


TD 2013/D10 - Income tax: does a franking credit arise in the franking account of a head company of a consolidated group when a franked distribution is made by an entity that is not a member of the consolidated group to a trust that is a subsidiary member of the consolidated group?

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This document has been finalised by TD 2014/8.



Draft Taxation Determination

Income tax: does a franking credit arise in the franking account of a head company of a consolidated group when a franked distribution is made by an entity that is not a member of the consolidated group to a trust that is a subsidiary member of the consolidated group?

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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.

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Ruling

1. Yes. Provided the head company is entitled to a tax offset under Division 207 of the *Income Tax Assessment Act 1997* (ITAA 1997)¹ because of the franked distribution, a franking credit will arise in the head company's franking account on the day on which the distribution is made.

2. Note that this draft Determination does not apply where the head company is a life insurance company (as defined in subsection 995-1(1)), or is treated as if it were a life insurance company by section 713-505, and:

- the head company is a mutual insurance company as defined in section 121AB of the *Income Tax Assessment Act 1936* (ITAA 1936), or
- the tax offset under Division 207 to which the head company is entitled because of the franked distribution is subject to the refundable tax offset rules in Division 67.

¹ All legislative references are to the ITAA 1997, unless otherwise indicated.

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Example

3. *Head Co is the head company of a consolidated group.² Head Co is not a life insurance company (nor treated as if it is a life insurance company). Trust T is a subsidiary member of the consolidated group.³*

4. *A public company, Z Co, that is not a member of the consolidated group, makes a franked distribution to Trust T on 30 April 2013. The amount of the franking credit on the distribution is \$3,000. Head Co is entitled to a tax offset of \$3,000 under Division 207 of the ITAA 1997.*

5. In these circumstances, a credit of \$3,000 arises in Head Co's franking account on 30 April 2013.

Note: this draft Determination equally applies to the franking account of a head company of a (MEC) multiple entry consolidated group.

Date of effect

6. 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 paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

11 December 2013

² Head Co meets the requirements of a head company under item 1 of the table in subsection 703-15(2).

³ Trust T meets the requirements of a subsidiary member under item 2 of the table in subsection 703-15(2).

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

7. Division 205 contains provisions that create a franking account for a corporate tax entity and identify when franking credits and debits arise in that account. One example of when a franking credit may arise in a corporate tax entity's franking account is where that entity receives a franked distribution from another corporate tax entity.⁴

8. Section 205-10 provides that each entity that is, or has been, a corporate tax entity has a franking account. Section 960-115 defines a corporate tax entity to be an entity that is:

- a company,⁵
- a corporate limited partnership,
- a corporate unit trust, or
- a public trading trust.

9. Whilst the head company of a consolidated group is a corporate tax entity as so defined, a trust that is a subsidiary member of the consolidated group – unless they are a corporate unit trust or a public trading trust – is not. And even if the trust is (or has been) a corporate tax entity as defined, section 709-65 provides that its franking account does not operate whilst it is such a subsidiary member. Accordingly, the head company is the only member of a consolidated group which has an operating franking account.

10. Under the single entity rule (SER) in subsection 701-1(1), a consolidated group is treated as a single entity for relevant income tax purposes. The SER provides that subsidiary members of a consolidated group are taken for 'head company core purposes' and 'entity core purposes' to be parts of the head company, rather than separate entities, during the period they are subsidiary members.

11. Head company core purposes and entity core purposes are defined in subsections 701-1(2) and (3) as working out the head company's and the subsidiary's liability for income tax or loss (core purposes). Moreover, it is the Commissioner's view that core purposes include all matters incidental and relevant to those calculations.⁶

⁴ See subsection 205-5(2) and item 3 of the table in subsection 205-15(1) (or item 5 of the table in subsection 219-15(2) where the franked distribution is made to a life insurance company).

⁵ A reference to a company excludes a company acting in the capacity of a trustee: Subsection 960-100(4). A reference to a company includes a reference to a corporate unit trust or public trading trust which met the requirements in section 713-130 and made a choice under section 703-50 to form a consolidated group: Section 713-135.

⁶ See paragraph 4 of Taxation Ruling TR 2004/11 *Income tax: consolidation: the meaning and application of the single entity rule in Part 3-90 of the Income Tax Assessment Act 1997*.

12. Under the SER, a franked distribution made by an entity that is not a member of the consolidated group to a subsidiary member of the consolidated group is treated, for core purposes, as though it was made to the head company. Particular imputation provisions clearly have a core purpose. For example, under section 207-20, an entity receiving a franked distribution is required to include the amount of the franking credit on the distribution in its assessable income and is entitled to a tax offset equal to the franking credit on the distribution.⁷ This is relevant for the determination of taxable income and ultimately income tax liability, and therefore falls within subsections 701-1(2) & (3).

13. The crediting of a corporate tax entity's franking account pursuant to section 205-15⁸ is a necessary incident of it receiving a franked distribution. As the head company is treated as the recipient of a franked distribution made by an entity that is not a member of the consolidated group to a subsidiary member, it is the head company which needs to credit its franking account. Determining this under the SER enables all imputation consequences of receipt of a franked distribution to be ascertained having regard only to one entity, namely the head company.

14. Whilst the SER does not affect the application of the income tax law to an entity that is not a member of the consolidated group,⁹ the act of crediting the head company's franking account does not of itself affect the income tax position of its shareholders. It is not until a subsequent event where the head company makes a franked distribution to its shareholders that those entities' income tax position is affected. The mere potential that its shareholders' income tax position will be affected in the future is not sufficient to disregard the SER for the purposes of determining whether a credit arises in the head company's franking account as a necessary incident of it being taken to be the entity in receipt of the relevant franked distribution.

15. Provided the head company is entitled to a tax offset under Division 207 because of a franked distribution it is taken under the SER to have received,¹⁰ the other requirements in item 3 of the table in subsection 205-15(1) will be satisfied,¹¹ given that:

- a franked distribution is (taken to be) made to the head company,
- the head company is an Australian resident for the income year in which the distribution is made,¹² and
- the head company is a franking entity when it is taken to receive the distribution.

⁷ Actual entitlement to such a tax offset however will depend on satisfaction of relevant integrity rules, such as those contained in Subdivision 207-F.

⁸ Or section 219-15 for a life insurance company or an entity treated by section 713-505 as if it were a life insurance company.

⁹ See paragraph 12 of TR 2004/11.

¹⁰ Division 207 contains a number of integrity rules which may deny the head company's entitlement to a tax offset in relevant circumstances. See in particular Subdivision 207-F.

¹¹ If the head company is a life insurance company, or is treated as a life insurance company under section 713-505, the relevant requirements for a credit (if any) to arise in the head company's franking account are in item 5 of the table in subsection 219-15(2).

¹² Note that paragraph 205-25(1)(a) generally requires the head company to have been an Australian resident for at least half of the relevant income year.

16. Under item 3 of the table in subsection 205-15(1),¹³ the credit arises in the franking account on the day on which the distribution is made. Therefore a franking credit can arise in the head company's franking account on the day the franked distribution is made to a trust that is a subsidiary member of the consolidated group.

Exclusions

17. A life insurance company that is a mutual insurance company as defined in section 121AB of the ITAA 1936 is not a franking entity.¹⁴ Accordingly, this draft Determination does not apply where such an entity is the head company of the relevant consolidated group.

18. Where the head company is a life insurance company (or is treated as such by section 713-505) and the tax offset under Division 207 to which it is entitled because of the franked distribution is subject to the refundable tax offset rules in Division 67, its franking account is not credited when it receives a franked distribution.¹⁵ Accordingly, this draft Determination also does not apply in these circumstances.

¹³ Or item 5 of the table in subsection 219-15(2), where the head company is a life insurance company (or treated by section 713-505 as if it is a life insurance company) and the offset is not subject to the refundable tax offset rules.

¹⁴ See paragraph 202-15(b).

¹⁵ See item 5 of the table in subsection 219-15(2).

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

19. There is an alternative view that the SER does not apply for purposes of crediting franking accounts. Under this view, other provisions will need to be relied upon to determine whether a credit arises in the head company's franking account where a franked distribution is made by an entity that is not a member of the consolidated group to a trust that is a subsidiary member of the consolidated group (trust member).

20. Section 709-70 is a particular provision which enables the head company's franking account to be credited if a credit would have otherwise arisen in the franking account of a subsidiary member of the consolidated group, had it been operational.¹⁶

21. Accordingly, under this alternative view, where the trust member in receipt of the franked distribution is a corporate tax entity (such as a public unit trust or corporate trading trust) when that distribution is made, section 709-70 would generally enable the head company's franking account to be credited. However, where the trust member is not (and has not been) a corporate tax entity, section 709-70 has no application as such a trust member does not itself have a franking account.¹⁷ Under this alternative view, whether a credit arises in the head company's franking account when the franked distribution is received by such a trust member will instead depend on whether the franked distribution flows indirectly from the trust member to any other member of the consolidated group.

22. In broad terms, where a franked distribution flows indirectly to the beneficiary of a trust, Subdivision 207-B works out that beneficiary's share of the franking credit and generally entitles the beneficiary to a tax offset equal to that share. Where that beneficiary is a franking entity when the distribution was made and is entitled to a tax offset under Division 207 because of the distribution, item 4 of the table in subsection 205-15(1) in turn credits the beneficiary's franking account with their share of the franking credit.¹⁸

23. Accordingly, under this alternative view, where the franked distribution flows indirectly to the head company of the consolidated group, a credit equal to its share of the franking credit arises in the head company's franking account in accordance with item 4 of the table in subsection 205-15(1).¹⁹

¹⁶ Section 709-65 provides that the franking accounts of subsidiary members do not operate whilst they are part of a consolidated group.

¹⁷ Where the trust member was formerly a corporate unit trust or a public trading trust and has not chosen under section 703-50 to be the head company of a group it consolidated, it will have a franking account, but will not be a franking entity as defined in section 202-15. Consequently it will not be able to credit its franking account.

¹⁸ Or item 6 of the table in subsection 219-15(2), where the beneficiary is a life insurance company (or treated by section 713-505 as if it is a life insurance company) and the offset is not subject to the refundable tax offset rules.

¹⁹ Or item 6 of the table in subsection 219-15(2), where the head company is a life insurance company (or treated by section 713-505 as if it is a life insurance company) and the offset is not subject to the refundable tax offset rules.

24. If the franked distribution instead flows indirectly to a different subsidiary member of the group that is a corporate tax entity ('subsidiary corporate beneficiary') when the distribution is made, for the reasons given in paragraph 22 of this draft Determination, under this alternative view a credit would arise in the subsidiary corporate beneficiary's franking account if it were operational. Consequently, under this alternative view a franking credit of the same amount arises in the head company's franking account under section 709-70.

25. However, under this alternative view if the franked distribution does not flow indirectly to the head company or a subsidiary corporate beneficiary (for example, if the trust does not have net income in the income year the franked distribution is received), no amount will be credited to the head company's franking account.

26. The Commissioner does not consider this alternative view to be available for a number of reasons, including the following:

27. Firstly, a franked distribution can only flow indirectly to the head company or a subsidiary corporate beneficiary under section 207-50 if that beneficiary has a share of the trust's 'net income'. To have 'net income' for an income year the trust would need to have assessable income for the income year. As a subsidiary member of the consolidated group, the trust does not have assessable income or deductions. Consequently it is difficult to see how the requirements for an amount to be credited to the head company's franking account would ever be satisfied.

28. Secondly, the fact that the franking credits on distributions received by subsidiary members that are trusts would therefore be effectively lost seems to run contrary to the general principles of the imputation system. That is, a company assessed in respect of a franked distribution ought to generally be entitled to credit its franking account provided the requirements in subsection 205-15(1)²⁰ are satisfied.

²⁰ Or subsection 219-15(2) if the company is a life insurance company or treated by section 713-505 as if it is a life insurance company.

Appendix 3 – Your comments

29. You are invited to comment on this draft Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

30. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	24 January 2014
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2004/11; TR 2006/10

Subject references:

- consolidated group
 - consolidation - franking
 - consolidation – membership
 - consolidation – multiple entry consolidated group
 - corporate tax entity
 - corporate unit trusts
 - franked dividends
 - franking accounts
 - franking credits
 - head company
 - imputation system
 - life insurance company
 - mutual insurance associations
 - net income of a trust
 - public trading trusts
 - rebates and offsets
 - shareholders
 - single entity rule
 - subsidiary member of a consolidated group
 - trust distributions
 - trusts
- ITAA 1997 Div 67
 - ITAA 1997 202-15
 - ITAA 1997 202-15(b)
 - ITAA 1997 Div 205
 - ITAA 1997 205-5(2)
 - ITAA 1997 205-10
 - ITAA 1997 205-15
 - ITAA 1997 205-15(1)
 - ITAA 1997 205-25(1)(a)
 - ITAA 1997 Div 207
 - ITAA 1997 207-20
 - ITAA 1997 Subdiv 207-B
 - ITAA 1997 Subdiv 207-F
 - ITAA 1997 207-50
 - ITAA 1997 219-15
 - ITAA 1997 219-15(2)
 - ITAA 1997 701-1(1)
 - ITAA 1997 701-1(2)
 - ITAA 1997 701-1(3)
 - ITAA 1997 703-15(2)
 - ITAA 1997 703-50
 - ITAA 1997 709-65
 - ITAA 1997 709-70
 - ITAA 1997 713-130
 - ITAA 1997 713-135
 - ITAA 1997 713-505
 - ITAA 1997 960-100(4)
 - ITAA 1997 960-115
 - ITAA 1997 995-1(1)
 - ITAA 1936 121AB

Legislative references:

- ITAA 1997

ATO references

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