

TD 2008/25 - 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, even where the trustee then pays an amount attributable to the dividend to an Australian resident company beneficiary?

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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, even where the trustee then pays an amount attributable to the dividend to an Australian resident company beneficiary?

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant 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. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Ruling

1. No. Section 23AJ of the *Income Tax Assessment Act 1936* (ITAA 1936)¹ does not apply to a dividend when it is paid by a company (not being a Part X Australian resident) to the trustee of a trust, even where the trustee then pays an amount attributable to the dividend to an Australian resident company beneficiary. However, section 23AJ will apply to a dividend that is paid to a trust which is part of a consolidated group or a multiple entity consolidated (MEC) group.

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

Date of effect

2. This Determination applies to years of income commencing both before and after its date of issue. However, the Determination does 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 77 of Taxation Ruling TR 2006/10 Income tax, fringe benefits and product grants and benefits: Public Rulings).

Commissioner of Taxation

13 August 2008

Appendix 1 – Explanation

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

Explanation

3. Section 23AJ 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).

4. Section 23AJ was originally introduced to reduce compliance costs for any Australian resident company entitled to a foreign tax credit under section 160AFC for underlying tax paid by a foreign company. Section 23AJ exempted the dividend² from income tax in circumstances where a foreign tax credit would otherwise have been allowed. The section was introduced as an adjunct to the foreign tax credit system in former Division 18 of Part III, and as a result, the section relies on the former foreign tax credit provisions and the controlled foreign company (CFC) provisions in Part X (which was introduced concurrently) for its concepts and definitions.

Non-portfolio-dividend

5. A dividend paid³ 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 cannot apply to the dividend.

6. 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 334A,⁴ amounting to at least 10% of the voting power, within the meaning of that section, in the company paying the dividend;

7. Subsection 334A(1) 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, and there is no arrangement in force which would allow any person to affect those rights. The phrase 'beneficial owner' is not defined for the purposes of section 334A. Accordingly, the phrase 'is to be construed in context and must reflect the purposes of the section in which it occurs'.⁵

² Both section 23AJ of the ITAA 1936 and the definition of non-portfolio dividend in section 317 of the ITAA 1936 rely on the definition of dividend contained in subsection 995-1(1) of the Income Tax Assessment Act 1997 (ITAA 1997) which extends the general law meaning of dividend. The general law meaning of dividend implies that a company/shareholder relationship exists: *Federal Commissioner of Taxation v. Patcorp Investments Pty Ltd* (1976) 140 CLR 247 at 303.

³ Subsection 6(1) defines 'paid', in relation to dividends or non-share dividends, to include credited or distributed.

⁴ The definition of 'non-portfolio dividend' was amended by *Tax Laws Amendment (2007 Measures No. 4) Act 2007*, by substituting 'section 334A' for 'section 160AFB', applicable in relation to income years, statutory accounting periods and notional accounting periods starting on or after the 1 July 2008.

⁵ *Commissioner of Taxation (Cth) v. Linter Textiles Australia Ltd (in liq)* (2005) 2005 ATC 4255 at 4263.

8. The definition of voting interest currently in section 334A was moved from former section 160AFB which provided the rules for grouping an Australian resident company with related foreign companies for the purposes of former Division 18 of Part III. When former 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. Former section 160AFB, when construed in context, was intended to ensure that an Australian resident company would only be entitled to a foreign tax credit for the underlying tax paid by a foreign company, 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.

9. Having regard to the context of former section 160AFB, the Commissioner considers that a company will be the beneficial owner of shares for the purposes of subsection 334A(1) when it holds the bundle of rights associated with ownership of those shares for its own benefit, and not for the benefit of others.⁶ By construing the phrase in this way, the original intention of former Division 18 of Part III 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.

10. The trustee is not the beneficial owner of shares for the purposes of section 334A(1) 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.

11. 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 the dividend in any event because paragraph 23AJ(a) expressly requires that the company receiving the non-portfolio dividend not do so in its capacity as a trustee of a trust. Therefore, section 23AJ will not apply even where the dividend is paid to a corporate nominee or a corporate trustee in respect of shares held in a bare trust for the benefit of a corporate beneficiary.

Dividend is taken to be paid to the trustee, not the beneficiary

12. It has been argued that section 23AJ should apply to a dividend that is paid by a company (not being a Part X Australian resident company) to the trustee of a trust who then pays it to an Australian resident company beneficiary, provided the dividend would have been a non-portfolio dividend had it been paid directly to the Australian resident company. It is said 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, thereby satisfying the requirement in section 23AJ that the dividend be paid to a company.

⁶ See *Wood Preservation Ltd v Prior* [1969] 1 All ER 364; *Ayerst (Inspector of Taxes) v C&K (Construction) Ltd* [1976] AC 167; *J Sainsbury PLC v O'Connor (Inspector of Taxes)* [1991] 1 WLR 963; *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (in liq)* (2005) 220 CLR 592.

13. The Commissioner does not accept this argument because the dividend is not paid to the corporate beneficiary in the sense required by section 23AJ. The ordinary meaning of the term 'paid' in relation to dividends or non-share dividends is extended by the definition of 'paid' in subsection 6(1) to include credited or distributed. The term 'paid' is the past tense of 'pay'. The term is defined in the *Macquarie Dictionary* as meaning 'gave (money, etc.) in discharge of debt or obligation'.⁷ In the context of section 23AJ, the Commissioner considers that the term 'paid' should be construed in accordance with its extended meaning to mean give, credit or distribute an amount to discharge a debt or obligation. Therefore the dividend is taken to be paid, for the purposes of section 23AJ, to the person who is entitled to receive the dividend in satisfaction of an obligation or a debt. This would be the registered shareholder, namely, the trustee. Even where the trustee directs that the dividend be made over directly to the corporate beneficiary, the dividend is not paid to the corporate beneficiary in the requisite sense because there is no debt or obligation on the part of the paying company to the corporate beneficiary.

14. The express exclusion in section 23AJ that precludes the section from applying to a dividend paid to a company in its capacity as trustee provides statutory support for the view that for the purposes of section 23AJ a dividend is taken to be paid to the person with the right to be paid the dividend, rather than the person who could be regarded as having been paid 'in-substance'.

Bare trusts

15. Another argument that has been put to the Commissioner is that section 23AJ should apply to a dividend paid to a person acting as a nominee for a company or paid to a trustee of a bare trust where the beneficiary is a company.⁸ The argument is based on the view that the company is the beneficial owner of the shares in the foreign company paying the dividend for the purposes of section 334A(1), and therefore the dividend would be a non-portfolio dividend. The company is said to be the beneficial owner of the shares because the beneficiary has both a beneficial interest in the trust property and also hold the rights over the shares associated with absolute ownership of the property. Given that the company is the beneficial owner of the shares and ultimately receives the dividend, in terms of policy, the company should be entitled to enjoy the benefit of the exemption under section 23AJ.

16. The Commissioner does not accept this argument primarily because he takes the view that the dividend is not paid to the corporate beneficiary: it is paid to the trustee. Furthermore, the Commissioner considers that what the corporate beneficiary receives does not have the character of a dividend. Rather, it is an amount of trust net income that is attributable to the dividend: *Federal Commissioner of Taxation v. Angus* (1961) 105 CLR 489.

⁷ The Macquarie Dictionary, 2001, rev. 3rd edn, The Macquarie Library Pty Ltd, NSW

⁸ Where the trustee has no interest in the trust assets other than by reason of the office of trustee and the holding of the legal title, and who never has had active duties to perform or who has ceased to have those duties with the result that in either case the property awaits transfer to the beneficiaries at their direction: *Herdegen v. Federal Commissioner of Taxation* (1988) 84 ALR 271; (1988) 88 ATC 4995; (1988) 20 ATR 24.

Trusts taxed like companies

17. Divisions 6B and 6C of Part III of the ITAA 1936, contain provisions which modify the income tax provisions in respect of the taxation of corporate unit trusts⁹ (or the trustee thereof) and public trading trusts¹⁰ (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 subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 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 corporate trustee of a corporate unit trust or a corporate trustee of a public trading trust.

Trusts that are part of consolidated groups or MEC groups

18. Where a dividend is paid in respect of shares which are held by a trust that is a subsidiary member of a consolidated group or a MEC group, the dividend can be a non-portfolio dividend. When a group of entities consolidates for tax purposes, the single entity rule (SER)¹¹ applies to deem the head company to own the assets of the subsidiary members. As a consequence, when a trust is part of a consolidated group, the head company will be taken to have full ownership of the shares, 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.

19. 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.

20. Subdivision 713-C of the ITAA 1997 contains special provisions that allow a corporate unit trust or public trading trust that chooses to form a consolidated group to be treated like the head company of the group, and in turn to be regarded as a company for most income tax purposes. Therefore, although an Australian resident company receiving a dividend in its capacity as trustee of a trust is specifically excluded from section 23AJ of the ITAA 1936, a trustee of a corporate unit trust or public trading trust that has chosen to be the head company of a consolidated group, and in turn to be regarded as a company for most income tax purposes, is not excluded. However, section 23AJ of the ITAA 1936 does not apply to a dividend paid to the trustee of a corporate unit trust or a public trading trust because the dividend will not be a non-portfolio dividend. The trustee is not the beneficial owner of the shares; the shares are held by the trustee for the benefit of the unit holders, who are not part of the consolidated group.

⁹ As defined in section 102J.

¹⁰ As defined in section 102N.

¹¹ Contained within section 701-1 of the ITAA 1997.

Appendix 2 – Alternative views

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

Alternative views

21. It has been argued that the Commissioner's view that section 23AJ does not apply when a partnership or trust is interposed between the foreign company paying the dividend and the Australian resident company results in treatment that is inconsistent with the treatment of foreign branch profits under section 23AH.
22. Section 23AH provides that, subject to certain exceptions, foreign income derived by a company when it is a resident carrying on a business, at or through a permanent establishment of the company in a listed country or an unlisted country is non-assessable, non-exempt income of the company. Subsection 23AH(10) applies to any indirect interest (through one or more partnerships or trusts) of a company in foreign income derived by a partnership or trustee through a permanent establishment of the partnership or trustee in a listed country or unlisted country as if that indirect interest were foreign income derived by the company through a permanent establishment of the company in that country.
23. Section 23AH and section 23AJ were first introduced and subsequently amended simultaneously, but unlike section 23AH, section 23AJ does not specifically provide that a dividend received indirectly by an Australian resident company through one or more interposed partnerships or trust estates could be treated the same way as a dividend received directly by the company. In the absence of a specific provision, it is reasonable to conclude that a dividend paid by a company to a trustee of a trust, and then on-paid as a distribution of net income to another company was not intended to be treated for the purposes of section 23AJ as a dividend paid directly by the first company to second company.

References

Previous draft:

TD 2007/D15

Related Rulings/Determinations:

TD 2008/23; TD 2008/24; TR 2006/10

Subject references:

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

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 23AH
- ITAA 1936 23AH(10)
- ITAA 1936 23AJ
- ITAA 1936 23AJ(a)
- ITAA 1936 Pt III Div 6B
- ITAA 1936 102J
- ITAA 1936 102L
- ITAA 1936 Pt III Div 6C
- ITAA 1936 102N
- ITAA 1936 102T
- ITAA 1936 Pt III Div 18
- ITAA 1936 160AFB
- ITAA 1936 160AFC
- ITAA 1936 Pt IVA
- ITAA 1936 Pt X
- ITAA 1936 317
- ITAA 1936 334A

- ITAA 1936 334A(1)

- ITAA 1997
- ITAA 1997 701-1
- ITAA 1997 Subdiv 713-C
- ITAA 1997 995-1(1)
- International Tax Agreements Act 1953 4
- Tax Laws Amendment (2007 Measures No. 4) Act 2007
- TAA 1953

Case references:

- Ayerst (Inspector of Taxes) v. C&K (Construction) Ltd [1976] AC 167
- Federal Commissioner of Taxation v. Angus (1961) 105 CLR 489; (1961) 35 ALJR 36; [1961] ALR 484; (1961) 12 ATD 277
- Federal Commissioner of Taxation v. Patcorp Investments Ltd (1976) 140 CLR 247; 76 ATC 4225; (1976) 6 ATR 420
- Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (in liq) (2005) 220 CLR 592; [2005] HCA 20; (2005) 2005 ATC 4255; (2005) 59 ATR 177
- Herdegen v. Federal Commissioner of Taxation (1988) 84 ALR 271; (1988) 88 ATC 4995; (1988) 20 ATR 24
- J Sainsbury PLC v. O'Connor (Inspector of Taxes) [1991] 1 WLR 963
- Wood Preservation Ltd v. Prior [1969] 1 All ER 364; [1969] 1 WLR 1077

Other references:

- The Macquarie Dictionary, 2001, rev. 3rd edn, The Macquarie Library Pty Ltd, NSW

ATO references

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