

You and your shares

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2001-02

TAXPACK REFERRED PUBLICATION

NAT 2632—6.2002



Choose **e-tax** for a **faster** refund

How self-assessment affects most individuals

Self-assessment means the Australian Taxation Office (ATO) uses the information you give on your tax return to work out your refund or tax bill. You are required by law to make sure you have shown all your assessable income and claimed only the deductions and tax offsets to which you are entitled.

What are your responsibilities?

Even if someone else—including a tax agent—helps you to prepare your tax return, you are still legally responsible for the accuracy of the information.

What if you lodge an incorrect tax return?

Our systems continually check for missing or wrong information. We have audit programs designed to detect where taxpayers have not declared all their assessable income or where they have incorrectly claimed deductions or tax offsets. If you become aware that your tax return is incorrect, you must contact us straightaway.

Initiatives to complement self-assessment

There are a number of initiatives administered by the ATO which complement self-assessment. Examples include:

- a change in penalty provisions so that if you take reasonable care with your tax affairs, you will not receive a penalty for honest mistakes—but please note that a general interest charge on omitted income or overclaimed deductions and tax offsets could still be payable
- private rulings
- your entitlement to interest on early payment or overpayment of a tax debt
- the process of applying for an amendment if you find you left something out of your tax return.

Do you need to ask for a private ruling?

If you have a concern about the way a tax law applies to your personal tax affairs, you may want to ask for a private ruling.

A private ruling will relate just to your situation. Write to the ATO describing your situation in detail and ask for advice. To do this, complete an *Application for a private ruling for individuals*. If you lodge your tax return before

you receive your private ruling, be aware that the ruling may alter the accuracy of your tax return.

The ATO publishes on its website all private rulings issued. What we publish will not contain anything which could identify you.

You can ask for a review of a private ruling decision if you disagree with it, even if you have not received your assessment. Details of the review procedures are sent to you when the private ruling decision is made. For more information on private rulings, visit the ATO website at <www.ato.gov.au>.

Publications

To get any publication referred to in this book:

- visit the ATO website at <www.ato.gov.au>
- ring our Publications Distribution Service on **1300 720 092** for the cost of a local call or
- visit an ATO office or an ATOaccess site.

Publications referred to in this book include:

- *Application for a private ruling for individuals* (NAT 4106—3.2001)
- *Personal investors guide to capital gains tax* (NAT 4152—6.2002)
- *Guide to the debt and equity tests* (available only on the ATO website)
- *Refund of imputation credits instructions and application* (NAT 4105—6.2002)
- *TaxPack 2002 supplement* (NAT 2677—6.2002)
- *How to claim a foreign tax credit* (NAT 2338—6.2002)
- *Taxation Determination TD 98/11—Income tax: capital gains: when are shares acquired, and instalments paid, under the Commonwealth Bank of Australia (CBA) and Telstra public share offers?*
- *Capital gains tax assets register: a new way of keeping records* (NAT 2684—7.1998).

Feedback

Reader feedback helps us to improve the information we provide. If you have any comments to make about this publication, please write to:

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As this is a publications area only, any tax matters will be passed on to a technical area; otherwise you can ring our Personal Tax Infoline on **13 2861** for help.

You and your shares 2001–02

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About this publication

This publication is available free from the Australian Taxation Office (ATO). The ATO prohibits any party from selling it. We regularly revise our publications to take account of changes to the law.

If you have an enquiry relating to your circumstances which this publication does not cover, ring the Personal Tax Infoline on **13 2861** or get help from a tax adviser.

As part of our commitment to produce accurate publications, taxpayers will not be subject to penalties if they can demonstrate that they based a tax claim on wrong information supplied by the ATO.

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Introduction

This publication is written primarily for people who hold shares as an investment. While much of the information also applies to people who carry on a business of trading in shares, it does not deal with the specific taxation treatment of shares held as trading stock or with the profits or losses arising from the disposal of such shares. If you need further advice on these aspects of owning shares, contact your professional adviser or the Australian Taxation Office (ATO).

The publication will help you understand the taxation implications of owning company shares. It covers how dividends received by Australian resident and non-resident individuals are taxed and the type of expenses that may be claimed as deductions against dividend income. If you acquired shares after 19 September 1985, capital gains tax may apply when you dispose of them. For more information, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Basic aspects

Shares

A company issues shares to raise the money needed to finance its operations. When a company issues shares, it grants shareholders various entitlements—for example, the right to receive dividends or the right to share in the capital of the company upon winding up. A company may issue different types of shares, so these entitlements may vary between different shareholders.

Non-share equity interests

Under a measure taking effect from 1 July 2001 (the ‘debt/equity rules’), certain interests which are not shares in legal form are treated in a similar way to shares for some tax law purposes. These interests are called non-share equity interests. Examples are some income securities and some stapled securities. The *Guide to the debt and equity tests* provides an overview of the debt/equity rules and explains what a non-share equity interest is.

How does a company pay out its profits?

Dividends

If you own shares in a company, you will generally be paid your share of the company’s profits as a dividend. In any income year you may receive both an interim and a final dividend. In most circumstances, you will be liable to pay income tax for that income year on the dividends you are paid or credited.

You must include in your assessable income dividends paid to you. Your shareholder dividend statement should contain details of the date a payment was made to

you—generally referred to on the statement as the payment date or date paid. Where the dividend is paid by cheque, it is deemed to have been paid to you on the date the cheque was posted to you by the company—not on the date the cheque was received, banked or cleared.

A dividend can be paid to you as money or other property, including shares.

Dividend reinvestment schemes

Most dividends you are paid or credited will be in the form of money, either by cheque or directly deposited into a bank account. However, the company may give you the option of reinvesting your dividends in the form of new shares in the company—this is called a dividend reinvestment scheme. If you take this option, you must pay tax on your reinvested dividends. Keep a record of the market value of the reinvested dividend (at the time of reinvestment) to help you work out any potential capital gains or capital losses on the eventual disposal of the shares.

Bonus shares

If you are paid or credited taxable bonus shares, the company issuing the shares should provide you with a dividend statement indicating the share value that is subject to tax. A company should also advise you when it issues tax-free bonus shares out of a share premium account.

From 1 July 1998, the paid-up value of bonus shares is generally not taxed as a dividend. However, if you received bonus shares on or after 20 September 1985, you may have to pay capital gains tax if you make a capital gain when you dispose of them. For more information, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Deemed dividends

Payments or other benefits you obtain from a private company in which you are a shareholder, or an associate of a shareholder, may be treated as if they were a taxable dividend paid to you. For more information, read the sections **Deemed dividends** on page 9, **Transactions that will create deemed dividends** on page 10 and **Amounts that will not be deemed to be dividends** on page 10.

Non-share dividends

Distributions from a non-share equity interest that do not constitute a non-share capital return are called non-share dividends.

How dividends are taxed

Dividends are taxed differently depending on whether the shareholder is a resident or non-resident of Australia. This section explains the taxation implications for

resident shareholders. If you are a non-resident, read the section **Dividends paid or credited to non-resident shareholders** on page 6 to see how the dividends you receive will be taxed.

Dividends paid to resident shareholders by Australian resident companies are taxed under a system known as imputation. It is called an imputation system because the tax paid by a company may be imputed or attributed to the shareholders.

The basis of the system is that if a company pays or credits you dividends which have been franked, you may be entitled to a franking tax offset for the tax the company has paid on its income. The franking tax offset will cover or partly cover the tax payable on the dividends.

Franked dividends

A resident company may pay or credit you a franked dividend. These dividends carry 'imputation credits', a credit for the tax paid by the company. Franked dividends can be either fully franked—meaning that the whole dividend carries imputation credit—or partly franked—meaning that only part of the dividend carries imputation credit.

Unfranked dividends

A resident company may pay or credit you an unfranked dividend. There is no imputation credit attached to these dividends.

How non-share dividends are taxed

For the purposes of the imputation system, debt/equity rules dealing with non-share equity interests are designed to apply to non-share dividends in the same way that they apply to dividends. A non-share dividend may be franked or unfranked. Any amount of the dividend, whether it be franked or unfranked, or any amount of imputation credit carried by the dividend, should be shown at the appropriate place on the tax return as if it were in respect of a share.

Non-equity share dividends

Under the debt/equity rules, dividends paid on certain interests, which are shares in legal form, are treated as not being dividends for imputation purposes. In consequence, these dividends cannot be franked. The *Guide to the debt and equity tests* contains an example of a redeemable preference share which would be a non-equity share.

The dividend statement

If an Australian company pays or credits you a dividend, or a non-share dividend, the company should also send you a statement advising:

- the amount of the dividend that is unfranked
- the amount of the dividend that is franked
- the amount of imputation credit
- the amount of tax file number (TFN) withholding tax withheld if you have not quoted your TFN to the company.

On the next page there is an example of a shareholder dividend statement.

EXAMPLE

On 15 February 2002, an Australian resident company, COALS TYER Ltd, paid John Citizen, a resident individual, a fully franked dividend of \$700 and an unfranked dividend of \$200. John received the dividend statement from COALS TYER Ltd shown on the next page.

We will follow the COALS TYER example through the next few sections of this publication to see what John needs to do with the information.

EXAMPLE

John's assessable income for 2001–02 in respect of the dividend is:

	\$
Amount of franked dividend	700
Imputation credit	300
Unfranked dividend	200
Total assessable dividend income	1 200

If these were the only dividends John was paid or credited for the income year, he can transfer these amounts directly to item **11** on his 2001–02 tax return.

Taxation implications

If you are paid or credited dividends, or non-share dividends, you are required to include the following amounts in assessable income on your tax return:

- the unfranked amount
- the franked amount
- the imputation credit.

We show you on the next page how John would complete item **11** on his tax return, using the figures in the example.

You can see on the COALS TYER statement that John had no TFN amount withheld from the dividends he was paid or credited. Where a resident shareholder does not provide an Australian company with their TFN, the company is required to deduct tax from the unfranked amount of any dividend at the highest income tax rate for individuals (47 per cent) plus Medicare levy (1.5 per cent)—a total rate for 2001–02 of 48.5 per cent. As John advised COALS TYER Ltd of his TFN, no TFN amount was withheld.

COALS TYER Limited				Payment date
ABN 00 000 000 000				15 February 2002
Shareholder dividend statement				
Notification of 2001 final dividend—paid 15 February 2002				
Security description	No. of shares	Unfranked amount	Franked amount	Imputation credit
Ordinary shares	6400	\$200	\$700	\$300
TFN amount		\$0.00	Net dividend	
			\$900.00	

Please note that your tax file number has been received and recorded.
 Please retain this advice for taxation purposes as a charge may be levied for a replacement.
 Please advise promptly in writing of any change of address.

If John had not advised COALS TYER Ltd of his TFN, a TFN amount would have been withheld from the unfranked amount of the dividend and shown by John on his tax return at **V** item **11**. A credit for the TFN amount withheld would then be allowed in John's tax assessment.

If John received more than one dividend statement during the income year, he would need to show the total amounts at **S**, **T**, **U** and **V** item **11** on his 2001–02 tax return.

Effect on tax payable

The following example shows how the fully franked dividend of \$700 and unfranked dividend of \$200 from COALS TYER Ltd affect John's tax liability. It is assumed that John has other income of \$40 000. Medicare levy is not included in the calculation.

EXAMPLE	\$
Unfranked dividend received	200
Franked dividend received	700
Imputation credit—non-cash	300
Other taxable income	40 000
Total assessable income	41 200
Tax on \$41 200—assessed at 2001–02 rates	8 740
less franking tax offset	300
Tax payable	8 440

John's assessable income includes the imputation credit in addition to the franked and unfranked dividends, and John's tax is based on this higher figure. However, he is able to use the tax already paid at the company level—the franking tax offset—to reduce the amount of tax that he has to pay.

Your franking tax offset

If you are paid or credited fully or partly franked dividends, or non-share dividends—that is, they carry imputation credits for which you are entitled to claim franking tax offsets—your assessable income includes both the amount of the dividends you were paid or credited and the amount of imputation credits attached to the dividends. You must include both amounts when you lodge your tax return—tax is payable at your applicable tax rate on these amounts.

If the imputation credit is included in your assessable income, you can claim the imputation credit as a franking tax offset.

The franking tax offset can be used to reduce your tax liability from all forms of income, not just dividends, and from taxable net capital gains. The John Citizen example on this page under the heading **Effect on tax payable** shows you how this works.

Prior to 1 July 2000 your franking tax offset could not create a refund. If you had any remaining franking tax offset available after your tax liability had been reduced to zero, they were disregarded and could not be refunded.

11 Dividends

Pages 5–8 in the instructions include a worksheet to help you to complete these amounts if you have more than one statement.

Show dollars and cents.

Tax file number amounts withheld from dividends **V**

Unfranked amount **S**

Franked amount **T**

Imputation credit **U**

Do not show cents.

However, from 1 July 2000, excess franking tax offset is refunded to eligible resident individuals after any income tax and Medicare levy liabilities have been met.

EXAMPLE

	\$
Tax payable on taxable income	2 000
less other tax offsets	1 500
Net tax payable	500
plus Medicare levy	200
	700
less: franking tax offset	1 000
Refund (of excess imputation credits)	300
<small>(Amounts are for illustrative purposes only.)</small>	

Claiming your franking tax offset when you do not need to lodge a tax return

If you are eligible to claim a franking tax offset for 2001–02 but you are not otherwise required to lodge a tax return, you should read the publication *Refund of imputation credits instructions and application*. To find out how to get this publication, see the inside front cover. If you need further information, please ring the Personal Tax Infoline on **13 2861**.

When you are not entitled to claim a franking tax offset

Your entitlement to a franking tax offset may be affected by the holding period rule and the related payments rule. The general effect of the holding period rule and the related payments rule is that even if a dividend is accompanied by a dividend statement advising that there is an imputation credit attached to the dividend, you are not entitled to claim the imputation credit.

Holding period rule

The holding period rule requires you to hold shares 'at risk' for at least 45 days (90 days for preference shares) to be eligible for the franking tax offset. This rule, however, does not apply if your total imputation credits entitlement is below \$5000. This is roughly equivalent to receiving a fully franked dividend of \$11 666, based on the current tax rate of 30 per cent for companies.

All this means is that you must own shares for at least 45 days, or 90 days for preference shares (not counting the day of acquisition or disposal), before being entitled to any franking tax offset.

Days on which you have 30 per cent or less of the ordinary financial risks of loss and opportunities for gain from owning the shares cannot be counted in determining whether you hold the shares for the required period.

Financial risk of owning shares may be reduced through arrangements such as hedges, options and futures.

You have to satisfy the holding period rule once only for each purchase of shares. You are then entitled to the imputation credits attached to those shares, unless the related payments rule applies—see below.

EXAMPLE

Imputation credits entitlement greater than \$5000

Matthew received fully franked dividends of \$13 066 (which include imputation credits of \$5600) for the 2001–02 income year. However, because he did not hold the shares for at least 45 days, he failed the holding period test and lost the benefit of the imputation credit.

Matthew would show a dividend of \$13 066 as a franked amount at **T** item **11** on his 2001–02 tax return but would not show the amount of imputation credit at **U**.

He would not receive a franking tax offset in his assessment.

For the purpose of the holding period rule, if a shareholder purchases substantially identical shares in a company over a period of time, the holding period rule uses the last in first out method to identify which shares will pass the holding period rule.

EXAMPLE

Substantially identical share

Jessica has held 1000 shares in Mimosa Pty Ltd for 12 months. She then purchases an additional 500 shares 10 days before Mimosa Pty Ltd shares go ex-dividend. Jessica sells 500 shares 20 days after Mimosa Pty Ltd shares go ex-dividend*. Her total imputation credit for the income year was more than \$5000. The shares she sold are deemed to have been held for less than 45 days, based on the last in first out method. Jessica would not be entitled to the imputation credits.

* A share or interest in a share becomes ex-dividend on the day after the last day on which you can acquire the share or interest in a share so as to entitle you to a dividend or distribution in respect of that share or interest.

Related payments rule

In certain circumstances, the related payments rule prevents you from claiming the imputation credits attached to franked dividends or credited on shares if a related payment is made. This rule applies if both of the following conditions are present:

- you are under an obligation to pass on the dividend to someone else
- you are not holding the shares 'at risk' around the dividend period.

Under the related payments rule you must be a qualified person for the payment of each dividend or distribution. To be a qualified person in relation to a dividend or distribution, you or your associate must hold the relevant

shares or interest at risk for the relevant qualification period of 45 days, or 90 days for preference shares.

Being a qualified person for the payment of current dividends or distributions does not mean that you are automatically a qualified person for future dividends or distributions. That is, the test must be satisfied for all subsequent dividends and distributions.

Disclosure on your income tax return (all years)

Where you are not entitled to a franking tax offset, show on your tax return the amount of franked dividend received at **T Franked amount**. Do not show the amount of any imputation credit at **U Imputation credit**.

Application of the rules to interests in partnerships and trusts

If you have interests in partnerships and trusts, other than widely held trusts which hold shares, the holding period rule and the related payments rule apply to your interests in the shares held by the partnership or trust in the same way that the rules apply to shares you own directly. Therefore, the partner or beneficiary has to hold their interest in the shares held by the partnership or trust at risk for the requisite period. The related payments rule will apply if they are not holding their interest in the partnership or trust at risk and they have an obligation to pass on their share of net income of the partnership or trust which is attributable to the franked dividend.

If you have interests in a widely held trust, the holding period rule and related payments rule apply to your interest in the trust (rather than in the shares held by the trust).

Allowable deductions from dividend income

If you invest in shares, you may be able to claim as a deduction from assessable income certain expenditure incurred in deriving your income from those shares. The following are examples of expenses that may be deductible.

Management fees

Where you pay ongoing management fees or retainers to investment advisers, you will be able to claim the expenditure as an allowable deduction. Only a proportion of the fee is deductible if the advice covers non-investment matters or relates in part to investments that do not produce assessable income. You cannot claim a deduction for a fee paid for drawing up an initial investment plan.

Interest

If you borrowed money to buy shares, you will be able to claim a deduction for the interest incurred on the loan, provided it is reasonable to expect that assessable

dividends will be derived from your investment in the shares. Where the loan was also used for private purposes, you will be able to claim only interest incurred on that part of the loan used to acquire the shares.

FID and other taxes

State governments charge Financial Institutions Duty (FID), government duty tax (GDT) and debits tax for operating certain types of accounts held with financial institutions such as banks, building societies and credit unions. You can claim a deduction for any FID charged on the deposit of assessable dividend income into your accounts. You can also claim a deduction for that part of any GDT or debits tax charged on debits from your account used to fund deductible expenses in relation to earning dividend income. If only a proportion of the debit was used to fund deductible expenses, only the same proportion of GDT or debits tax is deductible.

Travel expenses

You may be able to claim a deduction for travel expenses where you need to travel to service your investment portfolio—for example, to consult with a broker or to attend a stock exchange or company meeting. You can claim a deduction for the full amount of your expenses where the sole purpose of the travel relates to the share investment. Where the travel is predominantly of a private nature, only the expenses which relate directly to servicing your portfolio will be allowable.

Cost of newspapers and journals

You may be able to claim the cost of purchasing specialist investment journals and other publications or subscriptions which you use to manage your share portfolio.

Internet access and computers

You may be able to claim the cost of Internet access in managing your portfolio. For example, if you use an Internet broker to buy and sell shares, the cost of Internet access for this purpose will be deductible. You can also claim a capital allowance (previously known as depreciation) for the decline in value of your computer equipment to the extent that it has been used for income-producing purposes. You cannot claim a capital allowance for the private use portion.

Borrowing expenses

You may be able to claim expenses you incurred directly in taking out a loan for purchasing shares which can reasonably be expected to produce assessable dividend income. The expenses may include establishment fees, legal expenses and stamp duty on the loan. If you incurred deductible expenses of this kind totalling \$100 or more, they are apportioned over 5 years or the term of the loan, whichever is less. If your expenses are less than \$100, they are fully deductible in the year you incur them.

Other deductions

Any other expenses that you incur which relate directly to maintaining your portfolio are also deductible. These could include bookkeeping expenses and postage.

Expenses that are not deductible

Unless you are considered to be a share trader, you cannot claim a deduction for the cost of acquiring shares—for example, expenses for brokerage and stamp duty. These will form part of the cost base for capital gains tax purposes when you dispose of the shares. For more information, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Dividends paid or credited by non-resident companies

Non-resident companies are not subject to the imputation system and you will not be entitled to claim a franking tax offset for any tax paid by the company. However, you may find that foreign tax has been withheld from the dividend so that the amount paid or credited to you is reduced.

In most circumstances, you will be liable to pay Australian income tax on the dividend. You must include on your tax return the full amount of the dividend at item **19 Foreign source income and foreign assets or property**. This means the amount you are paid or credited plus the amount of any foreign tax which has been deducted. You may be able to claim a credit for the foreign tax paid.

In certain circumstances, foreign dividends may be exempt from tax. For example, they may be exempt to avoid any double taxation, or exempt because the portfolio out of which the dividends have been paid has already been taxed at a comparable rate.

There are special rules which need to be satisfied for you to claim a foreign tax credit. See question **19** in *TaxPack 2002 supplement* and the publication *How to claim a foreign tax credit*. To find out how to get these publications, see the inside front cover.

EXAMPLE

Emma Citizen has shares in a company resident in the United States. She was entitled to be paid a dividend of \$400. Before she was paid the dividend the company deducted \$60 in foreign tax, sending Emma the remaining \$340.

When she fills in her Australian tax return, Emma should include \$400 at **M** item **19** on her tax return and she may be able to claim a foreign tax credit of \$60 at **O** item **19**.

Dividends paid or credited to non-resident shareholders

Non-resident individuals can also be paid or credited franked dividends or unfranked dividends from Australian resident companies. However, they are taxed differently from resident shareholders.

Franked dividends

If you are a non-resident of Australia, any franked dividends you are paid or credited are exempt from Australian income and withholding taxes. However, you are not entitled to any franking tax offset for franked dividends. You cannot use any imputation credit attached to franked dividends to reduce the amount of tax payable on other income and you cannot get a refund of the imputation credit. You should not include the amount of any franked dividend or any imputation credit on an Australian tax return.

Unfranked dividends

The other type of dividend a resident company may pay or credit you is an unfranked dividend. There is no imputation credit attached to these dividends.

Any unfranked dividends paid or credited to a non-resident are subject to a final withholding tax. Withholding tax is imposed on the full amount of the dividends; that is, no deductions may be made from the dividends, and a flat rate of withholding tax is applied whether or not you have other taxable Australian income. Withholding tax is also deducted from the unfranked portion of any partly franked dividends that you are paid or credited.

Withholding tax is deducted by the company before a dividend is paid, so you will be paid or credited only the reduced amount. It is deducted at a rate of 30 per cent unless you are a resident of a country with which Australia has entered into a taxation agreement that varies the amount of withholding tax that can be levied on dividends.

Australia has entered into taxation agreements with more than 35 countries and the rate of withholding tax on dividends is limited to 15 per cent in most of these agreements. Details of the rates that apply to residents of specific countries can be obtained from the ATO.

The withholding tax on unfranked dividends is a final tax, so you will have no further Australian tax liability on the dividend income. Therefore, if the only income you earned was dividend income which was a fully franked dividend or an unfranked amount of a dividend which was subject to withholding tax, you do not need to lodge an Australian tax return.

If you were paid or credited dividends which were not franked—and from which withholding tax was not deducted—you must include those dividends on your Australian tax return.

Deductions

You cannot claim any expenses incurred in deriving dividends which are not assessable in Australia, including any dividend which you do not need to show on your Australian tax return.

Partners who have an amount attributable to a dividend included in their net income or loss from a partnership

When calculating its net income or loss for tax purposes, a partnership that is paid or credited a franked dividend includes both the amount of the dividend and the imputation credit in its assessable income. This is subject to the partnership satisfying the holding period rule and other rules contained in the provisions dealing with franked dividends.

If a share of the net income or loss of a partnership shown at item **12** on your *2002 tax return for individuals* (supplementary section) is attributable to a franked dividend, you may be entitled to claim a franking tax offset, which is your share of the partnership's imputation credit arising from that dividend.

You are not entitled to a franking tax offset if you do not satisfy the holding period rule or related payments rule in relation to your interest in the shares held by the partnership, or the partnership does not satisfy those rules in relation to the shares.

If the partnership satisfies the rules in relation to the shares and the small shareholder exemption applies to you, you do not have to satisfy the holding period rule.

For more information, read the section **When you are not entitled to claim a franking tax offset** on page 4.

EXAMPLE

	\$
Partnership	
Franked dividend	700
Imputation credit—non-cash	300
Net income of partnership	1 000
Individual partner—$\frac{1}{2}$ share	
Taxable $\frac{1}{2}$ share of net income of the partnership	500
Other income	20 000
Total assessable income	20 500
Gross tax— 2001–02 rates	2 530
less $\frac{1}{2}$ of total franking tax offset	150
Net tax	2 380

Beneficiaries who have an amount attributable to a dividend included in their net income from a trust

A trust that is paid or credited franked dividends includes both the amount of the dividend and the imputation credit in its assessable income when calculating its net income or loss for tax purposes. This is subject to the trust satisfying the holding period rule and other rules contained in the provisions dealing with franked dividends.

If there is income of a trust to which no beneficiary is entitled, the trustee's share of the net income of the trust is assessable. They will be entitled to a franking tax offset for any imputation credit included in that share of the net income.

If you are the beneficiary of a trust and the trust makes a loss for tax purposes, there is no net income of the trust and any imputation credit is lost. Trust losses cannot be distributed to beneficiaries. Note that for trusts that distribute income, excess imputation credits have been refundable since the 2001 income year.

If a share of the net income of a trust shown at item **12** on your tax return is attributable to a franked dividend, you may be entitled to claim a franking tax offset. This is your share of the trust's imputation credit arising from that dividend.

If the trust is a widely held trust, you will not be entitled to a franking tax offset if you do not satisfy the holding period rule or related payments rule in relation to your interest in the trust or the trust does not satisfy those rules in relation to the shares. If the trust is not a widely held trust, you must satisfy the holding period rule and related payments rule in relation to your interest in the shares held by the trust in order to be entitled to the franking tax offset.

If the trust satisfies the rules in relation to the shares and the small shareholder exemption applies to you, you do not have to satisfy the holding period rule.

For more information, read the section **When you are not entitled to claim a franking tax offset** on page 4.

Special rules apply to beneficiaries of trusts—other than trusts that elect to be family trusts within the meaning of the *Income Tax Assessment Act 1936* (ITAA 1936) or deceased estates—to determine whether they hold their interest 'at risk'.

EXAMPLE**Trust with net income in 2001–02**

	\$
Trust	
Franked dividend	2 100
Imputation credit—non-cash	900
Net income of trust	3 000
Beneficiary	
Taxable $\frac{1}{3}$ share of net income of trust	1 000
Other income	10 000
Total assessable income	11 000
Gross tax—2001–02 rates	850
less $\frac{1}{3}$ of total franking tax offset	300
Net tax	550

EXAMPLE**Trust with loss in 2001–02**

	\$
Trust	
Franked dividend	2 100
Imputation credit—non-cash	900
Total income of the trust	3 000
less deductible expenses of the trust	4 000
Loss	(1 000)
Trust losses cannot be distributed to beneficiaries. Imputation credits are not refundable in this example.	

Joint ownership of shares

Shares may be held in joint names. If you hold shares jointly with another person, such as your spouse, it is assumed that ownership of the shares is divided equally. Shares can be owned in unequal proportions. You have to be able to demonstrate this—for example, with a record of the amount contributed by each party to the cost of acquiring the shares. Dividend income and imputation credits are assessable in the same proportion as the shares are owned.

Shares held in children's names

Custodians, such as parents or grandparents holding shares on behalf of minors (under a legal disability), should be treated as the owners of the shares unless the child was considered the genuine beneficial owner. If a child is the owner of shares, any dividend income should be included in the child's tax return. Note that in some circumstances the income of a minor is subject to the highest marginal rate of tax. Any excess imputation credits may also be refundable.

Commonwealth Bank and Telstra 1 shares

If you purchased shares in the Commonwealth Bank of Australia (CBA) or the first float of Telstra from the Government (through instalment receipts) and you

sold them during the year, you may have to pay capital gains tax.

If you use the indexation method to calculate your capital gain, indexation of the instalments is available from the following dates:

- for CBA —first instalment—13 July 1996
—final instalment—14 November 1997
- for Telstra —first instalment—15 November 1997
—final instalment—17 November 1998.

For more information, see *Taxation Determination TD 98/11—Income tax: capital gains: when are shares acquired, and instalments paid, under the Commonwealth Bank of Australia (CBA) and Telstra public share offers?* or the publication *Personal investors guide to capital gains tax*. To find out how to get these publications, see the inside front cover.

Telstra 2 shares

If you purchased shares in the Telstra 2 share offer, you would have received an 'instalment receipt' after making your first payment. The instalment receipt was issued as evidence that you owned a beneficial interest in the shares.

If you sold the instalment receipts or shares for less than the amount you paid for them, you may offset the loss against any capital gains for the income year or carry forward the loss if you do not have a capital gain for the year. If you made a gain, you may have to pay capital gains tax on the difference between the cost base of the instalment receipts or shares and the capital proceeds from the sale.

You will not be entitled to indexation of the cost base of the instalment receipts or shares which were purchased after 11.45 a.m. (by legal time in the Australian Capital Territory) on 21 September 1999.

For more information, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Liquidation, takeovers and mergers

If you had purchased shares in a company that has gone into liquidation, please refer to the publication *Guide to capital gains tax* for information on how to calculate your capital gains tax.

If you had purchased shares in a company that has been taken over or merged with another company, please refer to the publication *Personal investors guide to capital gains tax* for information on how to calculate your capital gains tax.

Rights issues

Companies may periodically issue their shareholders with rights to purchase additional shares. A particular

issue might be described as a 'one-for-4' issue, meaning that you are entitled to purchase an additional share for every 4 shares you currently own. You can choose to exercise the right, sell it on the stock exchange or allow it to lapse.

Unless you deal regularly with rights issues or other similar products, the only tax consequences that may arise involve the capital gains tax measures. For information on how the capital gains tax measures apply to rights issues, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Options

Companies may also issue their shareholders with options. If you receive an option, you have the right to acquire shares in the company at a specified price on a stipulated date. You are also able to trade these options on the stock exchange or allow them to lapse.

Options are similar to rights and the terms are often used interchangeably. The main difference between options and rights is that options can usually be held for a much longer period than rights before they lapse or must be exercised. Options may also be issued initially to both existing shareholders and non-shareholders while rights can only be issued initially to existing shareholders.

Exchange traded options are types of options that are not created by the company but by independent 3rd parties and are traded on the stock exchange. They come in 2 forms:

- call option is a contract which entitles its holder to buy a fixed number of shares in the designated company at a stated price on or before a specified expiry date
- put option is a contract which entitles its holder to sell a fixed number of shares in the designated company at a stated price on or before a specified expiry date.

The taxation of options is similar to that of rights. Unless you deal with them regularly, the only tax consequences that may arise involve the capital gains tax measures. This is discussed in detail in the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Share warrants

Share warrants come in many different forms—for example, equity warrants, endowment warrants, portfolio warrants, capital plus warrants and instalment warrants.

The income tax and capital gains consequences of holding, acquiring and disposing of these financial products can be quite complex.

If you have disposed of any of these products, contact your professional adviser or ring the ATO.

Off market share buy-backs

If you disposed of shares back to a company under a buy-back arrangement, you may have made a capital gain or capital loss. Some of the buy-back price may be treated as a dividend for tax purposes. The time you make the capital gain or capital loss will depend on the particular buy-back offer. If the information provided by the company is not sufficient for you to calculate your capital gain or capital loss, you may need to seek advice from your professional adviser or the ATO.

Keeping records

It is advisable to keep records of both income and deductions relating to your share investment for 5 years from the date you lodge your tax return.

Remember that your investment in shares or other assets such as instalment receipts may also give rise to a capital gain when you dispose of them. For capital gains tax purposes, you will need to keep detailed records of any shares or other assets you acquired on or after 20 September 1985 or of any other related transaction. You will need to keep those records for 5 years after you dispose of the shares.

You must keep records setting out in English:

- the date you acquired the asset
- any amounts which will form part of the cost base of the asset
- the date you dispose of the asset and the capital proceeds from the sale.

From 1 January 1998, you can choose to enter information from your capital gains tax records into an asset register. Keeping an asset register may enable you to discard records that you may otherwise be required to keep for long periods of time. For more information, see the publication *Capital gains tax asset register: a new way of keeping records*. To find out how to get this publication, see the inside front cover.

Keep all the information that a company gives you on your shares. It may be important when calculating your capital gains tax liability after you dispose of them.

You must also keep records relating to your ownership of assets for 5 years from the date you dispose of them.

Deemed dividends

Deemed dividends from private companies

Where certain transactions between a private company and a shareholder or shareholder's associate occur, they are deemed to create an unfranked dividend assessable to the shareholder or associate. The amount of the deemed dividend is generally limited to the private company's distributable surplus.

Payments made to a shareholder or their associate in their capacity as an employee, or as an associate of an employee of the private company, are not subject to these rules.

Shareholders and their associates to whom a payment or loan is made by a private company or who have a debt forgiven by a private company will need to have regard to the rules when considering their tax liabilities. Under the rules, 'payment' has an extended meaning. For more information, read the section **Payments treated as dividends** below.

Shareholders and associates

The shareholder or associate need not be a shareholder or associate at the time the transaction occurred, as long as a reasonable person would conclude that the transaction occurred because the person was a shareholder or associate at some time.

The associates of a natural person are widely defined and include:

- a relative of the person
- a partner of the person
- a partnership in which the person is a partner
- a spouse
- a child of a partner of the person
- a trustee of a trust where the person—or another entity that is an associate of the person—benefits under the trust
- companies which are controlled or influenced by the person.

Transactions that will create deemed dividends

Payments treated as dividends

Payments made by a private company to a shareholder or associate which are treated as deemed dividends include:

- an amount paid or credited to the shareholder or associate
- an amount paid or credited on behalf of, or for the benefit of, the shareholder or associate
- a transfer of property to the shareholder or associate.

A payment does not include an amount which is a loan. The amount paid or credited is deemed to be a dividend to the extent of the private company's distributable surplus.

EXAMPLE

Steven owns shares in a private company, X Pty Ltd. On 30 June 2002, X Pty Ltd made a payment of \$5000 to Steven's mother, Helen. Helen is not an employee of X Pty Ltd and she is not an associate of an employee of the company. The payment will be taken to be an unfranked dividend paid to Helen and she must include the \$5000 as assessable income at **S** item 11 on her 2001–02 tax return.

Loans treated as dividends

If a private company makes a loan to a shareholder or associate in an income year and the loan is not fully repaid by the end of that income year, generally the outstanding amount of the loan will be regarded as a non-commercial loan and treated as an unfranked dividend to the extent of the private company's distributable surplus—unless it satisfies the criteria of an excluded loan as explained in the section **Excluded loans** on the next page.

A loan includes:

- an advance of money
- a provision of credit or any other form of financial accommodation
- an amount paid for, on account of, on behalf of, or at the request of, a shareholder or associate where there is an express or implied obligation to repay the amount
- a transaction that in substance effects a loan of money.

As a general rule, loans in existence before 4 December 1997 will not be treated as a dividend under the relevant provisions unless they are altered by extending the term or increasing the amount of the loan.

EXAMPLE

Vanessa is a shareholder in the private company, X Pty Ltd. Vanessa's credit card bills, totalling \$10 000, are paid with company cheques throughout the income year and debited to her loan account. Interest is not payable on the balance of the loan account.

If Vanessa repays the \$10 000 to X Pty Ltd by the end of the company's income year, no amount will be treated as a deemed dividend. If she does not repay any part of the \$10 000, the full \$10 000 will be treated as an unfranked dividend. If she repays \$3000, then \$7000 will be treated as an unfranked dividend.

Forgiven debts treated as dividends

If a private company forgives, wholly or partly, a debt owed to it by a shareholder or associate, the amount forgiven will be treated as a dividend to the extent of the private company's distributable surplus at the end of its income year. This will not be the case if the debt has previously been treated as a deemed dividend.

Amounts that will not be deemed to be dividends

The following transactions will not result in a deemed dividend:

- a repayment of a debt owed by a private company to a shareholder or associate, provided the amount of the debt does not exceed the amount the company would have owed if the company and shareholder or associate had been dealing with each other at arm's length

- a loan made in the ordinary course of a private company's business on the usual terms which it applies to arm's length loans of a similar type
- a payment or loan which forms part of the assessable income of the shareholder or associate by virtue of some other provision of ITAA 1936 or the *Income Tax Assessment Act 1997*
- a loan made during the course of winding up a company where the loan is either repaid or offset by distributions by the end of the income year following the year in which the loan is made
- a payment or loan which has been specifically excluded from the assessable income of the shareholder or associate by virtue of an exempting provision in ITAA 1936
- a loan made solely for the purpose of enabling the shareholder or associate to acquire shares or rights to shares under an employee share scheme to which Division 13A of ITAA 1936 applies
- the forgiveness or release of a debt of a shareholder or associate under the *Bankruptcy Act 1966*.

Excluded loans

Loans which meet the following criteria are not treated as dividends in the year the loan is made:

- The loan must be made under a written agreement.
- The rate of interest payable on the loan must be equal to or exceed the bank variable housing loan interest rate last published by the Reserve Bank of Australia before the start of the income year in which the loan was made.
- If the loan is secured by a registered mortgage over real property, the term of the loan must be no more than 25 years and the amount of the loan must not exceed 91 per cent of the value of the property over which the security is provided—less any other liabilities for which the property also provides security.
- For all other loans, the term of the loan must be no more than 7 years.

The relevant provisions require that the written agreement be in place before any amount is advanced to the shareholder or associate. However, for loans made during the 2001–02 income year, this requirement will be satisfied if the written agreement was put in place by 30 June 2002.

All loans made during a year which are not treated as dividends at the end of the year and which have the same maximum term are, for tax purposes, amalgamated to form a single loan. Shareholders or their associates are required to make a minimum yearly repayment in respect of that amalgamated loan. The minimum repayment is calculated by using the formula set out in the legislation. A failure to make such a repayment will result in the outstanding amount of the loan being treated as a deemed dividend to the extent of the private company's distributable surplus.

EXAMPLE

A private company made an unsecured loan to a shareholder on 1 July 2000. The loan was made under a written agreement which specified that the rate of interest payable for all future years must equal or exceed the benchmark interest rate for the year. For 2001–02 the benchmark interest rate was 6.8 per cent per annum.

The term of the loan is 5 years. For the year ended 30 June 2001, as it met the criteria for minimum interest rate and maximum term, the loan is not treated as a dividend.

If the amount of the loan not repaid at 30 June 2001 was \$100 000, the minimum yearly repayment required for the 2001–02 income year is calculated as follows:

$$\begin{aligned} & \text{Amount of loan not repaid by} \\ & \text{end of previous income year} \times \text{current year's} \\ & \text{benchmark interest rate} \\ & 1 - \left\{ \frac{1}{1 + \text{current year's benchmark interest rate}} \right\}^{\text{remaining term}} \\ & = \frac{100\,000 \times 0.068}{1 - \left\{ \frac{1}{1 + 0.068} \right\}^5} \\ & = \$24\,258.61 \\ & = \text{minimum yearly repayment required for the} \\ & \text{2001–02 income year.} \end{aligned}$$

If repayments made in the 2001–02 income year equal or exceed the minimum yearly repayment, the amount of the loan not repaid at the end of the income year is not taken to be a dividend.

Deemed dividend cannot exceed distributable surplus

The private company's distributable surplus is the maximum amount that can be treated as a deemed dividend. The company that made the payment or loan or forgave the debt will have to determine how much of the payment or forgiven debt is to be treated as having come from their distributable surplus. The distributable surplus is worked out at the end of the company's year of income using the following formula:

$$\text{Net assets} - \text{non-commercial loans} - \text{paid-up share value} - \text{repayments of non-commercial loans}$$

Non-commercial loans are loans which have previously been treated as deemed dividends.

Hardship

The Commissioner of Taxation has a discretion to disregard a failure to make a minimum yearly repayment. He also has a discretion to exclude a forgiven debt from being treated as a dividend. Finally, the Commissioner has the power to disregard the creation of a present liability under a guarantee provided by the private company to an entity other than a private company.

Prevention of double taxation

As a general rule, if a subsequent dividend paid by the private company is used to offset an amount that has

already been subject to tax as a deemed dividend, that amount will not be included as assessable income.

EXAMPLE

Simone is a shareholder in a private company, Martley Pty Ltd. She borrowed, on a non-commercial basis, \$500 from the company in September 2000. The loan was not repaid by 30 June 2001. Simone included an amount of \$500 as assessable income—as a deemed dividend—on her 2000–01 tax return.

In December 2001, Simone became entitled to receive an unfranked dividend of \$1100 from Martley Pty Ltd. However, Simone agreed that Martley Pty Ltd would offset \$500 of her entitlement against the outstanding loan and pay the balance of \$600 to her. Therefore, Simone is only required to include an amount of \$600 in her assessable income for the 2001–02 year. This is because she had previously included the other \$500—the loan which had been treated as a deemed dividend—on her 2000–01 tax return.

Trustee loans

Where a trustee makes a loan to a shareholder or associate of a private company and the private company is a beneficiary of the trust, a deemed loan may arise if:

- the private company is or has been presently entitled to an amount from the net income of the trust estate
- the trustee has not paid the amount to the private company
- the trustee has made a loan to a shareholder of the private company or an associate of the shareholder after the time that the private company first became presently entitled to that amount.



Lodge your tax return over the Internet using e-tax

If you are looking for an easy and convenient way to do your tax return, look no further than *e-tax 2002*. It is available **free** from the Australian Taxation Office. *e-tax* can estimate items such as capital gains and your tax refund or tax debt. *e-tax* allows you to complete your tax return confidentially and at your

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