TA 2015/2 - Franked distributions funded by raising capital to release franking credits to shareholders

From 28 November 2023, section 207-159 of the *Income Tax Assessment Act 1997* applies to prevent certain distributions funded by capital raising from being frankable. This provision is intended to address the concerns raised in this Alert.

This document has changed over time. This version was published on *28 November 2023*

Australian Government
Australian Taxation Office

Taxpayer Alert

TA 2015/2

Franked distributions funded by raising capital to release franking credits to shareholders

From 28 November 2023, section 207-159 of the *Income Tax Assessment Act 1997* applies to prevent certain distributions funded by capital raising from being frankable. This provision is intended to address the concerns raised in this Alert.

This Alert provides a summary of our concerns about a significant or emerging higher risk tax or superannuation issue that we currently have under risk assessment.

Refer to PS LA 2008/15 for more about Alerts. See Alerts issued to date.

Description

We are currently reviewing arrangements which display all or most of the following features:

- A company with a significant franking credit balance raises new capital from existing or new shareholders. This may occur through issuing renounceable rights to shareholders. Shareholders may include large institutional superannuation funds.
- At a similar time to the capital raising, the company makes franked distributions to its shareholders, in a similar amount to the amount of capital raised. This may occur as a special dividend or through an off-market buy-back of shares, where the dividend forms part of the purchase price of the shares.
- Overall:
    a. there is minimal net cash inflow to or outflow from the company
    b. the net asset position of the company remains essentially unchanged (in a buy-back variant, the number of shares on issue following the transaction may be marginally reduced due to the difference between the buy-back price and the issue price of the new shares) but their franking account is significantly reduced, and
    c. there is minimal impact on the shareholders, except in some cases they may receive refunds of franking credits, and in the case of buy-backs they may also get improved capital gains tax outcomes.
- The franked distributions (or franked component of buy-back consideration) may be unusually large compared to ordinary dividends previously declared and paid by the company (as distinct from a typical dividend reinvestment plan applicable to an ordinary regular dividend).

- The franked distribution may be receivable by all existing shareholders of the company, or shareholders may have a choice as to whether to participate (for example, in a buy-back scenario).

What are our concerns?

We are concerned that the arrangement is being used by companies for the purpose of, or for purposes which include, releasing franking credits or streaming dividends to shareholders. This may attract the operation of the anti-avoidance rule in section 177EA of the *Income Tax Assessment Act 1936* or other anti-avoidance rules. One immediate purported effect of these arrangements is the release of franking credits that may otherwise have been retained by the company.

If section 177EA (or other anti-avoidance rules) applies to an arrangement, there may be adverse implications at the shareholder level and the corporate level.

What are we doing?

We are currently reviewing these arrangements and are engaging in discussions with taxpayers. We are developing our technical position on the arrangements.

What should you do?

If you have entered into, or are contemplating entering into, an arrangement of this type we encourage you to discuss your situation with us by emailing PGI Advice.

Penalties may apply to participants and promoters of this type of arrangement.

Date issued:	**7 May 2015**