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 document has been finalised by TD 2008/24.

There is a Compendium for this document: **TD 2008/24EC** .

Draft Taxation Determination

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 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. No. Section 23AJ of the *Income Tax Assessment Act 1936* (ITAA 1936)[1] cannot 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.

Date of effect

2. When the final Determination is issued, it is proposed to 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 paragraph 75 to 77 of Taxation Ruling TR 2006/10).

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

Commissioner of Taxation
26 September 2007

Appendix 1 – Explanation

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. Section 23AJ of the ITAA 1936 provides that:

> A non-portfolio dividend (as defined in section 317) paid to a company is not assessable income, and is not exempt income, of the company if:
>
> (a) the company is an Australian resident and does not receive the dividend in the capacity of a trustee; and
>
> (b) the company that paid the dividend is not a Part X Australian resident (as defined in that section).

Non-portfolio dividend

4. A dividend paid to a company, in its capacity as a partner in a partnership (including a limited partnership), is not a non-portfolio dividend as defined in section 317. Therefore, section 23AJ does not apply to the dividend.

5. Section 317 defines a 'non-portfolio dividend' to be:

> a dividend (other than an eligible finance share dividend or a widely distributed finance share dividend) paid to a company where that company has a voting interest, within the meaning of section 160AFB,[2] amounting to at least 10% of the voting power, within the meaning of that section, in the company paying the dividend.

6. 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. The phrase 'beneficial owner' is not defined for the purposes of section 160AFB. Accordingly, the phrase 'is to be construed in context and must reflect the purposes of the section in which it occurs'.[3]

7. Section 160AFB provides the rules for grouping an Australian resident company with related foreign companies for the purposes of Division 18. When section 160AFB was enacted, an Australian resident company was entitled to a foreign tax credit for the tax paid on the profits out of which a dividend had been paid to the Australian resident company by its foreign subsidiary. Section 160AFB, when construed in context, was intended to ensure that an Australian resident company would only be entitled to a foreign tax credit for the underlying tax paid by a foreign company, if the Australian resident company held a sufficient ownership interest in the foreign company, such that the foreign company could be regarded as part of the Australian resident company's corporate group.

---

[2] Tax Laws Amendment (2007 Measures No. 4) Bill 2007, introduced into Parliament on the 21 June 2007, proposes new foreign income tax credit offset rules. It is proposed that section 160AFB will be repealed and 'voting interest' will be defined in new section 334A. New section 334A is intended to apply to income years beginning on or after the 1 July following Royal Assent.

[3] *Federal Commissioner of Taxation v. Linter Textiles* 2005 ATC 4255 at page 4263.

8. Having regard to the context of section 160AFB, the Commissioner considers that a company will be the beneficial owner of shares for the purposes of subsection 160AFB(4) when it holds the bundle of rights associated with ownership of those shares for its own benefit, and not for the benefit of others. By construing the phrase in this way, the original intention of Division 18 is maintained, such that an Australian resident company would have only been entitled to a foreign tax credit in respect of the underlying tax paid by the foreign company that would have been a part of the Australian resident company's corporate group.

9. For the purposes of subsection 160AFB(4), a corporate partner is not the beneficial owner of shares which are assets of the partnership (including a limited partnership). When a partner is the registered owner of shares, the partner is the registered owner of the shares on behalf of, and for the benefit of, the partnership. In other words, while the partner is the legal owner of the shares and holds rights associated with ownership of the shares, the partner does not hold the shares for their own benefit: the shares are held for the benefit of each and every partner. James LJ articulated this principle in *Dean v. McDowell*[4] when he observed:

> [O]ne partner must not directly or indirectly use the partnership assets for his own private benefit. He must not, in anything connected with the partnership, take any profit clandestinely for himself, nor must he carry on the business of the partnership or any business similar to the business of the partnership in his own or another name separate from it, otherwise that for the benefit of the partnership.

10. This means that partner who is the registered owner cannot exercise the voting rights or other rights associated with ownership of those shares for their own benefit. For example, the partner cannot sell the shares and keep the proceeds from the sale.

11. Where all the partners are the registered owners jointly, no single partner would be the beneficial owner for the purposes of section 160AFB. Although the partnership could be regarded as the beneficial owner of the shares because the partners can jointly exercise and enjoy the ownership rights associated with the partnership assets, each partner still owns the shares for the benefit of each and every partner. Therefore each partner, on their own, does not have the requisite voting interest in the company paying the dividend, and is not the beneficial owner of the shares.

12. By contrast, where a dividend is paid in respect of shares which are held by a partner (or partners) in a partnership that is part of a consolidated group,[5] the dividend can be a non-portfolio dividend. When a group of entities consolidates for tax purposes, the single entity rule (SER)[6] applies to deem the head company to own the assets of the subsidiary members. In other words, when the partnership is part of a consolidated group, the head company will have full ownership of the shares, meaning all the rights associated with ownership of the shares are held by the head company for its own benefit. Accordingly, the head company is taken to be the beneficial owner of the shares, and can have the relevant voting interest required under the definition of non-portfolio dividends in section 317.

---

[4] (1878) 8 Ch 345 at 350-351. See also at 354 per Cotton LJ, at 355-356 per Thesiger LJ.
[5] That is, all the partners are members of the consolidated group.
[6] Contained within section 701-1 of the *Income Tax Assessment Act 1997*.

Dividend paid to a company

13. Even if a dividend paid to a company, in its capacity as partner in a partnership, was a non-portfolio dividend, the dividend has not been paid to a company as required by section 23AJ. For tax purposes, the dividend is taken to have been paid to a partnership. The scheme of the Tax Act requires that the provisions which apply in respect of partnerships in Division 5 of Part III must be applied to amounts received or incurred by partners, on behalf of the partnership, as if the partnership itself was the taxpayer. In other words, amounts received or incurred by the partners are characterised in the hands of the partnership: see *Fletcher & Others v. Federal Commissioner of Taxation* (*Fletcher*).[7]

14. In *Fletcher*, the Full Bench of the High Court observed that although a partnership is not a taxable entity, the 'net income' of the partnership must be calculated for an income year as if the partnership were a resident taxpayer, and then the partnership must furnish a return for that income year to the Commissioner. The High Court went on to note that the net income or loss of a partnership is calculated by the subtraction of allowable deductions from assessable income[8] and each resident partner in the partnership must include their share of the net income in their assessable income for that income year:[9] subsection 92(1).[10] After making these observations the High Court concluded that:

> [T]he question whether the adjusted amounts of interest payable …..were wholly or partly deductible under s.51(1) arises in the context of the calculation of the net income or loss of the partnership for tax purposes and falls to be answered on the basis that the partnership itself was a resident taxpayer.

15. Applying the reasoning in *Fletcher,* the question whether a dividend is non-assessable non–exempt income under section 23AJ falls to be answered by asking whether the section applies to a dividend paid to a partnership, as if the partnership itself was a resident taxpayer. The answer to this question must be no (unless the partnership is a corporate limited partnership) because a partnership is not a company as defined in section 6(1).[11]

16. It follows that the dividend will not constitute non-assessable non-exempt income of the partner. An amount will only be included in the non-assessable non-exempt income of the partner under section 92(4) if the amount had been characterised as such in the hands of the partnership because of the operation of section 90.

17. The only circumstance where a dividend paid to a partner would be taken to have been paid to a company is where the dividend is paid to a partner, and the partnership is a member of a consolidated group. In these circumstances, the SER will operate to deem the dividend to have been paid to the head company, thereby satisfying the requirement in section 23AJ that the dividend be paid to a company. Section 23AJ can therefore apply.

---

[7] See *Fletcher & Ors v. Federal Commissioner of Taxation* (1991) 173 CLR 1; 91 ATC 4950 at 4956; (1991) 22 ATR 613 at 620.
[8] Refer to section 90.
[9] Refer to subsection 92(1).
[10] Subsection 92(2) entitles the partner to a deduction in respect their share of any partnership loss.
[11] Although a limited partnership is not covered by the definition of company in section 6(1), section 94J provides that a reference in the income tax law (other than the definitions of dividend, and resident or resident of Australia in section 6 of this Act) to a company includes a reference to a corporate limited partnership.

Appendix 2 – Alternative views

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

18. It has been argued that section 23AJ should apply to a dividend that is paid to an Australian resident company, in its capacity as a partner in a partnership, on the basis that had such a dividend been intended to be excluded, section 23AJ would have expressly provided for the exclusion, as the provision does in respect of a dividend paid to an Australian resident company that receives the dividend in its capacity as a trustee.

19. The Commissioner does not accept this argument. The Commissioner considers that it was unnecessary to expressly exclude a dividend received by a partner in its capacity as partner from the application of section 23AJ, because a partner is a trustee as defined in section 6(1). Where a partner receives a dividend in respect of shares which the partner purchased in their own name, but paid for out of partnership funds, the partner holds the shares on trust for the benefit of the partnership.[12] Alternatively, the partner is a trustee under the extended definition of trustee in section 6(1) because the partner receives the dividend whilst acting in a fiduciary capacity. Partners owe fiduciary obligations to one another in relation to the conduct of the business of the partnership and in respect of the assets of the partnership.[13]

[12] see Lindley on The Law of Partnership 14th ed. (1979).
[13] See *Chan v. Zacharia* (1984) 154 CLR 178 at 196 per Deane J.

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. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date:	**26 October 2007**
Contact officer:	**Helene Aubernon**
E-mail address:	**helene.aubernon@ato.gov.au**
Telephone:	**(08) 8208 1842**
Facsimile:	**(08) 8208 1898**
Address:	**Australian Taxation Office** **International Centre of Expertise** **Law and Practice** **GPO Box 800** **Adelaide SA 5001**

References

Previous draft:

Not previously issued as a draft

Subject references:

- beneficial owner
- company
- corporate limited partnership
- consolidated group
- head company
- non-assessable non-exempt income
- non-portfolio dividend
- partnership
- resident
- single entity rule

Legislative references:

- ITAA 1936 6
- ITAA 1936 6(1)
- ITAA 1936 23AJ
- ITAA 1936 51(1)
- ITAA 1936 90
- ITAA 1936 92(1)
- ITAA 1936 92(2)
- ITAA 1936 92(4)
- ITAA 1936 94J
- ITAA 1936 Div 18
- ITAA 1936 160AFB
- ITAA 1936 160AFB(4)
- ITAA 1936 Pt X
- ITAA 1936 317
- ITAA 1997 701-1

Case references:

- Chan v. Zacharia (1984) 154 CLR 178
- Dean v. McDowell (1878) 8 Ch 345
- Federal Commissioner of Taxation v. Linter Textiles Australia Ltd (in liq) [2005] HCA 20; 2005 ATC 4255; (2005) 215 ALR 1; (2005) 220 CLR 592; (2005) 59 ATR 177; (2005) 79 ALJR 913
- Fletcher & Ors v. Federal Commissioner of Taxation (1991) 173 CLR 1; 91 ATC 4950; (1991) 22 ATR 613

Other references:

- Tax Laws Amendment (2007 Measures No. 4) Bill 2007
- Lindley on the Law of Partnership 14th Edition, London, Sweet & Maxwell, 1979.

ATO references

NO: 2006/9183
ISSN: 1038-8982
ATOlaw topic: Income Tax ~~ Entity specific matters ~~ companies
Income Tax ~~ Entity specific matters ~~ partnerships
Income Tax ~~ Exempt income ~~ investment income