

PCG 2025/3 - Capital raised for the purpose of funding franked distributions - ATO compliance approach

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 There is a Compendium for this document: **PCG 2025/3EC** .



Practical Compliance Guideline

Capital raised for the purpose of funding franked distributions – ATO compliance approach

❶ Relying on this Guideline

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

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What this Guideline is about

1. This Guideline outlines when we are likely to have cause to apply our compliance resources in relation to the integrity measure in section 207-159 of the *Income Tax Assessment Act 1997* (ITAA 1997). It sets out the framework we use to assess the level of risk that this provision applies to deny franking credits attached to a distribution.
2. The integrity measure is intended to discourage arrangements that feature the raising of capital to fund the payment of franked distributions and the release of franking credits in a way that generally does not significantly change the financial position of the entity. It addresses arrangements that are entered into for a purpose (other than an incidental purpose) and with the principal effect of accelerating the release of franking credits to members of entities in circumstances that cannot be explained by existing distribution practices, and which are typically artificial or contrived.¹
3. The integrity measure addresses the concerns raised in Taxpayer Alert TA 2015/2 *Franked distributions funded by raising capital to release franking credits to shareholders*. This Guideline will assist taxpayers to understand our compliance approach to those issues.
4. The application of section 177EA of the *Income Tax Assessment Act 1936* (ITAA 1936), or any provision other than section 207-159 of the ITAA 1997, is outside the scope of this Guideline.
5. This Guideline applies to corporate tax entities² that have made a distribution which purports to be a frankable distribution as defined in section 202-40 of the ITAA 1997.
6. All further legislative references in this Guideline are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

¹ See paragraph 5.16 of the Explanatory Memorandum to the Treasury Laws Amendment (2023 Measures No. 1) Bill 2023.

² As defined in section 960-115 of the ITAA 1997. Note the entity issuing the equity interests does not necessarily have to be the entity making the distribution.

How to use this Guideline

7. You can use the framework in this Guideline to understand the:
- level of compliance risk present in your arrangements in relation to the integrity measure, enabling you to make informed decisions about the likelihood that you will be subject to compliance action
 - features of arrangements that we consider present greater compliance risk
 - types of documentation that we consider to be relevant when assessing the compliance risk associated with your arrangement.
8. You may be required to, or we may ask you to, report your risk rating under this Guideline through the reportable tax position schedule.

Date of effect

9. This Guideline applies to distributions made on or after 28 November 2023.

Our compliance approach

10. The risk assessment framework in this Guideline is made up of 3 zones.
11. You can expect the following engagement from us in relation to a particular distribution, depending on the risk zone that applies to an arrangement.

Table 1: Risk zone and our compliance approach

Risk zone	Risk level	Our compliance approach
White	Self-assessment of risk level unnecessary	We will not have cause to review the arrangement other than to confirm ongoing consistency with the agreed or determined approach.
Green	Low risk	We will generally not have cause to apply compliance resources to review the arrangement with respect to section 207-159, except to confirm you meet the requirements to be in the green zone.
Red	High risk	We are likely to apply compliance resources and commence a review or audit.

12. It is not possible for this Guideline to cover every potential factual scenario that may arise. This Guideline does not provide guidance on our compliance approach to arrangements outside of the white, green and red zones. For arrangements not specifically covered by this Guideline, the following factors can be used to guide you as to what arrangements we are more likely to have cause to apply compliance resources when considering the application of the integrity measure:

- whether franked distributions paid are unusually large and not consistent with the ordinary distribution practice of the entity
- whether there is minimal or no material net change in the financial position of the entity from the arrangement
- whether there is a lack of clear and genuine commercial purpose for issuing equity (other than access to franking credits) as part of the arrangement
- the extent of alignment in timing and amount between the issue of equity interests and the making of a distribution that the company purports to be frankable.

13. Where your arrangement is not within the zones in this Guideline, this does not mean that there is a high risk of the integrity measure applying, however we may engage with you to better understand your arrangement. You may also apply for a private ruling to obtain advice on your specific circumstances.

Criteria to apply section 207-159

14. There are 4 criteria that must *all* be satisfied for section 207-159 to apply to make a distribution, or part of a distribution, unfrankable. For example, the fact that a company does not have an established practice of making distributions, does not by itself mean that section 207-159 will apply to an arrangement.

15. If any one of the criteria is not satisfied, section 207-159 will not apply.

First criterion – not consistent with established practice

16. The first criterion is that the distribution is not consistent with an established practice of the entity making distributions of that kind (for example, in respect of ordinary shares) on a regular basis.³

17. The first criterion will be satisfied if the entity has no established practice of making distributions of the relevant kind, or if it does have such a practice, the relevant distribution is not made at a time or in a manner in accordance with that practice.

18. The mere existence of a board-endorsed or published dividend policy of the entity, in the absence of a practice of regular distributions, is not by itself sufficient to constitute an established practice.

19. A significant change in the time and manner of distributions can result in a break in established practice (for example, a sustained period of not paying dividends). However, as indicated in paragraph 14 of this Guideline, this is only one of the 4 criteria that need to be satisfied for section 207-159 to apply.

20. The statutory factors to consider in determining whether the first criterion applies are:

- the nature of distributions made by the entity before the time that the relevant distribution was made (including the extent to which such distributions were a return on capital)
- the timing of such distributions
- the amount of such distributions
- any explanations given by the entity for making such distributions
- the amount of the franking credits on, and the franking percentages for, such distributions
- any other relevant consideration.⁴

³ See paragraph 207-159(1)(a).

⁴ See subsection 207-159(2). Note that certain distributions funded by issuing equity interests need to be disregarded when considering if this criterion is met under subsection 207-159(3).

Second criterion – issue of equity interests

21. The second criterion is that there must have been an issue of equity interests by the entity making the distribution or any other entity. The issue of equity interests can occur before, at or after the distribution.⁵

Third criterion – principal effect and purpose of funding a substantial part of the distribution

22. The third criterion is that it is reasonable to conclude having regard to all relevant circumstances that⁶:

- the principal effect of the issue of any of the equity interests was the direct or indirect funding of a substantial part of the relevant distribution or the relevant part, and
- any entity that issued or facilitated the issue of any of the equity interests did so for a purpose (other than an incidental purpose) of funding a substantial part of the relevant distribution or the relevant part.

23. The amount of the distribution that is unfrankable is limited only to the portion directly or indirectly funded by the capital raising. Where the principal effect of the capital raising is to fund the entire distribution, the entire distribution will be unfrankable. Conversely, if the principal effect of the equity issue is to fund a substantial part of the distribution, the amount of the distribution that is unfrankable will be determined in proportion to the part of the distribution funded by the equity issue. For example, if \$70 million from the issue of equity interests funds a \$100 million distribution, where section 207-159 applies, \$70 million of the distribution would be unfrankable. If no substantial part of the distribution was funded directly or indirectly by an issue of equity interests, then the provision will not make any part of the distribution unfrankable.

24. The meaning of a 'substantial' part will depend on the facts and circumstances of each distribution. A relevant factor is the proportion of the distribution funded by the capital raising. This proportion does not need to be a majority but must be more than a small or minor part of the distribution. It may also be necessary to consider additional factors such as market conditions or the size or performance of the entity that is making the distribution.

25. As set out in paragraph 31 of this Guideline, for the purposes of assessing risk we consider that where the issue of equity interests funded (directly or indirectly) less than 20% of the entire franked distribution paid to all eligible shareholders, it will not be a 'substantial' part. If the proportion is over 20%, this does not mean the arrangement is automatically high risk.

26. The statutory factors to consider in determining whether the third criterion applies are:

- the timing and amount of the equity interests being issued relative to the timing and amount of the relevant distribution
- the extent to which the financial position of the entity (or another relevant entity) is changed as a result of the issue of equity interests and making the relevant distribution
- how the funds from the issue of the equity interests are used
- whether there are any reasons for the issue of equity interests other than the funding of the relevant distribution or any part of the relevant distribution

⁵ See paragraph 207-159(1)(b).

⁶ See paragraph 207-159(1)(c).

- the extent to which the issue of the equity interests was underwritten
- how the history of the amount of franking credits in the franking account maintained by the entity making the distribution compares to the history of profits and share capital of the entity
- the nature and relationship between the entities, in situations where one entity issues the equity interests and another makes the relevant distribution
- the extent to which the identity of the parties participating in the issue of the equity interests corresponds with the parties that did, or were entitled to receive, the relevant distribution
- any other distributions made before or after the relevant distribution by the same entity, and
- any other relevant consideration, for example, whether the entity is seeking to attach a large amount of franking credits to the relevant distribution compared to its profits or share capital.⁷

Fourth criterion – not a direct response to Australian Prudential Regulation Authority or Australian Securities and Investments Commission

27. The fourth criterion is that the issue of the equity interests was not a direct response in order to meet a requirement, direction or recommendation from the Australian Prudential Regulation Authority (APRA) or the Australian Securities and Investments Commission (ASIC).⁸

White zone arrangements

28. You are in the white zone and do not need to consider your risk rating where you have:

- either
 - a current private or class ruling that provides our view that the relevant distribution is frankable, or
 - we have provided you with a low risk or high assurance rating for the relevant distribution as part of a review, and
- there have not been material changes to the arrangement since the date on which the ruling or rating was provided that are relevant to the application of section 207-159.

Green zone arrangements

29. We will not have cause to apply compliance resources to consider the application of section 207-159 to green zone arrangements, other than to confirm that the features of the relevant scenario are present in your circumstances. If you choose to rely on this Guideline, you should document how your circumstances meet the requirements for the green zone.

30. If your arrangement is in the green zone, it will not be in the red zone. However, as stated in paragraph 4 of this Guideline, this only relates to the application of section 207-

⁷ See subsection 207-159(4). See paragraph 5.48 of the Explanatory Memorandum to the Treasury Laws Amendment (2023 Measures No. 1) Bill 2023.

⁸ See paragraph 207-159(1)(d).

159 and does not relate to the risk assessment of other tax issues related to the arrangement.

31. Your arrangement will be in the green zone where *any* of the following apply (each scenario operates independently).

Table 2: Green zone scenarios

Scenario	Arrangement
1	The distribution is consistent with the past practice over the preceding 3 years of distributions paid in relation to the relevant class of shares, where all of the following are fundamentally consistent: • timing (for example, biannual) • amount (for example, consistent pay-out ratio or percentage of free cash flow), and • franking percentage. This is relevant to the first criterion – not consistent with established practice.
2	The distribution is made under an arrangement involving a dividend reinvestment plan (whether underwritten or not) that is undertaken for normal commercial purposes, where it is not an artificial or contrived arrangement. This is relevant to the third criterion – principal effect and purpose of funding a substantial part of the distribution.
3	The issue of equity interests funded (directly or indirectly) less than 20% of the entire franked distributions paid to all eligible shareholders. This is relevant to the third criterion – principal effect and purpose of funding a substantial part of the distribution.
4	The issue of equity interests by entities regulated by APRA is to meet minimum regulatory requirements, or to maintain a reasonable buffer beyond the minimum regulatory requirements. This includes additional Tier 1 capital issued in connection with the redemption of another instrument. This is relevant to the fourth criterion – not a direct response to APRA or ASIC.
5	If you are a private company⁹, the distribution was made under an arrangement where the capital raising and distribution are initiated to facilitate the departure of one or more shareholders from the company (for example, succession planning and shareholder exits). This is relevant to the third criterion – principal effect and purpose of funding a substantial part of the distribution.

Green zone arrangement example – scenario 1

Example 1 – dividends that are consistent with an established practice

32. *Chung Group, a company listed on the Australian Securities Exchange (ASX), publishes a dividend policy.*

33. *Chung Group's dividend policy in respect of ordinary shares seeks to pay fully franked dividends biannually in a range of 40% to 50% of its free cash flow per annum. Its practice of paying dividends during the past 3 years is consistent with this dividend policy. Free cash flow is defined as cash from operating activities and investing activities (but excluding major growth projects).*

⁹ The term 'private company' for the purpose of this Guideline takes its meaning from section 103A of the ITAA 1936.

34. *Chung Group is also implementing several long-term growth projects. Chung Group raises new share capital as an additional source of funding for the growth projects and to maintain the company's target capital structure and gearing ratio.*

35. *While waiting for the project contractors to render their invoices (which are dependent on the achievement of milestones), the funds from the new capital raising are temporarily applied towards repayment of revolving debt facilities.*

36. *The capital raising is undertaken to ensure that the company's net debt to EBITDA¹⁰ gearing ratio (measured on a rolling 12-month basis) will not go above a certain target range which is considered prudent by the board of directors.*

37. *The funds that Chung Group will use to pay the dividends will be sourced from the company's operations and income from its investments as well as by drawing down on the revolving debt facilities (for any cash shortfall).*

38. *Chung Group concludes that the franked distribution it is proposing to pay in respect of ordinary shares falls under scenario 1 of the green zone under this Guideline. This is because the franked distribution is in respect of ordinary shares and is fundamentally consistent with its past practice over the preceding 3 years in terms of timing, amount, and franking percentage.*

39. *We will generally not have cause to apply compliance resources to review the arrangement with respect to section 207-159.*

Green zone arrangement examples – scenario 2

Example 2 – dividend reinvestment plan undertaken for normal commercial purposes

40. *Timlin Manufacturing, an ASX-listed company, has had a dividend reinvestment plan (DRP) for ordinary dividends that has been in operation for a significant period of time.*

41. *The DRP encourages investment by retail investors as it enables eligible shareholders to increase their shareholding by reinvesting the dividends payable on their ordinary shares to obtain new ordinary shares issued by the company (without transaction costs).*

42. *Timlin Manufacturing determines that the distributions under the DRP will fall under scenario 2 of the green zone under this Guideline, as the DRP is undertaken for normal commercial purposes, and is not an artificial or contrived arrangement. This is due to the DRP being in place for an extended period of time, ongoing for ordinary dividends and designed to support retail investors to increase their shareholdings.*

43. *While Timlin Manufacturing can rely solely on scenario 2 of the green zone to determine that the arrangement is low risk under this Guideline, it is noted that:*

- *Scenario 3 may apply where the distributions subject to the DRP are less than 20% of the entire franked distribution paid to all eligible shareholders.*
- *Scenario 1 may also apply depending on the previous distribution practice.*

44. *We will generally not have cause to apply compliance resources to review the arrangement with respect to section 207-159.*

¹⁰ Earnings before interest, taxes, depreciation and amortisation.

Example 3 – dividend reinvestment plan undertaken for normal commercial purposes

45. TigerLand Developers, an ASX-listed company, recommences a DRP that has been suspended for a number of years. TigerLand Developers' ASX announcement states that the DRP has been recommenced on an ongoing basis to raise capital to invest in its upcoming property development projects.

46. The DRP encourages investment by retail investors as it enables eligible shareholders to increase their shareholding by reinvesting the dividends payable on their ordinary shares to obtain new ordinary shares issued by the company (without transaction costs). Under the DRP, TigerLand Developers issue the new shares at a small discount to the market price at the time the dividend is declared. Small Joe Brokers underwrite the DRP to a certain participation rate.

47. TigerLand Developers declare a fully franked dividend of 30c per ordinary share in September 2025. The declared dividend amounts to \$70 million, in relation to which \$8 million of shares are issued under the DRP and underwriting arrangement.

48. TigerLand Developers determines that the distribution falls under scenario 2 of the green zone under this Guideline, as the DRP is undertaken for normal commercial purposes, and is not an artificial or contrived arrangement.

49. We will generally not have cause to apply compliance resources to review the arrangement with respect to section 207-159.

Example 4 – dividend reinvestment plan not undertaken for normal commercial purposes (red zone arrangement example)

50. In February 2024, Pink Maple Enterprises (Pink Maple), an ASX-listed company, announces a special dividend of \$3 per share that it purports to fully frank. In conjunction with the announcement, the company launches a new temporary DRP which only applies to the special dividend, giving shareholders the option to reinvest the special dividend to obtain additional ordinary shares. The DRP is fully underwritten by Shark Capital (in the event of a shortfall if shareholders elect to receive cash rather than additional shares).

51. The special dividend does not align with an increase in Pink Maple's profits.

52. In March 2024, Pink Maple pays \$50 million via the special dividend.

53. Shareholders owning approximately 50% of Pink Maple's issued shares participate in the temporary DRP for the special dividend. Pink Maple raise approximately \$50 million in capital through participation in the DRP and the issue of remaining shares to the underwriter. The entire special dividend amount is funded by the capital raised.

54. Pink Maple determines that the distribution does not fall within scenario 2 of the green zone of this Guideline. Although the issue of equity is through the DRP, it does not meet the requirement that the DRP be undertaken for normal commercial purposes and not be an artificial or contrived arrangement.

55. The factors that demonstrate that the arrangement is artificial and contrived include:

- There is no net change in the financial position of the company (apart from changes to the franking account balance) as the capital raised was paid out via the special dividend.
- There is an absence of a clear and genuine commercial purpose for the features of the arrangement.

- *There is a close alignment in the timing between the issue of equity interests and the relevant distribution.*

56. *We would apply compliance resources to review the arrangement as a matter of priority, as the distribution meets all of the requirements to be within the red zone per paragraph 84 of this Guideline.*

Green zone arrangement examples – scenario 4

57. Note that all references to APRA's minimum regulatory requirements in paragraphs 58 to 78 of this Guideline are illustrative only and intended to reflect the principles expressed in this Guideline. When applying this Guideline, we expect you to have reference to the current APRA (or ASIC) regulatory framework at the time of application.

Example 5 – equity raised to meet minimum regulatory requirements, including maintaining a reasonable buffer beyond minimum requirements

58. *Savings Bank of Australia (Savings) is an Australian authorised deposit-taking institution for the purposes of the Banking Act 1959 and is subject to minimum regulatory requirements as administered by APRA, including maintenance of mandatory levels of Tier 1 capital.*

59. *APRA's minimum regulatory requirements mean that Savings needs to maintain Tier 1 capital of 11% of risk-weighted assets, of which 1.5% can be additional Tier 1 capital (AT1). APRA requires boards to set internal capital targets as part of their Internal Capital Adequacy Assessment Process and, as part of this, it expects banks to set a buffer beyond the minimum regulatory requirement reflective of their circumstances (in the case of Savings, the board considers the appropriate buffer is 1%).*

60. *The board of Savings is also maintaining a conservative policy to ensure it maintains a level above this buffer as part of its approach to capital management, which generally means it will maintain a level of Tier 1 capital between 12% and 13%. In addition, Savings generally maintains 1.75% to 2% AT1 capital as part of its approach to capital management, noting only 1.5% can be counted towards meeting its minimum Tier 1 capital requirements.*

61. *One of Savings' previously issued AT1 capital instruments – \$200 million of Capital Notes 1 – will be redeemed on 1 September 2024. To ensure Savings continues to maintain an adequate amount of Tier 1 capital (and specifically AT1 capital), it proposes to issue a new AT1 instrument – Capital Notes 3 – on 1 July 2024 to raise \$200 million.*

62. *The issue of Capital Notes 3 is a new capital raising. The proceeds from the issue of Capital Notes 3 are expected to effectively replace funding previously provided by Capital Notes 1 to:*

- *maintain Savings' AT1 capital ratios, and*
- *be used for general corporate purposes.*

63. *Savings has a policy of paying fully franked dividends on its ordinary shares twice a year. In addition, under the terms of its various capital notes instruments, if a distribution is paid, it is franked.*

64. *Savings announces that it will pay a fully franked special dividend in respect of its ordinary shares on 1 October 2024, in line with its capital management plan. This will reduce the level of Common Equity Tier 1 capital (which includes retained profits) on its balance sheet, which is a different category of Tier 1 capital to AT1 capital.*

65. *The issue of Capital Notes 3, in combination with the payment of the special dividend, will fall under scenario 4 of the green zone under this Guideline, as the Capital Notes 3 have been issued to ensure Savings meets APRA's regulatory requirements.*

66. *We will generally not have cause to apply compliance resources to review the arrangement with respect to section 207-159.*

Example 6 – anticipation of changes in Australian Prudential Regulation Authority requirements

67. *In late 2025, APRA changes the minimum regulatory requirements for Savings Bank in response to supervisory concerns. These changes, which will come into effect on 1 July 2026, increase the amount of Tier 1 capital required from 11% to 12%.*

68. *In anticipation of the increase in capital requirements, Savings undertakes a new ordinary share capital issuance on 1 February 2026 to increase the amount of its Tier 1 capital.*

69. *After the capital raising, Savings' Tier 1 capital ratio sits at 13.75%, as APRA's new requirement is 12%, and the board recommends maintaining a buffer of at least 1%. As in Example 5 of this Guideline, Savings also apply a conservative approach to maintaining this buffer, resulting in it carrying more than 13%.*

70. *In December 2026, Savings undertakes a divestment of a major business for \$2 billion. As a result, it reassesses its capital position and realises it is carrying too much Common Equity Tier 1 capital. In February 2027, Savings announces a fully franked special dividend to reduce the amount of Common Equity Tier 1 capital it is holding on its balance sheet.*

71. *The issue of new ordinary shares in combination with the payment of the special dividend, will fall under scenario 4 of the green zone under this Guideline, as the new issuance of ordinary shares is made to ensure Savings meets APRA's minimum regulatory requirements.*

72. *We will generally not have cause to apply compliance resources to review the arrangement with respect to section 207-159.*

Example 7 – adhering to the Australian Prudential Regulation Authority's minimum regulatory requirements in changing economic conditions

73. *In mid-2026, there is distress in financial markets, with analysts suggesting potential financial market volatility emanating from offshore in the latter half of the 2026 calendar year.*

74. *In anticipation of tightening in liquidity and capital markets, Savings undertakes a new share capital issuance on 1 September 2026 to increase the amount of ordinary share capital. This is done to safeguard their balance sheet and liquidity position through the period of anticipated market volatility and to lower any risk of not meeting APRA's minimum regulatory requirements.*

75. *After the new capital raising, Savings' Tier 1 capital ratio sits at 14.25% which creates a temporary significant buffer above APRA's Tier 1 minimum regulatory requirement of 12%.*

76. *After a period of volatility, on 1 September 2027, liquidity and capital market conditions return to a more normal state and Savings decides to lower its capital buffer to reduce its cost of capital. It announces a fully franked special dividend on 1 December 2027 to reduce the amount of Common Equity Tier 1 capital.*

77. *The issue of new ordinary shares in combination with the payment of the special dividend will fall under scenario 4 of the green zone under this Guideline, as the new issuance of ordinary shares was made to ensure a conservative capital position through the period of anticipated financial market volatility and to lower the risk of not being able to meet APRA's minimum regulatory requirements.*

78. *We will generally not have cause to apply compliance resources to review the arrangement with respect to section 207-159.*

Green zone arrangement example – scenario 5

Example 8 – sale of a business

79. *Hawks Harvest is a private company wholly owned by the trustee of the Richards Family Trust. Hawks Harvest has built a successful manufacturing business, specialising in the production of farm machinery. Hawks Harvest generally reinvests all its profits in the business and has only paid a dividend once in its ten-year history.*

80. *The sole shareholder of Hawks Harvest completes negotiations with ABC Equity Ltd (ABC), a private equity firm, for the sale of 100% of the shares in Hawks Harvest for a purchase price of \$100 million minus a permitted dividend amount approximating the balance of retained profits. Completion of the contract is subject to:*

- *the successful completion by ABC of a capital raising under which it will raise \$50 million to partially fund the acquisition by issuing new interests to selected investors*
- *the declaration and payment by Hawks Harvest of a pre-sale dividend in the amount of its retained profits, up to a maximum of \$20 million*
- *ABC providing Hawks Harvest with a loan to enable it to pay the pre-sale dividend*
- *the payment by ABC of the agreed purchase price of \$100 million minus the pre-sale dividend amount (up to \$80 million).*

81. *ABC successfully completes the capital raising and combines the funds raised with its own existing funds to finance the loan to Hawks Harvest (which is used to pay the pre-sale dividend) and the payment of the purchase price. Without ABC's capital raising and subsequent loan, Hawks Harvest would not have had the cash resources to pay the dividend.*

82. *This arrangement will fall under scenario 5 of the green zone under this Guideline, as Hawks Harvest is a private company, and the arrangement is properly regarded as an arrangement where the principal effect and purpose of the capital raising is to facilitate the departure of a shareholder.*

83. *We will generally not have cause to apply compliance resources to review the arrangement with respect to section 207-159.*

Red zone arrangements

84. You are in the red zone in relation to a distribution where *all* of the following apply.

Table 3: Characteristics of a red zone arrangement

Factors	Characteristics
1	There is a close alignment in the timing (for example, less than 12 months) between an issue of equity interests and the declaration or payment of the relevant distribution. This is relevant to the third criterion – principal effect and purpose of funding a substantial part of the distribution.
2	The distribution is: - a special dividend, or - unusually large (that is, significantly higher amount, or of a significantly higher pay-out ratio or percentage of free cash flow) when compared to distributions previously declared and paid by the company over the prior 3 years. This does not apply if there has been a comparable increase in the company's profit that aligns with the special dividend or unusually large distribution. This is relevant to the first criterion – not consistent with established practice.
3	One or more of the following factors relevant to the third criterion – principal effect and purpose of funding a substantial part of the distribution applies: - There is an absence of evidence for a clear and genuine commercial purpose (other than releasing franking credits) for the features of the arrangement. - There is no change, or minimal change, in the financial position of the entity¹¹ as a result of the arrangement. - Most of the funds raised by the equity issuance are used to fund (directly or indirectly) the relevant distribution. - The distribution forms part of an artificial or contrived arrangement designed to facilitate the release of franking credits.

Red zone arrangement examples

85. Refer to Example 4 – dividend reinvestment plan not undertaken for normal commercial purposes, at paragraphs 50 to 56 of this Guideline, for an additional red zone example.

Example 9 – pro rata renounceable entitlement offer

86. *In November 2023, Bontempel Sports announces a pro rata renounceable entitlement offer under which it will issue new ordinary shares at \$2 per share, with existing shareholders entitled to subscribe for 1 new share for every 20 existing shares they hold.*

87. *The entitlement offer is taken up by all shareholders. It is completed in December 2023 and raises a total of \$80 million. The funds raised under the entitlement offer are not used by Bontempel Sports in its business but are deposited in an interest-bearing account.*

88. *In May 2024, Bontempel Sports uses the proceeds from the entitlement offer to pay a special dividend equating to a total of approximately \$75 million, that it fully franks.*

¹¹ Note that the entity may refer to the entity making the relevant distribution, a connected entity of the entity making the relevant distribution, or the entity in which the equity interests were issued – see paragraph 207-159(4)(c).

89. *The distribution meets all of the requirements to be within the red zone under this Guideline, as:*

- *There is a close alignment in the timing between the issue of equity interests and the relevant distribution.*
- *The distribution is a special dividend, which does not align to a corresponding increase in the profit of the company.*
- *One or more factors relevant to the third criterion (noting that any one of these would result in the arrangement being in the red zone) are satisfied.*
 - *There is an absence of evidence of a clear and genuine commercial purpose for the features of the arrangement.*
 - *There is minimal change to the financial position of the entity (aside from the change in their franking account balance), as there is a close alignment between the amount of the issue of equity interests and the distribution.*
 - *A majority of funds raised by the equity issuance are directly used to fund the distribution.*
 - *It forms part of an artificial and contrived arrangement designed to facilitate the release of franking credits. One factor that demonstrates this is that the equity raising was from the same or materially the same members receiving the franked distributions and there is minimal change to the economic position of the entity.*

90. *We would apply compliance resources to the arrangement.*

Example 10 – franked dividend income not taxed because of deductible trust losses

91. *The trustee of the Border Family Discretionary Trust (the Border Trust) owns all the shares in Suns Merchandising, which conducts a successful retail operation. Suns Merchandising is profitable, with a significant franking account balance, but has minimal cash reserves and no relevant history of dividend payments.*

92. *Separately, the trustee of the Border Trust conducts a property development business which has been performing poorly, accumulating significant tax losses.*

93. *Following a decision of its board, Suns Merchandising undertakes a capital raising under which it raises \$2 million in additional funds, for the stated purpose of facilitating expansion of the retail business. However, the genuine plans made for expansion are minimal.*

94. *Soon after the capital raising is completed, the board determines that the funds raised exceed the amount needed to finance the expansion. It resolves to return surplus funds of \$1.7 million as a franked dividend. The balance of \$300,000 is invested in the expansion program.*

95. *The Border Trust fully deducts its carried forward tax losses (having satisfied the relevant trust loss recoupment test) against the \$1.7 million dividend income and its other assessable income, leaving it with a nominal amount of trust income and net income for the income year.*

96. *The distribution does not meet any of the requirements to be within the green zone under this Guideline.*

97. *The distribution meets all of the requirements to be within the red zone under this Guideline, as:*

- *There is a close alignment in the timing between an issue of equity interests and the declaration or payment of the relevant distribution.*
- *The dividend is unusually large compared to distributions in respect of ordinary shares previously declared and paid by the company over the prior 3 years, without a corresponding increase in the profit of the company.*
- *One or more factors relevant to the third criterion (noting that any one of these would result in the arrangement being in the red zone) are satisfied.*
 - *There is an absence of evidence for a clear and genuine commercial purpose for the features of the arrangement, as the purported commercial purpose of expanding the retail business does not appear to be genuine.*
 - *While there is a change to the financial position of the entity to the extent that some funds are retained, the distribution that is purported to be franked is fully funded by the capital raising and to that extent there is no change to the financial position of the entity.*
 - *A majority of funds raised by the equity issuance are directly used to fund the distribution.*
 - *It forms part of an artificial and contrived arrangement designed to facilitate the release of franking credits. This is evident from the fact that Suns Merchandising stated they were raising capital for the purpose of funding retail expansion, but then soon after made the franked distribution. Other relevant factors are Suns Merchandising's lack of liquidity and that the arrangement facilitated the advantageous and accelerated use of the Border Trust's tax losses.*

98. *We would apply compliance resources to the arrangement.*

Record keeping relevant to the purpose of capital raising

99. Paragraphs 100 to 121 of this Guideline outline, and provide examples of, the types of documentation we consider relevant to determining whether any entity that issued or facilitated the issue of any of the relevant equity interests did so for a purpose (other than an incidental purpose) of funding a substantial part of the relevant distribution or the relevant part of a distribution.

100. Documentation prepared by the entity on the reasons for undertaking the capital raising will be taken into account. However, the purpose of the capital raising as asserted by the entity will not in itself be determinative. The totality of factors must be objectively considered, including whether the documentation reflects the substance of the arrangement and the conduct of the party or parties involved.

101. The types of documents that will be relevant to this test, where they are relevant to the matters listed in subsection 207-159(4), will include but are not limited to:

- minutes of board and other meetings at which the capital raising, the making of the franked distribution, or both, were considered
- the entity's annual reports
- announcements to a securities exchange, such as the ASX

- a scheme implementation agreement or deed (where relevant)
- disclosure documents lodged with a regulator or a securities exchange (for example, a scheme booklet or a prospectus).

Example 11 – documentation relevant to the purpose of capital raising for a public company

102. *Giannakis Mining announces in January 2024 that it has received a proposal from Interlandi Minerals, an unrelated entity, to acquire all the ordinary shares in Giannakis Mining via a scheme of arrangement under Part 5.1 of the Corporations Act 2001. The scheme of arrangement is implemented in May 2024.*

103. *As permitted (but not required) by the scheme of arrangement, and at the discretion of the directors, a special dividend of 45c per share is paid by Giannakis Mining in March 2024 (prior to the scheme implementation date). The aggregate amount of the special dividend is \$80 million. The special dividend is significantly higher than any past dividend paid by Giannakis Mining over the last 3 years, which has ranged from 1.5c to 6.5c per share.*

104. *In May 2023, Giannakis Mining had undertaken a capital raising of \$78 million through the issue of ordinary shares. The relevant ASX announcement details the capital raising offer and states that the purpose of the capital raising was to fund debt repayments following the successful expansion of its iron ore mining operations.*

105. *Giannakis Mining's 2023 annual report states that the amount from the capital raising was predominantly used to repay bank debt.*

106. *The distribution does not fall within the green zone under this Guideline, because it is not covered by any of scenarios 1 to 5 listed in Table 2 of this Guideline. However, it is also not in the red zone, because none of the factors in that zone relevant to the third criterion apply.*

107. *Giannakis Mining is able to demonstrate the commercial purpose of the equity issuance and the use of funds by reference to documentation such as the ASX announcements and its annual report, which reflect the substance of the arrangement and conduct of the parties. Therefore, these records will assist Giannakis Mining to demonstrate that section 207-159 does not apply in its circumstances.*

Example 12 – documentation relevant to an established practice affected by economic conditions for a public company

108. *Callaway Ecocharge Co is an ASX-listed company specialising in renewable energy solutions and has a practice of paying 60–70% of its annual profits after tax as bi-annual franked dividends over the past 3 and a half years. This practice is consistent with its published dividend policy.*

109. *In March 2028, there are major global supply chain disruptions due to growing political instability and an imminent threat of war between nations on the major global shipping routes that Callaway Ecocharge uses. There is no certainty on when tensions will subside.*

110. *Callaway Ecocharge announces to shareholders that they will temporarily halt paying their bi-annual franked dividends to preserve cash as the adverse trading conditions have been impacting business operations and profits. Callaway Ecocharge intends to recommence paying dividends once global trade conditions improve, which is outlined in its board minutes and published on its website's announcement page.*

111. *Due to the ongoing uncertainty and geopolitical tensions, Callaway Ecocharge anticipates that it will require additional cash to fund its debt repayments to third parties. In January 2029, Callaway Ecocharge undertakes a capital raising through the issue of ordinary shares. The relevant ASX announcement and the prospectus lodged with ASIC details the capital raising offer and states the purpose is to fund its debt repayments.*

112. *The supply chain disruptions continue to the end of 2030. Callaway Ecocharge does not pay any dividend during this period. Its annual report states that the amount from the capital raising is predominantly used to repay third-party debt during the 2029 and 2030 financial years.*

113. *At the beginning of February 2031, global supply chain conditions begin to improve and continue to stabilise until May 2031. Callaway Ecocharge's operations recover quickly and it announces that it will recommence paying dividends in accordance with its pre-existing policy. It pays its first fully franked dividend in August 2031. A residual portion of the capital raised indirectly contributed to the funding of its subsequent distributions.*

114. *The distribution does not fall within the green zone under this Guideline, because it is not covered by any of scenarios 1 to 5 listed in Table 2 of this Guideline. It does not fall under scenario 1 as there has not been a consistent dividend practice in accordance with its pre-existing policy due to distributions halting for 3 years due to geopolitical conflicts. However, it is also not in the red zone, because none of the factors in that zone relevant to the first and third criterion apply.*

115. *Callaway Ecocharge can demonstrate the commercial purpose of the capital raising and the use of funds to repay its debts to third parties by reference to documentation such as the ASX announcements, ASIC prospectus, its 2029 and 2030 annual report, meeting minutes, announcements on its website. The documentation reflects the substance of the arrangement and Callaway Ecocharge's conduct. Therefore, these records will assist Callaway Ecocharge to demonstrate that section 207-159 does not apply in its circumstances.*

Example 13 – documentation relevant to the purpose of capital raising for a private company

116. *Byting Edge Software was once a leading player in the technology and software development industry, known for its innovative products. The company enjoyed several years of profitability. During this time, it adopted a policy of paying semi-annual dividends to its shareholders of 60% of its net profit after tax (excluding extraordinary items).*

117. *Over the past few years, Byting Edge Software has faced significant challenges, including increased competition, market saturation and internal management issues. As a result, the company has suffered persistent financial losses, with declining revenues and mounting debts. Byting Edge Software has a significant franking account credit balance but lacks the financial capacity to pay dividends to its shareholders.*

118. *To rehabilitate the business and return it to profitability, Byting Edge Software proposes to undertake a capital raising by issuing new shares. The funds raised will be used to restructure the company, invest in new product development and improve operational efficiency. This is reflected in the board meeting minutes and relevant correspondence.*

119. *Byting Edge Software completes the capital raising and commences its business rehabilitation program. The program is successful, the funds obtained under the capital raising are predominantly expended and Byting Edge Software becomes profitable within 3 years. The board is now planning to resume paying dividends in accordance with its pre-existing policy.*

120. *The board considers this Guideline and determines that a distribution does not fall within the green zone under this Guideline, because it is not covered by any of scenarios 1 to 5 listed in Table 2 of this Guideline. (In particular, it does not fall under scenario 1 as there has not been a consistent established dividend practice for 3 years and at least 20% of the proposed dividends will be financed by the capital raising.) However, it is also not in the red zone, because none of the factors in that zone relevant to the third criterion apply.*

121. *Byting Edge Software ensures that it is in a position to demonstrate the commercial purpose of the equity issuance and the use of funds with relevant documentation such as the business plans, financial projections, minutes of board meetings, and correspondence relating to the capital raising. The documentation reflects the substance of the arrangement and Byting Edge Software's conduct. Therefore, these records will assist Byting Edge Software to demonstrate that section 207-159 does not apply in its circumstances.*

Commissioner of Taxation

24 September 2025

References

Legislative references:

- ITAA 1936 103A
- ITAA 1936 177EA
- ITAA 1997 202-40
- ITAA 1997 207-159
- ITAA 1997 207-159(1)(a)
- ITAA 1997 207-159(1)(b)
- ITAA 1997 207-159(1)(c)
- ITAA 1997 207-159(1)(d)
- ITAA 1997 207-159(2)
- ITAA 1997 207-159(3)

- ITAA 1997 207-159(4)
- ITAA 1997 207-159(4)(c)
- ITAA 1997 960-115
- Corporations Act 2001 Part 5.1

Other references:

- Explanatory Memorandum to the Treasury Laws Amendment (2023 Measures No. 1) Bill 2023
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