DENTONS

Taxation

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2024

Taxation

1. Australia's tax system

Overview

The law relating to taxation in Australia is detailed and can be complex.

Careful consideration should be given to the nature of the business to be conducted in Australia and any taxation implications resulting from the nature of the business. The following information should not be used in substitution for detailed legal advice.

Australian tax laws are amended frequently. The Australian tax year ends on 30 June each year, however it is possible to apply for a substituted year end to coincide with the financial year of a foreign parent company.

Direct taxes

The principal direct tax is income tax, which is levied by the Federal Government. It is assessed on individuals, companies and trusts.

Partnerships are subject to pass through tax treatment. Participants in joint ventures who take a share in the product of the venture are generally taxed as separate taxpayers.

Australian residents are subject to tax in Australia on income derived from all (worldwide) sources, but tax offset will typically be available where foreign tax is paid by an Australian resident taxpayer for income derived from a foreign source. Non-residents are normally taxed in Australia on income derived from Australian sources only.

The general income tax rate for companies is currently 30%, although a reduced rate is available for small businesses. The current personal tax rates for individuals are based on a sliding scale from 0% to 45% for the component of the individual's assessable income over the relevant threshold for each rate.

Most businesses are required to pay quarterly 'pay as you go' (PAYG) instalments throughout the year based on their estimated tax liability, although it is necessary to lodge an annual tax return to determine their actual income tax liability.

Income tax is calculated by deducting allowable deductions from assessable income. Allowable deductions include certain deductions for expenses incurred in carrying on business and capital allowances for depreciating assets. Deductions may also be allowed for losses for previous years.

Tax is also payable on capital gains derived from the disposal of most capital assets acquired after 19 September 1985. The net capital gains of the taxpayer (reduced by capital losses) are included in the taxpayer's total assessable income in the same way as other items of assessable income. A net capital loss may be carried forward and offset against future capital gains.

Dividends paid by Australian resident companies may be franked (wholly or partly) with imputation credits that reflect the tax paid by the company on the profits distributed to members.

There are special rules that ensure uniformity of franking on distributions during a franking period. Non-resident shareholders are not eligible for credits or rebates on franked distributions. Dividends paid to non-resident shareholders may be subject to withholding tax if the distributions are not franked.

Indirect taxes

The principal indirect tax assessed and imposed by the Federal Government is the 10% Goods and Services Tax (GST). There are also excise duties imposed on certain commodities and customs duties on imported goods.

State taxes

State taxes comprise mainly of payroll tax (levied on the gross payroll of a business), land tax (levied on the unimproved value of land) and stamp duties (levied on certain transactions and documents).

Local taxes

Local taxes usually comprise of rates, which are generally levied by reference to the value of land.

2. Common tax issues for foreign investors

Australian Business Numbers

If you carry on an enterprise in Australia, you will need to apply for an Australian Business Number (ABN). If you don't have an ABN and you are required to, then Australian businesses may need to withhold 49 per cent of any amounts payable to you, subject to certain conditions and exemptions.

Fringe benefits tax

Fringe benefits tax is a tax payable by employers on the value of certain benefits that have been provided to their employees or to associates of their employees. It typically applies to 'in kind' benefits and is payable at the top personal tax rate based on the taxable value of the benefit.

Superannuation contributions

Superannuation contributions are tax deductible to the employer making the contributions, if they are made to a fund which complies with federal legislation and do not exceed a maximum threshold. Income derived by a complying fund, including the contributions it receives, is taxable at the rate of 15%.

Medicare levy

A health care levy (known as the Medicare levy) is payable by individuals at rates of up to 2% of the individual's assessable income. The government announced in its 2017/18 Federal Budget that from 1 July 2019, the Medicare levy will increase from 2% to 2.7%. Legislation is currently being developed for this measure.

High income taxpayers (A$90,000 for individuals or A$180,000 for families) without private patient hospital insurance are liable to pay up to an extra 1.5% surcharge in addition to the general levy.

Goods and services tax (GST)

GST applies at a flat rate of 10% on the supply of most goods and services. GST is a multi-staged tax payable by suppliers (similar to a value added tax), where each stage in a supply chain is potentially taxable, but with registered entities being entitled to refunds of GST incurred on their business inputs (referred to as 'input tax credits').

Importantly, GST is not applied to most exports of goods and services.

Businesses must register for GST if they make taxable supplies of more than A$75,000 per year, regardless of whether the business in Australia is conducted through an Australian company or an Australian branch.

The liability to pay GST is generally imposed on the supplier. Most registered entities are required to account for GST either monthly or quarterly.

Some supplies are classified as GST-free. These include certain supplies relating to health, aged care, education and food, as well as sales of farm land and supplies of businesses as going concerns.

Other supplies may be exempt so that no GST liability arises, but the supplier may be denied input tax credits on business inputs relating to that supply. Exempt supplies may include certain financial supplies (e.g., loan, currency and derivative transactions and share transfers), residential rents and sales of established residential premises.

Payroll tax

Each state and territory has payroll tax legislation under which an employer is liable to pay tax on the employer's payroll. The tax is only payable where the employer's payroll exceeds a minimum threshold. The payroll tax rates and thresholds vary depending on the particular state or territory.

Stamp duty

Each state and territory imposes its own stamp duties. Stamp duty is a tax on transactions and certain instruments (including conveyances of real property and business assets). The rates and duties payable vary among the states and territories and depend on the nature of the transaction.

The duty is generally payable by the purchaser or transferee.

Land tax

Land tax is an annual tax levied on the owner of land in Australia, based on the unimproved capital value of the land (which excludes the value of the building or capital improvements).

Superannuation guarantee levy

All employers must make superannuation contributions for the benefit of all their employees. The minimum contribution is currently 11.5% and will remain at this rate until 1 July 2025 when the levy will increase to 12%.

Death, inheritance and gift taxes

There are no specific death, inheritance or gift taxes in Australia, although each of these events can have significant tax implications.

Capital gains tax (CGT)

CGT applies to a wide range of events (such as an asset disposal) affecting most forms of property or enforceable rights.

The CGT liability is determined by subtracting the cost base of the asset from the capital proceeds for the event. Gains are generally assessed on realisation or another specified event (such as ceasing to be an Australian resident), not on an accruals basis.

The ordinary income tax rates apply to capital gains, however Australian resident individuals are generally eligible for a 50% discount on CGT if they have held the asset for at least 12 months.

There are a range of concessions and deferral mechanisms for businesses and individuals.

Non-residents are generally taxed only on capital gains derived from 'taxable Australian property' such as land, indirect interests in land along with mining or prospecting rights.

Withholding tax

The general rule that non-residents are liable for Australian tax on all Australian source income is modified in relation to dividends, interest and royalties.

Payers are required to withhold tax from interest, dividends and royalties paid to non-residents. Trustees, agents or others who receive interest, dividends or royalties on behalf of a non-resident where withholding tax has not been withheld by the payer, are also required to withhold tax.

The tax rates of withholding tax vary, depending on whether a 'Double Tax Treaty' applies, among other things. The dividend, interest or royalty does not need to be actually paid to the non-resident to be subject to withholding tax. The liability can also arise where the income is re-invested, accumulated, capitalised or otherwise dealt with on behalf of the non-resident.

Certain other payments to non-residents by a resident business are subject to foreign resident withholding tax rules. For example, foreign resident capital gains withholding (FRCGW) applies when a foreign vendor disposes of 'taxable Australian property' (such as land, mining tenements or shares in a land-rich company) at the rate of 12.5%. However, the Australian Government recently announced that the FRCGW rate will increase to 15% from 1 January 2025. The FRCGW is a non-final withholding and, upon filing a tax return with the ATO, the foreign vendor may be entitled to a credit to be offset against the vendor's CGT liability on the transaction.

Withholding taxes may also apply to distributions from certain trusts, known as managed investment trusts (MITs). These distributions may be subject to concessional rates.

Thin capitalisation

Australia's thin capitalisation rules are designed to prevent entities with cross border operations from funding their operations with excessive levels of debt to procure a more favourable Australian tax result.

These rules apply to most multinational businesses operating in Australia with at least A$2 million in debt deductions (calculated on an associate inclusive basis). Different tests apply for 'general class entities' (which includes most multinational businesses) compared to banks and other financial entities. The rules for 'general class entities' were substantially amended in April 2024 and now contain three tests: the default "fixed ratio test", and two elective tests being the "group ratio test" and the "third party debt test".

The default test is the fixed ratio test, which disallows debt deductions to the extent that net debt deductions exceed 30% of "tax EBITDA". The excess is disallowed but the denied amount may be carried forward for up to 15 years subject to an integrity rule, and subject to the company continuing to use the fixed ratio test.

The group ratio test (allows a group company to claim net debt deductions up to the level of the worldwide group's net interest expense as a share of earnings) or third party debt test (allows all debt deductions that are attributable to genuine third party debt only) may be elected as alternatives to the fixed ratio test, but a taxpayer who chooses either of those tests cannot carry forward the amount of any disallowed debt deductions. Further, any carry forward disallowed amounts from prior years will be lost if the company switches from the fixed ratio test to either the group ratio test or the third party debt test.

Transfer pricing rules

Transfer pricing rules seek to counter international profit-shifting techniques by ensuring that related parties to international transactions determine their pricing based on arm's length methodologies.

These rules allow the Tax Commissioner to reallocate income or adjust deductions to reflect an arm's length arrangement. The rules extend to branches or divisions of the same enterprise, where non-arm's length transactions are made between an Australian permanent establishment and an overseas permanent establishment of the same enterprise.

Other international tax avoidance measures

To complement the transfer pricing and thin capitalisation rules, Australia has a series of overlapping international tax avoidance measures, which include the controlled foreign company (CFC) rules and general anti-avoidance rules (GAAR).

The CFC rules may require Australian business entities to include in their assessable income, amounts representing income or gains from foreign companies in which the Australian entity has a controlling interest (even if the income or gain is retained by the controlled foreign company (CFC) and has not been distributed). The CFC's attributable income for the purposes of the CFC rules varies depending on whether the CFC is a resident of a listed or an unlisted country and, if the CFC resides in an unlisted country, whether the nature of the CFC's activities give rise to an exemption for active business income. The seven listed countries are Canada, France, Germany, Japan, New Zealand, the United Kingdom and the United States.

A range of additional measures apply to entities that are characterised as Significant Global Entities (SGEs). Broadly, an SGE is an entity (or member of a group of entities) with annual global income of A$1 billion or more. In addition to other international tax rules, SGEs may be subject to a Diverted Profits Tax (DPT), Multinational Anti-Avoidance Law (MAAL) and Country (CbC) reporting obligations. Australia has also enacted hybrid mismatch rules which broadly implement the OECD BEPS Action 2 recommendations with respect to neutralising hybrid mismatches.

Research and development

A research and development (R&D) tax incentive provides R&D tax offsets to encourage companies to engage in research and development in Australia. The incentive provides up to 43.5% refundable tax offset for eligible companies with an aggregate turnover of less than A$20 million per annum and a 38.5% non-refundable tax offset for all other eligible entities.

If an entity's notional R&D deduction for an income year exceeds a threshold of A$100 million, the rate of the R&D tax offset is reduced to the company tax rate for the portion that exceeds the threshold. This reduction applies for income years starting before 1 July 2024.

Tax consolidation regime

The consolidation regime allows qualifying groups of entities to be treated as a single entity for income tax purposes.

Once part of a consolidated group, intra-group transactions will be ignored for tax purposes. The consolidated group will generally be required to lodge only one income tax return and one franking account.

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