TD 2008/24EC - Compendium

Ruling Compendium – TD 2008/24

This is a compendium of responses to the issues raised by external parties to draft Tax Determination TD 2007/D14 – Income tax: can section 23AJ of the *Income Tax Assessment Act 1936* apply to a dividend when it is paid by a company (not being a Part X Australian resident) to an Australian resident company which receives it in its capacity as a partner in a partnership?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1.	The references in paragraphs 4 and 9 of the draft Determination to '(including a limited partnership)' should be amended to read: '(other than a limited partnership which is treated as a company by section 94J)'. As the references stand, they are misleading.	The final Determination has been amended to make it clear that section 23AJ of the *Income Tax Assessment Act 1936* (ITAA 1936)[1] does not apply to dividends paid to a partner, it its capacity as partner, in a corporate limited partnership.
2.	The arguments in paragraphs 7 and 8 are overly embellished. The context of section 160AFB in Division 18 does not add anything about the nature or quality of the requisite corporate group to the clearly defined requirements of beneficial ownership, set out in subsection 160AFB(4), and the absence of a person in a position to affect rights, set out in subsection 160AFB(5). The latter of those requirements, which is not mentioned in the draft Determination, provides much clearer support for the position taken than the inferences claimed to be drawn from the context of the provision.	The Commissioner considers that the first requirement of subsection 160AFB(4) (that is, the first company being the 'beneficial owner' of shares in the other company) is the overriding condition that must be satisfied in order for a dividend to qualify as a non-portfolio dividend as defined in section 317. As such the term 'beneficial owner' must be interpreted in the context of section 160AFB, and the comments in paragraphs 7 and 8 of the Determination are provided as a framework for that analysis. (The final Determination has been changed to update references to section 160AFB which was repealed by No 143 of 2007, and the term 'voting interest' now being defined in section 334A of the ITAA 1936.)

[1] All subsequent references are to the ITAA 1936 unless otherwise indicated.

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3.	Clarification is sought on whether section 23AJ applies to dividends paid to a corporate limited partnership.	The final Determination has been amended to make it clear that section 23AJ does not apply to dividends paid to a partner, it its capacity as partner, in a corporate limited partnership. Division 5A essentially provides that corporate limited partnerships (CLPs) are treated (and taxed) as companies (section 94J), and the partners are treated (taxed) as shareholders (section 94Q). An interest in a corporate limited partnership is included within an income tax law reference to a share (section 94P). The Explanatory Memorandum to Taxation Laws Amendment Act (No. 6) 1992 which introduced Division 5A states that 'The object of this new Division is to ensure that certain limited partnerships will be treated as companies for taxation purposes. This is not confined to the payment of income tax by limited partnerships, but includes all other purposes under income tax law, including the payment of tax by partners in limited partnerships; for instance, imputation and the taxation of dividends to shareholders ***[new section 94A]'***. Therefore as a CLP is treated as a company for tax purposes under Division 5A, it would satisfy the requirement under section 23AJ that a dividend is paid to a company. However Division 5A is deficient in that Division 5A does not ensure that a CLP is the beneficial owner of the partnership assets for tax purposes. The result is that while a dividend may be paid to a company (being a CLP treated as a company via Division 5A), such a company is not considered to be the beneficial owner of the shares the dividend has been paid in respect of and as a consequence the dividend is not a non-portfolio dividend for the purposes of section 23AJ.
4.	The draft Determination should be amended to make it clear whether it only applies to partnerships that are recognised at law (for example, under a State Partnership Act) or to 'tax law partnerships' as well.	The final Determination confirms that the Determination applies to dividends paid to a partner either in a 'general law' or a 'tax law' partnership.

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5.	The Commissioner should consider application of the view in the draft Determination to scenarios that are not currently addressed in the draft Determination (such as 'foreign hybrid companies' which are deemed to be partnerships under Division 830 of the Income Tax Assessment Act 1997), and whether equivalent outcomes would be appropriate in those circumstances. A consistent approach should be applied to all such cases.	The Determination was intended to address the situation where a partnership was interposed between the foreign company paying a non-portfolio dividend and an Australian company receiving it. For completeness, a few simple scenarios were also included. However, it is not intended that the Determination address every possible situation. Paragraph 21 has been inserted in the final Determination to provide greater clarity on the application of section 23AJ to dividends paid to foreign hybrids which are treated as partnerships for the purposes of the Act under Division 830 of the *Income Tax Assessment Act 1997* (ITAA 1997).
6.	The Commissioner should consider whether the conclusions in the draft Determination achieve the intended policy objectives of section 23AJ, and whether the literal interpretation adopted in the draft Determination is appropriate given that it leads to anomalous outcomes.	The Commissioner considers that the view expressed in the Determination is consistent with the policy objective of section 23AJ. According to the Explanatory Memorandum accompanying the *Taxation Laws Amendment (Foreign Income) Bill 1990*, the original section 23AJ was introduced with the stated intention of reducing compliance costs for companies entitled to credit for underlying tax as providing the exemption for the dividends would be broadly equivalent to allowing the foreign tax credits. In 2004, the application of section 23AJ was expanded by removing the requirement that the dividend be paid by a company that is a resident of a country with a tax system comparable to that in Australia. The expansion of the exemption was intended to remove an impediment to the distribution of foreign profits to Australia, which in turn removed a deterrent to Australian companies expanding their active business offshore.

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		The Explanatory Memorandum accompanying the *New International Tax Arrangements (Participation Exemption and Other Measures) Bill 2004* (which significantly amended section 23AJ) also cited reducing the costs of compliance for Australian companies which operate through foreign companies and simplifying the foreign source income rules among key intentions behind the changes. The Explanatory Memorandum went on to state that with the introduction of the new measures, all non-portfolio dividends would be excluded from assessable income, which meant that foreign tax credits would not be required to prevent double taxation in relation to non-portfolio dividends. In particular, foreign tax credits for underlying foreign company tax would not be required, which allowed section 160AFC of the ITAA 1936 to be repealed. Former section 160AFC provided a credit for foreign underlying tax to an Australian company receiving dividends from a foreign company that is a related company (under the rules in former section 160AFB). Essentially former section 160AFB provides that an Australian company is treated as related to any number of linked foreign companies provided that: • each company in the chain – starting with the Australian company – has at least a 10% voting interest in the company in the tier below it, and • the Australian company has a direct or indirect interest of at least 5% in the voting shares of each foreign company that is a member of the chain. Former subsection 160AFB(4) provides that a company shall be taken to have a voting interest in another company, if the first-mentioned company is the 'beneficial owner' of shares in the other company that carry the right to exercise any of the voting power in that other company, and there is no arrangement in force which would allow any person to affect those rights. The reference only to companies in subsection 160AFB(4) supports an interpretation that entitlement to a foreign tax credit for underlying tax paid was only available when dividends were down a chain of related companies.

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7.	The Determination should address potential treaty obligations under the Double Tax Agreements.	The Determination is not about potential treaty issues. The Tax Office will consider issuing guidance on treaty obligations if industry, practitioners or the community consider such guidance is necessary, including the nature of the issues to be covered.
8.	The treatment of foreign dividends under section 23AJ is inconsistent with the treatment of foreign branch profits under section 23AH of the 1936 Act.	The tax treatment is different but it is the Commissioner's view the differing treatment of foreign income paid indirectly through a partnership or trust under sections 23AJ and 23AH was intended by Parliament. *Taxation Laws Amendment (Foreign Income) Bill 1990* which introduced section 23AH (Foreign Branch Profits) and section 23AJ (Non-Portfolio Dividends) and the *New International Tax Arrangements (Participation Exemption and Other Measures) Bill 2004* which significantly amended both sections, specifically provided for the foreign branch profits exemption in section 23AH where partnerships or trusts were interposed between the Australian resident company and the foreign company (former subsection 23AH(3) and current subsection 23AH(10)). Arguably, had the Parliament intended to allow the section 23AJ exemption to apply where a trust or partnership has been interposed between the Australian company and the non-portfolio dividend paying foreign resident company, it would have specifically done so.
9.	Should the Determination define what a Part X resident is? Would a footnote suffice?	Paragraph 3 of the final Determination has been changed so that it is clear that section 317 defines a Part X resident. It is not considered necessary to provide the definition within the Determination as the view arrived at is not dependent on this definition.
10.	The Determination should address treaty implications on interpretation of beneficial owner.	In the Commissioner's view, interpreting the term 'beneficial owner' in the context of Australia's tax treaties is outside the scope of this Determination. We are currently considering whether another Taxation Ruling or Determination which specifically addresses this issue is warranted.