TD 2008/24 - 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?

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

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?

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant 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. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Ruling

1. No. Section 23AJ of the *Income Tax Assessment Act 1936* (ITAA 1936)[1] does not 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, unless the dividend is paid to a partner in a partnership which is part of a consolidated group or a multiple entity consolidated (MEC) group.[2]

[1] All subsequent legislative references are to the ITAA 1936 unless otherwise indicated.
[2] That is, all the partners are members of the consolidated group or MEC group.

Date of effect

2. This Determination applies to years of income commencing both before and after its date of issue. However, the Determination 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 issue of the Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10 Income tax, fringe benefits tax and product grants and benefits: Public Rulings).

Commissioner of Taxation
13 August 2008

Appendix 1 – Explanation

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

Explanation

3. Section 23AJ 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).

4. Section 23AJ was originally introduced to reduce compliance costs for any Australian resident company entitled to a foreign tax credit under section 160AFC for underlying tax paid by a foreign company. Section 23AJ exempted the dividend[3] from income tax in circumstances where a foreign tax credit would otherwise have been allowed. The section was introduced as an adjunct to the foreign tax credit system in former Division 18 of Part III, and as a result, the section relies on the former foreign tax credit provisions and the controlled foreign company (CFC) provisions in Part X (which was introduced concurrently) for its concepts and definitions.

Not a non-portfolio dividend

5. A dividend paid[4] to a company, in its capacity as a partner in a partnership (as defined[5] in subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997)) is not a non-portfolio dividend as defined in section 317 of the ITAA 1936. Therefore, section 23AJ of the ITAA 1936 does not apply to the dividend.

6. 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 334A,[6] amounting to at least 10% of the voting power, within the meaning of that section, in the company paying the dividend;

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[3] Both section 23AJ of the ITAA 1936 and the definition of non-portfolio dividend in section 317 of the ITAA 1936 rely on the definition of dividend contained in subsection 995-1(1) of the Income Tax Assessment Act 1997 (ITAA 1997) which extends the general law meaning of dividend. The general law meaning of dividend implies that a company/shareholder relationship exists: *Federal Commissioner of Taxation v. Patcorp Investments Pty Ltd* (1976) 140 CLR 247 at 303.

[4] Subsection 6(1) defines 'paid', in relation to dividends or non-share dividends, to include credited or distributed.

[5] The definition of 'partnership' in subsection 995-1(1) of the ITAA 1997 extends the meaning of partnership beyond the general law meaning of partnership used in the various Partnership Acts (which may be called a general law partnership) to persons who are in receipt of assessable income jointly (what may be called a tax law partnership).

[6] The definition of 'non-portfolio dividend' was amended by *Tax Laws Amendment (2007 Measures No. 4) Act 2007*, by substituting 'section 334A' for 'section 160AFB', applicable in relation to income years, statutory accounting periods and notional accounting periods starting on or after the 1 July 2008.

Beneficial ownership

7. Subsection 334A(1) 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, and there is no arrangement in force which would allow any person to affect those rights. The phrase 'beneficial owner' is not defined for the purposes of section 334A. Accordingly, the phrase 'is to be construed in context and must reflect the purposes of the section in which it occurs'.[7]

8. The definition of voting interest in section 334A was taken from former section 160AFB which provided the rules for grouping an Australian resident company with related foreign companies for the purposes of former Division 18 of Part III. When former 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. Former 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.

9. Having regard to the context of former section 160AFB, the Commissioner considers that a company will be the beneficial owner of shares for the purposes of subsection 334A(1) when it holds the bundle of rights associated with ownership of those shares for its own benefit, and not for the benefit of others.[8] By construing the phrase in this way, the original intention of former Division 18 of Part III 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.

10. For the purposes of subsection 334A(1), a corporate partner is not the beneficial owner of shares that are assets of the partnership.

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[7] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (in liq)* (2005) 2005 ATC 4255 at 4263.

[8] See *Wood Preservation Ltd v. Prior* [1969] 1 All ER 364; [1969] 1 WLR 1077; *Ayerst (Inspector of Taxes) v. C&K (Construction) Ltd* [1976] AC 167; *J Sainsbury PLC v. O'Connor (Inspector of Taxes)* [1991] 1 WLR 963; *Commissioner of Taxation v Linter Textiles Australia Ltd (in liq)* (2005) 220 CLR 592; [2005] HCA 20; (2005) 2005 ATC 4255; (2005) 59 ATR 177.

Beneficial interest not the same as beneficial ownership

11. An interest of a partner in a partnership has been characterised as an equitable interest in the nature of a chose in action because it is a right or interest enforceable in equity.[9] It has also been characterised as a 'beneficial interest'. In *Canny Gabriel Castle Jackson Advertising Pty Ltd v. Volume Sales (Finance) Pty Ltd*,[10] the High Court described the nature of a partner's interest in a partnership as a beneficial interest in each of the partnership assets. A beneficial interest in the assets does not equate to beneficial ownership of the assets because a partner does not have title to any specific asset owned by the partnership.[11] The beneficial interest is an interest which will not take effect in possession until the partnership is dissolved.[12] That is, whilst the partnership exists, a partner has by virtue of holding a beneficial interest in the assets of the partnership, a right to a proportion of the surplus after the realisation of the assets and payment of the debts and liabilities of the partnership.[13] The nature of a beneficial interest in a partnership is described in *Lindley on The Law of Partnership*[14] as the following.

> First, in the situation being supposed (ie. during the continuance of the partnership) the beneficial interest, considered as a several interest, is in the nature of a future interest taking effect in possession on (and not before) the determination of the partnership (whether by change in the membership thereof or by general dissolution). The reason is that during the continuance of the partnership, each partner is entitled to require the partnership property to be applied for the purposes of the partnership and no partner is entitled to the several enjoyment of his share. Secondly, when, on the determination of the partnership the several beneficial interest falls into possession, it takes effect subject to the right of the other partners to have the property of the partnership applied in payment of the debts and liabilities of the firm and otherwise in accordance with…the Partnership Act.

One partner is registered owner of the shares

12. 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*[15] 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.

13. This means that a partner who is the registered owner of shares 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.

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[9] *Federal Commissioner of Taxation v. Everett* (1980) 143 CLR 440 at 446-447.
[10] (1974) 131 CLR 321 at 327-328.
[11] *Canny Gabriel Castle Jackson Advertising Pty Ltd v. Volume Sales (Finance) Pty Ltd* (1974) 131 CLR 321 at 327-328; *Livingston v. Commissioner Of Stamp Duties* (Qld) (1960) 107 CLR 411 at 453; *Federal Commissioner of Taxation v. Everett* 143 CLR 440 at 446-447.
[12] *Connell v. Bond Corporation Pty Ltd* (1992) 8 WAR 352 at 364.
[13] *Bakewell v. Deputy Federal Commissioner of Taxation (SA)* (1937) 58 CLR 743 at 770; *Bolton v. Federal Commissioner of Taxation* (1964) 13 ATD 378 at 382.
[14] (15th ed, 1984) at p 517.
[15] (1878) 8 Ch D 345 at 350-351. See also at 354 per Cotton LJ at 355-356 per Thesiger LJ.

All partners are registered owners of the shares jointly

14. Where all the partners are the registered owners jointly, no single partner would be the beneficial owner for the purposes of section 334A. 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's ownership interest in the shares is 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.

Arrangement in force

15. Furthermore, the Commissioner considers that the corporate partner, who is the registered owner of the shares, does not have the required voting interest in the non-resident company paying the dividend, because there is an arrangement in force (being the partnership) whereby the remaining partners of the partnership are in a position to affect the first-mentioned corporate partner's right to exercise their voting power (paragraph 334A(1)(b) and subsection 334A(2)).

Partnership part of a consolidated group or a MEC group

16. 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 or a MEC group,[16] the dividend can be a non-portfolio dividend. When a group of entities consolidates for tax purposes, the single entity rule (SER)[17] 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.

Dividend not paid to a company

17. Even if a dividend paid to an Australian resident 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 were the taxpayer. In other words, amounts received or incurred by the partners are characterised in the hands of the partnership: see *Fletcher v. Federal Commissioner of Taxation* (*Fletcher*).[18]

[16] That is, all the partners are members of the consolidated group or MEC group.
[17] See section 701-1 of the ITAA 1997.
[18] See *Fletcher v. Federal Commissioner of Taxation* (1991) 173 CLR 1 at 14-15; (1991) 103 ALR 97; (1991) 91 ATC 4950 at 4956; (1991) 22 ATR 613 at 620.

18. 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[19] and each resident partner in the partnership must include their share of the net income in their assessable income for that income year.[20] After making these observations the High Court concluded that:[21]

> [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.

19. Applying the reasoning in *Fletcher,* the question whether a dividend is non-assessable non–exempt income under section 23AJ is 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 because a partnership is not a company,[22] as defined in subsection 995-1(1) of ITAA 1997.[23]

20. 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.

Dividend paid to a foreign hybrid company

21. Section 23AJ of the ITAA 1936 cannot apply to a dividend paid to a company that is a foreign hybrid company, as defined in Division 830 of ITAA 1997, because the company is not an Australian resident company. Furthermore, such a company is treated as if it was a partnership for Australian tax purposes, and therefore the dividend is taken to have been paid to a partnership for the purposes of section 23AJ.

Dividend paid to corporate limited partnership

22. It should be noted that even though a dividend is taken to have been paid to a company when it is paid to a corporate limited partnership that is taxed like a company,[24] such a dividend will still not constitute non-assessable non-exempt income of the company. This is because the provisions of Division 5A of Part III do not deem the corporate limited partnership to be the beneficial owner of the share upon which the dividend is paid. Therefore, such a dividend cannot satisfy the definition of a non-portfolio dividend for the purposes of section 23AJ.

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[19] See section 90.
[20] See subsection 92(1).Subsection 92(2) entitles the partner to a deduction in respect their share of any partnership loss.
[21] *Fletcher v. Federal Commissioner of Taxation* (1991) ALR 103 97 at 105.
[22] See paragraph 22 of this Determination, for the treatment of a Corporate Limited Partnership.
[23] Although a limited partnership is not covered by the definition of company in subsection 995-1(1) of ITAA 1997, section 94J of the ITAA 1936 provides that a reference in the income tax law (other than the definitions of dividend, and resident or resident of Australia in subsection 6(1) of the ITAA 1936) to a company includes a reference to a corporate limited partnership.
[24] Refer to section 94J.

Partnership part of a consolidated group or a MEC group

23. 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 or a MEC group.[25] 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.

[25] That is, all the partners are members of the consolidated group or MEC group.

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 binding public ruling.

Alternative views

Partner not expressly excluded

24. 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 by Parliament to be excluded, section 23AJ would have expressly provided for it, in the same way the provision does in respect of a dividend paid to an Australian resident company that receives the dividend in its capacity as a trustee.

25. 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 subsection 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.[26] Alternatively, the partner is a trustee under the extended definition of trustee in subsection 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.[27]

Inconsistent with treatment of branch profits under section 23AH

26. Another argument that has been made is that by denying the application of section 23AJ to a dividend that is paid indirectly by a foreign company to an Australian resident company through a partnership or trust the treatment is inconsistent with the treatment of foreign branch profits under section 23AH.

27. Section 23AH provides that, subject to certain exceptions, foreign income derived by a company when it is a resident carrying on a business, at or through a permanent establishment of the company in a listed country or an unlisted country is non-assessable, non-exempt income of the company. Subsection 23AH(10) applies to any indirect interest (through one or more partnerships or trust estates) of a company in foreign income derived by a partnership or trustee through a permanent establishment of the partnership or trustee in a listed country or unlisted country as if that indirect interest were foreign income derived by the company through a permanent establishment of the company in that country.

28. Section 23AH and section 23AJ were both introduced and subsequently amended at the same time, but unlike section 23AH, section 23AJ does not specifically provide that a dividend received indirectly by an Australian resident company, through one or more interposed partnerships or trust estates, can be treated the same way as a dividend received directly by the company. In the absence of a specific provision, it is reasonable to conclude that a dividend paid by a company to a partnership, and then on-paid as a distribution of net income to another company was not intended to be treated for the purposes of section 23AJ as a dividend paid directly by the first company to the second company.

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[26] see Lindley on The Law of Partnership 15th ed. (1984).
[27] See *Chan v. Zacharia* (1984) 154 CLR 178 at 196 per Deane J.

References

Previous draft:
TD 2007/D14

Related Rulings/Determinations:
TD 2008/23; TD 2008/25; TR 2006/10

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

Legislative references:
- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 23AH
- ITAA 1936 23AH(10)
- ITAA 1936 23AJ
- ITAA 1936 51(1)
- ITAA 1936 Pt III Div 5
- ITAA 1936 Pt III Div 5A
- ITAA 1936 90
- ITAA 1936 92(1)
- ITAA 1936 92(2)
- ITAA 1936 92(4)
- ITAA 1936 94J
- ITAA 1936 Pt III Div 18
- ITAA 1936 160AFB
- ITAA 1936 160AFC
- ITAA 1936 Pt IVA
- ITAA 1936 Pt X
- ITAA 1936 317
- ITAA 1936 334A
- ITAA 1936 334A(1)
- ITAA 1936 334A(1)(b)
- ITAA 1936 334A(2)
- ITAA 1997
- ITAA 1997 701-1
- ITAA 1997 Div 830
- ITAA 1997 995-1(1)
- International Tax Agreements Act 1953 4
- Tax Laws Amendment (2007 Measures No. 4) Act 2007
- TAA 1953

Case references:
- Ayerst (Inspector of Taxes) v. C&K (Construction) Ltd [1976] AC 167
- Bakewell v. Deputy Federal Commissioner of Taxation (SA) (1937) 58 CLR 743; (1937) 11 ALJ 34; [1937] ALR 173
- Bolton v. Federal Commissioner of Taxation (1964) 13 ATD 378
- Canny Gabriel Castle Jackson Advertising Pty Ltd v. Volume Sales (Finance) Pty Ltd (1974) 131 CLR 321; (1974) 48 ALJR 217; (1974) 3 ALJ 409
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- Wood Preservation Ltd v. Prior [1969] 1 All ER 364;[1969] 1 WLR 1077

Other references:
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