TD 2006/D13 - Income tax: can a dividend, or part of a dividend, be non-assessable non-exempt income under both section 23AJ and section 23AI of the Income Tax Assessment Act 1936 ?

This document has been finalised by TD 2006/51.

Draft Taxation Determination

Income tax: can a dividend, or part of a dividend, be non-assessable non-exempt income under both section 23AJ and section 23AI of the *Income Tax Assessment Act 1936*?

This Ruling provides you with the following level of protection:

This publication is a draft for industry and professional comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation 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. You can rely on this publication (excluding appendices) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you under-pay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the under-payment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. No. Section 23AJ of the *Income Tax Assessment Act 1936* (ITAA 1936)[1] does not apply to a dividend to the extent that the dividend is 'non-assessable non-exempt income'[2] under section 23AI.

Date of effect

2. When the final Determination is issued, it is proposed to apply to dividends paid after 30 June 2004. However, the Determination will 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 21 and 22 of Taxation Ruling TR 92/20).

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[1] All legislative references are to the ITAA 1936 unless otherwise stated.

[2] A dividend, or part of a dividend, that is not assessable income and is not exempt income under section 23AJ or section 23AI is 'non-assessable non-exempt income' as defined in the *Income Tax Assessment Act 1997* (ITAA 1997) (see section 6-23 of the ITAA 1997).

Commissioner of Taxation
1 March 2006

Appendix 1 – Explanation

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

Explanation

3. A dividend to which section 23AJ applies is not assessable income and is not exempt income. An 'attribution account payment' (defined as including a dividend[3]) under Part X (Controlled Foreign Companies) is not assessable income and is not exempt income to the extent that section 23AI applies to it.

4. Section 23AJ applies if:

- a company that is not a 'Part X Australian resident' pays a 'non-portfolio dividend';[4]
- the dividend is paid to an Australian resident company; and
- the Australian resident company does not receive the dividend in the capacity of a trustee.

5. Section 23AI applies if:

- an attribution account payment is made to a taxpayer (other than a partnership or taxpayer in the capacity of trustee); and
- on making the payment, an attribution debit[5] arises for the entity making the payment in relation to the taxpayer.

6. Prima facie, sections 23AJ and 23AI may both apply in respect of the same dividend if:

- the attribution account payment is a non-portfolio dividend;
- the taxpayer receiving that payment is an Australian resident company; and
- there is an attribution surplus in relation to that company immediately prior to the attribution account payment being made which causes an attribution debit to arise.

7. On its own, section 23AJ applies to the whole of the non-portfolio dividend, whilst section 23AI only applies to the non-portfolio dividend to the extent of the attribution debit.

8. Broadly, the purpose of section 23AJ applying to a dividend is to exclude the non-portfolio dividend from the income tax base.

9. The purpose of section 23AI applying to a dividend is to prevent double taxation. This is in recognition of the fact that, in effect, the dividend has been paid out of profits that have previously been taxed in Australia under Part X. In further recognition of this fact, the treatment of the dividend as non-assessable non-exempt income is disregarded to preserve entitlements to deductions and foreign tax credits.

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[3] See paragraph 365(1)(a).
[4] 'Part X Australian resident' and 'non-portfolio dividend' are defined in section 317.
[5] An attribution debit arises where there is an attribution surplus in relation to the entity immediately prior to the attribution account payment being made (see subsection 372(1)). An attribution surplus arises where the attribution credits exceed the attribution debits (see section 370). An attribution credit arises where, broadly, an amount has been included in an Australian resident taxpayer's assessable income under Part X.

10. In this regard, subsection 23AI(2) provides, in essence, that the fact that an attribution account payment is non-assessable non-exempt income under section 23AI is to be disregarded for the purpose of determining allowable deductions under any other provision.[6] The intention of subsection 23AI(2) is to allow the taxpayer to obtain a deduction for a loss or outgoing that would otherwise be deductible (for example under section 8-1 of the ITAA 1997) but for the fact that the income is non-assessable non-exempt.[7] There is no such provision within section 23AJ.

11. Section 160AFCD likewise treats a dividend that is non-assessable non-exempt income under section 23AI as assessable for the purposes of paragraph 160AF(1)(a). This permits a company, in certain circumstances, to claim a foreign tax credit for foreign tax paid in respect of the dividend. Again, there is no equivalent provision for a dividend that is non-assessable non-exempt income under section 23AJ.

12. As sections 23AJ and 23AI may each produce different outcomes in the above respects, it needs to be determined to what extent each provision applies.

13. In *Project Blue Sky Inc. and Others v. Australian Broadcasting Authority*,[8] the majority of the High Court stated:

> The primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of all the provisions of the statute. The meaning of the provision must be determined 'by reference to the language of the instrument viewed as a whole'. In *Commissioner for Railways (NSW) v. Agalianos*,[9] Dixon CJ pointed out that 'the context, the general purpose and policy of a provision and its consistency and fairness are surer guides to its meaning than the logic with which it is constructed'. Thus, the process of construction must always begin by examining the context of the provision that is being construed. A legislative instrument must be construed on the prima facie basis that its provisions are intended to give effect to harmonious goals.[10]

14. A construction under which section 23AI applies exclusively to the dividend to the extent an attribution debit arises is wholly consistent with the structure of the Act when read in its entirety. Any other construction would negate the specifically intended consequences of section 23AI applying (see paragraphs 10-11).

15. For example, if both section 23AJ and section 23AI were to apply in respect of a dividend, subsection 23AI(2) would not operate to allow a deduction under section 8-1 of the ITAA 1997 for a loss or outgoing that is incurred in gaining or producing the section 23AI income. This is because the whole of the dividend would still be non-assessable non-exempt income under section 23AJ (see paragraph 8-1(2)(c) of the ITAA 1997). Similarly, if section 23AJ alone applied in respect of the dividend, deductions (other than those permitted under section 25-90 of the ITAA 1997) and foreign tax credits would not be available.

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[6] Note, section 25-90 of the ITAA 1997 allows a deduction for certain costs (including interest) incurred in deriving income that is non-assessable non-exempt income under section 23AI or section 23AJ.
[7] See the Explanatory Memorandum to the Taxation Laws Amendment (Foreign Income) Bill 1990, page 35.
[8] (1998) 194 CLR 355.
[9] (1955) 29 ALJ 461; [1955] ALR 645; (1955) 92 CLR 390; [1955] WCR (NSW) 2.
[10] Per McHugh, Gummow, Kirby and Hayne JJ at 381-382.

16. To read the Act in a manner which does not give section 23AI primary and exclusive operation to the extent of an attribution debit would render ineffective the specific legislative treatment of dividend income representing profits previously attributed under Part X.

17. Therefore, where sections 23AJ and 23AI appear to overlap (that is a payment of a non-portfolio dividend to a resident company giving rise to an attribution debit), the better construction is that section 23AI applies exclusively to the extent of the attribution debit and section 23AJ applies to any part of the dividend that exceeds the attribution debit.

18. The consequences of this construction include the following:

- the whole of the dividend is non-assessable non-exempt income;
- section 25-90 of the ITAA 1997 allows a deduction for those costs in relation to a debt interest issued by an 'Australian entity'[11] (including interest) that are incurred in deriving the dividend income and covered by paragraph 820-40(1)(a) of the ITAA 1997 (the definition of 'debt deduction');
- deductions for other losses or outgoings incurred in gaining or producing the dividend may be permitted (for example, under section 8-1 of the ITAA 1997) but only to the extent that they are incurred in gaining or producing that part of the dividend that is non-assessable non-exempt income under section 23AI;[12]
- that part of the dividend that is non-assessable non-exempt income under section 23AJ (that is that part of the dividend that is not covered by section 23AI) will increase conduit foreign income (see section 802-30 of the ITAA 1997);[13] and
- the taxpayer may be entitled to a foreign tax credit under section 160AFCD for foreign tax they are taken to have paid and been personally liable for in respect of that part of the dividend to which section 23AI applies.

[11] 'Australian entity' has the meaning given by section 336.

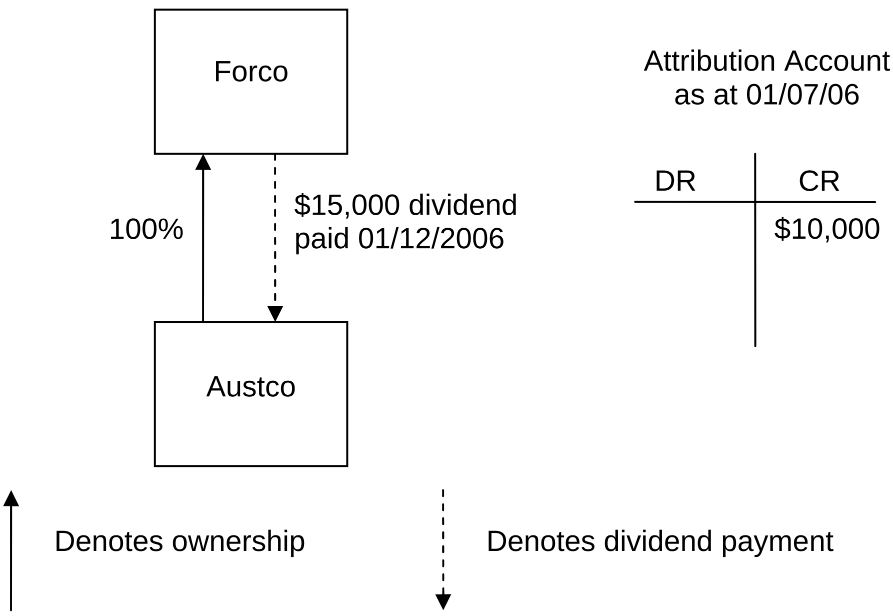
[12] Note that expenses incurred in deriving the attributable income may continue to be deductible against the attributable income under general principles.

[13] Note that if the company is applying the Foreign Dividend Account (FDA) provisions, the part of the dividend that is non-assessable non-exempt income under section 23AJ (that is that part of the dividend that is not covered by section 23AI) will give rise to a FDA credit under subsection 128TA(1). The FDA provisions were repealed from 14 December 2005, subject to the transitional provisions (see Part 3 of Schedule 2 to the *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005)*.

In finalising this determination, consideration will be given as to whether the examples contained in this Appendix can be located in the Ruling section.

Example

19. *Austco, an Australian resident company, owns 100% of Forco, a controlled foreign company. As at 1 July 2006, there was an attribution surplus of $10,000 in the attribution account in relation to Austco.*



20. *On 1 December 2006, Forco pays a dividend of $15,000 to Austco (Forco has not paid any other dividends to Austco). The dividend is an attribution account payment. Since there is an attribution surplus of $10,000 immediately before the payment, there is an attribution debit of $10,000 on payment of the dividend.*

21. *Section 23AI applies to the extent of $10,000 of the dividend. Section 23AJ applies to the remaining $5,000 of the dividend.*

22. *The whole of the dividend is non-assessable non-exempt income for Austco. In addition, Austco:*

- *will be entitled to a deduction for interest costs specified in paragraph 820-40(1)(a) of the ITAA 1997 incurred in deriving the dividend income;*
- *will be entitled to a deduction for other outgoings under section 8-1 of the ITAA 1997 (where the requirements of that section are met) only to the extent that they are incurred in deriving $10,000 of the dividend (that is that part of the dividend to which section 23AI applies);*
- *may be entitled to a foreign tax credit for any foreign tax it is taken to have paid and been personally liable for in respect of that $10,000 in accordance with section 160AFCD; and*
- *may increase its conduit foreign income by a net amount of $5,000 (that is that part of the dividend to which section 23AJ applies).*

Appendix 2 – Your comments

23. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date:	**31 March 2006**
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20; TD 2006/D14

Subject references:

- controlled foreign companies
- dividend income
- foreign attributable income
- foreign attribution credits
- foreign attribution debits
- foreign income
- non-assessable non-exempt income
- non-portfolio foreign income

Legislative references:

- ITAA 1936 23AI
- ITAA 1936 23AI(2)
- ITAA 1936 23AJ
- ITAA 1936 128TA(1)
- ITAA 1936 160AF(1)(a)
- ITAA 1936 160AFCD
- ITAA 1936 Pt X
- ITAA 1936 317
- ITAA 1936 336
- ITAA 1936 365(1)(a)
- ITAA 1936 370
- ITAA 1936 372(1)
- ITAA 1997 6-23
- ITAA 1997 8-1
- ITAA 1997 8-1(2)(c)
- ITAA 1997 25-90
- ITAA 1997 802-30
- ITAA 1997 820-40(1)(a)
- Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005 Pt 3 Sch 2

Case references:

- Project Blue Sky Inc & Others v. Australian Broadcasting Authority (1998) 194 CLR 355
- Commissioner of Railways (NSW) v. Agalianos (1955) 29 ALJ 461; [1955] ALR 645; (1955) 92 CLR 390; [1955] WCR (NSW) 2

Other references:

- Explanatory Memorandum to the Taxation Laws Amendment (Foreign Income) Bill 1990

ATO references

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