singapore in 2015, and the incorporation of local subsidiary Singapore Concentrate Manufacturing (Singapore) Pte. Ltd. (CMSPL):

1. PBS was nominated by PepsiCo as the "Seller" under the EBA;

2. CMSPL sold supplied concentrate to PBS;

3. PBS sold concentrate to Schweppes;

4. Schweppes placed its purchase orders with PBS;

5. PBS invoiced Schweppes for the concentrate that had been supplied;

6. Schweppes paid PBS (into a PBS bank account) for the concentrate in accordance with those invoices;

7. PBS recorded the sales to Schweppes in its Australian income tax returns and financial statements; and

8. PBS on-paid almost of the money received from Schweppes to CMSPL, retaining only a small margin.

The overall structure is in the diagram below.

(c) Primary Contention: Royalty Withholding Tax

The key issues relating to royalty withholding tax were:

1. Whether the payments made by Schweppes were, to any extent, consideration for the use of, or the right to use, the items set out in paragraphs (4)(a) and (b) of Article 12 of the U.S.-Australia tax treaty (U.S. tax treaty) and the items set out in paragraphs (a) to (d) of the definition of "royalty" in Section 6(1) of the ITAA 1936 — in this case being (relevantly) trademarks and related property or rights;

2. If so, whether the relevant portions of the payments were income derived by PepsiCo for the purposes of Section 128B(2B)(a) of the ITAA 1936 and amounts to which they were beneficially entitled for the purposes of Article 12 of the U.S. tax treaty;

3. If so, whether the relevant portions of the payments were paid, or taken to have been paid, to PepsiCo (as applicable) for the purposes of Section 128B(2B)(b)(i) as affected by Section 128A(2); and

4. If so, the amount of the royalties (upon which royalty withholding tax is payable). The expert evidence filed by the Commissioner and PepsiCo provided competing ranges of 9.0% or 8.5% (depending on the brand) to 2.5% of Schweppes's net sales revenue.

The order in which the issues were considered impacts on the analysis.

Was there "consideration for" a brand?

Focused purely on the EBA, the answer was "no." In advancing this argument, PepsiCo relied on the 2011 Federal Court decision in *International Business Machines Corporation* [2011] FCA 335, in which it appeared the characterization of the payment as a royalty was determined by focusing on the legal form, not the substance, of the relevant agreement. PepsiCo argued this to be consistent with the context and purpose of the EBA, establishing a mutually beneficial co-operative arrangement between the parties, with non-monetary consideration passing both ways, under which the parties undertake activities to increase goodwill in the brands.

Justice Moshinsky took a different view at first instance, relying on *Dick Smith* (2005) 221 CLR 496, *Archibald Howie* (1948) 77 CLR 143 and *Lendlease* (2014) 254 CLR 142, he concluded that the payments by Schweppes under the EBAs were, to an extent, consideration for the use of, or the right to use, the trademarks. He considered the following aspects significant to this conclusion:

1. PepsiCo (the U.S. entity) was a contracting party to the EBA;

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2. The EBAs contained (expressly or by implication) a licence by PepsiCo of the relevant trademarks and other intellectual property;

3. The trademarks license was fundamental to the arrangement;

4. Failure by Schweppes to pay for the concentrate could terminate the EBA and therefore the licence;

5. There were no examples of PepsiCo concentrate ever being offered without a licence of the brand; and

6. The brands are some of the strongest and most valuable in the global beverage industry.

However, at the Full Federal Court, the majority was unwilling to characterize the payments in this way, pointing to the limited nature of the intellectual rights granted (incidental and necessary in light of the services provided by Schweppes) and also the fact that this approach ignored the benefits to PepsiCo in Schweppes promoting the brand in the Australian market. This was fundamental to the analysis, undermining the proposition from the ATO that the documents were drafted in a way that effectively gifted the right to use valuable IP rights for free.

Similarly, the High Court majority held that the payments under the EBAs were for concentrate only, and no portion was consideration for the use of trademarks or other IP; therefore, no royalty arose. The majority emphasized the proper construction of the composite arrangements and arm's-length pricing.

Which entity derived the income?

PBS was nominated the Seller of the concentrate in 2015. PBS and Schweppes accepted and acknowledged this change in accordance with the terms of the EBA. Based on the terms of the documents and the actions of the parties, the rights and obligations under the EBA regarding the delivery of the concentrate and the receipt of the consideration has been moved to PBS.

Justice Moshinsky concluded at first instance that PepsiCo was still entitled to receive at least a portion of the consideration paid by Schweppes, charactering the nomination as a mere direction by PepsiCo to Schweppes to pay PBS. His analysis focused on the fact that (in the order in which the issues were considered) a portion of the consideration was characterized as for the use of the trademark.

The Full Federal Court and the High Court disagreed with this analysis. The nomination of PBS as the Seller of the concentrate was legally effective in assigning the right to receipt of the consideration. No portion of the payment (even if it was a royalty) was a debt due to PepsiCo.

The High Court unanimously held that payments made by Schweppes were neither "paid or credited" to, nor "derived by," PepsiCo; title in concentrate passed from the nominated Australian seller to Schweppes, not via PepsiCo, so royalty withholding tax could not in any event apply on derivation grounds.

"Beneficial entitlement" and "Paid"

Arguments relating to which entity was "beneficially entitled" to the consideration, and which entity the consideration was "paid" to, were essentially the same as those regarding the derivation on income. For similar reasons, Justice Moshinsky's view at first instance that PepsiCo was beneficially entitled to the relevant amounts within the meaning of Article 12 of the Australia-United States tax treaty (and entitled to be paid these amounts) was overturned. The Full Federal Court and High Court concluded that the contracting Seller was entitled to the amounts paid under the contract — reflecting both the substance and the form of the arrangement.

Amount of the royalty

Experts called by PepsiCo and the Commissioner were instructed to assume that the payments by Schweppes under the EBA were, to some extent, for the intellectual property owned by PepsiCo and used by Schweppes and instructed to determine the amount paid for the use of the intellectual property. The methods presented by the expert for PepsiCo. covered a broad range of valuation arguments that built a position on the relevance of the EBA terms, the difficulty of conducting a more holistic valuation analysis, and corroboration from a rule of thumb, whereas the expert for the Commissioner all involved royalty price setting based on identifying and considering comparable licence agreements from third-party transactions found in different databases. Justice Moshinsky adopted the recommendation of the Commissioner's expert, based on the average of Quartile 3. He considered it appropriate given the strength of the Pepsi, Mountain Dew and Gatorade brands, which resulted in a royalty rate for those brands of approximately 5.88%.

The Full Federal Court looked at this issue from a different perspective. Having concluded that the right to use the IP came with a corresponding obligation to market products in the Australian market which resulted in a benefit to Pepsi, and this benefit had been ignored by the ATO, the instructed approach to valuation became less relevant (arguably, irrelevant).

(d) Secondary Contention: Diverted Profits Tax

In applying the DPT, the Commissioner narrowly defined the "scheme" as the entry into the relevant EBA on terms where no royalty was paid for the use of intellectual property. The Full Federal Court did not accept as a reasonable counterfactual that, had the relevant scheme not been entered into or carried out, the EBA might reasonably be expected to have expressed the payments to be made by Schweppes to be for all of the property and rights provided by the PepsiCo Group entities (rather than for concentrate only), with the resulting tax benefit arising from the royalty withholding tax that would otherwise be payable on the proportion of the consideration payable for the use of the trademark.

Ultimately, the following facts lead the Full Federal Court to conclude that there was no reasonable alternative hypothesis under which a tax benefit of the type proposed simply did not exist:

(i) The FOBO model, and the pricing structure, used by both PepsiCo and others in the beverage industry globally, had not changed since the early 1900s;

(ii) Schweppes and PepsiCo were independent parties, negotiating with one another on an arm's length basis, resulting in contractual terms reflecting the commercial relationship between them;

(iii) The payments to be made by Schweppes were for the concentrate alone and very limited consequential rights to the trademarks and other intellectual property; and

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(iv) Promotion through the activities undertaken by Schweppes would have been of material value to Pepsi's brand.

The High Court also concluded the Commissioner's proposed alternatives were not reasonable because they re-wrote the bargain; the Court made it clear that taxpayers need not always adduce a competing reasonable postulate to discharge their onus under DPT/Part IVA. The conclusion on the tax benefit turned on critical, fact-specific features: arm's-length dealings between unrelated parties; pricing that was not disputed as excessive; and the absence of a royalty being consistent with market practice.

(e) PCG 2025/D4 — Low Risk Payments

This continues to be an area of concern for the ATO. Taxpayers have been left in the unacceptable position that there is clearly a disconnect between what the ATO, tax advisors and the courts consider is a payment subject to royalty withholding tax. PCG 2025/D4 is an attempt to provide some certainty as to the payments that are not subject to royalty withholding tax. The examples provided are, however, so narrow that they do not afford any significant comfort when it comes to taxpayers undertaking a variety of relatively standard transactions.

The draft sets out when the ATO regards cross-border payments under certain software arrangements as sufficiently low-risk that it will not review them to determine whether any part of them is a "royalty" subject to Australian withholding tax. This represents a compliance approach, not an interpretative ruling. It must be read with TR 2024/D1 on software and IP royalty characterization.

PCG 2025/D4 only identifies arrangements that will not attract ATO compliance attention; it does not change the law or the ATO's interpretative position in TR 2024/D1. The ATO has flagged that it may expand the guidelines in future to cover broader compliance approaches beyond the low-risk zone.

Schedule 1 provides a self-assessment framework to determine whether an arrangement sits in a low-risk category for royalty withholding purposes. Unlike other PCGs, the draft adopts a two-zone model: a "white zone" and a "green zone." Arrangements in these zones will not receive ATO compliance resources with respect to royalty withholding beyond verifying self-assessment. There is not yet any red zone for higher-risk cases.

The ruling provides the following example:

> Example 1 — internet security software solely acquired for private or domestic use
>
> 28. Sarah wants to enhance her online security and, after researching various internet security software options, decides that she wants a subscription for internet security software from AntiVirus Co.
>
> 29. AntiVirus Co is a provider based in a foreign country and specialises in developing internet security software to detect and neutralise computer viruses.
>
> 30. Sarah selects a one-year subscription plan on AntiVirus Co's website, enters her payment details, downloads a copy of the software and follows the easy setup instructions to install the internet security software onto her personal computer.
>
> 31. For the purposes of this Guideline, the payment by Sarah to AntiVirus Co is categorised in the green zone as the software acquired is solely for her private or domestic use.

While there is always some benefit in understanding the ATO's analysis of such a transaction, since the risk of such a transaction being subject to royalty withholding tax was low, even before this PCG, the utility of examples like this, and the PCG as a whole, is questionable.

(f) Observations

The significant divergence of views — on multiple issues — between the ATO and the judgements of Justice Moshinsky, the Full Federal Court and the High Court (and between the majority and minority on various issues) shows the wide range of potential outcomes with respect to these relatively common issues for cross border supply chains. As an additional layer of complication, sitting behind this case are a number of ATO disputes and audits on similar issues. The taxation of cross border supply chains involving the use of IP will remain in a state of flux for some time.

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VII. Taxation of a Branch

Foreign companies carrying on business in Australia will generally monitor their activities in Australia with the objective of limiting the risk that their Australian operations represent an Australian "permanent establishment" (PE). The reason for this is that — with the benefit of treaty protection — business profits will not be taxable in Australia if the foreign company does not have a PE. On occasion, foreign companies may consider employing Australian staff — sales and marketing teams (and possibly research and development (R&D) teams) — in an Australian subsidiary (remunerated under an intercompany services agreement on a cost-plus basis) while continuing to sell products and provide services directly from off-shore with the objective of retaining the benefit of treaty protection for the Australian business profits. Australia has introduced a specific anti-avoidance rule (the MAAL) with this structure in mind, deeming a PE to exist where certain attributes exist. This issue is discussed in XVI.B., below.

Once the operations of a foreign company are such that either a branch or subsidiary is required for the purpose of carrying on business in Australia, the advantages and disadvantages of operating an Australian office through either an offshore entity or an Australian company need to be determined on a case-by-case basis. However, as a rule, using an offshore entity will generally produce a better result from a tax perspective, but this needs to be compared with what may be the additional costs of carrying on a business in Australia in this manner. The key issues to consider are set out below.

A. Will the Australian Operations of an Offshore Entity Constitute a Permanent Establishment?

A PE includes a fixed place of business through which the business of an enterprise is wholly or partly carried on. This can include carrying on business through an office. As an example, if the Australian office of an offshore entity will lease office space in Australia; employ staff; and perform activities that are more than simply preparatory and/or auxiliary in nature, it could be expected that the offshore entity would be characterized as having an Australian PE.

An enterprise will not be regarded as having a PE solely as a result of the maintenance of a fixed place of business for the purpose of activities that have a preparatory or auxiliary character for the enterprise. The primary test of whether an activity has a preparatory or auxiliary character is whether the activity in itself forms an "essential and significant" part of the activity of the enterprise as a whole.

If an offshore entity does not have a PE in Australia and has the benefit of a comprehensive double tax treaty between Australia and the entity's country of residence, the offshore entity may not be taxed in Australia on its business profits.

B. What Will the Australian Office Do: Regional Office or Purely Carrying on Business in Australia?

If an offshore entity has an Australian PE, it would be taxed at 30% on the profits attributed to the Australian PE and/or has an Australian source (depending on the circumstances).

By contrast, an Australian company would be taxed at 30% on its worldwide taxable income. There are concessions excluding from the taxable income of an Australian company certain types of income earned through a foreign branch, but as a rule an Australian incorporated company is more likely to be attributed with the income of a regional group managed from Australia as opposed to an Australian branch of a foreign company.

As such, if the Australian team is involved in the management of operations throughout Asia, the Australian company may be subject to tax on income in Australia that would not be attributed to the Australian branch of a foreign company.

C. Would an Australian Company Earn Concessionally Taxed Income?

There is no separate "branch profits tax." Therefore, entities carrying on business in Australia through a branch will not be subject to an additional Australian tax on distribution of the profits offshore. Examples of such income or operations that are exempt in Australia include gold mining income, bloodstock operations (breeding thoroughbred horses) or operations that provide high tax write-off deductions (such as infrastructure projects or R&D operations).

By contrast, the payment of a dividend by an Australian company may incur a dividend withholding tax liability. The rate is 30% of the gross dividend paid, but this rate may be reduced in the following circumstances:

(i) The dividends are "franked," i.e., they are declared to be paid out of profits that have been subject to Australian corporate tax (taxed profits can differ from accounting profits due to, for example, faster depreciation allowed under tax laws (see V.B.4.f., above) or due to the availability of R&D concessions);

(ii) The profits relate to foreign income that is not taxable in Australia; and/or

(iii) The foreign parent is a company that qualifies for the benefits of a tax treaty that provides an exemption from dividend withholding tax for dividends paid to a shareholder that owns 80% or more of the subsidiary for the 12-month period prior to the dividend being declared. The Australia-United States tax treaty includes such a provision for entities that qualify for the benefits of Article 10(3).

D. Disposal of the Business

Any gain from the disposal of the shares of either an offshore entity or an Australian company should not be taxable in Australia if at least 50% of the assets of these entities are not direct or indirect interests in Australian real estate.

By contrast, the sale of a business (i.e., not the entity) carried on by a foreign entity through an Australian PE would be taxable in Australia. For this reason, an offshore entity is often established for the purpose of carrying on business in Australia to ensure that, if there is a desire to sell the Australian business in the future, it can be done tax free (by selling the shares in the entity) (see VI.B.1.a., above).

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E. Administrative Considerations

The table below sets out administrative considerations that may be relevant to the choice of a branch or subsidiary structure.

For the purpose of this summary we have assumed an Australian branch of a U.S. entity (Offshore Co) has annual expenses of A$750,000 to A$2 million and annual income (determined on a cost-plus basis) of approximately 10% more than its expenses (which would typically be an appropriate mark-up for transfer pricing purposes of a local distribution business of a U.S. multinational).

Administrative Consideration	Offshore Co with Australian Branch	Ausco
Required to lodge financial accounts with the Australian Securities and Investments Commission (ASIC)?	The accounts lodged would be the accounts of the Offshore Co	No accounts would need to be lodged unless the subsidiary, or the Australian group of which it was a member, satisfied two of the following three tests: • A$25 million revenue • A$12.5 million gross assets • More than 50 employees If these tests are satisfied, audited accounts would need to be lodged.
Fee for lodgement of financial reports with ASIC?	Currently A$1,217	*X*
Fee for ASIC annual review?	Currently A$1,217	Currently A$263
Registration process that requires detailed information?	Detailed process requiring more information.	Less detailed process requiring less information.
Short set up time?	*X* Set-up time tends to be longer due to the registration requirement (it usually takes 7–10 days for the registration to be approved and costs $488).	2–3 days
Required to appoint a director?	*X*	Requires at least one Australian resident director. This can be satisfied by a local employee. If a local resident director has to be hired, in the experience of the author, the role can be filled at an approximate cost of A$7,500 – A$10,000.
Required to hold directors' meetings?	*X*	Required to pass a solvency resolution each year for its annual review.
Local maintenance/legal costs?	Approximate costs for attending to local filing of A$650. Costs for acting as local agent of the branch are A$750.	Approximate costs for attending to annual company statements of A$500, and for attending to local financial reporting or class order release from reporting of A$500.
Required to appoint a public officer and notify the Commissioner of Taxation?	□	□
Required to register for a Tax File Number (TFN)?	□	□
Required to lodge an annual income tax return?	□	□
Required to register for Goods and Services Tax (GST) and report its GST on a quarterly Business Activity Statement (BAS)?	(if GST turnover is over A$75,000)	(if GST turnover is over A$75,000)
Required to register for Pay As You Go (PAYG) withholding and lodge PAYG annual reports?	(presumably for payments to employees and tax installments on corporate profit)	(presumably for payments to employees and tax installments on corporate profit)
Possible limitation on general commercial acceptance?	In very limited circumstances: (1) a foreign company may be requested to substantiate that it has authority to enter into agreements.	Generally accepted commercially

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	The use of a branch can also lead to practical difficulties in day-to-day dealings with government organizations, financiers and third parties. Certain organizations may also be reluctant to deal with a company not incorporated in Australia. That said, foreign companies regularly carry on business in Australia and this is generally not an overly important consideration.	
Possible limitation on commercial acceptance with lenders?	If the lender has limited experience with lending to offshore entities, there may be an additional internal sign-off required by the bank before it can lend. The lender would be likely to require a foreign legal opinion on foreign legal issues (e.g., good standing, power and authority, etc.) in addition to an Australian opinion on the enforceability of the finance and security documents. That said, to the extent that the lender requires a parent guarantee, a legal opinion from a firm in the foreign jurisdiction would likely be required in any event (i.e., even if an Ausco was used).	*X*
Limitation of liability?	Assuming Offshore Co's operations are limited to the branch's business, liability may effectively be limited to the extent of any capital contributed to Offshore Co's capital — this should be confirmed by foreign legal advice.	The parent is not normally liable for the debts or obligations of the subsidiary, except to the extent of any capital contributed to the subsidiary, any parent company guarantee, or possibly for debts incurred by the subsidiary to the extent that they were incurred while a wholly-owned subsidiary is insolvent.

1. Corporate Requirements

A company registered as a foreign company is required to file a copy of its annual financial statements (which are available for public inspection), whereas a subsidiary company incorporated in Australia only has to file the financial statements for the subsidiary. Generally, where a share is held by a company incorporated outside Australia, the Australian company is not regarded as a small proprietary company and the filing of accounts is required.

Where an Australian subsidiary is established, it would usually be incorporated in the State of Victoria — irrespective of the state in which it carries on business. This is because Victoria does not impose share transfer duty.

2. Goods and Services Tax

The GST consequences of a branch (operating through a PE) versus a subsidiary selling in Australia, to Australian customers are generally the same. This is because the branch and the subsidiary would be carrying on business in Australia and are therefore capable of making supplies connected with Australia.

If the GST registration threshold is met, the entity (i.e., the Australian subsidiary or branch) would need to register for GST and remit GST to the Australian Taxation Office on all taxable supplies it makes. GST is charged at a rate of 10%.

An entity will make a taxable supply in Australia if:

(i) The entity makes a supply for consideration;

(ii) The supply is made in the course or furtherance of an enterprise that it carries on;

(iii) The supply is connected with Australia; and

(iv) The entity is registered or required to be registered for GST purposes (an entity is required to be registered for GST purposes if its annual GST turnover is above the relevant threshold, being A$75,000).

The concept of carrying on an enterprise in Australia for GST purposes, is defined in terms of the definition of "permanent establishment" in the Income Tax Assessment Act 1936 (ITAA 1936).

A supply by a branch or PE would be connected with Australia if:

(i) The entity carries on an enterprise through a PE in Australia; and

(ii) The supply is made through that PE.

For a supply to be connected with Australia, a connection must be established between the Australian PE and the supply.

There is no specific set of circumstances that must be satisfied before a supply is connected with a PE. Rather, each case will be determined on the basis of the individual facts and circumstances. However, some factors that will usually indicate that the supply is made through a PE include:

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(i) The PE has the authority to sign contracts or accept purchase orders for the supply;

(ii) The PE has the authority to make important decisions with respect to the supply;

(iii) The PE physically makes, manufactures or produces, the supply;

(iv) If the supply is a service, the service is provided by the PE;

(v) If the supply is the provision of advice or information such as a legal opinion, the PE provides that advice or information; and

(vi) If the supply is the grant, creation, assignment, transfer or surrender of a right, the PE grants, creates, assigns, transfers or surrenders that right.

An entity is required to be registered for GST in Australia where its current or projected annual GST turnover meets the registration turnover threshold of A$75,000. The annual turnover threshold will be met if the entity has a turnover of A$75,000 or more, derived from services it performs in Australia. If registered or required to be for GST, the entity would need to collect GST from its customers located in Australia and remit it to the Australian Taxation Office (ATO). Entities that are registered for GST in Australia, must lodge a Business Activity Statement (BAS) with the ATO in the approved form in each tax period. It is on the BAS the entity remits the GST on its sales for each tax period and claims any input tax credits for which it holds a valid tax invoice.

3. Thin Capitalization

Australia has a thin capitalization regime which denies tax deductions for debt deductions (mainly interest and borrowing costs) incurred by foreign entities and foreign controlled Australian entities, where the debt funding used to finance their Australian operations exceeds certain levels. The thin capitalization rules will apply to the foreign company even where it only has a branch office in Australia.

Broadly, the thin capitalization rules provide that debt funding cannot exceed 60% of Australian assets (less certain liabilities). Where this 60% threshold is exceeded and the foreign company cannot prove that the debt funding was on an arm's-length basis as consistent with global gearing levels for the multinational group, then the foreign company will be denied the ability to deduct the expenses it incurs on the debt (e.g., interest expenses) to the extent of the excess.

The thin capitalization rules have a *de minimis* rule which allows the foreign company to fully deduct all its debt deductions in an income year where the foreign company and its associates have total debt deductions in that income year of A$2 million or less.

4. Employees

Where a foreign entity has employees who are liable for taxation in Australia, it will need to register for and remit tax installment deductions known as Pay-As-You-Go (PAYG) withholding tax in respect of that employee.

The foreign entity will also need to make a minimum level of superannuation contributions for each employee to avoid a penalty tax known as the Superannuation Guarantee Charge. The Superannuation Guarantee Charge will be greater than the minimum level of required superannuation contributions and has the additional penalty of being nondeductible. The minimum level of superannuation contributions is discussed at V.B.12., above.

If the employees of the foreign entity also receive fringe benefits (such as travel or accommodation benefits), then the foreign company may be liable to pay fringe benefits tax in respect of the provision of those benefits. Fringe benefits tax applies at the rate of 47% on the taxable value of fringe benefits provided.

Once the annual gross salaries of Australian employees of the foreign entity exceed the payroll tax threshold, it will be subject to payroll tax on the gross salary and wages it pays to such employees. The payroll tax rate and payroll tax threshold varies depending on where in Australia the employees provide their services. For instance, in New South Wales the payroll tax threshold is currently A$689,000 per annum and the payroll tax rate is currently 5.45%. The employment tax issues discussed above for the Australian branch apply equally to an Australian subsidiary, with the exception that, as the subsidiary is a separate legal entity, it will be liable for the taxation and superannuation obligations related to its employment of the employees instead of the foreign entity.

5. Public Officer

Every company carrying on business in Australia or deriving in Australia income from property must appoint a public officer within three months of commencing business or deriving income in Australia. The public officer must be ordinarily resident in Australia.

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VIII. Taxation of a Partnership

A. General Partnerships

A partnership includes both an association of persons carrying on a business as partners and parties "in receipt of income jointly," but does not include a company. The reference to the receipt of income jointly usually includes within the definition of a partnership for tax purposes various entities not included within the meaning of that term at general law. For instance, passive property investments can be partnerships for tax purposes if there is a joint entitlement to the income from the property. A partnership is required to furnish a tax return each year but is not itself assessed to tax. That is, the filing of a partnership tax return is for information purposes only. Each partner is assessable with respect to his or her share of the partnership income. For a copy of a partnership tax return, see Worksheet 11.

Where a partner in a partnership does not have control of his or her share of the partnership income or is a trustee of a trust that has beneficiaries over age 18 presently entitled to the income, or has no beneficiaries presently entitled, he or she is liable to a further tax on that portion of his or her taxable income attributable to the partnership income, so that the total tax on his or her partnership income is 50% of that income.[182]

[182] ITAA 1936, Sec. 94.

B. Limited Partnerships

Limited partnerships are taxed in Australia as companies for income and capital gains tax purposes and taxed on taxable income at 30%, i.e., flow-through taxation does not apply (with limited exceptions for venture capital investment limited partnerships). Such partnerships are called "corporate limited partnerships."[183] For instance, a distribution of profits by a limited partnership to a partner will be taxed as dividend payment in the partner's hands.

A "limited partnership" is defined as a partnership where the liability of at least one of the partners is limited.

Significantly, a limited partnership is a resident of Australia if the partnership was formed in Australia; carries on business in Australia; or has its central management and control in Australia. Where a limited partnership is classed as an Australian resident it will be subject to tax on its worldwide income. This contrasts with a foreign limited partnership which would only be subject to Australian tax on Australian sourced income.

Comment: The risk that a limited partnership can be deemed an Australian resident by merely carrying on business in Australia may not arise if there is a company interposing between the foreign limited partnership and any Australian investment (as the foreign company test limits the risk of being classified as an Australian resident).

[183] ITAA 1936, Secs. 94A to 94Y.

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IX. Taxation of Other Business Entities

A. *Trusts*

1. *In General*

An income tax return is required for each resident trust setting out the net taxable income of the trust. Where a beneficiary is presently entitled to a portion of the income of a trust and is not under a legal disability, the beneficiary should include that portion of the taxable income of the trust in its assessable income. For a copy of a trust tax return, see Worksheet 13.

The net taxable income of a trust for a year of income is taxable in the hands of the beneficiaries to the extent to which those beneficiaries are presently entitled to the income of the trust for that year. The income to which a beneficiary is presently entitled is included with other income in the individual's tax return. Any remaining portion of the net taxable income is assessable to the trustee.

Where the beneficiary is presently entitled to the income distribution but is under a legal disability (for example, the beneficiary is less than age 18), the trustee is assessed on that distribution at individual tax rates. If the beneficiary derives assessable income other than the distribution, the beneficiary also is required to lodge a tax return including the distribution of income received from the trust. A credit is allowed for the tax paid by the trustee on that distribution against any tax payable by the beneficiary on his or her assessable income including the trust distribution.

Where the income of a trust of accumulated but not distributed, or it is accumulated with no beneficiary presently entitled to the income, the highest marginal rate of tax (normally 47% for the 2025–2026 year of income) is imposed on the trustee. As a practical matter, this tends to encourage trusts to fully distribute their income each year to the underlying beneficiaries. The only exception to this rule is for trust estates that come into existence as a result of a will, intestacy order, or bankruptcy, where the Commissioner considers it unreasonable that the income of the trust estate should be taxed at the rate of 47%. In such cases, the trustee is taxed on the income at individual tax rates. There are also specific anti-avoidance rules designed to minimize any potential advantage gained by trusts where beneficiaries are under age 16. Very broadly, these rules limit the extent to which family trusts can be used to divert income to under aged children.

Beneficiaries who are not Australian residents are only subject to tax on income of the trust to which they are presently entitled to, to the extent that it is foreign sourced. Similar to the situation where a beneficiary is under a legal disability, the trustee is first assessed on such taxable trust income at the marginal tax rate applicable to the nonresident beneficiary. The nonresident beneficiary is then required to lodge an income tax return including the taxable trust income in its assessable income and may claim a credit for the tax levied on the trustee. Where the amount of tax paid by the trustee exceeds the nonresident beneficiary's taxable income, then the beneficiary may claim a refund from the ATO in respect of the excess.

For trusts that are not managed investment trusts (MITs), the withholding tax rate where the beneficiary is a company is 30%. If the beneficiary is an individual, the withholding tax rate reflects the marginal tax rate applicable to non-Australian resident individuals (i.e., from 32.5% and up to 45% being the top marginal tax rate for income in excess of A$190,000 for the year ending June 30, 2026). A special withholding tax regime applies to MITs (as discussed in IV.C.1.a., above).

Where distributions of income and taxable capital gains by trusts have not been previously subject to tax in the hands of the trustee or the beneficiaries and, if they had been derived directly by the beneficiaries, would have been subject to tax, such distributions will on receipt be subject to tax in the hands of the beneficiaries. This provision is designed primarily to tax distributions received from trusts resident outside Australia that: (i) as a result have not been subject to tax on income derived in earlier years; (ii) have been accumulated in the trust to form the corpus of the trust; and (iii) are subsequently distributed to resident beneficiaries as corpus and not income.[184]

2. *Trust Taxation*

Trusts that carry on a trading business and are widely held are taxed like companies under Division 6C of the Income Tax Assessment Act 1936 (ITAA 1936).

A "trading business" is a business that does not consist solely of "eligible investment business." An eligible investment business means one or more of:

(i) Investing in land for the purpose, or primarily for the purpose, of deriving rent; or

(ii) Investing or trading in any or all of the following:

- Secured or unsecured loans;
- Bonds, debentures, stock or other securities;
- Shares in a company (including shares in a foreign hybrid company);
- Units in a unit trust;
- Futures contracts;
- Forward contracts;
- Interest rate swap contracts;
- Currency swap contracts;
- Forward exchange rate contracts;
- Forward interest rate contracts;
- Life assurance policies;
- A right or option with respect to such a loan, security, share, unit, contract or policy specified above;
- Any similar financial instruments; or

[184] ITAA 1936, Sec. 99B. The High Court in *Bamford v. Commissioner of Taxation* [2010] HCA 10, settled two issues in relation to the taxation of trusts. In this regard, the Court confirmed that the "proportionate" approach is the correct approach in determining the share of the income of a trust estate that a beneficiary is presently entitled to (i.e., beneficiaries should only be taxed on their share of the net income of the trust estate as the beneficiaries' proportionate shares of the trust's income). The Court also confirmed that income of a trust estate refers to the distributable income of the trust and can be affected by the trust deed and exercise of the trustee's discretion.

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(iii) Investing or trading in financial instruments (not covered by paragraph (b)) that arise under financial arrangements that are not otherwise excluded under section 102MA of ITAA 1936.

"Widely held" for these purposes means a trust that is listed on a stock exchange, has its units offered to the public, has more than 50 beneficiaries or if a defined list of tax advantage investors hold more than 20% of the rights to income or capital in the trust. For this reason, the use of a trust as a funds management vehicle for collective investment in the retail sector is generally limited to investment in rental property, equities and debt markets. A widely held trust would not often be used as a vehicle through which to carry on an ordinary trading or property development (for sale) business.[185]

Trusts in Australia are usually managed such that, if they are widely held, their activities are limited to eligible investment businesses. For this reason, most listed trusts in Australia are used for the purpose of investing in land (for rent) and portfolio investments in debt securities and equities.

3. Reimbursement Agreements

a. In General

Australia's domestic anti-avoidance framework is comprised of general rules and a suite of targeted provisions aimed at combatting particular arrangements. Amongst the targeted provisions sits Section 100A of the Income Tax Assessment Act 1936 (Cth), which is designed to combat arrangements involving the notional allocation of a trust's net income to tax advantaged beneficiaries while the underlying value is distributed to another party. Notwithstanding that Section 100A was first introduced in 1979, the scope of its application remains the subject of much discussion today both in view of evolving structures for the allocation of income, and underlying value, between beneficiaries, and the updated ATO guidance published in late 2022.

The following discussion provides a summary of the current state of the law and guidance as it relates to Section 100A and recommended best practice in undertaking trust distributions. The summary also addresses some of the GST and stamp duty implications that need to be considered as part of the trust distribution process.

b. Section 100A

Section 100A was introduced (prior to the general anti-avoidance rules in Part IVA) in 1979 to combat tax avoidance schemes designed to notionally allocate a trust's (Section 95) net income to tax advantaged beneficiaries, while the underlying value is distributed to another party (generally, another beneficiary or reinvested with the trustee). It is a self-executing anti-avoidance rule. As set out on page 5 of the Explanatory Memorandum (EM):

> The particular tax avoidance arrangements rely on a nominal "beneficiary" being introduced into the trust and being made presently entitled to income of the trust, thus relieving the trustee of any tax liability in respect of the income. However, it is a feature of the arrangements that the introduced beneficiary also escapes tax by one means or another, e.g., as a tax-exempt body or organisation. This 'beneficiary' retains only a minor portion of the trust income, while the group in whose favour the trust in substance exists effectively enjoys the major portion, but in a tax free[186] form.

Critical to the application of Section 100A is the existence of a "reimbursement agreement" out of which the relevant present entitlement must have risen.[187] Broadly, a reimbursement agreement is any agreement that provides for the payment of money or the transfer of property to, or the provision of services or other benefits for, a person or persons other than the presently entitled beneficiary and which was entered into for the purpose (whether or not the sole purpose) of securing a reduction in a person's liability to income tax. The concept of reimbursement agreement excludes, however, agreements entered into in the course of ordinary family or commercial dealings.

c. Older Case Law

Various arrangements have been caught by Section 100A over the years. Albeit focused on trust stripping,[188] Section 100A is not limited to fact patterns with the indicia of a classic trust strip, generally involving an existing trust with significant profits which are then stripped. The section is broad enough to also capture new trusts set up for the purposes of directing future profits to tax advantaged beneficiaries.[189]

A line of older cases focused on schemes designed to introduce an unrelated, loss-making trust as a beneficiary for a fee calculated as a fraction of the trust income to which the loss trust was presently entitled. The *BRK (Bris)*[190] and *Idlecroft*[191] cases are examples. Each of those cases related to a mass marketed scheme called the "Hendon Scheme",[192] whereby Westside Commerce Centre Pty. Ltd. (WCC), as trustee for a loss-making trust (the Hendon Unit Trust), was appointed as a beneficiary. A number of these schemes failed as a consequence of a more fundamental issue — the appointment of income was invalid due to lack of proper provision having been made for such appointment (i.e., the nominations of WCC as a beneficiary) in the relevant deed. Where this resulted in the present entitlement falling to default beneficiaries, Section 100A was held to apply despite the fact that the default beneficiaries were arguably not a party to the relevant agreement (relegating the notion that beneficiaries need to be a party to the reimbursement arrange-

[185] See ITAA 1936 Division 6C.

[186] The EM should not be interpreted to suggest Section 100A only applies if the tax bill is nil. A reduced rate of tax can also be caught: see *FCT v. Prestige Motors Pty. Ltd.* [1998] FCA 221, at p. 220.

[187] Or arisen by reason of an act transaction or circumstances that occurred in connection with or as a result of a reimbursement agreement.

[188] See generally commentary on the concept of trust stripping in *East Finchley Pty. Ltd. v. Federal Commissioner of Taxation* [1989] FCA 720.

[189] *Prestige* at p. 219.

[190] *BRK (Bris) Pty. Ltd. v. Federal Commissioner of Taxation* (2001) 46 ATR 347.

[191] *Idlecroft Pty. Ltd. v. Commissioner of Taxation* [2005] FCAFC 141.

[192] *See BRK (Bris).*

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ment to merely a rule of general application, its relevance ultimately depending on the circumstances).[193]

In *Raftland*, a loss-making trust (E&M Unit Trust) was introduced as a beneficiary, avoiding (but for the application of Section 100A) any tax on the Rafland Trust's profits. Similarly, in *Prestige*,[194] the scheme started with an introduced loss-making trust, until the losses were fully utilized, at which time the scheme transitioned to the distribution of trust income to a tax-exempt life insurance company.[195]

A different scheme of some popularity involved the allocation of small amounts of income to multiple lowly taxed income beneficiaries over the age of 18, friends and family, possibly offshore, with each distribution falling under the relevant low-income tax-free threshold and subsequently lent back to the trustee or never called.[196]

Critical to the success (or failure) of these schemes was timing, specifically, ensuring the beneficiary group did not agree to apply the trust income in accordance with the terms of the agreement until sometime subsequent to their present entitlement having crystallized,[197] a difficult task in a context where "agreement" is broadly defined and includes informal, implied, and unenforceable agreements, arrangements or understandings.[198]

d. Recent Case Law

The two recent cases being discussed today are *Guardian*[199] and *B&F Investments*.[200] Both involve the use of what could be loosely called a "bucket company" to shield profits from the top marginal tax rate applicable to individuals.

The *Guardian* case relied on the principal of synchronicity.[201] Section 100A did not apply to trust income distributed to a corporate beneficiary, AITCS, as the decision to declare the subsequent franked AITCS dividend occurred too late. The reasoning focused on the Section 100A requirement that the reimbursement agreement precede the present entitlement.[202] As at June 30 of the relevant income years, 2012 and 2013, Justice Login concluded that there was no understanding that AITCS would pay dividends as part of a reimbursement agreement. This was despite the fact that very similar transactions occurred in the 2012, 2013, and (with certain variations) 2014 income years. The Commissioner's case on appeal to the Full Federal Court was limited to the 2013 income year scheme, referred to as the "2013 Arrangement," and in particular the primary judge's finding that "whether AITCS would again pay a dividend was 'wholly conjectural'".[203] As noted by the Court, however, this is not the test.

In *B&F Investments*, the Full Federal Court decision turned on the application of Section 100A(8), which required a view about the purpose of a party in undertaking an activity (i.e., entering into an agreement). *B&F Investments* highlighted the difference in approach to the purpose requirement in Section 100A(8) when compared to Part IVA. As opposed to Sections 100A(5) or (6), or Section 177C, "it is incoherent to posit an alternative postulate in coming to a view about what a person's purpose was" for the purposes of Section 100A(8). The intended effect of the arrangement was that IPCo's profits could be distributed without any marginal tax payable at the shareholder level. The additional steps — the buy-back, the additional de-minimis income payments made to IP Trust, the deed of variation, the timing of BE Co's incorporation were all one-off steps for which no commercial justification was put forward. These steps were executed as part of an arrangement entered into for the purpose of ensuring the IP Trustee would not be liable to tax. The share buy-back strategy was designed by advisers for various potential clients. It was not necessary to consider what would have occurred but for the entering into this scheme. Section 100A can apply in a situation in which, absent the agreement, the trust may not have existed at all or, absent the agreement, would not have any income. On the facts as found by the primary judge, Section 100A applied.

e. ATO Guidance

The key documents setting out the ATO's views on the application of Section 100A consists of Taxation Ruling 2022/4 and Practical Compliance Guideline 2022/2, in addition to a variety of Tax Alerts and ATO website guidance.[204]

The ruling, TR 2022/4, focuses on the four key requirements for Section 100A to apply,[205] namely (as entitled by the Commissioner) the:

(i) *Connection requirement:* present entitlement (or an amount paid or applied for the benefit of the beneficiary) must have arisen out of, as a result of or in connection with a reimbursement agreement (being an agreement, understanding or arrangement that has the three qualities described in the following points in this paragraph);

(ii) *Benefit to another requirement:* the agreement must provide for the payment of money or transfer of property to, or provision of services or other benefits for, a person other than that beneficiary;

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[193] The High Court (at 61) in *Raftland Pty. Ltd. as trustee of the Raftland Trust v. Commissioner of Taxation* [2008] HCA 21 also noted that a reimbursement agreement does not have to be legally enforceable and that it is not necessary that the beneficiary is a party to it. With that said, as noted below, an arrangement must have at least two parties.

[194] *See Prestige.*

[195] In *Prestige*, it was contended that, absent the agreement, the whole trust would not have existed. The Full Court did not constrain the language of Section 100A in that way such that the need for a "classic" dividend strip was not required.

[196] See *East Finchley* and *Case X40* 90 ATC 342 — the distribution of A$585 each to 217 non-resident beneficiaries located in India.

[197] Despite the breadth of the "agreement" definition.

[198] By subsection 100A(13); *see also Prestige, Idlecroft* and *Raftland.*

[199] *Commissioner of Taxation v. Guardian AIT Pty. Ltd. ATF Australian Investment Trust* [2023] FCAFC 3.

[200] *B&F Investments Pty. Ltd. as trustee for the Illuka Park Trust v. Commissioner of Taxation* [2023] FCAFC 89.

[201] First introduced by analytical psychologist Carl G. Jung, prior to the current version of Section 100A.

[202] *See also East Finchley*, where the trustee argued the offshore beneficiaries agreed to lend the trust income to which they were presently entitled back to the trustee at a time after becoming presently entitled.

[203] At para. 94.

[204] See https://www.ato.gov.au/businesses-and-organisations/trusts/in-detail/trust-reimbursement-agreements/trust-taxation-reimbursement-agreement.

[205] See Appendix 2 of TR 2022/4 for examples of the application of Section 100A, including examples that do not fall within the scope of the provision.

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(iii) *Tax reduction purpose requirement:* a purpose of one or more of the parties to the agreement must be that a person would be liable to pay less income tax for a year of income; and

(iv) *Ordinary dealing exception is not satisfied:* the agreement must not be one that has been 'entered into in the course of ordinary family or commercial dealing.'

The Commissioner considers that an agreement may be "inferred from the surrounding circumstances or the conduct of the parties."[206] This may be true, but it must be more than an expectation. The ATO's reference to repeated behavior, should be interpreted by taking into account the decision in *Guardian*. Past behavior may provide an expectation as to what may occur in the future, but this is not enough.[207] It does not constitute an understanding between two parties as to what will occur. The ATO considers that the Court's decision, that no agreement existed at the time the present entitlement arose in *Guardian*, largely turned on the particular facts of the case.[208] Clearly, questions around when an understanding exists will remain an important issue.

The ATO considers that the amount the taxpayer would have been made entitled to (or have been paid or had applied for their benefit) absent the reimbursement agreement (or absent the relevant act, transaction or circumstance occurring in connection with the reimbursement agreement) *involves a prediction as to events which would have otherwise taken place. The prediction must be sufficiently reliable for it to be regarded as reasonable.*[209] The prediction goes to the amount subject to the reimbursement agreement[210] — it does not undermine the fact that the agreement itself must exist at the time of, or prior to, the named beneficiary becoming presently entitled to the relevant amount.

The Commissioner considers the concept of 'benefits' extends beyond payments and that it also includes loans or the release, abandonment, failure to demand payment of, or the postponing of the payment of, a debt. Additionally, the Commissioner considers that an agreement that (or which includes that) a beneficiary will not demand payment of an amount to which they are presently entitled would be one that provides for the provision of benefits for a person other than the beneficiary alone.[211]

The Commissioner correctly notes this reference to purpose is to an actual purpose, at the time of the agreement. Alternative postulates are not necessary. A party's understanding is relevant, regardless of whether that understanding is objectively correct.[212] This includes the purpose of an advisor, where the adviser is a party to the agreement or where the adviser is authorized to act on behalf of another party. However, this has some limitations. While not directly mentioned in the ruling, without authority to act on a taxpayer's behalf, the views of an advisor are irrelevant if they are not shared with the taxpayer or other relevant party to the arrangement.[213]

Unsurprisingly, the Commissioner resists an argument that tax avoidance schemes can still be ordinary family or commercial dealings. While it may be too strong a position to suggest the concepts are mutually exclusive, the phrase 'ordinary family or commercial dealing' will generally exclude artificial, complicated, or contrived transactions with a tax avoidance purpose. Commercial steps that cannot be explained by reference to a sensible commercial objective will struggle to fall within the scope of this exemption. A number of steps which (arguably) are each commercial may, in combination, fail.[214] 'Family' refers to a relationship of natural persons based on birth or affinity, and may often involve co-residence. As noted by the Commissioner, a dealing can achieve commercial objectives, even in the absence of market value or where the parties do not deal at arm's length.[215]

For post-July 1, 2014, years of income, Practical Compliance Guideline 2022/2 categorizes the risks associated with particular arrangements (and therefore the compliance resources) on a sliding scale with "green" and "red" attributes. Green zone transactions with red zone attributes tend to default to red. The broad themes of the red zone category are set out as follows:

- Presently entitled beneficiaries lend or gift some of their entitlement to another party;[216]
- Deeds varied[217] to take advantage of differences between trust law and tax law income;[218]
- *Trust income allocated to third-party loss-making entities for a fee;*[219]
- Corporate beneficiaries returning income to the trust as a franked dividend;[220]
- Trustees setting off a beneficiary's unpaid present entitlements (UPEs) against the subscription price to acquire units of a lessor value or under a compulsory reinvestment provision (or trust instruments provides the trustee with a unilateral right to issue new units in satisfaction of a UPE);
- Amounts topping up an adult child's taxable income towards A$180,000 in circumstances where the amount are used to satisfy the obligations of the parents, or expenses characterized as family expenses that would usually born by parents (e.g., home loans, secondary education expenses or reimbursement for other expenses incurred while the beneficiary was a minor).

[206] TR 2022/4 at para. 10.
[207] *See Guardian.*
[208] *See* the *Guardian* Decision Impact Statement.
[209] TR2022/4 at 15.
[210] Section 100A(5).
[211] TR2022/4 at 18.
[212] TR2022/4 at 22, relying on *B&F Investments.*
[213] *See Guardian.*
[214] *See Guardian.*
[215] TR2022/4 at paras. 101 and 102.
[216] Variations of *East Finchley* and Examples 14 and 15 in the Appendix to the PCG.
[217] Trusts originally settled with distributable income defined by reference to trust law income would seem to be lower risk?
[218] I.e., *B&F Investments*, TA 2013/1, and TA 2016/12.
[219] *See also BRK (Bris), Idlecroft, Raftland, Prestige*, and PCG 2022/1 Ex. 18.
[220] *See Guardian.*

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f. Section 100A and Division 7A UPE

For completeness, regard should be had to the AAT decision of *Bendel*.[221] The Tribunal decided that an unpaid present entitlement (UPE) to a corporate beneficiary did not constitute a loan to the trustee of a discretionary trust within the meaning of Subsection 109D(3). In reaching its decision, the Tribunal reasoned that a loan within the meaning of Subsection 109D(3) did not reach so far as to embrace the rights in equity created when entitlements to trust income (or capital) were created but not satisfied and remained unpaid. The balance of an outstanding or unpaid entitlement of a corporate beneficiary of a trust, whether held on a separate trust or otherwise, was not a loan to the trustee of the trust. *Bendel* is currently on appeal to the Federal Court.

g. Attribution Managed Investment Trusts

Some of the issues associated with Section 100A fall away for Attribution Managed Investment Trusts (AMITs). One of the specific design features of Division 276 of the Income Tax Assessment Act 1997 was the exclusion of AMITs from Division 6. As such, Section 100A does not apply. Designed specifically to disregard present entitlement as the basis on which the allocate Section 95 net income, alternate mechanisms exist to manage the mischief to which Section 100A applies.

h. Best Practice

In the author's view, the following guidelines are important to keep in mind when undertaking trust arrangements and distributions:

• Keep it simple. Ordinary family and commercial dealings usually are.

• Distributions to tax advantaged beneficiaries should generally not be caught by Section 100A, if the named beneficiary has not changed its mind/consented to how it will use the trust funds to which it is entitled.

• Blatant addition of beneficiaries will likely be reimbursement agreement.

• Loss trusts are a red flag.

• Consider using trust law income as the standard distribution clause — do not mend deeds at a later point in time.

• Ensure beneficiaries receive the actual cash comprising their trust distributions.

• Documentation is important. Deeds of gift, and even independent advice, would be best practice.

• Be aware that beneficiaries may be interviewed by the ATO. Ensure they are able and willing to provide evidence.

i. Trust Law Challenges

Where a trustee is considering making a distribution to a beneficiary, whether in cash or in kind, they will also need to ensure that they have the power to do so, both under the trust deed and the provisions of general law governing the obligations of the trust deed.

A well drafted trust deed should generally contain wide powers allowing a trustee to make distributions to a beneficiary whether under a discretionary trust and pursuant to the exercise of a discretion to make the distribution or where the beneficiary is otherwise entitled to take. However, the terms of the trust deed will in each case need to be examined to ensure that the trustee is empowered to make the relevant distribution and does so in accordance with any procedures required under the trust deed.

In a case where the beneficiary is absolutely entitled, the principle in *Saunders v. Vautier*[222] remains good law in NSW that requires the trustee to make a distribution if the beneficiary so requires it.

Where the beneficiary has no specific entitlement to a distribution, but the trustee has discretion to make a distribution, consideration will need to be given to the obligations imposed on a trustee at law that may overlay the trust instrument as regards how a discretion may be exercised.

The duties of the trustee at general law, established by case law, include the following:

• To act honestly and in good faith (*R v. Holl* (1881) 7 QBD 575 at 580–1);

• In determining whether or not a trustee has acted honestly and in good faith, the trustee may exercise a power to disadvantage a beneficiary without giving the beneficiary a fair opportunity of making representations to them before they exercised the discretion (*Karger v. Paul* [1984] VR 161);

• The trustee also has a duty to act upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred (*Karger v. Paul*). This means having to take an informed view as to whether or not to exercise a discretionary power and not to act capriciously or wantonly (*Lutheran Church of Australia (SA District) Inc. v. Farmers Cooperative Executors and Trustees Ltd.* (1970) 121 CLR 628, at 639);

• A trustee must also act with due consideration for the purpose of which the power was given and not for some other purpose (*Ray Paulings Settlement Trust (No. 1)* [1964] Ch. 303).

As a general matter, a trustee may depart from their duties only if directed to do so by the beneficiaries being *sui juris* and absolutely entitled, or by the Court. However, equally, in these circumstances it does not follow that the trustee must obey such a direction. That is, a trustee is not bound to follow the directions of beneficiaries to depart from the strict terms of the trust (*Re Brockbank* [1948] 1 Ch. 206; *Application of Richard Albarran; Harb v. Harb* [2010] NSWSC 1251).

In most of Australia's States and Territories, courts have statutory jurisdiction to excuse a trustee wholly or partly from

[221] *Bendel & Anor v. Commissioner of Taxation (Taxation)* [2023] AATA 3074 (September 28, 2023).

[222] (1841) 4 Beav 115 [49 ER 282]; *affd* (1841) Cr and Ph 240 [41 ER 482].

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the consequences of a breach provided the trustee has acted in an appropriate way.[223]

Where a discretionary power is vested in a trustee, there is no necessary obligation that the trustee must exercise the discretion. However, the trustee must consider whether to exercise the discretion and once the powers exercised the trustee will be bound by it (*Cock v. Smith* [1909] HCA 64; *Smith v. Cock* [1911] 12 CLR 30).

j. Universal Obligations of Trustees

The trustee's obligation to be properly informed has been described as a "universal obligation" (*Owies v. JJE Nominees Pty. Ltd.* [2022] VSCA 142). The Court of Appeal of Victoria found that the trustee had not taken steps to inform itself of the circumstances of all the primary beneficiaries of a discretionary trust before making distributions. Failure to consider the broader significance of the decision as to how far trustees need to go to inform themselves before deciding on what distribution should be made and to whom may result in removal of the trustee, as was the outcome in the *Owies* case.

In order to justify a removal of a trustee, the Court in *Owies* stared that it "must find something which induces the Court to think either that the trust property will not be safe, or that the trust will not be properly executed in the interests of the beneficiaries."[224] The justification may be found in a lack of impartiality as between beneficiaries.[225] The Court held that the trustee had, over a number of years, failed to act impartially, failed to give real and genuine consideration to the interests of two of the primary beneficiaries, and relations between the beneficiaries and those involved in managing the trustee are, at least from this vantage point, irreconcilably damaged, such that it was not in the best interests of the beneficiaries for the trustee to continue in office. The *Owies* case underscores the importance of the care that trustees need to take when exercising a discretionary power to make distributions of property, even if the trust deed describes the power as absolute. It appears that those duties may extend to actively seeking information concerning the situation of a beneficiary.

B. Superannuation Funds

1. In General

The Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) are the government agencies responsible for the regulation of superannuation funds. APRA is responsible for the prudential regulation of banks and other deposit-taking institutions, life and general insurance companies, superannuation funds and RSA providers. ASIC is responsible for consumer protection and market integrity across the financial system, including the areas of insurance and superannuation. The ATO has been primarily responsible for the regulation of self-managed superannuation funds (SMSFs). These are funds with fewer than five members and where all the members actively participate in the fund's management. Funds with fewer than five members, but which do not come within the definition of a SMSF, remain the responsibility of APRA and ASIC.

While ITAA 1997 contains provisions dealing with the taxation of superannuation funds, an extensive regulatory code is contained in the following statutes:

(i) The Superannuation Industry (Supervision) Act 1993 (SISA) and Superannuation Industry (Supervision) Regs (SISR);

(ii) The Superannuation (Resolution of Complaints) Act, 1993;

(iii) The Superannuation (Self-Managed Superannuation Fund) Taxation Act, 1987; and

(iv) The Corporations Act, 2001.

The investment income of complying superannuation funds, less expenses, is subject to tax at a rate of 15%. Superannuation funds also are taxed at a rate of 15% on employer contributions and other contributions for which the contributor obtains a deduction.

Complying superannuation funds are allowed a full imputation credit for franked dividends (see V.B.3.c., above) received from Australian companies, and credits for dividend and interest withholding tax on income received from foreign sources.

Complying superannuation funds are subject to capital gains tax at a rate of 15% on the disposal of all assets (this rate is reduced to 10% where the asset has been held for more than one year;).

Eligible low-income earners may be entitled to receive the low-income superannuation contributions. The low-income superannuation contribution seeks to effectively return the tax paid on concessional contributions by a person's superannuation fund or retirement savings account (RSA) provider to a person who is a low income earner. Low-income earners are defined as individuals with an adjusted taxable income of A$37,000 or less. This tax rebate of up to A$500 annually (due to the fact that, under the current law, this 15% "concessional" tax rate may in fact be higher than the low-income earner's personal tax rate). It is proposed that this tax rebate will be calculated by applying a 15% rebate of tax to the concessional contributions made by or for individuals on adjusted incomes up to A$37,000 with an annual maximum amount payable of A$500. The rebate may be paid directly to the individual's superannuation fund to directly boost retirement savings.

2. Compliant Funds

In SISA, a "superannuation fund" is defined as:

(i) A fund that is an indefinitely continuing fund and a provident, benefit, superannuation or retirement fund; or

(ii) A public sector superannuation scheme.

To be "indefinitely continuing" means that the fund must not be one that will terminate or be wound up after a specified period. A provision in the governing rules of the fund to avoid a breach of the rules relating to perpetuities does not prevent the fund from being treated as an indefinitely continuing fund for the purpose of the definition of "superannuation fund." Al-

[223] *Trustee Act 1925* (NSW), s 85; *Trustee Act 1958* (Vic), s 67; *Trustee Act 1936* (SA), s 56; *Trustee Act 1973* (Qld) s 76; *Trustee Act 1962* (WA) s 75.

[224] *Re Wrightson* [1908] 1 Ch. 789, 802–3 (Warrington J); [1908] UKLawRp Ch. 34.

[225] *Nicholls* (1991) 10 ACSR 723, 728 (Needham J).

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so, the rules of law relating to perpetuities do not apply, and are taken never to have applied, to the trusts of any superannuation entity, regardless of when the entity was established.

An entity is eligible for concessional tax treatment as a "complying superannuation fund" if it holds a notice that is current from APRA (or the ATO in the case of a SMSF) stating that it is a complying superannuation fund.

Essentially, a superannuation fund will receive a complying fund notice from the applicable regulator if it:

(i) Is a resident regulated superannuation fund (i.e., a regulated superannuation fund that is an Australian Superannuation fund); or

(ii) Has met the prescribed conditions for being a complying superannuation fund for purposes of SISA.

A fund that is, or is part of, an exempt public sector superannuation scheme is taken to be a complying superannuation fund for the purposes of ITAA 1997, and is entitled to concessional tax treatment as such, without having to be a regulated superannuation fund or being subject to SISA.[226]

3. *Fund Governance*

The governing rules or trust deed, in addition to the regulatory framework, are the principal documents governing the operation of a superannuation entity.

Certain trust law duties and obligations of trustees are codified in SISA as covenants. These covenants are deemed to be included in the governing rules of a superannuation entity and cannot be avoided or modified.[227] The covenants are in addition to the other duties and obligations under the general trust law.

A superannuation entity's governing rules are deemed to contain (if they do not already do so) covenants by the trustee to the following effect:

(i) To act honestly in all matters affecting the entity;

(ii) To exercise the degree of care, skill and diligence of an ordinary prudent person;

(iii) To act in the best interests of beneficiaries;

(iv) To keep fund assets separate;

(v) Not to do anything that would impede the proper performance of functions and powers;

(vi) To formulate and give effect to an investment strategy;

(vii) To manage reserves responsibly;

(viii) To allow a beneficiary access to certain information; and

(ix) To do such other acts as are prescribed in SISR.

As may be seen from the above, the covenants cover most aspects of the management and control of a superannuation entity. For example, the trustee's duties and powers must be performed and exercised in the best interests of the beneficiaries, and the withholding of a benefit properly payable to a member would contravene that covenant.[228]

In relation to holding assets (especially real property) in the name of the trustees of a superannuation fund (without reference to the trusteeship of the particular fund), the ATO's view is that if the fund name does not appear on the registration of ownership of real estate, there should be a caveat lodged over the title. An exception to the caveat requirement may arise if:

(i) It is clear that fund assets have been used to acquire the property;

(ii) The decisions relating to the acquisition have been appropriately documented; and

(iii) The contract refers to the trusteeship (i.e., there is sufficient supporting evidence that the property is a fund asset).

The ATO explained that there had been cases where liquidators and trustees in bankruptcy sold superannuation fund assets in the liquidation or bankruptcy of funds and the ATO had to ensure that there is sufficient evidence of the ownership of fund assets. Also, the references to caveats and declarations of trust should be seen as examples of the evidence required, and not the only evidence acceptable to the ATO.

The trustee of a regulated superannuation fund must comply with the "sole purpose test" set out in SISA Sec. 62. Essentially, the test requires the trustee to ensure the fund is maintained solely for one or more of the "core purposes," or for one or more of the core purposes and for one or more of the "ancillary purposes." The test does not imply that the trustee is required to maintain the fund so that the same kind of benefits will be provided to each member of the fund.

The "sole purpose test" is a civil penalty provision, and trustees may be liable to civil and criminal proceedings if the provision is breached.

a. *Core Purposes*

The core purposes for a regulated superannuation fund are:

(i) The provision of benefits for each member of the fund on or after the member's retirement from any business, trade, profession, vocation, calling, occupation or employment in which the member was engaged (whether the member's retirement occurred before or after the member joined the fund);

(ii) The provision of benefits for each member of the fund on or after the member attains the age of 65;

(iii) The provision of benefits:

- For each member of the fund on or after whichever is the earlier of:
  - — The member's retirement from any business, trade, profession, vocation, calling, occupation or employment in which the member was engaged; or
  - — The member attains the age of 65;
  - — With respect to each member of the fund on or after the member's death if:

[226] SISA Secs. 14, 42, 45 and 343; Regs. 5 to 8.
[227] SISA Sec. 52.
[228] SISR, Reg. 52(2)–(5).

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◦ The death occurred before the member's retirement from any business, trade, profession, vocation, calling, occupation or employment in which the member was engaged; and

◦ The benefits are provided to the member's legal personal representative, to any or all of the member's defendants, or to both; or

— With respect to each member of the fund on or after the member's death if:

◦ The death occurred before the member attained the age of 65; and

◦ The benefits are provided to the member's legal personal representative, to any or all of the member's defendants, or to both.[229]

b. Ancillary Purposes

The ancillary purposes for a regulated superannuation fund are:

(i) The provision of benefits for each member of the fund on or after the termination of the member's employment with an employer who had, or any of whose associates had, at any time contributed to the fund in relation to the member;

(ii) The provision of benefits for each member of the fund on or after the member's cessation of work if the work was for gain or reward in any business, trade, profession, vocation, calling, occupation or employment in which the member was engaged and the cessation is on account of ill health;

(iii) The provision of benefits with respect to each member of the fund on or after the member's death if:

- The death occurred after the member's retirement from any business, trade, profession, vocation, calling, occupation or employment in which the member was engaged (whether the member's retirement occurred before or after the member joined the fund); and
- The benefits are provided to the member's legal personal representative, to any or all of the member's dependents, or to both;

(iv) The provision of benefits in respect of each member of the fund on or after the member's death if:

- The death occurred after the member attained the age of 65; and
- The benefits are provided to the member's legal personal representative, to any or all of the member's dependents, or to both; and

(v) The provision of such other benefits as are approved by the Regulator.

The approved additional ancillary purpose is the provision of any benefit permitted or required to be paid under SISR Pt 6 (i.e., the preservation and payment standards).

[229] SISR, Reg. 13.18.

4. Super Fund Operations

A regulated superannuation fund may accept contributions only in accordance with the rules in SISR Reg. 7.04, as summarized below.

Where an amount paid to a superannuation fund cannot be accepted under the rules, the amount is returned to the entity or person that paid the amount. This is to avoid potential unintended consequences that may arise if the amount were returned to the member, such as an increased tax liability.

a. Rule 1: Age of Member and Work Test

A regulated superannuation fund may accept contributions in accordance with the table below:[230]

Age of Member	Contributions and Conditions
Under 65	All contributions made in respect of the member
Over 65, but under 70	Contributions made in respect of the member that are: (i) mandated employer contributions; (ii) if the member satisfies the work test (see below) during the financial year in which the contributions are made: • employer contributions (except mandated employer contributions); or • member contributions (see below)
Over 70, but under 75	Contributions made in respect of the member that are: (i) mandated employer contributions; or (ii) if the member has been gainfully employed on at least a part-time basis during the financial year in which the contributions are made
75 or over	Mandated employer contributions

In any of the above circumstances, a fund may accept contributions in respect of a member if it is reasonably satisfied that the contribution is in respect of a period during which the fund may accept the contribution, even though the contribution is actually made after that period.[231]

"Employer contributions" has the same meaning as in SISR Reg. 1.03(1), and "employer contributions" and "member contributions" have the same meanings as in SISR Reg. 5.01(1).

(1) Work Test

A person is "gainfully employed on a part-time basis" during a financial year if the person was gainfully employed at least 40 hours in a period of not more than 30 consecutive days in that financial year.[232]

"Gainfully employed" means being employed or self-employed for gain or reward in any business, trade, profession,

[230] SISR Reg. 7.04(1).
[231] SISR Reg. 7.04(6).
[232] SISR Reg. 7.01(3).

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vocation, calling, occupation or employment. "Gain or reward" is the receipt of remuneration such as wages, business income, bonuses and commissions, in return for personal exertion in these activities. It does not include the passive receipt of income.[233]

"Mandated employer contributions" are:

(i) Superannuation Guarantee contributions; i.e., contributions made by or on behalf of an employer to reduce the employer's potential liability to the Superannuation Guarantee charge;

(ii) Superannuation Guarantee shortfall components; i.e., payments of the shortfall component of the Superannuation Guarantee charge by the ATO;

(iii) Award contributions made by or on behalf of an employer in satisfaction of the employer's obligations under an industrial agreement or award; and

(iv) Payments from the Superannuation Holding Accounts Special Account.[234]

Where members have an effective arrangement with their employer to salary sacrifice to superannuation, all superannuation contributions under the arrangement are considered to be made by the employer. However, only those contributions to the required Superannuation Guarantee level (currently 12%), or the industrial award or agreement level (if higher than the Superannuation Guarantee level), are mandated employer contributions. Any excess may be accepted only if they comply with the relevant rules noted above.

(2) Member Contributions

In Superannuation Circular No. I.A.1 (Contributions and Benefit Accrual Standards for Regulated Superannuation Funds), APRA-classified "Employer Eligible Termination Payments" (employer ETPs) as non-mandated employer contributions for the purposes of the SISR contribution standards. APRA has now reviewed this classification in consultation with the ATO and considers that employer ETPs (and directed termination payments) are appropriately regarded as "member contributions" made by the member, rather than non-mandated employer contributions, for the following reasons:

(i) An employer ETP is income an employee has already derived and is entitled to receive, regardless of whether the employee elects to take the ETP as a cash payment or have the employer roll over the ETP to a superannuation fund on the employee's behalf. The effect of the rollover is to defer tax;

(ii) Where an employer ETP is contributed to a superannuation fund at the direction of the employee, the contribution has been effectively funded from the member's own resources as the employee had an entitlement to receive the ETP; and

(iii) A member contribution made by a member (a personal contribution) is a contribution that has been effectively funded from the member's own resources.[235]

As noted above, personal contributions can be accepted under the SISR rules in respect of a member between the ages of 65 and 74 provided the member satisfies the work test. For members who are 70 or more but below 75, the contributions must be made by the members themselves.

b. Rule 2: Member Contributions Where No Tax File Number Is Provided

In addition to Rule 1, a regulated superannuation fund must not accept any member contributions if the member's Tax File Number (TFN) has not been quoted (for superannuation purposes) to the trustee of the fund.[236]

c. Rule 3: Non-concessional Contributions Cap

A regulated superannuation fund also must not accept any fund-capped contributions in a financial year in respect of a member that exceed the following thresholds:

(i) If the member is age 64 or less on July 1 of the financial year, three times the amount of the non-concessional contributions cap; or

(ii) If the member is age 65 or more but under age 75 on July 1 of the financial year, the non-concessional contributions cap.[237]

"Fund-capped contributions" are contributions made by members other than the following:

(i) A contribution to which a valid and acknowledged notice under Section 290-170 of ITAA 1997 relates (i.e., a deductible personal contribution);

(ii) A contribution that meets the requirements of Section 292-95(1)(d) of ITAA 1997 (i.e., payments from a structured settlement or order for personal injuries;

(iii) A contribution that meets the requirements of Section 292-100(9) of ITAA 1997 (i.e., contributions within a CGT cap amount);

(iv) A payment of the shortfall component of the Superannuation Guarantee charge by the ATO);

(v) A payment under Section 61 or 61A of the Small Superannuation Accounts Act 1995 (i.e., transfers from the member's account in the Superannuation Holding Accounts Special Account);

(vi) A government co-contribution; and

(vii) A contribution that is a "directed termination payment" (i.e., a rolled-over transitional employment termination payment as allowed under ITTPA).

The non-concessional contributions cap is currently A$110,000, increasing to A$120,000 for the 2024–2025 year.

d. Non-compliance

If a regulated superannuation fund receives an amount in a manner that is inconsistent with the rules discussed above, the fund must return the amount to the entity or person that paid the

[233] SISR Reg. 1.03(1).
[234] SISR Reg. 5.01(1), (2).
[235] Update to Circular No. 1.A.1, June 18, 2007.
[236] SISR Reg. 7.04(2).
[237] *Id.*

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amount within 30 days of becoming aware that the amount was received in a manner that is inconsistent with the rules unless:

(i) For an amount received in a manner inconsistent with Rule 2, the member's TFN is quoted (for superannuation purposes) within 30 days of this amount being received by the fund; or

(ii) For an amount received in a manner inconsistent with Rule 3, a valid notice under ITAA 1997 Sec. 290-170 is received by the fund within 30 days of this amount being received by the fund (these are notices informing the fund that they are personal contributions and the contributor is claiming a tax deduction for the contributions).[238]

In addition to the above, special rules provide for the returned contribution amounts to be increased or reduced in the circumstances specified in Reg. 7.04(4)(b); for example, to take account of unit price movements, reasonable administration and transaction costs incurred by the fund and risk insurance interests.

5. Returns on Investment

The trustee of a regulated superannuation fund must, subject to the member protection standards (see below), determine the costs and investment returns to be credited/debited from time to time against members' benefits in the fund. The terms "costs" and "investment return" are defined in SISR Reg. 5.01(1).

In broad terms, "costs" and "investment returns" must be distributed in a "fair and reasonable" manner among all the members and all the kinds of benefits of each member. If the fund maintains reserves, it must also have regard to certain specified matters. If costs charged against members' benefits are refunded, the refunded amount must be distributed in a fair and reasonable manner to the members affected.

If a member's benefits are reduced in connection with the payment of superannuation contributions surcharge, the reduction amount is taken from the member's benefits in the following order: first, from preserved benefits, then from restricted non-preserved benefits and, last, from unrestricted non-preserved benefits.[239]

6. Preservation of Benefits

The trustee of a regulated superannuation fund must not allow a member's right or claim to accrued benefits, or the amount of those accrued benefits, to be altered to the member's detriment by amendment of the governing rules or by any other act carried out, or consented to, by the trustee.[240]

The restriction does not apply if the alteration:

(i) Does not relate to a member's minimum benefits and has the written consent of the member or the Regulator;

(ii) Is necessary to ensure compliance with SIS and income tax laws, or is expressly permitted by the SIS legislation;

(iii) Is to rectify mistakes;

(iv) Is to enable the trustee to be reimbursed for superannuation contributions surcharge amounts, or interest on those amounts, paid or to be paid;

(v) Is to give effect to a payment split or satisfy the Family Law (Superannuation) Regulations 2001, Reg. 14G; or

(vi) Is to enable the trustee to be reimbursed for an amount paid or to be paid because of an overpayment of government co-contributions.

7. Portability Requirements

Generally, a member's benefits in a regulated superannuation fund may be rolled over with the member's consent or the fund to which the rollover is to be made consents to the rollover.[241] A member's benefits may be transferred only with the member's consent or the transferee fund's consent, unless the transfer is to a successor fund.[242]

A reduction of accrued benefits can be made only by a trust deed amendment approved by all members and the Australian Prudential Regulation Authority (APRA).

8. Payment of Benefits

A superannuation fund member's benefits in the fund must be cashed, or rolled over for immediate cashing, as soon as practicable after the member dies.[243]

Under rules in effect prior to that date, a member's benefits in a regulated superannuation fund must be cashed as soon as practicable after the occurrence of any of the following events:

(i) The member has reached the age of 65 but not the age of 75 and is not gainfully employed to at least "a part-time equivalent level;"

(ii) The member reached the age of 75 before July 1, 2004, and has not, since July 1, 2004, continued to be gainfully employed for at least 30 hours a week;

(iii) The member reached the age of 75 after June 30, 2004; and

(iv) The member dies.[244]

Temporary residents may access their superannuation upon permanent departure from Australia if they satisfy the rules prescribed in SISR.

The SISA provisions do not prohibit a member's benefits from being paid with fund assets provided the relevant provisions relating to preservation and payment of benefits are complied with, such as satisfying a condition of release with no cashing restriction.

9. Information Reporting

The trustee of a regulated superannuation fund must provide information to members, former members, and other persons. In summary, the rules for superannuation products or interests cover the following disclosures:

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[238] SISR Reg. 7.04(4).
[239] SISR Regs. 5.01, 5.02A, 5.02B, 5.02C and 5.03.
[240] SISR Reg. 13.16.
[241] SISR Reg. 6.28.
[242] SISR Reg. 6.29.
[243] SISR Reg. 6.21(1).
[244] *id.*

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(i) Point of sale disclosure requirements, as provided in the Corporations Act Sec. 1013D, the content requirements for Product Disclosure Statements, and general information requirements relating to superannuation products in Part 7.9 Division 4 of the Corporations Act and the Corporations Regulations;

(ii) Periodic statements for retail clients;[245]

(iii) Periodic disclosure of fund information;[246]

(iv) Ongoing disclosure of material changes and significant events;[247]

(v) Information and documents to be given to existing holders of superannuation products on request;[248]

(vi) Information about complaints;[249] and

(vii) Periodic reporting requirements when product holders cease to hold the product (exiting members or deceased members).[250]

10. Investment Requirements

The trustee of a regulated superannuation fund must undertake all of the investment activities of the fund with four overriding principles in mind: (1) the sole purpose test; (2) the fund's investment strategy; (3) the arm's-length rule; and (4) the general trustee covenants. In addition, appropriate regard must be given to the SISA or SISR provision that deals specifically with the particular investment concerned (e.g., investing in in-house assets, borrowing or lending money), or other specific investment controls. From time to time, the Regulators issue specific warnings about particular types of investments by superannuation funds (e.g., installment warrants, hedge funds) which must also be taken into consideration.

11. Regulatory Requirements

a. In General

Division 295 of ITAA 1997 provides the special rules for the taxation of superannuation entities. It sets out the rules on how to calculate the entity's taxable income and identify the components of that taxable income, as well as how to calculate the no-TFN contributions income of relevant entities for an income year. The tax under Division 295 is payable by the trustee of the entity.

A complying fund is an entity that satisfies the prescribed conditions in SISA for complying superannuation funds, while a noncomplying fund is an entity which fails, for whatever reason, to comply with those conditions. The taxable income of an entity is calculated as if the trustee were a taxpayer and a resident or, in the case of a foreign superannuation fund, a nonresident.

A complying superannuation fund is taxed at a concessional rate of 15% on the low-tax component of its taxable income and at 45% on the non-arm's-length component of its taxable income. A noncomplying superannuation fund or ADF is taxed at 45% on all of its taxable income. Additional tax is imposed on the no-TFN contributions income of a complying superannuation fund at 31.5% and of a noncomplying superannuation fund at 1.5%.[251]

Complying funds are eligible for a one-third discount on the capital gains that are included in assessable income in respect of assets acquired on or after September 21, 1999 and disposed of after that date. For assets acquired before that date, the fund may choose between having the CGT discount or calculating the capital gains using an indexed cost base (frozen at September 30, 1999) on the disposal of the assets after September 21, 1999. A special regime of taxation increases the assessable income of complying superannuation funds that become noncomplying, or of foreign superannuation funds that become resident, in the year in which the fund's complying or residency status changes. In each year of income, a superannuation entity that is regulated under SISA is required to lodge a regulatory annual return with APRA or, if the entity is a SMSF, with the ATO. Most superannuation entities are also required to lodge an income tax return with the Commissioner of Taxation each year.

b. Annual and Periodic Returns

For an SMSF, the SISA provides that the trustee of a SMSF at any time during the year of income must give the Commissioner an annual return for the year within the reporting period or such longer period allowed by the Commissioner.[252]

The annual return (for each year ending June 30) must be in the approved form and must contain such information as the form requires in respect of the year of income. The dates the return is due can vary:

• If a SMSF is reviewed by the ATO at registration, the first year return due date is October 31. The ATO will contact the SMSF if that is the case;

• In all other cases, new SMSFs must lodge their first annual tax return on February 28 in the next year;

• For subsequent income years, if the SMSF has a tax agent, the SMSF annual return due date is the next May 15. However, the deadline is brought forward to October 31 when the SMSF submits its returns independently.

c. Lodging Copy of Auditor's Report

The trustee of a superannuation entity must, within the prescribed period after the end of each year of income, ensure that the Regulator is provided with a certified true copy of the report given by an approved auditor to the trustee or registrable

[245] Corporations Act Sec. 1017D; Corporations Regulations Pt 7.9 Subdiv 5.2 to 5.3.

[246] Corporations Act Sec. 1017DA; Corporations Regulations Pt 7.9 Subdiv 5.4 to 5.7.

[247] Corporations Act Sec. 1020G; Corporations Regulations Pt 7.9 Subdiv 5.8.

[248] Corporations Act Sec. 1017C; Corporations Regulations Pt 7.9 Subdiv 5.9 to 5.10.

[249] Corporations Act Sec. 1017DA(1)(a)(iii); Corporations Regulations Pt 7.9 Subdiv 5.11.

[250] Corporations Act Sec. 1017D(5)(g); Corporations Regulations Pt 7.9 Subdiv 5.12 to 5.13.

[251] Income Tax Rates Act 1986, Sec. 29.

[252] SISA Sec. 36A.

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superannuation entity (RSE) licensee in relation to the entity in respect of that year of income.[253]

The period after the end of the year of income of the entity for lodging the auditor's report is:

(i) for an SMSF: within nine months; and

(ii) for any other superannuation entity: within four months.

The auditor's report must be in an approved format.

d. Newly-Established Entities

The trustee of a newly established superannuation entity must, within seven days after its establishment, provide information to APRA or a specified person as prescribed.[254]

The information to be given by a new superannuation fund is set out in SISR Reg. 11.04.

A new superannuation fund may comply with the information requirements in conjunction with its election to become a regulated superannuation fund. For this purpose, the new fund must, within 60 days of its establishment, provide the required information and election to the Commissioner using the approved form application to register for superannuation entities. A new superannuation fund includes a former resident ADF that has converted to a superannuation fund.

When a superannuation entity lodges the approved form above, the ATO will also allocate an ABN and a TFN to the entity. An entity may, if it so wishes, also use the form to register for the GST. Where the entity is not a SMSF and, therefore, not regulated by the ATO for SIS prudential purposes, the ATO will forward relevant information in the form concerning the entity to APRA.

A superannuation fund is considered to come into existence after its trust deed is signed and property is set apart for the benefit of specified members (e.g., when the fund receives contributions).

e. Significant Adverse Events

The trustee of a superannuation entity must inform the Regulator in writing of the occurrence of an event having a significant adverse effect on the financial position of the entity within three business days after becoming aware of such an event.[255] An event has a significant adverse effect if, as a result of the event, the trustee will not, or may not, be able to pay benefits to beneficiaries as and when they fall due at any time before the trustee's next annual report to beneficiaries.

Section 106 is a civil penalty provision.

f. Information at Request of Regulator

The Regulator may, by written notice, require the trustee of a superannuation entity to provide, within a specified time, information or reports on such matters as are set out in the notice.[256]

In addition, the Regulator may, by written notice, require a "relevant person" to produce, at such reasonable time and reasonable place as are specified, any books relating to the affairs of the entity.[257] A relevant person in relation to a superannuation entity means an individual trustee or investment manager, a responsible officer of a corporate trustee or corporate investment manager, an auditor or actuary of the entity, or a custodian in relation to the entity. Similar powers to request production of books apply for the purposes of investigation of a superannuation entity by the Regulator.[258]

The Regulator may also request information from the trustee of a superannuation entity for the purposes of its statistical data collection program.[259]

g. Change in Fund Status and Other Information Requirements

The trustee of a superannuation fund that has been declared not to be a public offer fund must notify APRA in writing of a breach of any of the conditions to which the fund was subject.

The trustee of a superannuation entity must notify the Regulator in writing of changes in the entity's contact details, or of a decision or resolution to wind up the entity.[260] Changes in contact details must be notified within one month or, in the case of an eligible rollover fund, immediately. A decision or resolution to wind up an entity must be notified before or as soon as practicable after the winding up commences or, in the case of a SMSF, before the winding up commences.

A regulated fund which becomes a SMSF, or a SMSF which ceases to be one, must provide prescribed information to the ATO within 28 days of the change in status.[261]

Notification of changes should be made using the ATO form Superannuation entities — change of details.[262]

Other disclosure or provision of information obligations may be imposed on a superannuation entity in connection with an investigation of the entity.[263]

C. Private Companies

1. In General

The definition of a private company is set out in V.A.2. As a rule, private companies are taxed the same as public companies, subject to the application of specific anti-avoidance rules referred to below.

2. Disguised Distributions of Profits

Companies are taxed at either 30% or 25% on their taxable income, whereas shareholders (individuals) may be taxed at up to 47% on dividend income (but for the ability to claim a tax offset under the Australian imputation regime for corporate tax paid on distributed profits). As such, there is a need to ensure that private companies cannot distribute corporate profits to shareholders in a form other than a dividend, when in fact (as a matter of substance) it is in fact a corporate distribution.

[253] SISA Sec. 36.
[254] SISA Sec. 36254(1); SISR Reg. 11.03.
[255] SISA Sec. 106.
[256] SISA Sec. 254(2).
[257] SISA Sec. 255(1); ISC v. Robertson, 95 ATC 4225.
[258] SISA Sec. 269; ISC v. Glaser, 98 ATC 4230.
[259] SISA Sec. 347A.
[260] SISR Reg. 11.07.
[261] SISR Reg. 11.07A.
[262] NAT 3036.
[263] SISA Part 25 and 25A.

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Division 7A of Part III of ITAA 1936 treats as dividends paid by a private company (which includes a limited partnership — as they are deemed to be a private company for Australian income tax purposes):

(i) Payments, including transfers of property for inadequate consideration, by the company to a shareholder (or associate);

(ii) Loans by the company to a shareholder (or associate) that are not fully repaid by year end; and

(iii) Debts that were owed by a shareholder (or associate) to a company and are forgiven by the company.

Where Division 7A applies, the relevant amount is included in the assessable income of the shareholder (or associate) as an unfranked dividend, and results in a franking debit to the private company's franking account. (See, generally, V.B.3.c., above.)

The amount deemed to be a dividend cannot exceed the company's "distributable surplus," which is the excess of the company's net assets over its paid-up capital and share premium reserve.

Division 7A provides for "excluded loans" to be free from its operation. Such a loan must satisfy the following criteria:

(i) It must be the subject of a written agreement;

(ii) The rate of interest on the loan must equal or exceed a prescribed benchmark rate;

(iii) The term of the loan may not exceed a prescribed maximum term (in the case of "secured loans," this is 25 years and in all other cases, seven years);

(iv) The prescribed minimum yearly repayment must be made; and

(v) The interest must be paid annually.

Trust distributions to company beneficiaries will result in deemed loans (and thus dividends under Division 7A) where:

(i) A private company is the recipient of a trust distribution;

(ii) The trustee has not paid the amount of the distribution to the private company; and

(iii) A shareholder (or an associate of a shareholder) of the private company became indebted to the trust after the date of the trust distribution to the company.

The offending loan by the trust is deemed to be a dividend of the borrower received from the company beneficiary and results in a debit to the company's franking account (see V.B.3.c., above). The protection afforded by loan agreements to loans by private companies does not apply in the case of such trust loans.

The deemed dividend rules under Division 7A also apply to "payments" by way of a license or right to use real property and chattels, such as cars, boats and real estate. This measure was introduced to reduce the scope of private companies to allow their shareholders or associates to use such company assets for free, or for less than their arm's-length value, without paying tax.

D. Venture Capital Limited Partnerships

Australia has special venture capital limited partnership concessions to encourage investment in venture capital. The provisions apply to investments structured as limited partnerships.

For the concessions to apply, the entity must be registered with Innovation Australia (previously the PDF Board).

The Venture Capital Act 2002 contains detailed legislative requirements that must be satisfied by the limited partnerships.

Limited partnerships that are used to invest in Australian venture capital companies or unit trusts, by acquiring shares or units respectively or certain convertible notes in either, are treated as ordinary partnerships. Consequently, the income, profits, gains and losses of the partnership flow through to the partners, who are taxed according to their tax status. The "flow-through" tax treatment applies to four categories of limited partnerships:

(i) Venture capital limited partnership. A limited partnership may be registered as a venture capital limited partnership if it meets a number of requirements under Venture Capital Act 2002 Part 2, which provide for formation under a law of any Australian State or Territory or under a law of a country with which Australia has a double tax treaty.

(ii) Australian venture capital fund of funds. A limited partnership may be registered as an Australian venture capital fund of funds if it meets a number of requirements under Venture Capital Act 2002 Part 2. These need to be formed in Australia.

(iii) Venture capital management partnership. A limited partnership that is a general partner of a venture capital limited partnership or an Australian venture capital fund of funds, and only carries on activities related to being a general partner, is a venture capital management partnership.

(iv) Early-stage venture capital limited partnership. A limited partnership is an early-stage venture capital limited partnership at a particular time if it is registered as such under Venture Capital Act 2002, which, among other things, requires the limited partnership to meet certain capital and asset value thresholds. Significantly, a limited partner in an ESCVLP or a general partner in the ESCVLP that is resident in a country with which Australia has a tax treaty will not be taxed on income derived from their investment provided the investment satisfies certain requirements.

Very broadly, if these entities make a partnership loss, the deduction allowable to a limited partner in respect of that loss cannot exceed the amount of the partner's financial exposure to the loss. The amount is calculated by deducting, from the partner's contribution to the partnership, the sum of:

(i) Any contributions that are repaid to the partner;

(ii) Any deductions allowed to the partner for partnership losses incurred in previous income years; and

(iii) Any debt interests issued by the partner that are secured by the partner's interest in the partnership.

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Deductions disallowed in one year (because the deduction limit is exceeded) can be carried forward and utilized in subsequent years.

Certain foreign residents can disregard capital gains and capital losses from CGT events that relate to venture capital investments. The exemption for venture capital investments in Australian companies or unit trusts applies to limited partners who are resident of any foreign country and general partners and venture capital limited partnerships resident of, or established in, countries with which Australia has a tax treaty in force.

To qualify for the exemption, investments must be made as follows:

(i) Through limited partnerships known as "venture capital limited partnerships" that are unconditionally registered (or are conditionally registered that become unconditionally registered) under Venture Capital Act 2002 Part 2;

(ii) Through limited partnerships known as "Australian venture capital funds of funds" that are unconditionally registered (or are conditionally registered that become unconditionally registered) under that Part;

(iii) Through limited partnerships known as "early-stage venture capital limited partnerships" that are unconditionally registered (or are conditionally registered that become unconditionally registered) under that Part; or

(iv) Directly by foreign residents who are registered under Part 3 of that Act.

General partners of venture capital limited partnerships and Australian fund of funds, and limited partners in venture capital limited partnerships and early-stage venture capital limited partnerships which are residents of countries with which Australia has a double tax treaty, enjoy capital gains tax treatment in respect of their share of profits ("carried interests") made by the limited partnership. This treatment is beneficial where the partner is an individual or trust because they are able to access the benefit of the CGT discount concession if the partnership agreement under which the gain arises was entered into at least 12 months before receiving their entitlement to profits. The CGT discount exempts half of the share of profits from Australian tax.

E. Listed Investment Companies

A "listed investment company" is an Australian resident company listed on the ASX or other approved stock exchange, at least 90% of whose CGT assets consist of "permitted investments," being a wide range of investment and financial assets and goodwill. Direct or indirect ownership or more than 10% of another company (other than an LIC) or trust is not permitted. A 100% subsidiary of an LIC that meets all the criteria, except listing, is also an LIC.

Eligible shareholders in listed investment companies are entitled to an equivalent of a CGT discount on gains realized by LICs on assets held for more than 12 months. Dividend statements provided by LICs must separately identify dividends sourced from such "LIC capital gains." Individuals, non-superannuation trusts and partnerships are entitled to a deduction equal to 50% of the LIC capital gain amount. Life insurance companies (where the shares are virtual PST assets) and complying superannuation entities are entitled to a 33 1/3% deduction.

F. Cooperatives

A cooperative is an unlisted company with rules limiting the number of shares that any one shareholder may take. It must be established for the purpose of carrying on a business having as one or more of its primary objects:

(i) The acquisition of commodities or goods for disposal or distribution to its members;

(ii) The disposal or distribution of its members' commodities or goods;

(iii) The storage, marketing, packing or processing of its members' commodities;

(iv) The rendering of services to its members; and

(v) The obtaining of funds from its members in order to make loans to members to enable them to acquire residential or residential/business premises.

At least 90% of the business it carries on in the ordinary course of that business must be with its members.

Cooperatives, unlike other companies, are specifically allowed deductions for amounts distributed from assessable income to members as rebates or bonuses based on business done, or as interest or dividends. Cooperatives have the option of franking distributions paid to members from assessable income.

G. Managed Investment Trusts

As described in II.A.1.h., above, Managed Investment Trusts (MITs) are a type of trust that is treated differently for Australian tax purposes. Broadly, a MIT is a trust that is a managed investment scheme for the Australian Corporations law purposes, is operated by an entity that has an Australian financial services license and is considered widely held for Australian tax purposes (as determined by a specific test in the MIT rules (see II.A.1.i., above)).

H. Registered Life Insurance Companies

There is a specific set of provisions in Division 320 of ITAA 1997 which tax life insurance companies that are registered under the Life Act.

I. Small Business Entities

Entities that are classified as "small business entities" are entitled to a number of tax concessions, which include:

(i) The ability to access the small business CGT concessions (these include exemptions and a rollover);

(ii) An ability to claim an immediate deduction for certain prepaid business expenses;

(iii) A simplified depreciation regime (allowing for a 15% rate (year of acquisition) and 30% rate (future holding years) for all depreciable assets on a pooled basis) and trading stock rule in Division 328 of ITAA 1997;

(iv) The ability to use the GDP-adjusted notional tax method to work out PAYG installments;

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(v) An FBT car parking exemption;

(vi) The ability to choose to account for GST on a cash basis;

(vii) The ability to choose to apportion GST input tax credits annually;

(viii) The ability to choose to pay GST by installments to make any adjustments under the indirect value shifting rules in Division 727 of ITAA 1997; and

(ix) An additional regime allowing for an immediate write-off for the cost of eligible depreciating assets costing up to A$20,000, provided they were installed ready for use by June 30, 2025. The A$20,000 limit applies on a per asset basis, so small businesses can write-off multiple assets.

A business will generally be a "small business entity" if it carries on a business and satisfies the A$10 million aggregated turnover test. However, for some concessions, a substituted aggregated turnover threshold of less than A$50 million applies (e.g., for simplified trading stock rules, prepayments, FBT car parking exemption, and PAYG instalments based on GDP-adjusted notional tax). The A$10 (or $50) million aggregated turnover test can be satisfied in three ways:

(i) The entity's aggregated turnover for the previous income year;

(ii) The entity's likely aggregated turnover for the current income year, worked out as at the first day of the income year; or

(iii) The entity's aggregated turnover for the current income year, worked out as at the end of the current income year.

Broadly, aggregated turnover is the entity's ordinary income derived in a year of income from carrying on the business.

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X. Taxation of Resident Individuals

Resident individuals are taxed on their taxable income at a progressive rate. See XVI.A., below.

A. *Tax Residence*

Individuals are residents of Australia if they generally reside in Australia or:

(i) Their domicile is in Australia (unless the Commissioner is satisfied that their permanent place of abode is outside Australia);

(ii) They are in Australia, continuously or intermittently, during more than one-half of the year of income (unless the Commissioner is satisfied that their usual place of abode is outside Australia and that they do not intend to take up residence in Australia); or

(iii) They are eligible employees for purposes of the Superannuation Contribution Act 1976, or are spouses or children under 16 years of age of such persons.

Income tax ruling TR 2023/1 sets out the ATO's guidance on the tax residency tests for individuals inbound to and outbound from Australia.

Additional factors are to be considered by the Commissioner in determining the residence of business migrants that come to Australia under the Business Migration Program. For example, if the only reason for an individual's absence from Australia is business, this may not be enough to support a claim that the individual is not a resident.

Each individual is assessed separately. There is no statutory provision either for the joint assessment of a husband and wife, or for the splitting of income between a husband and wife.

As a rule, all entities determine their taxable income by reference to the same rules. Some rules more relevant to individuals (both in terms of income and expenses) are set out below.

B. *Specific Items of Income*

1. *Beneficial Interests*

Beneficial interests that are specifically included in assessable income include beneficial interests in income derived under any will, settlement, deed, gift or instrument of trust.[264] This is not in lieu of an estate or gift tax. Rather, it simply reflects the general principle that the beneficiary of an estate/trust is required to include its share of the income in its assessable income (see more generally IX.A., above).

2. *Retirement or Employment Termination Payments*

Payments made due to the termination of employment (for example, "golden handshakes") which are made within 12 months of the termination are referred to as employment termination payments (ETPs) and may benefit from concessionary ETP taxation. Termination payments made after 12 months of the termination do not get the beneficial treatment of ETPs and are taxed to recipient employees as income according to their individual marginal tax rate.

The portion of an ETP that relates to either the employee's pre-July 1, 1983, service or to the employee's termination as a result of a disability (as defined), is tax-free. The remaining part of the ETP is taxable at effective tax rates that vary depending on the amount of the ETP received in the income year and in respect of the employment termination and the recipient employee's age. Broadly, where an employee is over the age of 55 (and hence reached their preservation age) then that part of the taxable component of their ETP up to an indexed life ETP cap (A$235,000 for the 2023–2024 income year) is taxed at 15% plus the 2% Medicare levy. The cap reduces to the extent that an employee has already received other life ETPs in the same income year or in relation to the same termination. Where an employee is below the age of 55, that part of the taxable component of their ETP below the life ETP cap is taxed at 30% plus the 2% Medicare levy. The remaining part of the taxable component of the ETP is taxed at 45% plus the 2% Medicare levy regardless of the recipient employee's age. The same tax treatments apply whether the ETP is paid to the employee or to another person such as their spouse or child.

The tax-free component of an ETP paid subsequent to the death of an employee is tax-free. The taxable component of an ETP paid on death is, however, taxed at different rates to those outlined in the preceding paragraph that relate to ETPs paid while an employee is living. Broadly, that part of the taxable component of a death ETP paid to a dependent (which is a defined term) is tax-free up to the indexed death ETP cap (A$235,000 for the 2023–2024 income year). This cap reduces to the extent that a death ETP has been received in respect of the same termination in an earlier income year. Where a death ETP is paid to a nondependent, then that part of the taxable component which is under the indexed death ETP cap will be taxed to them at 30% plus the 2% Medicare levy. That part of the taxable component of a death ETP that exceeds the indexed death ETP cap is taxed at 45% plus the 2% Medicare levy regardless of whether it is received by a dependent or not. The taxation of death ETPs can produce adverse tax results because it does not recognize any pre-July 1, 1983, service by an employee (which is tax-free if the employee is alive). Accordingly, it may be more beneficial for a dying employee to receive an ETP while they are alive than wait for a death ETP to be paid to their dependents.

There are special rules related to the taxation of genuine redundancy payments, payments for unused annual leave, payments for unused long service leave and foreign termination payments. Payments from superannuation funds are taxed differently under rules related to superannuation benefits.[265]

3. *Life Insurance Policies*

There is a growing market for the issuance of foreign life policies to policy holders located in or moving to Australia.

A life insurance policy for income tax purposes is defined as:

(i) A life policy under the Life Insurance Act 1995 ("Life Act"), which includes:

[264] See *FCT v. Belford* (1952) 88 CLR 489, 5 AITR 392.

[265] ITAA 1997, Divs. 80, 82 and 83.

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• A contract of insurance that provides for the payment of money on the death of a person or on the happening of a contingency dependent on the termination or continuance of human life;

• A contract of insurance that is subject to payment of premiums for a term dependent on the termination or continuance of human life;

• A contract of insurance that provides for the payment of an annuity for a term dependent on the continuance of human life;

• A contract that provides for the payment of an annuity for a term not dependent on the continuance of human life but exceeding the term of 10 years;

• A contract of insurance which is a continuous disability policy;

• A contract (whether or not it is a contract of insurance) that constitutes an investment account contract;

• A contract (whether or not a contract of insurance) that constitutes an investment-linked contract;

(ii) A contract made in the course of carrying on business that is life insurance business because of a declaration in force by the Australian Prudential Regulatory Authority under section 12A or 12B of the Life Act on application by a company; and

(iii) A contract under which the company issuing the policy undertakes to pay money on one or more specified dates and neither the payment of that money nor the payment of premiums is dependent on the death or survival of the person to whom the policy is issued or of any other person (referred to as a sinking fund policy under the Life Act).

A contract that provides for the payment of money on the death of a person is not a life policy if the contract term is to be not more than one year and payment is only to be made in the event of death by accident or from a specified sickness.

Items (1), (2), (3) and (5) of the definition of life policy above refer to a "contract for insurance." This term is not defined for the purpose of the Life Act and takes its ordinary meaning. A contract of insurance is one whereby one party, the insurer, in consideration of the payment of money, the premium, promises to pay the other party, the insured, a sum of money or to provide him with a corresponding benefit upon the occurrence of one or more specified events.[266] If there is a discretion as to whether an indemnity or other benefit will be provided, the arrangement is not a contract of insurance. A contract of insurance is intended to confer security and certainty on the insured and not merely an expectation of payment however well founded.

The Life Act includes in the definition of a life policy an investment-linked contract. An investment-linked contract is a contract:

(i) The principal object of which is the provision of benefits calculated by reference to units the value of which is related to the market value of a specified class or group of assets or the party by whom the benefits are to be provided; and

(ii) That provides for benefits to be paid: on death; or on a specified date or specified dates or on death before the specified date, or the last of the specified dates, as the case may be.

a. Tax Analysis for Policyholders

In general, a policyholder cannot claim an immediate deduction for premiums and other expenses (e.g., provider fees and management fees) paid in respect of a life policy as they are considered capital or private in nature. An exception to this general rule is where the investor is an employer and the life insurance policy is an accident or term policy in respect of a key employee and the policy is effected for income-producing purposes (to provide against a possible loss of revenue or a possible outgoing of a revenue nature).

Receipts under life insurance policies, as they are generally of a private or capital nature, are not included in assessable income and subject to income tax in the hands of a policyholder. This is subject to specific statutory provisions set out below.

(1) Bonuses

A bonus, other than a reversionary bonus, received on a life insurance policy is assessable income.

Bonuses on life insurance contracts are traditionally amounts added to the sum insured on certain whole life policies ("with-profits" policies). Such bonuses are said to be "reversionary" when the entitlement to the bonus only accrues on the completion or surrender of the policy. In *Case 34*,[267] the Board of Review contrasted a reversionary bonus with an annual bonus which is payable immediately.

The distinction depends on whether the bonus can be withdrawn from the policy independently of the (partial or complete) surrender or completion of the policy. If it can be so withdrawn, there could be a risk as to whether it is a true policy of life insurance. This risk is often managed (in the case of insurance bonds) by treating any withdrawal of the bonus as a partial surrender of the policy.

(2) Reversionary Bonuses

Reversionary bonuses on life policies held for less than 10 years are included in assessable income. This effectively ensures that taxpayers cannot take out short-term life insurance policies for the purpose of making tax-free gains in the form of reversionary bonuses. The bonuses on short term policies are assessable if they are received within the first 10 years on the following basis (if they are not otherwise assessable as ordinary income):

(i) 100% of the bonus if the bonus is received within eight years;

(ii) 2/3 of the bonus if the bonus is received in the ninth year; and

[266] Prudential Insurance Co. v. Inland Revenue Commissioner [1904] 2 KB 658, and Encyclopaedic Australian Legal Dictionary.

[267] (1965) 12 CTBR (NS).

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(iii) 1/3 of the bonus if the bonus is received in the tenth year.[268]

This provision does not apply to an amount received in consequence of the death of the person insured.

If the recipient of the payment is not a resident for Australian income tax purposes, or is a temporary resident, it will only be taxed on the bonus to the extent that it represents Australian sourced income.

(3) Capital Gains Tax

Any capital gain or capital loss made upon full redemption or death may be disregarded for tax purposes in respect of policies of insurance on the life of an individual where the person benefiting from the event:

(i) Is the original beneficial owner of the policy; or

(ii) Acquired the interest in the policy for no consideration (this includes the executors/personal representatives of the policyholder — for example, if the policy had a single policyholder who was also the sole life assured, the death benefits would be paid to his executors).

Similarly, any capital gain or capital loss made by the policyholder upon partial withdrawal or surrender of the policy is disregarded for tax purposes.

(4) Foreign Resident and Temporary Resident Policyholders

Temporary residents and nonresidents will not be subject to tax on capital gains made in respect of a life insurance policy and will be subject to income tax on other assessable income referred to above if, and only if, the assessable amount has an Australian source. Source in this context will generally be determined by reference to whether the life insurance policy is disposed of under a contract executed in Australia or whether the policyholder is in Australia at the time of maturity of the life insurance policy — in which case there is a risk that any gain on disposal will have an Australian source.

b. Tax Analysis for Foreign Life Insurers

If the life insurers are nonresidents without the benefit of double tax treaty relief, they will be taxed on their Australian sourced income — which is effectively a question of fact determined taking into account a number of factors including the place where the relevant contracts are concluded and where the services are provided.

Arguably, the source of the premiums received under a policy should be determined by the location of the policyholder and where the product is issued. Therefore, if a life insurance company issues a policy to policyholders physically located outside of Australia at the time the policy is issued (irrespective of the residency of the policy holder at that time), the premium income received should not have an Australian source and should not be assessable as ordinary income. They will be required to report any Australian sourced income in an Australian income tax return. In this case, the relevant entity may also be required to appoint a public officer.

[268] *Id.*, Sec. 26AH.

The Taxation of Financial Arrangement (TOFA) provisions deal with changes to the tax-timing treatment of financial arrangements. Broadly, the measures contain rules that cover tax timing treatments for financial arrangements, including elective tax timing and character hedging rules that are designed to minimize tax timing and character mismatches. An exemption exists for rights and obligations of a life insurance company under a life insurance policy. It should be noted that, if the foreign insurance company increases the frequency at which it issues policies to policyholders located in Australia at the time the policy is issued (irrespective of their residency), it may be taken to be carrying on a business in Australia. Every company carrying on business in Australia must be represented by a public officer. The public officer must be appointed within three months of the company commencing to carry on business in Australia or first deriving income in Australia. The appointment is satisfied when notice in writing specifying the name of the officer and an address for service of notice is given to the Commissioner of Taxation. A public officer must be a natural person who has attained the age of 18 years and is ordinarily resident in Australia.

4. Capital Gains Tax

The rules regarding the taxation of capital gains were discussed at V.B.3.b. These rules generally apply on the same basis for individuals as they do for companies, but there are some additional concessions available to individuals (referred to in V.B.3.b.). Specifically, the tax rate applicable to gains made on the sale of an asset under the capital gains tax (CGT) regime is reduced by 50% if the asset is held for more than 12 months prior to the time of the sale.

In addition, to ensure individuals cannot claim a capital loss for assets used for personal purposes, "personal use assets" (an asset kept mainly for personal use and enjoyment) that cost less than A$10,000 and "collectables" (artwork, jewelry, antiques and similar assets) that cost less than A$500 are generally excluded from the CGT regime. This can include non-fungible tokens (NFTs) and crypto assets in appropriate circumstances.

C. Specific Deductions

1. Superannuation Fund

A deduction is allowed for contributions to a superannuation fund for the benefit of employees. There are no limits on contributions. However, an individual may be subject to excess contribution tax of 30% for contributions in any one year of more than A$25,000 (increased to A$35,000 for employees aged 50 years or older).

2. Political Donations

Individuals are entitled to a deduction of up to A$1,500 for contributions and gifts that are not made in the course of carrying on a business to:

(i) A political party that is registered under Part XI of the Commonwealth Electoral Act 1918 or under corresponding State or Territory legislation; or

(ii) An individual when the individual is an independent member, or an independent candidate in an election for

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members, of an Australian legislature or a local governing body.[269]

Companies cannot claim a deduction for political donations (they can however claim deductions for payments made to employees or directors even if they are politicians (e.g., such as salary and wages)).

Nondeductible political donations cannot be included in the cost base of a capital asset.

3. Substantiation Rules

a. In General

There are various rules throughout ITAA 1936 and ITAA 1997 requiring a taxpayer to substantiate expenses by way of documentary evidence supporting the deduction claim. The rules apply to an employee claiming employment-related expenses, and motor vehicle and travel expenses incurred by individuals and partnerships. The rules applicable to employees are subject to two exclusions:

(i) Substantiation of claims is not required, within limits, of allowances for expenses incurred in carrying out duties for an employer, or claims, within limits, of allowances paid to employees for fares and other transport costs where the allowances are payable under an award and are not higher in amount than was payable under the award; and

(ii) Aggregated employment-related expenses for the year of income must exceed A$300 before the rules apply.[270]

b. Motor Vehicle Expenses

The alternatives available for substantiating motor vehicle expenses are set out in (1) to (4), below.

(1) Business Proportion Basis

A deduction is allowed for the business proportion of running costs including registration, insurance, repairs and maintenance, depreciation, interest on borrowed funds and leasing costs, where applicable. A logbook is required to be maintained to substantiate the costs and the business proportion of the total usage.

In the first year in which a deduction is claimed for motor vehicle expenses, the logbook must be kept for a period of 12 weeks to establish the proportionate business use of the vehicle. In subsequent years, that business proportion may be used to claim a deduction provided the actual business use in the later year is not reduced by more than 10% from that substantiated by the logbook. A significant change in business usage requires the use of a logbook for a further 12 weeks to establish the current proportion. The taxpayer is required to record the total distance traveled in each year and the expenses incurred with respect to the vehicle. Documentation supporting the expenses is not required.

(2) Annual Vehicle Operating Costs Basis

A deduction is allowed for 33.3% of the annual vehicle operating costs. The taxpayer is required to maintain documentary evidence in the form of receipts, invoices, etc. in relation to the costs incurred in the year of income. It is not necessary to maintain a logbook recording details of business trips.

(3) Vehicle Cost Basis

An annual deduction is allowed for 12% of the purchase price of a vehicle or 12% of the market value of a leased vehicle when the lease commenced. The vehicle value is limited to the depreciation cost limit for motor vehicles. There is no requirement to maintain any documentation for costs incurred or for business usage.

(4) Kilometers Traveled Basis

Where business travel is 5,000 km or less per year, the deduction is calculated by multiplying a rate of expenditure determined by the vehicle's engine size by the distance traveled for business purposes in the year of income. No documentation need be maintained for costs incurred or for business usage.

4. Business Travel Expenses

Traveling expenses of a spouse or relative that accompanies an employee or a self-employed person on a business trip are not deductible where the accompanying person is not an employee of the spouse's employer or, if the accompanying person is such an employee, the duties performed by the accompanying person are incidental to the traveler and the accompanying person would not have made the trip apart from the personal relationship.[271]

5. Entertainment Expenses

Deductions with respect to club dues, yachts, boats and leisure facilities such as ski lodges, holiday cottages, etc., are not allowable unless a genuine and substantial business need for such facilities can be established.[272]

Deductions are not allowed for entertainment expenses. This rule applies to business meals, drinks, cocktail parties and staff social functions, and includes tickets or boxes for theatrical or sporting events. It also covers the payment of hostess allowances to spouses of executives. Entertainment allowances received by an employee continue to form part of the employee's assessable income, but the employee is not entitled to a deduction for entertainment expenses funded by an allowance.[273]

D. Tax Rates

The following tax rates apply to personal income of Australian resident individuals for the year to June 30, 2026:

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[269] ITAA 1997, Sec. 30-242.
[270] See generally, ITAA 1997, Div. 900.
[271] ITAA 1997, Sec. 26-30.
[272] ITAA 1997, Sec. 26-50.
[273] ITAA 1997, Div. 32.

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Taxable Income (A$)	Tax Payable (A$)
0–18,200	Nil
18,201–45,000	Nil + 16% of excess over 18,200
45,001–135,000	$4,288 + 30% of excess over 45,000
135,001–190,000	$31,288 + 37% of excess over 135,000
190,001 and over	$51,638 + 45% of excess over 190,000

1. Special Professionals

Certain professionals are eligible to income average for purposes of calculating their personal income tax. Income averaging is available to qualifying Australian resident performers, production associates, sportsperson, authors (including artists, composers, and writers), and inventors with irregular or abnormal cycles of income. Average taxable professional income is taxed at an average rate over a period of five years, the key benefit of which is a reduction in tax.[274]

2. Primary Producers

Individuals who carry on a primary production business in Australia for two or more income years in a row may be entitled to calculate the tax on their taxable income at the rate applicable to their taxable income as averaged over a period of five years. Lower taxable income in the years before the income year under review will therefore produce an average income lower than the taxable income for the year and may result in application of a lower tax rate. The benefit of the averaging provisions is restricted to the primary production income included in the taxable income.[275]

3. Medicare Taxes

To help finance Australia's national public healthcare system, known as Medicare, a 2% levy applies to the taxable income of resident individuals.[276] Subject to deductions and exemptions for low-income earners, the Medicare levy is an additional tax to personal income tax. The current taxable income threshold is A$24,276 for individuals and A$40,939 for families (including sole parent families). Taxpayers with taxable income below these amounts are exempt from the Medicare levy.

In addition, a separate Medicare Levy Surcharge, ranging from 1% to 1.5% of taxable income, applies to medium and high-income earners without adequate private health insurance coverage.

4. Future Reduction in Tax Rates

The Australian Government has announced further personal income tax cuts that will take effect over two income years. From July 1, 2026, the marginal rate of 16% applying to the taxable income band AUD 18,201–AUD 45,000 will be reduced to 15%, with a further reduction to 14% from July 1, 2027. These measures are framed as additional cost-of-living relief and are intended to keep fiscal settings consistent with inflation returning sustainably to the Reserve Bank of Australia's target band.

The combined tax cuts will lower average tax rates for all taxpayers, particularly low- and middle-income taxpayers. Treasury analysis published alongside the Budget projects nominal household disposable income to be about 1.9% higher by reference to 2027–8 versus 2023–4 tax settings (see https://budget.gov.au/content/01-cost-of-living.htm#m1).

[274] ITAA 1997, Div. 405.

[275] ITAA 1997, Sec. 392.

[276] Medicare Levy Act, 1986 and ITAA 1997, Secs. 251R–251Y.

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XI. Taxation of Nonresident Individuals

A. *Nonresidents*

Nonresident individuals are subject to the same general jurisdictional limits as for foreign companies and are subject to the same withholding tax rules (see VI., above).

A resident individual who becomes a nonresident is viewed as having disposed of his or her assets that are not taxable Australian property for their current market value at the time of the change in residency. Such individual can elect to defer this deemed disposal capital gains tax (CGT) event to the date when the assets are sold (or to when some other CGT event occurs). In this case, these assets are deemed to be a taxable Australian property until the relevant CGT event occurs.

A point of distinction in the taxation of nonresident individuals is that double tax treaties usually contain favorable provisions applicable specifically to them (see XV.B., below).

B. *Temporary Residents*

Australia limits the tax payable by foreigners who stay in Australia for a limited period of time. The objective of these rules is to counter the fact that, historically, the tax system has discouraged foreign expatriates from going to Australia, making it difficult for companies with an Australian presence to encourage foreigners to relocate there. Australia has a modified tax system for individuals in Australia who are "temporary residents."

A temporary resident is a person who:

(i) Holds a temporary visa granted under the Migration Act 1958;

(ii) Is not an Australian resident within the meaning of the Social Security Act 1991; and

(iii) Does not have a spouse who is an Australian resident within the meaning of the Social Security Act 1991.

Temporary residents include most expatriates coming to Australia for a fixed period work contract (for example, two to four years).

The consequences of being a temporary resident are that:

(i) Ordinary and statutory income with a foreign source (other than employment income derived whilst a temporary resident) is not subject to Australian tax; and

(ii) Capital gains made on assets that are not taxable Australian property (see VI.B.1.a., above) are not subject to Australian capital gains tax.

In broad terms, with the exception of employment income, temporary residents are taxed as if they are nonresidents from a non-tax treaty country during the period they retain "temporary residency" status. There is no time limit on the temporary resident exemptions, the only proviso is that the individual continues to hold a temporary visa and continues to satisfy the temporary resident definition.

As noted above, employment income derived while an individual is a temporary resident is specifically excluded from the temporary resident income exemption. Whether employment income is subject to Australian tax will depend on ordinary income tax principles such as where the employment services were provided, whether the temporary resident is a resident or nonresident for tax purposes and whether certain income tax exemptions for residents working overseas in sections 23AF and 23AG of ITAA 1936 can apply.

The concept of a temporary resident is not mutually exclusive from the concept of a nonresident or Australian resident. This is due to the fact that the definition of "resident" for the purposes of the Social Security Act 1991 is different (i.e., narrower) than that contained within the taxation legislation. As such, a temporary resident may be either a nonresident or an Australian resident for more general tax purposes. These latter classifications as a tax resident or nonresident are important in determining whether a temporary resident's employment income (being specifically excluded from the temporary resident income exemption) is otherwise subject to Australian tax. Individuals that are not resident for tax purposes are not subject to Australian tax on their foreign-sourced employment income.

There are special rules relating to the taxation of shares and options obtained by a temporary resident under an employee share scheme (ESS). The rules have the following implications:

(i) Discount on the consideration payable by a temporary resident to acquire ESS shares or options is subject to Australian income tax; and

(ii) Capital gains made by a temporary resident on the disposal of ESS shares or options are subject to Australian capital gains tax, to the extent to which the discount and/or capital gain relate to the period the temporary resident was either an Australian resident or undertaking their employment activities in Australia. This means that nonresidents may be subject to tax in Australia on gains from the disposal of shares that are not taxable Australian property if they relate to performance of employment duties in Australia. This result is arguably counter-intuitive to the general aims of the temporary residence rules, which were enacted for the purpose of encouraging skilled foreign expatriates to come to work in Australia. For instance, previously, where a nonresident individual worked in Australia on a temporary basis, was assessed on the discount on acquisition of the ESS shares/options and then left Australia, they generally would not have been subject to Australian capital gains tax on a subsequent disposal of their ESS shares or options even if those shares or options were acquired during the period they were employed in Australia. Under the new rules contained in Division 83A of ITAA 1997, a portion of the benefit of such shares and options related to the Australian employment is taxable.

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C. Tax Rates

For the year to June 30, 2025 and following, the individual income tax rates for foreign residents are as follows:

Taxable Income (A$)	Tax Payable (A$)
0–135,000	30%
135,001–190,000	40,500 + 37% of excess over 135,000
190,001 and over	60,850 + 45% of excess over 190,000

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XII. Estate/Inheritance/Transfer and Gift Taxes

There are no federal or state estate, death or gift duties or taxes.

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XIII. Transfer Pricing

A. *Disclosure Requirements*

Taxpayers are required to file an international dealings schedule (IDS) and/or a reportable tax position schedule (RTPS) with their tax return if they meet certain criteria. These schedules assist the ATO in identifying profit shifting risks and in selecting cases for reviews or audits.

Most multinationals with an Australian presence, and Australian corporates with offshore operations, will be required to lodge an IDS. This is because an IDS is required from any taxpayer that:

(i) Pays interest or royalties offshore;

(ii) Is affected by the Division 820 thin capitalization rules;

(iii) Qualifies for Section 46FA deductions for flow-on dividends;

(iv) Has offshore operations held in a branch or foreign entity; or

(v) Has foreign related party dealings of A$2 million or more.

The Australian IDS is regularly updated, and usually includes new disclosure requirements each year.

The IDS imposes obligations to disclose information on (but not limited to) the following:

(i) International related party transactions (including restructuring events, cost contribution arrangements, receipts or payments of non-monetary consideration);

(ii) Financial arrangements;

(iii) Interests in foreign entities;

(iv) Thin capitalization;

(v) Specific rules for financial entities;

(vi) Hybrid mismatches;

(vii) Details of arm's length methodologies used; and

(viii) The level of documentation held to support the selection and application of the most appropriate arm's length methodologies.

Taxpayers that are engaged in dealings with foreign related parties and have related party dealings of A$2 million or more are required to complete an IDS with their income tax return for the year by the due date. The IDS replaced the old Schedule 25A and significantly increases disclosure requirements for taxpayers. It imposes obligations to disclose information on (but not limited to) the following:

(i) The nature and amount of certain categories of transactions;

(ii) Details of dealings of a financial nature;

(iii) Receipts or payments of non-monetary consideration;

(iv) Details of restructuring events;

(v) Details of arm's-length methodologies used; and

(vi) The level of documentation held to support the selection and application of the most appropriate arm's-length methodologies.

If a taxpayer voluntarily lodges Part A of its local file at the same time as its income tax return, questions 2 to 17 of the IDS (most of the questions relating to international related party transactions) do not need to be completed.

The ATO also requires large businesses to disclose their most contestable and material tax positions in a RTPS, to be attached to their annual income statements. The RTPS is a schedule to the company income tax return and should be completed by a public company or a foreign-owned company with total business income of A$25 million or more in the current tax return, and that is part of a group with total business income of A$250 million or more in the current year. A company must also file the RTPS if it is notified by the ATO to do so.

The RTPS includes three types of transactions that need to be disclosed:

(i) Category A: where, given relevant authorities, the position taken is either about as likely to be correct as incorrect; or less likely to be correct than incorrect. This may include circumstances that are "reasonably arguable", based on administrative or industry practice (without appropriate legislative support), transfer pricing positions not covered by Section 284-255, compliant contemporaneous transfer pricing documentation;

(ii) Category B: where an entity prepares financial statements in accordance with the relevant accounting standards, including but not limited to applying AASB Interpretation 23 (uncertainty over income tax treatments) in recognizing, measuring and disclosing uncertain tax positions, and has recognized an uncertain tax position and/or disclosed a contingent liability for a position (asset) in its financial statements for the corresponding income year; and

(iii) Category C: this category requires the disclosures of specific arrangements of concern and self-assessed risk ratings for arrangements covered by the ATO's Practical Compliance Guidelines (PCGs). Each year the ATO publishes what it has learned from Category C disclosures for public and multinational businesses, and areas of focus.

Taxpayers are required to specify which of the various Organization for Economic Cooperation and Development (OECD) transfer pricing methods they apply, the levels of documentation they hold in respect of each method, and the proportion of the international related party dealings each method applies to. The OECD methods available for transfer pricing purposes are discussed in greater detail in XIII.B., below.

For further discussion of the Australia transfer pricing system, see also Chapter 10 of 6940 T.M., *Transfer Pricing: Rules and Practice in Selected Countries (A–B).*

B. *International Profit Shifting*

1. *In General*

A multinational company with operations in Australia will need to ensure that its documentation processes meet the standards in Australia, which are generally aligned with OECD de-

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velopments and practice. Australia's transfer pricing rules include specific references to the OECD Base Erosion and Profit Shifting (BEPS) amendments to the OECD Transfer Pricing Guidelines as formally approved by the OECD in May 2015. The updates to these guidelines generally focus on issues relating to transactions involving intangibles, the contractual allocation of risks and corresponding profits where the risks and profits are not supported by activities actually carried out, and the appropriate level of returns to intra-group funding.

The 2015 OECD Transfer Pricing Guidelines — Aligning Transfer Pricing Outcomes with Value Creation, Actions 8–10 — 2015 Final Reports — provide new (and more comprehensive) guidance on the application of transfer pricing rules and the arm's length test. The 2015 OECD Transfer Pricing Guidelines have changed what is required to be prepared for transfer pricing purposes. The rules, which apply in Australia as from income years beginning on or after December 31, 2017, call for a more thorough, two-sided analysis of risk, including analysis of how and where risks are substantively managed and controlled (as opposed to the prior rules).

However, there are some important differences between the OECD and Australia's domestic laws. At a minimum, this means that multinationals will need to carefully consider whether existing documentation processes meet the new technical and timing standards in Australia for their related-party dealings. Areas that will continue to be the focus of attention will include intra-group debt arrangements, historical loss positions, business restructures, and previous and future tax and financial disclosures. Importantly, the amendments will not result in Australia adopting the OECD Authorized Approach for attributing profits to a permanent establishment (PE). Australia is currently guided by the OECD Commentary as it read before July 22, 2010, i.e., Australia follows the Relevant Business Activity Approach when attributing profits to an Australian PE.

2. Scope of the Provision

Subdivisions 815-B to D of the Income Tax Assessment Act 1997 (ITAA 1997) to ensure that consistent rules apply to both tax treaty and non-tax treaty cases, and to relevant dealings between parties as to whether they are associated. In addition, subdivision 284-E of Schedule 1 to the Taxation Administration Act 1953 (TAA 1953) contains new rules related to transfer pricing documentation.

3. Basic Rule

Subdivision 815-B covers dealings between separate legal entities. It requires certain amounts (taxable income, a loss of a particular sort, tax offsets and withholding tax payable) to be worked out by applying the "internationally accepted arm's-length principle." Broadly, this principle is brought into the domestic law by requiring the commercial and financial conditions operating between entities, and which produce a transfer pricing benefit, to be replaced with the arm's-length conditions. The identification of arm's-length conditions involves hypothesizing what independent entities dealing at arm's length would have done in the place of the actual entities in comparable circumstances. If that exercise results in a transfer pricing benefit to the taxpayer, a tax adjustment must be made accordingly.

Generally, the rules are intended to be self-executing, consistent with Australia's self-assessment system, but also provide for consequential adjustments, at the discretion of the Commissioner. The rules are to be applied as consistently as possible with relevant OECD guidance. There are also equivalent rules for partnerships and trusts.

4. Reconstruction Provisions

The "basic rule" must be applied taking account of the form and substance of the actual conditions between the parties. Broadly, this is intended to limit the Commissioner's ability to hypothesize conditions outside the actual commercial arrangements of the parties. However, there are exceptions to the basic rule. Where an exception applies, the reconstruction provisions in Section 815-130 of Subdivision 815-B empowers the Commissioner to disregard the actual commercial or financial relations in order to reconstruct transactions for the purpose of identifying arm's-length conditions and making a tax adjustment. Broadly, these exceptions exist where:

(i) The form and substance of the arrangements are not consistent; or

(ii) Parties who deal wholly independently with one another in comparable circumstances would not have dealt with each other in that way, or at all.

5. Permanent Establishments

Subdivision 815-C applies to cross-border dealings involving a single entity, such as between the head office of a non-resident foreign entity and its Australian PE or the head office of an Australian resident entity and its foreign PE. The rules operate to ensure that the attribution of income and expenses of the entity between its parts is reflective of an allocation that could be expected if the parts of the entity were separate entities dealing wholly independently with each other. The decision of whether to adopt the more complex OECD-endorsed separate entity approach continues to be the subject of a separate domestic law review. However, under current law, the separate entity approach is not applied. That is, there needs to be an allocation of actual receipts and outgoings in accordance with internationally accepted arm's-length principles (as opposed to creating notional transactions between the PE and head office).

6. Documentation and Limitations Period for Assessment

Subdivision 284-E of Schedule 1 of the TAA 1953 explains the current documentation standards, which did not previously exist. Documentation continues not to be mandatory; however, penalty risk will only be reduced by preparing and maintaining contemporaneous, supporting documentation that meets a "reasonably arguable position" standard. Bringing this within the self-assessment regime will mean extra responsibility on those charged with tax risk management, including directors and public officers.

There is now a limitation period on transfer pricing adjustments of seven years from the date of assessment. Previously, there was no limitation period.

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C. Country-by-Country Reporting

1. In General

Australia's master file and local file requirements are part of the country's implementation of the OECD's Country-by-Country (CbC) reporting regime, designed to enhance transparency in transfer pricing and international tax compliance for multinational enterprise (MNE) groups. The requirements are legislated under Subdivision 815-E of the Income Tax Assessment Act 1997 and closely follow the OECD Transfer Pricing Guidelines.

An Australian entity which is a member of a group with a global annual turnover of more than A$1 billion (referred to as a Country-by-Country (CbC) reporting entity) needs to lodge a CbC report, a Master File and a Local File with the ATO. These three documents must be lodged with the ATO within 12 months of the year-end. CbC reporting applies to an entity that is a CbC reporting entity for the income year proceeding the relevant income year. When CbC reporting entity status triggers CbC reporting obligations depends on the start date of a taxpayer's income year. CbC reporting entities are a subset of significant global entities (SGEs) that are required to provide CbC reports and general purpose financial statements (GPFS) to the Australian Taxation Office (ATO) if they have not been filed with the Australian Securities and Investments Commission (ASIC).

2. Master File

The Master File provides a high-level overview of the global business operations, transfer pricing policies, and allocation of income and economic activity of the MNE group. Its purpose is to assist tax authorities in evaluating significant transfer pricing risks.

The content of the Master File must align with Annex I to Chapter V of the OECD Transfer Pricing Guidelines. This includes:

- Organizational structure: A chart illustrating the MNE's legal and ownership structure and geographical location of operating entities;
- Description of the MNE's business: Including important drivers of business profit, supply chain for the group's five largest products/services, and any products/services exceeding 5% of group turnover;
- Intangibles: A description of the group's overall strategy for the development, ownership, and exploitation of intangibles, including a list of important intangibles and which entities legally own them;
- Intercompany financial activities: Details of how the group is financed, including identification of central financing functions; Financial and tax positions: The group's annual consolidated financial statements and a list of and brief description of the group's existing unilateral advance pricing agreements (APAs) and other tax rulings.

The Master File must be lodged in English.

The Australian reporting entity is generally required to lodge the Master File unless exempted.

3. Master File Exemption

The ATO has provided some administrative concessions in relation to the CbC report and the Master File to avoid duplication. Broadly, if the CbC report will be lodged by a foreign parent entity with its local tax authority (e.g., the Internal Revenue Service of the United States) and there are appropriate automatic exchange of information arrangements in place with the ATO (which is the case between the United States and Australia), then the ATO will obtain the CbC report though exchange of information with the foreign tax authority. There will thus be no need to provide the CbC report locally.

4. Local File

The information to be included in the local file is listed in Annex II to Chapter V of the Transfer Pricing Guidelines. The contents of the ATO's long form local file closely follow OECD guidance in Annex II to Chapter V. Short form lodgment requirements are significantly less.

The components of the information required are set out below:

Section	Requirement to Lodge
1. Short form Local File	All entities
2. Local File Parts A and B	Long form Local File lodgers only
3. Financial statements	Long form Local File lodgers only

The Local File contains mostly factual information on the cross-border related party transactions entered into by each Australian entity (but does not have functional analysis or benchmarking, etc., which forms part of the separate transfer pricing documentation). The Local File also requires copies of intercompany legal agreements to be lodged with the ATO (where they exist). Part A of the Local File is essentially equivalent to what would otherwise be included at questions 2 to 17 of the Australian International Dealings Schedule, (IDS) which is typically filed with the Australian tax return. Taxpayers have the option of voluntarily lodging Part A of their Local File early (at the same time as their tax return), thereby relieving them of the need to complete Questions 2 to 17 of the IDS. In practice, many taxpayers are opting to lodge the entire Australian Local File at the same time as their tax return, to avoid having to make a subsequent filing of the remaining sections of the Local File.

A reporting entity may lodge a short form of the local file if, because of the scale of the entity's business operations and complexity, it is deemed to have a low risk of requiring a transfer pricing adjustment. Specifically:

- The entity must have no IRPDs that are (i) derivatives (e.g. swaps, forwards, future or options in respect of interest rates, currency, commodities or other assets), (ii) assignments or license of intellectual property (or similar property or rights, or any part thereof), or (iii) of a capital nature; and

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- The entity must meet at least one of the following materiality standards: (i) the aggregate value of its IRPDs is less than A$2m; (ii) the simplified transfer pricing record-keeping (STPRK) criteria for small taxpayers or materiality.

The short form Local File requires high-level disclosures about five aspects of your local Australian entities and operations:

(i) Organizational reporting structure including overseas reporting lines for local functions;

(ii) Business and strategy;

(iii) Business restructures including significant changes in ownership structure, related party funding arrangements, assets or operations;

(iv) Transfer of intangibles including associated related party licensing or service arrangements;

(v) Key competitors.

Part A of the Local File contains detailed information about all "international related party dealings" (IRPD), including: the name and country of residence of counterparties; the type of transaction; consideration; the transfer pricing method relied on; and other transactional data that is also required when completing the IDS, such as the capital asset pricing methodology.

Under an ATO administrative concession, the reporting entity can show aggregated values at Part A for all agreements in a "relevant agreement series".

Part B of the Local File requires the reporting entity to provide copies of agreements for the transactions shown at Part A and other information relating to those transactions. Additional guidance can be found on the ATO website.

Additional guidance regarding the contents of Local File Part A and Part B and the required financial statements can be found on the ATO website.[277]

Companies are required to provide a sufficient level of information and detail to ensure the ATO is informed about activities:

- Formal and effective overseas reporting lines for functions and staff, including any dual or multiple reporting lines;

- Significant changes in ownership or related party funding structures, including any resulting cross border tax hybrid arrangements;

- Significant disposals, acquisitions, commencement or cessation of operations;

- Transactions or dealings connected with relevant changes or transfers.

Comment: Whether a change is significant includes consideration of the anticipated impact on a company's Australian tax liabilities, including withholding tax liabilities, for the reporting period or following income years compared to the circumstances before the change. Where there has not been any significant changes in ownership or related party funding structures, disposals or acquisitions, or commencement or cessation of operations, this should be positively stated in the short form Local File.

From January 1, 2025, CbC reporting entities must use the updated Local File/Master File (LCMSF) service for lodgments covering periods beginning on or after January 1, 2024. These changes are designed to improve risk detection and reduce follow-up on incomplete information.

D. Public Country-by-Country Reporting

1. In General

As discussed in XIII.C., above, under Australia's current transfer pricing reporting obligations contained in Subdivision 815-E of the ITAA 1997, country-by-country (CbC) reporting entities with a sufficient connection to Australia are subject to confidential CbC reporting obligations, including a Master File, Local File and CbC reports. They are disclosed on a confidential basis, implementing key features of the BEPS Action 13 recommendations. The application of Subdivision 815-E is generally limited to Australian tax resident entities, whereas Section 815-355 of Subdivision 815-E applies to foreign entities carrying on business through an Australian permanent establishment and partnerships with at least one Australian partner (among other entities).

The Australian Government has introduced a number of targeted measures to improve corporate tax transparency disclosures in Australia. This has been consistent with a number of global measures that have been introduced in the past few years and which have focused on transparency and accountability in corporate disclosures. In particular, public CbC reporting was implemented by the European Union in December 2021, through Directive (EU) 2021/2101.

The public CbC reporting rules are one such measure. It implements a new public reporting requirement in addition to the existing confidential CbC reporting regime. The information is to be published on an Australian Government website, with publication facilitated by the ATO Commissioner. The objective of these amendments is to assist investors and the public to compare entity tax disclosures and assess whether an entity's economic presence in a jurisdiction aligns with the amount of tax they pay in that jurisdiction, with the aim of improving corporate tax transparency.

These measures will require the parent entity of CbC reporting groups to provide specified information to the Commissioner in an approved form, including a summary of the information currently provided in the CbC report.

The public CbC rules apply to years of income that started on or after July 1, 2024. CbC reporting parent companies will be required to provide the public CbC reports within 12 months after the end of the income year to which the reporting obligation relates.

2. Reporting Obligation

The public CbC reporting measures are imposed on the CbC reporting parent company, as defined in Section 815-375 of ITAA 1997. A CbC parent company is the head entity of a CbC reporting group (i.e., it is not controlled by any other

[277] See: https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/country-by-country-reporting/local-file-master-file-2024/local-file.

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member of the CbC reporting group), where the annual global consolidated income of the group is A$1 billion or more for the relevant period.

For the CbCR parent to be within the scope of the measures, it must be one of the following:

- A constitutional corporation;
- A partnership in which each of the partners is a constitutional corporation; or
- A trust in which each of the trustees is a constitutional corporation.

The concept of a constitutional corporation is defined in Section 995-1 of ITAA 1997, and it refers specifically to paragraph 51(xx) of the Australian Constitution. Broadly, constitutional corporations are either foreign corporations, or trading or financial corporations formed in Australia.

Accordingly, a broad range of entities are covered and there are currently no carve-out provisions for specific entities. The Commissioner may exclude specific entities or classes of entities from having to publish the required information through a written notice or by implementing a legislative instrument. Practice Statement PS LA 2025/D1 provides guidance to staff about exercising the Commissioner's discretion to grant an exemption from public CBC reporting obligations. This includes guidance on how the Commissioner will administer the exemption and the information entities should provide with their exemption application. The draft PS LA is open for consultation until September 5, 2025. We understand that further guidance will be provided later this year as to the types of entities will be excluded as part of this consultation process.

Government-related entities may be relieved from the public CBC reporting regime under a specific exclusion. This includes: (i) a department of the State of the Commonwealth; (ii) a Department of the Australian Parliament established under the Parliamentary Services Act 1999; (iii) an executive agency or statutory agency, within the meaning of the Public Service Act 1999; (iv) a department of state of a state or territory; (v) a local government body established by or under a state or territory law; (vi) and various other government entities. A government-related entity can be relieved from the regime by written notice from the Commissioner.

Significantly, a CbC reporting parent company is subject to the public CbC reporting measures as long as one member of the CbC reporting group is an Australian resident or a foreign resident operating through an Australian permanent establishment, and A$10 million or more of its aggregate turnover was Australian sourced.

Public CBC reporting parents can register with the ATO. It allows for more efficient processing and helps to simplify the process of giving the public CBC report to the ATO; requesting an extension of time to provide the public CBC report; and requesting an exemption from reporting obligations for a reporting period.

Registration enables a reporting parent entity to provide authorization for representatives to act on its behalf. This includes having representatives satisfy its obligations, such as lodging the report or applying for a reporting exemption. Representatives can include designated officers or employees, an adviser, or other nominated person. The public CBC registration form is in a fillable portable document format (PDF) on the ATO website.[278]

3. *Scope of Disclosure*

The public CbC reporting measures require the CbC reporting parent to disclose tax information for each jurisdiction in which the CbC reporting group operates. For Australia and specified jurisdictions determined by the Minister, particular information must be published on a CBC basis. For operations in other jurisdictions, the public CBC reporting parent has the choice to publish information on an aggregated basis. The Minister's determination of jurisdictions for specified jurisdictions are outlined in the Taxation Administration (Country by Country Reporting Jurisdictions) Determination 2024.

There are no limitations on this obligation for non-cooperative jurisdictions, "grey listed" entities, or particular geographies.

Australia proposes to require the disclosure of a number of additional items that are not covered by the confidential CbC report or the EU public CbC reporting rules.

The following information is required (either on a specified entity or aggregate basis):

- Description of main business activities;
- Number of employees (on a full-time equivalent basis) at the end of the reporting period;
- Revenue from unrelated parties;
- Revenue from related parties that are not tax residents of the jurisdiction;
- Profit or loss before income tax;
- Book value at the end of the reporting period of tangible assets, other than cash and cash equivalents;
- Income tax paid (on a cash basis);
- Income tax accrued (current year);
- Reasons for the difference between income tax accrued (current year) and the amount of income tax due if the income tax rate applicable to the jurisdiction were applied to profit and loss before income tax; and
- Currency used in calculating and presenting the above information.

4. *Regulatory Powers*

The Australian Government has the power to prescribe further tax information for reporting entities to publish in addition to the list set out in the legislation. The regulations may be subject to disallowance and, therefore, will be subject to appropriate parliamentary scrutiny. Hence, the Government's regulation making power is likely subject to the Australian Parliament's disallowance process, such that either House may disallow such a legislative instrument: see Section 42 of the Legislation Act 2003 (Cth).

The Commissioner may specify classes of entities that are exempt from the public CbCR measures via legislative instru-

[278] See: https://www.ato.gov.au/forms-and-instructions/public-country-by-country-cbc-registration-form.

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ment (noting that this is not a legislative power as it is administrative in character).

Section 25 of the Administrative Appeals Tribunal Act 1975 (Cth) (AAT Act) sets out that an enactment may provide that applications may be made to the Administrative Appeals Tribunal (AAT) for the review of decisions made in the exercise of powers conferred by that enactment. 'Enactment' is defined as an act or an instrument (including rules, regulations or by-laws) made under an act.

5. Non-Compliance

If CbC reporting parent companies do not comply with the proposed measures to provide the relevant disclosures on a jurisdiction-by-jurisdiction basis, the penalty provisions that the Commissioner may seek to enliven in Australia's tax legislation are Part III of the TAA (Sections 8C and 8E). Section 8E of the TAA provides that a Section 8C offence is punishable on conviction by a fine not exceeding 20 penalty units for a first offence (a unit being A$313).

Accordingly, the applicable fines under Section 8E are:

• If the offence is the first offence, a fine not exceeding 20 penalty units (A$6,260);

• If the court is satisfied that the person has previously been convicted of a 'relevant offence', a fine not exceeding 40 penalty units (A$12,520);

• If the taxation offence is committed by a natural person, the court is satisfied that the person has previously been convicted of two or more 'relevant offences' and the Commissioner makes an election to treat the offence otherwise than as a prescribed taxation offence, a fine not exceeding 50 penalty units (A$15,650) and/or imprisonment for a period not exceeding 12 months; and

• If the taxation offence is committed by a corporation and the court is satisfied that the corporation has previously been convicted of two or more 'relevant offences', a fine not exceeding 250 penalty units (A$78,250).

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XIV. Special Provisions Relating to Multinational Operations

A. Controlled Foreign Companies

The controlled foreign company (CFC) provisions are anti-avoidance rules enacted with the objective of countering schemes involving the "parking" of income offshore in foreign companies — typically set up in tax havens. Very broadly, these rules apply by ensuring that Australian residents with interests in CFCs are subject to tax in Australia, on an accruals basis, on their share of specified types of concessionally taxed income of the CFC. The income of the CFC subject to tax in Australia on this basis is called "attributable income."

There are two mechanisms in the CFC rules designed to limit the extent to which this income is subject to double taxation. First, if the income of the CFC is subject to foreign tax, an Australian resident taxed on that income under the CFC rules will usually receive a tax credit for the foreign tax paid by the CFC.[279]

Secondly, if the attributable income is ultimately distributed by the CFC to an Australian resident company or individual that has previously been taxed on that income under the CFC rules, the distribution is exempt from Australian tax.

1. Threshold Requirements

For the CFC rules to apply to an Australian resident's shareholding in a foreign company, there must be various threshold requirements satisfied — specifically:

(i) The foreign company must be a "CFC;"

(ii) The CFC must have "attributable income" for a "statutory accounting period" in respect of an "attributable taxpayer;" and

(iii) The attributable taxpayer must be entitled to an "attribution percentage" with respect to the CFC.

Where these three threshold requirements are satisfied, the Australian resident attributable taxpayer must include in its assessable income its attribution percentage of the attributable income of the CFC at the end of the CFC's statutory accounting period. This can result in an Australian resident taxpayer being required to include in its assessable income an amount for which it is not entitled to the cash profits for many years — or worse — not at all.

These concepts are discussed in 2. to 6., below.

2. Definition of a Controlled Foreign Company

A foreign company qualifies as a CFC where:

(i) Five or fewer Australian residents, hold a 50% or more "associate-inclusive control interest" in the company; or

(ii) Both the following criteria are satisfied:

- There is a single Australian entity whose "associate-inclusive control interest" in the company is not less than 40%; and
- The company is not "controlled" (by reference to effective or *de facto* control) by a group of entities excluding the Australian entity; or

(iii) A group of five or fewer Australian entities, either alone or together with associates, effectively controls the foreign company.[280]

The associate-inclusive control interest an Australian entity has in a foreign entity at any time is the total of what the Australian entity (or its associates) holds, or is entitled to acquire, directly or indirectly, in:

(i) The total paid-up share capital of the company;

(ii) The total rights of shareholders to vote, or participate in any decision making regarding specified issues; or

(iii) The total rights to the distribution of capital or profits of the company to its shareholders on a winding up or otherwise.

If different percentages apply, the greater or greatest of the percentages is used. That is, the associate inclusive control interest an Australian resident has in a CFC may be quite high (say, if they are entitled to 100% of the voting rights in the company) even though they have no (or little) rights to the income or capital from the foreign entity.

3. Attributable Income

If a company is a CFC, the next step is to determine whether the CFC has any attributable income.[281]

The calculation of attributed income depends upon whether the company is from a "listed" or "unlisted" country.

Listed countries are the United Kingdom, United States, New Zealand, Germany, France, Canada and Japan. The basic types of income from these jurisdictions that can be caught by the CFC rules as attributable income are set out in Worksheet 2. This list is fairly short. It is based on the logic that these countries have taxing regimes comparable to Australia and, consequently, with the exception of certain "anomalies" (when compared to the Australian domestic taxing regime), are unlikely to be countries in which an Australian resident would park income to avoid tax.

For unlisted countries the CFC rules will generally apply to adjusted tainted income. The components of adjusted tainted income are set out in Worksheet 3. Very broadly, adjusted tainted income is limited to income from "passive" investments, and income derived from the sale of goods or provision of services to entities with a connection with Australia. That is, an exemption generally applies from the foreign income accruals system for active income derived by a CFC unrelated to Australia. Income derived by a CFC from active trading or manufacturing operations is not generally to be included in the attributable income of a CFC.

4. Statutory Accounting Period

A CFC's annual statutory accounting period is deemed to end on June 30, unless an election is filed with the ATO to vary the accounting period.

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[279] ITAA 1936, Part X.

[280] ITAA 1936, Sec. 340.

[281] ITAA 1936, Sec. 456.

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5. Attributable Taxpayer

An Australian entity is an attributable taxpayer in respect of a CFC if it, and its associates, have an associate-inclusive control interest in the CFC of 10% (or more).

The concept of an associate-inclusive control interest has been set out in 1., above, regarding the definition of a CFC.

The effect of this 10% test is that it excludes from the application of these CFC rules relatively small investments/interests in foreign companies (although these may be caught by the FIF rules discussed below).

6. Attributable Percentage

If the requirements of 2., 3. and 5., above, are satisfied, the attributable taxpayer will be taxed on its attributable percentage of the attributable income of the CFC.

An attributable percentage is equal to the associate — inclusive control interest it holds. That is, interests held by associates are ignored. This can have the effect that even though a company is an attributable taxpayer (as a consequence of an interest held by an associate), the entity's attribution percentage is nil.

7. Migration of a CFC

Where a company changes residence from Australia to a listed or unlisted country and is a CFC following the change, all assets of the company are deemed to have been acquired on the date of change of residence.

An exemption applies from the foreign income accruals system for active income derived by a CFC in a noncomparable tax jurisdiction. Income derived by a CFC from active trading operations is not required to be accrued to an Australian resident holding a prescribed interest in the CFC. For instance, despite the fact that interest is passive income, interest derived by a foreign subsidiary of an Australian bank may not be attributable under the CFC rules.

Where, as a result of a CFC changing its residence from an unlisted country to a listed country or to Australia, an amount is included in a resident taxpayer's attributable assessable income, Section 457 of ITAA 1936 allows the taxpayer to elect to defer the attribution of so much of the attributable amount as relates to unrealized gains on an asset, until the CFC pays a dividend out of the gain derived from the disposal of the asset.

The scope of the tax exemption that applies to distributions of CFC income that have already been attributed under the CFC measures was broadened to include distributions of attributed income to corporate unit trusts, public trading trusts and superannuation trusts taxed as separate taxpayers.

Where an unlisted country CFC changes its residence to Australia and distributes its profits to a resident taxpayer, no attribution debit arises with respect to the distribution, so that the taxpayer is not taxed on both the CFC's attributable and actually distributed income.

B. Controlled Foreign Trusts

Similar (and more complicated) rules exist in relation to income accumulated in offshore foreign trusts referred to in the transfer trust provisions of Division 6AAA of Part III of ITAA 1936.

Very broadly, income of a foreign trust that is not taxed in a comparable tax jurisdiction, but can be accrued to an Australian transferor, is subject to Australian tax on distribution to an Australian resident at normal tax rates, plus an additional tax calculated as an interest charge applied from the time the trust derived the income to the time it is taxed in Australia. Income of a foreign trust taxed in a comparable tax jurisdiction is not subject to the additional tax on distribution to an Australian resident.

C. Thin Capitalization

The object of the thin capitalization rules is to limit the extent to which multinationals with an Australian taxable presence can reduce their domestic Australian tax base through the use of debt generating excessive deductions, which amount to base erosion or profit shifting arrangements.

These provisions are in Division 820 of ITAA 1997 and apply to multinational organizations, specifically to:

(i) Australian entities that operate offshore through a permanent establishment or through an entity that it controls; (Outward Investing Entities); and

(ii) Foreign entities that derive assessable income in Australia or an Australian entity that is foreign controlled (Inward Investing Entities);

collectively referred to as "General Class Investors".

Excluded from the scope of General Class Investors are specified types of financial entities referred to as "Financial Class Investors" and "Authorized Deposit Taking Institutions" or "ADIs" for which different rules apply (acknowledging the fact that debt limitation rules applicable for corporates are generally not appropriate for entities in the financial services industry).

1. Outward Investing Entities

An entity is an Outward Investing Entity for all or part of a year of income if:

(i) It carries on business at an overseas PE;

(ii) It has a specified type of controlling interest in an Australian-controlled foreign company, Australian-controlled foreign trust or Australian-controlled foreign corporate limited partnership or is a general partner of a foreign corporate limited partnership; or

(iii) It is an associate entity of an Outward Investing Entity.

2. Inward Investing Entities

Broadly, an entity will be an Inward Investing Entity if:

(i) Five or fewer foreign entities hold a controlling interest of 50% or more;

(ii) A foreign entity exercises de facto effective control over the Australian entity; or

(iii) The entity derives assessable income in Australia (not necessarily limited to Australian branch operations).

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3. *Application of Provisions*

Where these provisions apply, they limit the extent to which the Australian business can be geared with deductible funding. The available gearing caps depend on the type of entity:

(i) For General Class Investors: the fixed ratio test is the primary test, and it allows an entity to claim "net debt deductions" up to 30% of the entity's "tax earnings before interest, taxes, depreciation and amortization (EBITDA)". General Class Investors may choose to substitute the 30% threshold with a "group ratio test", which allows an entity to deduct net debt deductions based on the parent entity's "group ratio" of tax EBITDA. General Class Investors also have available a "third party debt test", which allows a deduction for all qualifying third party debt. Third party debt for these purposes excludes debt raised from, or guaranteed by, entities with 20% or more common ownership. A choice to use the "group ratio test" or "third party debt test" must be made in an approved form on or before the day the entity lodges or is required to lodge its income tax return;

(ii) Financial entities (other than banks) are entitled to borrow up to 93.75% of the value of the entities' Australian assets (referred to as 15:1 gearing ratio, depending on their activities) or rely on a:

(1) "worldwide gearing debt test" — which allows an entity's Australian operations to be geared up to 100% of the gearing of the worldwide group (by reference to assets); or

(2) the "third party debt test"; and

(iii) Australian banks are required to retain equity capital of at least 6% of their risk-weighted Australian assets, plus an additional amount for certain Australian assets the Australian Prudential Regulation Authority (APRA) requires capital to be held against.

"Tax EBITDA" is a new concept. It is determined for an income year as follows according to Australia's income tax rules:

- Step 1: Work out the entity's taxable income or tax loss for the income year (disregarding the operation of the thin capitalization rules and treating a tax loss as a negative amount);
- Step 2: Add the entity's 'net debt deductions' for the income year;
- Step 3: Add the sum of the entity's decline in value and capital works deductions (if any) for the income year (very broadly, as determined under Divisions 40 and 43). Subject to step 4, the result of step 3 is the entity's tax EBITDA for the income year; and
- Step 4: If the result of step 3 is less than zero, the taxpayer has to treat it as being zero.

By contrast, as noted above, the group ratio test relies on the parent's financial accounts (accounting concepts). It was introduced to account for the main short fall of the fixed ratio test, that it is an inflexible test that does not accommodate the fact that different sectors may be leveraged differently for genuine commercial reasons. The group ratio test supplements the operation of the fixed ratio test and accounts for more highly leveraged industries. An entity's 'group ratio' for an income year is worked out according to the following steps:

- Step 1: Work out the group net third party interest expense (payments between group members and their associate entities are disregarded);
- Step 2: Work out the group EBITDA;
- Step 3: Divide the result of step 1 by the result of step 2; subject to step 4, the result of step 3 is the entity's group ratio for the income year; and
- Step 4: If the result of step 2 is zero, the entity's group ratio for the income year is zero.

In certain cases, entities are entitled to rely on other gearing ratios that are based on: (i) what is acceptable as an arm's-length amount of gearing by reference to market standards within a particular industry; or (ii) gearing levels based on the worldwide gearing level for the multinational group.

Financial entities must comply with accounting standards applicable under the Corporations Law for the purpose of determining what are the entities' assets and liabilities and their value.

Comment: As discussed in II.F.3., above, Australia is compliant with International Financial Reporting Standards. Taxpayers are required to do their calculations for thin capitalization purposes using International Financial Reporting Standards, with some modifications.

4. *Debt Creation Rule — Division 820-EAA*

The debt creation rules, also known as the debt deduction creation rules (DDCR), are contained in Subdivision 820-EAA of the Income Tax Assessment Act 1997. These rules were introduced to address the risk of taxpayers obtaining excessive debt deductions through arrangements involving the creation of debt in connection with acquisitions from, or payments to, associate entities (referred to as an "associate pair").

Key features of the debt creation rules include a disallowance of debt deductions to the extent they are incurred in relation to the acquisition of CGT assets from an associate and financial arrangements entered into to fund certain payments or distributions to one or more associates.

The rules apply to certain non-ADI entities subject to Division 820, provided their total debt deductions (including those of associates) exceed A$2 million for the income year.

The rules are very broad in scope. As a very simple example, an amount borrowed from a related entity for the purpose of paying a dividend to a parent/shareholder would fall within the scope of the provisions. Similarly, an amount borrowed from a related entity as part of restructure to acquire an asset from a group entity could also be caught. The rules are designed on the premise that transactions with associates should not create deductible debt.

The DDCR are applied before the thin capitalization rules. If a debt deduction is disallowed under section 820-EAA, it is disregarded for the purposes of applying the thin capitalization rules.

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There is also a specific anti-avoidance rule (section 820-423D), and the general anti-avoidance rule (Part IVA) may also apply to restructures undertaken in response to these rules.

These rules can also apply to related party transactions entered into before the enactment of the provisions if the debt is still outstanding and the interest deductions are being claimed. This raises the difficult question of attempting to trace whether there is any direct or indirect relationship between existing debt and historic intragroup transactions. The taxpayer bears the onus of showing that the DDCR does not apply.

Comment: The inability to trace appropriately (noting historically these rules did not exist) is a material compliance issue, leading some multinationals to consider capitalizing debt (i.e., convert to equity) as the only sure way to manage both compliance costs and tax risk for existing debt.

The rules do not apply to certain entities if their total debt deductions (including those of associates) are less than A$2 million for the income year. Exclusions also apply for ADIs, securitisation vehicles, certain special purpose entities, and Australian plantation forestry entities.

The ATO has issued Practical Compliance Guideline PCG 2025/2, which sets out the compliance approach and risk assessment framework for restructures in response to the new rules. The guideline provides examples of low-risk and high-risk restructures and outlines the evidence and records expected to support positions taken. The ATO's risk assessment framework categorizes restructures into different risk zones (color coded as white, yellow, green, red) based on factors such as the underlying commercial rationale and the extent of related party involvement. The ATO will focus compliance resources on high-risk restructures, particularly those that appear to be undertaken primarily to maximize debt deductions. The final PCG is largely the same as the draft that was released as PCG 2024/D3. There is no material shift in the ATO's stance on these measures. This was a disappointing outcome given the number of submissions made on the original draft and its potential breadth of application, especially to transactions undertaken prior to the introduction of these rules.

Comment: Part of the difficulty in applying these rules is reflected in the manner in which they have been interpreted by the ATO. Advisors and taxpayers were hoping for something that interpreted the rules in a way that limited their literal scope of application.

Examples of what are acknowledged as low risk by the Commissioner are limited to circumstances such as:

- An acquisition of a land interest from a third party;
- Global cash pooling arrangements in which an Australian entity remains in a positive cash flow position at all times during the income year;
- An acquisition funded by related party bridging finance which is shortly repaid from proceeds of external financing, with no debt deductions arising from the related party debt;
- The repayment of all related party debt with retained earnings;
- The repayment of bridging finance using external financing;
- The repayment of related party debt using an equity capital injection or issuing additional equity interests;
- The repayment of a cash pooling arrangement balance to nil.

The above concessions from the Commissioner would seem to very clearly fall outside both the wording and purpose of the provisions. The breadth of transaction that may be considered high risk and caught (as per the ATO guidance) include:

- The repayment of offshore related party debt using third party debt issued by an external Australian lender; and
- An offshore related party entity acquiring related party debt under a factoring agreement for funds previously used to pay dividends to a parent entity.

Comment: These rules, potentially, can apply to a broad range of corporate restructuring transactions and other circumstances where related party finance is used to fund payments within a corporate group.

D. Global Minimum Tax

1. Current Status of the Legislation

The Australian Government has been committed to implementing the OECD's two-pillar solution for international taxation. As part of this commitment, Australia has enacted the Global Anti-Base Erosion (GloBE) rules, a key component of the Pillar Two framework. However, this commitment has been called into question in light of the United States' concerns regarding the Pillar Two rules, and the G7's June 28, 2025, statement outlining the framework of a proposed "side-by-side" solution under which U.S. parented groups would be exempt from Pillar Two's income inclusion rule (IIR) and undertaxed profits rule (UTPR).

Based on Australian law as currently in force, the IIR and Domestic Minimum Tax (DMT) are applicable in Australia for financial years commencing on or after January 1, 2024, and the Undertaxed Profits Rule (UTPR) is in force for years commencing on or after January 1, 2025.

The package of legislation and commentary to implement these rules include:

1. Taxation (Multinational — Global and Domestic Minimum Tax) Imposition Act 2024 (Imposition Bill), which imposes the IIR, DMT and UTPR;
2. Taxation (Multinational — Global and Domestic Minimum Tax) Act 2024 (Assessment Bill), which contains some of the core concepts needed for calculating the amount of tax, the power for the Treasurer to make Rules and some key definitions;
3. Taxation (Multinational — Global and Domestic Minimum Tax) Consequential Act 2024 (Consequential Bill), which amends a number of existing Acts;
4. Taxation (Multinational — Global and Domestic Minimum Tax) Rules 2024 (Rules).

Multinational groups are subject to these new rules where they satisfy the following two criteria:

i) The group structure satisfies the requirements to be a multinational group (MNE), broadly, the group must op-

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erate through entities or permanent establishments in more than one jurisdiction;

ii) The MNE has consolidated annual revenue of at least 750 million euros in at least two of the four fiscal years immediately preceding the test year.

The legislative package forms part of a coordinated approach across the OECD to ensure that in-scope MNEs with a connection to Australia pay a global minimum tax (GMT) and domestic minimum tax (DMT) of 15%.

Regarding Pillar One, it is not clear when it will be enacted.

2. Application of the IIR and UTPR

The IIR applies a top up liability on the Australian parent of an MNE Group in relation to Low-Taxed Constituent Entities (LTCE) with an effective tax rate (ETR) of less than 15%. The IIR does not apply if the local country in which the LTCE is located collects any deficient liability below the 15% rate under its own Pillar Two measures (such as an QDMTT).

The UTPR entitles Australia to impose a top-up tax on Australian entities where related LTCEs to which payments are made are not subject to a 15% minimum tax rate. This is effectively a secondary, backup tax to ensure that the global operations of MNEs are subject to a minimum tax rate of 15% in circumstances where a foreign jurisdiction has not introduced an appropriate IIR. The UTPR applies to financial years as from January 1, 2025, and is designed to allocate any residual top-up tax to group entities in Australia if the IIR has not been fully applied elsewhere.

Covered taxes under the Australian rules include income taxes and certain other profit-based taxes, while covered entities are those that are part of an MNE group within the scope of Pillar Two. The ATO has issued preliminary guidance on the identification of covered entities, the calculation of covered taxes, and the application of the rules to hybrid entities and joint ventures, with further detail anticipated as the regime is finalized.[282]

3. Computation of GloBE Income and Loss

The computation of GloBE income and loss under the Australian regime is based on the group's consolidated financial statements, subject to specific adjustments to align with the GloBE rules. Adjusted covered taxes are determined by reference to the current tax expense in the financial accounts, with modifications for timing differences, uncertain tax positions, and certain deferred tax items. The ETR is calculated on a jurisdictional basis, and if it falls below 15%, a top-up tax is imposed to bring the total tax paid up to the minimum. Rules for the allocation of top-up tax among group entities, the treatment of losses, and the carry-forward of excess taxes and losses are in line with OECD guidance.

4. Qualified Refundable Tax Credits

The introduction of the global minimum tax (GMT) is expected to have a significant impact on Australia's existing tax incentives, particularly refundable tax credits such as the R&D tax incentive. Under the OECD rules, only "qualified" refundable tax credits — those that are paid as cash or cash equivalents within four years — are treated as income for GloBE purposes, rather than as a reduction in covered taxes. The Australian Government is reviewing the design and administration of existing credits to ensure they remain effective and do not inadvertently reduce the ETR for GloBE purposes. There is ongoing consultation with stakeholders to assess the impact of the GMT on the incentive framework and to consider potential reforms to maintain Australia's competitiveness.

5. Transitional Safe Harbor

Australia's transitional safe harbor rules allow in-scope MNE groups to use simplified calculations based on Country-by-Country Reporting (CbCR) data for the first three years of implementation of the GMT (2024–2026). To qualify for the safe harbor, MNE groups must meet specific tests relating to revenue, profit, and tax rates, including a de minimis test, a simplified ETR test, and a routine profits test. The safe harbor is intended to reduce the initial compliance burden and provide time for groups to adapt their systems and processes to the new requirements.

The ATO has stated that it is committed to adopting a "soft-landing approach" during the transitional period, allowing taxpayers to take "reasonable measures" to meet their obligations. More guidance regarding the ATO's concessional approach to the enforcement of penalties during this transitional period is contained in Practical Compliance Guideline PCG 2025/4.[283]

What constitutes "reasonable measures" is described in PCG 2025/4 as including the lodging of returns in a timely manner, the maintenance of adequate records, proactive engagement with the ATO where delays in lodging are anticipated, and the remedying of mistakes or errors in a timely manner. Evidence of these actions will be important (especially in terms of explaining positions taken regarding the application of these rules).

Comment: Appreciating that significant global entities can under Australian law be subject to enhanced penalties 500 times the base penalty, and double penalties for false and misleading statements of not reasonably arguable positions, this transitional relief while taxpayers come up to speed with the requirements of these new rules is a sensible application of compliance tools available to the ATO.

6. Compliance Framework

The additional compliance obligations under the GloBE rules are significant, the key elements of which consist of the following:

• A GloBE Information Return (GIR) — consistent with the GloBE Model Rules. This may be satisfied through the MNE group filing the return in a foreign jurisdiction which has the required information exchange protocols with Australia and notifying the Commissioner (similar to

[282] See: https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/multinationals/global-and-domestic-minimum-tax/when-and-how-the-pillar-two-rules-apply.

[283] See: https://www.ato.gov.au/law/view/document?docid=DPC/PCG2025D3/NAT/ATO/00001. Taxpayers were invited to comment on the draft Guideline prior to August 29, 2025.

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the current Australian filing requirements for the CbC Report);

• An Australian GloBE Tax Return — supplementing the GIR, for purposes of collecting IIR top-up tax and UTPR top-up tax;

• A DMT Return — for the purposes of assessing and collecting the DMT. Currently all Australian entities or permanent establishments of an applicable MNE group are required to lodge a separate DMT Return. The Australian Department of the Treasury is seeking views on whether there are circumstances in which lodgment of the DMT Return by each entity or permanent establishment might not be warranted (e.g., where they are consolidated for Australian income tax purposes);

• The Foreign Notification Form (FNF) — annual notification to the Commissioner if a foreign entity has lodged the GIR on behalf of an Australian entity and the relevant jurisdiction.

The compliance framework for the GMT will require in-scope groups to file with the ATO within 15 months of the end of the relevant income year (within 18 months for the first year). The returns must include detailed information on the group's structure, GloBE income, covered taxes, ETR calculations, and top-up tax liabilities. The ATO will have broad powers to conduct compliance checks, audits, and reviews, and significant penalties will apply for non-compliance, including failure to file, late filing, or providing false or misleading information. The legislation provides for a formal process for appeals and reviews, consistent with existing tax administration procedures, including the right to object to assessments and seek review by the Administrative Appeals Tribunal or the Federal Court.

7. *Differences in Interpretation and Application*

While Australia's approach is closely aligned with the OECD Model Rules, the interaction between the GMT and Australia's existing CFC regime, as well as the U.S. Global Intangible Low-Taxed Income (GILTI) regime, is under review to ensure consistency and avoid double taxation. For financial statement reporting, the Australian legislation allows the use of either IFRS or Australian Accounting Standards, provided they are applied consistently across the group. The ATO is expected to issue further guidance on the interaction between GloBE calculations and local accounting standards, including the treatment of deferred tax assets and liabilities.

8. *The DMT*

The DMT imposes tax on Australian LTCEs with an ETR of less than 15% of foreign MNEs. As stated above, the DMT is applicable in Australia for financial years commencing on or after January 1, 2024.

Comment: With most countries introducing a QDMTT, the application of these GloBE rules in terms of the collection of tax revenue in Australia may not have a material impact, other than possibly via Australia's own DMT.

9. *Exemptions from Lodging IIR/UTPR Tax Returns and Australian DMT Tax Returns*

On December 22, 2025 the Federal Treasury registered Taxation Administration (Exemptions from Requirement to Lodge Australian IIR/UTPR Tax Return and Australian DMT Tax Return) Determination 2025. This is a legislative instrument made under subsections 127-35(5) and 127-45(5) of Schedule 1 to the *Taxation Administration Act 1953*, which authorizes the Commissioner to specify circumstances in which a group entity need not lodge an Australian GloBE Tax Return or DMT Return for a fiscal year. There can be no exemption from the obligation to lodge the GIR or the FNF.

a. *Returns and Default Filing Obligations*

Absent an exemption, each Australian group entity must lodge a DMT Return and an Australian GloBE Tax Return (including a "nil" return where applicable), plus a GIR (or an FNF if the GIR is lodged offshore). The first returns for 31 December balancers are due by June 30, 2026 (18 months for the first transitional year; thereafter 15 months). A Designated Local Entity (DLE) may be appointed to lodge on behalf of all Australian group entities, and the ATO intends to combine the Australian GloBE Tax Return, DMT Return and FNF into a single form. The Commissioner may extend the deadline for lodging the Australian GloBE Tax Return/DMT Return, but not that for lodging the GIR/FNF.

b. *What the Determination Does*

The instrument creates separate exemption "gateways" for the DMT Return and the Australian GloBE Tax Return applied entity-by-entity and year-by-year. The lodging exemptions are intentionally narrow and confined to scenarios where a liability cannot arise. Where not covered by the determination, entities must lodge even for "nil" amounts. There is no case-by-case discretion, and no exemption at all for the GIR or FNF.

c. *Exemptions from the Obligation to Lodge a DMT Return*

The five principal DMT Return exemptions are as follows:

(i) Subsidiary members of Australian tax-consolidated or MEC groups: such a subsidiary is exempt because any top-up amounts are centralized in the head company under Australia's consolidation rules;

(ii) Certain GloBE JVs and JV subsidiaries: a GloBE JV or JV subsidiary that is not GloBE-located in Australia and is not the head office of an Australian permanent establishment (PE) can be exempt;

(iii) Foreign-located group entities: a non-Australian GloBE-located entity is exempt unless it is an Australian-created stateless flow-through entity or the head office of an Australian PE;

(iv) Defined securitization entities: a defined securitization entity that cannot have an Australian DMT liability is exempt; and

(v) Certain flow-through entities with zero profit: a flow-through entity whose financial accounting net income/loss is reduced to zero under the flow-through rules and that

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has no domestic top-up tax amount (subject to limitations, including UPE status and reverse-hybrid exclusions) can be exempt.

The instrument also contemplates GloBE JV/JV subsidiaries of applicable MNE groups for DMT lodging purposes, consistent with the broader ATO guidance on JV profiles and lodging demarcation.

d. Exemptions from the Obligation to Lodge a Australian GloBE Tax Return

To be exempt from the obligation to lodge an Australian GloBE Tax Return, a group entity must satisfy both an IIR limb and a UTPR limb for the fiscal year:

(i) IIR limb — the entity cannot have an Australian IIR tax liability because it is:

- Not a parent entity located in Australia;
- An Australian parent that only holds interests in entities in Australia; or
- An Australian parent that is not required to apply the Australian IIR because a higher-tier parent applies a Qualified IIR under the ordering rule, so that the Australian parent cannot have an IIR top-up tax amount.

(ii) UTPR limb — at least one applies:

- The group entity is a subsidiary member of a tax-consolidated or MEC group;
- The group entity is not GloBE-located in Australia and is not the head office of an Australian PE;
- The group entity qualifies as a GloBE Investment Entity or Insurance Investment Entity;
- The group entity qualifies as a GloBE Securitisation Entity and qualifies for the securitization concessions; or
- Very broadly, Australia's UTPR rights are turned off.

e. No Relief for GIR and FNF

The Commissioner cannot provide an exemption from the obligation to lodge the GIR or the FNF.

f. Interaction with Broader Administrative Settings

The rules on lodging the various returns set out above interact with broader administrative rules as follows:

(i) The ATO's transitional compliance approach provides for the full remission of late-lodgment penalties for fiscal years commencing on or before December 31, 2026 and ending on or before June 30, 2028 where a taxpayer acts in good faith and takes reasonable measures, but this does not displace the need to lodge on time or seek extensions where possible;

(ii) The ATO is developing a combined return form (CGDMT Return) that will incorporate the Australian GloBE Tax Return, DMT Return, and FNF in a single lodgement, with the GIR remaining a standalone OECD-standardized return; and

(iii) A DLE may be nominated to lodge on behalf of all Australian group entities, discharging their obligations when the DLE lodges; the DLE cannot be an excluded entity or a PE.

10. Future Developments

In light of the controversial political agreement reached in June 2025 between the G7 countries and the United States to implement a proposed "side-by-side" solution that would exempt U.S. parented MNEs from the Pillar Two measures, the negotiations have moved to the OECD.[284] How such a side-by-side system with the United States would work is not clear. The impact on U.S.-parented group companies operating in Australia and the willingness of the other OECD/G20 Inclusive Framework members to accept such a system needs to be worked through.

[284] See "G7 Statement on Global Minimum Tax": https://home.treasury.gov/news/press-releases/sb0181.

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XV. Avoidance of Double Taxation

A. Unilateral Relief

Australia provides exemptions (from Australian tax) and tax offsets (for foreign tax) to ensure that Australian residents are not, as a rule, subject to double taxation on their offshore income. These regimes apply independent of Australia's tax treaty regime, and therefore are available for income earned in all countries, not just those countries with which Australia has tax treaties.

1. Exempt Foreign Income

a. Foreign Salary and Wages

Salary or wages of an Australian resident subject to tax in a foreign country are exempt from Australian tax, provided the individual is overseas for a continuous period in excess of 90 days and the foreign service is directly attributable to any of the following:

(i) The delivery of Australia's overseas aid program by the individual's employer;

(ii) The activities of the individual's employer in operating a developing country relief fund or a public disaster relief fund;

(iii) The activities of the individual's employer being a prescribed institution that is exempt from Australian income tax;

(iv) The individual's deployment outside Australia by an Australian government (or an authority thereof) as a member of a disciplined force; or

(v) An activity of a kind specified in the regulations.[285]

b. Foreign Operations of Australian Companies

Foreign trading profits of Australian companies often qualify for an exemption from Australian taxation. This is discussed in more detail at V.B.3.d., above.

2. Foreign Tax Credits

Australia's foreign tax credit regime — referred to as Foreign Tax Offsets or FTOs — is discussed in detail in V.B.7., above.

3. Foreign-source Losses

Excess foreign income deductions — foreign losses — can be offset against domestic assessable income. Therefore, in utilizing deductions, no distinction is made in respect of the source of the assessable income, whether foreign or domestic. A taxpayer combines both foreign and domestic deductions. Where the combined deductions exceed assessable income, the excess is a tax loss and is applied against assessable income of a future income year.

[285] ITAA 1936, Sec. 23AG (1AA).

B. Treaty Interpretation and Application

For the texts and status of Australia's tax treaties, see International Tax Treaties.

1. Creation of Income Tax Treaty Relationship

The process leading to the signing of a bilateral double taxation agreement (which generally takes about two years) usually commences with the countries exchanging their model tax treaties, which operate as base documents to negotiate positions that are acceptable to both countries. Australia's model is based on the 2017 OECD Model Tax Convention on Income and on Capital, with a small number of formal reservations referred to in the 10th Ed. of the OECD Commentary.

Formal rounds of negotiations occur before the draft agreement is finalized and signed by a member of the government of each country (for Australia, the Federal Treasurer). It usually takes at least 12 months between the first contact between the countries and the signing of an agreement. It is then necessary for Australia to give the agreement the force of law (see below). When the agreement has been made law, the Australian Government informs the other country that the agreement has been ratified and (on the receipt of reciprocal confirmation) the agreement enters into force. The whole process generally takes approximately two years.

Tax treaties are tabled in Parliament and subject to the scrutiny of the Joint Standing Committee on Treaties to report on: (i) matters arising from treaties and related "National Interest Analyses" (NIAs); (ii) questions relating to a treaty, whether or not negotiated to completion, which are referred to the Committee by either House of Parliament or a Minister; and (iii) such other matters as may be referred to the Committee by the Minister for Foreign Affairs and on such conditions as the Minister prescribes. An NIA will include discussions of the economic, environmental, social, and cultural effects of the treaty where relevant; the obligations imposed by the treaty; its direct financial cost to Australia; how the treaty will be implemented domestically; what consultation has occurred; and certain related matters.

a. Implementation into Domestic Law

Section 4 of the International Tax Agreements Act 1953 (ITAA 1953) provides that ITAA 1997 and ITAA 1936 are incorporated into and must be read as part of ITAA 1953. The provisions of ITAA 1953 — including the tax treaties — override any inconsistent provisions in ITAA 1997 or ITAA 1936 (with the exception of Australia's anti-avoidance rules (GAAR) contained in Part IVA of ITAA 1936).

b. Explanatory Materials

In relation to matters of controversy between the Contracting States, the rules of interpretation found in the Vienna Convention on the Law of Treaties apply. Between taxpayers and the respective tax administrations, however, the ordinary domestic rules of statutory interpretation apply. The important point here is that the "ordinary rules" of interpretation that apply to domestic tax law incorporating a double taxation agreement take into account the fact that the agreement is also an international treaty. The principles applicable to the interpre-

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tation of Australia's international treaties were considered by the High Court in *Applicant A v. Minister for Immigration and Ethnic Affairs* (1997) 142 ALR 331, in which McHugh J (at p 351–352) set out a number of propositions relating to the interpretation of international treaties (including tax treaties):

(i) A "holistic" approach to the interpretation of treaties was required by Article 31 of the Vienna Convention (see below). Primacy was to be given to the written text of the Convention, but the context, object, and purpose of the treaty must also be taken into consideration.

(ii) Taking the text as the starting point was consistent with the basic principle of interpretation that courts should focus their attention on the "four corners of the actual text" in discerning the meaning of that text. The need to give the text primacy in interpretation was accentuated by the tendency of multinational instruments to be the result of various compromises by various States or groups of States.

(iii) The mandatory requirement that courts look to the context, object and purpose of treaty provisions as well as the text was consistent with the general principle that international instruments should be interpreted in a more liberal manner than would be adopted if a court was required to construe exclusively domestic legislation.

(iv) International treaties often fail to exhibit the precision of domestic legislation. This was sometimes the necessary price paid for multinational political comity. The lack of precision in treaties confirmed the need to adopt interpretative principles which were founded on the view that treaties could not be expected to be applied with taut logical precision.

Where the interpretation of the agreement is ambiguous, it is proper to have regard to the OECD Model Commentary.[286] An undefined term in a tax treaty should be given the meaning it has under the relevant domestic law (and OECD Commentary) when the treaty is being applied (as opposed to when it is signed).[287] This is consistent with the approach set out in the commentary to Article 3(2) of the OECD Model Convention which states that the domestic legislation which must be referred to in order to determine the meaning of terms not defined in the Convention is the legislation in force when the tax is imposed. An "ambulatory" approach is also consistent with the Commissioner's views in its updated Taxation Ruling TR 2001/13. Later versions of the Commentary may also be relied on, to the extent it provides additional guidance to understand a concept or language used in an earlier version of the Commentary.

2. Administrative Measures

The ATO provides guidance in the form of public and private rulings on the interpretation of tax treaties (see IV.A.2.a., above). Tax Ruling TR 2001/13 sets out the Commissioner's general approach to interpreting double tax treaty provisions, which is referred to as authority for some of the commentary set out in this chapter. Generally, notes prepared by foreign tax authorities/governments as part of the negotiation process to assist with their own interpretation of the treaty is not relevant to Australia's interpretation of a particular treaty.

3. Specific Provisions

a. Permanent Establishment

The Commissioner's guidance on what constitutes a permanent establishment (PE) — and in particular what constitutes "a place at or through which a person carries on a business" — is set out in Tax Ruling TR 2002/5. While it is focused on the definition of a PE under Australia's domestic law, it is generally referenced for purposes of interpreting Australia's tax treaties. It relies heavily on the OECD Commentary and the key takeaways from the ruling and related rulings/guidance are as follows:

(i) As a rule of thumb, if a business operates at or through a place continuously for six months or more, it will generally be considered to be temporally permanent. (The Commissioner may consider forced presence in Australia for more than six months as a result of the COVID-19 pandemic to be temporary, subject to the facts and degree of permanence in each case (paragraph 35 TR 2002/5)).

(ii) The Commissioner in Tax Ruling TD2005/2 has concluded that, where an internet service provider (ISP) is acting as a mere conduit, a nonresident seller of trading stock (or service provider) will not, by virtue of the website alone, have a PE in Australia. This assumes that the ISP is carrying on a business as an ISP, is dealing at arm's length with the taxpayer and does not provide other services to the taxpayer in addition to the hosting arrangement which may give rise to a PE of the taxpayer. A distinction is drawn between computer equipment and the data and software used by, or stored on, that equipment. A website is considered to be a combination of computer software and electronic data. The distinction between the website and the server on which the website is stored is important when the enterprise that operates the server is different from the enterprise that carries on business through the website. The server on which a website is stored is a piece of equipment with a physical location and may constitute a "fixed place of business" of an enterprise which has that server at its disposal. However, the fact that an enterprise has a certain amount of space on the server of an ISP allocated for it to use to store software and data does not result in the server being at the disposal of the enterprise. The enterprise is not considered to have acquired a place of business by virtue of the hosting arrangements. Where a multinational wishes to acquire servers, it is necessary to consider whether the servers should be acquired by separate companies located within Australia for the purposes of carrying on a discrete ISP business that is remunerated on an arm's length basis.

(iii) A place where the person is carrying on business through a dependent agent that has, and habitually exercises, the power to negotiate and conclude contracts. The existence of a general authority is not sufficient — there

[286] *Thiel v. FCT* (1990) 21 ATR 531.

[287] *Thiel v. FCT* (1990) 21 ATR 531; *Virgin Holdings SA v. FC of T* 2008 ATC; *Undershaft No. 1 Ltd v. FC of T; Undershaft No. 2 BV v. FC of T* 2009 ATC.

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must also be a habitual exercise of that authority.[288] In that case, the only contracts executed were a license and sub-license in relation to IP. This was not sufficient repetition to constitute a PE. It should be noted that Australian has enacted a unilateral measure regarding dependent agents (see the discussion of the MAAL).

(iv) A business must be a carried on — merely acquiring a property for rent in Australia may not, in itself, constitute carrying on business through an Australian PE.[289]

(v) A place where the person has, is using or is installing substantial equipment or substantial machinery typically represents a PE. What is "substantial" equipment or machinery causes problems in practice. In *McDermott Industries (Aust.) Pty. Ltd. v. FC of T* 2005 ATC 4398, the Full Federal Court held that bare boat charter (of barges) fell within Article 4(3) of the Australia-Singapore tax treaty, which operated to deem a PE in Australia if the Singapore enterprise owned "substantial equipment" that was used in Australia under contract with the Singapore enterprise. By contrast, the Commissioner said that the hiring out of equipment under a hire-purchase agreement would not be considered to be the hiring out of "substantial equipment" for the purposes of Article 4(3) of the treaty.[290]

(vi) Shipping and aircraft leasing under the Australia-United Kingdom and Australia-United States tax treaties is dealt with in Tax Ruling TR 2007/10. Whether an item was a "substantial equipment" is a question of fact and degree. Equipment can be substantial in either an absolute or a relative sense, and it would be extremely rare for the ships and types of aircraft to which TR 2007/10 applied not to be substantial equipment (by reason of their size alone). The ruling also analyses the meaning of "maintains … for rental or other purposes … within Australia," the application of the 12-month test, and the scope of the hire-purchase exclusion (paragraphs 26–34).

b. Business Profits

Despite the differences in purpose and drafting, the rules in the treaties do not displace the operation of ordinary domestic rules about when income and expenditure are to be recognized for tax purposes. They do not require Australia to depart from its basic approach of allocating actual income and expenditure and do not require the recognition income or expenditure as being generated through dealings between a head office and a PE.

Accordingly, Australia does not apply the authorized OECD approach, but rather the relevant business activity (RBA) approach, which (very broadly) attributes external income and expenses to the PE based on functions, assets, and risks. Australia views the branch as a division or part of its head office for Australian tax purposes (i.e., dealings between the branch and the head office are not recognized).

The Board of Taxation released a report in June 2015 following its review of tax arrangements applying to PEs. The report sets out the Board's findings on the "relevant business activity" (RBA) and the "functionally separate entity" (FSE) approaches to determining the profits attributable to a PE under Article 7 of the OECD Model Tax Convention on Income and Capital.

c. Services

The dependent and independent agent provisions of Australia's treaties are generally in line with OECD standard language, providing an exemption from Australian taxation for employees of foreign companies in Australia for less than 183 days (if remunerated from offshore). The requirement that the remuneration must not be deductible in Australia will not be satisfied if the costs are recharged to the Australian subsidiary/branch of the group.

d. Capital Gains

(1) Capital Gains vs. Business Profits Article

Under Australian domestic laws, nonresidents of Australia will generally be taxed on income or capital gains from the alienation of (direct or indirect interest in) real property situated in Australia (including mining rights) and an asset that has at any time been used by the taxpayer in carrying on a business wholly or partly through a PE in Australia.

This domestic jurisdictional nexus is generally consistent with Australia's double tax treaties — which allocate to Australian taxing rights over: (i) assets attributed to a PE; plus (ii) the direct and indirect alienation of real property.

Tax treaties entered into by Australia after the introduction of the capital gains provisions specifically include the income tax on capital gains (i.e., treaties negotiated after the Austrian agreement). Tax treaties negotiated and entered into before the introduction of the CGT provisions in Australia's domestic tax laws do not specifically deal with how those gains are to be treated under the agreement. However, as discussed earlier, due to the preferred application by the Courts (and the ATO) of the ambulatory approach to treaty interpretation, it is clear that pre-CGT treaties do apply to capital gains.

The phrase "business profits" was discussed by the High Court in the *Thiel* case 90 ATC 4717. It held that profits from a speculative, one-off unit trust and share deal were profits of an enterprise which "carried on business" in Australia within the meaning of Article 7 (Business profits) of the former Swiss 1980 agreement. Since the Swiss resident did not have a PE in Australia, the profits were exempt from Australian tax. Provided a taxpayer has a commercial purpose when entering into a transaction, it will not be necessary for the taxpayer to prove it was conducting a trade or business (in the normal sense) to come within Article 7.

However more recent tax treaties provide that "the term 'enterprise' applies to the carrying on of any business" and therefore restricts the application of Article 7 to profits from the carrying on of a business.

(2) Exit Tax

Generally, the transition to become a nonresident is a taxable event that will result in a deemed capital gain for all assets that do not relate to an Australian PE or Australian real property. Noting the general correlation between Australia's domestic

[288] *Unisys Corporation v. FC of T* 2002 ATC 5146.
[289] Income Tax Ruling IT 2423.
[290] Taxation Determination TD 2007/31.

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rules and its treaties, this should mean the assets not taxable at the time of exit should still be taxable at the time of eventual disposal.

It is possible for individuals to defer this taxable event, electing to pay the tax when the asset is sold. This raises the issue as to whether the subsequent disposal, as it occurs at a time when the nonresident individual qualifies for the benefit of treaty relief, is arguably not taxable in Australia.

e. Fiscally Transparent Entities

The term "fiscally transparent" is used to describe entities that are ignored for tax purposes, for example, certain foreign limited partnerships and disregarded limited liability companies. Relevantly, it is the fact of fiscally transparent entities not being liable to tax in a particular State which precludes their qualifying for treaty benefits. This is on the basis that an entity must be liable to tax in a "Contracting State" to qualify as a "resident," being the category of persons to which tax treaties apply.

Although the shareholders, partners or beneficiaries in a fiscally transparent entity will generally be liable to tax on their share of the entity's income, difficulties arise in determining their entitlement to treaty benefits, in particular, where there is an inconsistency in the tax treatment of the relevant entity between the source jurisdiction and the jurisdiction of residence of its shareholders, partners or beneficiaries.

The appropriate taxation of fiscally transparent entities was addressed in the report titled "The Application of the OECD Model Tax Convention to Partnerships," as published by the OECD Committee on Fiscal Affairs in 1999 (the "Partnership Report"). In short, the Partnership Report concludes that, where a partnership does not qualify as a resident, its partners should be entitled to the benefits of a tax treaty to the extent that they are liable to tax on their share of the partnership income.

(1) OECD Model Treaty Commentary

Read as a whole, the evolving body of commentary accompanying the various iterations of the OECD Model Convention clearly demonstrates the OECD's view that it is appropriate to look through fiscally transparent entities and avail their members of treaty benefits where available, even in circumstances where only one of the Contracting States treats the entity as fiscally transparent.

The approach suggested in the Partnership Report was incorporated into Paragraph 5 of Article 1 of the commentary accompanying the OECD Model Convention published in 2000 as follows:

> the partners [in that partnership] should be entitled, with respect to their share of the income of the partnership, to the benefits provided by the Conventions entered into by the States of which they are residents to the extent that the partnership's income is allocated to them for the purpose of taxation in their State of residence.

Additionally, the same commentaries regarding Article 1 specify at paragraph 8.4 in relation to Article 4 that,

> Where a single State disregards a partnership for tax purposes and treats it as fiscally transparent, taxing the partners on their share of the partnership income, the partnership itself is not liable to tax and may not, therefore, be considered to be a resident of that State. In such a case, since the income of the partnership "flows through" to the partners under the domestic law of that State, the partners are the persons who are liable to tax on that income and are thus the appropriate persons to claim the benefits of the conventions concluded by the States of which they are resident.

The reference to partnerships in the commentary published prior to 2017 has since been expanded to apply to all entities. In this respect, Article 1(2) of the Model Tax Convention published in 2017 now includes the following:

> For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting Jurisdiction shall be considered to be income of a resident of a Contracting Jurisdiction but only to the extent that the income is treated, for purposes of taxation by that Contracting Jurisdiction, as the income of a resident of that State.

Absent a clear and intentional departure from the terms of an existing Article, changes to the OECD Model Convention should be viewed for Australian purposes as clarifying, not changing, the meaning of the OECD Model. In this respect, the introduction of the above paragraph into Article 1 should be viewed as clarifying that it is appropriate to look through fiscally transparent entities the income of which is taxable to the underlying shareholders, partner or beneficiaries. Supporting this proposition is the commentary accompanying the OECD Model as published in 2017, which indicates that Article 1(2) was introduced, in part, to ensure that the benefits of the relevant treaty are granted in appropriate cases.

Article 1(2) of the OECD Model Convention is materially identical in its terms to Article 3(1) of the Multilateral Convention to Implement Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "Multilateral Instrument" or MLI). Relevantly, the explanatory memorandum accompanying the MLI indicates that Article 3(1) was included to mitigate the risk of double taxation (following recommendations made in the course of the BEPS Action 6 Report regarding the prevention of treaty benefits in inappropriate circumstances).

With respect to the interpretative value of the OECD Model Convention and its accompanying commentaries in Australia, Taxation Ruling 2001/13 acknowledges that the OECD Model is relevant to the interpretation of tax treaties that are based on it as both:

(i) A supplementary means of interpretation to which recourse may be had in cases of ambiguity under Article 32 of the Vienna Convention on the Law of Treaties (the "Vienna Convention"); and

(ii) Potentially as a primary material (to which recourse may be had in the absence of ambiguity) under Article 31 of the Vienna Convention.

(See also the *Thiel* case, above).

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(2) Australian Taxation Office Guidance

In Taxation Determination 2011/25, the Commissioner considered whether Article 7 (Business Profits) should apply to Australian sourced profits of a foreign limited partnership which is treated as fiscally transparent in a jurisdiction with which Australia has concluded a tax treaty. The Commissioner referred directly to the commentary accompanying the OECD Model Convention published in 2010 in expressing the view that the benefits of Article 7 should be available to the extent that the business profits are treated as the profits of the partners (not the limited partnership) for purposes of the tax laws of the Contracting State in which the partners are resident, the profits are not dealt with under another article of the treaty (such as Article 13) and the partners themselves satisfy the other requirements of the treaty. In such cases, the Commissioner states that the profits of the limited partnership will not be subject to tax in Australia, even in circumstances where profits are derived through chains comprising multiple transparent limited partnerships.

Additionally, earlier sanitized private rulings issued by the Commissioner (while not binding) are consistent with the view expressed in Taxation Determination 2011/25. In ATO Interpretative Decision 2010/188, the Commissioner found that, although a United States limited liability company (LLC) which has made an election to be disregarded for tax purposes does not qualify as a "resident of the United States" within the meaning of Article 4(1)(b) of the Australia-United States tax treaty, inclusive of the amendments made by the 2001 Protocol, the single owner of the LLC should be entitled to claim the benefits of the treaty where available.

Similarly, in ATO Interpretative Decision 2013/58, the Commissioner found that the benefits of Article 11 of the Australia-United States tax treaty were available to the single owner of a disregarded U.S. LLC. In reaching this conclusion, the ATO cited the commentaries accompanying the OECD Model Convention, which were, in the Commissioner's view, broad enough to extend to a disregarded U.S. LLC. The Commissioner also referred to the ATO's own guidance, specifically, that in Taxation Ruling 2001/13 the ATO advocates a liberal interpretation of treaties in a manner which smooths over "gaps, imprecisions and ambiguities" in favor of the object and purpose of the treaty being interpreted.

(3) Australian Case Law

Australian judicial decisions to date suggest that it is appropriate to look-through an entity and avail its members of treaty benefits in circumstances where both the source jurisdiction and the jurisdiction in which the entity's members are resident treat the entity as being fiscally transparent. Where, however, there is an inconsistency in the tax treatment of the intermediate entity (or entities) between the source jurisdiction and the jurisdiction in which the entity's members are resident, the Australian case law is less clear. The most recent judicial decision (ultimately decided at the High Court, but with a focus on the Federal Court analysis) provided on the taxation of transparent entities should have provided certainty on this point but, instead, circumvented the issue by finding (contrary to the view's expressed in prior decisions) that the relevant entity was not separately taxable under the domestic tax law of either Contracting State.

(4) Resource Capital Fund III LP

In *Resource Capital Fund III LP v. Commissioner of Taxation* (referred to collectively with the subsequent appeal decision and special leave proceedings as *RCF III*), the Federal Court considered whether it was appropriate to look through a Cayman Islands limited partnership and avail its U.S. resident partners of treaty benefits with respect to a gain arising from the disposal of shares in St Barbara Mines Limited, an entity which at all relevant times conducted a gold mining enterprise on mining tenements in Australia. Relevantly, St Barbara Mines Limited owned both the tenements themselves and any other assets used in connection with the tenements including plant, equipment and mining information (leading the Commissioner to assert it was land-rich).

The first issue in dispute was whether the assessment in respect of the gain could be issued to the limited partnership, being an entity treated as fiscally transparent in the United States but, otherwise, taxable under Australia's domestic tax law. In particular, the Federal Court considered how, if at all, the Australia-United States tax treaty should be applied.

As to whether the limited partnership could qualify as a "resident of the United States," Edmonds J found in favor of the taxpayer, preferring an interpretation of Article 4(1)(b)(iii) of the Australia-United States tax treaty, under which a partnership must first be treated as a resident of the United States for the purposes of U.S. domestic law before qualifying as a "resident of the United States" under the treaty.

However, Edmonds J was ultimately of the view that it did not matter whether the limited partnership was a resident for purposes of the Australia-United States tax treaty as it was the limited partners themselves that Australia was entitled to tax. This view followed a review of the commentaries accompanying various iterations of the OECD Model Convention (including some of the passages excerpted above) and also the explanatory memorandum accompanying the Bill introducing the 2001 Protocol, which made it clear that a secondary policy goal of the protocol was to prevent double taxation of capital gains derived by U.S. residents on the disposal of interests in Australian entities while retaining Australian taxing rights.

Other factors that were relied on by the taxpayer to support a look through approach included: (i) the terms of Article 7(9), which deem an enterprise carried on by a fiscally transparent entity in a Contracting State to be carried on by that entity's members (with the entity itself being treated as akin to a PE); and (ii) the Technical Explanation of the 2001 Protocol issued by the Internal Revenue Service which states that companies holding shares through fiscally transparent entities, such as partnerships, should be considered to hold directly their proportionate interest in the shares held by the intermediate entity for the purposes of Article 10 (Dividends). In light of the above, Edmonds J formed the view that the Australia-United States tax treaty and Australia's domestic tax law are inconsistent as regards the tax treatment of fiscally transparent entities. The former advocates a look-through approach, whereas the latter treats the fiscally transparent entity as the relevant taxpayer. Having regard to the provisions of section 4(2) of the International Tax Agreements Act 1953 (Cth) (Agreements Act),

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Edmonds J held that such inconsistency was to be resolved in favor of the Australia-United States tax treaty.

On appeal in *Commissioner of Taxation v. Resource Capital Fund III LP*, the Full Federal Court overturned the decision of Edmonds J. The Court formed the view that, rather than there being an inconsistency between Australia's domestic tax law and the Australia-United States tax treaty, the relevant inconsistency actually related to the imposition of tax on the gain, with the consequence that the provisions of the treaty applied differently between Australia as the source country and the United States as the place of residence of many of the limited partners. In light of this and the view that the limited partnership was a taxable entity under Australia's domestic tax law, the Court concluded that the Commissioner's assessment was not precluded by section 4(2) of the Agreements Act.

Despite finding for the Commissioner, the Federal Court left open the following,

> It may be open to argument by the US partners that they should obtain the benefits of the DTA on the basis that it was appropriate for Australia to view the gain as derived by the partners resident in the US, and to apply the provisions of the DTA accordingly, as discussed in the OECD commentary (about which we express no view) but that consideration is a separate issue to the question of whether the effect of the provisions of the DTA was to allocate the liability for the tax on the gain differently to the Assessment Act.

The excerpt above suggests that the Federal Court viewed the identification of the relevant taxpayer (or at least the person 'deriving' income) as being mutually exclusive from the issue of how to allocate tax liabilities under the Assessment Act. Respectfully, why the former should not impact (if not, determine) the latter is unclear. More broadly, the Court's view that the Australia-United States tax treaty applies differently in the United States from how it applies in Australia seems at odds with the stated purpose of the treaty, that is, to avoid double taxation and prevent fiscal evasion.

Possibly, the Full Federal Court *RCF III* decision should be read in the context of the appeal proceedings, that is, taking into consideration that the limited partners were not joined as parties. As a result, the Court was left in the unenviable position of having to determine the tax implications arising from a disposal of shares which (in its view) constituted TAP where the only taxpayer it was presented with was a limited partnership. Although the ultimate result (the taxation of the capital gain in Australia) may have been correct, the reasoning by which that conclusion was reached appears strained and, to a large extent, at odds with prior guidance and authorities.

The ATO appears to acknowledge this in the Decision Impact Statement issued in response to the Full Federal Court decision, wherein the Commissioner made it clear that, where Article 7 applies, it should be open for partners in a fiscally transparent partnership to claim the benefits of the Australia-United States tax treaty (in accordance with Taxation Determination 2011/25) and that the scope of the Full Federal Court decision should be limited to gains arising from the alienation of property dealt with under Article 13.

In October 2014, the High Court (Crennan and Keane JJ) refused an application for special leave to appeal from the decision of the Full Federal Court in *RCF III*. The High Court formed the view that the Full Federal Court's decision was not attended by sufficient doubt to warrant a grant of special leave. Relevantly, the issues discussed in the special leave proceedings were similar to those raised in the later decision of *Resource Capital Fund IV LP v. Commissioner of Taxation* (see (5), below) albeit the High Court appears to have been persuaded by the arguments put forth by the Commissioner (and subsequently rejected) in those proceedings. In particular, the special leave transcript suggests that Crennan J appears to have formed the view that a limited partnership is, in fact, "subject to Australian revenue law" and "an independent taxable entity in Australia." Further, the High Court seems unpersuaded by Slater, SC's argument that, although the Assessment Act applies as if references to a company were references to a partnership, neither the Assessment Act nor the general law give a partnership the status of a corporation.

(5) Resource Capital Fund IV LP

In *Resource Capital Fund IV LP v. Commissioner of Taxation* (RCF IV) the Federal Court was called to consider effectively the same facts for two sister funds of Resource Capital Fund III, namely Resource Capital Fund IV and Resource Capital Fund V. The Commissioner issued assessments in respect of gains arising to these sister funds from the disposal of their shares and interests in Talison Lithium Limited, an Australian mining company. Having concluded that the limited partnership was not a separate taxable entity, the Federal Court turned to the issue of whether the partners in that limited partnership were entitled to relief under the U.S. Convention. The Federal Court found the gain to be in the nature of ordinary income arising from an isolated business transaction, drawing on the principles enunciated in *Commissioner of Taxation v. Myer Emporium Ltd.* Further, having regard to the facts and circumstances of the disposal, the Court found the gain to be Australian sourced (and therefore taxable in the hands of a foreign resident). Accordingly, the issue for determination became whether the partners in the partnership were entitled to relief under Article 7 (Business Profits) of the Australia-United States tax treaty and, as a related point, whether the Commissioner was bound to follow and apply Taxation Determination 2011/25. Ultimately, the Court concluded that those partners that were "residents of the United States" for purposes of the Australia-United States tax treaty were entitled to relief under Article 7. The Court found that the "enterprise" with respect to which relief was available was constituted, in each case, by the passive investment activities carried out by the partners themselves and that the terms of the treaty (in particular, Article 4(1)(b)(ii)) should not be understood to give a partnership residence separate from its partners.

Relevantly, the Federal Court did not arrive at this conclusion by applying a "look-through" approach to resolve an inconsistency in the tax treatment of partnerships between Australia and the United States. Instead, the Court's decision appears to be predicated on the view, expressed earlier in the judgement, that a partnership is not a separate taxable entity under Australia's domestic tax law and, accordingly, there is no inconsistency in the treatment of partnerships between Australia and the United States.

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In this sense, the Court in *RCF IV* circumvented a number of the issues raised in the Partnership Report and subsequently ruled on by Edmonds J in *RCF III*, the result being that the decision in *RCF IV* might be limited only to partnerships or even the specific category of corporate limited partnerships to which Division 5A of the Assessment Act applies. Although the Court acknowledges a "general approach" in the Australia-United States tax treaty of treating partnerships as fiscally transparent, it defers to the issue of whether the partners were entitled to rely on Taxation Determination 2011/25 rather than addressing directly the issue of how to tax an entity which is viewed as fiscally transparent in one Contracting State but taxable in another.

(6) Double Taxation Risk Mitigation

There are ultimately two approaches available to taxpayers for dealing with the uncertainties described above. The first is to structure arrangements conservatively with a view to mitigating the risks which fiscally transparent entities attract. The second is to seek relief through the application of the mutual agreement procedure.

(a) Structuring Arrangements

Conservatively, taxpayers structuring in the near term might consider installing independently taxable, treaty qualifying entities as the immediate offshore parent for Australian investments but must do so having regard to Part IVA of the Assessment Act and, as a related point, the appropriate commercial drivers underpinning the investment.

Otherwise, the use of a corporate limited partnership of the kind to which Division 5A applies is currently preferable to other kinds of disregarded entities which are not viewed as transparent under Australian domestic tax law, for example, a foreign LLC which has made an election to be disregarded for tax purposes.

(b) Mutual Agreement Procedure

Taxpayers seeking relief from the double taxation of income derived through a fiscally transparent entity may initiate the mutual agreement procedure (MAP). The relevant competent authority would then make a determination as to the merits of the case, that is, whether taxation in Australia at the level of the fiscally transparent entity would be "in accordance with" the treaty. In this respect, an outcome which results in the double taxation of income (for example, at the level of transparent and then again at the level of its sole member) should not be in accordance with Australia's tax treaties.

One issue which might arise in the course of the MAP process is the ability of the Australian competent authority to defer from Australian judicial decisions which interpret the treaty and Australia's domestic legislation. Although the general principles of treaty interpretation suggest Australia should resolve inconsistencies in favor of concluded tax treaties and the commentary accompanying the OECD Model Convention published in 2017 actually anticipates that competent authorities will allow relief in priority to domestic law, whether the Australian competent authority would take this view remains unclear.

By way of indication, the ATO has resolved most MAP cases to date in less than two years. Of the 25 cases considered by the Australian competent authority, eight have resulted in an agreement being reached which fully eliminated double taxation. Otherwise, there has been one agreement partially reducing double taxation and other cases have been unsuccessful, denied access, treated as having insufficient merit, withdrawn or dealt with by unilateral means.

(7) Conclusion

Australia's current approach to the taxation of fiscally transparent entities is arguably at odds with its obligations under concluded bilateral tax treaties, at least, in circumstances where there is an inconsistency in the tax treatment of the transparent entity between the jurisdiction in which income is sourced and the jurisdiction in which the entity's shareholders, partners or beneficiaries are resident. What is required is a return to the reasoning of the Full Court (Edmonds J) in *RCF III* thereby allowing investment in Australia through fiscally transparent entities without having to navigate the real risks of double taxation.

f. Non-discrimination

A recent case has shown a rare application of the non-discrimination clause in an Australian context. In *Addy v. FCT* [2021] HCA 34, the High Court held that Australia's "backpacker tax" offends the prohibition on nationality discrimination in Article 25(1) of the Australia-U.K. tax treaty, which provides that: "Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected."

Ms. Addy was a U.K. national who went to Australia on a working holiday (with a working visa). She was more heavily taxed on her Australian sourced income than other Australian tax residents, who earned the same income from the same sources in the same period of time, because she fell under the "backpacker tax."

The question was whether the more burdensome taxation imposed on those holding a working holiday visa, which depends upon not being an Australian national, contravenes Article 25(1). The short answer is "yes:" applying the ordinary taxation laws to an Australian national in substantially similar circumstances deriving the same income from the same source (that is, "in the same circumstances" in all respects relevant to taxation excluding the protected characteristic and consequences flowing from the protected characteristic), they would be taxed at the lower rates under the usual rules applicable to residents.[291]

The Court resolved the case by adopting a principled and logical approach to the application of the nationality non-discrimination clause.

[291] See Reimer and Rust (eds), Klaus Vogel on Double Taxation Conventions, 4th ed (2015), vol II at 1695 [35].

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4. Can a Treaty Impose a Higher Tax than Under Domestic Law?

A treaty can impose a higher tax than would be imposed under Australian domestic law.

While tax treaties are generally seen as intended to provide a "shield" against double taxation, they can operate to expand Australia's jurisdictional scope to tax. In a number of Australia's treaties, countries have agreed to expand the existing areas of domestic tax liability provided that this occurs within any applicable constitutional limits. Of particular relevance to this issue is the Source of Income Articles in Australia's treaties. They provide that, items of income that Australia may tax under the treaty are to be treated as having a source in Australia for purposes of Australian domestic law (irrespective of the source of the income absent the treaty).

While this has been the position of the ATO for an extended period of time, legislative support for this position is more recent (and consistent).

5. Interaction of MAP Proceedings with Domestic Proceedings

In *Oracle Corporation Australia Pty Ltd v. Commissioner of Taxation (Stay Application)* [2024] FCA 1262, which is on appeal, Oracle Corp. Australia applied in the Federal Court for a temporary stay of domestic court proceedings until MAP proceedings under the Australia-Ireland tax treaty were completed. The case revolved around whether payments made by Oracle Australia to Oracle Ireland were royalties under the treaty and subject to Australian withholding tax.

Justice Perram dismissed the application for a stay on the basis that continuing domestic proceedings would provide necessary judicial clarity for similar cases, given that the royalty definition has been contentious under Australian tax law and international treaties.

Justice Perram highlighted the complementary nature of MAP and domestic litigation. MAP and judicial processes can coexist to address taxpayer grievances and avoid double taxation. Granting a stay might unnecessarily delay a judicial determination with far-reaching implications for other cases involving software payments.

On November 28, 2024, Oracle filed an appeal.

C. Australia-United States Tax Treaty

1. In General

The Australia-U.S. tax treaty is comprised of the 1982 tax treaty,[292] as amended by the Protocol of September 27, 2001. See International Tax Treaties for the text of the 1982 treaty and 2001 Protocol. The United States has regulations relating to the treaty, but there are no Australian regulations applying to it. The treaty entered into force on October 31, 1983. The amending Protocol entered into effect in Australia:

(i) With respect to withholding tax on dividends, royalties and interest, on July 1, 2003; and

(ii) With respect to other Australian tax on income, profits and gains, for years of income beginning on or after July 1, 2003.

2. Taxes Covered

The U.S. taxes covered by the Australia-United States tax treaty are the federal income taxes imposed by the Internal Revenue Code. The Australian taxes covered by the treaty are the Australian income tax, (including tax on capital gains) and resource rent tax with respect to offshore projects relating to exploration for or the exploitation of petroleum resources. The treaty specifies that its provisions will apply to any future tax imposed by the United States or by Australia if that tax is substantially similar in character to the taxes now subject to the treaty.[293]

3. Relief from Double Taxation

The Australia-U.S. tax treaty adopts two methods for the relief of double taxation of income flowing between the two countries.

a. Income Taxed on Source Basis

Certain income is taxed (in priority) by the country in which it has its source, and also may be taxed by the country of which the recipient is a resident. If the country of residence also taxes the income, it will give a credit against its tax for the tax imposed by the country of source. Where both countries tax the income, the effect of the allowance of the tax credit is that the taxpayer pays an amount of tax equal to the higher of the two taxes.

The "source" basis of taxation is maintained with respect to all classes of income not specifically taxed on a residence basis. Income from the following types of activities are taxed on a source basis:

(i) Income from real property is taxed in the country where the property is situated. For these purposes real property can include a leasehold interest in land, whether or not improved, and rights to exploit or explore for natural resources.

(ii) Income from the alienation of real property. In the case of the United States, real property for these purposes includes a "U.S. real property interest" and real property as defined by Article 6 above in (i). In the case of Australia, it has the same meaning that it has under Australian domestic law and includes the definition set out in (i) and shares or comparable interests in a company, or an interest in a partnership or trust, the assets of which consist wholly or principally of real property.

(iii) Industrial or commercial profits derived in one country by a resident of the other country where the enterprise carries on trade or business through a PE in that other country.

[292] Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed on Aug. 6, 1982.

[293] 1982 Australia-U.S. tax treaty, Art. 1(2).

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(iv) Independent personal services performed by an individual resident of one contracting state in the other State where the individual is either present in the other State for a period of more than 183 days in that year of income or has a fixed base regularly available to him for purpose of performing his or her activities.

(v) Certain types of dependent personal services performed by a resident of one contracting state in the other.

(vi) Unfranked dividends from Australia, although the general withholding tax rate of 15%, is reduced:

- To zero, where a beneficially entitled company holds 80% or more of the voting power of the company paying the dividends for a 12-month period ending when the dividend is paid and satisfies public listing requirements in the Limitation on Benefits Article; and
- To 5%, where the entity beneficially entitled to those dividends is a company that holds 10% or more of the voting power in the company paying the dividend.

(In the case of non-portfolio investment by an Australian resident in Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs), these limited rates may not be available.)

(vii) Royalties, although subject to the limit on source country taxation of 5%.

(viii) Interest, although subject to the limit on source country taxation of 10%. However, as is discussed at II.A.1.e., above, this is also Australia's domestic interest withholding tax rate. This rate is reduced to nil if the interest is derived by one of the Contracting States (or a political or administrative subdivision or central bank) or a financial institution which is unrelated from and dealing wholly independently with the payer.

(ix) Capital gains, which may be taxed by the source country due to the inclusion of a comprehensive Alienation of Property Article.

b. Income Taxed on Residence Basis

Certain categories of income specifically covered by the U.S. Treaty are taxed only by the country in which the recipient resides. Because only one country taxes, there is no double taxation. The residence basis of taxation is generally applied with respect to:

(i) Shipping and air transport profits;[294]

(ii) Industrial or commercial profits, if the recipient has no PE in the country of origin of the income;[295]

(iii) Pensions and purchased annuities;[296] and

(iv) Remuneration earned during a short-term visit (generally less than 183 days) to one country by a resident of the other country.[297]

The Australia-U.S. tax treaty authorizes the taxation authorities of the two countries to confer where a taxpayer shows proof that the action of the taxation authority of one of the countries has resulted or is likely to result in double taxation, contrary to the provisions of the treaty.[298] Provision also is made for the exchange of information directly between the two authorities[299] and for one authority to collect outstanding taxes on behalf of the other.

D. OECD Multilateral Instrument

Australia signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, also known as the Multilateral Instrument (MLI), on June 7, 2017. The MLI was given the force of law in Australia by the Treasury Laws Amendment (OECD Multilateral Instrument) Act of 2018, which received Royal Assent on August 24, 2018. The MLI entered into force for Australia on January 1, 2019.

Australia has adopted MLI Articles 6, 8, 11, 15 and 16 without reservation.

Australia's primary reservations to the MLI are:

- Article 3, 9, 13, 14 and 17 are adopted, but preserving existing corresponding bilateral detailed rules where appropriate;
- Article 4 adopted, but requiring tax administrations to agree to the tax status of the relevant dual resident entity before treaty relief is available;
- Article 7 is adopted, but only the principal purpose test (PPT), including the discretion not to apply the PPT in certain circumstances;
- Articles 18 to 26 are adopted, but with the following limitations: disputes subject of a decision by a court or administrative tribunal will not be eligible for arbitration; breaches of confidentiality by taxpayers and advisors will terminate the arbitration process; and disputes involving the application of the general anti-avoidance rules of Part IVA of the Income Tax Assessment Act 1936 or section 67 of the Fringe Benefits Tax Assessment Act 1986 are excluded.

Australia has not adopted Articles 5, 10 or 12.

[294] 1982 Australia-U.S. tax treaty, Art. 8.
[295] 1982 Australia-U.S. tax treaty, Art. 7.
[296] 1982 Australia-U.S. tax treaty, Art. 18.
[297] 1982 Australia-U.S. tax treaty, Arts. 14 and 15.
[298] 1982 Australia-U.S. tax treaty, Art. 24.
[299] 1982 Australia-U.S. tax treaty, Art. 25.

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XVI. Anti-Avoidance

A. *General Anti-avoidance Rules*

Part IVA of ITAA 1936 is the general anti-avoidance rule for income tax. For the provisions of Part IVA to apply to an arrangement, it is necessary for there to be:

(i) A scheme;

(ii) A tax benefit obtained by the taxpayer in connection with that scheme; and

(iii) Based on a consideration of the matters set out in section 177D(b), a conclusion formed that, objectively speaking, the dominant purpose of any person who entered into or carried out the scheme was to enable the taxpayer to obtain that tax benefit.

The application of Part IVA of ITAA 1936 is highly dependent upon the specific tax profile of the relevant taxpayers and their purpose, determined objectively, for undertaking the relevant scheme.

1. *Scheme*

Section 177A(1) of ITAA 1936 defines "scheme" to mean:

(i) Any agreement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and

(ii) Any scheme, plan, proposal, action, course of action or course of conduct.

This is an extremely broad definition. As a generalization, the narrower the terms of the scheme, the more likely the Commissioner can identify the relevant dominant purpose as the obtaining of a tax benefit. As was discussed by Gummow and Hayne JJ in *Commissioner of Taxation v. Hart*,[300] a scheme can be "the taking of but one step." Callinan J made similar comments, with the qualification that:

> it is not for the [Commissioner] to attempt to seize upon and isolate one event, or series of events, which, standing alone may appear to have a complexion which it or they cannot truly bear when other, relevant, connected events are taken, or should be taken, into account.

2. *Tax Benefit*

A "tax benefit" in connection with a scheme includes a reference to an amount not being included in the assessable income (or being allowed as a deduction) of the taxpayer of a year of income where that amount would have been assessable (or would not have been deductible).

A similar provision applies to capital gains and capital losses, foreign tax credits and interest, dividend or royalty withholding tax.

The identification of the scheme is a prerequisite to the determination of the tax benefit that is connected to the scheme.

In the Federal Court decision *Macquarie Finance Ltd. v. Commissioner of Taxation*,[301] Hill J said that in determining whether there was a tax benefit obtained from the scheme entered into, it is necessary to consider what might reasonably be expected to have happened had the present scheme not been entered into or carried out.

This follows from the judgment of the High Court in *Commissioner of Taxation v. Peabody*,[302] where it was said:

> A reasonable expectation requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.

3. *Dominant Purpose*

As a rule, where the Commissioner attempts to apply Part IVA of ITAA 1936 o a taxpayer's involvement in a scheme, the focus of any judicial proceedings is upon the dominant purpose of the relevant parties to the scheme in entering into the transaction. As stated by Hill J in *Macquarie* "Part IVA requires the drawing of a conclusion from the eight matters listed in 177D(b) as to the dominant purpose of some person, including the taxpayer, for entering into or carrying out the scheme."

The eight factors are:

(i) The manner in which the scheme was entered into or carried out;

(ii) The form and substance of the scheme;

(iii) The time at which the scheme was entered into and the length of the period during which the scheme was carried out;

(iv) The result in relation to the operation of ITAA 1936 and ITAA 1997 that, but for Part IVA, would be achieved by the scheme;

(v) Any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;

(vi) Any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;

(vii) Any other consequence for the relevant taxpayer, or for any person referred to above in (vi), of the scheme having been entered into or carried out; and

(viii) The nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to above in (vi).

The application of this dominant purpose test will depend upon the particular circumstances of the relevant taxpayer. However, as a rule the consequence of these rules applying is that, by reference to international standards, the Commissioner

[300] (2004) HCA 26.

[301] (2004) FCA 1170.

[302] (1994) 181 CLR 359.

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has a very powerful mechanism to attack structures entered into based on their tax attributes.

Legislative Note: The Australian Government has proposed (most recently on May 14, 2024 in the Federal Budget) to expand the scope of Part IVA so that it would apply to:

1. Schemes that reduce tax paid in Australia by accessing a lower withholding tax rate on income paid to foreign residents;

2. Schemes that achieve an Australian income tax benefit, even where the dominant purpose was to reduce foreign income tax.

The Federal Budget proposes to introduce this expansion in the scope of Part IVA to income years commencing on or after the day the amending legislation receives Royal Assent, regardless of whether the scheme was entered into before that date.

B. The Multinational Anti-Avoidance Law

The Multinational Anti-Avoidance Law (MAAL) is Australia's unilateral response to BEPS Action 7.

The MAAL applies to "significant global entities" — a member of an accounting consolidated group with annual global income exceeding A$1 billion.

The MAAL enables the ATO to cancel "tax benefits," and impose significant penalties, obtained from certain schemes designed to avoid tax in Australia through the use of an offshore principal selling to Australian customers. The MAAL is penal and its potential application needs to be carefully monitored.

The MAAL will apply if:

(i) A foreign entity supplies goods or services to an Australian customer;

(ii) An Australian entity that is an associate of or is commercially dependent on the foreign entity undertakes activities directly in connection with the supply;

(iii) Some or all of the income derived by the foreign entity is not attributable to an Australian PE; and

(iv) The principal purpose, or one of the principal purposes of the scheme, is to obtain an Australian tax benefit or to obtain both an Australian and a foreign tax benefit.

These requirements are discussed in 1. to 5., below.

1. Nonresident Makes Supply to Australian Customer

a. In General

The MAAL only applies to supplies made by nonresidents. Therefore, it only applies where the entity selling the "product" of a multinational group, whether this be a good or service, is an offshore entity (such as, for example, a Singapore regional "principal entity" selling goods to local markets) that is making sales to an Australian customer.

An "Australian customer" is a party resident and/or located in Australia, *other than* members of the consolidated accounting group of the offshore supplier.

Therefore, supplies made by an offshore company to an Australian subsidiary of the same multinational group should not be caught by the MAAL. The MAAL has therefore encouraged a shift towards (where an Australian sales and marketing team is necessary) the use of an Australian limited risk distribution subsidiary — whereby local sales and marketing subsidiaries sell product to the end user Australian customer acquired from an offshore regional or global hub — as opposed to using an offshore principal to sell directly to an Australian customer.

b. Financial Supplies Excluded

The concept of "supply" is defined by reference to its meaning in section 9–10 of the A New Tax System (Goods and Services Tax) Act 1999. Relevantly, it excludes a supply of a "debt interest" as defined by Section 995-1 of the Income Tax Assessment Act 1997 and Section 177A of the MAAL. Therefore, supplies of finance fall outside the scope of the MAAL. As a rule, this means banks are generally not concerned by the MAAL (other than potentially in the context of services provided independent of lending activities).

2. Nonresident's Income from the Supply Is Not Attributable to Australian Permanent Establishment

The relevant income for these purposes is the income earned by an offshore principal from selling directly to Australian customers. The use of an offshore principal (located in a country with which Australia has a double tax treaty) would typically avoid the existence of an Australian PE (assuming no dependent party in Australia has the authority to conclude contracts on behalf of the offshore parent) and therefore the income earned from selling to Australian customers would generally not be taxable in Australia.

3. Activities are Undertaken in Australia Directly in Connection with Supply

This is often the key issue in determining whether the MAAL will apply.

The concept of "directly in connection with" is not defined but the Explanatory Memorandum (EM) to the Act relevantly sets out, at [3.40]:

> All activities that contribute to **bringing about** the contract for the supply, such as the **building of client relationships**, are captured.

By way of example, an Australian subsidiary with a sales team generating sales for an offshore principal would typically be seen as activities being undertaken "directly in connection with the supply" by the offshore entity. The examples in the EM suggest that if there are Australian based staff (employed by an Australian subsidiary) that are focused on generating Australian customers for an offshore principal, or (potentially) focused on selling new products to existing customers of an offshore principal, the MAAL could apply. The examples in the EM refer to customers targeted by the Australian sales personnel with direct contact with the specific customers prior to becoming a customer as the basis for satisfying this test.

The ATO generally considers three factors that need to be taken into account for purposes of this test (as set out in Law Companion Guide LCG 2015/2):

(i) The nature of the activities undertaken in Australia in relation to the Australian sales;

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(ii) The extent to which the Australian entity staff are responsible for contractual and commercial negotiations with Australian customers; and

(iii) The level (if any) of day-to-day contact between Australian staff and the Australian customers.

4. Activities Are Undertaken Through Australian Entity That Is Associate of, or Commercially Dependent on, Offshore Supplier of "Product"

As a rule, most activities that would satisfy this test would be carried on by a wholly owned subsidiary of the group selling product to Australian customers. However, to avoid structures where Australian staff are employed by another entity that is owned by a third party, the ATO in LCG 2015/2 suggests the following factors should be taken into account in answering this question:

- Whether the foreign entity sells direct to Australian customers through truly independent Australian sales agents.
- Whether there are related Australian entities involved in some aspect of the sales process.
- The nature of the relationship between the foreign entity and the Australian entity undertaking activities connected to the Australian sales.
- If the foreign entity and the Australian entity are not connected, whether the otherwise independent Australian entity would remain a viable 'going concern' without its dealings with the foreign entity.

5. Scheme Was Carried Out for Principal Purpose of Obtaining "Tax Benefit" (Reduction in Tax in Australia or Offshore)

The MAAL can apply if a principal purpose of the person that carried out the scheme was to obtain a tax benefit (the "principal purpose test") taking into account specified matters described in Part IVA of ITAA 1936.

Relevantly, the EM provides two examples (examples 3.6 and 3.8) which illustrate the operation of the principal purpose test. In these examples, it is established that there will be no "principal purpose of obtaining a tax benefit" if the Australian-based team's role is limited to:

(i) identifying potential customers; and

(ii) communicating standard terms,

and where the substantial negotiation of the contractual terms and ultimate provision of the relevant service is undertaken in the jurisdiction in which the revenue is booked.

A key issue is the extent to which the activities that contribute to bringing about the contract for the supply undertaken are undertaken by an associated entity in Australia. The factors the Commissioner considers (in paragraph 61 of the LCG 2015/2) should be taken into account are:

(i) Where commercial and contractual negotiations are needed, are staff of the Australian based entity directly involved in these negotiations with Australian customers?

(ii) Does the foreign entity not have the requisite personnel and commercial capacity (including staff with the relevant qualifications to undertake the requisite functions, financial and otherwise) to carry out the activities needed to obtain the contracts?

(iii) Are the activities performed by the staff of the foreign entity in relation to bringing about the contract for the supply predominantly routine clerical and administrative activities?

(iv) Have the activities undertaken by the foreign entity and the Australian based entity been split in such a way so as to avoid the foreign entity having a PE in Australia?

(v) Do staff from the foreign entity rarely have any direct communication with customers in Australia in relation to the contract or the supply?

(vi) Does the Australian based entity provide significant levels of support to customers in Australia in order to bring the customer to a position where the customer is ready to enter into a contract with the foreign entity?

As a matter of practice, the manner in which the ATO has applied this test goes beyond its scope — almost going so far as to assume that (all other things being equal) the use of an offshore regional principal with an Australian subsidiary involved in any engagement with Australian customers is motivated by a tax avoidance purpose and falls within the scope of these rules (unless proven otherwise).

a. What Does "Principal" Mean?

The purpose must be one of the main purposes, having regard to all the relevant facts and circumstances. This recognizes that a scheme may be entered into or carried out for a number of purposes, some or all of which are principal purposes. The EM also refers to the OECD Report on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, which uses the "principal purposes" threshold. The OECD commentary provides (at paragraphs 12 to 13) that:

> 12. The reference to "one of the principal purposes" in paragraph 7 means that obtaining the benefit under a tax convention need not be the sole or dominant purpose of a particular arrangement or transaction. It is sufficient that at least one of the principal purposes was to obtain the benefit …
>
> 13. A purpose will not be a principal purpose when it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was not a principal consideration and would not have justified entering into any arrangement or transaction that has, alone or together with other transactions, resulted in the benefit. In particular, where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit.

The Commissioner has provided in guidance note LCG 2015/2 at paragraph 16:

> … consistent with the proposed new OECD Model Commentary, the ATO considers that where the particular form in which the scheme is implemented is

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> more reasonably explained by reference to the tax benefit obtained (or also by any reduction in a foreign tax liability), then it may be concluded that one of the principal purposes of the scheme was to obtain that benefit. Where the scheme is inextricably linked to a core commercial activity and the particular form in which the scheme is implemented is conventional and straightforward and not driven by such tax benefit considerations, then it is unlikely that one of its principal purposes was to obtain the tax benefit.

In summary, it is likely that the principal purpose test may be satisfied if one of the persons who entered into or carried out the scheme was driven to do so by a substantial, but not necessarily predominant, purpose of enabling a taxpayer to obtain a tax benefit. The principal purpose test would not be satisfied if that tax benefit was merely incidental or was essential to the core commercial activity of the taxpayer.

The purpose test is determined by reference to objective evidence. The Commissioner must look at the nature of the activities that led to the conclusion of the contract for the supply and which entity conducts them; in particular, how each of the relevant entities interacts with the Australian customer in relation to the supply.

b. Obtaining Tax Benefit

It should be noted that the MAAL also requires an examination of whether the scheme has resulted in a relevant entity reducing its liability to tax under a foreign law as a result of the scheme.

In this context, LCG 2015/2 raises the following additional framing questions to consider:

> (i) Is the income from sales to Australian customers not subject to tax in the country of residence of the foreign entity?
>
> (ii) Does the foreign entity receive a tax concession (corporate or otherwise) under a foreign law that reduces taxation on the income from sales to Australian customers?
>
> (iii) Does the foreign entity make related party payments to other members of the global group that relate to the income from Australian sales, which are not taxed (or taxed at a concessional rate) in the hands of the member of the group that receives them?
>
> (iv) Does the scheme involve transactions that result in a reduction in tax due to the operation of a foreign tax law or a tax treaty?
>
> (v) If foreign tax is paid by any member of the global group in relation to the income from Australian sales, is the rate of foreign tax paid lower than Australia's corporate rate of taxation?

These questions reflect the fact that the rules are focused on both the avoidance of tax in Australia, and the reduction of tax offshore through the use of low tax paying jurisdictions to minimize the global tax paid by a multinational group.

6. Quantum of Liability

Even if the MAAL were to apply, one of the more problematic issues facing the application of these rules is that even if a PE were to exist, the profits attributed to a deemed MAAL PE would not be material.

Australia's rules regarding the attribution of profits of a nonresident company to an Australian PE were originally contained in the now-repealed Division 13 of the 1936 ITAA, and the 'business profits' articles of its comprehensive double taxation treaties.

> The business profits article of most treaties includes the relevant set of rules for present purposes in Article 5(1), being: The profits of an enterprise of one of the Contracting States shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.
>
> The allocation of expenses is also often covered. Using the Australia- Singapore tax treaty as an example (see Article 5(3)): In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses of the enterprise, being expenses which are incurred for the purposes of the permanent establishment and which would be deductible if the permanent establishment were an independent entity which paid those expenses, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere.

Tax treaties are subject to the international rules of treaty interpretation: see generally *Fothergill v. Monarch Airlines* [1981] AC 251 and the 1969 Vienna Convention on the Law of Treaties. As discussed in *Thiel v. FCT* (1990) 21 ATR 531, it is acceptable to have regard to the OECD Model Convention and Commentaries for purposes of interpreting undefined terms.

a. Administrative Guidance

The ATO considered the now-repealed Division 13, and Australia's typical treaty business profits articles, in public ruling TR 2001/11. Although Division 13 has been repealed, the principles set out in the ruling remain relevant. At paragraph 3.19 the Commissioner states:

> There is a variety of language used in tax treaties and domestic law to describe the attribution concept. Articles 10 to 12 and 21 of the Vietnamese agreement and the OECD Model Convention use the phrase 'effectively connected with'; in the case of Articles 10 to 12 this refers to the property giving rise to the type of income in question and in Article 21 to the income. Similarly, Article 13 of the Vietnamese Agreement on capital gains refers to property that forms part of the business property of a PE. In the ITAA 1936, subsection 136AE(4) refers to the derivation of income or the incurring of expenditure being attributable to activities carried on by the taxpayer at or through the PE, section 23AH refers to foreign income derived in carrying on a business at or through a PE, and subparagraph 128B(3)(h)(ii) to interest derived by a nonresident in carrying on business in Australia

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> at or through a PE of the non-resident in Australia (similar language occurs elsewhere in section 128B). Notwithstanding this variety of expression, the same operating idea of attribution applies in these and similar cases.

The Commissioner considered the correct approach to the attribution of income and expenses to a PE and indicated that attribution should be undertaken by reference to an "arm's length separate enterprise principle" (see TR 2001/11 at [1.7]). This involves a functional analysis to identify the economically significant activities of the PE (see [4.17]–[4.25]), which allows the hypothetical construction of the "capital structure, assets and liabilities, [and] independent management and business strategy" of the PE, which in turn allows the attribution of an arm's length profit.

The effect of such an approach is that (at [3.16]):

> [I]ncome is attributable to activities conducted at or through a PE to the extent that those activities are, in substance, a contributing factor in generating the income or give rise to benefits from expenditure incurred.

b. OECD Commentary

The ATO has accepted that subsequent editions of the OECD Commentary remain relevant to the interpretation of earlier-concluded treaties, so long as the underlying substance of the Model Convention remains consistent (see public ruling TR 2001/13 at [108]). This aligns with the OECD view, as set out in paragraphs 9 and 33 to 36.1 of the Introduction to the 2014 OECD Model Convention. For present purposes, although Article 7 of the Model Convention has been subject to amendment since the implementation of the equivalent Article 5 of the Australia-Singapore tax treaty, these amendments are not relevant. Accordingly, reference should be made to the OECD commentary (including earlier versions), to the extent that the referenced portions do not relate to provisions that have been amended in a way so as to make the use of such commentary inappropriate.

It should also be noted that, under Australian transfer pricing provisions, for purposes of attributing profits to a PE under Sub-division 815-C of ITAA 1997, specific reference is made to the Commentary on Article 7 of the OECD Model Convention as it read before July 22, 2010 (i.e, the 2008 version). By contrast, for the purpose of applying our transfer pricing provisions to transactions between entities under Sub-division 815-B of ITAA 1997, specific reference is made to the OECD Commentary as it read on July 22, 2010. These distinctions, and the more general ambulatory approach to treaty interpretation, have been taken into account in our commentary below.

The OECD Commentary (2008) provides, (at [14, Article 7]):

> [T]he profits to be attributed to a permanent establishment are those which that permanent establishment would have made if, instead of dealing with the rest of the enterprise, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market.

> This process requires a series of analytical steps, being (at [18, Article 7]):Under [the] first step, the economically significant activities and responsibilities undertaken through the permanent establishment will be identified.
>
> …
>
> Under the second step … the remuneration of any such dealings will be determined by applying … the arm's length principle … by reference to the functions performed, assets used and risk assumed by the enterprise through the permanent establishment.

With particular regard to dependent agents, the OECD Commentary (2008) states (at [26, Article 7]):

> As a first step, the activities that the dependent agent undertakes for the enterprise will be identified through a functional and factual analysis that will determine the functions undertaken by the dependent agent both on its own account and on behalf of the enterprise. The dependent agent and the enterprise on behalf of which it is acting constitute two separate potential taxpayers. On the one hand, the dependent agent will derive its own income and profits from the activities that it performs on its own account for the enterprise … On the other hand, the deemed permanent establishment of the enterprise will be attributed the assets and risks of the enterprise relating to the functions performed by the dependent agent on behalf of that enterprise (i.e. the activities that the dependent agent undertakes for that enterprise), together with sufficient capital to support those assets and risks. Profits will then be attributed to the deemed permanent establishment on the basis of those assets, risks and capital.

For purposes of discerning the appropriate profits to be attributed, as set out above, it is necessary to attribute expenses (as set out in Article 5(3) of the Australia-Singapore tax treaty). In terms of the attribution of expenses, the OECD Commentary (2008) broadly notes that some expenses may be simple to attribute, by way of a *pro rata* allocation (at [27], Article 7):

> In the case, for example, of general administrative expenses incurred at the head office of the enterprise, it may be appropriate to take into account a proportionate part based on the ratio that the permanent establishment's turnover (or perhaps gross profits) bears to that of the enterprise as a whole.

This position is subject to a qualification, however, to the effect that (at [27], Article 7):

> [I]t is considered that the amount of expenses to be taken into account as incurred for the purposes of the permanent establishment should be the actual amount so incurred.

Accordingly, the expenses attributed to a PE are to be those actually incurred for purposes of the assets, risks and capital assigned to the PE under the approach set out above.

This additionally aligns with the further OECD 2010 Report on the Attribution of Profits to Permanent Establishments (2010 Report), which summarizes the intended process as follows (at [172]):

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Functions, assets, risks and free capital are attributed to the PE together with the income and expenses arising from transactions with other enterprises (both associated and independent).

The 2010 Report additionally specifically considers dependent agent PEs, noting (at [228]) that such a PE should not exert a "force of attraction" on foreign-sourced profits that it did not play a part in generating. Instead, an analysis should be undertaken of the "significant people functions" performed by the PE, with regard to how those functions inform the assumption/management of risk and the economic ownership of assets and capital. Appropriate amounts of income and outgoings should then be attributed on the basis of those hypothetical risks, assets and capital. In the author's opinion, in the context of most multinational groups, this should result in the profit attributed to the PE being very low, or nil.

c. *Additional Administrative Guidance*

The ATO additionally released in 2005 a non-binding set of guidance materials entitled "Attributing profits to a dependent agent permanent establishment."

The process identified in this publication reflects the process identified above. Additionally, however, the publication includes a number of worked examples that, while lacking precedential value, are indicative of the ATO's position and key concerns.

The types of outgoings that are attributed to the PEs include costs relating to advertising, bad debts and stock losses, consistent with the approach described above. However, even taking into account this additional guidance, the basis on which the ATO could on a reasonable basis attribute profits to an Australian deemed MAAL PE is questionable.

C. Diverted Profits Tax

The diverted profits tax (DPT) applies to tax benefits arising in income years that start on or after July 1, 2017. The DPT allows the Commissioner of Taxation to tax the diverted profits of certain entities at a rate of 40%.

The DPT applies only to multinationals with annual global income of at least A$1 billion (known as significant global entities) where it is reasonable to conclude that the Australian income of the group exceeds A$25 million and (very broadly):

(i) The taxpayer has obtained a tax benefit in connection with the scheme in an income year;

(ii) It would be concluded that one of the persons who entered into or carried out the scheme did so for a principal purpose of enabling the relevant taxpayer to obtain a tax benefit, or both to obtain a tax benefit and reduce a foreign tax liability;

(iii) A foreign entity that is an associate of the relevant taxpayer is one of the persons connected with the scheme;

(iv) It is reasonable to conclude that:

- Any increase in foreign tax of foreign entities associated with the scheme is less than 80% of the reduction in the Australian tax liability. Very broadly, what this means is that, if profits are shifted from Australia (currently with a corporate tax rate of 30%) to another country with a tax rate of less than 24%, this requirement for the application of the MAAL will be satisfied; and

- The profit made as a result of the scheme by each entity that is associated does not reasonably reflect the economic substance of the entity's activities in connection with the scheme (referred to below as the "sufficient economic substance test"). The sufficient economic substance test makes a specific reference to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. In determining whether the sufficient economic substance test applies, the activities of an entity connected with the scheme may be disregarded if that entity's role in the scheme is "minor or ancillary."

The DPT will not apply where the taxpayer satisfies any one of the following tests:

- The A$25 million income threshold test: The Australian entity and associated Australian entities' assessable income, exempt income, and non-assessable non-exempt income does not exceed A$25 million;

- The sufficient foreign tax test: An increase in foreign tax liabilities from the arrangement to be at least equal to 80% of the corresponding reduction in the Australian tax liability;

- The sufficient economic substance test: Broadly, this exception is based upon whether it is reasonable to conclude that, based on the information available to the ATO at the time, the transaction was designed to secure the tax reduction. In applying the test, it is the economic substance of the entity's activities in connection with the scheme that is relevant, not the overall economic substance of the entity itself. The focus will be on the quantum of the profit made relative to the economic substance of the entity's activities undertaken in connection with the scheme.

The economic substance test may not be satisfied, for example, where:

— The entity's role in the scheme does not make commercial sense;

— The scheme as a whole does not make commercial sense;

— The scheme does not produce a real economic effect because the transactions under the scheme are self-cancelling, offsetting or circular; or

— The entity's role is primarily explicable by the tax consequences which arise as a result of the scheme, for example re-invoicing schemes, outsourcing arrangements, sale and leaseback arrangements, sale and license back arrangements, and arrangements involving interposed or fiscally transparent entities.

The DPT will also not apply to the following entities:

(i) A managed investment fund;

(ii) A foreign collection investment vehicle with wide membership;

(iii) A foreign entity owned by a foreign government;

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(iv) A complying superannuation entity;

(v) A foreign pension fund.

The DPT assessment and appeals process largely remains the same and encourages taxpayers to comply at an early stage in the context of rules that may ultimately be viewed as weighted in the Commissioner's favor.

The Commissioner's ability to form a conclusion is not prevented by a lack of, or incomplete, information provided by the taxpayer. Furthermore, the Commissioner is not required to actively seek additional information to reach a conclusion in relation to these tests.

If the DPT applies, the Commissioner may issue an assessment to the relevant taxpayer and pursuant to the Diverted Profits Tax Act of 2017 impose tax on the amount of the diverted profits at a penalty rate of 40%.

Where the Commissioner issues a DPT assessment, the taxpayer has 21 days to pay the amount therein.

After the issuance of the notice of a DPT assessment, a period of review follows, which generally lasts 12 months after the date the notice has been given. During this period, the taxpayer can provide the Commissioner with further information, putting forth its reasons why the assessment should be reduced or withdrawn.

If at the end of that review period, the taxpayer remains dissatisfied with the DPT assessment (or an amended assessment), the taxpayer has 60 days to file an appeal with the Federal Court of Australia. In such case, the court will generally be restricted to considering evidence that was provided to the Commissioner before the end of the review period. That is, any information or documents that the taxpayer or an associate had in its custody or control at a time before, during or after the period of review, and which the Commissioner did not have in his or her custody or control during the period of review, will generally not be admissible in the proceedings.

The potential scope of application of the DPT is extremely broad. The ATO has provided three key documents as guidance on when the DPT will be applied in practice. These are:

(1) PSLA 2017/2, with internal directions to ATO staff in applying the DPT test, required processing and internal agency sign-off before issuing an assessment;

(2) Law Companion Ruling LCR 2018/6, which is focused explaining the key concepts introduced by the measure; and

(3) Practical Compliance Guideline PCG 2018/5, which sets out the ATO's client engagement framework and its approach to risk assessment and compliance activity when the DPT is identified as a potential area of concern.

PCG 2018/5 also provides example scenarios that would be considered higher risk and likely to attract the attention of the ATO.

D. Anti-Hybrid Rules

The anti-hybrid rules in Division 832 of ITAA 1997 neutralize the effects of hybrid mismatch arrangements. The legislation is intended to implement the OECD's recommendations in its BEPS Action 2 Final Report on Neutralising the Effects of Hybrid Mismatch Arrangements dated October 5, 2015 (the OECD Action 2 Report), although there are some differences (notably the integrity rule which applies to certain financing arrangements). Broadly, hybrid mismatch arrangements arise where entities exploit differences in the taxation treatment of an entity or instrument under the laws of at least two tax jurisdictions to defer or reduce income tax. This can result in double non-taxation, including long term tax deferral. There is no materiality or *de minimis* threshold.

The types of hybrid mismatch arrangements are deduction/deduction mismatch arrangements (D/D Mismatch) and deduction/non-inclusion mismatch arrangements (D/NI Mismatch). A D/D Mismatch occurs when a business receives a deduction in two countries for the same payment. A D/NI Mismatch occurs when a deduction is provided for a payment in one country, but the corresponding income is not included as assessable income in another country. The breadth of this test is extremely broad. As discussed in Income Tax Ruling TD2024/4, this test is not limited to the jurisdiction in which the recipient is resident. The non-inclusion country can include a jurisdiction other than the jurisdiction in which the payee is resident. It is possible to look at other jurisdictions by reference to hypothetical income or profits. As an example, a payee can be a liable entity in the US despite not earning an income in the US (see examples 2 and 3 in TD2024/4).

Division 832 neutralizes the effects of hybrid mismatches by modifying the outcomes that arise under Australian income tax law. In most cases this occurs by requiring the Australian company to disallow all or part of the deduction, or alternatively by including an amount in assessable income.

In some circumstances the modification of the Australian income tax outcome is subject to whether the effect of the mismatch has been neutralized under the taxation law in a foreign jurisdiction. This aligns with the OECD's recommended ordering of primary response and secondary response hybrid mismatch provisions. In applying the provisions in Division 832, regard should be had to the commentary in the OECD Action 2 Report and the OECD Branch Mismatch Arrangements Report.

The anti-hybrid rules target various hybrid arrangements through different subdivisions within Division 832 as follows:

(i) Subdivision 832-C: this Subdivision neutralizes a hybrid financial instrument mismatch if it involves a deduction, or non-inclusion, in Australia. The mismatch must be attributable to differences in the treatment of the financial instrument arising from the terms of the interest or arrangement.

(ii) Subdivision 832-D: this Subdivision neutralizes a hybrid payer mismatch if it involves a deduction, or non-inclusion, in Australia. Broadly, an entity is a hybrid payer if a payment it makes is disregarded for the purposes of the tax law of one country (resulting in non-inclusion) but is deductible for the purposes of the tax law of another country. The OECD Action 2 Report explains that a person making a payment is a hybrid payer in circumstances where the tax treatment of the payer, under the laws of the payee jurisdiction, results in the payment being disregarded for tax purposes in the hands of the payee.

(iii) Subdivision 832-E: this Subdivision neutralizes a reverse hybrid mismatch if it involves a deduction, or non-inclusion, in Australia. A reverse hybrid is any person

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treated as transparent under the laws of the jurisdiction where it is established but as a separate entity (i.e., opaque) under the laws of the jurisdiction of the investor. The transparency or opacity is tested by reference to the payment that is subject to the reverse hybrid rule. A payment results in a hybrid mismatch if a mismatch would not have arisen had the accrued income been paid directly to the investor.

(iv) Subdivision 832-F: this Subdivision neutralizes a branch hybrid mismatch if the payment is made directly or indirectly to a branch hybrid, and the mismatch would not have arisen, or would have been less, if the residence country had not recognized the permanent establishment. That is, the payment is not included in ordinary income by either the residence or branch jurisdiction.

(v) Subdivision 832-G: this Subdivision neutralizes a deducting hybrid mismatch if it involves a deduction in Australia. An entity is a deducting hybrid if a payment it makes is deductible for the purposes of the tax law of two countries.

(vi) Subdivision 832-H: this Subdivision neutralizes an imported hybrid mismatch. This involves identifying if a hybrid mismatch involving two foreign countries has been imported into Australia through a deduction, which effectively shelters receipts in Australia from tax. On December 16, 2021 the Commissioner of Taxation released Practical Compliance Guideline 2021/5 which sets out the Commissioner's approach to assessing the relative levels of tax compliance risk associated with the imported hybrid mismatch rule for non-structured arrangements. The Guideline contains the Commissioner's expectations as to the level of information a taxpayer is required to obtain to evidence compliance with the imported hybrid mismatch rule and support its entitlement to a deduction. Taxpayers required to file a Reportable Tax Position Schedule with their tax return may be required to self-assess and disclose their "risk zone" under the Guideline.

(vii) Subdivision 832-J: this Subdivision contains an integrity measure which disallows a deduction for interest broadly where the interest is subject to foreign income tax at a rate of 10% or less. It is aimed at preventing multinationals from circumventing the hybrid mismatch rules by routing investment or financing into Australia via an entity located in a no or low tax (10% or less) jurisdiction. However, unlike the other Subdivisions, there must have been a principal purpose of enabling a deduction to be obtained in respect of the interest payment and enabling foreign income tax to be imposed on the payment at a rate of 10% or less or enabling foreign income tax not to be imposed on the payment. The Commissioner has set out guidance on the integrity rule in Law Companion Ruling 2021/1.

Part IVA of ITAA 1936 (i.e., the general anti-avoidance regime) may have applied to specific transactions involving a D/NI Mismatch or D/D Mismatch where an Australian tax benefit was obtained and the requisite sole or dominant purpose of obtaining the tax benefit was present. However, Part IVA would not have been capable of applying where the mismatch was effectively imported into Australia (which is caught by Subdivision 832-H) or where there was no purpose of obtaining the tax benefit. With the exception of Subdivision 832-J, generally there does not need to be a purpose of obtaining a tax benefit for the anti-hybrid rules to apply. The anti-hybrid rules generally apply where either: (i) the entities are related (for example, they are part of the same accounting consolidated group); or (ii) the payment is made under a "structured arrangement." A structured arrangement exists where either the mismatch is priced into the terms of the scheme under which the payment is made, or it is reasonable to conclude that the mismatch is a design feature of the scheme under which the payment is made. Although this latter limb could be viewed as a quasi-purpose test, the Commissioner has said in his guidance on the concept of structured arrangement, contained in Law Companion Ruling 2019/3, that "the test does not require one to consider the purpose of the parties to the transaction or scheme. The rationale, commercial or otherwise, for entering into the scheme, whilst perhaps one of a number of facts to be taken into account, need not determine whether the hybrid mismatch was a design feature of the scheme."

There is a risk that the Commissioner could apply Part IVA where a taxpayer restructures an existing hybrid arrangement to avoid the application of the hybrid mismatch rules. The ATO has released Practical Compliance Guideline 2018/7, which sets out what kind of restructuring that the Commissioner considers to be "low risk" and to which the Commissioner would not seek to apply the general anti-avoidance rules.

The Commissioner considers that a low-risk arrangement is one involving a straightforward restructuring that involves removing the hybrid elements of existing arrangements whilst keeping the surrounding facts and circumstances unaltered. PCG 2018/7 provides that the application of Part IVA will generally be determined on the character of the schemes before and after any change, rather than the fact of change. In circumstances where a taxpayer engages in ordinary commercial dealings both before and after the change, the fact that the change preserves a tax benefit will generally be insignificant as a tax avoidance purpose will not be inferred from normal business dealings merely because a tax benefit is achieved as an outcome.

PCG 2018/7 lists the factors that the Commissioner expects to be present for a restructure to be classified as 'low risk.' Ideally, all of these factors will be present. However, the ATO recognizes that this may not be possible in all circumstances — for example where one of the factors is not appropriate or relevant in the particular circumstance.

The relevant factors are:

(i) There is no change to the entities or jurisdictions of entities involved under the replacement arrangement, unless the change in entities is the result of the removal from the original arrangement of an entity whose tax characteristics gave rise to the hybrid outcome. The ATO states that this factor is concerned with the interposition of entities or jurisdictions unconnected with the original arrangement, where the interposition might be indicative of tax driven restructuring.

(ii) The original arrangement prior to the restructure would not have attracted the application of Part IVA.

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(iii) The replacement arrangement on a stand-alone basis would not attract the application of Part IVA (that is, viewed without regard to the original arrangement or the restructuring steps).

(iv) The restructure and the replacement arrangement are effected in a straightforward manner, explicable only by an objective of eliminating hybrid outcomes.

(v) Both the restructure steps and the replacement arrangement are implemented in a commercial manner reflecting arm's length conditions.

E. Crimes (Taxation Offenses) Act, 1980

In response to certain tax avoidance schemes that had been in wide use, the government adopted criminal legislation as a deterrent. The legislation imposes criminal liability upon persons participating in such schemes, both as principals and in "aiding and abetting the offense." The latter limb of the legislation is designed to catch persons that advise upon such schemes and has caused concern among lawyers and accountants that render taxation advice to their clients. The penalties are quite severe: including up to 10 years in jail for conviction.

F. Australian Taxation Office Access to Accountants' Papers

Agreement has been reached with the Commissioner on guidelines for access by the ATO to the working papers and advice papers held by external accountants and their clients.

Basically, the Commissioner will continue to seek access without restriction to those documents that are prepared in connection with the conception, implementation, and formal recording of a transaction or arrangement, and that explain the setting, context, and purpose of that transaction or arrangement.

Generally, the Commissioner will not seek access to documents, such as the statutory audit file or those relating to a prudential tax audit, except in cases of fraud, evasion or other illegality, and as a last resort where other avenues have failed.

Accountants' advice to taxpayers will be sought only in exceptional circumstances in cases of fraud, evasion or other illegality.

The guidelines recognize that while broad powers of access to documents are required in exceptional circumstances, it is important that taxpayers be able to consult with their accountants, in normal business dealings, on a confidential basis, such as exists under concepts of legal privilege.

G. Cash Transactions

Financial institutions and other cash dealers must formally report cash transactions of A$10,000 or more to The Australian Transactions Reports and Analysis Centre (AUSTRAC). A cash dealer also is required to report any transactions that he suspects involve a breach of Commonwealth law.

The provisions impose obligations to report currency transfers to and from Australia that involve the transfer of foreign currency of A$10,000 or more out of Australia, and the transfer of Australian or foreign currency of A$10,000 or more into Australia. Compulsory verification procedures are set down for persons opening or operating accounts with financial institutions and make it an offense to open or operate an account with a cash dealer under a false name. Cash dealers affected include most financial institutions, gambling houses, casinos and bookmakers, as well as firms dealing in travelers' checks, money orders, etc. There are exemptions from the reporting requirements for transactions undertaken by certain high cash flow businesses, employers for payroll withdrawals and government agencies. For instance, a cash transaction is an exempt transaction for a high cash flow business if it is between a financial services licensee whose license covers dealing in derivatives and a clearing and settlement facility that is associated with a financial market of which the financial services licensee is a member. This exemption is based on certain businesses for which the risk of abuse is outweighed by the obligation of complying with the provisions.

H. Tax Scheme Promotion Rules

Division 290 of Schedule 1 of the Taxation Administration Act 1953 (TAA) includes rules designed to deter two specific types of behavior:

(i) The promotion of "tax exploitation schemes"; and

(ii) The incorrect use of "product rulings" (being binding statements by the Commissioner of Taxation regarding the tax treatment of particular financial "products").

These are discussed in 1. and 2., below, respectively. If the Federal Court of Australia is satisfied, on application by the Commissioner of Taxation, that any "entity" (which includes companies, partnerships, trusts and individuals) has undertaken these activities, the Court may order the entity to pay a civil penalty to the Commonwealth of the greater of:

(i) A$550,000 (for an individual) or A$2.75 million (for a corporate); or

(ii) Twice the consideration received or receivable by the entity and its associates with respect to the scheme.

The Commissioner may also, in certain circumstances, apply to the Federal Court for an injunction restraining or modifying the entity's behavior. The Commissioner and the promoter may also enter into a voluntary arrangement whereby the promoter agrees not to undertake the particular activity concerned.

1. Promotion of Tax Avoidance Schemes

An entity must not engage in behavior that results in that or another entity being the "promoter" of a "tax exploitation scheme."

A promoter is someone who undertakes a substantial role in the marketing (or otherwise encourages the growth) of a scheme and receives consideration with respect to that marketing and promotion. It does not include a mere advisor. It does not include an employee who merely distributes information or material prepared by another entity.

A tax exploitation scheme is (broadly) a scheme where it is reasonable to conclude that an entity was involved in the scheme for the dominant purpose of getting a "scheme benefit," and it is *not* "reasonably arguable" that the scheme benefit is available as a matter of law. A scheme benefit includes any tax related liability, credit or refund. This includes most of the federal taxes referred to in IV., above (including income tax, GST, fringe benefits tax, petroleum resource rent tax and superannuation surcharges) but does not include stamp duty (which is a

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state-based tax). A benefit is reasonably arguable if it would be concluded, having regard to the relevant authorities, that what is argued is "about as likely to be correct as incorrect." The reasonably arguable test does not require that the treatment given to a particular matter by a taxpayer be the better view or be more likely than not the correct treatment. All that is required is that the prospects that the taxpayer's treatment will be upheld by a court or Tribunal as being correct must be substantial, whether or not those prospects are less than or greater than 50%.

There are exceptions to this rule. These are, if:

(i) The conduct was due to a reasonable mistake of fact;

(ii) The conduct was due to the actions of another person beyond the entity's control and the entity took reasonable precautions and exercised due diligence to avoid the conduct;

(iii) The tax outcome agrees with tax advice that has previously been given to the entity by the Commissioner of Taxation or a statement in a publication approved in writing by the Commissioner;

(iv) It is more than four years since the entity last engaged in conduct (with the exception of tax evasion or fraud for which there is no time limit);

(v) The entity did not know, and had no reasonable grounds for knowing, that the entity's actions would produce that result; or

(vi) The entity's involvement in the transaction cannot fall within the scope of the rules.

2. Incorrect Use of Product Rulings

Product rulings are public documents issued by the Commissioner of Taxation that set out the Commissioner's opinion regarding the income tax treatment of a particular arrangement. A ruling is legally binding on the Commissioner. A ruling can be relied on by taxpayers that enter into an arrangement in a manner that is consistent with the relevant ruling. The reference to "product" reflects the fact that these rulings typically focus on financial products offered to the retail investor market. Product rulings are a subset of the public ruling system and are discussed in greater detail at IV.A.2.a., above.

To protect the veracity of the product ruling system, these tax promoter rules subject to the civil penalties set out above the promotion of a scheme, based on conformity with a product ruling, that is "materially different" from that described in the product ruling.

3. Tax Adviser Misconduct

The current Australian Federal Government proposed on August 8, 2023 to "oversee the biggest crackdown on tax adviser misconduct in Australian history."[303]

The measures cover three priority areas:

(i) Strengthening the integrity of the tax system: enhancing the scope of the tax promoter penalty laws (which have remained largely untouched since their creation in the 2000s and have only been applied six times);

(ii) Increasing the powers of regulators: removing certain limitations in the tax secrecy laws, protecting whistleblowers and introducing certain other measures; and

(iii) Strengthening regulatory arrangements to ensure they are fit for their purpose: including strengthening the range of sanctions available to various regulatory bodies in Australia such as the Tax Practitioners Board.

A Treasury consultation paper and draft regulations were published on December 10, 2023 with feedback on the proposals due by January 21, 2024.

On November 16, 2023, the Treasury Laws Amendment (Tax Accountability and Fairness) Act 2023 was enacted to implement these measures, taking effect from July 1, 2024.

Schedule 1 amends the TAA 1953. The Commissioner's entitlement to apply to the Federal Court of Australia for an order that an entity has contravened the promoter penalty laws will be extended to six years from the time the conduct that is alleged to have contravened the laws was last undertaken, with an exception from the time limitation periods for schemes that involve, or if implemented would involve, tax evasion (for which the time period will be unlimited). The penalty for a body corporate or significant global entity SGE is the greatest of: (i) 50,000 penalty units (one penalty unit is A$313); (ii) three times the benefits received or receivable (directly or indirectly) by the entity and associates of the entity in respect of the scheme; and (iii) 10% of the aggregated turnover of the entity for the most recent income year to end before the entity engaged, or began to engage, in conduct that contravenes the promoter penalty laws; subject to an overall cap of 2.5 million penalty units.

Schedule 2 to the Bill amends Part IVD of the TAA 1953 to extend whistleblower protections to eligible whistleblowers who make disclosures to the Tax Practitioners Board (TPB) where they believe the information may assist the TPB to perform its functions or duties under the Tax Agent Services Act (TAS Act). As stated in the EM at paragraph 2.4: "The PwC scandal exposed severe shortcomings in Australia's regulatory frameworks, including limitations in the abilities of Australia's regulators to receive and share information from whistleblowers. These limitations arbitrarily and negatively constrain the integrity of the taxation system." A disclosure of information now qualifies for protection if made to the Commissioner to assist the Commissioner perform their functions or duties under the taxation law, or to the TPB to assist the TPB to perform its functions or duties under the TAS Act. A discloser is further protected if they make disclosures for the purposes of obtaining assistance in relation to a disclosure to a medical practitioner, psychologist or an entity prescribed in the regulations.

Schedule 3 aims to enhance public confidence in the regulation of the tax profession by increase the information published on the TPB Register, remove the 12-month time limit for certain information to remain on the register, extend the timeframe that the TPB has to conduct an investigation, and better target the TPB's delegation powers.

Comment: Beyond these amendments, it is not clear whether the Federal Government will introduce additional measures relating to BEPS Action 12 (Mandatory Disclosure

[303] The Hon Mark Dreyfus KC MP 6 August 2023 Media Release.

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Rules). There has been very little additional guidance provided to date, and this may be the extent of the reforms in this space.

I. Asset Financing for Tax Preferred Entities

Division 250 of ITAA 1997 contains anti-avoidance rules dealing with the tax treatment of asset financing arrangements entered into between tax-paying entities and tax preferred end users. These rules are designed to ensure that tax attributes (such as depreciation and capital allowances) cannot be shifted by tax preferred end users to taxpayers that value tax deductions more highly.

The rules effectively reverse the tax consequences of the asset financing arrangement, and the taxpayer is treated as if it had merely lent money to the end user. That is:

(i) The capital allowances and depreciation deductions of the taxpayer are denied; and

(ii) The consideration received by the taxpayer for the provision of the asset to the tax preferred end user (typically rent under a lease) will be treated as the repayment of a deemed loan — meaning the receipts are characterized as (assessable) interest and (non-assessable) repayment of principal. The deemed interest element is calculated using a compounding accrual method set out in Division 250. Applying a compounding accrual method to the deemed interest may mean that income is required to be recognized in advance of being received.

1. Application of Rules

Broadly, Division 250 may apply to a taxpayer regarding an asset if:

(i) The asset is being put to a tax preferred use;

(ii) The arrangement is for more than 12 months;

(iii) Financial benefits are provided to the taxpayer (or a connected entity) by:

- A tax preferred end user (or a connected entity);
- Any tax preferred entity (or a connected entity); or
- A nonresident.

(iv) The taxpayer would (but for Division 250) be entitled to depreciate or otherwise claim capital allowance deductions; and

(v) The taxpayer does not have a "predominant economic interest" in the asset.

2. Exclusions

There are a number of specific exclusions. In particular for:

(i) Arrangements involving taxpayers that are small business entities or where the financial benefits do not exceed A$5 million;

(ii) Arrangements where the tax preferred use of the asset does not exceed five years in the case of leases of real property or three years in any other case;

(iii) Arrangements where Division 250 reduces the tax liability by the taxpayer; and

(iv) Arrangements excluded at the discretion of the Commissioner.

3. Tax Preferred End Use

a. End User

These rules focus on the party that is the end user of the asset. This concept is central to many of the elements discussed above and below. An entity is the end user of an asset if the entity uses, controls the use, is able to control the use or will be able to control the use of the asset. The control can be direct or indirect. It includes a lessee.

b. Tax Preferred End User

An end user is a tax preferred end user if the end user is a tax preferred entity or a nonresident.

c. Tax Preferred Entity

A tax preferred entity includes an exempt entity, exempt Australian government agency and exempt foreign government agency.

An asset will be put to a tax preferred end use if the asset is:

(i) Leased to an end user — the end user is either a nonresident (that will use the asset wholly or principally outside Australia) or a tax preferred entity; or

(ii) Used in connection with the production, supply, carriage, transmission or delivery of goods or the provision of services — the end user of the goods, service or facilities is either a nonresident (that will use the asset wholly or principally outside Australia) or a tax preferred entity (other than an exempt foreign government agency).

4. Duration of Arrangement

The second requirement is that the arrangement period must be greater than 12 months. Generally, the arrangement period commences when the asset is put to a tax preferred use. Where there are extension or renewal rights, the taxpayer is to assume that the extension or renewal will not be exercised unless the commercial consequences of not renewing or extending would be such that it is reasonable to assume that the extension or renewal would occur.

5. Financial Benefits Test

Financial benefits are not limited to monetary amounts. The financial benefits arising from the tax preferred use will include financial benefits:

(i) Relating to bringing the asset into a state, condition or location in which it can be put to the tax preferred use;

(ii) Relating to the end of the tax preferred use, such as any guaranteed residual value;

(iii) Provided in relation to the termination or expiration of the arrangement in relation to the asset;

(iv) In relation to the purchase or acquisition of the asset; or

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(v) Calculated by reference to receipts generated by the use of the asset.

Importantly for infrastructure projects, financial benefits will not include road tolls paid by road users collected by the tax preferred entity and passed on; nor financial benefits provided under national marketing and distribution arrangements for electricity by a tax preferred authority to the electricity generator representing amounts payable by the electricity users.

6. Entitlement to Capital Allowances

The next requirement is that the taxpayer would have otherwise been entitled to deduction of the cost of the relevant asset under the depreciation or other capital allowance rules. Financing arrangements involving assets which do not entitle the relevant taxpayer to deductions for these amounts over the term of the arrangement will not be affected by Division 250.

7. Predominant Economic Interest Test

This particular requirement is likely, in practice, to be the one that really determines the application of Division 250.

A taxpayer will be taken as lacking the predominant economic interest in the asset if one or more of the following tests are satisfied:

a. Limited Recourse Debt Test

This test varies depending on the end user. If the end user is a nonresident, the limited recourse debt test will be breached if more than 55% of the cost of acquisition or construction of the asset is financed by limited recourse debt. If the end user is a tax preferred entity, the limited recourse debt test will be breached if more than 80% of the cost of acquisition or construction of the asset is financed by limited recourse debt.

If the taxpayer is a corporate tax entity then this test will not apply if the tax preferred use of the asset is not a lease or is a lease of real property but less than half the space within the property is occupied by members of the tax preferred sector (e.g., government entities and nonresidents); and the asset is used wholly or principally in Australia; and no tax-exempt entity or nonresident provides financing of the taxpayer's interest in the asset. Similar rules apply to trusts.

b. Right to Acquire Asset Test

This test will be satisfied if a member of the tax preferred sector has a right to acquire the asset at the end of the arrangement period at less than market value.

c. Effectively Non-cancellable Long-term Arrangement Test

This applies where the arrangement period is greater than either 30 years or 75% of the remaining effective life of the asset test.

d. Level of Expected Financial Benefits Test

This test applies if the asset has a guaranteed residual value, if the arrangement is a debt interest or if the total of the present value of the financial benefits is more than 70% of the adjustable value of the asset.

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Worksheet 17 Fringe Benefits Tax Return. NAT 1067
https://www.ato.gov.au/forms-and-instructions/fringe-benefits-tax-return-2024.

Note: Tax forms and instructions are available for download at ato.gov.au, by entering the NAT form number or the form name.

Working Papers for this Portfolio can be found online at https://bloombergtax.com.

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