US withholding taxes, franking credits and structuring

By Renuka Somers, CTA, Head, US–Australia Tax Desk, Asena Advisors LLC

Abstract: In this article, the author considers the impact of US withholding taxes and the foreign income tax offset on the application of the franking credit rules, with a case study illustrating the implications of US-sourced royalties for an Australian resident company in this context.

Introduction

Payments of foreign withholding taxes can result in the loss of franking credits for shareholders due to the exclusion of foreign income taxes from franking credits. This increases the effective tax rate on returns to Australian shareholders. This article explores the tax impact for shareholders in the context of US withholding taxes on royalties derived by an Australian resident company, and whether the restructuring of foreign operations could be a viable means to address the issue.

Case study

AU Co. is an Australian resident company and derives US-sourced royalty income. US withholding tax is deducted by its customers prior to payment of the royalties to AU Co. (see Diagram 1).

What is the true tax impact of the withholding payments for AU Co. shareholders once the FITO and franking credits are accounted for?

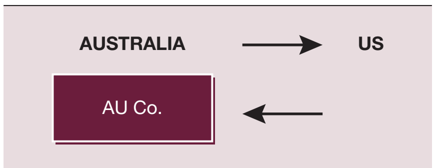
Should AU Co. restructure its operations for tax efficiencies?

US withholding tax

Non-resident aliens of the US (such as AU Co., a foreign company[1]) are subject to US withholding tax on "fixed or determinable, annual, or periodic" (FDAP) income such as interest, dividends, rents or royalties paid by US companies.

Section 1441 of the *Internal Revenue Code* (US) (IRC) specifically requires a "withholding agent", being any person having the control, receipt, custody, disposal or payment of items of income such as dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other FDAP gains, profits (to the extent that such items constitute gross income from sources within the US), of any "nonresident alien individual" or of any foreign partnership, to deduct and withhold tax at the rate of 30%. This requirement is extended to US-sourced income paid to foreign corporations.[2]

Diagram 1. Cross-border income and withholding



Internal Revenue Service (IRS) Publication 515 states that:[3]

- a withholding agent may be a US or foreign person, and may be considered a withholding agent even if there is no requirement to withhold from a payment or even if another person has withheld the required amount from the payment;
- the withholding agent is personally liable for any tax required to be withheld, and this liability is independent of the tax liability of the foreign person to whom the payment is made. If the withholding agent fails to withhold and the foreign payee fails to satisfy its US tax liability, then both the withholding agent and the foreign person are liable for tax, as well as interest and any applicable penalties;
- the withholding agent must report amounts withheld on IRS Form 1042-S and file a tax return on Form 1042; and
- the withholding agent is required to withhold tax at 30% from the gross amount paid to a foreign payee unless they can reliably associate the payment with valid documentation that establishes that:
  - the payee is a US person; or
  - the payee is a foreign person that is the beneficial owner of the income and is entitled to a reduced rate of withholding under the code or an applicable income tax treaty.

The Australia–US tax treaty rate for royalty income

The Australia–US tax treaty[4] states that royalties from sources in a contracting state (country), being royalties to which a resident of the other state is beneficially entitled, may be taxed in that other state, and that the royalties may also be taxed in the state in which they have their source, and according to the law of that state, at up to 5% of the gross amount of the royalties.[5] However, if the payee has a "permanent establishment" (PE) in the source state or performs independent personal services through a fixed base in that state, the provisions of art 7 (business profits) or art 14 independent personal services) apply.[6]

"Permanent establishment"

The term "permanent establishment" is defined in art 5 of the treaty to mean a fixed place of business through which the business of an enterprise is wholly or partly carried on, and includes (among other places) a place of management, a branch, an office, a factory or a workshop.

Article 5 states that a PE is not established solely as a result factors such as the following:

- the use of facilities for the purpose of storage, display or delivery of goods or merchandise;
- the maintenance of stock or merchandise for the purpose of storage, display or delivery;
- the maintenance of a stock or merchandise for the purpose of processing by another enterprise;
- the maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise; or
- the maintenance of a fixed place of business for the purpose of activities which have a preparatory or auxiliary character, such as advertising or scientific research.

However, a PE may be deemed to exist where certain factors such as the following, are present:

- the enterprise carries on business in that other state through a person, other than an agent of independent status, who has authority to conclude contracts on behalf of that enterprise and habitually exercises that authority in the other state;
- the enterprise maintains substantial equipment in the other state for rental or other purposes for a period of more than 12 months;
- the enterprise engages in supervisory activities for more than nine months in any 24-month period in connection with a building site or construction, assembly or installation project in that other state; or
- the enterprise has goods or merchandise belonging to it that:
  - were purchased by it in that other state, and not subjected to prior substantial processing outside that other state; or
  - were produced by it or on its behalf in that other state,

  and are, after such purchase or production, subjected to substantial processing in that other state by an enterprise where either enterprise participates directly or indirectly in the management, control or capital of the other enterprise, or where the same persons participate directly or indirectly in the management, control or capital of both enterprises.

Article 5 of the treaty further provides that:

- an enterprise of one of the contracting states shall not be deemed to have a PE in the other contracting state merely because that enterprise carries on business in that other state through a broker, general commission agent or any other agent of independent status where such broker or agent is acting in the ordinary course of his business as a broker, general commission agent or other agent of independent status; and
- the fact that a company which is a resident of one of the contracting states controls or is controlled by a company which is a resident of the other contracting state, or which carries on business in that other state (whether through a PE or otherwise), shall not of itself constitute either company a PE of the other.

Limitation of benefits

The application of the reduced rate of withholding under the US–Australia treaty is subject to art 16 (limitation on benefits), which limits treaty benefits to residents of the contracting states who are "qualified persons".

A company is a "qualified person" if:

- its principal class of shares is listed, and regularly traded, on a recognised stock exchange;[7] or
- at least 50% of the vote and value of the shares in the company is owned, directly or indirectly, by five or fewer companies that are listed on a recognised stock exchange, and where the shares are held indirectly, each intermediate owner is a resident of Australia or the US.[8]

What does this mean for AU Co.?

Due to the US withholding tax rights on royalty income derived from US sources, if AU Co. does not have a fixed place of business in the US, its US-sourced royalty income would be subject to US withholding taxes (withheld by the payer/"withholding agent") at the rate of 5%, assuming that AU Co. is a "qualified person" for the purposes of art 16 of the US–Australia treaty.

How does this then affect its Australian tax position?

FITO

The foreign income tax offset (FITO) rules are contained in Div 770 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) and aim to protect taxpayers from double taxation of income that is taxable in Australia and which has been subject to foreign income taxes.

The FITO, while based on the total foreign income tax paid, is capped at the amount of the Australian income tax that would have been payable on the relevant income.[9]

If the total foreign income tax paid is less than AU$1,000, a taxpayer may claim the amount of the foreign income tax. If the foreign income tax exceeds $1,000, the taxpayer may either claim $1,000 or the amount of the offset up to the offset cap — ie the amount of Australian income tax that would be attributable to the income that has attracted the foreign income tax — calculated as follows:[10]

Step 1: the amount of Australian income tax payable by the taxpayer for the income year.

***Less*:**

Step 2: the amount of tax that would have been payable if the following assumptions were made:

(a) the assessable income excluded:

(i) the assessable amounts in respect of which eligible foreign income tax was paid; and

(ii) any *other* ordinary or statutory income from a non-Australian source, irrespective of whether foreign tax has been paid on that income; and

(b) the taxpayer was not entitled to any deductions for:

(i) debt deductions attributable to the taxpayer's overseas permanent establishment; or

(ii) any deductions that reasonably relate to the amounts of income excluded under (a) above.

The explanatory memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007 provides the following example of the calculation of the FITO cap:[11]

"Example 1.21

Austco is an Australian resident company that derives the following taxable income for the 2008-09 income year:

Portfolio dividend (from Foreign Country A) $1,000,000

(foreign income tax paid of $100,000)

Interest income (from Foreign Country B) $1,000,000

(no foreign tax paid)

Australian-sourced income	$1,000,000
Total assessable income	**$3,000,000**
Less:	
Interest expense *	$500,000
Other expenses related to Australian-sourced income	$500,000
Total allowable deductions	**$1,000,000**
Taxable income	**$2,000,000**
Australian tax payable	**$600,000**

* Debt deduction – not attributable to an overseas permanent establishment of Austco – incurred in relation to dividend income.

Austco calculates its tax offset cap in the following way (assuming Austco does not choose the $1,000 cap):

Step 1 – Work out the amount of tax payable by Austco

$600,000

Step 2 – Work out the tax payable by Austco if the assumptions in subsection 770-75(4) were made

Assume that Austco's assessable income did not include the following amounts:

- Portfolio dividend $1,000,000

  This is an amount in respect of which foreign income tax was paid.

- Interest income $1,000,000

  This is ordinary income from a source other than an Australian source.

Even though the debt deduction of $500,000 is incurred in relation to the dividend income from Foreign Country A, it is not disregarded for the purposes of the cap calculation since it is not attributable to an overseas permanent establishment of Austco.

Therefore, the tax payable by Austco based on the assumptions in subsection 770-75(4) is nil (ie, taxable income of $2,000,000 less exclusion of interest and dividend amounts of $2,000,000).

Step 3 – Work out the amount of tax payable at Step 1, less the tax payable at Step 2

$600,000 – $0

This amount of $600,000 is the tax offset limit.

As the foreign income tax paid of $100,000 is less than the tax offset limit of $600,000, Austco is entitled to a tax offset of $100,000."

Franking credits

"Franking credits" will most commonly arise where an Australian resident company pays PAYG instalments or income tax.[12] The franking credit rules are contained in Div 202 ITAA97 and attempt to eliminate the double taxation of dividends in Australia by providing shareholders with a credit for tax paid at the company level.

The maximum franking credit that could be attached to a distribution to a shareholders is calculated as follows:[13]

$$\text{amount of the frankable distribution} \times \frac{1}{\text{Applicable gross-up rate}}$$

The "applicable gross-up rate" means the corporate tax gross-up rate of the company for the income year in which the distribution is made.[14] The corporate tax gross-up rate of an entity for an income year is the amount worked out using the following formula:[15]

$$\frac{100\ \% - \text{Corporate tax rate for imputation purposes of the entity for the income year}}{\text{Corporate tax rate for imputation purposes of the entity for the income year}}$$

If a company has a 30% corporate tax rate and makes distribution of $100, the maximum franking credit that could be attached to the distribution would be:[16]

$100 × 1 / ((100% – 30%)/ 30%) = $42.92

The shareholder would receive a fully franked dividend of $100, with a franking credit of $42.92. With the franking credit, taxes only apply to the $100, even though the shareholder would declare $142.92 (the $100 distribution + the franking credit of $42.92) as taxable income.

How do foreign withholding taxes affect the FITO and franking credits for AU Co.?

AU Co. would receive a FITO for the withholding tax payment when it declares the royalty income for Australian tax purposes. However, foreign taxes are not recognised as giving rise to a franking credit for the purposes of the franking credit rules in s 205-15 ITAA97.

The table in s 205-15 sets out when a credit arises in the franking account of an entity, and the amount of the credit, including when:

- the entity pays a PAYG instalment, the entity satisfies the residency requirement for the income year in relation to which the PAYG instalment is paid and the entity is a franking entity for the whole or part of the relevant PAYG instalment period (item 1); and
- the entity pays income tax, the entity satisfies the residency requirement for the income year for which the tax is paid and the entity is a franking entity for the whole or part of that income year (item 2).

Section 202-15 defines a "franking entity" as a corporate tax entity that is not a life insurance company that is a mutual insurance company, and is not acting as a corporate trustee of a trust.

"Corporate tax entity" is defined as a company, a corporate limited partnership or a public trading trust.[17]

The residency requirement is satisfied for an entity making a distribution if, in the case of a company, the company is an Australian resident at that time.[18]

Although item 2 of the table in s 205-15 provides a credit for payments of "income tax", "income tax" is defined in s 995-1 ITAA97 by reference to the following (Australian) tax legislation only:

> "***'income tax'*** means income tax imposed by any of these:
>
> (a) the *Income Tax Act 1986*;
>
> (b) the *Income Tax (Diverted Income) Act 1981*;
>
> (c) the *Income Tax (Former Complying Superannuation Funds) Act 1994*;
>
> (d) the *Income Tax (Former Non-resident Superannuation Funds) Act 1994*;
>
> (e) the *Income Tax (Fund Contributions) Act 1989*."

Consequently, foreign tax arising from a law of a foreign country and not included in this list would not be an "income tax imposed by any of these" laws, and could therefore not be credit to a company's franking account.

So, in the case of an Australian resident company that has been subject to foreign withholding taxes, the company could not credit its franking account for those taxes — thus reducing the franking credits its Australian resident shareholders can claim, and in turn, increasing the effective tax rate on foreign sourced income — in the example in Tax Matrix 1, to 49.65%.

Tax Matrix 1 in Table 1 illustrates the effect of the FITO and franking credits in simplified terms.

Why does this situation arise?

Part A of the explanatory memorandum to the Taxation Laws Amendment (Company Distributions) Bill 1987, Income Tax (Franking Deficit) Bill 1987, and the Income Tax Rates Amendment Bill 1987 (EM), which first introduced the imputation system into the ITAA stated:[19]

> "This Bill will insert a new Part – Part IIIAA – in the Income Tax Assessment Act 1936 ('the Assessment Act') to provide for the introduction of the full imputation system of company taxation that is to apply from 1 July 1987. Under this system, dividends paid on or after 1 July 1987 by Australian resident companies – *to the extent*

Table 1. Tax Matrix 1

Tax Matrix 1: tax impact of US withholding taxes (excluding foreign exchange rates)		
US-sourced royalty income		$100.00
Tax in the US:		
5% withholding tax	5%	$5.00
Total US tax paid		$5.00
US effective tax rate		5%
Tax in Australia:		
Royalty income derived by AU Co.		$100.00
Australian corporate tax rate for AU Co.*	30%	$30.00
Less: FITO	5%	($5.00)
Net tax payable		$25.00
Net after tax proceeds		$70.00
Dividend distribution		$70.00
Allocated franking credits (Australian corporate tax paid) (s 205-15 ITAA97)		$25.00
Grossed-up assessable dividend		$95.00
Tax @ 47%**	47%	$44.65
Net after tax distribution to shareholder		$50.35
Effective tax on underlying profits after distribution to shareholder		49.65%

Assumptions:

* AU Co. has an aggregated turnover in excess of $50m and is not a base rate entity for the purposes of s 23AA of the *Income Tax Rates Act 1986* (Cth).

** Australian resident individual shareholder at the top marginal tax rate for 2020-21 of 45% plus 2% Medicare levy.

that tax is paid or payable at the company level in respect of income of the 1986–87 and later income years – will carry credits for that tax to relieve personal income tax payable by resident individual shareholders.

In basic terms, the system will operate to impute or allocate tax paid at the company level as a credit to such shareholders who will be assessed on the total amount of the dividend and the imputation credit, but will be entitled to a rebate of tax equal to the imputation credit. Dividends with an imputation credit attached will be known as 'franked' dividends, and the extent to which they are franked as the 'franked amount' of the dividends. Where franked dividends pass from one resident company to another, the attached imputation credit will be effectively transferred to the recipient company thus enabling that company to frank a similar amount of dividends paid to its shareholders." (emphasis added)

The exclusion of foreign tax credits from the franking account is discussed in the EM.

The EM states that "[a] franking credit arises where a company which is sufficiently resident … is served with a notice of a determination reducing the amount of a franking deficit tax offset (see later) to which the company is entitled, *or reducing a foreign tax credit allowable to the company*" (emphasis added);[20] and that "[a] franking debit arises where a company … is served with notice of a determination of a foreign tax credit or an increase in the amount of a foreign tax credit",[21] indicating that the payment of foreign taxes was intended to have a corresponding negative impact on franking credits. This is reflected further in the EM in relation to the following provisions of Pt IIIAA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36):[22,23]

"**Section 160APT: Reduction of foreign tax credit**

Section 160APT achieves, in relation to foreign tax credits, broadly the same result as section 160APS produces in relation to franking deficit tax offsets. Under section 160APT, there arises a franking credit equal to the adjusted amount in relation to foreign tax credits allowable. The foreign tax credit originally allowed would have given rise to a franking debit under proposed new section 160AQA, and this section is necessary to reduce the franking debit where the foreign tax credit is itself reduced."

"**Section 160AQA: Allowance of foreign tax credit**

Under section 160AQA, a franking debit arises where the Commissioner serves on a company a notice of a determination that a foreign tax credit is allowable, or of a determination increasing the amount of a foreign tax credit that is allowable (paragraphs (a) and (b)).

In the first case the amount of the franking debit is the adjusted amount in relation to the foreign tax credit (paragraph (c)), and m the latter it is the adjusted amount in relation to the increase m the foreign tax credit (paragraph (d))."

While Pt IIIAA has since been repealed, the effect under the current legislation (Div 205 ITAA97) remains the same with the exclusion of foreign taxes from the definition of "income tax" for the purposes of franking credits.

Alternative options: is it tax effective for AU Co. to establish a US Inc. or PE?

Is it tax effective for:

(1) AU Co. to establish a US C-Corporation ("US Co.") as the payee for the US-sourced income; or

(2) AU Co. to set up a PE in the US?

Consideration 1: is US Co. an agent of a foreign person or the beneficial owner of the income?

There would be no US withholding tax obligation if US Co. were the beneficial owner of the royalty income, US Co. being a "US person".[24] However, for US Co. to be the beneficial owner of the royalty income, AU Co.'s contractual rights would need to be assigned to US Co. or US Co. would need to enter into new contracts with the US customers. In this case, the effective tax rate from the flow of funds through US Co. through to its shareholders (possibly AU Co. or an AU Trust) would need to be considered in order to determine if this was a tax effective means of proceeding.

In the absence of such action, AU Co. would continue to be the beneficial owner of the income, being the relevant party providing the services for which the royalties are paid.[25] If the payments are made to US Co. on behalf of AU Co., US Co. would be acting as agent for AU Co and the US withholding tax obligation would continue, or be passed on to US Co.[26]

The US Treasury Regulations state that if a withholding agent makes a payment to a US person and has actual knowledge that the US person is receiving the payment as an agent of a foreign person, they must treat the payment as having been made to the foreign person, unless the US person is a financial institution.[27]

Consequently if royalty payments are made to US Co. on the basis that it is a "US Person" alone, US Co. would then have the withholding obligation having control of the royalty income that is being paid to a foreign corporation that is the beneficial owner of the income[28]. Failing to do so would make US Co. liable for the withholding tax liability, and would also expose US Co. to penalties.[29]

Consideration 2: is a US PE tax effective for AU Co.?

If AU Co. sets up a PE in the US, it would not be subject to withholding taxes on its US-sourced income.[30] However, as the royalties would be taxed as business profits under the treaty,[31] US corporate tax would apply to the PE's US-sourced income (at 21%). Additionally, a 5% branch profits tax would also apply on earnings that are repatriated, or deemed to be repatriated, to AU Co. This could result in an effective tax rate of 64.78%, after accounting for Australian corporate tax, FITO and franking credits. These issues are discussed below.

US income tax liability

The PE would need to be a fixed place of business such as an office, place of management or branch.[32] In this case, the business profits of the PE would be taxable only in the US to the extent that those profits were attributable to the US.[33]

Generally, business profits attributable to a PE are the amount that an independent enterprise engaged in the same or similar activities would be expected to derive under the same or similar conditions, and the PE is allowed deductions for expenses incurred for the purposes of the PE, including executive and general administrative expenses whether or not incurred locally.[34]

The IRS states:[35]

> "… if the foreign company elects to be taxed under the provisions of an applicable U.S. income tax treaty, it will generally only be subject to US tax on its profits attributable to a permanent establishment …
>
> Permanent Establishment Concept in U.S. Income Tax Treaties:
>
> In most cases, U.S. income tax treaties define a U.S. permanent establishment to include a fixed place of business in the United States through which the foreign enterprise carries on its business. However, a foreign enterprise will not be deemed to have a U.S. permanent establishment if its activities in the United States are limited to certain activities–generally those of a preparatory or auxiliary nature … A foreign enterprise will also be considered to have a U.S. permanent establishment in respect of activities undertaken on its behalf by a dependent agent who has and habitually exercises in the United States an authority to conclude relevant contracts that are binding on the foreign enterprise …"

US branch profits tax

In addition to US income taxes, branch profits tax (BPT) could apply to earnings that are repatriated, or deemed repatriated, to AU Co.

A 30% BPT is imposed (unless reduced or exempted by an applicable tax treaty) on the effectively connected income (ECI) of a US branch of a foreign corporation where the earnings are repatriated, or deemed repatriated, to the home office of the branch.[36]

The BPT is imposed on the dividend equivalent amount (DEA) — the after-tax effectively connected earnings and profits (ECEP) that are not reinvested in the US and are deemed to have been effectively distributed out of the US branch to the foreign corporation.[37] To the extent of an increase in US net equity during the tax year, the corporation is deemed to have reinvested a portion of current-year ECEP in its US assets, and this portion would not be subject to BPT.[38]

The IRS states in its Practice Unit on *Branch profits tax concepts*:[39]

> "As a result of the enactment of IRC §884(a), the branch profits tax is calculated and paid by the foreign corporation on a Form 1120-F (U.S. Income Tax Return of a Foreign Corporation). The tax applies regardless of whether the U.S. trade or business of the foreign corporation is substantial compared to its worldwide activities. It treats the U.S. trade or business of the foreign corporation as if it were incorporated as a subsidiary of the foreign corporation and deems the profits of the subsidiary to be remitted, pursuant to a formula, to the foreign corporation at the end of the year. It eliminates the competitive advantage in operating as a branch vis-à-vis a subsidiary with respect to repatriation of profits. Moreover, the branch profits tax computation's formulary nature strongly discourages the use of branch operations because it takes away control of the timing of the payment of the dividend equivalent amount. For example, a subsidiary can declare and pay a dividend on any date during its taxable year, but a branch must pay it only at year end."

The imposition of the US BPT is recognised and effected in art 10 of the tax treaty which provides for full residence country taxation of such dividends with a limited source state right to tax.[40]

Pursuant to the terms of the treaty, the BPT would be 5% of the gross amount of the DEA.[41]

The combined effect of these factors is that AU Co.'s effective tax rate would in fact *increase* to 64.78%, as illustrated in Tax Matrix 2 in Table 2.

Conclusion

The interaction of the FITO and the franking credit rules can significantly affect shareholder returns as foreign taxes are excluded from applicable income taxes from which franking credits can arise.

Restructuring a business in a cross-border context may not always be a viable option in such circumstances, and it is imperative that the underlying business structure, the sourcing of income and the application of the treaty benefits be considered carefully beforehand.

Renuka Somers, CTA
Head, US–Australia Tax Desk
Asena Advisors

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1 S 7701(a)(1) and (3)-(5) of the *Internal Revenue Code* (US) (IRC).

2 S 1442 IRC.

3 Department of the Treasury, Internal Revenue Service, *Withholding of tax on nonresident aliens and foreign entities*, Publication 515. Available at https://www.irs.gov/pub/irs-pdf/p515.pdf.

4 *Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, 6 August 1982, as amended to 2001 (Australia–US tax treaty).

5 Art 12(1)-(2) of the Australia–US tax treaty.

6 Art 12(2)-(3)) of the Australia–US tax treaty.

7 Art 16(2)(c)(i) of the Australia–US tax treaty.

8 Art 16(2)(c)(ii) of the Australia–US tax treaty.

9 Ss 770-70 and 770-75 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).

10 S 770-75(2) ITAA97.

11 Para 1.150 of the explanatory memorandum to the Tax Laws Amendment (2007 Measures No. 4) Bill 2007.

12 Items 1 and 2 of the table in s 205-15 ITAA97.

13 S 202-60(2) ITAA97.

14 S 202-60 ITAA97.

15 S 995-1 ITAA97.

16 S 202-60(2) ITAA97.

17 S 960-115 ITAA97.

18 S 202-20(a) ITAA97.

Table 2. Tax Matrix 2

Tax Matrix 2: tax impact of US PE (excluding foreign exchange rates)		
US-sourced royalty income		$100.00
Tax in the US:		
Corporate tax	21%	$21.00
Branch profits tax	5%	$5.00
Total US tax paid		$26.00
US effective tax rate		26%
Tax in Australia:		
Royalty income derived by AU Co.		$100.00
Australian corporate tax rate for AU Co.*	30%	$30.00
Less: FITO	26%	($26.00)
Net tax payable		$4.00
Net after tax proceeds		$70.00
Dividend to Australian resident shareholder		$70.00
Allocated franking credits (Australian corporate tax paid) (s 205-15 ITAA97)		$4.00
Grossed-up assessable dividend		$74.00
Tax @ 47%**	47%	$34.78
Net distribution to shareholder		$35.22
Effective tax on underlying profits after distribution to shareholder		$64.78

Assumptions:

* AU Co. has an aggregated turnover in excess of $50m and is not a base rate entity for the purposes of s 23AA of the *Income Tax Rates Act 1986* (Cth).

** Australian resident individual shareholder at the top marginal tax rate for 2020-21 of 45% plus 2% Medicare levy.

19 P 3 of the explanatory memorandum to the Taxation Laws Amendment (Company Distributions) Bill 1987 (EM).

20 P 8 of the EM.

21 P 9 of the EM.

22 Pp 41-42 of the EM.

23 P 45 of the EM.

24 S 7701(a)(1) IRC.

25 S 1442 IRC.

26 S 1.441-7(a)(1) of the *Treasury Regulations* (US).

27 S 1.1441-1(b)(ii)) of the *Treasury Regulations*.

28 Ss 1441-1442 IRC; s 1.1441-1(a) of the *Treasury Regulations*.

29 S 1.1441-1(b)(7) of the *Treasury Regulations*.

30 Art 12(2)-(3) of the Australia–US tax treaty.

31 Art 7 of the Australia–US tax treaty.

32 Art 5(2) of the Australia–US tax treaty.

33 Art 7(1) of the Australia–US tax treaty; s 882(a)(1) IRC.

34 Art 7(2)-(3) of the Australia–US tax treaty.

35 Internal Revenue Service, *Creation of a permanent establishment (PE) through the activities of a dependent agent in the United States*, IRS Practice Unit. Available at www.irs.gov/pub/default_path_no_value/tre_t_016_07_02.pdf.

36 S 884(a) IRC.

37 S 884(b) IRC.

38 S 884(b) IRC.

39 Internal Revenue Service, *Branch profits tax concepts*, IRS Practice Unit. Available at www.irs.gov/pub/int_practice_units/RPWCUP_08_2_01.PDF.

40 *Department of the Treasury technical explanation of the protocol between the government of the United States of America and the government of Australia signed at Canberra On September 27, 2001, amending the Convention between the United States of America and Australia with respect to taxes on income signed at Sydney on August 6, 1982*, pp 12-13.

41 Art 10(2)(a) of the Australia–US tax treaty.