TD 2008/25EC - Compendium

Ruling Compendium – TD 2008/25

This is a compendium of responses to the issues raised by external parties to draft Tax Determination TD 2007/D15 – Income tax: can section 23AJ of the *Income Tax Assessment Act 1936* apply to a dividend paid by a company (not being a Part X Australian resident) to the trustee of a trust, even where the trustee then pays an amount attributable to the dividend to an Australian resident company beneficiary?

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

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1.	Dividends received by a trustee of a bare trust or a nominee, on behalf of a corporate beneficiary should qualify for the income tax exemption under section 23AJ. That is, where a corporate beneficiary is absolutely entitled to particular shares held on trust, the corporate beneficiary should be treated as having been paid the dividend in respect of those shares. Provided that the other requirements of section 23AJ are satisfied, section 23AJ should apply. Such treatment is not novel. The tax law contains many instances where the existence of a bare trust is effectively ignored and the beneficiary is treated as directly owning the trust assets. Accordingly, the final Determination should either expressly confirm this position or, at least, exclude the application of the principles contained in the Determination in relation to dividends paid to a nominee or the trustee of a bare trust where the beneficiary is a company.	Whilst it is true that the tax law contains instances where the existence of a bare trust is effectively ignored, those instances are expressly provided for in the law. For example, section 484 of the *Income Tax Assessment Act 1936* (ITAA 1936)[1] provides that a bare trustee's interest in a foreign investment fund or a foreign life assurance policy is attributed to the beneficiary. By contrast section 23AJ does not expressly provide that a trustee of a bare trust is ignored for the purposes of the provision. The Commissioner's considered view is that the corporate beneficiary is not paid the dividend for the purposes of section 23AJ when the corporate beneficiary is absolutely entitled to the shares held by the trust. Section 23AJ must be construed as applying to the person who has the right to be paid the dividend, and when the shares are held on trust, the trustee has the right to be paid the dividend. Construing the term 'paid' such that receipt of the dividend by the trustee is not ignored for the purposes of section 23AJ is consistent with the express exclusion in section 23AJ which provides that the section does not apply to dividends received by a trustee in their capacity of a trustee: see paragraph 23AJ(a).

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

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		Furthermore, the Commissioner notes that even where there is a bare trust, the beneficiary does not actually receive a dividend from the paying company. When shares are held on trust, any dividends received by the trustee are included in the net income of the trust. When the dividend is on-paid to the corporate beneficiary, the amount paid is not a dividend but rather a share of the net income of the trust estate that is attributable to the dividend: see *Federal Commissioner of Taxation v. Angus* (1961) 105 CLR 489; (1961) 35 ALJR 36; [1961] ALR 484; (1961) 12 ATD 277 (*Angus*).
2.	Taxation Ruling IT 2555 considered whether a corporate beneficiary 'receives a dividend from a foreign company' for the purposes of section 160AFC of the ITAA 1936. In that ruling, the Commissioner considered whether an Australian company that indirectly receives a dividend via an interposed trust could arguably satisfy this precondition for entitlement to underlying tax credits, (although it was not necessary for the Commissioner to conclude in this regard in reaching the decision in that ruling). In particular, paragraph 11 of the Ruling noted the following: 11. If a strict literal approach were to be applied to the interpretation and application of subsection 160AFC(1), it could not be said, therefore, that the corporate beneficiary has passed the primary condition for eligibility for an underlying tax credit in respect of the foreign dividend income. It could nevertheless be argued that when regard is had to the overall result in the interposed trust situation, a liberal interpretation should be applied, so that the corporate beneficiary should be treated as having (indirectly) received the dividend and thus as having met the primary condition of subsection 160AFC(1).	Paragraph 11 of Taxation Ruling IT No 2555 Income tax: foreign tax credit system – foreign tax credit entitlement of corporate beneficiaries of trusts, should not be read in isolation. Paragraph 12 of IT No 2555 goes on to say: Be that as it may, another condition of subsection 160AFC(1) that needs to be satisfied before the corporate beneficiary would be entitled to underlying tax credit in respect of the foreign dividend income … Therefore, the Commissioner did not articulate a view one way or the other on whether the strict literal approach was to be preferred; instead, IT No 2555 focussed on whether another condition in section 160AFC was satisfied. The Commissioner's view in the draft Determination is consistent with the conclusion in the final paragraph of IT No 2555, which discusses whether a corporate beneficiary should be entitled to a credit under section 160AFC where the shares in a foreign company are held for the benefit of the corporate beneficiary by a trustee of a bare trust or a nominee.

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	Applying the above' literal approach' in these circumstances can also lead to anomalous outcomes.	In IT No 2555 consideration was given to whether it would be appropriate for the corporate beneficiary to be treated as *effectively* exercising the requisite voting rights in the foreign company and therefore qualifying for the underlying foreign tax credit in respect of the dividends derived by the corporate beneficiary via the trust. The Commissioner's concluded view was that the trustee of a bare trust still exercised the voting rights and this could not be ignored for the purposes of section 160AFC. The ruling explained that 'the relevant provisions preclude the anomalous situation arising of underlying tax credit being available to some corporate beneficiaries but not to others'.
3.	Is there any tension between what is said in paragraph 15 of the draft Determination re: *Angus* and paragraph 16 of Taxation Ruling TR 92/13? Paragraph 16 reads as follows: … when dividend income derived by a trustee is distributed to a beneficiary, the imputation provisions are consistent with the so-called 'conduit' theory of trust income. Under that theory, an amount of trust income distributed by a trustee to a beneficiary retains the character it had when it was derived by the trustee, unless a provision of the trust deed or of any relevant statute provides otherwise. There is judicial authority to support this theory; see *Syme v. C of T (Vic*) (1914) 18 CLR 519 and *FC of T v. Tadcaster Pty. Ltd.* (1982) 13 ATR 245 at 249; 82 ATC 4316 at 4319.	The draft Determination refers to the High Court decision in *Angus* to support the proposition that where a dividend is paid indirectly by a foreign company to an Australian company via an interposed trustee, it is the trustee and not the corporate beneficiary who receives, and is thus paid the dividend. When the dividend is on-paid the beneficiary receives an amount of net income that is attributable to the dividend. This has been the Commissioner's long-standing view: see paragraph 10 of Taxation Ruling IT No 2555. In the Commissioner's view there is no tension between what is said in the draft Determination in relation to *Angus* and paragraph 16 of Taxation Ruling 92/13 Income tax: distribution by trustees of dividend income under the imputation system, as the paragraphs are not dealing with the same point. *Syme v. C of T (Vic) (1914) 18 CLR 519* and FC of T v. *Tadcaster Pty. Ltd. (1982) 61 FLR 402; (1982) 13 ATR 245 at 249; (1982) 82 ATC 4316 at 4319* are among a number of cases that provide a line of authority which holds that where a taxing statute refers to 'income derived from' property, the interposition of a trustee between income-producing property and the beneficiary does not prevent the beneficiary from saying that their income is still derived from the property.

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		By contrast, *Angus* proceeded on the basis that the taxpayer did not receive the dividend as a shareholder in the company even though the ultimate source of the income was the distribution of a dividend. In *Angus* the decision of the High Court was looking at whether the taxpayer received the relevant income as a shareholder or as a beneficiary of a trust. This case is authority for the proposition that what the beneficiary receives is not a dividend, but rather a distribution of trust income. Following the decision in *Angus* section 6B[2] was enacted. It is through the operation of section 6B that the so-called 'conduit' theory is given effect, by ***attributing*** the 'character' of the income in the hands of the trustee to the beneficiary.
4.	Paragraph 11 should clarify that it means corporate trustee of corporate unit trust or public trading trust.	The final Determination has been amended to make it clear that the express exclusion in section 23AJ applies to a dividend paid to a corporate trustee of a corporate unit trust or a corporate trustee of a public trading trust.
5.	In circumstances where the trust is a member of a tax consolidated group, but the trustee is not a member, it seems illogical for the trust to be consolidated, such that the head entity of the group is treated as effectively owning the underlying shares, yet section 23AJ treatment is nevertheless denied.	The final Determination confirms that where a trust is a subsidiary member of a consolidated group, section 23AJ will apply to dividends paid in respect of shares that are property of the trust. The effect of the single entity rule (SER) in section 701-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) is that for income tax purposes the actions and transactions of a subsidiary member are treated as having been undertaken by the head company and the assets a subsidiary member of the group owns are taken to be owned by the head company (excluding intra-group assets) while the subsidiary remains a member of the group. Therefore, from the consolidated group's perspective, where a trust is a subsidiary member of a consolidated group, the head company is taken to be the beneficial owner of the shares that are trust property and the dividend is taken to have been paid to the head company.

[2] Following the repeal of section 23(q), the original objective of section 6B ceased and its function now is related to the foreign tax credit system. In conjunction with section 6AB(4) it determines the amount of foreign income and the deemed amount of foreign tax paid in respect of income to which the taxpayer is beneficially entitled.

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6.	A non-corporate entity could be holding shares as trustee and still be included within a consolidated group. Further, a corporate until trust (Div 6B trust) or a public trading trust (Div 6C trust) can be the head entity of a consolidated group. The effect of section 713-135 ITAA 97 would be to treat such trusts as companies for all purposes of the Act. In so far as the draft Determination effectively precludes the benefit of section 23AJ being enjoyed by a Div 6B or 6C trust, the policy intent of the legislation is contradicted. Recent tax policy seems routinely to take the position that a Div 6B or 6C trust is to be treated as if it is a company, even though the deeming rules in section 102L and 102T do not effect this outcome. Section 713-135 should be construed as indicative of the intent.	Subdivision 713-C of the ITAA 1997 contains special provisions that allow a corporate unit trust or public trading trust that chooses to form a consolidated group to be the head company of the group, and in turn, to be regarded as a company for most income tax purposes. In particular, subsection 713-140(4) of the ITAA 1997 provides that: > The trustee is not covered by a reference in the applied law to a trustee (except a reference in section 254 of the *Income Tax Assessment Act 1936*). The "applied law" for the purposes of Subdivision 713-C of the ITAA 1997 includes the ITAA 1936.[3] Therefore, the exception in section 23AJ of the ITAA 1936, applying to companies receiving dividends in their capacity as trustee, would not apply to the trustee of a corporate unit trust or public trading trust which is covered by subdivision 713-C of the ITAA 1997. However, where the trustee of such a corporate unit trust or public trading trust receives a dividend from a company (not being a Part X Australian resident), the dividend is not a non-portfolio dividend. The trustee is not the beneficial owner of the shares as the shares are held by the trustee for the benefit of unit holders, who are not part of the consolidated group.
7.	The Commissioner should consider whether application of the view in the draft Determination would similarly apply to other scenarios that are not currently addressed in the draft Determinations (such as dividends received via an interposed trust where the trust is a member of a tax consolidated group but the trustee is not), and whether equivalent outcomes would be appropriate in those circumstances. A consistent approach should be applied to all such cases.	The final Determination covers the most common trust scenarios, and the Commissioner has provided his considered view in each case.

[3] See subsection 713-135(2) of the ITAA 1997.

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8.	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 in the Determination is consistent with the policy objective of section 23AJ. Section 23AJ applies in cases where former section 160AFC would have applied to give a foreign tax credit as was originally intended. According to the Explanatory Memorandum accompanying the *Taxation Laws Amendment (Foreign Income) Bill 1990*, section 23AJ was introduced with the intention of reducing compliance costs for certain companies entitled to credit for underlying foreign tax paid in respect of dividend income. In 2004, 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 Explanatory Memorandum accompanying the *New International Tax Arrangements (Participation Exemption and Other Measures) Bill 2004* (the Explanatory Memorandum) explained that section 23AJ was amended largely to reduce the costs of compliance for Australian companies which conduct businesses through foreign companies. The Explanatory Memorandum went on to explain at paragraph 2.73 that with the introduction of the new measures, all non-portfolio dividends would be excluded from assessable income, which meant that foreign tax credits were no longer necessary to prevent double taxation in relation to non-portfolio dividends. In particular, foreign tax credits for underlying foreign company tax were no longer necessary, which meant section 160AFC could be repealed.

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		Former section 160AFC provided a credit for foreign underlying tax to an Australian company receiving dividends from a foreign company that was a related company (under the rules in former section 160AFB). Essentially former section 160AFB provided that an Australian company was treated as related to 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. The Commissioner's long-standing view has been that section 160AFC did not apply when there was a partnership or trust interposed in a chain of companies. That is, a foreign tax credit was only available if the dividends were paid through an unbroken chain of companies.
9.	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 identify such guidance is necessary, including the nature of the issues to be covered.
10.	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 Commissioner acknowledges that the tax treatment is different but he considers that the differing treatment of foreign income paid indirectly through a partnership or trust under sections 23AJ and 23AH was intended by Parliament.

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		Taxation Laws Amendment (Foreign Income) Bill 1990 which introduced both section 23AH and section 23AJ and the *New International Tax Arrangements (Participation Exemption and Other Measures) Bill 2004* which significantly amended these sections, expressly provided that section 23AH could apply where the profits passed through an interposed partnership or trust to the Australian resident company from the foreign company (former section 23AH(3) and current section 23AH(10) of the ITAA 1936). It is the Commissioner's view that had Parliament intended to allow section 23AJ to apply where a trust or partnership had been interposed between the Australian resident company and the foreign company, it would have expressly provided for it in the section.
11.	Should the Determination define what a Part X resident is? Would a footnote suffice?	Paragraph 3 of the final Determination has been changed to be clearer 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 dependant on this definition.
12.	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. This office is currently considering whether another Taxation Ruling or Determination which specifically addresses this issue is warranted.