

TD 2006/D40 - Income tax: imputation: franked distributions: qualified persons: does an entity have to be a qualified person within the meaning of Division 1A of Part IIIAA of the Income Tax Assessment Act 1936 to avoid the application of paragraphs 207-145(1)(a) and 207-150(1)(a) of the Income Tax Assessment Act 1997 in respect of a franked distribution made directly or indirectly to the entity on or after 1 July 2002?

 This cover sheet is provided for information only. It does not form part of *TD 2006/D40 - Income tax: imputation: franked distributions: qualified persons: does an entity have to be a qualified person within the meaning of Division 1A of Part IIIAA of the Income Tax Assessment Act 1936 to avoid the application of paragraphs 207-145(1)(a) and 207-150(1)(a) of the Income Tax Assessment Act 1997 in respect of a franked distribution made directly or indirectly to the entity on or after 1 July 2002?*

This document has been finalised by TD 2007/11.



Draft Taxation Determination

Income tax: imputation: franked distributions: qualified persons: does an entity have to be a qualified person within the meaning of Division 1A of Part IIIAA of the *Income Tax Assessment Act 1936* to avoid the application of paragraphs 207-145(1)(a) and 207-150(1)(a) of the *Income Tax Assessment Act 1997* in respect of a franked distribution made directly or indirectly to the entity on or after 1 July 2002?

① This publication provides you with the following level of protection:

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation 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. You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. Yes. It is necessary to have regard to the rules in Division 1A of the former Part IIIAA of the *Income Tax Assessment Act 1936* (ITAA 1936) in determining whether an entity is a qualified person for the purposes of paragraphs 207-145(1)(a) and 207-150(1)(a) of the *Income Tax Assessment Act 1997* (ITAA 1997)¹ in respect of a franked distribution made directly or indirectly to the entity after 30 June 2002.²

¹ Unless otherwise stated, all references to legislative provisions in this draft Taxation Determination are to provisions of the ITAA 1997.

² Note, regard should also be had to Division 1A in determining whether an entity is a qualified person for the purposes of paragraph 210-170(1)(e) in respect of distributions made after 30 June 2002 and franked with a venture capital credit.

TD 2006/D40

Date of effect

2. It is proposed that when the final Determination is issued, it will apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

20 December 2006

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Explanation

3. One of the design features of the imputation system is that entities who are not the true economic owners of a company and so not sufficiently subject to the risks of loss or opportunities for gain associated with ownership are not able to claim a credit for the tax paid by the company under the imputation system.³ This is reflected in the qualified person rules contained in Division 1A of Part IIIAA of the ITAA 1936.
4. Subject to certain transitional rules, Part IIIAA ceased to have application from 1 July 2002 (refer section 160AOAA of the ITAA 1936). This was due to the introduction of the Simplified Imputation System into the ITAA 1997.
5. However, the qualified person rules have continued to remain an integral feature of the imputation system even after 30 June 2002. In particular the rules contained in Division 1A have continued to inform the operation of the imputation system since that date via the express terms of sections 207-145 and 207-150.
6. Division 207 sets out the consequences of an entity receiving directly or indirectly a franked distribution from a corporate tax entity. Generally an entity receiving a franked distribution will be entitled to gross up their assessable income for the franking credit and obtain a tax offset equal to the franking credit received.⁴
7. Section 207-145 of Subdivision 207-F applies where a franked distribution is made to an entity. Section 207-150 of Subdivision 207-F applies where a franked distribution flows indirectly to an entity.
8. Under paragraph 207-145(1)(a), if an entity to whom a franked distribution is made is 'not a qualified person in relation to the distribution for the purposes of Division 1A of former Part IIIAA of the *Income Tax Assessment Act 1936*...' they are not entitled to gross up their income for the franking credit received, nor claim a tax offset equal to the franking credit.⁵ A similar result applies to entities to whom franked distributions flow indirectly.⁶
9. The very wording of sections 207-145 and 207-150 makes it clear that regard is to be had to the rules in Division 1A of the former Part IIIAA of the ITAA 1936 in determining whether a person is a qualified person for the purposes of these provisions in respect of a franked distribution, irrespective of whether the distribution is made after 30 June 2002. There is nothing in the relevant extrinsic material to indicate the contrary.

³ Paragraphs 4.6 and 4.7 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 2) 1999 which, on enactment, inserted Division 1A into Part IIIAA of the ITAA 1936.

⁴ Subdivisions 207-A and 207-B.

⁵ Paragraphs 207-145(1)(e) and (f). The word 'former' was inserted into paragraph 207-145(1)(a) by the *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*.

⁶ Paragraphs 207-150(1)(a), (f) and (g).

Appendix 2 – Alternative views

❶ *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.*

Alternative views

The ‘qualified person’ test in Division 1A of Part IIIA of the ITAA 1936 cannot be satisfied in respect of a franked distribution made after 30 June 2002

10. On this view the introduction of section 160AOAA into the ITAA 1936 by the *New Business Tax System (Imputation) Act 2002* prevents the qualified person rules in Division 1A of Part IIIA from having any application to a franked distribution that is made after 30 June 2002.

11. This view is not accepted for a number of reasons.

12. First, while section 160AOAA of the ITAA 1936 has the effect that Part IIIA does not apply to events occurring after 30 June 2002, sections 207-145 and 207-150 were inserted into the ITAA 1997 with effect from 29 June 2002 by the same Act which introduced section 160AOAA into the ITAA 1936. Paragraphs 5.51 and 5.53 of the Explanatory Memorandum to the Bill enacted as the *New Business Tax System (Imputation) Act 2002* make it clear that Parliament intended that the introduction of sections 207-145 and 207-150 would have the result, among other matters, of preserving the operation of the qualified person rules in Division 1A as an element of the imputation system post 1 July 2002. Moreover, sections 207-145 and 207-150 have this clear effect according to their terms.

13. Second, the *New Business Tax System (Imputation) Act 2002* also inserted a definition of ‘qualified person’ into subsection 995-1(1). This definition stated that ‘a person is a qualified person in relation to a distribution if the person would have been a ‘qualified person’ in relation to the distribution under Division 1A ... as in force on 30 June 2002’. The introduction of this definition into the ITAA 1997 to accompany the introduction of sections 207-145 and 207-150 into the Act provides further support for the Commissioner’s view that Division 1A continues to inform the operation of the imputation system for events occurring after 1 July 2002.

14. Third, if adopted, this construction of paragraphs 207-145(1)(a) and 207-150(1)(a) would produce an absurd result: either the provisions have never had any practical field of operation or they have had the effect of denying franking credits in respect of all distributions made after 30 June 2002. Having regard to paragraphs 5.51 and 5.53 of the Explanatory Memorandum to the Bill enacted as the *New Business Tax System (Imputation) Act 2002*, it is difficult to accept that Parliament intended either of these results.

The ‘qualified person’ test in Division 1A of Part IIIA of the ITAA 1936 cannot be satisfied in respect of a franked distribution made on or after 14 September 2006

15. It has also been argued that Division 1A of Part IIIA instead has no application to franked distributions made on or after 14 September 2006, being the date on which:

- Part IIIA was repealed from the ITAA 1936;
- the definition of ‘qualified person’ was repealed from subsection 995-1(1); and

- the word 'former' was inserted before the words 'Part IIIAA' in paragraphs 207-145(1)(a) and 207-150(1)(a).⁷

16. Again this view is not accepted for a number of reasons.

17. First, despite the repeal of the definition of 'qualified person' from subsection 995-1(1) and the amendments to paragraphs 207-145(1)(a) and 207-150(1)(a) effected by the *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*, it remains the case that sections 207-145 and 207-150 have the clear effect according to their terms that regard is to be had to the rules in Division 1A in determining whether a person is a qualified person for the purposes of these provisions.

18. Second, as with paragraph 14 of this draft Determination, this construction, if adopted, would have an absurd effect on paragraphs 207-145(1)(a) and 207-150(1)(a).

19. Third, the qualified person rules contained in Division 1A are a key integrity feature of the Australian imputation system. If it had been Parliament's intention that these rules ceased to have operation from 14 September 2006, it may be expected this intention would have been expressed clearly and unambiguously in the Explanatory Memorandum to the Bill enacted as the *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*. No such intention was expressed.

⁷ Refer *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*, Schedule 1 items 153 and 258 and Schedule 2 items 710 and 711.

Appendix 3 – Your comments

20. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel or relevant Tax officers. The Tax Office may use a version (names and identifying information removed) of the compendium in providing responses to persons providing comments. Please advise if you do not want your comments included in the latter version of the compendium.)

Due date:	2 February 2007
Contact officer:	Andrew Harnisch
Email address:	Andrew.Harnisch@ato.gov.au
Telephone:	(02) 6216 2653
Facsimile:	(02) 6216 1247
Address:	2 Constitution Avenue Civic ACT 2601

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- dividend income
- franked distributions
- franked dividends
- franking credits
- franking rebates
- imputation credits
- imputation system
- qualified person
- shareholders
- shares

- ITAA 1936 Pt IIIAA
- ITAA 1936 Pt IIIAA Div 1A
- ITAA 1936 160AOAA
- ITAA 1997 Div 207
- ITAA 1997 Subdiv 207-A
- ITAA 1997 Subdiv 207-B
- ITAA 1997 Subdiv 207-F
- ITAA 1997 207-145
- ITAA 1997 207-145(1)(a)
- ITAA 1997 207-145(1)(e)
- ITAA 1997 207-145(1)(f)
- ITAA 1997 207-150
- ITAA 1997 207-150(1)(a)
- ITAA 1997 207-150(1)(f)
- ITAA 1997 207-150(1)(g)
- ITAA 1997 210-170(1)(e)
- ITAA 1997 995-1(1)

Legislative references:

- Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006
- Taxation Laws Amendment Act (No. 2) 1999
- New Business Tax System (Imputation) Act 2002

Other references:

- Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 2) 1999
- Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002

ATO references

NO: 2006/18211

ISSN: 1038-8982

ATOLaw topic: Income Tax ~~ Tax integrity measures ~~ qualified persons - franking credits
Income Tax ~~ Entity specific matters ~~ franking of dividends - company matters