TD 2014/10EC - Compendium

Ruling Compendium – TD 2014/10

This is a compendium of responses to the issues raised by external parties to Draft Taxation Determination TD 2014/D1 *Income tax: can section 177EA of the Income Tax Assessment Act 1936 apply to a 'dividend washing' scheme of the type described in this Taxation Determination?*

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	ATO Response/Action taken
1	The draft Determination is inconsistent with views expressed in two earlier Private Binding Rulings which may result in a general administrative practice. The ATO is introducing a new interpretation of the law. The final Determination should only apply prospectively from the date of issue or after the ATO first issued a media statement on 3rd October 2013.	Taxation Ruling TR 2006/10 *Public Rulings* at paragraph 61 states that generally public rulings have both a past and future application, in that they represent the Commissioner's opinion as to what the correct interpretation of the law has always been. Paragraph 62 of TR 2006/10 further provides that there are situations where it is appropriate for a public ruling to have a prospective date of application, most notably where the ATO has facilitated or contributed to taxpayers adopting a different view of the law. In the present situation, that there is no previous published ATO view document concerning the application of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) to a dividend washing scheme. As is noted in the submissions, the PBR register contains edited versions of two relatively recent private rulings in respect of the 2013 income tax that potentially took the opposite view to that taken in the Determination. However, it is clear that a general administrative practice is not established where there is mere silence by the Commissioner (paragraph 3 of TD 2011/19) or where there are a few private rulings on a matter (paragraph 50 to 52 of TD 2011/19). PSLA 2011/27 provides similar guidance at paragraph 39. As there is clearly no general administrative practice in this area, the ATO has not facilitated or contributed to taxpayers adopting a different view of the law.

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		Accordingly, it is appropriate for the Determination to have both past and future application as per the guidance provided in TR 2006/10.
2	Given the issuance of the favourable PBRs provided there is an expectation that the non-application of section 177EA of the *Income Tax Assessment Act 1936* (ITAA 1936) to Dividend Washing Scheme is 'reasonably arguable'. This is important for the purpose of the promoter penalty legislation (Division 290 of Schedule 1 to the *Taxation Administration Act 1953*).	The matter raised is outside the scope of this Determination. The Determination relates to a participant in a dividend washing scheme.
3	The Draft Determination should consider circumstances where: 1) there is a difference between the number of shares sold and then subsequently acquired that is 'substantially identical membership interest', 2) there is a gap of a day or more between the sale of the original shares and the purchase of the cum-dividend shares, particularly where there is substantial price movement of the underlying security in the intervening period, 3) the transaction results in a cash profit	The Example in the Determination is based on actual situations the ATO is aware of. No further examples were provided detailing other commercial strategies that are similar to the Example in the Determination but are stated to have a different commercial objective. In relation to their being a difference between the number of shares sold and then subsequently reacquired the Determination at paragraph 11 states that the application of Part IVA would be limited to the acquisition of the same or substantially similar quantity of Parcel B shares to that of the Parcel A shares sold.

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	without taking into consideration the franking credits attached to the second lot of shares (Parcel B), 4) the selling of shares ex dividend and subsequent buying of cum dividend shares 'are part of a broader commercial strategy and do not result in a *prima facie* cash loss.'	
4	The cost of Parcel A in the example should be compared to the proceeds received on the sale of these shares to determine if a gain or loss is made on Parcel A trade.	The advantage of a gain or a loss resulting from the sale of Parcel A is not relevant to the acquisition of Parcel B. The sale of Parcel A to fund the acquisition of Parcel B is relevant for the purpose of the Example described in the Determination.
5	The ATO should articulate its views as to what a 'more than incidental purpose' means in this context, potentially with the benefit of additional examples. This is particularly the case given the comments from Gageler J in *Mills v. Commissioner of Taxation* (Mills) where (at Paragraph 66) it was stated that 'a purpose can be incidental even where it is central to the design of a scheme if that design is directed to the achievement of another purpose,' which in this case would be the derivation of the cash profit.	A consideration of the relevant circumstances of the dividend washing scheme leads to a likely conclusion that a person or entity undertaking the trades as described in the Example of the Determination did so for a more than incidental purpose of enabling the holder of Parcel B to obtain an imputation benefit. In the example provided in the Determination, there does not seem to be any other commercial purpose for the transaction other than the generation of additional imputation benefits. This can be contrasted with the decision in Mills, where there was an underlying commercial transaction being the raising of Tier 1 capital. In any event a general discussion of the meaning of 'more than incidental purpose' is outside the scope of the Determination. The impact of the decision in Mills on ATO policy is discussed in Decision Impact Statement DIS S225/2012 and includes discussion on 'incidental purpose'. Note the facts in that case are very different to the Example in the Determination.
6	The definition of 'scheme for a disposition' under paragraph 177EA(14)(b) follows that	There is a causal relationship between the sale of Parcel A and the acquisition of Parcel B. These are not unrelated transactions and form part of the same scheme

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	Parcel A is one scheme of disposition and Parcel B is a separate scheme of disposition. It is not clear why paragraph 19 of the Determination refers to only one scheme of disposition.	and therefore there is a scheme of disposition for the purposes of section 177EA.
7	The seven factors considered in paragraph 24 need to be reconsidered: 1. the participant in the example is the 'true economic owner' as they are exposed to the share price movement and holds the shares sufficiently at risk for the purpose of the 45 day rule (paragraph 24(a)), 2. the draft Determination is only tenable to the extent there is a cash loss (paragraph 24(b)), 3. the comments at paragraph 24(c) needs to be refined as the example is based on a single transaction not multiple transactions, 4. paragraph 24(d) infers that the only reason for transactions to occur on the Special Market is to source the imputation benefit, this understates the commercial rationale for transactions where the Special Market is used to support the options market, 5. the form and substance of the	1. The participant in the Example in the Determination is the economic owner of 10,000 shares whilst the legal form is that the participant holds 20,000 shares. The participant is only exposed to 10,000 shares whilst obtaining imputation benefits for 20,000 shares. Hence the participant is the true economic owner of 10,000 shares under the dividend washing scheme. 2. The Example in the Determination results in a cash loss. This reflects real life examples of which the ATO is aware. No further examples were provided detailing other commercial strategies similar to the Example in the Determination, but which results in a cash positive situation where the target of the strategy is that commercial gain rather than the generation of additional franking credits. 3. The strategy considered by the Determination can be in relation to a single transaction or multiple transactions. 4. Whilst the Special Market can be used to settle options, it is unlikely that participants in dividend washing schemes are using the Special Market for this purpose, as they would have to pass ownership of any share acquired to settle options to the option counterparty prior to receiving any franked dividends. 5. The form and substance of the transaction is not the same. There is a causal relationship between the sale of Parcel A and the acquisition of Parcel B which results in the participant being exposed to a single parcel of shares (the substance) instead of two parcels of shares (the form).

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	transaction is the same, the issue arising is that both parcels of shares have the entitlement to receive a dividend and franking credit, such that the franking credit claimed is disproportionate to the shares held, but this does not result in a conclusion that the substance of the transaction is different to the form (paragraph 24(e)).	
8	In relation to the determination, it would be useful if the TD described in more details the implications of section 177EA applying to a dividend washing trade.	The Determination has been updated to provide further details on the result of applying section 177EA of the ITAA 1936 to the Example in the Determination. Refer to paragraphs 12 and 30 of the Determination for additional information.
9	I would also suggest that the determination explain how the ATO's approach ties in with the former Government's announcements in the Federal Budget and the current Government's announcement on 6 November 2013.	The matter raised is outside the scope of this Determination. Furthermore a public ruling is intended to contain advice on the way enacted law applies in defined circumstances that are common to many taxpayers.
10	Does the draft Ruling apply to anyone who purchases shares or sells shares on a cum-dividend basis, especially if purchased or sold just before shares go 'ex-div' considering that it more likely that the previous owner of the shares were the 'true economic owner'?	The Determination applies to the Example in the Determination.
11	The draft determination does not address subsection **177EA(4)** which would have a	By reason of subsection 177EA(4) of the ITAA 1936, the mere acquisition of membership interests by a person would not of itself support a conclusion that

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	material impact on the interpretation and application of section 117EA and would appear to be relevant to the example used in TD 2014/D1. Section 177EA(4) states 'It is not to be concluded for the purpose of paragraph (3)(e) that a person entered into or carried out a scheme for a purpose mentioned in that paragraph merely because the person acquired membership interests, or an interest in membership interests, in the entity.' Section 117EA(14)(b) does not override section 177EA(4) and section 177EA(4) makes it clear that any action captured by the definition in section 117EA(14)(b) needs to be something more than simply acquiring a membership interest. The operation of section 177EA(4) does not appear to be constrained by any test referring to the source of the consideration used to acquire the membership interest. Equally the ability to claim franking credits is not constrained by any consideration of what a shareholder may do with any consideration they may receive from the sale of relevant securities ex-dividend.	would fall within paragraph 177EA(3)(e) about that person's purpose. This would be so even if, for example, the person acquired the interests cum dividend and the declared dividends were to have franking credits attached. Without other relevant circumstances, the prima facie conclusion that the person acquired the membership interests for the purpose of taking on the risks and opportunities of the ownership of the company, and that any imputation benefits are a mere incident of that, will not be displaced. However the relevant circumstances as outlined in paragraph 25 of the Determination shows further features than just the mere acquisition of shares (Parcel B). The scheme in substance exposes the holder of Parcel A and Parcel B to the risk of a single parcel of shares whilst obtaining benefits on both. The scheme involves more than merely acquiring a membership interest in an entity. The scheme involves the sourcing of imputation benefits from the acquisition of the Parcel B shares on the Special Market, utilising the proceeds from the sale of Parcel A, with a before tax loss made on the transaction.
12	The Draft Determination provides no discussion of the way in which the	The Determination expresses the Commissioner's opinion about how section 177EA of the ITAA 1936 applies to a dividend washing scheme.

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	Commissioner would use his powers under section 177F and what the precise outcome for a taxpayer would be. In other words, the tax outcome resulting from the propositions in the Draft Determination need to be considered using the simple numbers in the example in the Draft Determination of 'additional franking credits of $600' and a loss of $200. Those tax outcomes would also need to consider the relevant brokerage costs incurred.	Section 177F deals with the cancellation of tax benefits obtained by a taxpayer in connection with a scheme, an analysis in relation to this section is outside the scope of the Determination.