

TD 2007/D15 - Income tax: can section 23AJ of the Income Tax Assessment Act 1936 apply to a dividend paid by a company (not being a Part X Australian resident) to the trustee of a trust, which then pays it to an Australian resident company beneficiary?

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This document has been finalised by TD 2008/25.

 There is a Compendium for this document: **TD 2008/25EC** .



Draft Taxation Determination

Income tax: can section 23AJ of the *Income Tax Assessment Act 1936* apply to a dividend paid by a company (not being a Part X Australian resident) to the trustee of a trust, which then pays it to an Australian resident company beneficiary?

❗ This publication provides you with the following level of protection:

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. No. Section 23AJ of the *Income Tax Assessment Act 1936* (ITAA 1936)¹ cannot apply to a dividend when it is paid by a company (not being a Part X Australian resident) to the trustee of a trust, which then pays it to an Australian resident company beneficiary.

Date of effect

2. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraph 75 to 77 of Taxation Ruling TR 2006/10).

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

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Commissioner of Taxation

26 September 2007

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Explanation

3. Section 23AJ of the ITAA 1936 provides that:

A non-portfolio dividend (as defined in section 317) paid to a company is not assessable income, and is not exempt income, of the company if:

- (a) the company is an Australian resident and does not receive the dividend in the capacity of a trustee; and
- (b) the company that paid the dividend is not a Part X Australian resident (as defined in that section).

Non-portfolio-dividend

4. A dividend paid to a company, in its capacity as a trustee of a trust, is not a non-portfolio dividend as defined in section 317. Therefore, section 23AJ does not apply to the dividend.

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

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

6. Subsection 160AFB(4) provides that a company shall be taken to have a voting interest in another company, if the first-mentioned company is the 'beneficial owner' of shares in the other company that carry the right to exercise any of the voting power in that other company. The phrase 'beneficial owner' is not defined for the purposes of section 160AFB. Accordingly, the phrase 'is to be construed in context and must reflect the purposes of the section in which it occurs.'³

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

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

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

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

9. The trustee is not the beneficial owner of shares for the purposes of section 160AFB if the shares are trust property. The shares are held by the legal owner (the trustee) for the benefit of others (the beneficiaries). Accordingly, the trustee does not have the requisite voting interest in the company paying the dividend, and the dividend is not a non-portfolio dividend.

10. Even if a dividend paid to a company in its capacity as trustee of a trust was a non-portfolio dividend, section 23AJ does not apply to a dividend, in any event, because paragraph 23AJ(a) requires that the company receiving the non-portfolio dividend not do so in its capacity as a trustee of a trust.

Trusts taxed like companies

11. Divisions 6B and 6C of the ITAA 1936, contain provisions which modify the income tax provisions in respect of the taxation of corporate unit trusts⁴ (or the trustee thereof) and public trading trusts⁵ (or trustee thereof). Section 102L of the ITAA 1936 specifies when a reference to a company includes a corporate unit trust or a corporate unit trustee. Likewise, section 102T of the ITAA 1936 specifies when a reference to a company will include a public trading trust or a trustee of the public trading trust. Neither section specifies that the reference to the company that is paid a dividend in section 23AJ of the ITAA 1936 includes a corporate unit trustee and public unit trustee. The definition of 'company' in subsection 6(1) of the ITAA 1936 or section 995-1 of the *Income Tax Assessment Act 1997* does not expressly include a corporate unit trustee or public unit trustee such that the reference to the company that is paid a dividend in section 23AJ of the ITAA 1936 would include these types of trustees. Therefore, the express exclusion in section 23AJ of the ITAA 1936 which applies to a dividend paid to a company, in its capacity as trustee, applies to a dividend paid to a trustee of a corporate unit trust or a trustee of a public trading trust.

⁴ As defined in section 102J.

⁵ As defined in section 102N.

Trusts that are part of consolidated groups

12. Where a dividend is paid in respect of shares which are held by a corporate trustee that is part of a consolidated group, and all the beneficiaries of the trust are members of the same consolidated group, the dividend can be a non-portfolio dividend. When a group of entities consolidates for tax purposes, the single entity rule (SER)⁶ applies to deem the head company to own the assets of the subsidiary members. As a consequence, when the trust and the trustee are part of the same consolidated group, the head company will be taken to have full ownership of the shares legally owned by the trustee, meaning all the rights associated with ownership of the shares are held by the head company for its own benefit. Accordingly, the head company will be taken to be the beneficial owner of the shares, and can have the relevant voting interest required under the definition of non-portfolio dividends in section 317.

13. The dividend will also be taken to have been paid to a company for the purposes of section 23AJ. The SER operates to deem the dividend paid to the trustee to have been paid to the head company. As a result the dividend can be non-assessable non-exempt income of the head company.

⁶ Contained within section 701-1 of the *Income Tax Assessment Act 1997*.

Appendix 2 – Alternative views

❶ *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.*

Alternative views

14. It has been argued that section 23AJ can apply to a dividend that is paid by a company (not being a Part X Australian resident company) to the trustee of a trust which then pays it to an Australian resident company beneficiary, provided that the dividend would have qualified as a non-portfolio dividend if it had been paid directly to the Australian resident company. The argument is that, in these circumstances, the dividend has 'in substance' or 'indirectly' been paid by the company (not being a Part X Australian resident company) to the corporate beneficiary.

15. The Commissioner does not accept this argument. The fact that the dividend has been paid to a trustee, the registered owner of the shares, cannot be ignored for the purposes of section 23AJ. When there is an interposed trust estate between the paying company and the Australian resident company beneficiary, it is the trustee and not the corporate beneficiary who receives the dividend. *Federal Commissioner of Taxation v. Angus*⁷ is authority for the proposition that what the beneficiary receives is not a dividend, but rather a distribution of trust income. Accordingly the requirement in section 23AJ that a dividend be paid to a company is not satisfied. Even where the dividend is paid in respect of shares held by a trustee of a bare trust, or paid in respect of shares held by a trustee as nominee for a resident company which is the sole beneficiary of the trust, the dividend is still paid to the trustee.

⁷ (1961) 105 CLR 489.

Appendix 3 – Your comments

16. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: the Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date: 26 October 2007

Contact officer: Helene Aubernon

E-mail address: helene.aubernon@ato.gov.au

Telephone: (08) 8208 1842

Facsimile: (08) 8208 1898

Address: Australian Taxation Office
International Centre of Expertise
Law and Practice
GPO Box 800
Adelaide SA 5001

References

Previous draft:

Not previously issued as a draft

Subject references:

- beneficial owner
- company
- consolidated group
- corporate unit trust
- head company
- non-assessable non-exempt income
- non-portfolio dividend
- public trading trust
- public unit trust
- resident
- single entity rule

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 23AJ
- ITAA 1936 23AJ(a)
- ITAA 1936 Div 6B
- ITAA 1936 102J
- ITAA 1936 102L
- ITAA 1936 Div 6C
- ITAA 1936 102N

- ITAA 1936 102T
- ITAA 1936 Div 18
- ITAA 1936 160AFB
- ITAA 1936 160AFB(4)
- ITAA 1936 Pt X
- ITAA 1936 317
- ITAA 1997 701-1
- ITAA 1997 995-1

Case references:

- Federal Commissioner of Taxation v. Angus (1961) 105 CLR 489; (1961) 12 ATD 277; [1961] ALR 484; (1961) 35 ALJR 36
- Federal Commissioner of Taxation v. Linter Textiles Australia Ltd (in liq) [2005] HCA 20; 2005 ATC 4255; (2005) 215 ALR 1; (2005) 220 CLR 592; (2005) 59 ATR 177; (2005) 79 ALJR 913

Other references:

- Tax Laws Amendment (2007 Measures No. 4) Bill 2007

ATO references

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