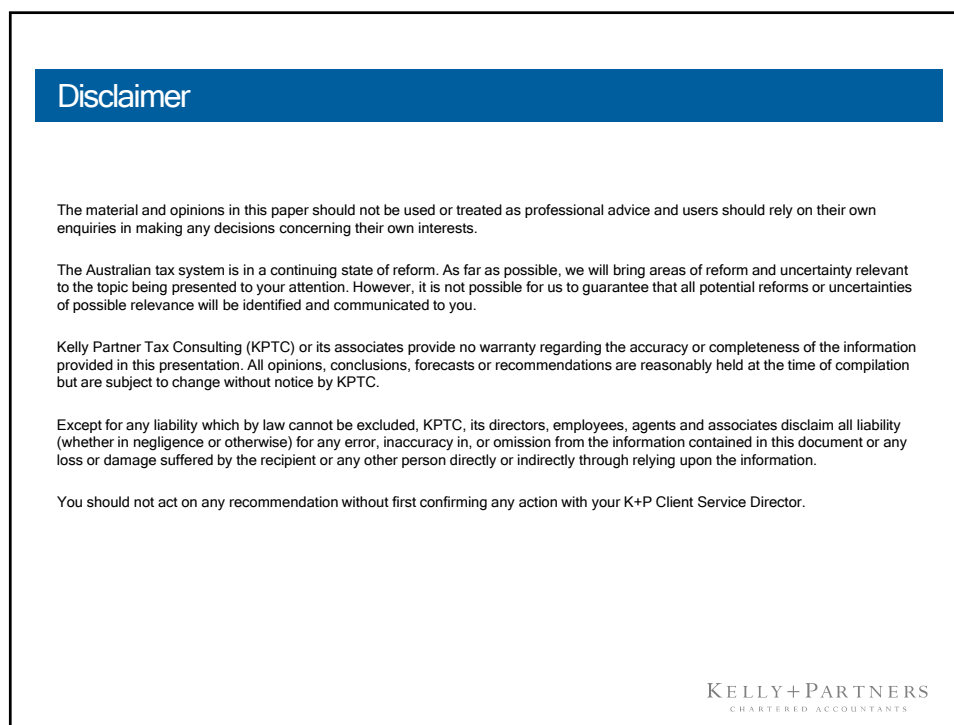




Investing offshore

Some Australian tax issues that should be considered when investing offshore

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Background to international tax

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What is international tax?

+ International Tax...

“...involves understanding how tax systems interact either when cross-border investment occurs or when there is a flow of funds, in some form, between two or more countries.”

+ The first rule of going cross-border is:

Get local legal and tax advice

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Law in other countries

- + Don't ever assume income tax is the same as Australia
- + Don't assume our GST rules reflect how VAT/GST is practised in other countries - its not just a different terminology
- + Presence of a **double tax treaty** will help
- + You'll need a good local advisor and you need to develop a good relationship with that advisor - do this before you start your offshore business
- + Don't assume the overseas advisor understands your business - you have to explain it
- + Don't assume the overseas advisor will answer the questions you have not asked!

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Some issues that you should discuss with your tax advisor

- ⊕ What structure will I use overseas?
- ⊕ How will tax be assessed in Australia?
- ⊕ When will it be assessed?
- ⊕ How do I deal with tax issues overseas?
- ⊕ How do I repatriate profits back from overseas?
- ⊕ What exit strategies can I implement?
- ⊕ Registration Issues
- ⊕ Availability of tax holidays & other government incentives



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...and there is more

- ⊕ Sovereign risk, currency risk, ownership, etc
- ⊕ Legal issues, such as limited liability
- ⊕ Tax rate for branch/partnership/company/trust and for staff
- ⊕ Group taxation
- ⊕ Taxation of profits → Subsidiary v Branch
- ⊕ Deductions
- ⊕ Tax incentives
- ⊕ Extraction of profits (withholding taxes)
- ⊕ Access to tax losses
- ⊕ Financing
- ⊕ Residence of shareholders
- ⊕ Indirect taxes
- ⊕ Exchange control
- ⊕ Taxation of expatriates
- ⊕ Exit strategy



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Tax residence

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Impact of residence in Australia

⊕ Material to **Australia's jurisdiction to tax**

⊕ There are tests for:

- Companies
- Individuals
- Some partnerships
- Trusts



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Residence of companies

- ⊕ Residence of Companies incorporated in Australia
- ⊕ Residence of Companies not incorporated in Australia
- ⊕ Company may be a dual resident if domestic law tests in two jurisdictions are satisfied.

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Staff working overseas?

- ⊕ If Australian resident = **taxed on worldwide income**



- ⊕ FBT
 - ⊕ Tax paid by employer in Australia, even if employee overseas

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Why is permanent establishment important?

+ What is a PE?

It is a fixed place of business through which activities of an organization are wholly or partially carried on in a foreign jurisdiction

+ Double Tax Treaties (DTA) define what is and isn't a PE

+ There are two types of PEs:

- a fixed place of business (associated enterprise)
- a dependent agent (unassociated enterprise)

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Agents

+ Dependent / Independent Agent concept

+ Dependent Agent = Permanent Establishment:

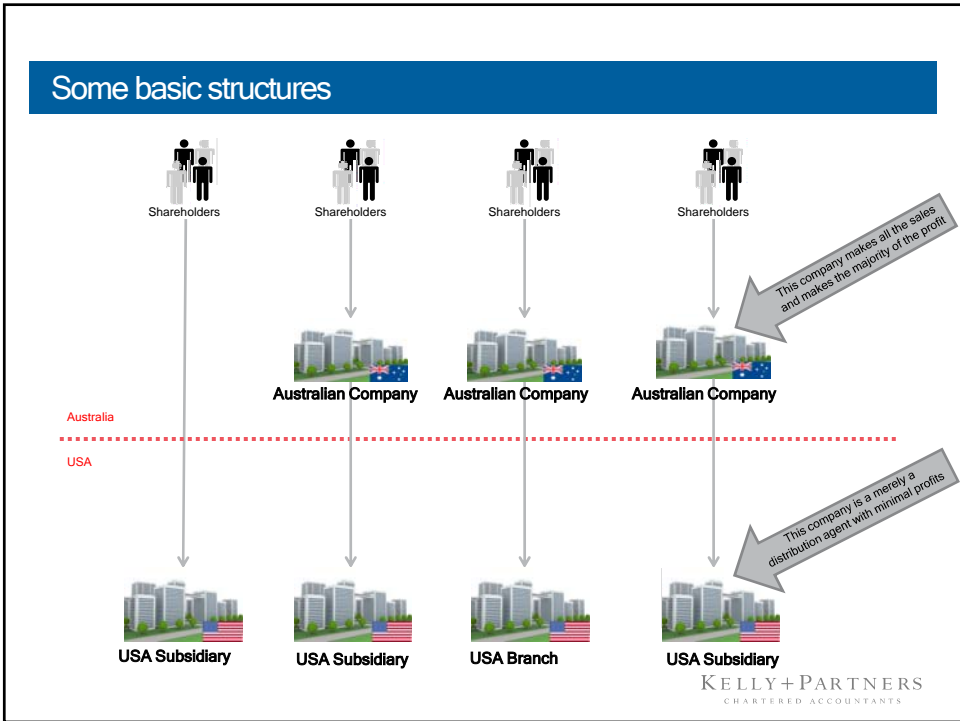

- has and habitually exercises authority to enter into contracts

+ Independent Agent ≠ Permanent Establishment:

- financial / economic independence
- legal independence
- activities carried on in normal course of business

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Investment structures



Some tax issues to take into account in deciding on structure

- ⊕ What is the CGT impact on exit of the foreign entity
- ⊕ Foreign tax offset
- ⊕ Franking credits
- ⊕ Where the foreign jurisdiction has a lower corporate tax rate, the reduced tax rates should allow it to use funds for offshore expansion
- ⊕ Withholding taxes

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Some other issues to consider include..

- ⊕ Ease of roll out of global strategy
- ⊕ Non-tax issues
- ⊕ Local tax and legal compliance
- ⊕ Financing

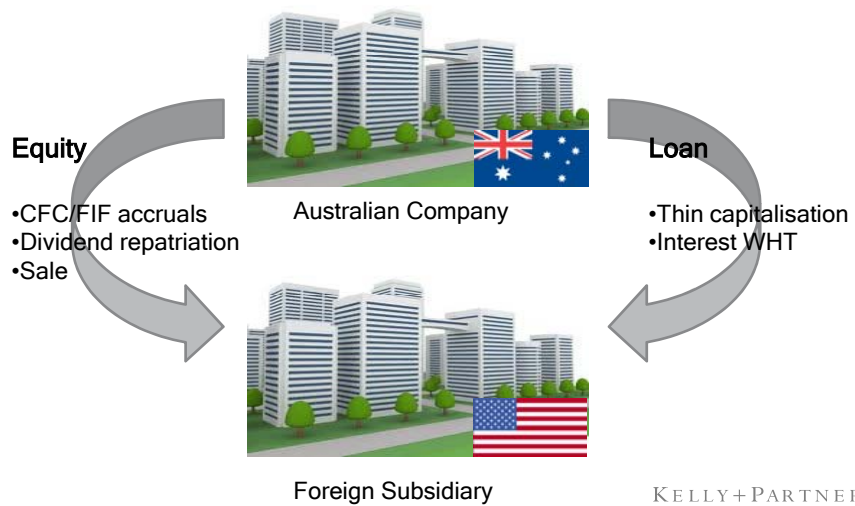


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Repatriation of profits - equity

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Overview



Extensions to Australian rules

- ⊕ **Controlled foreign companies (CFC)**
 - Rules designed to remove foreign country favourable tax on non active income and capital gains - complex
- ⊕ **Foreign investment funds (FIF)**
 - A foreign company or a foreign trust
- ⊕ **Transferor trusts**
 - Attribute to Australian resident beneficiaries income derived by a non-resident trust estate where the Australian resident has transferred property or provided services to the non-resident trust estate

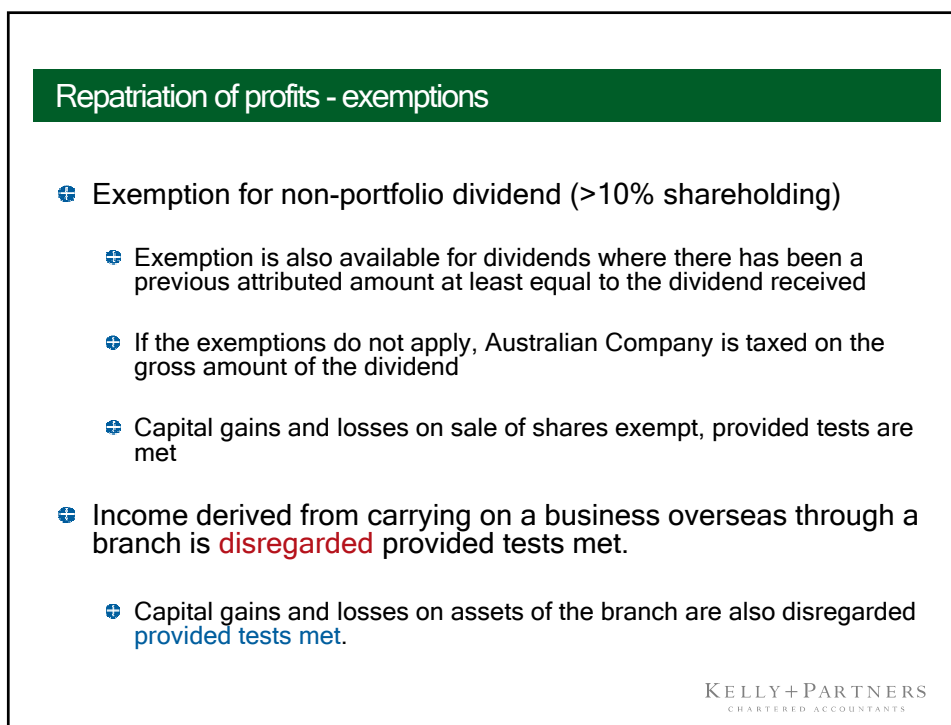
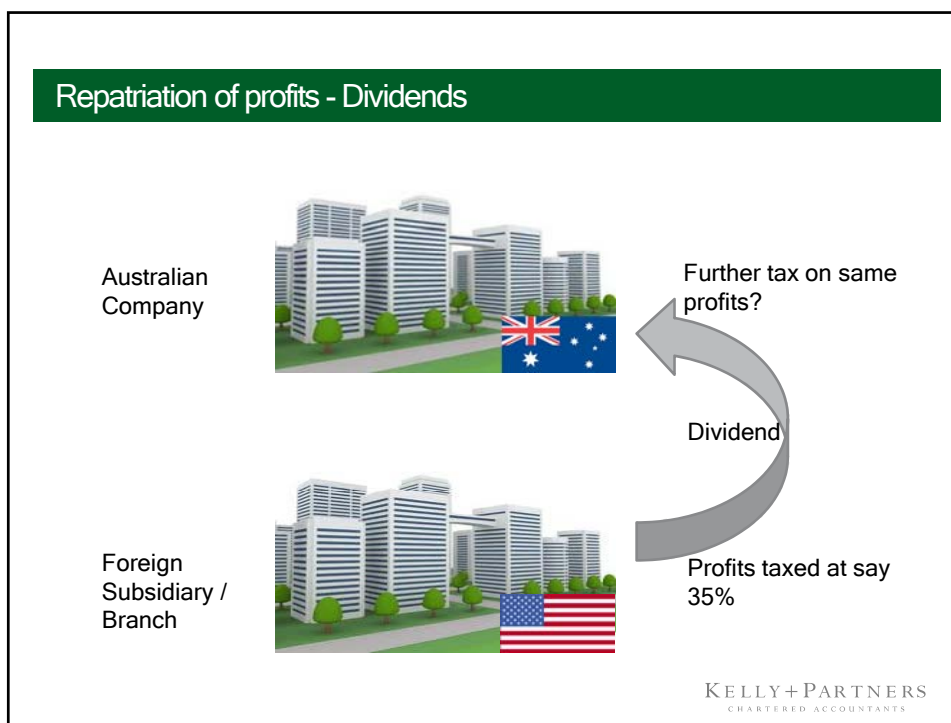
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BASIC PRINCIPLES: Withholding taxes

- ⊕ Tax in hands of **recipient**
- ⊕ **Income Streams**
 - Rental
 - Interest
 - Dividends
 - Royalties
 - Service Fees
- ⊕ **Types of Withholding Tax**
 - Final
 - Assessment



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Intellectual Capital

+ Licence

- a process and its know how,
- a brand,
- a right to duplicate software and other copyrighted IP

+ Double tax treaty definition of royalty important - not standard

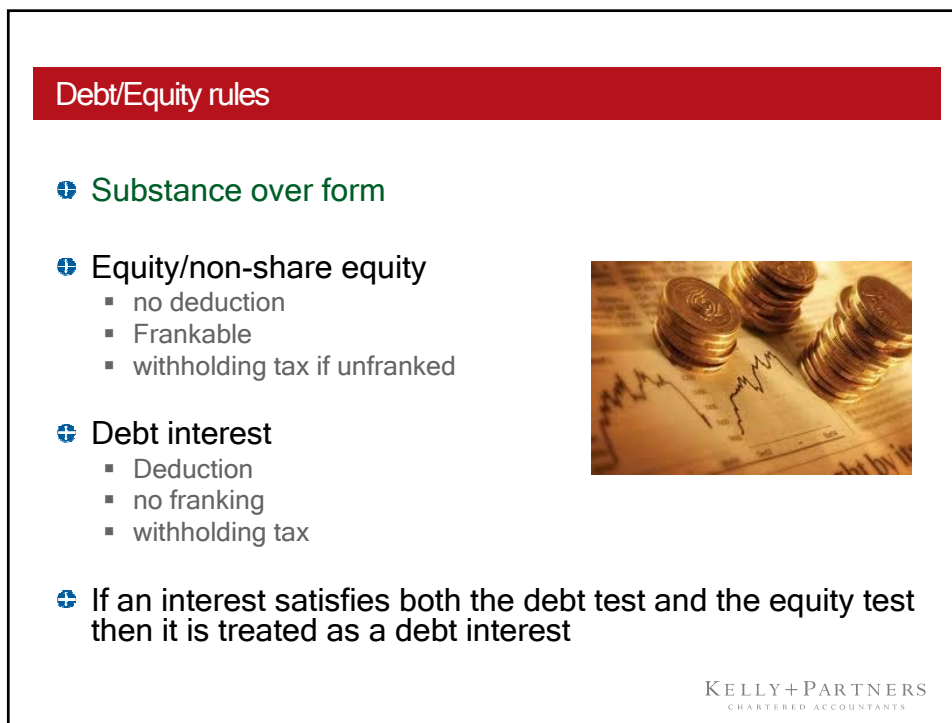
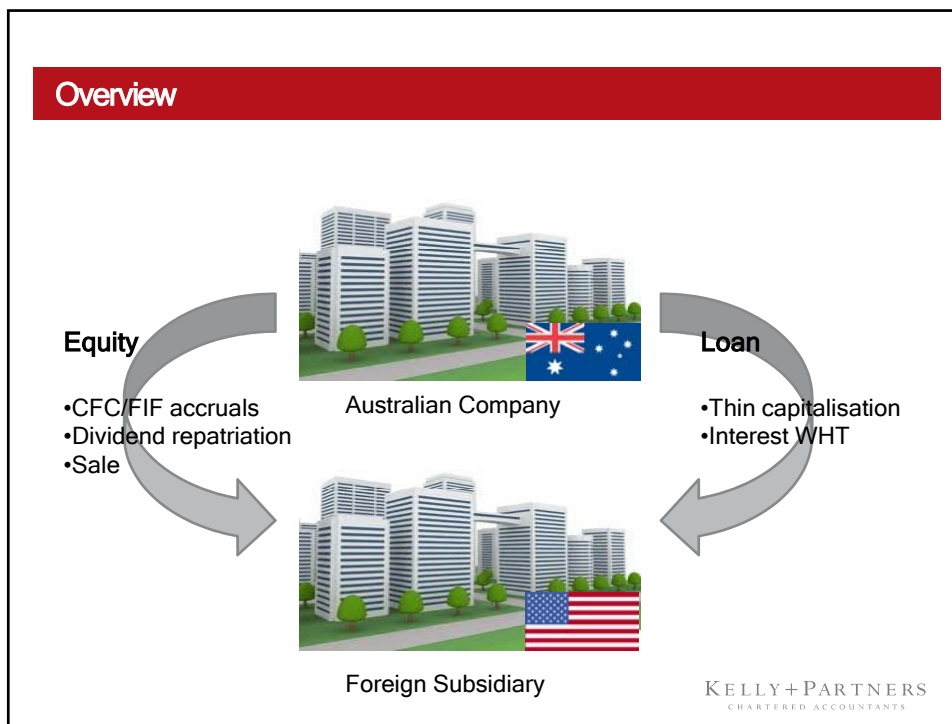
+ Training may be a service not a royalty - split contracts

+ Avoid double charging for same “service”

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INTEREST DEDUCTIBILITY & THIN CAP

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Thin Cap

- ⊕ An excessive amount of debt capital should not be used to finance Australian operations.
- ⊕ Applies to debt deductions >\$250,000
- ⊕ Maximum Allowable Debt is the Greatest threshold amount that arises under:
 - Safe harbour test
 - Arms length test or
 - 120% worldwide gearing debt test

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TRANSFER PRICING

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Transfer Pricing Rules

- ⊕ Been around since 1982 - Div 13
- ⊕ ATO uses risk review technique
- ⊕ ATO less interested in commercially profitable businesses with international dealings
- ⊕ ATO **very interested in loss companies** and special focus dealings
 - Australian exporter head offices
 - R&D and Intellectual Property transfers and royalties
 - Interest free loans from Australian exporter to related entities overseas

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Pricing exported goods and services

- ⊕ Transfer pricing requires pricing to be arm's length between **RELATED** parties
- ⊕ Based on what **independent parties** would have done under an international agreement
- ⊕ Requires a benchmarking analysis to evidence arm's length - optional not mandatory
- ⊕ No issue if an exporter sells to non related parties - e.g. 3rd party distributors or direct via independent commission agents

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Pricing goods and services to related parties

- ⊕ If an exporter sells goods or services to related parties then how you set prices is important
- ⊕ If an exporter **licences** a copyrighted, trade marked or patented process or know how to a related party then how the royalty rate is set is important - it may be a service rather than a royalty
- ⊕ If an exporter **lends funds** to an overseas subsidiary or branch then the interest rate charged is important - what do banks charge for similar risk loans?
- ⊕ Transfer pricing transactional methods are relevant - CUP, Resale Price, Cost plus - in your budget process to set prices

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TAX RISK MANAGEMENT

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Tax Risk Management applies to...

- ⊕ Tax entries
 - Tax provision, expense, deferred tax, IFRS, tax balance sheet
- ⊕ Tax return
 - Preparation review and sign off
- ⊕ Acquisition / divestments
 - Sign off on Tax issues
- ⊕ Specific advice
 - Risk sharing or mitigation
- ⊕ Transactional
 - Identification of issues
- ⊕ Tax sensitive entries
 - Identification at relevant time



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Tax Risk Management offshore

- ⊕ In other countries you need confidence that
 - Returns, instalments, information filings are lodged on time
 - No penalties, no interest
 - Tax audits
 - ✓ Notified
 - ✓ Properly managed and resolved
- ⊕ You should have the **same tax risk profile** in each country
 - This must be communicated to staff & advisors
- ⊕ Communication should be strong and consistent

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It's not hard to implement

- ✦ Develop a clear understanding of risks
- ✦ Understand your Tax Risk Profile
- ✦ Use checklists and systems
- ✦ Use of advisors prudently
- ✦ Reporting and sign off essential
- ✦ Makes sure you have the IT capability to support your tax processes
- ✦ Centralised reporting and control is important
- ✦ Include tax risk management as part of the internal audit review
- ✦ Do not forget to minimise taxes while reducing exposure to risks
- ✦ It is a **dynamic process and requires constant attention** to gain benefits in the long term



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...and finally

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Key points

- ⊕ Tax risk is an issue that **needs to be managed**
- ⊕ Australian international tax rules are complex
 - Get good advice here and o/s **before** commencing business
- ⊕ **Plan** your international structure well as there can be significant differences in your tax liability
- ⊕ Focus on local rules, how business will be started and how tax obligations will be met

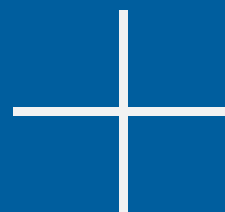
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Key Points

- ⊕ **Effective tax** rate to shareholders is critical
 - AIM: Minimise tax & maximise fully franked dividend in Australia
- ⊕ Transfer pricing is very important
 - Transfer pricing documentation critical and a good tax risk management technique
- ⊕ **Don't forget commercial risks**

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