TR 2006/7A1 - Addendum - Income tax: special income derived by a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the year of income

Addendum

Taxation Ruling TR 2006/7

Income tax: special income derived by a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the year of income

This Addendum is a public ruling for the purposes of the *Taxation Administration Act* 1953. It amends Taxation Ruling TR 2006/7 to reflect the decision of the Full Federal Court in *Darrelen Pty Ltd, Trustee of the Henfam Superannuation Fund v FCT* [2010] FCAFC 35 in relation to the factors to be considered by the Commissioner in former subsection 273(2) of the *Income Tax Assessment Act 1936.*

This Addendum also amends Taxation Ruling TR 2006/7 to note that it still applies following the repeal of section 273 of the *Income Tax Assessment Act 1936* to the extent that section 295-550 of the *Income Tax Assessment Act 1997* expresses the same ideas.

TR 2006/7 is amended as follows:

1. Paragraph 1

Insert:

> 1A. Section 273 of the ITAA 1936 was repealed with effect from 1 July 2007. Section 273 has been re-written, with some modifications in section 295-550 of the *Income Tax Assessment Act 1997* (ITAA 1997). To the extent that section 295-550 of the ITAA 1997 expresses the same ideas as section 273 this ruling is also taken to be a ruling about section 295-550 of the ITAA 1997.[A1]
>
> 1B. Section 273(2) provided the Commissioner with a discretion about the treatment of dividends from private companies as special income, having regard to specified factors in paragraphs 273(2)(a) to (f). In contrast, subsection 295-550(2) of the ITAA 1997 does not confer a discretion on the Commissioner. Rather subsection 295-550(2) of the ITAA 1997 has an objective test requiring the amount received to be consistent with an arm's length dealing. However, the factors that need to be considered in applying this test (set out in

[A1] Section 357-85 of Schedule 1 to the *Taxation Administration Act 1953*.

subsection 295-550(3) of the ITAA 1997) are substantively the same as those in subsection 273(2).

1C. Section 295-550 of the ITAA 1997 refers to the income covered by it as 'non arm's-length income'. To the extent that this ruling addresses issues in section 295-550 of the ITAA 1997 that are the same as were in section 273 the references to 'special income' should be read as 'non-arm's length income'.

2. Paragraph 16

Omit the paragraph; substitute:

16. Subsection 273(9) also extends the scope of subsection 273(2). It ensures that subsection 273(2) applies to distributions that are paid by a private company that are not dividends, but are non-share dividends as that term is defined in section 974-120 of the ITAA 1997. Non-share dividends are distributions to holders of equity that are not dividends paid to shareholders.

3. Paragraph 20

Omit the paragraph; substitute:

20. The Commissioner will consider the matters listed in paragraph 273(2)(a) to (d) in comparison with each other. In cases where the dividend paid relates to a share which has a par value, the Commissioner will compare this value with the partly paid value under paragraph 273(2)(a). The cost of the shares considered under paragraph 273(2)(b) will be compared with the market value of the shares at the time of acquisition, which is considered under paragraph 273(2)(a). The rate of dividend considered under paragraph 273(2)(c) will be compared to the rate of dividend paid on any other shares in the company, which is considered under paragraph 273(2)(d).

4. Paragraph 23

Omit the paragraph; substitute:

23. The market value of the shares will also be compared to the rate of return on investment to determine whether the rate of return is consistent with an arm's length outcome. This matter is considered under paragraph 273(2)(f) in determining whether the payment of the dividend is consistent with an arm's length outcome.[A2]

[A2] *Darrelen Pty Ltd, Trustee of the Henfam Superannuation Fund v FCT* [2010] FCAFC 35

5. Paragraph 37

Omit the paragraph; substitute:

> 37. The rate of dividend will be considered in comparison with the rate of dividend paid on any other shares in the company which is considered under paragraph 273(2)(d).

6. Paragraph 38

Omit the paragraph; substitute:

> 38. In *Darrelen Pty Ltd, Trustee of the Henfam Superannuation Fund v FCT* [2010] FCAFC 35 (*Darrelen*), the Full Federal Court held that paragraph 273(2)(c) does not *also* permit reference to the rate of return on the investment. However, the court held that the Commissioner may nonetheless have regard to the rate of return on the investment under paragraph 273(2)(f).

7. Paragraph 39

Omit the first sentence.

8. Paragraph 45

Omit the second sentence; substitute: 'While the dividend yield is high, a $3.85 dividend on a $1.00 share, it reflects the investment risk undertaken by the investors and the growth in the property market.'

9. Paragraph 54

Omit the last two dot points; substitute:

- the relationship between the superannuation fund, ADF or PST and any party with which the private company has dealings;
- who the superannuation fund, ADF or PST acquires the shares from and the circumstances of that acquisition; and
- the rate of return on the superannuation fund's investment.

10. Paragraph 68

Omit the first sentence, substitute: 'While the dividend yield is high, a $3.85 dividend on a $1.00 share, it reflects the investment risk undertaken by the investors and the growth in the property market.'

11. Paragraph 139

Insert footnote at the end of the second sentence:

[1A.] Section 273 of the ITAA 1936 was repealed with effect from 1 July 2007 and has been re-written, with some modifications, in section 295-550 of the ITAA 1997.

12. Paragraph 155

Insert footnote at the end of the paragraph:

[8B.] Subsection 295-550(2) of the ITAA 1997 does not confer a discretion on the Commissioner, but contains an objective test.

13. Paragraph 164

Omit the paragraph.

14. Paragraph 169

Omit the paragraph; substitute:

169. In the ordinary course of events, paragraph 273(2)(a) now obliges the Commissioner to consider the 'value of shares'. The Commissioner will interpret this to mean that regard must be had to the market value of the shares. This becomes especially relevant in comparison to the cost of the shares considered under paragraph 273(2)(b) and the rate of return on investment considered under paragraph 273(2)(f) in determining whether the payment of the dividend is consistent with an arm's length outcome.

15. Paragraph 171

Insert:

171A. The essence of the dispute in *Darrelen* was whether, in exercising his discretion under subsection 273(2), the Commissioner is entitled to have regard to a disparity between the cost and the market value at the time of acquisition, or whether, as the taxpayer argued, the inquiry is limited to whether the dividends themselves were paid on a non-arm's length basis. The court agreed that the Commissioner is entitled to have regard to such disparity. The Court observed that 'the policy underlying s 273, and its predecessors, is to enable the Commissioner to deny the concessional taxation of income which has been diverted from taxpayers not enjoying that status.' In the *Darrelen* case, the court considered that 'the income diversion has occurred by recourse to a non-arm's length transaction on the acquisition of the shares.'

16. Paragraph 172

Omit the first sentence; substitute: 'In accordance with these Board of Review cases and *Darrelen*, and the reasoning found therein, the Commissioner will compare the cost of the shares with the market value of the shares at the time of acquisition.'

17. Paragraph 173

Omit the paragraph; substitute:

> 173. The Commissioner will take a number of factors into consideration in determining whether the rate of the dividend paid is consistent with an arm's length outcome. These may include how the rate of dividend paid compares to the rate paid on other shares in the company.

18. Paragraph 174 and 175

Omit the paragraphs

19. Paragraph 179

Insert:

> 179A. One of these matters is whether the rate of return on investment is consistent with an arm's length outcome when compared with both the cost of the shares and the value of the shares. The comparison to value may be appropriate because a comparison to cost may not be informative in all circumstances. These circumstances include when a share is owned for a long time and the value of the shares has increased substantially, or when the value of the shares increases substantially for some other commercial reason. For these reasons, it may be necessary to compare the rate of return with both the cost of the shares and the value of the shares.
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> 179B. It is not possible to provide a set formula for determining the rate of return on investment which, if exceeded, will result in the Commissioner treating the dividend as special income. Such a formula could not account for all of the variables that the Commissioner is required to consider. The higher the rate of return on investment, the more likely that the private company dividend was not derived on an arm's length basis. It is therefore more likely that the dividend will be special income.
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> 179C. One of the variables that the Commissioner may take into consideration is the level of risk. This may be relevant because the higher the level of risk, the more likely it is that a high rate of return is the result of market forces.

20. Paragraph 180

Omit the first sentence; substitute: 'Another of the relevant matters that the Commissioner may consider is the extent to which the fund is being maintained for employees who are at arm's length from the shareholders of the company.'

21. Legislative References

Insert:

- ITAA 1997 295-550
- ITAA 1997 295-550(2)
- ITAA 1997 295-550(3)

22. Case References

Insert:

- *Darrelen Pty Ltd as trustee of Henfam Superannuation Fund v. FC of T* 2010 ATC 20-180; [2010] FCAFC 35

This Addendum applies both before and after its date of issue.

Commissioner of Taxation
7 December 2011

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