TD 2004/4 - Income tax: is a dividend paid before 1 July 1987 an unfranked dividend for the purposes of section 705-50 of the Income Tax Assessment Act 1997?

Taxation Determination

Income tax: is a dividend paid before 1 July 1987 an unfranked dividend for the purposes of section 705-50 of the *Income Tax Assessment Act 1997*?

Preamble

The number, subject heading, date of effect and paragraphs 1 to 8 of this document are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner. The remainder of this Determination is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Determination is a 'public ruling' and how it is binding on the Commissioner.*
*[**Note:** This is a consolidated version of this document. Refer to the ATO Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]*

1. Yes. A dividend paid before 1 July 1987 is an unfranked dividend for the purposes of section 705-50 of the *Income Tax Assessment Act 1997* (ITAA 1997). The expression 'unfranked or partly franked dividends' in paragraph 705-50(2)(b) of the ITAA 1997 includes any dividends that have not been fully franked, including dividends that were not frankable because they were paid prior to the commencement of the imputation system on 1 July 1987.

2. An alternative construction is available that the expression 'unfranked or partly franked dividends' in paragraph 705-50(2)(b) can only refer to dividends paid on or after 1 July 1987 because it only became possible to frank dividends on and after this date.

3. The construction in paragraph 1 is preferred because it promotes the purpose of section 705-50 and is consistent with the meaning previously given to the expression unfranked dividend under the income tax laws (as explained in paragraphs 6 – 8).

4. Subsection 705-50(1) provides that its object '… is to limit deferral of tax on profits that were not subject to tax because of *over-depreciation of assets and were distributed to recipients untaxed because of their entitlement to the intercorporate dividend rebate.' The mischief identified applies in relation to the distribution of untaxed profits arising from the over-depreciation of assets both before and after 1 July 1987. The combined operation of paragraphs 705-50(2)(b) and (c) ensure that whilst all dividends paid before 1 July 1987 will be unfranked dividends for section 705-50 purposes, consistent with the legislative intent, only those paid out of untaxed profits will be identified as creating the potential for tax deferral.

5. In the absence of a defined meaning the adjective 'unfranked' only requires that a dividend not be franked. The reference to '…the dividends, so far as they were not franked

dividends…' in paragraph 705-50(3)(a) also clarifies that this is the meaning of unfranked dividend in paragraph 705-50(2)(b).

6. The introduction of the imputation system on 1 July 1987 was accompanied by the abolition of undistributed profits tax under Division 7 of the *Income Tax Assessment Act 1936* (ITAA 1936). Under phasing-out arrangements a private company continued to be liable for undistributed profits tax in respect of the 1986-87 and later income years in relation to certain dividends received from other private companies (called 'phasing-out dividends') if it failed to make a sufficient distribution to its shareholders during 'the prescribed period' being 'the period of one year commencing 2 months before the end of the year of income' (subsection 103(1) of the ITAA 1936). Dividends paid by a private company during the part of a prescribed period after 30 June 1987 could not be taken into account in ascertaining whether a sufficient distribution had been made to the extent that the whole or part of the dividend was franked (subsection 105A(4AA) of the ITAA 1936).

7. Clause 19 of the Explanatory Memorandum to *Taxation Laws Amendment Bill (No 4) 1988* describes all dividends that were paid during the prescribed period to the extent that they were not franked as being unfranked dividends, without distinguishing whether the dividends were paid before or on or after 1 July 1987:[1]

> In the situation where a private company has paid, during the prescribed period, unfranked or partly franked dividends of an unfranked amount greater than the phasing-out amount, the company is required to …

8. The definition of an 'unfranked dividend' in section 160APA of the ITAA 1936 expressly includes a dividend that is not a frankable dividend. The definition of unfranked dividend is not determinative as it only applies for the purposes of Part IIIAA of the ITAA 1936 or where expressly incorporated by reference (such as in subsections 45(4) and 45C(6) of the ITAA 1936). Also Part IIIAA ceased to apply to events occurring on or after 1 July 2002 except as specified in the *Income Tax (Transitional Provisions) Act 1997* with the commencement of the simplified imputation system in Part 3-6 of the ITAA 1997. However the definition is illustrative of an interpretation consistently applied under the income tax laws.

Date of effect

9. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

10. *Tax Laws Amendment (2010 Measures No. 1) Act 2010* has amended paragraph 705-50(2)(b) of the ITAA 1997 so that where an entity becomes a subsidiary member of a consolidated group or a Multiple Entity Consolidated (MEC) group during the period from 9 May 2007 to 30 June 2009, the joining entity will only be required to look at dividends paid during the period of 5 years ending at the joining time in determining whether an over-depreciation adjustment is required under section 705-50 of the ITAA 1997. This means dividends paid before 1 July 1987 will no longer need to be considered in making this

[1] This is consistent with Taxation Ruling IT 2439.

determination. In addition, section 705-50 of the *Income Tax Assessment Act 1997* is repealed effective from 1 July 2009.

11. Consequently, this Determination will not have application to an entity that joins a consolidated group or a MEC group on or after 9 May 2007.

Commissioner of Taxation
31 March 2004

Previous draft:

TD 2003/D13

Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 97/16; IT 2439

Subject references:

- unfranked dividends
- consolidation – assets
- over-depreciation of an asset

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 Pt 3-6
- ITAA 1997 705-50
- ITAA 1997 705-50(1)
- ITAA 1997 705-50(2)(b)
- ITAA 1997 705-50(2)(c)
- ITAA 1997 705-50(3)(a)
- ITAA 1936 45(4)
- ITAA 1936 45C(6)
- ITAA 1936 103(1)
- ITAA 1936 105A(4AA)
- ITAA 1936 Pt IIIAA
- ITAA 1936 160APA
- ITAA 1936 Div 7
- Income Tax Transitional Provisions Act 1997
- Taxation Laws Amendment Bill (No 4) 1998
- Tax Laws Amendment (2010 Measures No. 1) Act 2010

ATO references
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