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## Taxation Determination

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Income tax: does a franking credit arise in the franking account of a head company of a consolidated group when a franked distribution is made by an entity that is not a member of the consolidated group to a trust that is a subsidiary member of the consolidated group?

**❶ This publication provides you with the following level of protection:**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

### Ruling

1. Yes. Provided the head company is entitled to a tax offset under Division 207 of the *Income Tax Assessment Act 1997* (ITAA 1997)<sup>1</sup> because of the franked distribution and satisfies the residency requirement for the income year in which the distribution is made,<sup>2</sup> a franking credit will arise in the head company's franking account on the day on which the distribution is made.

2. Note that this Determination does not apply where the head company is a life insurance company (as defined in subsection 995-1(1)), or is treated as if it were a life insurance company by section 713-505, and:

- the head company is a mutual insurance company as defined in section 121AB of the *Income Tax Assessment Act 1936* (ITAA 1936), or

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<sup>1</sup> All legislative references are to the ITAA 1997, unless otherwise indicated.

<sup>2</sup> See paragraph 205-25(1)(a).

# TD 2014/8

- the tax offset under Division 207 to which the head company is entitled because of the franked distribution is subject to the refundable tax offset rules in Division 67.

## Example

3. *Head Co is the head company of a consolidated group which formed prior to 1 July 2012.<sup>3</sup> Head Co is not a life insurance company (nor treated as if it is a life insurance company). Trust T is a subsidiary member of the consolidated group.<sup>4</sup>*

4. *A public company, Z Co, that is not a member of the consolidated group, makes a franked distribution to Trust T on 30 April 2013. The amount of the franking credit on the distribution is \$3,000. Head Co is entitled to a tax offset of \$3,000 under Division 207 of the ITAA 1997.*

5. In these circumstances, a credit of \$3,000 arises in Head Co's franking account on 30 April 2013.

**Note:** this Determination equally applies to the franking account of a head company of a (MEC) multiple entry consolidated group.

## Date of effect

6. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

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**Commissioner of Taxation**

16 April 2014

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<sup>3</sup> Head Co meets the requirements of a head company under item 1 of the table in subsection 703-15(2).

<sup>4</sup> Trust T meets the requirements of a subsidiary member under item 2 of the table in subsection 703-15(2).

## Appendix 1 – Explanation

**❶** *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

### Explanation

7. Division 205 contains provisions that create a franking account for a corporate tax entity and identify when franking credits and debits arise in that account. One example of when a franking credit may arise in a corporate tax entity's franking account is where that entity receives a franked distribution from another corporate tax entity. In this instance the head company will need to satisfy the requirements of item 3 of the table in subsection 205-15(1).<sup>5</sup>

8. Section 205-10 provides that each entity that is, or has been, a corporate tax entity has a franking account. Section 960-115 defines a corporate tax entity to be an entity that is:

- a company<sup>6</sup>
- a corporate limited partnership
- a corporate unit trust, or
- a public trading trust.

9. Section 709-65 provides that an entity's franking account does not operate whilst it is a subsidiary member of a consolidated group. Accordingly, the head company is the only member of a consolidated group which has an operating franking account.

10. Under the single entity rule (SER) in subsection 701-1(1), a consolidated group is treated as a single entity for relevant income tax purposes. The SER provides that subsidiary members of a consolidated group are taken for 'head company core purposes' and 'entity core purposes' to be parts of the head company, rather than separate entities, during the period they are subsidiary members.

11. Head company core purposes and entity core purposes are defined in subsections 701-1(2) and (3) as working out the head company's and the subsidiary's liability for income tax or loss (core purposes). Moreover, it is the Commissioner's view that core purposes include all matters incidental and relevant to those calculations.<sup>7</sup>

<sup>5</sup> Or item 5 of the table in subsection 219-15(2) where the franked distribution is made to a life insurance company.

<sup>6</sup> A reference to a company excludes a company acting in the capacity of a trustee: Subsection 960-100(4). A reference to a company includes a reference to a corporate unit trust or public trading trust which met the requirements in section 713-130 and made a choice under section 703-50 to form a consolidated group: Section 713-135.

<sup>7</sup> See paragraph 4 of Taxation Ruling TR 2004/11 *Income tax: consolidation: the meaning and application of the single entity rule in Part 3-90 of the Income Tax Assessment Act 1997*.

12. Under the SER, a franked distribution made by an entity that is not a member of the consolidated group to a subsidiary member of the consolidated group is treated, for core purposes, as though it was made to the head company. Particular imputation provisions clearly have a core purpose. For example, under section 207-20, an entity receiving a franked distribution is required to include the amount of the franking credit on the distribution in its assessable income and is entitled to a tax offset equal to the franking credit on the distribution.<sup>8</sup> This is relevant for the determination of taxable income and ultimately income tax liability, and therefore falls within subsections 701-1(2) & (3).

13. The crediting of a corporate tax entity's franking account pursuant to section 205-15<sup>9</sup> is a necessary incident of it receiving a franked distribution. As the head company is treated as the recipient of a franked distribution made by an entity that is not a member of the consolidated group to a subsidiary member, it is the head company which needs to credit its franking account. Determining this under the SER enables all imputation consequences of receipt of a franked distribution to be ascertained having regard only to one entity, namely the head company.

14. Whilst the SER does not affect the application of the income tax law to an entity that is not a member of the consolidated group,<sup>10</sup> the act of crediting the head company's franking account does not of itself affect the income tax position of its shareholders. It is not until a subsequent event where the head company makes a franked distribution to its shareholders that those entities' income tax position is affected. The mere potential that its shareholders' income tax position will be affected in the future is not sufficient to disregard the SER for the purposes of determining whether a credit arises in the head company's franking account as a necessary incident of it being taken to be the entity in receipt of the relevant franked distribution.

15. Provided the head company is entitled to a tax offset under Division 207 because of a franked distribution it is taken under the SER to have received,<sup>11</sup> the other requirements in item 3 of the table in subsection 205-15(1) will be satisfied,<sup>12</sup> given that:

- a franked distribution is (taken to be) made to the head company (distribution requirement)
- the head company is an Australian resident when the franking distribution is made to the subsidiary member (and provided that it is also meets the further residency requirements),<sup>13</sup> and
- the head company is a franking entity when it is taken to receive the distribution (franking entity requirement).

<sup>8</sup> Actual entitlement to such a tax offset however will depend on satisfaction of relevant integrity rules, such as those contained in Subdivision 207-F.

<sup>9</sup> Or section 219-15 for a life insurance company or an entity treated by section 713-505 as if it were a life insurance company.

<sup>10</sup> See paragraph 12 of TR 2004/11.

<sup>11</sup> Division 207 contains a number of integrity rules which may deny the head company's entitlement to a tax offset in relevant circumstances. See in particular Subdivision 207-F.

<sup>12</sup> If the head company is a life insurance company, or is treated as a life insurance company under section 713-505, the relevant requirements for a credit (if any) to arise in the head company's franking account are in item 5 of the table in subsection 219-15(2).

<sup>13</sup> See paragraph 205-25(1)(a).

16. Under item 3 of the table in subsection 205-15(1),<sup>14</sup> the credit arises in the franking account on the day on which the distribution is made. Therefore a franking credit can arise in the head company's franking account on the day the franked distribution is made to a trust that is a subsidiary member of the consolidated group.

### **Exclusions**

17. A life insurance company that is a mutual insurance company as defined in section 121AB of the ITAA 1936 is not a franking entity.<sup>15</sup> Accordingly, this Determination does not apply where such an entity is the head company of the relevant consolidated group.

18. Where the head company is a life insurance company (or is treated as such by section 713-505) and the tax offset under Division 207 to which it is entitled because of the franked distribution is subject to the refundable tax offset rules in Division 67, its franking account is not credited when it receives a franked distribution.<sup>16</sup> Accordingly, this Determination also does not apply in these circumstances.

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<sup>14</sup> Or item 5 of the table in subsection 219-15(2), where the head company is a life insurance company (or treated by section 713-505 as if it is a life insurance company) and the offset is not subject to the refundable tax offset rules.

<sup>15</sup> See paragraph 202-15(b).

<sup>16</sup> See item 5 of the table in subsection 219-15(2).

**References***Previous draft:*

TD 2013/D10

- ITAA 1997
- ITAA 1997 Div 67
- ITAA 1997 202-15
- ITAA 1997 202-15(b)

*Related Rulings/Determinations:*

TR 2004/11; TR 2006/10

- ITAA 1997 Div 205
- ITAA 1997 205-5(2)
- ITAA 1997 205-10
- ITAA 1997 205-15

*Subject references:*

- consolidated group
  - consolidation - franking
  - consolidation – membership
  - consolidation – multiple entry consolidated group
  - corporate tax entity
  - corporate unit trusts
  - franked dividends
  - franking accounts
  - franking credits
  - head company
  - imputation system
  - life insurance company
  - mutual insurance associations
  - public trading trusts
  - rebates and offsets
  - shareholders
  - single entity rule
  - subsidiary member of a consolidated group
  - trust distributions
  - trusts
- ITAA 1997 205-15(1)
  - ITAA 1997 205-25(1)(a)
  - ITAA 1997 Div 207
  - ITAA 1997 207-20
  - ITAA 1997 Subdiv 207-F
  - ITAA 1997 207-50
  - ITAA 1997 219-15
  - ITAA 1997 219-15(2)
  - ITAA 1997 701-1(1)
  - ITAA 1997 701-1(2)
  - ITAA 1997 701-1(3)
  - ITAA 1997 703-15(2)
  - ITAA 1997 703-50
  - ITAA 1997 709-65
  - ITAA 1997 713-130
  - ITAA 1997 713-135
  - ITAA 1997 713-505
  - ITAA 1997 960-100(4)
  - ITAA 1997 960-115
  - ITAA 1997 995-1(1)
  - ITAA 1936 121AB

*Legislative references:*

## ATO references

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|---------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| NO:           | 1-570KLNx                                                                                                                                                            |
| ISSN:         | 1038-8982                                                                                                                                                            |
| ATOLaw topic: | Income Tax~~Consolidation~~trusts<br>Income Tax~~Consolidation~~income tax liability<br>Income Tax~~Entity specific matters~~franking of dividends – company matters |

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