

ATO reviewing arrangements where profits pass through an interposed company BONUS (4)

In February, the Commissioner released Taxpayer Alert TA 2023/1: *Interposition of a holding company to access company profits tax-free*.

In the Alert, the Commissioner says the ATO is currently reviewing arrangements where an individual accesses the profits of a private company in a tax-free form (that is, without an additional tax liability for the individual) by arranging for the profits to be passed to the individual through an interposed holding company.

In these arrangements, a company is interposed between a private company with retained profits (first company) and its shareholder, and a CGT roll-over is applied to disregard the CGT consequences. The first company then pays a franked dividend to the interposed company, which uses the proceeds to fund a loan to the individual, on terms which do not comply with section 109N of the *Income Tax Assessment Act 1936* (this provides the conditions which must be satisfied for loans made by private companies not to be deemed to be dividends in the hands of the recipient).

These arrangements typically display all or most of the following features:

- the private company (first company) has retained profits on which it may have paid tax at the corporate rate. Shares in the first company are held by an individual who may also be a director of the first company
- the individual disposes of their shares in the first company to a private company (interposed company), receiving shares in the interposed company in return
- the shares in the interposed company are issued at a paid-up amount being the same as, or similar to, the net assets of the first company which includes the retained profits of the first company
- the individual applies a CGT roll-over, to disregard for tax purposes any capital gain on the disposal of those shares in the first company
- the first company declares a franked dividend to the interposed company
- the first company discharges its liability to pay the dividend by ways such as cash, cheque or promissory note
- the interposed company provides a loan to the individual, sourced from the dividend received. The terms of the loan do not comply with section 109N. For example, the loan may be interest-free and repayable at call
- neither the interposed company nor the first company have sufficient distributable surplus for Division 7A to treat the loan made to the individual as a deemed dividend (whether directly from the interposed company or indirectly from the first company),
- viewed objectively, the arrangements have the dominant purpose of tax avoidance.

The ATO's concerns are that individual taxpayers and private companies under their control may be entering into these arrangements under the misapprehension that they are effective in avoiding additional tax being paid by the individual taxpayer. Accordingly, the ATO will closely examine these arrangements, including those where a holding company is interposed between a trustee shareholder and a company, as similar concerns apply.

More specifically, aspects of the arrangement that concern the ATO include whether:

- there is any intention for the purported “loan” to the individual to be repaid or whether the amount may be taken to be an assessable dividend paid to the individual
- the arrangements comprise a “dividend stripping” scheme or operation, such that:
 - legislation applies to include the amount of the purported loan in the taxpayer’s assessable income, and
 - the legislation applies to cancel the franking credit on the dividend paid to the interposed company, or
- this is a scheme to which the general anti-avoidance provisions in the Tax Act apply.

Anybody who has entered, is contemplating entering into an arrangement of this type, the Commissioner encourages you to:

- ask the ATO for its view through a private ruling, or
- seek independent professional advice from us.