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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

SENATE

NEW BUSINESS TAX SYSTEM (MISCELLANEOUS) BILL 1999

SUPPLEMENTARY EXPLANATORY MEMORANDUM

Requests for amendments to be moved on behalf of the Government

(Circulated by authority of the
Treasurer, the Hon Peter Costello, MP)

Table of contents

General outline and financial impact	1
Chapter 1 Refunding imputation credits to certain charities and gift-deductible organisations	3

General outline and financial impact

The amendments amend the New Business Tax System (Miscellaneous) Bill 1999 to allow refundable imputation credits (franking rebates) to certain charities and gift deductible organisations.

Date of effect: The amendments apply in relation to dividends paid on or after 1 July 2000.

Proposal announced: Treasurer's Press Release No. 24 of 13 April 2000.

Financial impact: The financial impact of these amendments are set out in the following table:

2000-2001	2001-2002	2002-2003	2003-2004
–	\$50m	\$50m	\$50m

Compliance cost impact: Eligible organisations who do not currently lodge a tax return may incur a small cost if they choose to lodge a return to take advantage of the refund.

Chapter 1

Refunding imputation credits to certain charities and gift-deductible organisations

Outline of Chapter

1.1 This Chapter explains the amendments to the New Business Tax System (Miscellaneous) Bill 1999 which will allow refundable imputation credits (franking rebates) to certain registered charities and gift-deductible organisations.

Context of Reform

1.2 Under the current law, resident tax-exempt entities, including resident registered charities and gift-deductible organisations, are not able to get a refund of underlying company tax paid on investments in and through companies. This may create a tax-driven distortion away from such investments.

1.3 By allowing refundable imputation credits to eligible charities and gift-deductible organisations, the tax-driven distortion is removed because the underlying company tax will be refunded. Given the nature of the organisations eligible for this concession, and the limited cost to the revenue from restricting it to those organisations, refunding underlying company tax in these circumstances is appropriate.

Summary of new law

1.4 Under the new law, from 1 July 2000 registered charities and gift-deductible organisations entitled to refundable imputation credits will obtain a franking rebate from franked dividends. These dividends may be received directly as a shareholder, or indirectly as a beneficiary of a trust that receives a franked dividend. As for resident individuals and superannuation entities, the franking rebate will be refundable.

1.5 Anti-avoidance rules apply to deny the franking rebate in certain circumstances where this concession is open to abuse. If these rules are triggered, a penalty may arise to the controller of a registered charity or gift-deductible organisation that wrongly claims a franking rebate. However, this penalty only arises if the controller or an associate of the controller has benefited from the transaction that triggered the application of the anti-avoidance rule.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Registered charities and gift-deductible organisations entitled to refundable imputation credits may obtain a franking rebate from franked dividends.	Tax-exempt organisations, including registered charities and gift-deductible organisations, cannot obtain franking rebates.

Detailed explanation of new law

1.6 The amendments to this Bill make the necessary changes to the *Income Tax Assessment Act 1936* (ITAA 1936) to allow a franking rebate to charities and gift-deductible organisations which are entitled to refundable imputation credits. By virtue of the amendments to the *Income Tax Assessment Act 1997* (ITAA 1997) made by existing Schedule 2 to this Bill, the franking rebate allowed will be refundable.

Which registered charities and gift-deductible organisations are entitled to refundable imputation credits?

1.7 To be eligible for refundable imputation credits an organisation must be prescribed by regulation or:

- be exempt from income tax;
- be a charity or a gift-deductible organisation;
- be resident in Australia;
- be endorsed by the Commissioner of Taxation (Commissioner) or (in the case of a gift-deductible organisation) be identified by name in Subdivision 30-B of the ITAA 1997; and
- have an ABN.

1.8 It is a general rule of the dividend imputation system that franking rebates are not available for tax-exempt dividends. The amendments implement an exception to that general rule. In recognition of this exception, the amendments identify charities and gift-deductible organisations entitled to the concession by reference to exempt institutions whose exempt status is disregarded for the purpose of calculating entitlement to a franking rebate. The exempt institutions referred to are the organisations that satisfy the requirements listed in paragraph 1.7 – they are referred to in this Chapter as eligible institutions. Provided the anti-avoidance rules explained below are not triggered, eligible institutions are entitled to a franking rebate (in the terms of the amendments, their exempt status is disregarded).

1.9 An exempt institution is an entity whose ordinary and statutory income is exempt under Division 50 of the ITAA 1997. An entity for these purposes covers any form that a charity or gift-deductible organisation could take, including a trust or unincorporated association. *[Amendment 1, definitions in section 160APA of the ITAA 1936]*

1.10 An exempt institution is an eligible institution (i.e. an institution able to claim a franking rebate provided the anti-avoidance rules described below are not triggered) if it satisfies one of 4 tests (or is prescribed by the income tax regulations as such *[amendment 7, subsection 160ARDAB(6)]*). The first test is satisfied if the institution:

- is covered by items 1.1, 1.5, 1.5A or 1.5B of the table in section 50-5 of the ITAA 1997 (these items cover institutions that are commonly described as charities, including institutions whose purpose is the advancement of religion – such as churches – or the advancement of education – such as non-profit private schools) *[amendment 7, paragraph 160ARDAB(2)(a)]*;
- is endorsed under Subdivision 50-B of the ITAA 1997 (which means that it is endorsed by the Commissioner as a tax-exempt organisation because it satisfies the criteria listed in section 50-110 of the ITAA 1997, including a requirement that it have an ABN) *[amendment 7, paragraph 160ARDAB(2)(b)]*; and
- has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia for the whole of the year of income for which the franking rebate is being claimed *[amendment 7, paragraph 160ARDAB(2)(c) and subsection 160ARDAB(7)]*.

1.11 The second test is satisfied if the exempt institution is:

- endorsed under paragraph 30-120(a) of the ITAA 1997 as an organisation eligible to receive deductible gifts because it satisfies the criteria listed in section 30-125 (including a requirement that the institution have an ABN); and
- has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia for the whole of the year of income for which the franking rebate is being claimed.

[Amendment 7, subsection 160ARDAB(3)]

1.12 The third test which an exempt institution may meet to be an eligible institution is satisfied if the institution:

- has an ABN;
- is described by name in a table in Subdivision 30-B of the ITAA 1997 (which contains a number of tables that list certain organisations which do not have to be endorsed to be eligible to receive deductible gifts); and
- has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia for the whole of the year of income for which the franking rebate is being claimed.

[Amendment 7, subsection 160ARDAB(4)]

1.13 Finally, an exempt institution will be an eligible institution if it is a public fund declared by the Treasurer to be a relief fund in accordance with subsection 30-85(2) of the ITAA 1997. However, a relief fund that is prescribed in the regulations as not being eligible for the concession will not be an eligible institution. *[Amendment 7, subsection 160ARDAB(5)]*

When will an eligible institution receive a franking rebate?

1.14 An eligible institution will receive a franking rebate if its exempt status is disregarded in relation to a franked dividend (received directly or indirectly through a trust). In effect, subject to the anti-avoidance rules explained at paragraphs 1.22 to 1.52, an eligible institution will receive a franking rebate in the same circumstances that an individual or superannuation fund would obtain a rebate from a franked dividend which is received directly or indirectly through a trust. No franking rebate will arise for a franked dividend received indirectly by an eligible institution through a partnership. *[Amendment 7, subsection 160ARDAB(1)]*

1.15 To identify dividends received indirectly through a trust, the amendments use the term 'notional trust amount'. A notional trust amount is defined as an amount representing a beneficiary's share of trust income which, but for the tax-exempt status of eligible institutions, would be included in an eligible institution's assessable income. *[Amendment 7, subsection 160ARDA(1)]*

1.16 To the extent that the beneficiary's share of trust income is attributable to a franked dividend, the beneficiary may be eligible to receive a franking rebate. Therefore, references throughout this Chapter to a notional trust amount identify franked dividends received indirectly by a beneficiary of a trust. (For ease of expression, in this Chapter a notional trust amount is said to be 'paid' in circumstances when a beneficiary becomes entitled to it.)

1.17 To provide eligible institutions with access to franking rebates, the following provisions of the ITAA 1936 are amended:

- section 160AQT (the provision that 'grosses-up' franked dividends received by a shareholder) *[amendment 2, subparagraph 160AQT(1A)(b)(v)]*;
- section 160AQU (the provision allowing a franking rebate for franked dividends received directly) *[amendment 3, subparagraph 160AQU(1)(b)(ii)]*; and
- section 160AQUX (the provision allowing a franking rebate for franked dividends received indirectly through a trust) *[amendment 6, subparagraph 160AQUX(1)(b)(iii)]*.

1.18 Consistent with the availability of a franking rebate for other taxpayers, a franking rebate is not available to an eligible institution if it is acting in the capacity of a trustee for another entity or person. *[Amendment 3, subparagraph 160AQU(1)(b)(ii); amendment 6, subparagraph 160AQUX(1)(b)(iii)]*

1.19 As mentioned above, the dividend imputation provisions are structured in such a way that a franking rebate is only available if the dividend or notional trust amount is included in a taxpayer's assessable income. To overcome the technical problem of providing a franking rebate to a tax-exempt entity, the income tax exemption of eligible institutions for the purposes of determining entitlement to a franking rebate is ignored. This is done to overcome that technical problem only – it has no substantive effect on the institution's general exemption from income tax. *[Amendment 2, subsection 160AQT(4A); amendment 3, subsection 160AQU(3); amendment 4, subsection 160AQUW(1); amendment 5, subsection 160AQUWA(2)]*

1.20 To prevent multiple franking rebates being claimed from a single franked dividend, an eligible institution will not be entitled to a franking rebate on a notional trust amount which is attributable to a franked dividend received directly or indirectly by another eligible institution. For example, if a charitable trust that is an eligible institution is paid a franked dividend it may receive a franking rebate. If it then distributes (directly or indirectly through another trust) the dividend income to another eligible institution as a trust beneficiary, the other eligible institution will not also be eligible to claim the franking rebate. *[Amendment 7, subsection 160ARDAB(8)]*

1.21 At the end of their income year, eligible institutions will be able to claim franking rebates to which they are entitled in a form approved by the Commissioner.

Anti-avoidance rules

1.22 It was indicated in paragraphs 1.5 and 1.8 that the eligibility of an eligible institution to a franking rebate is subject to anti-avoidance rules. These anti-avoidance rules are necessary having regard to the object of the amendments.

1.23 The object of the amendments is to ensure that ordinary investment income received by an eligible institution is not subject to underlying taxation simply because it is received through a company as a franked dividend. Because dividends and notional trust amounts received by an eligible institution are untaxed but can give rise to a refund of franking rebates, there is a risk to the revenue that this measure may be used to confer undue tax benefits which are inconsistent with its object. Therefore, in addition to the ordinary rules governing access to franking rebates for all taxpayers (including the franking credit trading and dividend streaming rules), anti-avoidance rules are required.

1.24 The modified general anti-avoidance rule announced by the Treasurer on 11 November 1999 would apply to any scheme where there is a sole or dominant purpose of providing franking benefits (or other tax benefits) to an eligible institution. However, even where there is not such a scheme, franking benefits will be denied if one of the rules explained below applies. *[Amendment 7, section 160ARDAC]*

1.25 These rules apply in a number of circumstances where it is inappropriate for an eligible institution to receive the benefit of the franking rebate. To some extent the rules explained below overlap so that a franking rebate may be denied under more than one head. However, the fact that one rule may cover transactions covered by another rule does not give rise to the implication that the other rule should be construed narrowly to avoid an overlap. *[Amendment 7, subsection 160ARDAC(1)]*

When will an anti-avoidance rule apply?

1.26 There are 5 broad categories of cases when franking rebates will be unavailable to an eligible institution. These categories, each of which is explained in detail below, are:

- reduced benefit to the eligible institution from the franked dividend or notional trust amount because of a transaction related to its payment;
- provision of a benefit, or incurring of a detriment by the eligible institution or another entity because of a transaction related to the payment of the franked dividend or notional trust amount;
- advantage obtained by the payer of the dividend or trust distribution (or an associate of the payer) because of a transaction related to the payment of the franked dividend or notional trust amount;
- full ownership of property comprising a dividend or notional trust amount does not pass to the eligible institution; and
- additional benefit obtained by an entity in connection with the payment of the franked dividend or notional trust amount.

1.27 Most of the transactions falling within these categories which preclude a franking rebate require a 'related transaction' in relation to the relevant franked dividend or notional trust amount. For these purposes, a related transaction exists if:

- something has occurred or may reasonably be expected to occur; and
- what has occurred (or may reasonably be expected to occur) arises as part of, in connection with or as a result of the payment (or receipt) of the dividend or notional trust amount, or any arrangement entered into in association with its payment (or receipt). *[Amendment 7, subsection 160ARDAA(1)]*

1.28 The above reference to 'arrangement' is intended to be broad. It includes formal and informal agreements, arrangements and understandings that are not legally binding. *[Amendment 7, subsection 160ARDAA(1)]*

1.29 The related transaction concept requires a link between a dividend or notional trust amount and an act, transaction or circumstance. The required link is that the act, transaction or circumstance must occur as part of, in connection with or as a result of:

- the payment or receipt of the dividend or trust amount; or
- an arrangement entered into in association with that payment or receipt.

1.30 Thus merely buying a share 'cum-div' (i.e. with the attached right to receive a declared dividend) would not amount to a related transaction. This is because the acquisition of the share does not occur as part of, in connection with or as a result of the payment or receipt of the dividend or an arrangement entered into in association with its payment or receipt. Similarly, naming rights arising from the association of a company with an eligible institution would not usually be part of a related transaction unless they arise in connection with the payment of dividends by the company to the institution.

Benefit to the eligible institution reduced

1.31 A franking rebate is not available to an eligible institution if, because of a related transaction (as defined above), the amount or value of the benefit derived from the relevant dividend or notional trust amount is less than its amount or value at the time it is paid. [*Amendment 7, subsection 160ARDAC(2)*]

1.32 For these purposes the amount or value of the dividend or notional trust amount includes the benefit arising from the franking rebate. Therefore, the rule would be triggered if, because of the related transaction, the total value received by an eligible institution from the dividend or notional trust amount is less than the sum of:

- the dividend or notional trust amount; and
- the imputation credits relating to it.

1.33 When applying this rule, it is necessary to ignore collateral arrangements and only have regard to the intrinsic value of the dividend or notional trust amount (and associated franking rebate) to determine whether the benefit obtained by the eligible institution is less than the amount or value of the dividend or notional trust amount at the time it is paid. For example, assuming a company tax rate of 30%, a \$70 fully-franked dividend would have an intrinsic value of \$100. If, having regard to any related transactions, an eligible institution to whom the dividend is paid derives a net benefit of only, say, \$80 from the dividend, then the rule would be triggered.

1.34 The reference to the value of the dividend or notional trust amount *at the time* it is paid ensures that, if property other than money comprises the whole or part of the dividend or amount, then the relevant time for valuing that property is:

- the time of payment of the dividend; or
- the time entitlement to the notional trust amount arose.

Example 1.1

Poverty Relief, an eligible institution, enters into an arrangement with a trust. Under the arrangement, the trust distributes to Poverty Relief a franked dividend received by the trust on condition that Poverty Relief buy supplies from, or use the services of, a particular entity.

No franking rebate for the notional trust amount is allowed because the value of the benefit arising to Poverty Relief has been reduced by the agreement to buy supplies from, or use the services of, the entity.

Note that this scenario, as with the scenarios explained in subsequent examples, may also be covered by some of the other anti-avoidance rules.

What is the effect of expenses incurred in obtaining a franked dividend or notional trust amount?

1.35 An eligible institution may incur some expenses in connection with obtaining a franked dividend or notional trust amount (and associated franking rebate). Provided that, in the opinion of the Commissioner, those expenses are reasonable, they will not, by themselves, be taken to trigger this rule. For these purposes, assuming there are no unusual circumstances, the Commissioner would accept as reasonable, commissions paid to an entity in consideration for managing the institution's legitimate investment activities if they do not exceed the ordinary arm's length commission paid in equivalent circumstances to trustee companies which are authorised under State or Territory legislation. *[Amendment 7, subsection 160ARDAC(3)]*

Example 1.2

Philanthrope, an eligible institution, receives a dividend from Blue Chip Co. Philanthrope seeks taxation advice from a third party in relation to the dividend. Provided the expenses incurred are reasonable in the circumstances, they would not by themselves prevent a franking rebate arising for the dividend.

Provision of a benefit, or incurring of a detriment, by the eligible institution or another taxpayer

1.36 A franking rebate is also denied to an eligible institution for a dividend or notional trust amount if:

- the institution or another entity provides, or becomes liable to provide, a benefit (or is reasonably likely to do so), or incurs (or is reasonably likely to incur) any other detriment, disadvantage, liability or obligation; and
- this arises because of a related transaction (as defined above).

[Amendment 7, subsection 160ARDAC(4)]

Example 1.3

Suppose in Example 1.1, the arrangement entered into between Poverty Relief and the trust was instead an agreement that a third party (not necessarily an associate of Poverty Relief) would be compelled to sell an asset it holds to the trust (or anyone else) for a fixed price if called upon to do so.

Again, Poverty Relief would be denied a franking rebate for the notional trust amount. This is because the third party has incurred a detriment or obligation (i.e. to sell its asset if called upon) as a result of the agreement entered into between the trust and Poverty Relief in relation to the notional trust amount.

The same result would follow if the obligation in Example 1.1 to buy supplies from, or use the services of, a particular entity were an obligation of an entity other than Poverty Relief.

1.37 This rule, together with subsections 160ARDAC (5) and (10) (explained below) is subject to a reinvestment exception. The exception would generally cover, among other things, dividend reinvestment plans operated by listed companies. Under the exception, none of subsections 160ARDAC (4), (5) or (10) will apply if:

- the institution has a genuine (i.e. not an illusory or artificial) choice between receiving either a cash dividend (or trust distribution) or shares (or a fixed interest in the trust as defined in subsections 160ARDAC(12)-(15));
- choosing the shares or trust interest furthers the purpose for which the institution was established and was not for the purpose, or purposes that included the purpose, of benefiting the company, trust or an associate;

- if the company, trust or associate benefits from the investment, that benefit is one ordinarily associated with reinvestment plans (i.e. the benefit is not unique or unusual) – in this regard a tax benefit other than the ordinary franking rebate from the dividend would not be a benefit ordinarily associated with reinvestment plans; and
- all relevant parties are dealing with each other on an arm's length basis.

[Amendment 7, subsection 160ARDAC(11)]

1.38 However, if another rule applies (e.g. subsection 160ARDAC(2) because the full value of the dividend or trust amount – including the franking rebate – is not retained by the eligible institution and subsection 160ARDAC(3) does not apply) the rebate would be denied.

Advantage obtained by payer or associate

1.39 Sometimes the entity paying a dividend or notional trust amount (or an associate of the entity) may obtain, or may reasonably be expected to obtain, a benefit because of a related transaction (as defined in paragraph 1.27). In these cases an eligible institution will, subject to the subsection 160ARDAC(11) reinvestment exception described in paragraph 1.37, be denied a franking rebate relating to the dividend or notional trust amount. *[Amendment 7, subsection 160ARDAC(5)]*

Example 1.4

An eligible institution enters into an arrangement with a closely-held company on a non-arm's length basis under which the eligible institution will immediately reinvest a franked dividend paid to it under a dividend reinvestment plan. As a result of the reinvestment the company increases the balance in its share capital account. This is a benefit that has arisen as a result of the making of the dividend so the eligible institution will not be entitled to a franking rebate for the dividend.

Example 1.5

A trust estate receives a franked dividend from a company. The trust enters into an arrangement with a school (which some beneficiaries of the trust attend) to distribute the franked dividend to the school building fund (an eligible institution) as an alternative to an increase in school fees. The trust and its associates have received a benefit as a result of paying the notional trust amount to the eligible institution, so no entitlement to a franking rebate arises.

Example 1.6

A trust estate receives a franked dividend from a company which it distributes to an eligible institution on the understanding that the institution will lend the distribution to the trust or its associates. The trust or its associates have received a benefit as a result of making the dividend, so no entitlement to a franking rebate arises.

What happens if the entity paying the dividend or notional trust amount is the controller of the exempt institution?

1.40 A special rule applies in determining whether a benefit arises under a related transaction if:

- the entity paying the dividend or notional trust amount is the controller of the exempt institution (or an associate of the controller); and
- the controller or associate obtains, or may reasonably be expected to obtain, a benefit from the institution.

1.41 This special rule is necessary because, in such circumstances, it may be impossible to prove the existence of a related transaction. The rule applies if:

- a dividend or notional trust amount is paid by the controller (or associate) to the eligible institution; and
- within a period covering 3 years before and after payment of the dividend or notional trust amount the institution provides a benefit to the controller or associate.

[Amendment 7, subsection 160ARDAE(1)]

1.42 If the rule applies then there is no need to show a related transaction between the payment and the receipt of the benefit: any franking rebates in relation to the dividend or notional trust amount will be denied. However, if the Commissioner is satisfied, having regard to all the circumstances, that it would be unreasonable to apply the rule, then the franking rebate will not be denied (assuming there is no actual related transaction). *[Amendment 7, subsection 160ARDAE(4)]*

1.43 'Controller' is defined for these purposes. *[Amendment 7, section 160ARDA]*

1.44 Subject to the Commissioner being satisfied that it would be unreasonable to apply the rule, it may apply even if the benefit received by the controller arises from a reinvestment of a dividend or trust amount. An example where the Commissioner would generally be satisfied that it would be unreasonable to apply the rule would be where the requirements in subsection 160ARDAC(11) (discussed in paragraph 1.37) are satisfied and the relationship between the eligible institution and the controller (and associates) is purely commercial.

Full ownership of property does not pass

1.45 A special rule applies in relation to an *in specie* dividend. An *in specie* dividend for these purposes is a dividend comprising, wholly or partly, of property other than money.

1.46 If ownership of the property comprising the *in specie* dividend does not pass immediately and absolutely to an eligible institution, then no franking rebate is available. [Amendment 7, subsection 160ARDAC(6)]

Example 1.7

A company distributes an asset to an eligible institution as an *in specie* dividend, but retains control over the asset. No franking rebate is available for the dividend because ownership of the asset has not passed absolutely to the eligible institution.

1.47 An equivalent rule also applies to notional trust amounts comprised of property other than money. [Amendment 7, subsection 160ARDAC(9)]

1.48 However, trusts pose a particular problem in determining whether the full value of a franked dividend received by the trust has been on-paid to a beneficiary. This is because if a trust estate is paid a dividend, or receives a dividend through another trust, then generally speaking a beneficiary that is presently entitled to that income will be assessed on it and, where eligible, will receive a franking benefit. This is the case even though there may not be an actual distribution from the trust.

1.49 If a trust retains income to which an eligible institution is presently entitled, the effect is much the same as if the trust had distributed it to the institution which then repaid it. In neither case should a franking rebate be allowed.

1.50 Therefore an eligible institution will not be allowed a franking rebate in respect of a dividend to which it is presently entitled through a trust unless the value of that dividend is actually distributed to it during the same income year that it becomes so entitled. For these purposes an amount is distributed only when it is actually paid over or transferred in the form of property. [Amendment 7, subsection 160ARDAC(7)]

Example 1.8

An eligible institution becomes presently entitled to income derived by a trust, including a franked dividend. The notional trust amount (which includes the dividend) is \$5,000. The trustee makes no actual payments, and transfers no property, to the institution during the year of income.

The eligible institution is not entitled to a franking rebate in relation to the notional trust amount attributable to the franked dividend. To be entitled it would have had to receive a payment of at least \$5,000 from the trustee (or a transfer of property of that value) during the year of income.

1.51 The Commissioner has a discretion to treat an amount as having been distributed to an eligible institution. This would be exercised when the Commissioner, having regard to all the circumstances, is satisfied that it would be reasonable to do so. For example, it would generally be appropriate to exercise the discretion if treating the amount as having been distributed and allowing the franking rebate in the circumstances in which it is claimed furthers the object of these amendments and could not be said to constitute any form of tax avoidance or abuse of the concession. Similarly, where there is no element of tax avoidance or abuse of the concession, the Commissioner would treat the issue of fixed interests in trusts in circumstances where subsection 160ARDAC(11) (discussed in paragraph 1.37) is satisfied as a distribution of the underlying notional trust amount. *[Amendment 7, subsection 160ARDAC(8)]*

Additional benefit obtained

1.52 Finally, subject to the subsection 160ARDAC(11) reinvestment exception described in paragraph 1.37, no franking rebate arises for a dividend or notional trust amount paid to an eligible institution if:

- in addition to the dividend or notional trust amount (and associated franking rebate) the eligible institution (or another person or entity) acquires, or will acquire (directly or indirectly), any property (including money);
- the property is acquired from the distributing entity or an associate of that entity; and
- the acquisition of property arises because of an arrangement entered into as part of, or in association with, the payment of a dividend or notional trust amount.

[Amendment 7, subsection 160ARDAC(10)]

Example 1.9

A trust estate receives a franked dividend from a company and distributes it to an eligible institution. The distribution is made on the understanding that the institution (or a beneficiary of the institution) will buy shares in a related entity of the trust. In this case the eligible institution cannot obtain a franking rebate from the on-paid dividend because, under the agreement with the trust (which was made in association with the payment of the distribution), the eligible institution or another entity acquired property from an associate of the trust.

Example 1.10

A trust estate receives a franked dividend from a company. The trust acquires property from a person for consideration comprising a cash payment and an undertaking by the trust to pass on the dividend it received to an eligible institution beneficiary. In this case the eligible institution cannot obtain a franking rebate from the on-paid dividend because, under the agreement between the trust and the person (which was made in association with the payment of the notional trust amount), the trustee provided property to that person (i.e. another entity).

What are the consequences of breaching an anti-avoidance rule?

Denial of franking rebate

1.53 If one of the above anti-avoidance rules is triggered, the eligible institution is not entitled to a franking rebate in relation to the relevant franked dividend or notional trust amount.

Deemed no present entitlement

1.54 If, notwithstanding the application of the anti-avoidance rules, an eligible institution claims a franking rebate in relation to a notional trust amount, then its present entitlement to the relevant share of trust income is disregarded. [*Amendment 7, section 160ARDAF*]

1.55 As a result of disregarding the present entitlement, there will be at least a part of the net income of the trust estate to which a beneficiary is not presently entitled. This would result in the trustee being assessed on that part under section 99 or 99A of the ITAA 1936.

Amount payable by controller in certain circumstances

1.56 A controller of an eligible institution may be liable to pay an amount if:

- an anti-avoidance rule is triggered because the controller (or an associate of the controller) benefits from a related

transaction or arrangement in relation to a dividend or notional trust amount; and

- the institution nevertheless claims a franking rebate in respect of the dividend or notional trust amount.

[Amendment 7, subsection 160ARDAD(1)]

1.57 The amount payable is generally the amount of the benefit obtained. However, it will be reduced to the extent that the Commissioner recovers the wrongly claimed franking rebate from the institution.

[Amendment 7, subsections 160ARDAD (4) and (5)]

1.58 The liability of a controller to pay this amount depends on the Commissioner giving written notice that it is payable. Generally speaking, the Commissioner will only give this written notice if he or she is satisfied that it is not possible or practicable to recover the refund from the relevant institution. Moreover, a notice can only be given if there is an amount outstanding on the date that the institution is liable to repay the wrongly refunded amount *[Amendment 7, paragraph 160ARDAD(1)(d)]*.

1.59 'Controller' is defined for these purposes. *[Amendment 7, section 160ARDAA]*

Application and transitional provisions

1.60 These amendments apply in relation to dividends paid on or after 1 July 2000. Therefore eligible institutions are entitled to a franking rebate in relation to a notional trust amount only where the franked dividend to which it relates was paid on or after that date (irrespective of when the notional trust amount arose). *[Item 7 of Schedule 2 of this Bill]*

Consequential amendments

1.61 There are no consequential amendments arising from these amendments.