



EMBARGO Budget. Not for release before 7.30 pm AEST, 13 May 1997.

MEASURES TO PREVENT DIVIDEND STREAMING

Financial Implications (\$m)

1997-98	1998-99	1999-00	2000-01
–	†‡	†‡	†‡

† The measure will protect the revenue base used for the forward estimates, by removing opportunities for significant future expansion of tax minimisation practices. In the absence of the measure, to the extent that the revenue base would not be protected, there would be a significant revenue loss compared to the forward estimates.

‡ The measure will result in unquantifiable revenue gains to the extent of existing tax minimisation.

Explanation

The Government has decided to introduce measures to address the unintended usage of franking credits through dividend streaming arrangements. Dividend streaming arrangements involve a company disproportionately directing franked dividends to shareholders who can benefit most from imputation credits.

The underlying principles of the imputation system as introduced in 1987, and as reflected in its affordability, include: first, that tax paid at the company level is in broad terms imputed to shareholders proportionately to their shareholdings; and second, that the benefits of imputation would be available only to the true economic owners of shares, and only to the extent that those taxpayers were able to use the franking credits themselves.

Dividend streaming undermines the first principle by attributing tax paid on behalf of all shareholders to only some of them by allowing the streaming of franking credits to maximise their value to certain shareholders over others. To allow such practices to continue would bring into question the affordability of the imputation system as originally designed.

Amendments to address schemes which undermine the second underlying principle are set out in the separate Treasurer's Press Release on 'Measures to Prevent Trading in Franking Credits'.

The *Income Tax Assessment Act 1936* (ITAA) already contains specific provisions designed to maintain the original objective of the imputation system by preventing dividend streaming. It is clear, however, that these provisions are not wholly effective. The Government intends to introduce amendments to the ITAA to strengthen the existing streaming provisions by:

- **providing an anti-avoidance rule targeting dividend streaming**, which would apply to arrangements whereby a company streams dividends so as to provide franking credits to shareholders who benefit most in preference to others;

- this rule will apply to dividends and distributions paid on or after 7.30 pm AEST, 13 May 1997, including those relating to arrangements entered into before that time;
- ensuring that **section 45Z** operates to treat dividends distributed to beneficial owners of shares which are equivalent to interest on a loan in the same way that dividends to direct owners are treated with respect to the operation of the debt dividend provisions (section 46D of the ITAA);
 - this amendment will apply to capital subscribed to trusts and finance raised on or after 7.30 pm AEST, 13 May 1997, and to the renewal, extension or rollover after that time of existing interests in trusts after the expiry of their present term;
- **amending the definition of ‘class of share’** in the ITAA by providing that a class of shares includes all shares having substantially the same rights;
 - a similar amendment would also apply in relation to interests held in a corporate limited partnership so that they are deemed to be one share class;
 - these amendments will apply to all shares and partnership interests, whether issued before or after 7.30 pm AEST, 13 May 1997, and will apply in relation to franking years commencing after that time.

The general anti-avoidance rule described in the Press Release on ‘Measures to Prevent Trading in Franking Credits’ will also have application to dividend streaming arrangements.

- As for the anti-avoidance rule targeting dividend streaming, this general anti-avoidance rule will apply to dividends and distributions paid on or after 7.30 pm AEST, 13 May 1997, including those relating to arrangements entered into before that time.

In the case of dividend streaming arrangements attracting the operation of either of the anti-avoidance provisions, the Commissioner will have the discretion either to deny franking credits on the streamed dividends or distributions paid under such an arrangement, or post a franking debit to the company streaming the dividends.

Details of the amendments are set out in the attachment.

The above material is an extract of the description of the measure as contained in *Budget Paper No 2: Budget Measures 1997-98*. This paper explains all outlays and revenue measures, and is available from Australian Government Bookshops or from the Treasury Internet site at <http://www.treasury.gov.au/budget>

CANBERRA
13 May 1997

Contact Officer: Simon Matthews (Australian Tax Office)
(tel: (06) 216 1523)

Catherine Courtenay
(02) 9374 2411

ATTACHMENT

General Anti-Streaming Rule

An anti-streaming rule will apply where, on or after 7.30 pm AEST, 13 May 1997, a company streams the payment of dividends or other distributions (eg bonus shares) in such a way as to give shareholders who benefit most from franking credits a franking credit advantage over those that would not benefit to the same degree. For such streaming to occur one of the following circumstances needs to be present:

- the dividend in question has a franking credit attached to it while the other relevant distribution does not; or
- the franked amount of the dividend is higher than that of the other dividend.

Where such a streaming arrangement exists, the Commissioner will make a determination specifying whether the streaming company will incur a franking debit, or whether the franking credits on the streamed dividends will be denied.

Some streaming arrangements will be subject to the general anti-avoidance rule explained in relation to the 'Measures to Prevent Trading in Franking Credits'. This general anti-avoidance rule will apply to deny franking credits (and therefore any franking rebate) on dividends or distributions paid on or after 7.30 pm AEST, 13 May 1997 under certain arrangements which have a purpose (other than an incidental purpose) of obtaining a tax advantage in relation to franking credits.

The rule will apply where:

- there is an arrangement for the issue, sale or other disposition of shares or an interest in shares (which, for these purposes, would include making a taxpayer a beneficiary of a discretionary trust holding shares);
- a dividend was payable or expected to be payable on the relevant shares, or a distribution was payable or expected to be payable on the relevant interest;
- the dividend or distribution was expected to have franking credits attached;
- it could reasonably be expected that any party to the arrangement will, as a result of the arrangement, obtain a tax advantage in relation to franking credits, being the obtaining of a franking rebate to offset income tax liabilities or a credit to a franking account, or that a party to the arrangement will not be able to obtain such a tax advantage; and
- the obtaining of the tax advantage was not an incidental purpose of the arrangement.

For an arrangement to exist, the issue, sale or disposition of shares and the purpose, not being an incidental purpose, of obtaining a tax advantage for one of the parties to the arrangement must be connected in some way.

This rule is discussed in further detail in the Treasurer's Press Release on 'Measures to Prevent Trading in Franking Credits'.

Section 45Z

Section 45Z and related provisions will be amended to ensure that, consistent with the operation of section 46D of the ITAA, where:

- the beneficiary of a trust becomes presently entitled to a share of the income of a trust estate,
- that share is attributable, wholly or partly, to dividends, and
- the entitlement of the beneficiary to its share of the trust's income is equivalent to an entitlement to interest on a loan,

the intercorporate dividend rebate and/or franking credit or franking rebate will not be allowed to the beneficiary. It will be immaterial whether the loan or its equivalent is to the company paying the dividends, the trust or an associate of either.

Example

- (a) A taxpayer subscribes money or property (eg shares) worth \$100,000 to a trust for redeemable units. Under the terms of the trust, the units are redeemable after five years for \$100,000, and in the interim the taxpayer is entitled to a share of the net income of the trust estate attributable to franked dividends (grossed up for the franking credits attached to them) of \$7,000 per annum.

The taxpayer, if a company, will not be entitled to the intercorporate dividend rebate or franking credits, and, if an individual, will not be entitled to a franking rebate.

- (b) A taxpayer subscribes \$100,000 for redeemable preference shares in a company. The shares are redeemable after five years, but do not carry dividends. The taxpayer also acquires an interest in a trust associated with the company for a nominal sum. The trust holds shares in companies paying franked dividends. The terms of the trust provide that while the shares in the company remain unredeemed the taxpayer is entitled to be paid a share of the net income of the trust estate attributable to franked dividends (grossed up for franking credits) of \$7,000 per annum.

The taxpayer, if a company, will not be entitled to the intercorporate dividend rebate or franking credits, and, if an individual, will not be entitled to a franking rebate.

Definition of Class of Share

To prevent inconsequential differences in share rights constituting a separate class, this measure will modify the existing definition in section 160APE of the ITAA concerning what constitutes a class of shares for the purposes of the dividend imputation provisions. It applies in relation to franking years which commence after 7.30 pm, AEST 13 May 1997.

Section 160APE will be amended to provide that a class of shares includes all shares having substantially the same rights having regard to all the rights attaching to the shares. Therefore, for example, shares which have substantially the same rights but differ only in their par value or voting rights will constitute a single class of shares.

By virtue of section 94L of the ITAA, corporate limited partnerships can pay franked dividends. Because these partnerships do not have an equivalent to classes of shares, the measure will operate to ensure that all partners are deemed to hold shares of one class.