PCG 2025/3EC - Compendium

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Practical compliance guideline compendium – PCG 2025/3

Relying on this Compendium

This Compendium of comments provides responses to comments received on draft Practical Compliance Guideline PCG 2024/D4 *Capital raised for the purpose of funding franked distributions – ATO compliance approach.* It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

All legislative references in this Compendium are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Issue number	Issue raised	ATO response
1	**Difficulties in undertaking self-assessment** The final Guideline should include additional examples and comments to increase taxpayers' ability to self-assess common commercial arrangements, such that they more clearly fall within the 'green zone' and the 'red zone', as there is a large gap between green zone and the red zone categories against which taxpayers must self-assess under the draft Guideline. Many taxpayers will fall outside of the fairly narrow green zone but will not exhibit each of the factors relevant to being in the red zone based on the draft Guideline. Further, the provision is self-executing and does not require the Commissioner to exercise discretion to apply and deny the frankability of a distribution. It is crucial that the final Guideline provides guidance which allows as many taxpayers as possible to self-assess their risk. **Other common merger and acquisition transactions** The final Guideline should include a variation on Example 8 where a new significant investor is introduced, a pre-transaction dividend is paid to existing owners and the existing owners remain shareholders. The final Guideline should include an example covering an initial public offering (IPO) that involves a pre-IPO dividend funded by IPO proceeds. That is conceptually not dissimilar to scenario 5 in that existing owners are paid a	As outlined in paragraph 12 of the final Guideline, it is not possible for the Guideline to cover every potential factual scenario that may arise. Our approach is focused on setting out key principles that can be broadly applied for self-assessment, rather than addressing a wide range of permutations. For this reason, including additional examples would be of limited value as each arrangement will be dependent on its own facts. For instance, Example 11 of the final Guideline refers to the type of documentation relevant to the purpose of a capital raising for a public company. This provides a practical example of what records will assist an entity to demonstrate that the integrity measure does not apply, with the principles being relevant to other merger and acquisition (M&A) scenarios that do not fall within the green zone. We consider the green zone scenarios and examples provided in the final Guideline align with the priority areas raised during our external consultation prior to publication of the draft Guideline. We have provided practical certainty on a range of common commercial arrangements that will be relevant for taxpayers, noting that there will be a variety of other factual scenarios that will fall outside the green zone.

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	dividend funded by new owners. The existing owners may or may not sell shares at the time of the IPO. In the final Guideline, the examples should clarify that the same conclusion in scenario 5 results, irrespective of whether the purchaser provides consideration by way of cash or scrip. **Arrangements motivated by asset protection** Closely held groups often seek to reduce the net assets of trading entities that are at high risk of being sued and commonly seek to distribute profits out of the company at the earliest opportunity. This may simply involve paying franked dividends up to a holding company. Where the trading company requires the continual use of the funds, they may seek to obtain the funds by way of loan, which the holding company may look to secure. Where this is an at-call loan, it can be classified as an equity interest for tax purposes. Alternatively, there may be arrangements involving more than 2 entities such as where the shareholder uses the dividend to subscribe for ordinary shares in a different company which lends the money back to the original trading company. This loan-in may be either a debt interest or an equity interest, but the issuance of shares by this other company creates the potential for the application of section 207-159 (for example, similar to the issuance of equity and loan in by ABC to Hawks Harvest in Example 8 of the draft Guideline).	To alleviate concerns, the Guideline also provides guidance on documentation relevant to the principal effect and purpose tests, and examples of how entities have satisfied themselves that they are not in the red zone. As paragraphs 13 to 15 of the final Guideline emphasise, if an arrangement doesn't fall within the risk zones, this does not mean that there is a high risk of the integrity measure applying. All 4 criteria must be satisfied for section 207-109 to apply. Taxpayers are also able to obtain advice on their specific circumstances, such as by obtaining a private or class ruling. See our response to Issue 2 of this Compendium concerning comments on expanding scenario 5 of the green zone.
2	**Public company merger and acquisition arrangements – scenario 5 of the green zone and Example 8** Scenario 5 and Example 8 of the final Guideline should extend to public M&A scenarios. Extending the context to include public M&A transactions does not undermine the purpose of the provision, particularly given pre-sale dividends, in the context of public M&A transactions, are ordinarily subject to the Commissioner's review in the class ruling process in any event. There is no legislative basis nor policy rationale for making a distinction between public and private M&A. Irrespective of whether a pre-sale dividend is paid in a private or public M&A transaction, an equity raising that partially or wholly funds the distribution would not have a principal effect, nor non-	Scenario 5 of the green zone and Example 8 of the final Guideline only apply to private companies with respect to a low-risk rating consistent with the policy expressed at paragraph 5.45B of the EM that the measure is not intended to affect family or commercial dealings of private groups initiated to facilitate the departure of one or more shareholders from the company. While scenario 5 and Example 8 do not extend to public companies, this does not mean that a distribution made in the context of an M&A transaction for a public company will be high risk. Example 11 of the Guideline provides an example of a public company M&A transaction to provide further guidance on

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	incidental purpose of funding the dividend. Rather, the purpose and effect of the capital raising is to facilitate the sale by the target company's existing shareholders (that is, the same commercial purpose as Example 8). The fact that taxpayers will fall in 'no man's land' is acknowledged by Example 11 of the draft Guideline which states that the taxpayer is neither in the green zone or red zone, but as the taxpayer is able to demonstrate the commercial purpose of the equity issuance and the use of funds by reference to documentation the provision should not apply. The brief reference in the Supplementary Explanatory Memorandum to the Treasury Laws Amendment (2023 Measures No. 1) Bill 2023 (Supplementary EM), at paragraph 4.7 that 'family or commercial dealings of private companies to facilitate the departure of one or more shareholders are not intended to be affected by the [provision]' provides no justification or positive intent that public companies should be treated differently to private companies. Rather, paragraph 5.45B of the Explanatory Memorandum to Treasury Laws Amendment (2023 Measures No. 1) Bill 2023[1] (EM) states that the provision targets 'contrived arrangements undertaken by closely held companies', while commercial dealings would not be targeted. This reflects Treasury's anticipation of greater integrity risk in the private company context, while legitimate M&A dealings, whether public or not, would not reflect any contrivance. The final Guideline should confirm if Example 8 of the draft Guideline is limited to private group wholly owned structures or whether a similar fact pattern in a public structure would apply as some of their members in the agriculture space often work in trust structures to manage joint arrangements and co-operatives with other businesses but aren't necessarily a private group. The final Guideline should acknowledge that there are comments in the Supplementary EM that refer to 'family or commercial dealings of private companies', however, we suggest that the reasoning and conclusion in Example 8 should not be limited to cases where the target company is a	how taxpayers can reasonably self-assess their circumstances using relevant documentation to determine whether they are within the red zone.

[1] Inserted through paragraph 4.8 of the Supplementary Explanatory Memorandum to that Bill.

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	private company. There is nothing in the legislation that makes this a relevant distinction. It is submitted that the same conclusions should follow if Hawks Harvest was a public company.	
3	**Include additional green zone scenario: no close alignment in the timing (for example, 12-month or more) between equity raising and franked distribution** The final Guideline should include a 12-month (or greater) delay between an equity raising, and a distribution as one of the green zone scenarios to demonstrate that generally where there is such a delay there will be 'insufficient linkage' between the equity raising and the distribution. An additional example or scenario should be included to demonstrate the application of these factors. This change would be consistent with Example 5.3 in the EM (includes a 12-month timeframe between the equity raising and the franked distribution) and would provide symmetry between the red zone (that is, factor 1 in Table 3 of the draft Guideline) and the green zone, thereby reducing the number of situations in which taxpayers fall in the gulf between the zones. This would also enhance taxpayers' ability to self-assess their risk and therefore assist in achieving the objectives of the Guideline.	We consider including a green zone scenario that focuses on the timing (for example, 12 months or more) between an equity raising and franked distribution is not appropriate, as this factor cannot be viewed in isolation. The principal effect and purpose test (third criterion) could still be satisfied where there is a relationship between the capital raising and franked distribution, regardless of there being a 12-month or greater delay. We do not consider it is appropriate to use the timing as a single factor to conclude that all arrangements that meet this criterion would be low risk. We also note that Example 5.3 in the EM considers an arrangement to have insufficient linkages between the capital raising and special dividend as the principal effect and purpose test is not satisfied, not because of the timing between the equity raising and distribution being more than 12 months. Rather, it was that the company's circumstances were for a genuine commercial purpose, where the capital raising was required for an acquisition and when the acquisition was unsuccessful, the surplus of cash was returned to shareholders as a special distribution.
4	**First criterion – not consistent with established practice** We welcome the administrative clarity provided by the Commissioner in relation to whether a distribution is in accordance with a company's 'established practice'. The draft Guideline helpfully provides that taxpayers are required to consider the preceding 3 years of distributions paid in relation to the relevant class of shares (for example, factor 2 of Table 3 of the draft Guideline). However, the Commissioner should provide additional guidance for taxpayers considering their established practice where external economic	At paragraphs 108 to 115 of the final Guideline, we have included new Example 12 to address where external economic conditions may affect consistency with an established practice. This provides guidance on how taxpayers can reasonably self-assess their circumstances when there is a break in practice due to external economic conditions and use relevant documentation to determine how their arrangement would not fall within the red zone.

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	conditions have had a significant impact on their distribution policy and their needs to raise additional capital. We recommend the final Guideline includes some flexibility to take into account future economic crises outside the control of taxpayers. This could be achieved by including in scenario 1 of Table 2 of the Guideline a statement that established practice can be present even where there is a temporary suspension or decrease in dividends due to economic conditions, by having reference to distributions in earlier periods (if relevant). For example, if a taxpayer has suspended or reduced dividends in certain periods because of volatility in economic conditions, that those periods may be disregarded (or at least, considered as a 'pause' in established practice) and that taxpayers can look back to earlier periods (if relevant) when applying the Guideline to their affairs, for example, the suspension of dividends by many Australian-listed companies during the COVID-19 pandemic.	
5	**Clarification on scenario 1 of the green zone** Scenario 1 of the green zone should acknowledge that the factors identified are examples of the relevant factors and that other factors in addition to the 3 listed (timing, quantum and franking percentage) can be relevant to an established practice, and that it is not necessary that all the listed factors be consistent. Scenario 1, as drafted, indicates that distribution consistency is required of all the 3 factors (timing, quantum and franking percentage) to be consistent with an established practice. Although expressed as a cumulative 'and' test, it can be presumed that a practice can be regarded as an established practice in cases where some, but not all 3 factors (timing, quantum and franking percentage) are met. For example, if a practice existed of a 6-monthly dividend in the amount of X% of retained profits, but some of those dividends were franked and some were not (depending upon the tax profile of the company), we presume that this would amount to an established practice where 2 of the 3 factors are consistent. It is submitted that factors other than the 3 identified in scenario 1 of the green zone may be relevant in identifying an established practice. For example, a dividend policy may be based upon the company achieving	In determining whether the first criterion applies, specifically whether an established practice of making distributions exists, there are relevant statutory factors to consider, as outlined in paragraph 20 of the final Guideline. Scenario 1 of the green zone is intended to provide practical guidance for taxpayers on circumstances when we are satisfied that an established practice exists. Taxpayers may be able to demonstrate the existence of an established practice in other circumstances, supported by documentation with the relevant statutory factors. We accept that the amount, franking percentage and timing does not need to be precisely or exactly consistent across the 3-year testing period. Therefore, in the final Guideline, we have added that all 3 factors only need to be 'fundamentally' consistent.

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	certain debt to equity ratios or having paid down a certain amount of debt. In a private or family company scenario, it may be that the dividend practice is determined by matters outside of the company such as cash needs of shareholders.	
6	**Scenario 3 of the green zone – 'Substantial part' of a distribution** The 5% threshold in the draft Guideline does not reflect a 'substantial part' and is more aligned to a *de minimus* threshold than a substantial part threshold. Paragraph 25 of the draft Guideline and scenario 3 of the green zone do not accord with the ordinary usage of the term 'substantial'. Dictionary definitions of 'substantial' include 'of large size or amount' and 'large in size, value or importance'. Large is defined as 'of considerable or relatively great size or extent' and 'big in size or amount'. 'Substantial' should be considered to mean the 'main' part consistent with the similar approach in Taxation Ruling TR 2005/5 *Income tax: ascertaining the right to tax United States (US) and United Kingdom (UK) resident financial institutions under the US and the UK Taxation Conventions in respect of interest income arising in Australia* which practically, for this purpose, should mean more than 50%. In TR 2005/5, the Commissioner states in relation to the meaning of the term 'substantially deriving its profits' that 'the relevant term substantially when used in conjunction with deriving profits' requires that the main source of the enterprise's profits be derived from its business of undertaking 'spread activities'. If this change is not made, an increased number of taxpayers will obtain only limited guidance from the Guideline (limited to the consideration of factors in paragraph 13 of the draft Guideline) with resulting likelihood that taxpayers may need to apply for rulings on their arrangement to obtain comfort that the ATO will not apply the rules compared to if a more appropriate higher percentage measure was adopted. We recommend that a percentage higher than 5% should be used to determine when an arrangement is in the green zone for the compliance approach. We suggest that the issue of equity interest which funded the distribution should be less than 40% of the entire franked dividend to be considered to not be a 'substantial part' for the third criterion. That is, at a	As outlined in paragraph 24 of the final Guideline, the meaning of 'substantial part' will depend on the facts and circumstances of each distribution. One of the relevant factors in determining a substantial part is the proportion of the distribution that is funded by the capital raising. The proportion does not need to be a majority of the distribution funded by the capital raising but it must be more than a small part of the distribution. We have considered the feedback and decided to increase the threshold of scenario 3 of the green zone. We have determined that a less than 20% threshold is appropriate for providing practical certainty on when we will generally not have cause to apply compliance resources, in the context that this is an anti-avoidance provision. As part of our maintenance of the Guideline, in accordance with Law Administration Practice Statement PS LA 2008/12 *Public advice and guidance products: selection, development, publication and review processes*, we will continue to monitor the relevance of the Guideline's application. This will include considering whether the 20% threshold remains appropriate, and where necessary, we may make updates to reflect evolving commercial practices. At paragraph 23 of the final Guideline, we have provided additional guidance on the 'proportionality' aspect of the integrity provision to improve clarity. For example, if a company raises $9.5 million in equity which directly or indirectly funds a $50 million distribution, this would be considered low risk. If the proportion is 20% or greater, this does not mean the arrangement is automatically high risk.

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	level of funding the dividend by the issue of equity interests equal to 40% or more of that dividend, the green zone scenario will not be met. This threshold should be increased from 5% to at least 20% of a distribution. This would concur with paragraph 3.10 of the Supplementary EM which states (emphasis added): …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.* While the EM does not conclude on a specific percentage (or range) that would be 'substantial' or 'more than small or minor', it points to a benchmark (being the majority of a distribution). A threshold of only 5% is drastically lower than that benchmark and would impose a heavy administrative burden on taxpayers (effectively requiring tracing of at least 95% of the distribution) and potentially leading to a much higher number of arrangements falling outside of the green zone, even where none of the red zone factors are present. Any threshold adopted in the final Guideline must concur with other relevant guidance and case law, including *Allied Mills Industries Pty. Ltd v Commissioner of Taxation* [1989] FCA 135 in which the court considered the meaning of 'substantial part' and referred to *Wiseburgh v Domville* (1956) 36 TC 527, where an agency agreement that was cancelled amounted to about 90% of the plaintiff's total earnings and its loss necessitated the complete reorganisation of the taxpayers business, a reduction in its staff, and the taking of new and smaller premises. In fact, a substantial part of the business undertaking had gone. This case law has been cited in ATO Interpretative Decision ATO ID 2003/105 *Income Tax: Income or capital - payment on termination of an agreement to provide services*. Taxation Ruling TR 2007/10 *Income tax: the treatment of shipping and aircraft leasing profits of United States and United Kingdom enterprises under the deemed substantial equipment permanent establishment provision of the respective Taxation Conventions* also provides the Commissioner's view of whether equipment is 'substantial' is a question of fact and degree to be	In response to feedback about issuing a binding taxation determination, we have prioritised providing guidance regarding the practical implications of the integrity provision and how we will assess compliance risk. As such, we will not be issuing a binding product in relation to the provision.

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	determined on balance, in a relative sense, and in an absolute sense. This indicates that 'substantial part' is intended to be more than a minor or *de minimus* part and supports increasing the 5% threshold to at least 20%. The 'third criterion' to be considered is that it is reasonable to conclude having regard to all relevant circumstances that the principal effect of the issue of any of the equity interest was the direct or indirect funding of the substantial part of the relevant distribution or relevant part and the entity that issues or facilitated the issue of the equity interest did so for the non-incidental purpose of funding a substantial part of the relevant distribution or relevant part. **Technical positions should be supported by a binding taxation determination** We recommend a taxation determination is issued and it does not need to state the 'safe harbour' threshold (that is, of 5%). Without a technical basis, the draft Guideline alone is insufficient to provide taxpayers certainty on this issue. A binding view should be provided by the Commissioner to explain that the 'relevant part' concept (paragraph 3.12 of the Supplementary EM) should be read consistent with achieving the ultimate purpose of the provisions, as opposed to the original purpose before the amendments were made. For example, $90 million capital raised may be said to fund a substantial portion of a $100 million distribution. Section 207-159 applies so that only $90 million of the $100 million distribution could be made unfrankable under section 207-159. If instead, $2 million of capital raised funded a portion of a $100 million distribution, it can be concluded (depending on the circumstances) that no amount of the distribution is unfrankable.	

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7	**Application to the banking sector** A submitter expressed support for the draft Guideline as issued and raised no concerns, indicating that it satisfactorily: • addressed the breadth of the scope of the prudential capital management and directions by Australian Prudential Regulation Authority (APRA) • addressed the scope for changes in target ratios of capital distributions with respect to prudent capital management • addressed the uniqueness of additional Tier 1 capital (and confirmed that they are unaffected by the legislation per Example 5.4 of the EM) • provided confirmation of the treatment of dividend reinvestment plans (DRP) and underwritten DRP which will allow the continuation of current practices.	We have noted this submission.
8	**Additional examples relating to the Australian Prudential Regulation Authority's proposed changes to the prudential standards** Examples 5, 6 and 7 of the draft Guideline helpfully address the exception in the provision for the issue of equity interests in direct response to a requirement, direction or recommendation from APRA or the Australian Securities and Investments Commission. We recommend including an additional example in the draft Guideline in relation to APRA's announcement in December 2024 to phase out the use of additional Tier 1 (AT1) capital instruments by Australian banks (effective from 1 January 2027 via amendments to APRA's prudential standards). Should the changes go ahead, we expect a number of Australian banks may undertake equity capital raisings (for example, by issuing additional ordinary shares) in the near future to raise the relevant CET1 capital, but will still distribute franking credits via ordinary and special dividends. These banks' ability to distribute franking credits will be more limited with the phasing out of AT1 capital instruments, and to provide comfort to allow these taxpayers to continue to distribute franking credits where such distribution is not part of an artificial or contrived arrangement and is done in accordance with existing franking integrity measures. This example should bear similarity to existing Example 6 of the draft Guideline but would adopt slightly different facts.	We are unable to address APRA's proposed changes to the prudential standards given they are not yet finalised. As noted in our response to Issue 6 of this Compendium, we will continue to monitor the relevance of the Guideline's application and update the Guideline in the future as appropriate. Once APRA has implemented its proposed changes, we can reassess the banking examples if stakeholders submit that they are no longer fit for purpose. We also note that another submitter provided positive feedback that the guidance addresses industry concerns.

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	In addition, while Examples 5, 6 and 7 of the draft Guideline address green zone arrangements which invoke the APRA exception, we suggest that it would be helpful to include an additional example covering a red zone example, to provide additional clarity on the nexus required for an equity raising to be a direct response to APRA and Australian Securities and Investments Commission requirements where the equity raising also serves other goals.	
9	**Clarification on Example 2 of the draft Guideline – dividend reinvestment plan undertaken for normal commercial purposes** We recommend the final Guideline make clear that distributions made under a DRP (underwritten or not), undertaken for normal commercial purposes and which are not an artificial or contrived arrangement are in the green zone, no matter what the percentage of that distribution is to the entire franked dividends paid. Paragraph 31 of the draft Guideline states that arrangements will be in the green zone 'where any of the following apply' and we recommend this should be made clear in the examples. Example 2 of the draft Guideline stating that 'for the avoidance of doubt' where distributions are less than 5% of the entire franked distribution that scenario 3 will also apply and that scenario 1 may also apply tends to create confusion. We suggest that Example 2 be modified as scenario 2 of the green zone operates independently of other scenarios. Examples 2 and 3 of the draft Guideline are DRP cases which are taken to be for normal commercial purposes. There is no elaboration in the facts in Example 2 to demonstrate why it is an appropriate conclusion.	We agree that distributions will be in the green zone (low risk) where they are made under a dividend reinvestment plan (underwritten or not) that is undertaken for normal commercial purposes and is not an artificial or contrived arrangement, regardless the percentage of that distribution is to the entire franked dividends paid. Our intent of including 'any' at paragraph 31 of the Guideline is to ensure clarity that only one of the scenarios needs to apply for the arrangement to be in the green zone. In the final Guideline, we have clarified Example 2 to reflect that taxpayers can rely on a single scenario to be in the green zone. Example 2 of the Guideline emphasises the DRP has been in place for an extended period of time, is an ongoing arrangement for ordinary dividends and is designed to support retail investors to increase their shareholdings. We consider these facts to be relevant in determining the DRP was undertaken for normal commercial purposes.
10	**Clarification on Example 3 of the draft Guideline – dividend reinvestment plan undertaken for normal commercial purposes** Example 3 of the draft Guideline states that the company wants to 'raise capital to invest in its upcoming property development projects'. Leaving aside a company undertaking a return on capital, any company will always require funds to conduct its ongoing business activities. Therefore it is not clear as to the difference between Examples 3 and 4 of the draft Guideline with respect to 'normal commercial purposes'.	In Example 3 of the Guideline, TigerLand Developers' DRP has a normal commercial purpose as it is raising capital to fund upcoming property and development projects, and its DRP is recommencing on an ongoing basis to allow retail investors to reinvest their dividends (including the ordinary dividend). Example 4 of the Guideline has a range of objective facts that give rise to the arrangement being artificial and contrived. In

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		particular, it highlights the concerns with the arrangement which include the following concerns: • The DRP is temporary and only applicable to 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 timing between the capital raising and special dividend. • There is no net change in the financial position of the company.
11	**Clarification on Example 4 – dividend reinvestment plan not undertaken for normal commercial purposes** In the draft Guideline, scenario 2 of the green zone effectively repeats the comments in the Supplementary EM. There is no further EM commentary regarding 'normal commercial purposes' or 'artificial or contrived'. No clarity is brought to these matters via Example 4 of the draft Guideline. Example 4 of the draft Guideline is listed in the 'Green zone arrangements examples – scenario 2'. However, the example concludes that this is a red zone arrangement (as well as not meeting the requirements to be a green zone arrangement). We recommend that a cross-reference to this example should be added to the red zone arrangements section. It is not clear what is intended to be conveyed by the term 'special dividend' in Example 4 of the draft Guideline. This term is used in multiple places in the draft Guideline. If this is meaning that the 'dividend is not consistent with established practice as per paragraph 207-159(1)(a)', it would be clearer to describe the dividend in that way rather than introducing a new and uncertain term. We suggest that in the final Guideline, Example 4 should elaborate on why the example amounts to an artificial or contrived arrangement so as to	We consider the current examples (Examples 2 to 4 of the Guideline) are sufficient to illustrate the principles for when DRP arrangements fall within either the green zone or red zone. Taxpayers are able to seek further advice on their specific circumstances, such as by obtaining a private or class ruling. While Example 4 of the Guideline relates to a DRP that falls within the red zone, the reason for including it with the other green zone DRP examples is to highlight the differences between a green zone and red zone arrangement. In the final Guideline, we have included a cross-reference to Example 4 at paragraph 85 and updated the example's title to provide clarity. Further, 'special dividend' is a commonly used term to describe dividends in the market. It is defined by Cambridge dictionary as 'part of the profit of a company that is paid to shareholders in addition to one of the normal payments'.[3] In the final Guideline, we have clarified in Example 4 that Pink Maple's profits have not increased, but a substantial

[3] Cambridge University Press & Assessment (2025) *Cambridge English Dictionary Online*, https://dictionary.cambridge.org/, accessed 9 September 2025.

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	delineate between Example 4 and a fully underwritten DRP that is not an artificial or contrived arrangement. **Paragraph 51 of the draft Guideline – *'special dividend does not align with an increase in Pink Maple's earnings'*** Given that scenario 2 of the green zone is focused on the effect and purpose tests in paragraph 207-159(1)(c), we assume that the factor in paragraph 51 of the draft Guideline is relevant to the effect and purpose tests (noting that it may also be relevant to the condition in paragraph 207-159(1)(a). It is not clear as to what is meant by 'earnings'. Is it referring to gross income, EBITDA[2], net income, retained earnings (undistributed profits) or other? Once the meaning of earnings is clarified, the final Guideline should clarify what inference if any is to be drawn from this fact. For the company to declare the dividend, it must be the case that the company has sufficient retained earnings (undistributed profits). These profits may relate to current profits or prior year profits (or both) in that sense, a dividend should always align with retained earnings. **Paragraph 54 of the draft Guideline** It is unclear why the company concludes that the DRP is not undertaken for normal commercial purposes and is artificial or contrived. **Paragraph 55 of the draft Guideline** It is submitted that at least the first and third factors listed in paragraph 55 of the draft Guideline will be present in any underwritten DRP. Yet, as a general proposition, an underwritten DRP is prima facie in scope of scenario 2 of the green zone. It is stated as a conclusion, without any further elaboration, that there is 'an absence of clear and genuine commercial purpose for the features of the arrangement'. We suggest that to better understand the relevant borderline here, that in the final Guideline, there also be a variation of the facts for Example 4 to provide indications of when an underwritten DRP will not fall foul of this absence of commercial purpose.	special dividend is being distributed to shareholders, which is essentially funded by the capital raising. Refer to our response in Issue 10 of this Compendium for reasons why we consider Example 4 of the Guideline is in the red zone.

[2] Earnings before interest, taxes, depreciation and amortisation.

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12	**Clarification on factor 2 of the red zone – not consistent with established practice** The matters against which a dividend is to be tested as to whether it is 'unusually large' should be expanded. Scenario 1 of the green zone accepts that an indicator of established practice is consistency of the amount of a dividend, expressed either as: • a percentage of profits or retained earnings, or • a percentage of free cash flow. However, a dividend that is unusually large as compared to dividends in the last 3 years without there being a corresponding increase in profit is in scope of factor 2 of the red zone. We presume such a dividend should not be in scope of factor 2 of the red zone if a dividend is: • unusually large as compared to dividends in last 3 years without there being a corresponding increase in profit • but is similar to dividends in last 3 years as a percentage of free cash flow (or of some other benchmark). However, as we read factor 2 of the red zone, such a dividend is in scope of factor 2 of the red zone.	In the final Guideline, we have updated the wording of factor 2 of the red zone to clarify that a distribution would be considered 'unusually large' where it is either a significantly higher amount, pay-out ratio or percentage of free cash flow when compared to prior dividends paid. The intention is to set out principles that taxpayers can reasonably apply in their circumstances rather than to be overly prescriptive in defining what is unusually large. If a dividend is unusually large in quantum or in terms of pay-out ratio or percentage of free cash flow, factor 2 of the red zone will apply if the dividend is not proportionate to an increase in profits. As outlined in paragraph 84 of the final Guideline, all red zone factors need to apply in order for the arrangement to be considered in the red zone. The fact that a company does not have an established practice of making distributions or makes an unusually large distribution that is not consistent with the ordinary distribution practice of the entity, does not by itself mean that section 207-159 will apply to an arrangement.
13	**Scenario 5 of the green zone: Example 8 suggestions** It is not clear in scenario 5 of the green zone or Example 8 of the draft Guideline as to what is the relevant definition of 'private company'. Is it the tax law definition, listed, other? By contrast, other parts of the draft Guideline refer to ASX-listed companies.	In the final Guideline, we have added footnote 9 to clarify that the term 'private company', for the purposes of the Guideline, takes its meaning from section 103A of the *Income Tax Assessment Act 1936* (ITAA 1936).
14	**Established practice where distributions were made to comply with Division 7A requirements** The submitter recommends the final Guideline also state that if the amount of the dividend is one that is paid in order to comply with Division 7A (that is, the minimum yearly repayment formula in section 109E of the ITAA 1936) this should also be considered to be consistent and able to support the conclusion that the dividend is one consistent with an established practice.	We consider Division 7A offsetting arrangements of the type described should not be excluded when determining whether the first criterion (conditions in paragraph 207-159 (1)(a)) applies. If a company regularly makes shareholders loans for which repayments are funded by offsetting dividends, it may be able to demonstrate that first criterion does not apply. However, if such dividends are irregular or ad hoc, it would be appropriate to consider the other relevant criteria,

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	The submitter notes that Division 7A loans are commonly dealt with by way of dividend and set-off and driven by the statutory formula. These are genuine established practices adopted by private companies who commonly pay dividends for these reasons as opposed the reasons that large listed companies pay dividends (that is, a closely-held company is not motivated by a need to keep investors happy and create demand for their stock). The final Guideline should acknowledge and recognise that closely held companies establish dividend practices for vastly different reasons to widely held public companies and would not be expected to adopt similar metrics in order to establish a practice of paying dividends of a particular kind. To the extent that a private company has a history of paying dividends for Division 7A compliance (even if such dividends are ad-hoc) this would be considered an established practice. **Practice established by other group entities** The submitter suggests that the practice established by other entities in the same group should be taken into account as a relevant consideration. If too strict an interpretation was taken, this would disadvantage newly established entities (in non-consolidated groups) that may merely act as another vehicle that otherwise carries out the group's overall objectives. An example may be where a holding company is interposed (for example, pursuant to a Division 615 roll-over). If that holding company immediately adopts a practice consistent with the original company, it should be considered to have that practice from inception, rather than having to wait over 3 years before it can be covered by scenario 1 of the green zone. Likewise, a group may establish a new company for each project or separate location it expands to. Such entities should also be able to benefit from the group's existing dividend practice rather than having to wait 3 years. For example, the new company may immediately start paying dividends using the exact same frequency and exact same metric (for example, percentage of free cash flow) as all other companies in the group that conduct the same kind of activity.	specifically the third criterion – the principal effect and purpose of funding a substantial part of the distribution. Additionally, we acknowledge the dividend practices in the private groups sector are influenced by a range of factors. While this may make it difficult to assess the conditions in paragraph 207-159(1)(a), as outlined in paragraph 14 of the final Guideline, this is only one of the criteria that is taken into account in determining whether the integrity measure applies. Having regard to the dividend practice of other entities will not be considered as relevant, as the condition provided in subparagraph 207-159(1)(a)(i) explicitly refers to the dividend practice of *the entity.* However, we would consider all relevant facts and circumstances in applying the legislation, including in considering the principal effect and purpose test.
15	**Third criterion – 'any other relevant consideration'**	We do not consider that the tax consequences for the shareholder will, of itself, be a sufficient basis for establishing an additional green zone scenario.

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	The final Guideline should state that tax outcomes will be considered as a relevant consideration for the Commissioner in allocating compliance resources. There should be an additional green zone scenario stating that distributions taxed at the top marginal rate are at low risk of the Commissioner having cause to allocate compliance resources, for example, in a closely held companies context, most shareholders would have marginal tax rate greater than or equal to the corporate tax rate. Such structures generally often prefer to reinvest profits at the corporate tax rate rather than accelerate the early release of franking credits. **Commercial purpose of the equity issuance and use of funds** Where all eligible shareholders have a tax rate that is equal to or greater than the corporate tax rate, and no losses are utilised against the distribution, the final Guideline should comment that these are factors that make it less likely that the Commissioner will dedicate compliance resources to their arrangements. Where there is an absence of any apparent tax benefits, it should be presumed that there is a commercial purpose for the arrangement. For example, internal transactions such as the refinancing and consolidation of intra-group loans and unpaid present entitlements between group members are ordinary transactions commonly done for commercial reasons, such as simplifying structures and administration of the group, protecting entities at risk of being sued and compliance with banking covenants. As dividends are often required to be paid in order to facilitate Division 7A loan repayments, we believe that this is a critical safe harbour that is required in the final Guideline.	However, when determining whether to apply compliance resources, all facts will be considered on a case-by-case basis. In the context of a private company, the overall tax consequences from the arrangement (such as whether all eligible shareholders have a tax rate that is equal to or greater than the corporate tax rate with losses not being utilised against the distribution, with the arrangement not having the effect of liberating franking credits that would otherwise be trapped), may be considered (but not in isolation) when determining whether we apply our compliance resources.