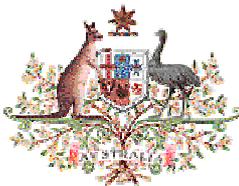


Trans-Tasman triangular tax

An Australian and New Zealand government discussion document



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PREFACE

This discussion document outlines a proposed mechanism for the reform of the taxation of triangular investment, or “triangular tax”, and seeks the views of the public on the details of the proposal.

Under present law, Australian shareholders in a New Zealand company operating in Australia are unable to access Australian franking credits. The same problem applies in reverse to New Zealand shareholders in Australian companies operating in New Zealand. In effect, both groups of shareholders are taxed twice on their income.

We have agreed that the examination of triangular taxation is a worthwhile step in addressing possible barriers to trans-Tasman investment. This is a problem that obviously requires a bilateral solution – one that preserves the tax bases of both countries and is acceptable to government and business in both countries.

To that end, we instructed officials in both countries to develop a workable model that allocates both franking and imputation credits to shareholders in proportion to their shareholding of the company. The mechanism is known as pro rata allocation.

As the next step in the evaluation of the model, before deciding whether to implement it or not, we seek the views of businesses, their tax advisers and other interested parties on its operation. The two governments will use this information in assessing the costs and benefits of implementing the proposed model.

Hon Peter Costello
Treasurer
Australia

Hon Dr Michael Cullen
Minister of Finance and Revenue
New Zealand

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Chapter 1

INTRODUCTION

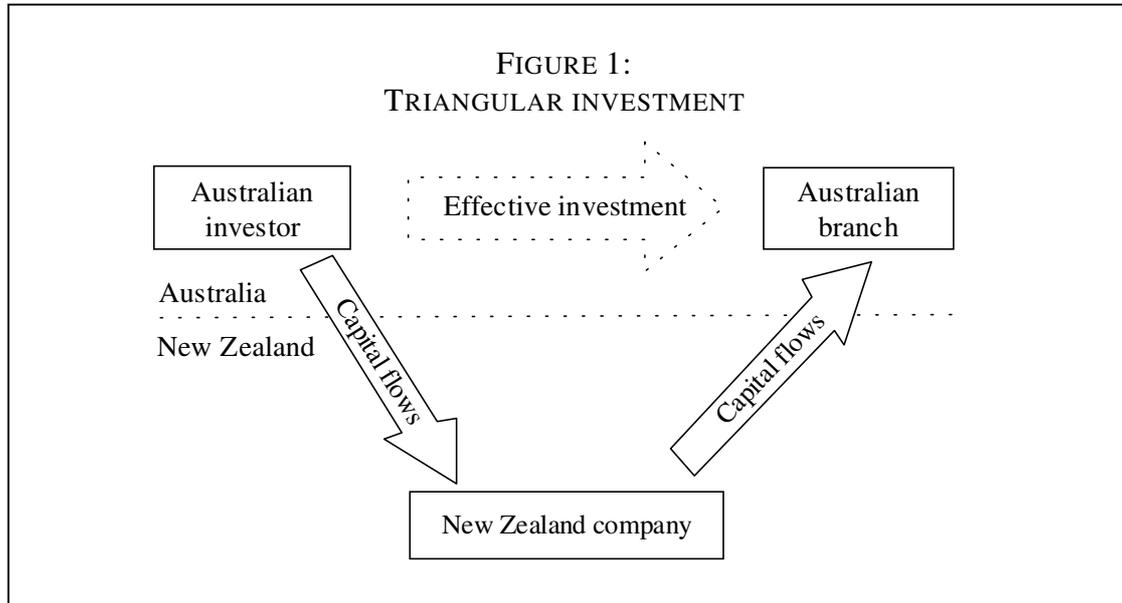
- 1.1 Trans-Tasman “triangular investment” is equity investment by an Australian or New Zealand investor through a company resident in the other jurisdiction that earns income in the country of the shareholder. This discussion document outlines a proposed mechanism for reducing the current double taxation imposed by Australia and New Zealand on dividends received through triangular investment.
- 1.2 To illustrate the underlying concepts simply, chapters 1 and 2 have the Australian or New Zealand company itself making the investment in the other country. Although this occurs with branch investment, investment through a subsidiary is just as likely. Chapter 3 and subsequent chapters discuss triangular investment through subsidiary companies as part of the mechanism for providing relief.

Triangular investment illustrated

- 1.3 Australian and New Zealand investors can invest in a company with the same residence as themselves or in a company resident elsewhere. If they invest in a company with the same residence, the home country imposes only one layer of taxation on income earned in its jurisdiction. When income is distributed to shareholders through dividends, tax paid in the home country is passed on to them through imputation credits.¹
- 1.4 Trans-Tasman “triangular investment” arises when Australian or New Zealand investors invest in their own country through a company with residence in the other jurisdiction. For example, an Australian investor invests in a New Zealand company that invests in Australia, as illustrated in figure 1. The term “triangular investment” similarly applies to a New Zealand investor investing in an Australian company that invests in New Zealand.
- 1.5 The New Zealand company in figure 1 attaches imputation credits to dividends for New Zealand tax paid. Australia does not recognise foreign imputation credits or dividends from non-resident companies as being eligible for Australian imputation credits, even though those dividends may have been paid out of profits which Australia has taxed at source. Australia imposes full source country taxation on income earned by the Australian branch. It taxes its investors once when the income is earned at the company level and again when the income is distributed to the investor by way of dividend. Therefore when the New Zealand company pays out the

¹ For the purposes of chapters 1 to 3, the term “imputation credit” is intended to include franking credits attached to a dividend for purposes of Australian income tax law, as well as imputation credits attached to a dividend for the purposes of New Zealand income tax law. From chapter 4 on Australian imputation credits are referred to as “franking credits”.

Australian source income as a dividend to the Australian investor, it cannot attach an Australian imputation credit. The lack of an Australian imputation credit means that the Australian investor will be effectively taxed twice on the Australian source income.



- 1.6 This is known as “triangular taxation”, although the term equally applies to the double taxation imposed by New Zealand on the New Zealand source income derived by an Australian company with New Zealand shareholders.
- 1.7 The taxation of trans-Tasman triangular investment is a consequence of Australia and New Zealand’s policy of allowing only:²
- tax paid in their country to generate imputation credits; and
 - resident companies to pass on imputation credits to their shareholders.
- 1.8 In the 1980s, when imputation rules were implemented by both Australia and New Zealand, these policies did not cause concern as Australians primarily invested into Australian companies and New Zealanders primarily invested into New Zealand companies. Since then, with the development of globalisation generally and Closer Economic Relations (CER) in particular, there has been a greater level of cross-investment between the two countries. This increased level of trans-Tasman cross-investment highlights the issue of triangular taxation, that Australia and New Zealand are respectively imposing two layers of tax upon the same underlying income.

² Australia and New Zealand’s current imputation models are not alone in this feature. It is common international practice. Australia has, however, proposed to allow franking credits for certain foreign dividend withholding tax from 1 July 2002.

- 1.9 Triangular taxation may arise between any two countries with imputation rules similar to those of Australia and New Zealand. However, owing to the special relationship embodied in CER, Australia and New Zealand are only concerned with examining the double taxation that arises on trans-Tasman triangular investment.

Benefits of reform of taxation of trans-Tasman triangular investment

- 1.10 Triangular tax relief would preserve Australia and New Zealand's source taxation, while reducing the extra layer of tax faced by their residents when taxed on their worldwide income. This is consistent with both countries' imputation systems, which are intended to tax resident investors only once on income earned in their home countries.
- 1.11 The issue of triangular taxation relief can also be considered from the perspective of the wider CER dynamic. Since the inception of CER, in 1983, the strategic underpinning of the economic relationship has been the closer alignment of the Australian and New Zealand economies.
- 1.12 Although the CER agreement is now a mature one, and significant inroads have been made towards creating a single market, the process is not yet complete. The capital market remains the least aligned part of the trans-Tasman market, and taxation disincentives may be impeding the flow of capital across the Tasman.
- 1.13 Both governments are committed to the removal of impediments to trans-Tasman business where possible, and addressing the problem of triangular taxation could be a significant step towards improving the ease of trans-Tasman capital flows.
- 1.14 Triangular tax reform would provide relief to Australian and New Zealand investors from the residence taxation imposed on income that has already been taxed at source by their home governments.

Australian and New Zealand governments' approach to triangular reform

- 1.15 Although the need to address possible barriers to trans-Tasman investment is an important consideration, reform must also consider the need to maintain the integrity of the respective tax bases. This is a key design objective.
- 1.16 It is important, therefore, that any triangular relief achieves a balance between the objectives of relieving disincentives to triangular investment and preserving the integrity of the Australian and New Zealand tax bases in a way that is acceptable to both business and the two governments.

Steps to trans-Tasman triangular reform

- 1.17 The possible reform of trans-Tasman triangular taxation was noted in Australia's Ralph Report:³

“The Australian Government propose to the New Zealand Government that discussions be held with a view to introducing a mechanism to allow franking credits to flow through trans-Tasman companies on a pro-rata basis to Australian and New Zealand investors.”

- 1.18 On 29 August 2000, the Australian Treasurer, Mr Peter Costello, and the New Zealand Minister of Finance, Dr Michael Cullen, issued a joint press statement advising that they had requested officials to develop a workable solution to the triangular issue and assess the costs and benefits of applying such a solution.
- 1.19 On 20 June 2001, Dr Cullen announced that Mr Costello and he had agreed that the mechanism should be one that allocates both franking and imputation credits to shareholders in proportion to their shareholding of the company. It would involve a mechanism known as pro rata allocation. As a further step in the process, a discussion document would be published to assist consultation.
- 1.20 This resulting discussion document outlines the preferred approach that the two governments will ultimately consider in deciding whether or not to reform the treatment of trans-Tasman triangular taxation. It also discusses other approaches to the provision of triangular relief and explains why both governments have decided not to pursue these other approaches.

Application date

- 1.21 It is proposed that triangular reform would apply no earlier than the New Zealand imputation year beginning 1 April 2003. Triangular reform would apply to companies from a particular day. For example, franking credits would arise in respect of franked dividends, or dividend withholding tax paid on unfranked dividends, paid on or after the start date.

³ *A Tax System Redesigned*, July 1999, at page 633.

TABLE 1:
SUMMARY OF PROPOSED REFORM

- Trans-Tasman investors would receive both an Australian and a New Zealand imputation credit for tax paid in both countries. Each country's imputation credits would continue to be redeemable only to resident shareholders.
- A mechanism that allocates both Australian and New Zealand imputation credits in proportion to the shareholder's ownership of the company is the preferred method. This method is known as "pro rata allocation".
- Australian companies would generally be entitled to maintain imputation credit accounts, and New Zealand companies would generally be entitled to maintain franking accounts. This would be subject to Australian companies fully complying with New Zealand law governing imputation credit accounts and New Zealand companies fully complying with Australian law governing franking accounts.
- Australia and New Zealand group structures, regardless of the percentage ownership, would generally be entitled to pass through both credits.

Submissions

- 1.22 The Australian and New Zealand governments welcome submissions on this discussion document by 3 May 2002. Submissions should be addressed to either:

Assistant Commissioner
Law, Design and Development
(Entities and Imputation)
Tax Design Group
Australian Tax Office
P O Box 900
Civic Square ACT 2608
CANBERRA

or The General Manager
Policy Advice Division
Trans-Tasman Triangular Tax
Inland Revenue Department
PO Box 2198
WELLINGTON

Or e-mail: Australia
New Zealand

ATO-Triangular@ato.gov.au
policy.webmaster@ird.govt.nz

- 1.23 In New Zealand, submissions may be published on the website of the Policy Advice Division of the Inland Revenue Department, in the interests of making the information widely available. Should you object to your submission being published in this way, please clearly specify this in your submission. Whether published on the website or not, submissions may also be made publicly available if requested within New Zealand under the Official Information Act 1982. The withholding of particular submissions or parts of submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. If you feel that your identity and/or any part of your submission should be properly withheld under that Act, please indicate this clearly in your submission.

Chapter 2

THE CURRENT TAXATION OF TRIANGULAR INCOME

- 2.1 This chapter discusses the existing rules for the taxation of triangular income and identifies their possible deficiencies.

Distinction between direct and triangular investment into Australia and New Zealand

- 2.2 Imputation systems are designed to impose only one layer of tax on resident companies' income earned in their home jurisdiction and distributed to resident shareholders. The rationale is that because the resident company is merely an intermediary for its shareholders, taxation should be on the basis of economic equivalence rather than legal identity, to eliminate distortions in investment behaviour. The equivalent in economic terms is that resident individuals investing in their home jurisdiction would face only one level of taxation by their government. Without a system of imputation, the equivalent investment in economic substance would face taxation at the company level when the income was earned, and then again when it was distributed to shareholders.
- 2.3 Both countries' imputation systems, however, mirror the taxation of an economically equivalent investment only when residents make investments directly through a resident intermediary company rather than indirectly, and possibly incidentally, through a company resident in the other jurisdiction. Indirect or "triangular" investment by residents in their home country through a company resident in the other jurisdiction is taxed on the basis of legal identity rather than economic equivalence.
- 2.4 The outcome is illustrated by the calculations set out in tables 2 and 3. Table 2 shows the difference in tax treatment for an Australian resident, at the top marginal tax rate of 48.5%, investing in Australia through an Australian company or indirectly through a New Zealand company. It is only when Australian investment is made through an Australian company that the income is taxed at the investor's marginal rate.
- 2.5 Table 3 shows the difference in tax treatment for a New Zealand resident, at the top marginal tax rate of 39%, investing in New Zealand through a New Zealand or Australian company. As shown in the table, it is only when New Zealand investment is made through a New Zealand company that the income is taxed at the investor's marginal rate.

TABLE 2:
TAX TREATMENT OF AN AUSTRALIAN RESIDENT INVESTING IN AUSTRALIA
THROUGH AN AUSTRALIAN OR A NEW ZEALAND COMPANY

	<i>Australian company</i>	<i>New Zealand company⁴</i>
Income earned in Australia	100	100
Tax paid in Australia	30	30
Tax paid in New Zealand		3 ⁵
Australian income after tax	70	67
Less New Zealand NRWT ⁶		(10)
Cash dividend to shareholder	70	57
Imputation credit ⁷	30	
Foreign tax credit		10
Assessable income	100	67
Tax on assessable income	48.50	32
Less franking rebate	(30)	
Less foreign tax credit		(10)
Tax payable	18.50	22
Net dividend received	51.50	35
Effective tax rate	48.5%	65%

2.6 Trans-Tasman companies may sometimes overcome such distortions by transferring investments in the other jurisdiction⁸ into a separate structure and seeking shareholders from that country. Although shareholding would be open to all investors, the benefit of being able to offer imputation credits to residents of the other country is a key marketing advantage. In practice, such structuring is an option only for large companies with significant operations in both countries, as it involves significant implementation costs.

2.7 The proposed reform will diminish the incentive to restructure by allowing trans-Tasman companies to attach Australian imputation credits if source taxation has been paid in Australia, and New Zealand imputation credits if source taxation has been paid in New Zealand.

⁴ This table assumes that no New Zealand imputation credits have been attached and thus New Zealand's foreign investor tax credit rules do not apply. These rules are further discussed in chapter 4.

⁵ Tax in New Zealand: (\$100 x 33%) \$33 less tax paid in Australia of \$30, giving net tax payable of \$3.

⁶ Non-resident withholding tax levied at 15%.

⁷ Section 160AQT amount, *Income Tax Assessment Act 1936*.

⁸ For a company in one jurisdiction looking to raise capital to make further investment in the other jurisdiction, a structure that could pass on imputation credits to shareholders is an option to be considered.

TABLE 3:
TAX TREATMENT OF A NEW ZEALAND RESIDENT INVESTING IN NEW ZEALAND
THROUGH A NEW ZEALAND OR AN AUSTRALIAN COMPANY

	<i>New Zealand company</i>	<i>Australian company⁹</i>
Income earned in New Zealand	100	100
Tax paid in New Zealand	33	33 ¹⁰
New Zealand income after tax	67	67
Less Australian DWT ¹¹		(10)
Cash dividend to shareholder	67	57
Imputation credit	33	
Foreign tax credit		10
Gross income	100	67
Tax on gross income	39	26
Less imputation credits	(33)	
Less foreign tax credit		(10)
Tax payable	6	16
Net dividend received	61	41
Effective tax rate	39%	59%

⁹ As in table 2, this example assumes no franking credits have been attached to the dividend, and so it is liable to dividend withholding tax.

¹⁰ No further tax due in Australia.

¹¹ Dividend withholding tax.

Chapter 3

OVERVIEW OF PROPOSED REFORM

Summary of proposed reform

- Trans-Tasman investors would be relieved on the taxation of dividends received from companies resident in the other country to the extent that tax on the underlying income has been paid in their home country.
- A mechanism that allocates both Australian and New Zealand imputation credits in proportion to the shareholder's ownership of the company, known as "pro rata allocation", is the preferred method.

3.1 The proposed triangular tax reform would provide tax relief to Australian and New Zealand shareholders on income which has already been taxed in the home jurisdiction and derived through a company resident in the other jurisdiction.

3.2 This chapter presents an overview of the important considerations in developing a triangular relief mechanism. In particular, it considers the scope of reform, introduces the proposed relief mechanism and discusses alternative approaches not being pursued.

Scope of reform

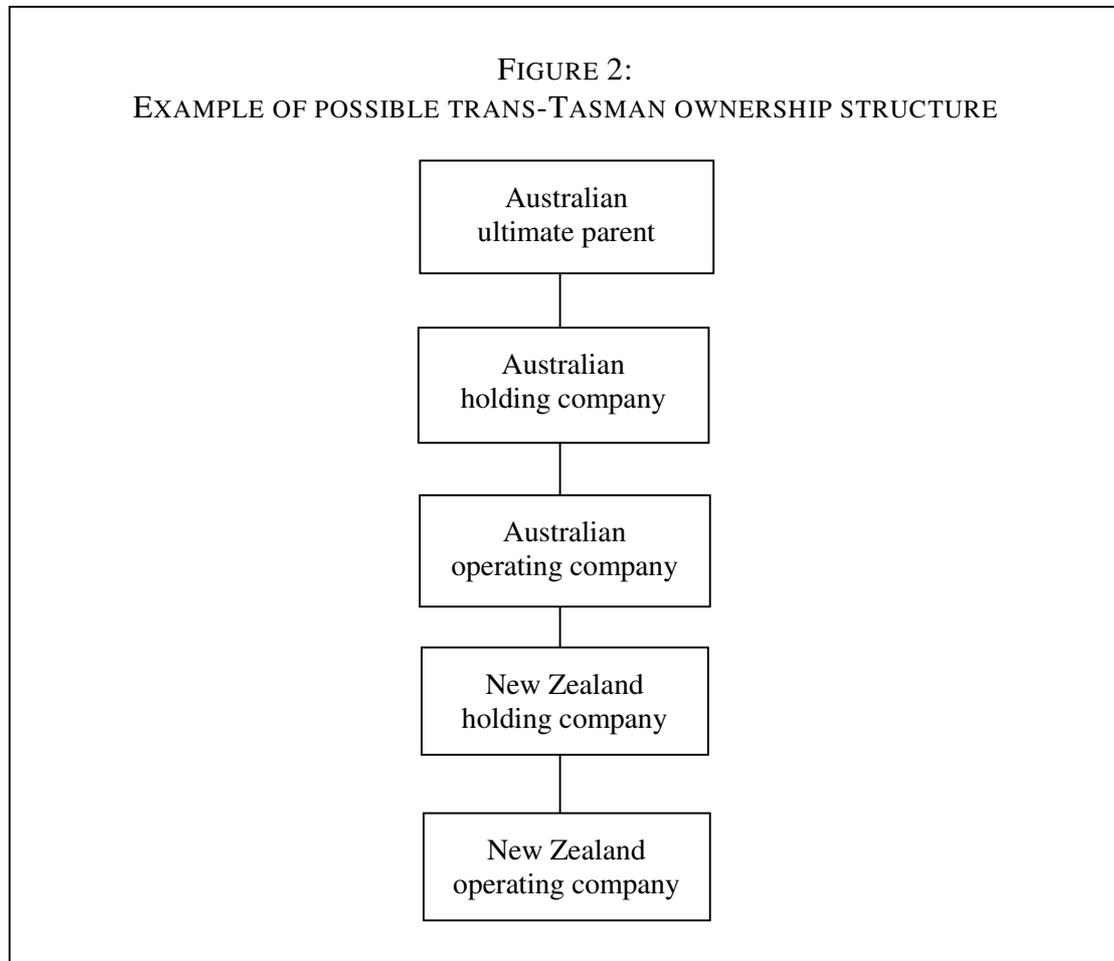
3.3 To make the underlying concepts and distortions clear, chapters 1 and 2 discussed triangular tax in very simple terms. The examples used have the intermediary company itself making the investment in the other country. This happens, however, only when investment takes place through a branch structure or some other direct investment¹² by the ultimate parent company rather than through a holding company.

3.4 Although investment through a branch, or some other form of direct investment, in the other jurisdiction by the ultimate parent company would receive relief from triangular taxation, it would not be restricted to such forms of investment.

¹² Investment that generates interest, dividends or royalties on which tax is deducted by the other jurisdiction. This is discussed further under "Creditable taxes" in chapter 4.

Ownership through wholly owned groups

- 3.5 Although triangular relief would apply to branch investment, it would also cater for structures involving an ultimate parent and subsidiary holding companies that are resident in the other country. Figure 2 shows a sample structure having an Australian company as the ultimate parent company.



- 3.6 Although the New Zealand shareholders of the Australian ultimate parent company in figure 2 will own a proportion of its capital, the Australian parent company itself does not directly invest or pay tax in New Zealand. As the companies in the group form one economic unit, triangular tax reform must be wide enough to cater for such commonly used ownership structures.

Ownership through interposed companies

- 3.7 In some cases, as a result of takeover and merger activity, the trans-Tasman chain of companies is not as “clean” as the one shown in figure 2. For instance, an Australian company may be owned by a New Zealand company that in turn is owned by an Australian company. This sort of structure is illustrated in figure 3. Because it is still an Australia/New Zealand group of companies, such a structure should not preclude triangular tax relief.

FIGURE 3:
EXAMPLE OF OWNERSHIP STRUCTURE WITH INTERPOSED COMPANIES

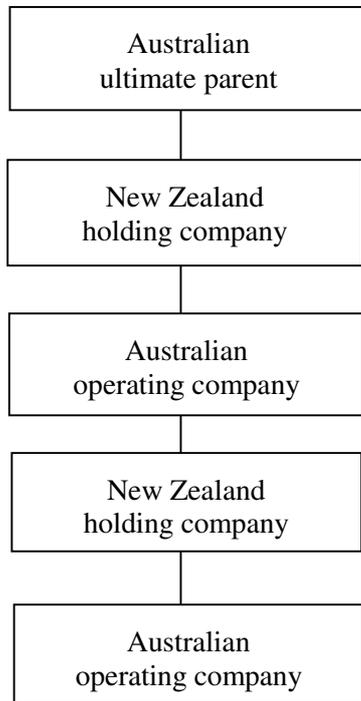
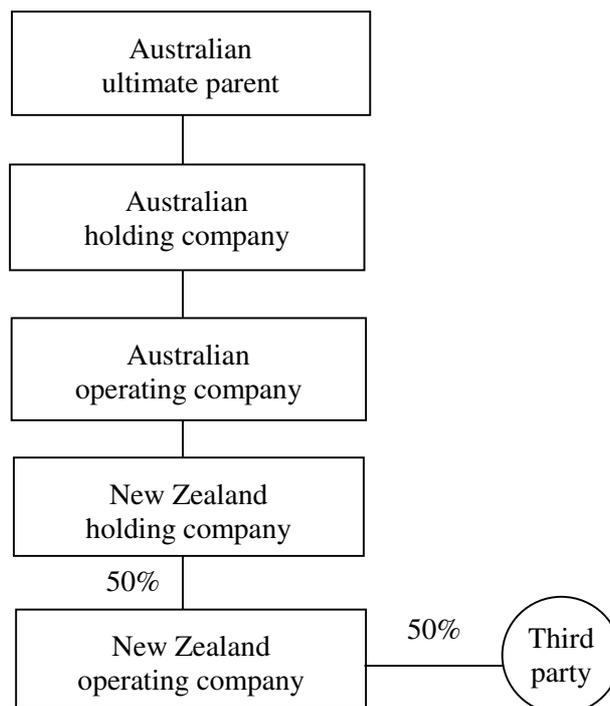


FIGURE 4:
EXAMPLE OF NON-WHOLLY OWNED GROUP STRUCTURE

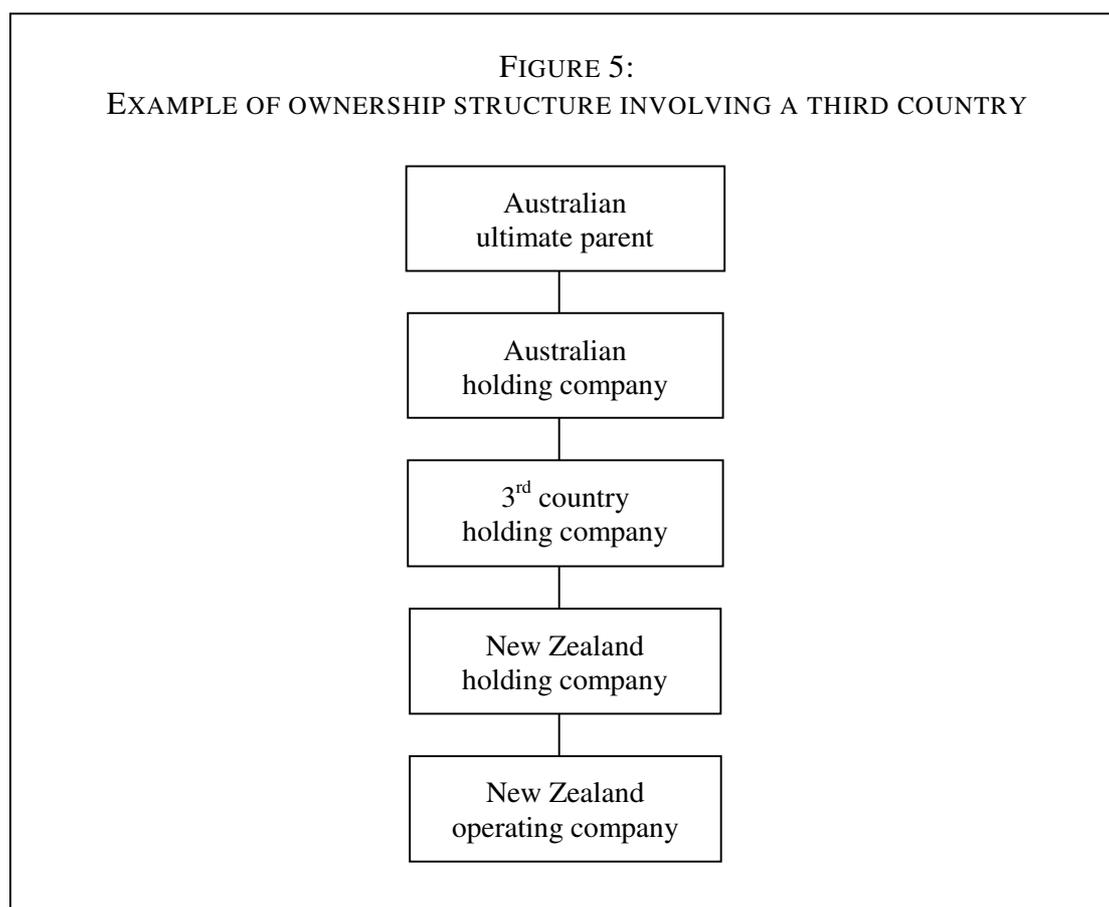


Ownership through non-wholly owned groups

3.8 It is not uncommon for companies further down the corporate chain to engage in joint venture activity with investors other than the ones holding shares in the ultimate parent. The result is a chain of companies that do not have a 100 percent common ownership, as in figure 4.

3.9 Although the shareholders of the Australian ultimate parent company in figure 4 have full rights to the Australian income, they have rights only to 50 percent of the income from the New Zealand operating company. The question, therefore, is whether triangular relief should be restricted to wholly owned chains, as is the case for both countries' grouping rules, or whether chains that are not wholly owned are acceptable. It appears that the avoidance concerns that provide the rationale for the 100 percent restriction for New Zealand's consolidation and grouping rules do not apply to triangular investment. It also appears that the rationale for the 100 percent restriction in Australia's proposed consolidation rules similarly does not apply to triangular investment. Relief could, therefore, be allowed for chains that are not wholly owned.

Ownership through chains involving third countries



- 3.10 Consideration has also been given to chains of companies in which a holding company from a third country is interposed between Australian and New Zealand companies, as shown in figure 5. As neither government has jurisdiction over a third country holding company, triangular tax relief should not extend to such structures. It is proposed, therefore, to restrict triangular reform to chains of ownership consisting of Australian and New Zealand entities only.

Proposed relief mechanism – “pro rata allocation”

- 3.11 The proposed mechanism for providing triangular tax relief is one known as “pro rata allocation”. It is the preferred approach for both governments as it is the only method of those considered that apportions the tax benefits on the basis of the shareholders’ ownership, which is consistent with both countries’ current policy on imputation. Shareholders have the right to a proportion of the total income of a company rather than to a specific income source derived by the company. It seems appropriate, therefore, that the credit allocation rules continue to require a company paying a dividend to attach the same proportion of each type of credit to each dividend that it pays. This also ensures that the total Australian or New Zealand tax rate imposed on shareholders is consistent with their proportionate share of each source of income derived by the company.
- 3.12 Relief from triangular tax that is based on a pro rata allocation of imputation credits would see dividends paid by an Australian or New Zealand company have both an Australian and a New Zealand imputation credit attached. Subject to the respective countries’ rules on the maximum allocation of credits (maximum ratio), the imputation credits would be allocated to shareholders in proportion to their shareholding in the company.
- 3.13 Take, for example, a company of which Australians owned 65 percent, New Zealanders 25 percent and other shareholders 10 percent. Subject to the maximum ratio, Australian shareholders could receive up to 65 percent of the Australian tax paid as an Australian imputation credit and 65 percent of the New Zealand tax paid as a New Zealand imputation credit. In this case only the Australian imputation credit would have any value to the Australian shareholder, as the New Zealand imputation credit could not be used.
- 3.14 The mechanism would work as follows:
- Australia would generally allow New Zealand resident companies to maintain franking accounts, and New Zealand would generally allow Australian resident companies to maintain imputation credit accounts.
 - Companies would be able to elect into the triangular rules to pass on the other country’s imputation credit.

- For Australian companies, dividends would continue to be exempt from dividend withholding tax to the extent they are franked, but the dividend withholding tax deducted from unfranked dividends would be creditable to the New Zealand company's franking account.
- For New Zealand companies, the foreign investor tax credit rules would continue to apply, but both the imputation credit attached to the dividend and the non-resident withholding tax deducted from the dividend would be creditable to the Australian company's imputation credit account.
- Australian shareholders in receipt of a New Zealand dividend with Australian imputation credits might have their franking rebate reduced by the amount of any supplementary dividend paid, but other options that give an equivalent result might be considered as well.¹³

3.15 The operation of the pro rata allocation mechanism would require Australian companies with an imputation credit account to comply with the New Zealand law governing its maintenance, as New Zealand companies currently do. Conversely, it would require New Zealand companies with a franking account to comply with the Australian law governing its maintenance, as Australian companies currently do.

Alternative approaches

3.16 There are three alternatives to the provision of triangular tax relief which both governments have considered but do not wish to pursue:

- mutual recognition, including pro rata revenue sharing;
- streaming; and
- apportionment.

Mutual recognition including pro rata revenue sharing

3.17 Mutual recognition would involve either providing imputation credits for company taxes paid in another country, or extending the full benefits of imputation to residents of another country on a reciprocal basis. Compensation might also be paid to the country that recognised the imputation credit from the country that received the tax. This is known as pro rata revenue sharing.

3.18 If compensation were paid, relief would be provided by the source country; otherwise the cost of the imputation credits would be borne by the residence country. Either way, the recognition could apply to all taxpayers or it could be limited to natural persons.

¹³ This issue is discussed further in paragraph 4.21.

- 3.19 Mutual recognition would involve the Australian government recognising a New Zealand imputation credit attached to a dividend that was distributed to an Australian resident shareholder, and vice versa. In this case, the imputation credit would be generated through the payment of New Zealand company tax, but could be used as a rebate against the Australian individual's tax liability. The Australian government, as the residence country, would bear the cost of recognition.
- 3.20 For the shareholders themselves, pro rata revenue sharing would be equivalent to the extension of the full benefits of imputation to residents of another country on a reciprocal basis. For individual shareholders, this method would see each country recognising the other country's imputation credits as if they were its own, but in turn receiving compensation from the other government. The compensation would be netted out and the government that had recognised the greater amount would receive a payment from the other for the difference. For example, if the Australian government had recognised \$20 million in New Zealand imputation credits and the New Zealand government had recognised \$15 million in Australian imputation credits, the latter would pay the Australian government \$5 million.
- 3.21 The effect of pro rata revenue sharing is equivalent to each government's company tax being treated as a withholding tax on behalf of the other. Both countries would preserve full residence taxation while giving up some source taxation. The mechanism would be similar to that already in place for social welfare.
- 3.22 Mutual recognition in whatever form, however, raises complex issues involving a possible substantial revenue impact, avoidance opportunities, international tax treaty obligations and national economic welfare. Mutual recognition would involve a loss of tax revenue from each government to its resident shareholders in respect of company tax paid to the other government. Alternatively, in the case of pro rata revenue sharing, there would be a loss of tax revenue from each country to the other country's resident shareholders in respect of company tax paid in its own country.
- 3.23 In theory, mutual recognition could offer potential efficiency gains and, as a result, generate revenue gains that could offset the initial revenue costs. The net revenue effects are, however, uncertain and could be substantially negative.
- 3.24 Mutual recognition also exceeds what is required to achieve triangular reform because shareholders in either country would receive imputation credits, regardless of whether tax was paid in their respective home countries. Neither government is willing, therefore, to pursue mutual recognition further at this stage.

Streaming

- 3.25 Streaming would see all tax paid in Australia being available to provide imputation credits solely to Australian shareholders, and all tax paid in New Zealand available to provide imputation credits solely to New Zealand shareholders. Such a model is contrary to Australia's and New Zealand's imputation rules as it provides tax benefits to shareholders disproportionate to their shareholdings.
- 3.26 A streaming model, however, would address some of the concerns of pro rata revenue sharing, as tax would have to be paid in the home country of the shareholder before an imputation credit was given. Both governments, however, are concerned about the fiscal risks of such a model, given that imputation credits would be allocated only to shareholders of countries in which the tax was paid. This means that most¹⁴ of the imputation credits allocated could be used to reduce the shareholders' home country tax liabilities.
- 3.27 Another concern is that to allow streaming in this environment might also signal that streaming of credits more generally is now acceptable. Both governments wish to avoid such a result, as it is still both countries' policy that imputation credits should not be streamed and should be allocated across all shareholders.

Apportionment

- 3.28 Apportionment would see the tax credit attached to dividends split into Australian and New Zealand imputation credit components according to the ratio of income earned in either country and in equal proportions for all shareholders. This method is similar to pro rata allocation except that the imputation credits are allocated not only in proportion to the residence of the shareholder, but also in proportion to the country in which the income is earned. It would give the same result as pro rata allocation when a company had no previous balances of imputation credits and fully distributed all tax-paid income.¹⁵
- 3.29 The source of income would become important under an apportionment approach, as each shareholder could receive Australian and New Zealand imputation credits in total only up to the maximum ratio. Thus if a company earned 50 percent of its income in Australia and 50 percent in New Zealand and paid full tax in both countries, the shareholder could at most receive 50 percent of a full Australian imputation credit and 50 percent of a full New Zealand imputation credit. If the company were resident in Australia, where it had previously been able to fully frank the dividend, it would now frank up to 50 percent and impute up to 50 percent. Alternatively, if the company

¹⁴ Charities in New Zealand, for instance, would still not be able to get benefits from the imputation credits, even under a streaming model. In Australia, however, registered charities are eligible for refunds of imputation credits following the government's recent reforms.

¹⁵ This is because pro rating effectively allows over-crediting (compared with apportionment), which is possible only if the company has previous balances of imputation credits or does not fully distribute all tax-paid income.

were from New Zealand, a previously fully imputed dividend could now be imputed only up to 50 percent and franked up to 50 percent.

- 3.30 Such a mechanism would be advantageous to the shareholders who currently do not receive any of their country's imputation credits, but it would disadvantage shareholders who can currently benefit from a fully franked or imputed dividend. It is also not consistent with the current imputation policy of both countries, which allows imputation credits to be allocated across all shareholders to the extent that tax has been paid, and not over sources of income.

Chapter 4

THE PRO RATA ALLOCATION RELIEF MECHANISM

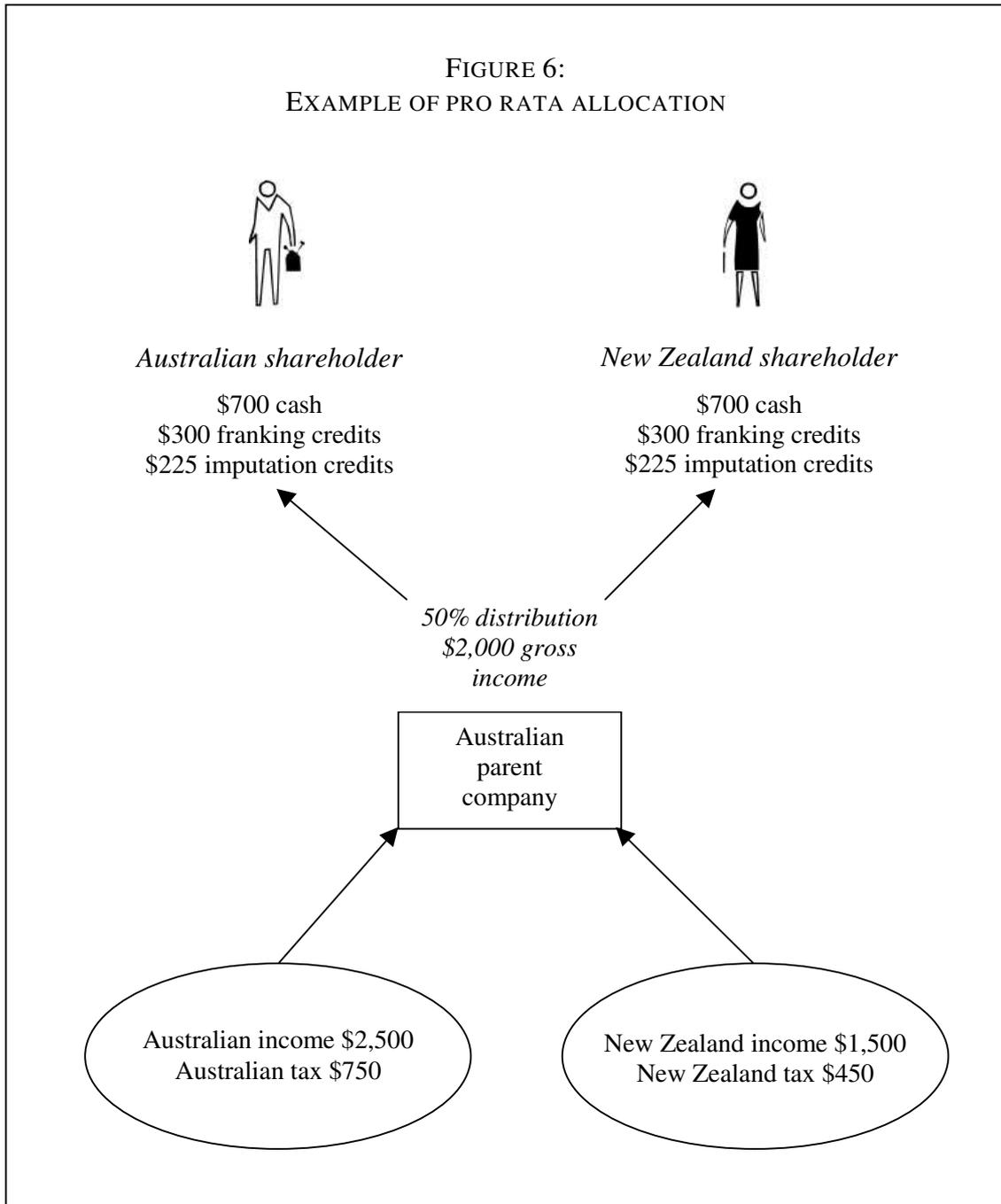
Summary of proposed pro rata allocation mechanism¹⁶

- Australian and New Zealand companies would be able to attach both Australian franking and New Zealand imputation credits to dividends paid, to the extent that tax has been paid in both countries. Each country's credits would continue to be redeemable only to resident shareholders.
- Consistent with current imputation rules, credits would arise to the franking and imputation credit accounts, as a result of tax paid or franking or imputation credits attached to dividends received.
- Credits would also arise in the other country's tracking account when withholding taxes were deducted in the other country. Non-resident withholding tax deducted in New Zealand from an Australian company's New Zealand income would be creditable to that company's imputation credit account. Dividend, interest and royalty withholding taxes deducted from a New Zealand company's Australian income would be creditable to that company's franking account.
- Australian and New Zealand group structures, regardless of the percentage of ownership, generally would be entitled to pass both credits through.
- Companies maintaining the other country's tracking account would be required to comply with that country's law, including rules on shareholder continuity, benchmark dividend ratios and anti-streaming.
- A method to minimise the impact of exchange rates on the respective imputation systems is needed. Submissions are sought on the best way to achieve this.
- A recovery mechanism would be established to ensure the collection of additional tax and penalties in the event of companies in the other country defaulting.

- 4.1 This chapter considers the mechanics of a pro rata allocation of imputation and franking credits to provide relief to Australian and New Zealand shareholders who invest in their home country through a company resident in the other jurisdiction and receive dividends from that company.

¹⁶ This mechanism is based on Australia's proposed simplified imputation system (SIS). Under the SIS, credits will be called "imputation credits" and companies will maintain imputation accounts. However, for consistency with current terminology when discussing the proposed operation of the pro rata mechanism, chapters 4 and 5 and the appendices refer to Australian imputation credits as "franking credits" and Australian imputation accounts as "franking accounts", to distinguish them from New Zealand imputation credits and New Zealand imputation accounts.

Illustration of mechanism



- 4.2 Figure 6 illustrates the operation of the proposed pro rata relief mechanism. The example concerns an Australian company that has an Australian and a New Zealand shareholder, each owning 50 percent of the shares. The company earns \$2,500 of Australian income and \$1,500 of New Zealand income, in the same unit of currency. The effective tax rate in both countries is assumed to be 30%, and the company has a 50 percent distribution policy.

- 4.3 Under the current rules, only the Australian franking credits are attached to the dividends to shareholders. Under the proposed reform, however, New Zealand imputation credits could also be attached in proportion to the shareholding. This means that a dividend could have both franking credits and imputation credits attached and could, in fact, be both fully franked and fully imputed. Although shareholders would receive imputation and franking credits, they would be able to redeem only the credits relating to their country of residence. Because the New Zealand shareholder in figure 6 owns 50 percent of the company, she can receive up to 50 percent of the tax paid, which is not enough to fully impute the dividend. Sufficient tax is paid, however, for the Australian shareholder to receive a fully franked dividend. No Australian dividend withholding tax is deducted from the dividend to the New Zealand shareholder as it has been fully franked.
- 4.4 Table 4 illustrates what would happen under the proposed reform to the tax payable on the dividends received by the New Zealand shareholder in figure 6. In this situation there would be no change to the position of the Australian shareholder in figure 6.

TABLE 4:
THE TAX TREATMENT OF TRIANGULAR INVESTMENT BY A NEW ZEALAND
INVESTOR, BEFORE AND AFTER THE REFORM

	<i>Before reform</i>	<i>After reform</i>
Cash dividend	\$700	\$700
Imputation credits	Nil	\$225
Gross income	\$700	\$925
Tax due @ 39%	\$273	\$361
Imputation credits	Nil	\$225
Tax payable	\$273	\$136
Net dividend	\$427	\$564
Effective tax rate ¹⁷	57.3%	43.6%

- 4.5 The effective tax rate is still not 39%, even with triangular relief. This is appropriate, as the dividend is not fully imputed, having been partially generated by Australian income with Australian, not New Zealand, tax paid.
- 4.6 Table 5 then illustrates what happens under the proposed reform to the tax paid by the Australian shareholder if the company in figure 6 had a New Zealand parent company instead of an Australian parent. In this situation there would be no change in the position of the New Zealand shareholder. The effective tax rate, however, is 48.5% for the Australian shareholder because the dividend is fully franked.

¹⁷ The effective tax rate is calculated on \$1000 of underlying pre-tax income.

TABLE 5:
THE TAX TREATMENT OF TRIANGULAR INVESTMENT BY AN AUSTRALIAN
INVESTOR, BEFORE AND AFTER THE REFORM

	<i>Before reform</i>	<i>After reform</i>
Cash dividend	\$700	\$700
Supplementary dividend ¹⁸	\$81	\$81
Less New Zealand NRWT ¹⁹	(\$117)	(\$117)
Net cash dividend	\$664	\$664
Foreign tax credit	\$117	\$117
Imputation credits	Nil	\$219 ²⁰
Assessable income	\$781	\$1000
Tax due @ 48.5%	\$379	\$485
Foreign tax credit	\$117	\$117
Franking rebate	Nil	\$219 ²¹
Tax payable	\$262	\$149
Net dividend	\$402	\$515
Effective tax rate ²²	59.8%	48.5%

Details of mechanism

Eligibility

- 4.7 Australia would allow New Zealand companies to maintain a franking account, and New Zealand would allow Australian companies to maintain an imputation credit account, although the current exclusions that apply to resident companies would also apply to companies in the other jurisdiction.²³
- 4.8 A New Zealand company would need to be a resident of New Zealand under the New Zealand residence rules to be able to maintain a franking account, and an Australian company would need to be a resident of Australia under the Australian residence rules to maintain an imputation credit account.

¹⁸ Although the tax rate used in the example is 30%, the supplementary dividend has been calculated at 67/187 of New Zealand imputation credit of \$225 under the current rules.

¹⁹ Non-resident withholding tax levied at 15%.

²⁰ The imputation credit of \$300 has been reduced by a \$81 supplementary dividend. This is discussed further in paragraph 4.21.

²¹ The franking rebate of \$300 has been reduced by a \$81 supplementary dividend. This is discussed further in paragraph 4.21.

²² The effective tax rate is calculated on \$1000 of underlying pre-tax income.

²³ This does not include the current exclusions on Australia/New Zealand dual-resident companies.

Australian corporate limited partnerships, corporate unit trusts and public trading trusts

Australian tax law treats corporate limited partnerships, corporate unit trusts and public trading trusts in the same way as companies, including for imputation purposes. These entities are generally treated as Australian residents if they conduct business or hold property in Australia, even though they may be formed in a foreign country. It is not proposed to extend the scope of these rules in the context of triangular taxation because the current law essentially treats them as residents, making triangular tax relief unnecessary. For example, a corporate limited partnership formed in New Zealand that conducts business in Australia would be treated as resident in Australia. It would have a franking account, and franking credits would arise on payment of Australian income tax, so that franked distributions could be paid to an Australian partner.

- 4.9 The Australian treatment of companies that are dual resident companies of New Zealand and another country is still under consideration. The New Zealand treatment of dual resident companies of Australia and another country, however, would require such companies to be subject to Australian tax for the purposes of a double tax agreement in order to maintain an imputation credit account. Should Australia not have a double tax agreement with the other country, the company would not be entitled to maintain an imputation credit account.
- 4.10 Although it is currently mandatory for resident companies in each jurisdiction to maintain their country's tracking account, under the proposed mechanism it would be elective for companies in the other jurisdiction. For instance, although at present it is mandatory for New Zealand companies to maintain an imputation credit account, Australian companies would be able to choose whether or not they wish to maintain one. Should Australian companies wish to maintain an imputation credit account, they would make an election to do so. An equivalent procedure would apply to New Zealand companies wishing to maintain a franking account.
- 4.11 For example, in order to maintain an imputation credit account and pay dividends with imputation credits attached, an Australian company would need to make an election and then notify New Zealand's Inland Revenue Department of that election. Imputation credits would generally arise for an Australian company only if the company had made an election. As a transitional measure, however, consideration could be given to allowing retrospective elections. Elections would be revocable, but a company's imputation credit account or franking account would be cancelled on revocation of the company's election.

Australia's exempting company rules and proposed changes

An *exempting company* in Australia is one that is, effectively, wholly owned by non-residents or tax-exempt entities. Although exempting companies must maintain franking accounts in the same way as other companies, franked dividends paid by an exempting company generally do not provide any benefit to resident shareholders and provide only an exemption from dividend withholding tax for non-residents.

If an exempting company ceases to be effectively wholly owned by non-residents or tax-exempt entities, it becomes a *former exempting company*. The franking account is converted to an *exempting account*, which quarantines the franking credits and debits relating to the period during which the company was an exempting company.

A surplus or credit balance in the exempting account may be used only to pay *exempted dividends*. An exempted dividend will exempt non-resident shareholders from Australian dividend withholding tax, but will generally not provide franking credits to resident shareholders.

The exempting company rules are designed to prevent non-resident owned companies that have accumulated large balances of franking credits, when sold to residents, giving an unwarranted benefit to the resident shareholders. The franking credits of a company under non-resident ownership are of no value to the non-resident shareholders other than as a means of exempting the dividend from dividend withholding tax. Upon sale of the company to residents, however, the franking credits would then be available to reduce the tax payable on dividends by residents, even though they were not shareholders when the franking credits were originally generated.

A company is considered to be effectively wholly owned by non-residents or tax exempt entities if 95 percent or more of the shares and interests in the company that confer economic ownership are held by non-residents or tax exempt entities. A "look-through" approach is adopted to determine the effective ownership of chains of resident companies, partnerships, or trusts. Non-resident partnerships and trusts are also "looked through".

For example, if shares in a company are held in a resident trust but the trust is controlled by non-resident individuals and all the income beneficiaries are non-resident, the shares of the company will be considered to be effectively owned by those non-residents, rather than the resident trust. Non-resident companies, however, are not looked through to find the ultimate effective owners, even though the ultimate effective owners may be predominantly Australian.

With the proposed triangular reform, unless changes were made to the exempting company rules, an Australian resident company that is a wholly owned subsidiary of a New Zealand parent company would be an exempting company, regardless of the level of Australian shareholding in the New Zealand company. This would mean that franked dividends paid by the subsidiary company would not result in a franking credit to the franking account of the parent company.

It is proposed, therefore, that the look-through approach be amended to include New Zealand companies, so that New Zealand companies as well as Australian entities and non-resident partnerships and trusts, are looked through to find the ultimate effective owners. Thus an Australian or New Zealand company would be an exempting company only if 95 percent or more of the ultimate effective ownership of the company were held by New Zealand or other shareholders not resident in Australia.

Neither the New Zealand parent nor the Australian subsidiary in the previous example would be exempting companies if the New Zealand parent had Australian shareholders in excess of 5 percent. If the ultimate Australian shareholding were less than 5 percent, however, the franking credits attached by the New Zealand company would not generally provide any benefit to its Australian shareholders.

Following triangular reform, if a New Zealand parent company has five percent or more ultimate Australian shareholders and an Australian subsidiary company and it migrates to Australia, the franking credits accumulated by the subsidiary company could be accessed by the shareholders in the parent company. This would not be possible under the current law because the subsidiary company would be an exempting company before the relocation of the parent company, and a former exempting company after relocation.

Flow-through mechanism

- 4.12 Consistent with the current rules governing credits to the tracking accounts, franking and imputation credits would arise either when tax was paid or when a company received a dividend with credits attached. Thus for an ultimate parent company to be able to distribute tax paid by a lower tier company as franking or imputation credits, dividends with credits attached would need to be paid up the chain of companies. This is consistent with the current requirements of both sets of imputation rules.

- 4.13 Except when Australia's exempting rules applied, as the credits flowed through the companies in proportion to the shareholding there would be no need for the lower tier companies that pay the tax to know the ultimate shareholding percentages. At each level the correct percentage would be passed on with the dividend, so by the time the credits reached the top company, the correct proportion of tax paid would be available to be passed on to the final shareholders.

Creditable taxes

- 4.14 It is proposed that withholding taxes imposed by one country on non-residents, as well as income tax paid directly, be creditable to that country's tracking account in the other jurisdiction. For example, if a royalty is paid from a New Zealand company to an Australian company, non-resident withholding tax would be deducted in New Zealand. A credit could then be made to the Australian company's imputation credit account for the non-resident withholding tax deducted in New Zealand, since non-resident withholding tax is simply another form of New Zealand tax. The treatment is consistent with the current rules that allow the imputation credit account to have New Zealand resident withholding tax credited to it.
- 4.15 For Australian companies maintaining an imputation credit account, the New Zealand withholding taxes that could be credited are non-resident withholding taxes on interest, royalties and dividends and non-resident contractors withholding tax. The approved issuer levy, however, would not be creditable to an imputation credit account as it is not a liability of the non-resident.
- 4.16 For New Zealand companies maintaining a franking account, the Australian withholding taxes that could be credited are dividend, interest and royalty withholding taxes. Franking credits for these withholding taxes would be an extension of the current imputation system. The justification for this proposed change is that these withholding taxes, like company tax, represent an additional layer of Australian tax on Australian income received by Australian shareholders.
- 4.17 Australia is also proposing to give a franking credit for foreign withholding tax on dividends paid that meets certain criteria. In the case of New Zealand withholding tax, Australia may want to reduce the franking credits for the withholding tax to the extent of any attached franking credits; otherwise the franking credits attached to the dividend would be excessive.
- 4.18 It is also proposed to allow a credit to an Australian company's imputation credit account for any non-resident withholding tax deducted from dividends in New Zealand. When the tax was eligible to be credited to both accounts, companies could choose into which account they wished it to be credited. A franking credit would arise in a company's franking account only to the extent that an imputation credit did not arise in the company's imputation credit account, and vice versa. Otherwise, the single payment of non-resident withholding tax on dividends could generate excessive tax benefits

through the creation of both a franking and an imputation credit for the same amount of the single payment of the tax.

Creditable taxes and interface with New Zealand's international tax rules

New Zealand dividend withholding payments

Dividend withholding payments made by New Zealand companies on foreign dividends received may, in effect, be passed on to the imputation credit accounts of Australian companies, depending on how they are accounted for in New Zealand.

New Zealand companies that do not maintain a dividend withholding payment account currently credit such payments to the imputation credit account, and they can be passed on to shareholders as New Zealand imputation credits, rather than dividend withholding payment credits. Under the proposed reform, if one of these shareholders were an Australian company with an imputation credit account, this imputation credit would simply be credited to it.

New Zealand companies that do maintain a dividend withholding payment credit account currently attach a dividend withholding payment credit to dividends paid to shareholders. Unlike an imputation credit, these credits are refundable to the extent they exceed the New Zealand tax liability of the shareholder. If the shareholder is a non-resident, the dividend withholding payment is refunded to the extent it exceeds the non-resident withholding tax due. The latter is then deemed paid.

At present, an Australian company that has received a dividend with a dividend withholding payment credit attached will receive a refund from the New Zealand government to the extent it exceeds the company's liability to non-resident withholding tax. Under the proposed reform, the non-resident withholding tax could then be credited to its imputation credit account.

Foreign investor tax credit rules

The foreign investor tax credit rules would continue to apply to New Zealand companies paying dividends to non-residents. New Zealand companies paying a supplementary dividend to non-residents would continue to receive a foreign investor tax credit against their company tax.

Non-resident shareholders receiving a New Zealand source dividend and a supplementary dividend would continue to be liable for non-resident withholding tax, which would be deducted at source by the New Zealand company. Imputation credits, reduced by the supplementary dividend, would continue to be attached to the dividend.

Australian companies that had elected to maintain an imputation credit account would credit both the imputation credits attached to the dividend to the account as well as the non-resident withholding tax deducted from the original and supplementary dividend.

The operation of the mechanism is illustrated in tables 9 and 10 in chapter 5.

Allowable credits

- 4.19 Withholding tax on dividends paid in one country is generally allowed as a foreign tax credit in the other country to the extent that tax is due in the home country. Under the proposed reform, it would be possible for the ultimate shareholder to receive a dividend with full imputation credits that has also had a withholding tax deducted by the source country.
- 4.20 For instance, all New Zealand dividends paid to non-residents are liable to non-resident withholding tax, and unfranked Australian dividends paid to non-residents are liable for dividend withholding tax.
- 4.21 Under the proposed reform, both countries would continue to allow a foreign tax credit for non-resident withholding tax or dividend withholding tax deducted in the other country, even though the dividends might also have franking or imputation credits attached. Australia might, however, limit the franking rebate on New Zealand dividends when and to the extent that a supplementary dividend is also paid.²⁴ As the supplementary dividend reflects a reduction in the New Zealand company tax rate for non-residents,²⁵ when combined with a full franking rebate it could result in a taxpayer paying a lower effective tax rate investing through a New Zealand rather than an Australian company. The limiting of the franking rebate by the level of the supplementary dividend, or another equivalent option, would ensure that Australian investors investing in Australia through a New Zealand or an Australian company paid the same amount of tax.

²⁴ In relation to this situation, other options that give an equivalent effect may be considered.

²⁵ Company tax is reduced so that when combined with the liability to NRWT, non-residents pay no more than a 33% tax rate in New Zealand.

Compliance requirements

- 4.22 The requirement for maintenance of the other country's tracking account is that the relevant company would have to comply fully with the domestic law in that country. Appendix 1 sets out the respective imputation rules. For instance, a New Zealand company that elected to maintain a franking account would have to comply with the Australian law governing its operation, as Australian companies currently do. The converse also applies, as Australian companies that wished to maintain imputation credit accounts would have to comply with New Zealand domestic law. The recent Australian redefinition of "debt" and "equity" may mean that instruments in New Zealand that are eligible for imputation credits, such as redeemable preference shares, may not be eligible for franking in Australia.
- 4.23 Compliance with the other country's domestic law includes compliance with the provisions relating to shareholder continuity in New Zealand, exempting companies in Australia, benchmark dividend and anti-streaming rules, even though each country has slightly different requirements.
- 4.24 One relaxation in the requirement of compliance with domestic law regards each country's current or potential grouping rules. New Zealand has provisions that allow wholly owned groups to maintain a consolidated tracking account on behalf of a New Zealand group. From 1 July 2002, Australia will have similar provisions. Rather than imposing New Zealand grouping rules on Australian companies maintaining imputation credit accounts and Australian grouping rules on New Zealand companies that maintain a franking account, it is proposed to allow the home country's consolidation rules to apply. This would mean that Australian companies would be entitled to maintain one consolidated imputation credit account, in accordance with the Australian grouping rules, and New Zealand companies would be able to maintain one consolidated franking account, in accordance with the New Zealand grouping rules.
- 4.25 This relaxation would be subject to the condition that it would only apply to companies that would normally be eligible for a franking account or an imputation credit account if resident in the other jurisdiction.

Currency issues

- 4.26 The tracking accounts of each country would have to be maintained in the currency of the country concerned. There are various implications at the shareholder level of converting the credit from its base currency into the other country's currency. Appendix 2 sets out possible options for dealing with these issues, and submissions are sought on the most suitable approach.

Administrative requirements

- 4.27 Australia and New Zealand have differing disclosure requirements for their tax tracking accounts. They are detailed in table 6.

- 4.28 It is not proposed to make any changes to the New Zealand requirements. Australian companies maintaining an imputation credit account would be required to file a reconciliation of the imputation credit account with Inland Revenue in New Zealand. The requirements for New Zealand companies maintaining a franking account have not been settled.

TABLE 6:
AUSTRALIA AND NEW ZEALAND'S IMPUTATION DISCLOSURE REQUIREMENTS

	<i>New Zealand</i>	<i>Australia</i>
Franking/imputation credit account required to be filed annually?	✓	✗ ²⁶
Dividend statement required to be filed?	✓ ²⁷	✗

- 4.29 For audit purposes, the Australian Tax Office or the Inland Revenue Department may require further information from the New Zealand or Australian company maintaining its country's tracking account. In the event of non-compliance, shareholders would be denied imputation credits, and the other jurisdiction's tax authority would enforce the request for information through the exchange of information article in the Australia/New Zealand Double Tax Agreement.
- 4.30 If a company were to run the other country's tracking account into debit, additional tax and penalties would be due. If an Australian company, for example, over-imputed its dividends, putting the imputation credit account into debit, New Zealand would seek to recover tax from the Australian company.
- 4.31 Although the primary liability would be with the company that caused the account to go into debit, all companies in the other jurisdiction with a 50 percent or greater common shareholding would also be jointly and severally liable for any additional tax and penalties. Lack of compliance by the parent company might see shareholders denied imputation credits in the home jurisdiction.
- 4.32 As a final safeguard against non-compliance by the parent company and the subsidiary companies, both governments are committed to ensuring that there is a mechanism in place to ensure the collection of additional tax and penalties, should companies in the other country default.

²⁶ A company is required to file a franking account if the franking account is in deficit at the end of the company's income year.

²⁷ The removal of the requirement to file a dividend statement is being considered as part of New Zealand's tax simplification initiatives.

4.33 Extending the previous example, the process would be as follows:

Assume an Australian ultimate parent company over-imputes dividends, causing the imputation credit account to have a debit balance of \$1,000. By 20 June following the imputation year, the Australian company is required to pay \$1,000 further New Zealand income tax, as well as 10 percent imputation penalty tax of \$100, giving a total due of \$1,100.

4.34 If the further tax and the imputation penalty tax were not paid by 20 June following the New Zealand imputation year ending 31 March, the New Zealand imputation credits attached to the dividends of the New Zealand shareholders would be denied. Inland Revenue would seek the tax due, along with additional penalties and interest accruing, in accordance with the New Zealand compliance and penalty rules, from the New Zealand subsidiary companies.

4.35 The reversion to the New Zealand group would be at the discretion of the Commissioner of Inland Revenue. The current rules applying to remission of penalties and interest for New Zealand companies would also apply to Australian companies with an imputation credit account.

4.36 As a final step, if recovery from the New Zealand group were to be unsuccessful or Inland Revenue considered recovery unlikely because of the companies' financial position, the debt would be transferred to the Australian Tax Office for enforcement.

4.37 Similar procedures would apply to New Zealand companies maintaining a franking account.

Compliance and administrative costs

4.38 There would be compliance costs for New Zealand and Australian companies that elected to benefit from triangular reform. They would have to become familiar with the imputation rules of the other jurisdiction as well as comply with that country's administrative requirements. They would also need to make amendments to the statements received by shareholders in order to incorporate a dividend with potentially an imputation and franking credit attached.

4.39 Because the reform would be elective, however, it is expected that companies that elected into the new rules would do so because the benefits of the reform would outweigh any additional compliance costs.

4.40 There would also be additional administrative costs for Inland Revenue and the Australian Tax Office as a result of a greater number of taxpayers being covered by each country's respective imputation rules. Specific issues, such as those related to compliance, would also arise because of the need to administer the law in relation to non-resident entities.

Chapter 5

HOW THE MECHANISM WOULD WORK

5.1 This chapter sets out a detailed example of how the pro rata mechanism would work with a group structure of companies that are not wholly owned. They earn income in their home jurisdictions as well as make an intercompany payment from a New Zealand to an Australian group company. The exchange rate is maintained constant throughout, so the issues raised in appendix 2 do not apply. The structure is shown in figure 7.

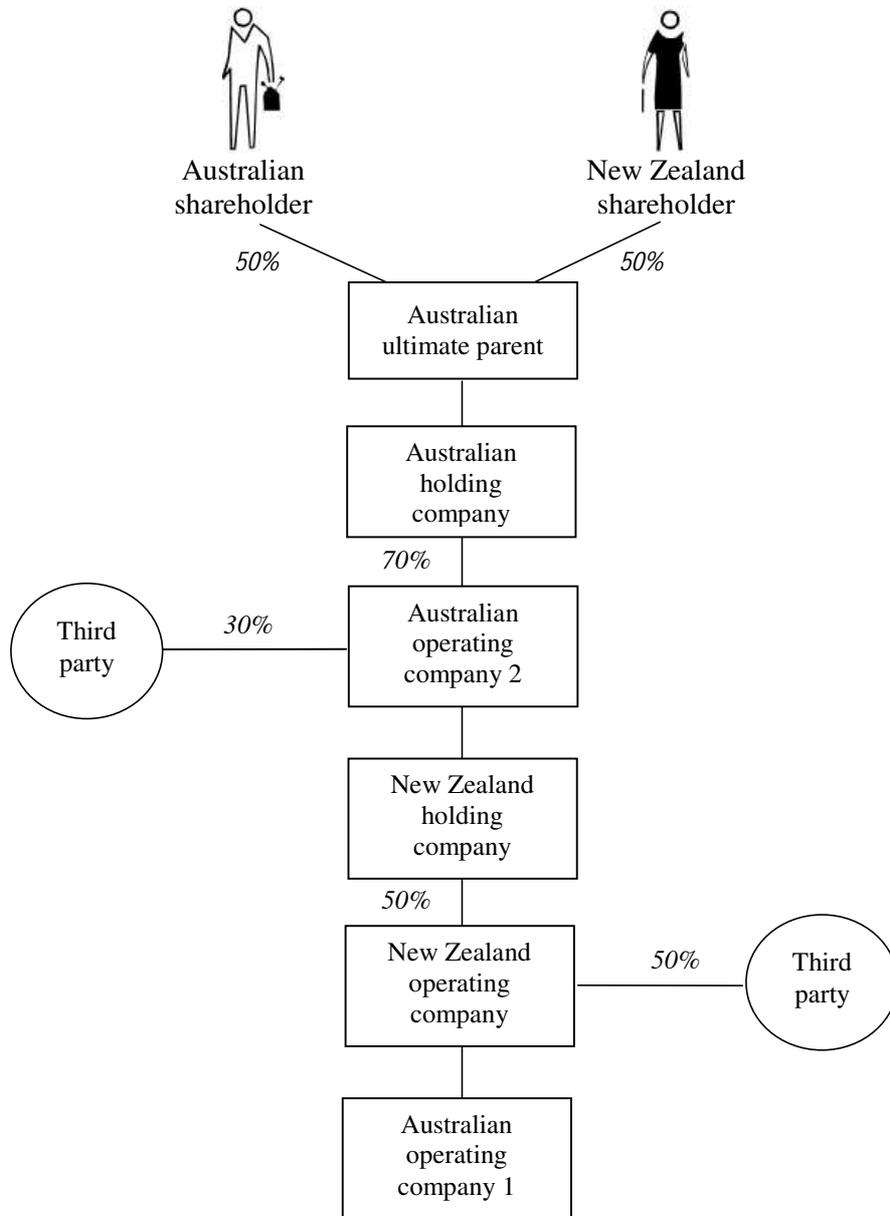
Original transactions

5.2 The original transactions are as follows and are illustrated in figure 8:

- The Australian operating company 1 earns A \$1,000 and pays A \$300 in tax, generating a credit balance of A \$300 in the franking account.
- The New Zealand operating company pays the Australian holding company a royalty of NZ \$900 after deducting non-resident withholding tax of NZ \$100, generating a credit to the imputation credit account of NZ \$100.
- The New Zealand operating company also earns NZ \$5,000 and pays NZ \$1,650 in tax, generating a credit balance in the imputation credit account of NZ \$1,650.
- The Australian operating company 2 earns A \$10,000 and pays A \$3,000 in tax, generating a credit balance in the franking account of A \$3,000.
- All Australian companies have elected to maintain an imputation credit account and all New Zealand companies have elected to maintain a franking account.

5.3 The corporate tax rates used are 30% for Australia and 33% for New Zealand.

FIGURE 7:
EXAMPLE OF NON-WHOLLY OWNED GROUP OF COMPANIES



Exchange rate 1NZD = 0.80 AUD
Ownership 100% unless otherwise specified

FIGURE 8:
ILLUSTRATION OF GROUP'S ORIGINAL TRANSACTIONS

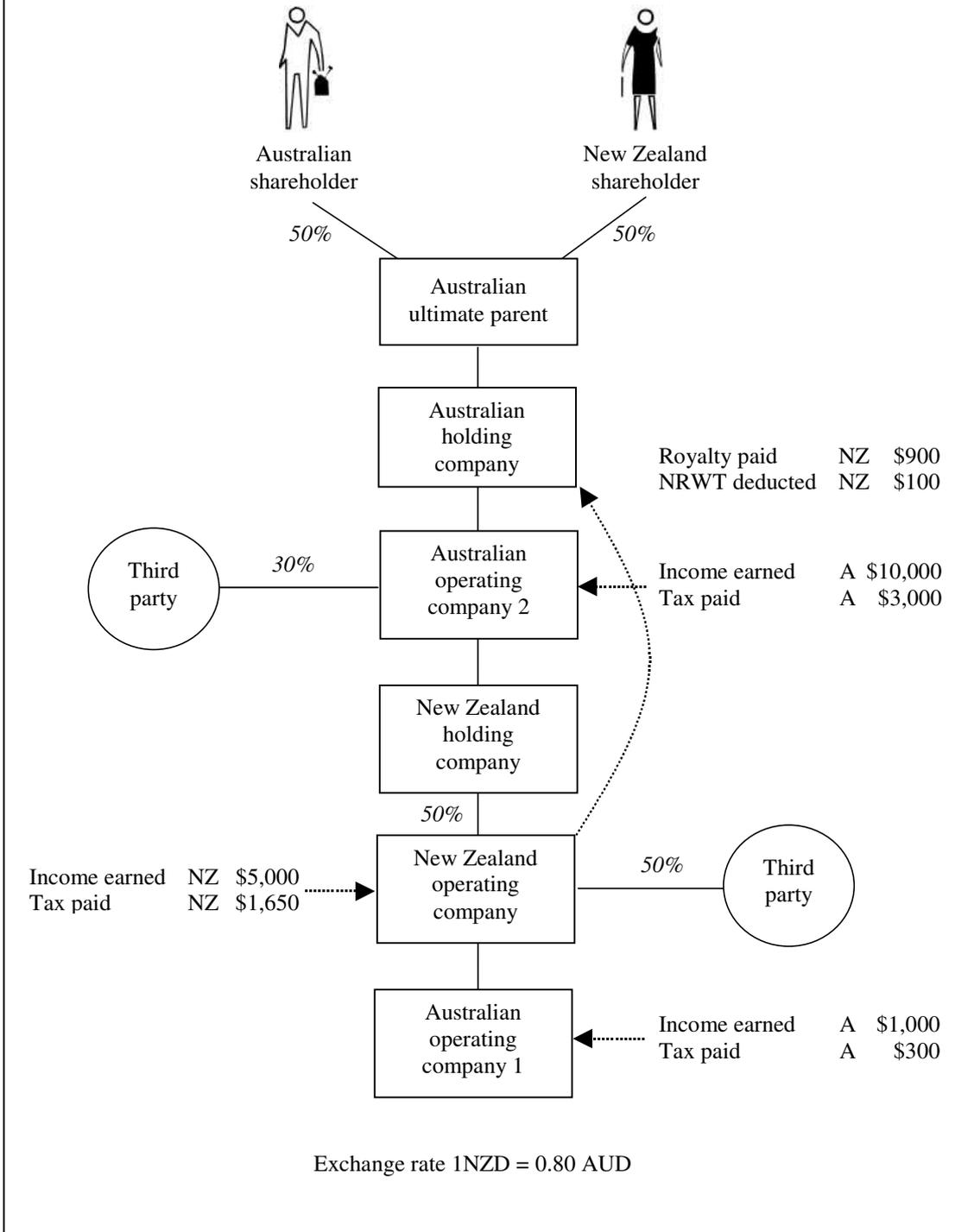
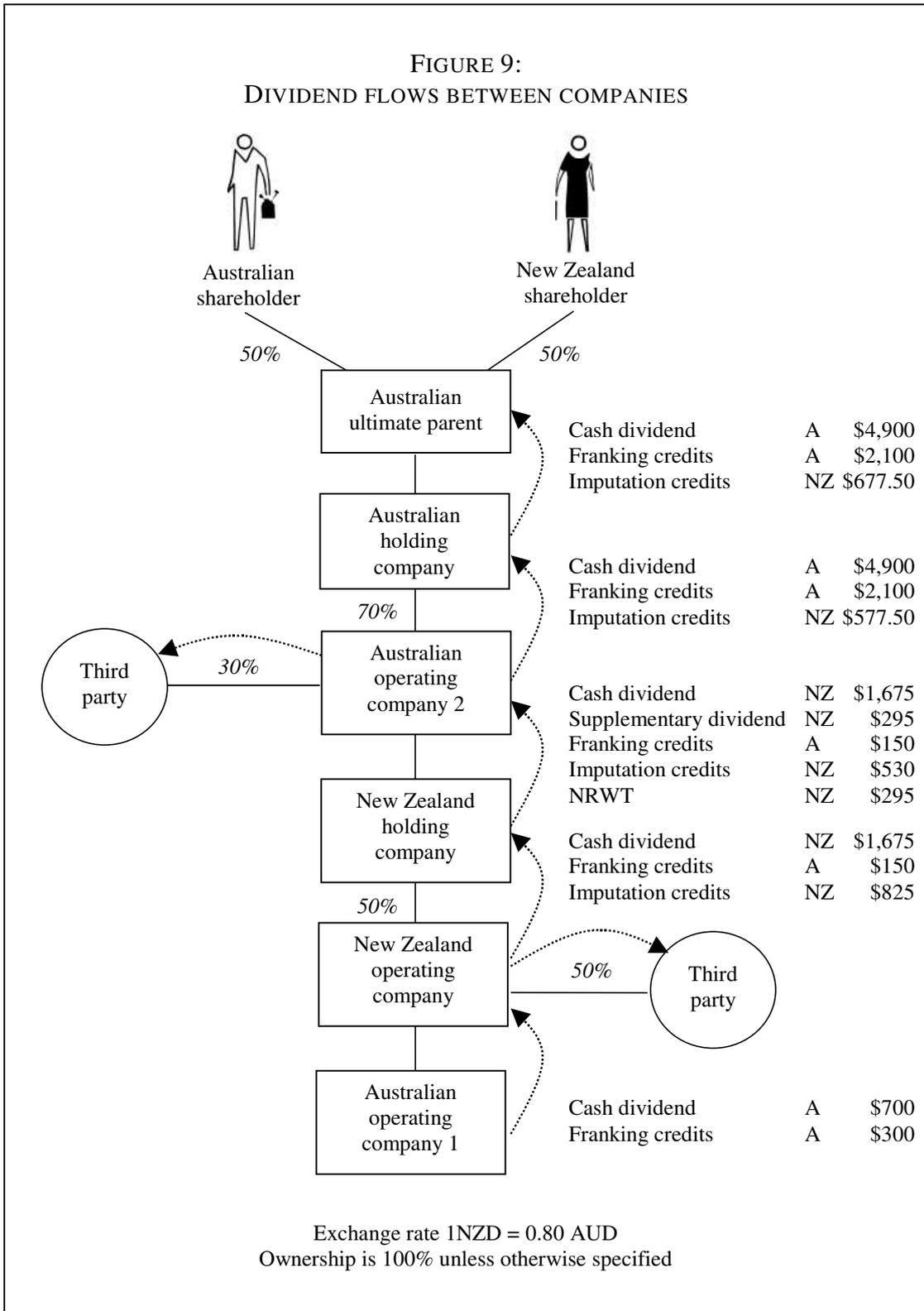
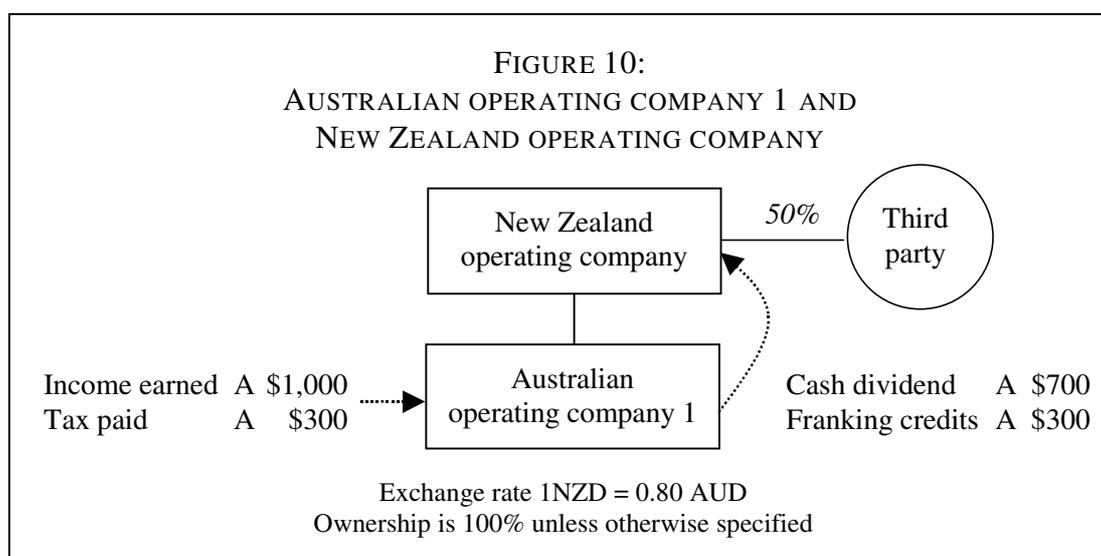


FIGURE 9:
DIVIDEND FLOWS BETWEEN COMPANIES



Operation of pro rata allocation mechanism

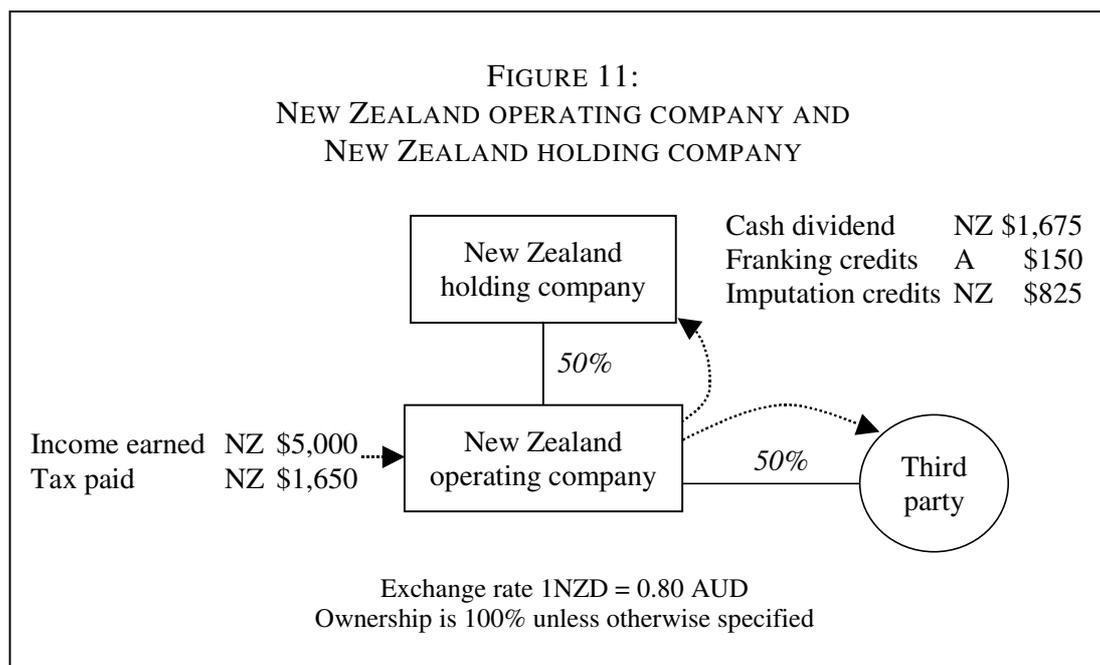
- 5.4 Figure 9 illustrates the steps involved in passing on the tax paid by the lower tier companies as franking and imputation credits to the ultimate shareholders of the parent company, while figures 10 to 14 show these steps individually.
- 5.5 Although almost all the franking and imputation credits flow up the chain of companies, some of the accompanying cash dividends do not. This is because the pro rata allocation mechanism involves two credits being attached to one dividend payment, even though only one payment of tax has been made on the underlying income. Consequently, the cash from the dividend may remain in an intermediary company while the franking or imputation credit passes up the chain.
- 5.6 Figure 10 shows the Australian operating company 1 paying a fully franked dividend of A \$700 to the New Zealand operating company. No dividend withholding tax is deducted as the dividend is fully franked.
- 5.7 There is now a nil balance in the franking account, as shown in table 7, because this dividend has transferred up the franking credit generated by the tax payment of A \$300.



**TABLE 7:
AUSTRALIAN OPERATING COMPANY 1'S FRANKING AND
IMPUTATION CREDIT ACCOUNTS**

	<i>Franking Account AUD</i>			<i>Imputation Credit Account NZD</i>		
	Dr	Cr	Bal	Dr	Cr	Bal
Tax paid		300	300 Cr			
Dividend to New Zealand operating company	300		0			

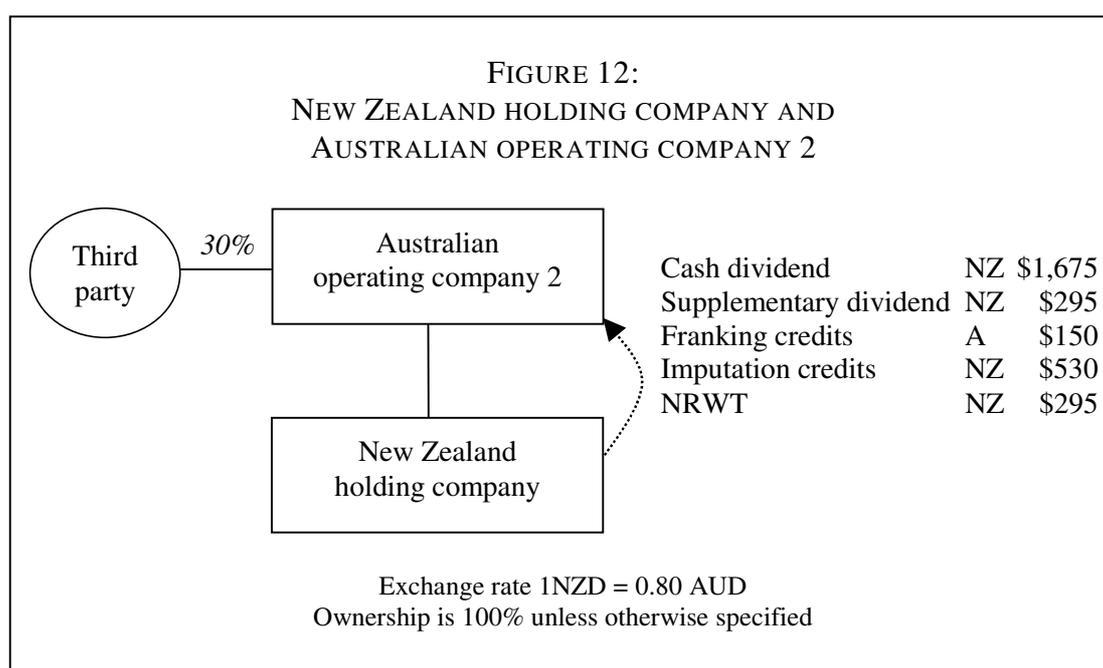
- 5.8 The New Zealand operating company pays a fully imputed dividend of NZ \$3,350 with franking credits of A \$300. Figure 11 shows the 50 percent received by the New Zealand holding company.
- 5.9 Table 8 shows the transactions in the New Zealand operating company's tracking account as a result of the original tax paid and the receipt of the dividend, as well as the effect of paying a fully imputed and partially franked dividend.



**TABLE 8:
NEW ZEALAND OPERATING COMPANY'S FRANKING AND
IMPUTATION CREDIT ACCOUNTS**

	<i>Franking Account AUD</i>			<i>Imputation Credit Account NZD</i>		
	Dr	Cr	Bal	Dr	Cr	Bal
Tax paid					1650	1650 Cr
Dividend from Australian operating company 1		300	300 Cr			
Dividend to New Zealand holding company	150		150 Cr	825		825 Cr
Dividend to third party	150		0	825		0

- 5.10 Figure 12 shows the New Zealand holding company paying a dividend of NZ \$1,675 and a supplementary dividend of NZ \$295²⁸ to the Australian operating company 2. Franking credits of A \$150 and imputation credits of NZ \$530²⁹ are attached to the dividend. Non-resident withholding tax of NZ \$295³⁰ is deducted from the dividend and paid to the New Zealand government.
- 5.11 Table 9 shows the New Zealand holding company's receipt of a foreign investor tax credit of NZ \$295,³¹ as well as the franking credits and imputation credits that were attached to the dividend received from the New Zealand operating company. It also shows the remainder of both credits attached to the dividend paid to the Australian operating company 2.



**TABLE 9:
NEW ZEALAND HOLDING COMPANY'S FRANKING AND
IMPUTATION CREDIT ACCOUNTS**

	<i>Franking Account AUD</i>			<i>Imputation Credit Account NZD</i>		
	Dr	Cr	Bal	Dr	Cr	Bal
Dividend from New Zealand operating company		150	150 Cr		825	825 Cr
Foreign investor tax credit				295		
Dividend to Australian operating company 2	150		0	530		0

²⁸ This is calculated as $\frac{67}{120} \times$ imputation credits of NZ \$530.

²⁹ Total imputation credits of NZ \$825 less foreign investor tax credit of NZ \$295.

³⁰ 15 percent of cash and supplementary dividend.

³¹ This is equal to supplementary dividend paid.

- 5.12 Figure 13 shows the Australian operating company 2 earning income of A \$10,000 and paying tax of A \$3,000. This gives tax-paid income of A \$7,000, which is then distributed as fully franked along with the maximum New Zealand imputation credits. The Australian holding company receives 70 percent of this distribution.
- 5.13 Table 10 shows all the transactions in the tracking accounts of the Australian operating company 2. It shows the original tax paid of A \$3,000, the non-resident withholding tax paid to the New Zealand government and the credits attached to the dividend received from the New Zealand holding company. Finally, it shows the credits it attaches to fully frank the dividend and all the New Zealand imputation credits it passes on.
- 5.14 A balance remains in the franking account as not all the Australian credits were necessary to fully frank the dividend.

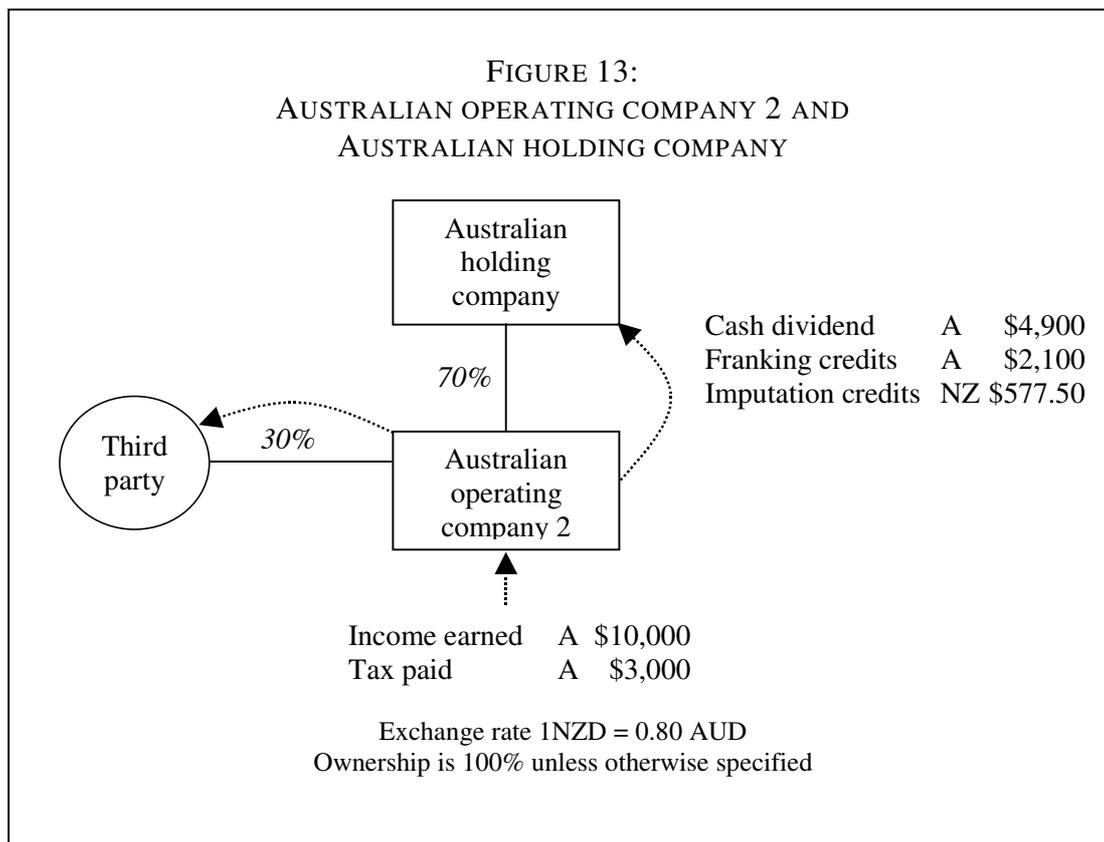
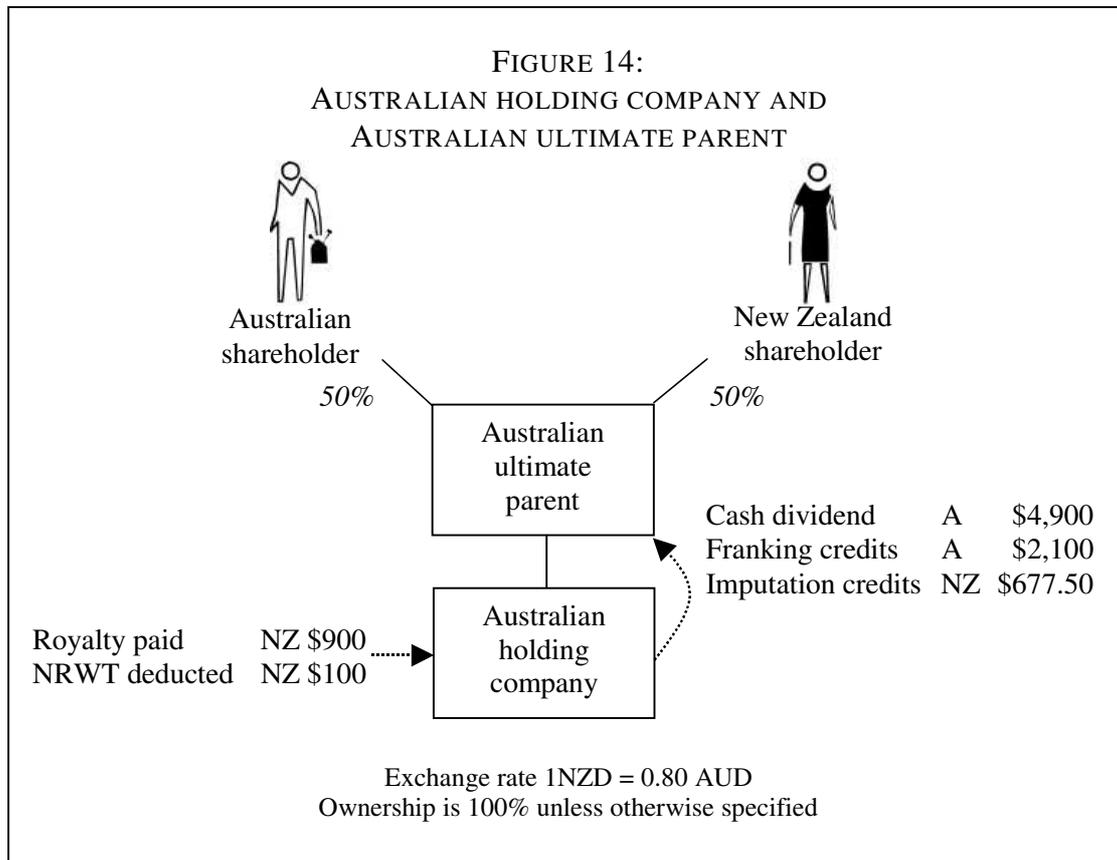


TABLE 10:
AUSTRALIAN OPERATING COMPANY 2'S FRANKING AND
IMPUTATION CREDIT ACCOUNTS

	<i>Franking Account AUD</i>			<i>Imputation Credit Account NZD</i>		
	Dr	Cr	Bal	Dr	Cr	Bal
Tax paid		3000	3000 Cr			
Dividend from New Zealand holding company		150	3150 Cr		530	530 Cr
NRWT deducted					295	825 Cr
Dividend to Australian holding company	2100		1050 Cr	577.50		247.50 Cr
Dividend to third party	900		150 Cr	247.50		0

5.15 Figure 14 shows the Australian holding company receiving a royalty of NZ \$900, which was paid by the New Zealand operating company. It also shows the Australian holding company paying a fully franked dividend of A \$4,900 with New Zealand imputation credits of NZ \$677.50 to the Australian ultimate parent. This dividend is then paid on equally to the Australian and New Zealand shareholders, who each own 50 percent of the Australian ultimate parent.



- 5.16 Table 11 shows the entries to the tracking accounts for the Australian holding company, and table 12 shows the entries for the Australian ultimate parent.

TABLE 11:
AUSTRALIAN HOLDING COMPANY'S FRANKING AND
IMPUTATION CREDIT ACCOUNTS

	<i>Franking Account AUD</i>			<i>Imputation Credit Account NZD</i>		
	Dr	Cr	Bal	Dr	Cr	Bal
NRWT from royalty paid by New Zealand operating company					100	100 Cr
Dividend from Australian operating company 2		2100	2100 Cr		577.50	677.50 Cr
Dividend to Australian ultimate parent	2100		0	677.50		0

TABLE 12:
AUSTRALIAN ULTIMATE PARENT'S FRANKING AND
IMPUTATION CREDIT ACCOUNTS

	<i>Franking Account AUD</i>			<i>Imputation Credit Account NZD</i>		
	Dr	Cr	Bal	Dr	Cr	Bal
Dividend from Australian holding company		2100	2100 Cr		677.50	677.50 Cr
Dividend to Australian shareholder	1050		1050 Cr	338.75		338.75 Cr
Dividend to New Zealand shareholder	1050		0	338.75		0

- 5.17 The Australian and New Zealand shareholders each receive a fully franked cash dividend of A \$2,450 with New Zealand imputation credits of NZ \$338.75. No dividend withholding tax is imposed on the New Zealand shareholder as the dividend is fully franked.
- 5.18 Table 13 shows the final tax treatment of the shareholders. Although both shareholders receive franking and imputation credits, the franking credits have value only to the Australian shareholder. Similarly, the imputation credits have value only to the New Zealand shareholder.

TABLE 13:
AUSTRALIAN AND NEW ZEALAND SHAREHOLDERS' FINAL TAX TREATMENT

	<i>Australian shareholder AUD</i>	<i>New Zealand shareholder NZD</i>
Cash dividend	2450	3062.50 ³²
Imputation credit	1050	338.75
Assessable/gross income	3500	3401.25
Tax due	1698 ³³	1326.50 ³⁴
Less franking rebate	(1050)	
Less imputation credit		(338.75)
Tax payable	648	987.75
Net dividend	1802	2074.75
Effective tax rate ³⁵	48.5%	53%

5.19 Although the New Zealand dividend would be only partially imputed under the proposed reform, at present it cannot be imputed at all, as shown in table 14. The effective tax rate has been reduced from 57% to 53%. Again, it is appropriate that the dividend is only partially imputed, as a proportion of the dividend is from Australian income. Triangular reform would provide relief relating only to the shareholders' proportion of the tax paid in their home country.

TABLE 14:
NEW ZEALAND SHAREHOLDER'S FINAL TAX TREATMENT BEFORE
AND AFTER TRIANGULAR TAX REFORM

	<i>Before reform</i>	<i>After reform</i>
Cash dividend	3062.50	3062.50
Imputation credit		338.75
Gross income	3062.50	3401.25
Tax due	1194	1326.50
Less imputation credit		(338.75)
Tax payable	1194	987.75
Net dividend	1868.50	2074.75
Effective tax rate ³⁶	57%	53%

³² Underlying income of A \$3500 less A \$1050 Australian tax = A \$2450 = NZ \$3062.50 at 0.80 exchange rate.

³³ This is calculated at the personal marginal tax rate of 48.5%.

³⁴ This is calculated at the personal marginal tax rate of 39%.

³⁵ The effective tax rate is based on underlying income of A \$3500/ NZ \$4375.

³⁶ The effective tax rate is based on NZ \$4375.

Appendix 1

THE AUSTRALIAN AND NEW ZEALAND IMPUTATION RULES COMPARED³⁷

	<i>Australia</i> ³⁸	<i>New Zealand</i>
Applicability	Generally applicable to all resident companies.	Generally mandatory for all resident companies. Specific prohibition for non-resident companies.
Maximum ratio	30/70	33/67
Benchmarking	A corporate tax entity may nominate the franking percentage (ratio). Otherwise the ratio is set by the first dividend paid. All frankable distributions made in the same six-month period will generally have to be franked to the same extent. An entity will not be allowed to increase or decrease the extent to which it franks distributions by more than 20% in the subsequent six-month period.	The benchmark dividend is the first dividend paid. All subsequent dividends must attach imputation credits in the same ratio as the benchmark dividend. Companies can subsequently change the ratio attached to dividends only if an officer of the company declares that the change is not part of an arrangement to obtain a tax advantage.
Continuity	There are no rules on continuity except that if certain companies cease to have non-residents or tax-exempts holding 95% or more of their shares, the franking credits of the company at the time of the change in shareholding can generally only be used to exempt dividends from dividend withholding tax.	Credits may generally be carried forward if 66% of the shareholding remains continuous.
Consolidated groups	One single franking account is to be maintained for the whole group.	Although each company within the group must maintain an imputation credit account, the consolidated group must also maintain a separate imputation credit account for the whole group.
Franking/imputation year	Same as the company's income year.	1 April to 31 March, regardless of the company's balance date.

³⁷ This table is a summary, not a comprehensive description of the rules.

³⁸ The Australian imputation rules are based on the Exposure Draft *New Business Tax System (Entity Taxation) Bill 2000*.

Filing requirements	A company dividend statement is not required to be filed. Generally, a franking account return is only required to be lodged when the franking account is in deficit at the end of the income year.	An annual imputation return and company dividend statement ³⁹ is required to be filed.
Streaming and trading	<ul style="list-style-type: none"> • If there is an arrangement that allows one shareholder or groups of shareholders to receive a greater tax advantage than another shareholder or groups of shareholders, the Commissioner may impose a franking debit in the company's franking account or cancel the franking benefits to shareholders. • Shares must be held "at risk" for more than 45 days. • Franking credits attached to dividends paid by companies with 95% or greater non-resident or tax-exempt ownership only "exempt" dividends from dividend withholding tax. They are generally of no benefit to residents. 	<ul style="list-style-type: none"> • Arrangements that allow one shareholder or groups of shareholders to receive a greater tax advantage than another shareholder or groups of shareholders are void and the associated imputation credits are lost. • No holding period rules.
Penalties	<ul style="list-style-type: none"> • If the franking account is in deficit at the end of the income year (or a deficit is deferred and tax is refunded within three months of the end of the franking year) franking deficit tax is payable. • An additional penalty (equivalent to current franking additional tax) is payable when the deficit / deferral amount is excessive. • Overfranking tax is imposed when the franking percentage of a dividend exceeds the benchmark rate. A penalty debit is imposed if a dividend is underfranked. • General penalties relating to statements also apply to franking account assessments. • The general interest charge applies in cases of late payment of franking deficit tax and overfranking tax. 	<ul style="list-style-type: none"> • If the imputation credit account is in debit at the end of the imputation year, imputation penalty tax of 10% is payable on the additional tax due. • Late payment penalties apply to any tax paid after the due date.

³⁹ The removal of the requirement to file a dividend statement is being considered as part of New Zealand's tax simplification initiatives.

Credits to franking account/imputation credit account	<ul style="list-style-type: none"> • Payment of income tax or a PAYG instalment. • Credit from receipt of a franked distribution. • Foreign withholding tax paid as a result of receipt of a foreign dividend (proposed). • Does not include: <ul style="list-style-type: none"> - foreign tax credits, - penalties, and - fringe benefit tax. 	<ul style="list-style-type: none"> • Tax paid to meet an income tax liability. • Dividend withholding payments if the company has no dividend withholding payment account. • Imputation credits attached to dividends. • Does not include: <ul style="list-style-type: none"> - foreign tax credits, - penalties, and - fringe benefit tax.
Debits to franking account/imputation credit account	<ul style="list-style-type: none"> • Franking credits attached to a frankable distribution. • Refunds of income tax paid. • Payment of franking deficit tax. • Underfranking penalty debits. • Dividend streaming penalty debits. • Tainting of share capital account debits. 	<ul style="list-style-type: none"> • Imputation credits attached to dividends. • Refunds of income tax paid. • Credits that fail to meet continuity tests.

Appendix 2

SUBMISSION POINT – IMPACT OF EXCHANGE RATES

Principal features of the current Australian and New Zealand systems

The four main features of the current imputation systems relating to exchange rates and currency conversion are:

- *The tracking account is maintained in the currency in which the tax is paid.*

The New Zealand imputation credit account is maintained in New Zealand dollars, and the Australian franking account is maintained in Australian dollars, consistent with the currency in which the tax is paid.

- *The shareholder's imputation or franking credit is in the same proportion to the total tax paid by the company as the shareholder's proportionate membership interest.*

For example, shareholders who own 50 percent of a company are entitled, subject to the maximum ratio, to 50 percent of the New Zealand tax paid as imputation credits.

- *The ratio of the value of the credits to the value of the dividend remains the same from when the company attaches the credit to the dividend to when shareholders return their income to their respective tax authorities.*

Shareholders receive the same proportion of credits on their dividends as that attached by a company. For example, if a company attaches franking credits in a 30/70 ratio to the dividend paid, the shareholder will receive franking credits in the same ratio.

- *Foreign dividends are taxed on the amount of local dollars the dividend could have bought on the day it was received.*

Although the foreign dividend will be paid in a foreign currency, for tax purposes it is converted into the local currency on the day the dividend is received.

These four features contribute to the robustness of the imputation rules as well as the relationship with foreign income. Ideally, they should all be retained in any triangular reform. This may not be possible, however, because triangular reform would involve a dividend paid in one currency, with two credits attached, one of which represents tax paid in the other currency.

Three options for incorporating the issue of exchange rates and currency conversions within the triangular reform have been identified. Essentially, each option involves a relaxation of one of the last three features of the current imputation systems. Submissions on these options as well as any other possible solutions are welcomed.

For reasons of compliance, consistency and administrative ease, the tracking account should continue to be maintained in the currency in which tax is paid.

Another important consideration is that there should be as much certainty of outcomes as possible for companies and shareholders.

Option 1 – Imputation and franking credits would be attached in the local currency of the company, with conversion being at the exchange rate on the day the dividend is declared.

This option would relax the proportionate requirement between the imputation/franking credit, total tax paid and membership interest.

The imputation and franking credits attached to a dividend would be in the same currency as the dividend paid. The imputation ratios⁴⁰ would be calculated on the date of declaration and the debit to the other country's tracking account would be converted at the exchange rate prevailing on the date the dividend was declared.

Shareholders in the other country would then convert both the dividend and their country's credit at the exchange rate applicable on the date of receipt.

Example 1

An Australian parent company with a 50/50 split of Australian and New Zealand shareholders declares on 1 June that it will pay a fully franked and fully imputed dividend on 15 July. The A/NZ exchange rate is 0.85 on the day of declaration, 1 June. The dividend to be paid out will be A \$7000 in total.

Franking credits of A \$3000 ($30/70 \times \text{A } \7000) in total will be attached, as will imputation credits of A \$3447 ($33/67 \times \text{A } \7000).

The franking account will be debited with A \$3000 when the dividend is paid. The imputation credit account will be debited with NZ \$4055 ($\text{A } \$3447 / 0.85$).

The exchange rate is 0.80 on 15 July. The New Zealand shareholders convert both the Australian dividend and the imputation credit at this rate when calculating the gross income and the imputation credit available.

⁴⁰ Ratio of credit to the cash dividend.

As the New Zealand shareholders received half the dividend paid, in total they will return NZ \$4375 as dividend income (A \$3500⁴¹ /0.80) and NZ \$2154 as the corresponding imputation credit (A \$1723.5⁴²/0.80). The NZ \$2154 imputation credit is not 50 percent of the total tax paid, NZ \$4055, so the requirement of shareholder proportionality is not satisfied.

Advantages

This option would maintain three features of the current imputation systems:

- The tracking account is maintained in the currency tax is paid.
- The imputation ratio remains the same for the company and the shareholder. When the company attached the New Zealand imputation ratio it was A \$3447/A \$7000, or 33/67. When the New Zealand shareholders return the dividend and imputation credit, the total returned will be NZ \$2154 / NZ \$4375 or 33/67.
- Foreign dividends are converted at the exchange rate on the day of receipt. The Australian dollar dividend of the New Zealand shareholders is converted for income tax purposes at 0.80, being the exchange rate on the date of receipt.

Disadvantages

Under this method the amount of credits may not reflect the underlying tax paid. Although this method would work if the shareholder receiving the dividend were not maintaining a tracking account, it would not be suitable for passing credits up a chain of companies.

If the Australian and New Zealand shareholders in example 1 were companies maintaining imputation credit accounts, on receipt of the dividend they would convert the New Zealand imputation credit of A \$3447 at 0.80. This would give a total credit to the respective imputation credit accounts of NZ \$4309, when in fact the underlying tax paid was only NZ \$4055.

This effect of the difference in exchange rates between the date of declaration and the date of payment could be mitigated by calculating the New Zealand dollar debit to the imputation credit account, using the forward exchange rate on the date of declaration for the proposed date of payment.

⁴¹ 50% of A \$7000.

⁴² 50% of A \$3447.

Such an approach, however, would not eliminate the additional compliance costs of having to convert in and out of the base currency, the currency of the country the tax was originally paid in, for the tracking account.

Option 2 – The ratio of credits from the other jurisdiction would be calculated on the day the dividend is declared, using the forward exchange rate that relates to the day the dividend is expected to be paid. Both imputation credits would, however, be attached in their own currency.

This option would relax the requirement that the ratio of the value of the credits to the value of the dividend remains the same from when the company attaches the credit to the dividend to when the shareholders return their income to their respective tax authorities.

The imputation and franking credits would be attached in their local currency. The imputation ratios would be calculated on the date of declaration. In the case of the other country's credit, the forward exchange rate relating to the day the dividend was expected to be paid would be used for conversion purposes.

As the imputation and franking credits are in their local currency, shareholders in the other country will convert only the dividend at the exchange rate on the day of receipt.

Example 2

As before, an Australian parent company with a 50/50 split of Australian and New Zealand shareholders declares on 1 June that it will pay a fully franked and fully imputed dividend on 15 July. On the day of declaration, the forward A/NZ exchange rate is 0.83 with respect to the date of payment, 15 July. The dividend to be paid out will be A \$7000 in total.

Franking credits of A \$3000 ($30/70 \times \text{A } \7000) in total will be attached, as will imputation credits of NZ \$4154 ($33/67 \times \text{A } \$7000 / 0.83$).

The franking account will be debited with A \$3000 when the dividend is paid. The imputation credit account will be debited with NZ \$4154.

The exchange rate is 0.80, on 15 July. The New Zealand shareholders will convert the Australian dividend at this rate when calculating their gross income. The New Zealand imputation credit would be attached in New Zealand dollars, and therefore does not need converting.

As the New Zealand shareholders would have received half the dividend paid, they will return a total of NZ \$4375 as dividend income ($\text{A } \$3500^{43} / 0.80$) and NZ \$2077 as the corresponding imputation credit ($50\% \times \text{NZ } \$4154$).

⁴³ 50% of A \$7000.

Advantages

This option would maintain three features of the current imputation systems:

- The tracking account is maintained in the currency tax is paid.
- The credit is the same proportion of the total tax paid as the shareholder's proportionate membership interest. The imputation credit returned by the New Zealand shareholders, NZ \$2077, is half the debit the company makes to its tracking account, NZ \$4154, which equals their proportionate membership interest in the company.
- Foreign dividends are converted at the exchange rate on the day of receipt. The Australian dollar dividend of the New Zealand shareholders is converted for income tax purposes at 0.80, being the exchange rate on the date of receipt.

Disadvantages

The main disadvantage is that the imputation ratio calculated when the dividend is declared would not necessarily be maintained at the shareholder level. The New Zealand shareholders received, in total, a dividend of NZ \$4375 and imputation credits of NZ \$2077, which is a ratio of only 32/67. In other words, the dividend, in the hands of the shareholder, is less than fully imputed, although at the time the company declared the dividend it was fully imputed.

Under-imputation is not the only possible outcome: if the exchange rate were to move the other way, the dividend would become over-imputed.

Because the forward rate is being used, however, it is unlikely that the outcome would diverge as much from full imputation as in this example. In practice, the only difference would relate to unexpected changes in the exchange rate between declaration and payment, which is usually no longer than two months.

Option 3 – Shareholders would convert their dividends at the exchange rate used by the company for calculating the imputation ratio on the day the dividend is declared. Both imputation credits would, however, be attached in their own currency.

This option would relax the requirement that foreign dividends are taxed on the amount of local dollars the dividend could have bought on the day it was received.

The exchange rate used for calculating the imputation ratio is the rate to which the shareholder is required to convert its dividend income for tax purposes. The exchange rate used could be either the actual rate on the date of declaration or the forward exchange rate for the date of payment.

The exchange rate used for calculating the imputation ratio would be included on the shareholder's dividend statement, and the shareholder would convert its dividend income using that rate.

Example 3

As before, an Australian parent company with a 50/50 split of Australian and New Zealand shareholders declares on 1 June that it will pay a fully franked and fully imputed dividend on 15 July. On the day of declaration, the forward A/NZ exchange rate is 0.83 with respect to the date of payment, 15 July. The dividend to be paid out will be A \$7000 in total.

Franking credits of A \$3000 ($30/70 \times \text{A } \7000) in total will be attached, as will imputation credits of NZ \$4154 ($33/67 \times \text{A } \$7000 / 0.83$).

The franking account will be debited with A \$3000 when the dividend is paid. The imputation credit account will be debited with NZ \$4154.

The exchange rate is 0.80 on 15 July, but the New Zealand shareholders will be required to convert the Australian dividend at the rate used for calculating the imputation ratio, 0.83.

As the New Zealand shareholders received half the dividend paid they will return a total of NZ \$4217 as dividend income ($\text{A } \$3500^{44} / 0.83$) and NZ \$2077 as the corresponding imputation credit ($50\% \times \text{NZ } \$4154$).

Advantages

This option would maintain three features of the current imputation systems:

- The tracking account is maintained in the currency tax is paid.
- The imputation credit is the same proportion of the total tax paid as the shareholder's proportionate membership interest. The credit returned by the New Zealand shareholders, NZ \$2077, is half the debit the company makes to its tracking account, NZ \$4154, which equals their proportionate membership interest in the company.
- The imputation ratio remains the same for the company and the shareholder. When the company attached the New Zealand imputation ratio it was $\text{NZ } \$2077 / \text{NZ } \4217 , or 33/67, and New Zealand shareholders will return the same amount in total.

⁴⁴ 50% of A \$7000.

Disadvantages

The main disadvantage is that when shareholders converted their dividend income, they would do so at a rate that is different from that applying on the day they received the dividend. Using the forward exchange rate for the payment date when calculating the imputation ratio could, however, lessen this effect. This would mean that the only exchange rate difference would arise from unexpected changes in the exchange rate between declaration and payment, which is usually no longer than two months.