



Taxpayer Alert

TA 2012/4

FOI status: may be released

TITLE: Accessing private company profits through a dividend access share arrangement attempting to circumvent taxation laws

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Australian Taxation Office (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

Taxpayer Alerts provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the ATO has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the ATO. In these latter cases, the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

Taxpayer Alerts give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and highlight the features which are of concern to the ATO. These issues will generally require more detailed analysis to provide the ATO view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a private ruling (noting that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Taxpayer Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

Overview

This Taxpayer Alert describes arrangements where the accumulated profits of a private company are distributed in a substantially tax-free form to an entity associated with the ordinary shareholders of the private company. The dividends are distributed on a new class of shares which the private company has created and issued to the associated entity for nominal consideration. The dividends are fully franked such that the associated entity will bear little or no additional income tax.

The ATO is concerned that such arrangements are carefully planned so that the ordinary shareholders and/or their associates will derive the economic benefit of the accumulated profits in a substantially (if not entirely) tax-free form.

Context for the arrangement

Generally speaking, the existence of undistributed profits in a private company creates a potential tax liability for its shareholders. That tax liability would ordinarily crystallise when the profits are eventually accessed by the shareholders, albeit with the benefit of franking credits if those profits are distributed as a franked dividend.

Some arrangements that shift value between the shares or their shareholders and their associates may have income tax consequences under the general value shifting rules or the deemed dividend provisions. Where arrangements involve income tax avoidance, there are also anti-avoidance rules for schemes that deal with dividend stripping, the cancellation of tax benefits for avoided income and the cancellation of franking credit benefits.

Description

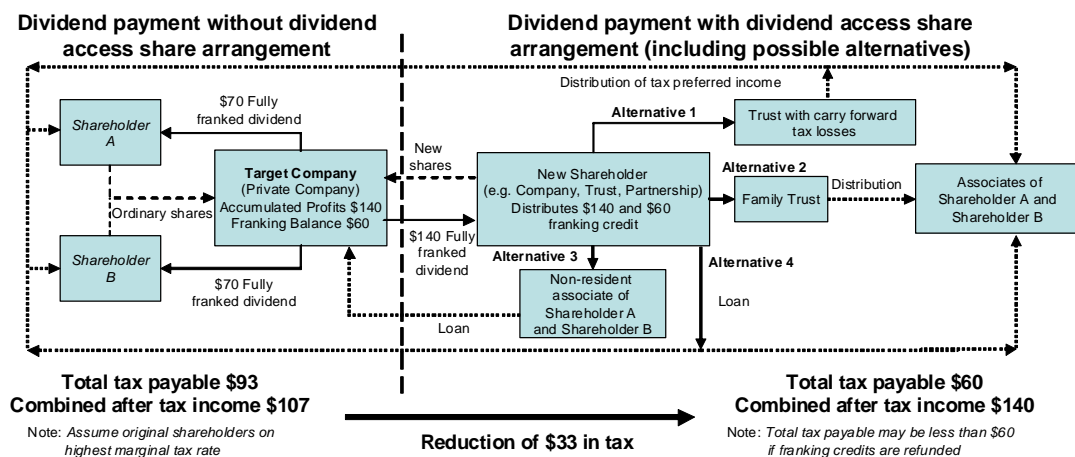
This Taxpayer Alert applies to arrangements generally marketed with some or all of the features substantially equivalent to the following:

1. A private company ("the target company") has accumulated significant profits which have been subject to income tax at the company tax rate.
2. The target company's ordinary shares are held by one or more individuals ("the original shareholders") who may also be the target company directors.
3. A tax intermediary recommends the following steps to the controller(s) of the target company.
4. The target company creates a new class of shares that has some or all of the following characteristics:
 - a. a right to receive a dividend distribution at the discretion of the target company's directors;
 - b. a lack of any voting rights or rights to participate in surplus assets of the target company upon its winding up;
 - c. a right by the target company to redeem the new shares within four years of the share's issue date; and/or
 - d. a right by the target company to abolish dividend entitlements on the new shares within four years of the share's issue date.
5. The new shares are issued to an entity or entities ("the new shareholders") that are closely associated with the ordinary shareholders of the target company.
6. The new shareholders pay nominal consideration for the new shares.
7. Significant profits accumulated in the target company are then distributed as a dividend to the new shareholders, potentially with franking credits.
8. A series of transactions is entered into as a means to transfer the economic benefits of all or some of the distributions to the control of the original shareholders/associates with a purpose of securing a better tax outcome. In

some cases, these transactions may be delayed for some time, for example, the distributions may be planned to spread over a four year period.

9. The original shareholders and their advisers may cite a commercial rationale, such as asset protection, for this type of arrangement. The nature of the transactions may involve the use of promissory notes and/or a 'round robin' bank facility that involves funds instantaneously flowing through accounts to create transaction records.
10. In certain arrangements the funds represented by the dividend distribution may be:
 - a. lent to the original shareholders and/or their associates;
 - b. distributed to a trust, or an individual, that has carry forward tax losses, which may result in no further tax being paid and may generate a refund of franking credits;
 - c. distributed through a series of trusts and companies and ultimately end up in the hands of, or the control of, the original shareholders and/or their family in a manner which attracts no or minimal additional tax; or
 - d. distributed to a non-resident and not subject to any further Australian tax. The non-resident then loans a comparable amount back to the target company.
11. The accumulated profits of the target company are effectively placed in the hands of, or in the control of, the original shareholders and/or their family in a substantially (or entirely) tax-free form.

Diagram of arrangement



Features which concern us

The ATO considers that arrangements of this type give rise to the following issues relevant to taxation laws, being whether:

- (a) an amount should be included in the assessment of any entity as an ordinary dividend or as a deemed dividend under Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936);
- (b) an amount should be deductible for the target company or its shareholders in respect of any fees paid to an entity recommending the arrangement under section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) or another provision;
- (c) the new shares may be debt interests under Division 974 of the ITAA 1997;
- (d) a taxing event may generate a capital gain under CGT event K8 for the original shareholders of the target company by virtue of the direct value shifting rules in Division 725 of the ITAA 1997;
- (e) an amount should be allowable as a franking credit/offset under Part 3-6 of the ITAA 1997;
- (f) the arrangement may be a scheme by way of or in the nature of, or have substantially the effect of, dividend stripping under section 177E of the ITAA 1936;
- (g) the arrangement may be a scheme to which sections 177A to 177D of Part IVA of the ITAA 1936 (the general anti-avoidance rules) may apply;
- (h) the general anti-avoidance rule for franking credit benefits in section 177EA of the ITAA 1936 may apply to the arrangement;
- (i) any amounts received by an entity recommending the arrangement are assessable income of that entity;
- (j) any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953); and
- (k) any entity involved with the arrangement that is a tax practitioner may be referred to the Tax Practitioner Board under the *Tax Agent Services Act 2009* regarding matters relevant to the Code of Professional Conduct.

The ATO is currently reviewing these arrangements.

The Commissioner's views on the application of section 177E of the ITAA 1936 are contained in Taxation Ruling [IT 2627](#) and Taxation Determination [TD 95/37](#). The Commissioner's view on the operation of the imputation system and section 177EA of the ITAA 1936 is discussed in Taxation Ruling [TR 2009/3](#). ATO Law Administration Practice Statement [PS LA 2005/24](#) Application of General Anti-Avoidance Rules provides guidelines in dealing with the application of the general anti-avoidance rules in Part IVA of the ITAA 1936.

Note 1: *You may have already sought advice from the ATO in respect of your arrangement by way of a private ruling or class ruling. If you have received a private ruling or class ruling in respect of your arrangement, you can rely on that ruling. A private or class ruling is legally binding on the Commissioner who will be bound to act in the way set out in the ruling, even if the ruling is later found to be incorrect. However, a private ruling only applies to a particular entity identified and the particular scheme described in the ruling. Similarly, a class ruling only applies to a*

specified class of entities and the particular scheme described in the ruling. If there is a material difference between the scheme described in the ruling, and the scheme that was actually implemented, the ruling will not be legally binding on the Commissioner. Also, other entities cannot rely on a private ruling issued in respect of a different entity.

Note 2: *If you have received a private ruling in respect of your arrangement, please check that the application of Part IVA of the ITAA 1936 is considered in that ruling. The applicant may not have sought for us to rule on the application of Part IVA to the arrangement ruled upon, or to an associated or wider arrangement of which that arrangement is part. If you want us to rule on whether Part IVA applies to your arrangement, we will first need to obtain and consider all the relevant facts about the arrangement, including (if relevant) the manner in which it has actually been implemented.*

Note 3: *Base penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where you make a false or misleading statement to the Commissioner. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the ATO. If you have any information about your involvement in the current arrangement, phone us on **1800 177 006**.*

*Tax agents with information can contact the Tax Agent infoline **13 72 86** Fast Key Code **3 4**.*

Note 4: *The Commissioner may amend an assessment at any time where he is of the opinion there has been fraud or evasion. See Law Administration Practice Statement PSLA 2008/6.*

Note 5: *Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the TAA 1953. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.*

Note 6: *A registered tax agent may have their registration cancelled or suspended by the Tax Practitioners Board under the Tax Agent Services Act 2009 for breach of a condition of registration including being penalised for being a promoter of a tax exploitation scheme.*

References

Subject references:

- Franking Credit
- Dividend Stripping
- Accumulated Profits
- Direct value shifting
- Division 7A
- CGT
- Part IVA

Legislative references:

Income Tax Assessment Act 1936

- [Division 7A](#)
- [Part IVA](#)

- [Section 177E](#)
- [Section 177EA](#)
- [Section 177F](#)

Income Tax Assessment Act 1997

- [Section 8-1](#)
- [Section 104-250](#)
- [Part 3-6](#)
- [Division 725](#)
- [Division 974](#)

Taxation Administration Act 1953

- [Division 290](#)

Related Practice Statements:

- [PS LA 2005/24](#)
- [PS LA 2008/6](#)
- [PS LA 2008/7](#)
- [PS LA 2008/15](#)

Related Rulings and Determinations:

- [IT 2627](#)
- [TR 2009/3](#)
- [TD 95/37](#)

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