Company tax rates – more complex than they should be

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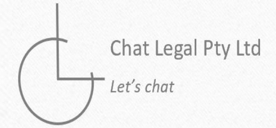
Cautionary note



Today's presentation will be less structured and more of maze of the rabbit hole that is making a frankable distribution

What is a dividend?

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- Section 6 ITAA 1936 (main)
- Various other sections providing additional definitions.
- Includes: 'any distribution made by a company to any of its shareholders, whether in money or other property; and any amount credited by a company to any of its shareholders and shareholders.'
- **Doesn't** include (although not exhaustive) monies paid out of share capital, as part of the redemption or cancellation of redeemable preference shares in certain circumstances and reversionary bonus on a policy of life-assurance

When can a dividend be declared?

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- Section 254T Corporations Act
- Company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend.
- Payment of the dividend is 'fair and reasonable' to the company's shareholders as a whole.
- Payment of dividend does not materially prejudice the company's ability to pay its creditors.
- **NOTE:**
  - Payment of a dividend would materially prejudice if the company would become insolvent as a result of the payment.
  - Director duty to prevent insolvent trading on payment of dividends – section 588G Corporations Act

Dividend imputation

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- Part 3-6 ITAA 1997
- Allows an 'Australian corporate tax entity' to pass to members of the company a credit for income tax paid by the entity on those profits. This is called 'franking a distribution' – ss200-5 and 200-10
- Allows such entity's Australian members to claim a tax offset for that credit – s200-5
- Allows such entity's Australian members to claim *a refund if they are unable to fully utilise the tax offset in reducing their income tax* – s200-5
- The amount of credits available to pass are kept via a franking account – s200-15
- Only certain distributions can be franked – s200-20

Dividend imputation

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- An entity must not frank a distribution from profits exceeding the maximum they would have paid and the distribution of any franked amounts in excess will limit any franked amounts to the maximum amount available – s200-25
- All frankable distributions made without a particular period must be franked to the same extent (i.e. no differing frankable proportions) – s200-30
- Tax offsets equal to the franking credits for Australian resident recipients of frankable distributions – 200-35
- If not an Australian recipient, consider Division 11A of Part III of ITAA 1936 and Subdivision 207-D ITAA 1997
- Certain entities (pooled development fund, life insurance companies, NZ resident companies and exempting companies etc) have special franking rules – s200-45

Franking a distribution

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- You can frank a distribution if – s202-5:
  - The entity is a **franking entity** that satisfies the **residency requirement**.
  - The distribution is a **frankable distribution**
  - The entity allocates a **franking credit** to the distribution.
- Franking entity – 202-15:
  - Corporate tax entity.
  - Is not a life insurance company that is a mutual insurance company.
  - If company is a trustee of a trust – it is not acting in its capacity as trustee of the trust.
- Residency requirement – 202-20:
  - Is an Australian resident.
  - Note slight differences between company, corporate limited partnership and public trading trust

Franking a distribution

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- Frankable distribution:
  - Frankable (whether a distribution or non-share dividend) unless specified they are unfrankable – s202-30
- Unfrankable distributions – 202-45:
  - Any premium on a purchase price of a buy-back of shares that is above the market value.
  - Distribution in respect of a non-equity share.
  - Distributions sourced from a company's share capital account.
  - Per ss215-10 or 215-15.
  - Per other various sections.
  - Demerger dividend.

Franking a distribution

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- How much franking credits?:
  - Maximum equivalent to maximum amount of income tax that the entity making the distribution could have paid, at the entity's **corporate tax rate for imputation** purposes for **the income year in which the distribution is made**, on the profits underlying the distribution – s202-55
  - Calculated per s202-50 $\text{Amount of the *frankable distribution} \times \frac{1}{\text{Applicable gross-up rate}}$
  - Applicable gross-up rate means **corporate tax gross-up rate** of the entity making the distribution for the **income year in which the distribution is made**.
  - Corporate tax gross-up rate (s995-1) – (100%-Corporate tax rate for imputation purposes of the entity)/Corporate tax rate for imputation purposes of the entity for the income year.
  - Corporate tax rate for imputation (s995-1) – The relevant corporate tax rate.* The definition here looks a few scenarios such as only partial-years and aggregated turnovers.

Franking a distribution

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- Obligations?
  - There must be a distribution statement given at least within 4 months after the end of the income year in which the distribution is made – s202-75
  - Dividend statement requirements – s202-80:
    - Identify entity making distribution;
    - State date and amount of distribution;
    - State franking credit amount and **franking percentage** for the distribution;
    - State the amount of any withholding tax that has been deducted.

    Note: Offence to fail to give above statement per *Taxation Administration Act 1953* (Cth)
  - Amendments available to distribution statement – s202-85
  - Note franking percentage calculated per s203-25

$$\frac{\text{*Franking credit allocated to the *frankable distribution}}{\text{*Maximum franking credit for the distribution}} \times 100$$

Some quirks

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- Prior references for franking credits was ‘corporate tax gross-up rate’ as opposed to the current ‘applicable gross-up rate’
- Importantly, ‘applicable gross-up rate does not consider rate that tax was paid but rather the **year that the company is paying the dividend**
- Even weirder they use the previous income year’s figures to consider the rate for the year that the company is paying the dividend.
- *Income Tax Rates Act 1986* is where to look, specifically, sections 23, 23AA and 23AB
- The question therefore is whether at the date of paying the dividend, if the company’s tax rate is 27.5% (where the entity is a **base rate entity**) or 30% (for other companies) – s23 ITRA

Some quirks

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- An entity is a base rate entity if **no more than 80%** of its assessable income for the year of income is base rate entity passive income **and** its aggregated turnover for the year of income is less than $50 million – s23AA ITRA
- Base rate entity passive income includes – s23AB ITRA:
  - A distribution by a company, other than a non-portfolio dividend
  - An amount of franking credit
  - A non-share dividend
  - Interest, royalties and rent
  - Net capital gains
  - Partnership and trust distributions that is base rate entity passive income
- Note certain exemptions for income received if entity is a financial institution

Benchmark rule – Division 203

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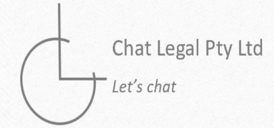
- Within a particular period, all frankable distributions must be made with the same franking percentage
- Franking percentage set by the first frankable distribution made during period
- Ensures no one member preferred over another
- Rule doesn't apply in certain circumstances (s203-20) that requires the company to be a listed publig company.
- Consequences for breaching rule in s203-50 includes paying over-franking tax.
- Note franking period for an entity that is a private company for an income year is the same as the income year.

Anti-streaming rules – Division 204



- Rules preventing exploitation of a company's benchmark franking percentage
- Rules preventing substitution of tax-exempt bonus share for a franked distribution
- Rules preventing streaming of imputation benefits to one member of a company in preference of another
- Requirement for entity to notify Commissioner if there is a significant difference in its benchmark franking percentage
- Rules above kept in line due to certain deeming of franking debits

Franking accounts – Division 205

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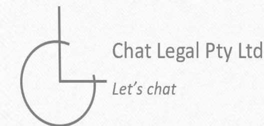
- Companies must keep a franking account
- Payment of PAYG instalment or income tax or receipt of franked distribution will generate a credit
- Refund of income tax or payment of a franked distribution will debit from the account
- Note there are various other circumstances, so consider if things fall inside or outside
- If there is a deficit, then a 'franking deficit tax'

Receiving distribution – Division 207



- Note franked distributions received by partnerships and trusts have their own unique subdivision 207-B
- Long story short – franked distributions **can** flow indirectly (subject to terms of trust deeds)
- In relation to a beneficiary of a trust – only if the distribution is made to the trustee of the trust and the beneficiary has an amount of the trust's net interest to be distributed to it
- Franked distributions can flow through an entity as well if certain requirements are met – s207-50
- "Holding period" rules – either hold for 45 days (90 days for preference) or get a family trust election – see TD 2007/11. Failure to satisfy results in franking credits being denied

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