

TD 2007/11 - Income tax: imputation: franked distributions: qualified persons: does an entity have to be a qualified person within the meaning of Division 1A of former Part IIIA of the Income Tax Assessment Act 1936 to avoid the application of paragraphs 207-145(1)(a) and 207-150(1)(a) of the Income Tax Assessment Act 1997 in respect of a franked distribution made directly or indirectly to the entity on or after 1 July 2002?

 This cover sheet is provided for information only. It does not form part of *TD 2007/11 - Income tax: imputation: franked distributions: qualified persons: does an entity have to be a qualified person within the meaning of Division 1A of former Part IIIA of the Income Tax Assessment Act 1936 to avoid the application of paragraphs 207-145(1)(a) and 207-150(1)(a) of the Income Tax Assessment Act 1997 in respect of a franked distribution made directly or indirectly to the entity on or after 1 July 2002?*



Taxation Determination

Income tax: imputation: franked distributions: qualified persons: does an entity have to be a qualified person within the meaning of Division 1A of former Part IIIAA of the *Income Tax Assessment Act 1936* to avoid the application of paragraphs 207-145(1)(a) and 207-150(1)(a) of the *Income Tax Assessment Act 1997* in respect of a franked distribution made directly or indirectly to the entity on or after 1 July 2002?

❶ **This publication provides you with the following level of protection:**

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. Yes. It is necessary to have regard to the rules in Division 1A of former Part IIIAA of the *Income Tax Assessment Act 1936* (Division 1A of the ITAA 1936), as in force at 30 June 2002, in determining whether an entity is a qualified person for the purposes of paragraphs 207-145(1)(a) and 207-150(1)(a) of the *Income Tax Assessment Act 1997* (ITAA 1997)¹ in respect of a franked distribution made directly or indirectly to the entity after 30 June 2002.²

¹ Unless otherwise stated, all references to legislative provisions in this Taxation Determination are to provisions of the ITAA 1997.

² Note, regard should also be had to Division 1A in determining whether an entity is a qualified person for the purposes of paragraph 210-170(1)(e) in respect of distributions made after 30 June 2002 and franked with a venture capital credit.

TD 2007/11

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 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

24 April 2007

Appendix 1 – Explanation

❶ *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. One of the design features of the imputation system is that entities who are not the true economic owners of a company and so not sufficiently subject to the risks of loss and opportunities for gain associated with ownership are not able to claim a credit for the tax paid by the company under the imputation system.³ This is reflected in the qualified person rules contained in Division 1A.

4. Subject to certain transitional rules, Part IIIAA of the ITAA 1936 ceased to have application from 1 July 2002 (refer former section 160AOAA of the ITAA 1936). This was due to the introduction of the Simplified Imputation System into the ITAA 1997.

5. However, the qualified person rules have continued to remain an integral feature of the imputation system even after 30 June 2002. In particular the rules contained in Division 1A have continued to inform the operation of the imputation system since that date via the express terms of sections 207-145 and 207-150.

6. Division 207 sets out the consequences of an entity receiving directly or indirectly a franked distribution from a corporate tax entity. Generally an entity receiving a franked distribution will be entitled to gross up their assessable income for the franking credit and obtain a tax offset equal to the franking credit received.⁴

7. Section 207-145 of Subdivision 207-F applies where a franked distribution is made to an entity. Section 207-150 of Subdivision 207-F applies where a franked distribution flows indirectly to an entity.

8. Under paragraph 207-145(1)(a), if an entity to whom a franked distribution is made is 'not a qualified person in relation to the distribution for the purposes of Division 1A of former Part IIIAA of the *Income Tax Assessment Act 1936*...' they are not entitled to gross up their income for the franking credit received, nor claim a tax offset equal to the franking credit.⁵ A similar result applies to entities to whom franked distributions flow indirectly.⁶

9. The very wording of sections 207-145 and 207-150 makes it clear that regard is to be had to the rules in Division 1A in determining whether a person is a qualified person for the purposes of these provisions in respect of a franked distribution, irrespective of whether the distribution is made after 30 June 2002. There is nothing in the relevant extrinsic material to indicate the contrary.

³ Paragraphs 4.6 and 4.7 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 2) 1999 which, on enactment, inserted Division 1A into Part IIIAA of the ITAA 1936.

⁴ Subdivisions 207-A and 207-B.

⁵ Paragraphs 207-145(1)(e) and (f). The word 'former' was inserted into paragraph 207-145(1)(a) by the *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*.

⁶ Paragraphs 207-150(1)(a), (f) and (g).

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 binding public ruling.***

Alternative views

The ‘qualified person’ test in Division 1A cannot be satisfied in respect of a franked distribution made after 30 June 2002

10. On this view the introduction of section 160AOAA into the ITAA 1936 by the *New Business Tax System (Imputation) Act 2002* prevents the qualified person rules in Division 1A from having any application to a franked distribution that is made after 30 June 2002.

11. This view is not accepted for a number of reasons.

12. First, while section 160AOAA of the ITAA 1936 has the effect that Part IIIAA of the ITAA 1936 does not apply to events occurring after 30 June 2002, sections 207-145 and 207-150 were inserted into the ITAA 1997 with effect from 29 June 2002 by the same Act which introduced section 160AOAA into the ITAA 1936. Paragraphs 5.51 and 5.53 of the Explanatory Memorandum to the Bill enacted as the *New Business Tax System (Imputation) Act 2002* make it clear that Parliament intended that the introduction of sections 207-145 and 207-150 would have the result, among other matters, of preserving the operation of the qualified person rules in Division 1A as an element of the imputation system post 1 July 2002. Moreover, sections 207-145 and 207-150 have this clear effect according to their terms.

13. Second, the *New Business Tax System (Imputation) Act 2002* also inserted a definition of ‘qualified person’ into subsection 995-1(1). This definition stated that ‘a person is a qualified person in relation to a distribution if the person would have been a qualified person in relation to the distribution under Division 1A ... as in force on 30 June 2002’. The introduction of this definition into the ITAA 1997 to accompany the introduction of sections 207-145 and 207-150 into the Act provides further support for the Commissioner’s view that Division 1A continues to inform the operation of the imputation system for events occurring after 1 July 2002.

14. Third, if adopted, this construction of paragraphs 207-145(1)(a) and 207-150(1)(a) would produce an absurd result: either the provisions have never had any practical field of operation or they have had the effect of denying franking credits in respect of all distributions made after 30 June 2002. Having regard to paragraphs 5.51 and 5.53 of the Explanatory Memorandum to the Bill enacted as the *New Business Tax System (Imputation) Act 2002*, it is difficult to accept that Parliament intended either of these results.

The ‘qualified person’ test in Division 1A cannot be satisfied in respect of a franked distribution made on or after 14 September 2006

15. It has also been argued that Division 1A instead has no application to franked distributions made on or after 14 September 2006, being the date on which:

- Part IIIAA was repealed from the ITAA 1936;
- the definition of ‘qualified person’ was repealed from subsection 995-1(1); and

- the word 'former' was inserted before the words 'Part IIIAA' in paragraphs 207-145(1)(a) and 207-150(1)(a).⁷

16. Again this view is not accepted for a number of reasons.

17. First, despite the repeal of the definition of 'qualified person' from subsection 995-1(1) and the amendments to paragraphs 207-145(1)(a) and 207-150(1)(a) effected by the *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*, it remains the case that sections 207-145 and 207-150 have the clear effect according to their terms that regard is to be had to the rules in Division 1A in determining whether a person is a qualified person for the purposes of these provisions.

18. Second, as with paragraph 14 of this Determination, this construction, if adopted, would have an absurd effect on paragraphs 207-145(1)(a) and 207-150(1)(a).

19. Third, the qualified person rules contained in Division 1A are a key integrity feature of the Australian imputation system. If it had been Parliament's intention that these rules ceased to have operation from 14 September 2006, it may be expected this intention would have been expressed clearly and unambiguously in the Explanatory Memorandum to the Bill enacted as the *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*. No such intention was expressed. Indeed the general savings provision contained in Item 10 of Schedule 6 to the Act was included in the Act to deal with the possibility that a repealed provision could be an element in the operation of an operative provision. The savings provision operates to ensure that the repealed provision continues to have the effect necessary to support the still operative provision.⁸

⁷ Refer *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*, Schedule 1 items 153 and 258 and Schedule 2 items 710 and 711.

⁸ Refer paragraph 2.55 of the Explanatory Memorandum to the *Tax Laws Amendment (Repeal of Inoperative Provisions) Bill 2006*.

References

Previous draft:

TD 2006/D40

Related Rulings/Determinations:

TR 2006/10

Subject references:

- dividend income
- franked distributions
- franked dividends
- franking credits
- franking rebates
- imputation credits
- imputation system
- qualified person
- shareholders
- shares

Legislative references:

- TAA 1953
- Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006
- Taxation Laws Amendment Act (No. 2) 1999
- New Business Tax System (Imputation) Act 2002
- ITAA 1936 Pt IIIAA

- ITAA 1936 Pt IIIAA Div 1A
- ITAA 1936 160AOAA
- ITAA 1997 Div 207
- ITAA 1997 Subdiv 207-A
- ITAA 1997 Subdiv 207-B
- ITAA 1997 Subdiv 207-F
- ITAA 1997 207-145
- ITAA 1997 207-145(1)(a)
- ITAA 1997 207-145(1)(e)
- ITAA 1997 207-145(1)(f)
- ITAA 1997 207-150
- ITAA 1997 207-150(1)(a)
- ITAA 1997 207-150(1)(f)
- ITAA 1997 207-150(1)(g)
- ITAA 1997 210-170(1)(e)
- ITAA 1997 995-1(1)

Other references:

- Explanatory Memorandum to the Tax Laws Amendment (Repeal of Inoperative Provisions) Bill 2006
- Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 2) 1999
- Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002

ATO references

NO: 2006/18211

ISSN: 1038-8982

ATOlaw topic: Income Tax ~~ Tax integrity measures ~~ qualified persons - franking credits
Income Tax ~~ Entity specific matters ~~ franking of dividends - company matters