

TA 2015/1 - Dividend stripping arrangements involving the transfer of private company shares to a self-managed superannuation fund

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! The Commissioner's views on the application of section 177E of the *Income Tax Assessment Act 1936* (ITAA 1936) are contained in Taxation Ruling [IT 2627](#) and Taxation Determination [TD 95/37](#).

The Commissioner's view on the operation of the imputation system and section 177EA of the ITAA 1936 is discussed in Taxation Ruling [TR 2009/3](#).

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Taxpayer Alert

TA 2015/1

Dividend stripping arrangements involving the transfer of private company shares to a self-managed superannuation fund

Taxpayer Alerts are intended to be an early warning of our concerns about significant or emerging potential aggressive tax planning issues or arrangements that the Australian Taxation Office (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

- ! ***While this Taxpayer Alert describes a type of arrangement, it is not possible to cover every potential variation of the arrangement to which the anti-avoidance rules or other provisions of the Income Tax Assessment Act 1936, Income Tax Assessment Act 1997 or Superannuation Industry (Supervision) Act 1993 may apply. Taxpayers who have entered into, or are contemplating entering, an arrangement similar to that described in this Taxpayer Alert should apply for a private ruling to obtain certainty as to the ATO view, rather than seek to distinguish certain aspects of their arrangement from the Taxpayer Alert. Taxpayers may also consider seeking independent professional advice.***

This Taxpayer Alert is issued under the authority of the Commissioner.

Overview

This Taxpayer Alert describes arrangements where a private company with accumulated profits channels franked dividends to a self-managed superannuation fund (SMSF) instead of to the company's original shareholders. As a result, the original shareholders escape tax on the dividends and the original shareholders or individuals associated with the original shareholders benefit as members of the SMSF from franking credit refunds to the SMSF.

What is the issue?

The ATO is concerned that contrived arrangements are being entered into by individuals (typically SMSF members approaching retirement) so that dividends subsequently flow to, and are purportedly treated as exempt from income tax in, the SMSF because the relevant shares are supporting pensions. The intention is for the original shareholders of the private

company and/or their associates to avoid 'top-up' income tax on the dividend income; and for the SMSF to receive a refund of the unused franking credit tax offset, which is available for tax free distribution to its members.

This arrangement has features of dividend stripping which could lead to the ATO cancelling any tax benefit for the transferring shareholder and/or denying the SMSF the franking credit tax offset.

Description

This Taxpayer Alert applies to arrangements that display all or most of the following:

1. A private company (the company) has significant previously taxed accumulated profits, which are available to be paid to shareholders as franked dividends (subject to 'top-up' tax at marginal individual rates).
2. A shareholder in the company transfers their shares (the shares) in that company to a SMSF of which the shareholder or their associate is a member. There may be more than one shareholder who transfers shares to the SMSF.
3. The trustee of the SMSF treats the shares as supporting the payment of pensions to the member(s) of the SMSF (and therefore all or part of the income from the shares is regarded as exempt income of the SMSF).
4. After the SMSF satisfies the 45 day holding period rule, the company distributes its accumulated profits to the SMSF as fully or partially franked dividends.
5. The trustee of the SMSF treats the franked dividends and the attached franking credits as exempt income, which entitles the SMSF to a refund of the unused franking credit tax offsets.
6. The company may be liquidated or deregistered after the value of the shares is substantially reduced (or reduced to nil) by the payment of the franked dividends.

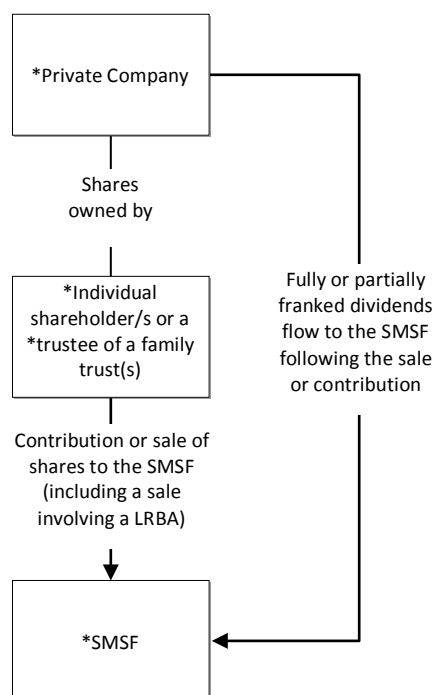
The arrangement may also include one or more of the following characteristics or variations:

7. The shareholder may transfer the shares to the SMSF as an in specie contribution and/or the SMSF may purchase the shares from the shareholder using:
 - (a) existing SMSF assets
 - (b) funding obtained from a limited recourse borrowing arrangement (LRBA) or some other form of financial accommodation, including paying for the shares using dividends received under the arrangement, or
 - (c) a combination of the above.
8. The company may make one or more distributions of franked dividends to the SMSF.
9. Distributions of franked dividends may also be made to other shareholders, if the SMSF does not hold 100% of the shares in the company.
10. The SMSF may receive franked dividends indirectly from the company, such as through a unit trust.
11. The SMSF (or another superannuation fund) may pay a superannuation benefit to enable the members to repay any outstanding shareholder or associate loans from the company prior to the acquisition of the shares by the SMSF.
12. A member of the SMSF may be in the accumulation phase and not receiving a pension, meaning that relevant franked dividends and attached franking credits will

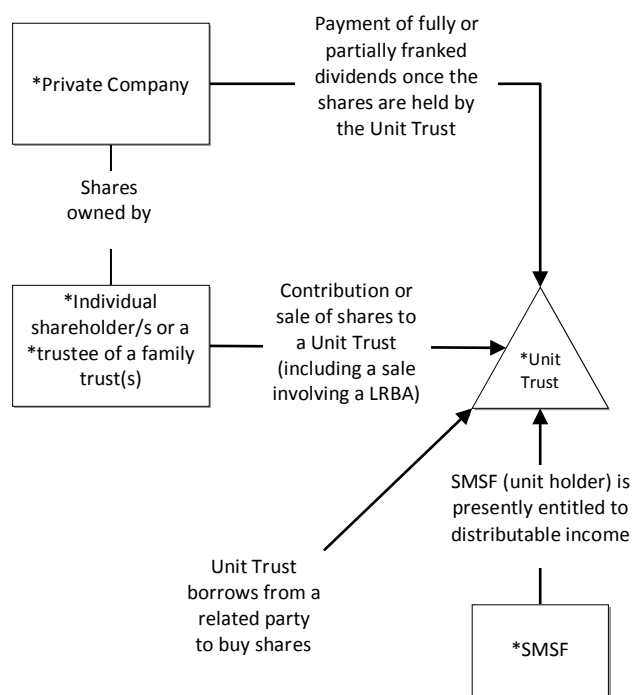
be assessable at 15%, resulting in a partial refund of the unused franking credit tax offsets to the SMSF.

Diagram of arrangement

1. Typical structure



2. Variation involving a Unit Trust



*These are typically all related parties with the entities involved being owned or controlled by one or more of the SMSF members, who are also beneficiaries of any family trust(s).

What are the ATO's concerns?

- a) The ATO considers that the **main anti-avoidance provisions** for arrangements of this type are whether:
 - (i) the franked dividends received by the SMSF may be part of a dividend stripping operation under paragraph 207-145(1)(d) of the *Income Tax Assessment Act 1997* (ITAA 1997)
 - (ii) the arrangement may be a scheme by way of or in the nature of, or have substantially the effect of, dividend stripping to which section 177E of the *Income Tax Assessment Act 1936* (ITAA 1936) applies
 - (iii) the arrangement may be a scheme to obtain imputation benefits to which section 177EA of the ITAA 1936 applies.
- b) The ATO considers that arrangements of this type may also give rise to **non-arm's length income** for the SMSF under section 295-550 of the ITAA 1997.
- c) **Other compliance issues** for arrangements of this type may include:
 - (i) capital gains tax consequences, for example, where transfers of shares are made below market value or the requirements of Division 152 of the ITAA 1997 (small business relief) are not met, even though that Division is relied upon as applying
 - (ii) ordinary dividend or deemed dividend consequences

- (iii) superannuation regulatory issues, for example, if the SMSF share acquisition from a related party is not covered by an exception contained in section 66 of the *Superannuation Industry (Supervision) Act 1993* (SISA); the market value ratio of the fund's in-house assets exceeds 5%; or the SMSF is maintained for purposes other than those set out in section 62 of the SISA. Breaches of the SISA may lead to the SMSF being made non-complying or the disqualification of an individual as a trustee, and/or
- (iv) excess contributions tax consequences.

 **Please note:**

Even if your arrangement differs in some respects from the arrangement described in paragraphs 1 to 12 above, the anti-avoidance rules or other provisions of the ITAA 1936, ITAA 1997 or SISA may still apply.

If the essence of an arrangement is to direct dividend income and attached franking credits from a private company to an SMSF instead of being paid to another entity, the arrangement, and whether it should be undertaken, requires careful consideration.

The ATO has significant concerns that taxpayers are seeking to distinguish arrangements from this Taxpayer Alert on the basis of some feature or other variation, rather than focussing on the essence of the arrangement and what it will (or is designed to) achieve. For example, seeking to distinguish the arrangement from this Taxpayer Alert on the basis of one or more of the following does not take the arrangement outside of the scope of this Taxpayer Alert:

- the private company also holds residential or commercial property when shares in the company are acquired by the SMSF
- the private company earns income on an ongoing basis
- distributions of franked dividends to the SMSF from the private company may happen over a number of income years instead of in the one income year
- the SMSF may receive franked dividends indirectly from the private company through various interposed entities, or
- there are no plans to deregister the private company.

What is the ATO doing about these compliance issues?

Private rulings

Prior to March 2014, the ATO had issued five private rulings on arrangements with features similar to those described in this Taxpayer Alert and did not apply the main anti-avoidance provisions (see paragraph (a) above). However, the ATO does not consider that this small number of private rulings constitutes a general administrative practice on such arrangements.

From March 2014, the ATO has consistently issued private rulings on arrangements with features similar to those described in this Taxpayer Alert and has applied the main anti-avoidance provisions (see paragraph (a) above). In addition, the ATO has applied the non-arm's length income provision (see paragraph (b) above) in some cases, applying the views expressed in Taxation Ruling TR 2006/7.

The ATO is continuing to closely examine private ruling applications for arrangements with features similar to those described in this Taxpayer Alert.

Compliance action

If you entered into an arrangement with features similar to those described in this Taxpayer Alert, the ATO may allocate compliance resources to consider applying all relevant provisions to your arrangement on a case-by-case basis, including:

- the main anti-avoidance provisions (see paragraph (a) above)
- the non-arm's length income provision (see paragraph (b) above)
- the provisions relevant to other compliance issues (see paragraph (c) above).

Further public guidance

The ATO will issue a public guidance product to explain the ATO view on how taxation and superannuation laws apply to arrangements with features similar to those in this Taxpayer Alert.

As part of consultation on this public guidance product, the ATO will consult on the application of the main anti-avoidance provisions to such arrangements, including those entered into before the issue of this Taxpayer Alert.

What should you do?

If you have entered into a similar arrangement to that described in this Taxpayer Alert you may wish to seek independent professional advice. If you would like to correct something in your tax return more information is available on our website ato.gov.au and search for [Correct a mistake or amend a return](#).

You may also ask us for our view through a private ruling or contact the officer named in the Taxpayer Alert. More information on private rulings is available on our website ato.gov.au and search for [Applying for a private ruling](#).

Frequently asked questions

Who should I contact if I have information about the arrangement?

If you have any information about the current arrangement, or would like to provide information about an individual or company potentially promoting the arrangement:

- phone us on **1800 177 006** (after the initial messages, wait for the 'Taxpayer Alert' option then press 1)
- complete the [ATO Tip-Off Form](#)

What penalties could apply if I participate in the arrangement?

If you participate in an arrangement similar to that described in this Taxpayer Alert, and do not have a private ruling or class ruling in respect of your arrangement, you may be liable to penalties (in addition to being required to pay any tax that is avoided).

More information on penalties is available on our website ato.gov.au and search for [Interest and penalties](#). Penalties of up to 75% of the tax avoided can apply.

How do I make a voluntary disclosure?

Any penalty relating to your participation will be significantly reduced if you make a voluntary disclosure. Generally, the reduction is greater if you make the disclosure *before* we notify you of an examination of your tax affairs (eg an audit).

More information on voluntary disclosures is available on our website ato.gov.au and search for [Voluntary disclosures](#) or phone **13 28 66**.

For further information, see Miscellaneous Taxation Ruling [MT 2012/3](#).

What if I have implemented a similar arrangement consistent with a private ruling issued to me stating that section 295-550 or paragraph 207-145(1)(d) of the ITAA 1997 or Part IVA of the ITAA 1936 does not apply?

Your ruling only applies in the circumstances set out in the 'Relevant facts and circumstances' section of the ruling. If you have relied on your ruling, that is, you have conducted your tax affairs in a way that is consistent with your ruling, we must apply the law to you in the way set out in the ruling. However, if you have implemented your arrangement in a materially different way from that set out in your ruling, the ruling will not apply to your circumstances.

More information is available on our website ato.gov.au and search for [Can I rely on a private ruling?](#)

Where can I find out more about Taxpayer Alerts?

Further information on Taxpayer Alerts, including circumstances in which one may be withdrawn, can be found in Law Administration Practice Statement [PS LA 2008/15](#).

A full list of [Taxpayer Alerts](#) issued by the ATO is available on our website, ato.gov.au.

References

Subject References:

dividend stripping
franking accounts
franking credits
holding period rule
in specie contributions
Part IVA
self-managed superannuation funds

Legislative References:

Income Tax Assessment Act 1936

[Part IVA](#)
[Section 177D](#)
[Section 177E](#)
[Section 177EA](#)

Income Tax Assessment Act 1997

[Section 207-145](#)
[Section 295-550](#)

Superannuation Industry (Supervision) Act 1993

[Section 66](#)
[Section 71](#)

Related Practice Statement:

[PS LA 2008/15](#)

Related Rulings:

[IT 2627](#)

[MT 2012/3](#)

[TR 2006/7](#)

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