Dividend washing arrangements

On 30 April 2014, the Commissioner of Taxation published Taxation Determination TD 2014/10 which answers the following question: ‘Can section 177EA of the Income Tax Assessment Act 1936 apply to a ‘dividend washing’ scheme of the type described in this Taxation Determination?’

Dividend washing (also referred to as distribution washing) allows an entity to obtain multiple franking credit entitlements in respect of a single underlying economic interest.

To ‘dividend wash’, an entity sells an interest shortly after becoming entitled to receive a fully franked distribution in respect of that interest, then shortly after, purchases a new and substantially identical interest that also provides an entitlement to another fully franked distribution.

Whilst acknowledging that the facts of each case need to be fully considered having regard to the statutory requirements of section 177EA, the Commissioner concludes in TD 2014/10 that section 177EA will generally apply to a ‘dividend washing’ scheme of the type described by the Commissioner in the Determination.

Where section 177EA applies, the Commissioner may make a determination that no imputation benefit is to arise in respect of the distribution (or in respect of a specified part of a distribution), or that a franking debit is to arise in the distributing entity’s franking account or exempting account.

The scheme described by the Commissioner in TD 2014/10 is as follows:

1. The trustee for the Payton self-managed superannuation fund (Payton) holds an interest, being a parcel of 10,000 shares, in ZCF Limited (ZCF) that is listed on the Australian Securities Exchange (ASX) (Parcel A). Payton has held Parcel A for at least 45 days.

2. On 12 August 2013 ZCF announces a fully franked dividend of 14c per share with a franking credit of 6c per share. Shares in ZCF will go ex-dividend (in that they will trade without an entitlement to receive this dividend) on 27 August 2013.

3. On 27 August 2013 Payton sells Parcel A (10,000 shares) for $5.00 each on an ex-dividend basis on the normal ASX market; Payton’s proceeds from the sale are $50,000.

4. Payton uses the proceeds received from the sale of Parcel A to purchase a further 10,000 ZCF shares (Parcel B) on a ‘Special Market’ operated by the ASX for $5.16 per share; the total cost of this transaction is $51,600. The Parcel B shares purchased on the Special Market include the rights to receive the franked dividends announced by ZCF on 12 August 2013. This is known as shares trading on a ‘cum-dividend’ basis.

5. The Special Market is open for trading from 27 August 2013 to 28 August 2013. ZCF Shares purchased on the Special Market can trade at a premium because shares purchased on this market include the rights to receive the franked dividends announced by ZCF on 12 August 2013.
6. On 14 October 2013 Payton receives franked dividends of $1,400 with franking credits of $600 in respect to both Parcel A and Parcel B; as such Payton receives dividends totalling $2,800 including franking credits of $1,200.

7. The result of the above transactions undertaken by Payton, excluding brokerage fees, is:

   a. a cost of $1,600 which is the difference between the proceeds from the sale of Parcel A and the purchase of Parcel B ($50,000 - $51,600), and

   b. additional dividends of $1,400 from Parcel B.

8. Without the additional franking credits of $600 attached to the dividends on Parcel B, the trades referred to in paragraphs 4 and 5 would result in a loss of $200.

9. After undertaking the trades referred to in paragraphs 4 and 5 Payton still holds the same number of shares in ZCF. Parcel B will be held by Payton for at least 45 days after the date of purchase.

Tax and Superannuation Amendment (2014 Measures No 2) Bill 2014, introduced into the House of Representatives on 29 May 2014, proposes legislative amendments to deal with dividend washing schemes. Under the proposed changes, which are to apply from 1 July 2013, the income tax law is to be amended to deny an entity the benefits of any additional franking credits that it receives as a result of ‘dividend washing’.

For ‘dividend washing’ schemes carried into effect before 1 July 2013, no doubt the Commissioner will apply his view as set out in TD 2014/10 to negate the effect of the imputation benefits obtained under the scheme.

Let’s talk

For a deeper discussion of how these issues might affect your business, please contact:

Tom Seymour, Managing Partner
+61 (7) 3257 8623
tom.seymour@au.pwc.com

Warren Dick, Sydney
+61 (2) 8266 2935
warren.dick@au.pwc.com

David Lewis, Perth
+61 (8) 9238 3336
david.r.lewis@au.pwc.com

Scott Bryant, Adelaide
+61 (8) 8228 7450
scott.a.bryant@au.pwc.com

David Ireland, Sydney
+61 (2) 8266 2883
david.ireland@au.pwc.com

Julian Myers, Brisbane
+61 (7) 3257 8722
julian.myers@au.pwc.com

Adam Davis, Melbourne
+61 (3) 8603 3022
adam.davis@au.pwc.com

Anthony Klein, Melbourne
+61 (3) 8603 6829
anthony.klein@au.pwc.com

Murray Evans, Newcastle
+61 (2) 4925 1139
murray.evans@au.pwc.com

© 2014 PricewaterhouseCoopers. All rights reserved. In this document, “PwC” refers to PricewaterhouseCoopers a partnership formed in Australia, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity. This publication is a general summary. It is not legal or tax advice. Readers should not act on the basis of this publication before obtaining professional advice. PricewaterhouseCoopers is not licensed to provide financial product advice under the Corporations Act 2001 Cth). Taxation is only one of the matters that you need to consider when making a decision on a financial product. You should consider taking advice from the holder of an Australian Financial Services License before making a decision on a financial product.

Liability limited by a scheme approved under Professional Standards Legislation.