

www.ato.gov.au

YOU AND YOUR SHARES

TAXPACK REFERRED PUBLICATION

2000-01



How self-assessment affects most individuals

Self-assessment means the Australian Taxation Office (ATO) uses the information you give in your tax return to work out your refund or tax bill. You are required by law to make sure you have shown all your assessable income and claimed only the deductions and tax offsets to which you are entitled.

What are your responsibilities?

Even if someone else—including a tax agent—helps you to prepare your tax return, you are still legally responsible for the accuracy of the information.

What if you lodge an incorrect tax return?

Our computers continually check for missing or wrong information. We have audit programs designed to detect where taxpayers have not declared all of their assessable income or where they have incorrectly claimed deductions or tax offsets. If you become aware that your tax return is incorrect, you must contact us straightaway.

Initiatives to complement self-assessment

There are a number of initiatives administered by the ATO which complement self-assessment. Examples include:

- a change in penalty provisions so that if you take reasonable care with your tax affairs, you will not receive a penalty for honest mistakes—but please note that interest on omitted income or overclaimed deductions and tax offsets could still be payable
- the process for applying for a private ruling
- your entitlement to interest on early payment or overpayment of a tax debt
- the process for applying for an amendment if you find you left something out of your tax return.

Do you need to ask for a private ruling?

If you have a concern about the way tax law applies to your personal tax affairs, you may want to ask for a private ruling. A private ruling will relate just to your situation. Write to the ATO describing your situation in detail and ask for advice. Include your tax file number. If you lodge your tax return before you receive your private ruling, be aware that the ruling may alter the accuracy of your return.

You can ask for a review of a private ruling decision if you disagree with it, even if you have not received your assessment. The ATO can give you more information about review procedures.

Copies of publications

To get a copy of any publication referred to in this book:

- visit our Internet site at **www.ato.gov.au**
- ring our Publications Distribution Service on **1300 720 092** for the cost of a local call or
- visit an ATO office.

Publications referred to in this book include:

- *Personal investors guide to capital gains tax* (NAT 4152—5.2001)
- *How to claim a foreign tax credit* (NAT 2338—6.2001)
- *TaxPack 2001* (NAT 0976—6.2001)
- *TaxPack 2001 supplement* (NAT 2677—6.2001)
- *Taxation Determination TD 98/11—Income tax: capital gains: when are shares acquired, and instalments paid, under the Commonwealth Bank of Australia (CBA) and Telstra public share offers?*
- *Refund of imputation credits—application and instructions for individuals* (NAT 4105—6.2001)
- *Capital gains tax register: a new way of keeping records* (NAT 2684—7.1998).

Feedback

Reader feedback helps us to improve the information we provide. If you have any comments to make about this publication, please write to:

The Editor
Public Assistance Branch
Australian Taxation Office
PO Box 900
CIVIC SQUARE ACT 2608

As this is a publications area only, any tax matters will be passed on to a technical area; otherwise you can ring our Personal Tax Infoline on **13 2861** for help.

You and your shares

2000–01

**Australian Taxation Office
Canberra**

© Commonwealth of Australia

ISBN 0 642 30817 9

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without permission from AusInfo. Requests and enquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

About this publication

This publication is available free from the Australian Taxation Office (ATO). The ATO prohibits any party from selling it. We regularly revise our publications to take account of changes to the law.

If you have an enquiry relating to your circumstances which this publication does not cover, ring the Personal Tax Infoline on **13 2861** or get help from a tax adviser.

As part of our commitment to produce accurate publications, taxpayers will not be subject to penalties if they can demonstrate that they based a tax claim on wrong information supplied by the ATO.

Contents

Introduction	1
Basic aspects	1
Shares	1
How does a company pay out its profits?	1
Dividends	1
Dividend reinvestment schemes	1
Bonus shares	1
Deemed dividends	1
How dividends are taxed	2
Franked dividends	2
Unfranked dividends	2
The dividend statement	2
Taxation implications	2
Effect on tax payable	3
Your franking tax offset	4
Claiming your franking tax offset when you do not need to lodge a tax return	4
When you are not entitled to claim a franking tax offset for a franked dividend	4
Holding period rule (period 13 May 1997 to 30 June 1999)	4
Small shareholder exemption (period 13 May 1997 to 30 June 1999)	5
Holding period rule (from 1 July 1999)	6
Small shareholder exemption (from 1 July 1999)	7
Related payments rule	7
Disclosure in your income tax return (all years)	7
Application of the rules to interests in partnerships and trusts	7
Deductions in relation to dividend income	8
Management fees	8
Interest	8
FID and other taxes	8
Travel expenses	8
Cost of newspapers and journals	8

Borrowing expenses	8
Other deductions	8
Expenses that are not deductible	8
Dividends paid or credited by non-resident companies	8
Dividends paid or credited to non-resident shareholders	9
Franked dividends	9
Unfranked dividends	9
Deductions	9
Partners who have an amount attributable to a dividend included in their net income or loss from a partnership	10
Beneficiaries who have an amount attributable to a dividend included in their net income from a trust	10
Joint ownership of shares	11
Commonwealth Bank and Telstra 1 shares	11
Telstra 2 shares	11
Rights issues	11
Options	12
Share warrants	12
Keeping records	12
Deemed dividends	12
Deemed dividends from private companies	12
Shareholders and associates	13
Transactions that will create deemed dividends	13
Payments treated as dividends	13
Loans treated as dividends	13
Forgiven debts treated as dividends	14
Amounts that will not be deemed to be dividends	14
Excluded loans	14
Deemed dividend cannot exceed distributable surplus	15
Hardship	15
Prevention of double taxation	15
Trustee loans	15

Introduction

This publication is written primarily for people who hold shares as an investment. While much of the information also applies to people who carry on a business of trading in shares, it does not deal with the specific taxation treatment of shares held as trading stock or with the profits or losses arising from the disposal of such shares. If you need further advice on these aspects of owning shares, contact your professional adviser or the Australian Taxation Office (ATO).

The publication will help you understand the taxation implications of owning company shares. It covers how dividends received by Australian resident and non-resident individuals are taxed and the type of expenses that may be claimed as deductions against dividend income. If you acquired shares after 19 September 1985 capital gains tax may apply when you dispose of them. For more information, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Basic aspects

Shares

A company issues shares to raise the money needed to finance its operations. When a company issues shares it grants shareholders various entitlements—for example, the right to receive dividends or the right to share in the capital of the company upon winding up. A company may issue different types of shares, so these entitlements may vary between different shareholders.

How does a company pay out its profits?

Dividends

If you own shares in a company you will generally be paid your share of the company's profits as a dividend. In any financial year you may receive both an interim and a final dividend. In most circumstances you will be liable to pay income tax for that financial year on the dividends you are paid or credited.

You must include in your assessable income dividends paid to you. Your shareholder dividend statement should contain details of the date a payment was made to you—generally referred to on the statement as the payment date or date paid. Where the dividend is paid by cheque, it is deemed

to have been paid to you on the date the cheque was posted to you by the company—not on the date the cheque was received, banked or cleared.

A dividend can be paid to you as money or other property, including shares.

Dividend reinvestment schemes

Most dividends you are paid or credited will be in the form of money, either by cheque or credit in a bank account. However, the company may give you the option of reinvesting your dividends in the form of new shares in the company—this is called a dividend reinvestment scheme. If you take this option you must pay tax on your reinvested dividends just as you would on cash dividends.

Bonus shares

Most bonus share issues before 1 July 1987 were paid out of a company's non-taxable capital profits, from asset revaluations or from share premiums. Bonus shares issued in those circumstances are not treated as taxable dividends.

The paid-up value of most bonus shares issued from 1 July 1987 to 30 June 1998 is taxed as a dividend. The only exception to this rule is where the bonus shares are paid out of a genuine share premium account. In this case the paid-up value of the bonus shares is not treated as a dividend.

From 1 July 1998, the paid-up value of bonus shares is generally not taxed as a dividend. However, if you received bonus shares on or after 20 September 1985, you may have to pay capital gains tax if you make a capital gain when you dispose of them. For more information, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

If you are paid or credited taxable bonus shares the company issuing the shares should provide you with a dividend statement indicating the share value that is subject to tax. A company should also advise you when it issues tax-free bonus shares out of a share premium account.

Deemed dividends

Payments or other benefits you obtain from a private company in which you are a shareholder, or an associate of a shareholder, may be treated as if they were a taxable dividend paid to you. For more information, read the sections **Deemed dividends** on pages 12–13, **Transactions that will create deemed dividends** on pages 13–14 and **Amounts that will not be deemed to be dividends** on pages 14–15.

How dividends are taxed

Dividends are taxed differently depending on whether the shareholder is a resident or non-resident of Australia. This section explains the taxation implications for resident shareholders. If you are a non-resident, read the section **Dividends paid or credited to non-resident shareholders** on page 9 to see how the dividends you receive will be taxed.

Dividends paid to resident shareholders by Australian resident companies are taxed under a system known as imputation. It is called an imputation system because the payment of company tax may be imputed or attributed to the shareholders.

The basis of the system is that if a company pays or credits you dividends which have been franked, you may be entitled to a franking tax offset for the tax the company has paid on its income. The franking tax offset will cover or partly cover the tax payable on the dividends.

Franked dividends

A resident company may pay or credit you a dividend that is called a franked dividend. These dividends are said to carry 'imputation credits', a credit for the tax paid by the company. Franked dividends can be either fully franked—meaning that the whole amount of the dividend carries imputation credit—or partly franked—meaning that only part of the amount of the dividend carries imputation credit.

Unfranked dividends

A resident company may also pay or credit you a dividend that is called an unfranked dividend. There is no imputation credit attached to these dividends. When a resident Australian company pays or credits you a dividend, you will also receive a dividend statement that tells you whether the dividends have been franked and to what extent.

The dividend statement

If an Australian company pays or credits you a dividend, the company should also send you a statement advising:

- the amount of the dividend that is unfranked
- the amount of the dividend that is franked
- the amount of imputation credit
- the amount of tax file number (TFN) withholding tax deducted if you have not quoted your TFN to the company.

On page 3 there is an example of a shareholder dividend statement.

Example

On 15 February 2001 an Australian resident company, OPQ Ltd, paid John Citizen, a resident individual, a fully franked dividend of \$660 and an unfranked dividend of \$200. John received the dividend statement from OPQ Ltd shown on page 3.

We will follow the OPQ example through the next few sections of this publication to see what John needs to do with the information.

Example

John Citizen's assessable income for 2000–01 in respect of the dividend is:	
	\$
Amount of franked dividend	660
Imputation credit	340
Unfranked dividend	200
Total assessable dividend income	1 200

If these are the only dividends John Citizen was paid or credited for the income year, he can transfer these amounts directly to item 11 on his 2000–01 tax return.

Taxation implications

If you are paid or credited dividends you are required to include the following amounts in assessable income on your tax return:

- the unfranked amount
- the franked amount
- the imputation credit.

We show you below how John Citizen would complete item 11 on his tax return, using the figures in the example.

You can see on the OPQ statement above that John had no TFN amount deducted from the dividends he was paid or credited. Where a resident shareholder does not provide an Australian company with their TFN, the company is required to deduct tax from the unfranked amount of any dividend at the highest income tax rate for individuals (47 per cent) plus Medicare levy (1.5 per cent)—a total rate for 2000–01 of 48.5 per cent. As John advised OPQ Ltd of his TFN, no TFN amount was deducted.

OPQ Limited

ABN 00 000 000 000

Shareholder dividend statement

Payment date

15 February 2001

Notification of 2000 final dividend—paid 15 February 2001

Security description	No. of shares	Unfranked amount	Franked amount	Imputation credit
Ordinary shares	6400	\$200	\$660	\$340

TFN amount \$0.00

Net dividend \$860.00

Please note that your tax file number has been received and recorded.

Please retain this advice for taxation purposes as a charge may be levied for a replacement.

Please advise promptly in writing any change of address.

If John had not advised OPQ Ltd of his TFN, a TFN amount would have been deducted from the unfranked amount of the dividend and shown by John on his tax return at **V**. A credit for the TFN amount deducted would then be allowed in John's tax assessment.

If John received more than one dividend statement during the income year he would need to show the total amounts at **S**, **T**, **U** and **V** of item 11 on his 2000–01 tax return.

Effect on tax payable

The following example shows how the fully franked dividend of \$660 and unfranked dividend of \$200 from OPQ Ltd affect John Citizen's tax liability. It is assumed that John has other income of \$40 000. Medicare levy is not included in the calculation.

Example

	\$
Unfranked dividend received	200
Franked dividend received	660
Imputation credit—non-cash	340
Other taxable income	40 000
Total assessable income	41 200
Tax on \$41 200—assessed at 2000–01 rates	8 740
Less franking tax offset	340
Tax payable	8 400

John Citizen's assessable income includes the imputation credit in addition to the franked and unfranked dividends, and John's tax is based on this higher figure. However, he is able to use the tax already paid at the company level—the franking tax offset—to reduce the amount of tax that he has to pay.

11 Dividends

If you are a non-resident make sure you have printed your country of residence on page 1.

Unfranked amount **S** , . Franked amount **T** , . Imputation credit **U** , . Tax file number amounts deducted from dividends **V** , .

Your franking tax offset

If you are paid or credited fully or partly franked dividends—that is, they carry an imputation credit for which you are entitled to claim a franking tax offset—your assessable income includes both the amount of the dividends you were paid or credited and the amount of imputation credit attached to the dividends. You must include both amounts when you lodge your tax return—tax is payable at your applicable tax rate on these amounts.

If the imputation credit is included in your assessable income, you can claim the imputation credit as a franking tax offset.

The franking tax offset can be used to reduce your tax liability from all forms of income, not just dividends, and from taxable net capital gains. The John Citizen example on page 3 under the heading **Effect on tax payable**, shows you how this works.

Prior to 1 July 2000 your franking tax offset could not create a refund. If you had any remaining franking tax offset available after your tax liability had been reduced to nil, it was lost. You could not:

- carry an excess amount forward to be used against any future tax liability
- carry it back to reduce any previous tax liability or
- transfer it to another person.

You could only use your franking tax offset to reduce your tax liability. You could not use it to reduce the Medicare levy. For further information on the Medicare levy, see *TaxPack 2001*.

However, under measures contained in the *New Business Tax System (Miscellaneous) Act 1999*, from 1 July 2000 excess franking tax offset will be refunded after any income tax and Medicare levy liabilities have been met.

Example

	\$
Tax payable on taxable income	2 000
Medicare levy	200
Basic tax payable	2 200
Less: other tax offsets	1 500
Residual basic tax payable	700
Less: franking tax offset (due to imputation credits)	1 000
Refund (due to excess imputation credits)	300

(Amounts are for illustrative purposes only.)

Claiming your franking tax offset when you do not need to lodge a tax return

If you are eligible to claim a franking tax offset for 2000–01, but you are not otherwise required to lodge a tax return, you should read the publication *Refund of imputation credits*. To find out how to get this publication, see the inside front cover. If you need further information, please ring the infoline on **13 6140**.

Note: Your entitlement to a franking tax offset may be affected by the holding period rule and the related payments rule (see pages 6 and 7). However, different rules apply for the periods 13 May 1997 to 30 June 1999 and from 1 July 1999.

The general thrust of these measures operate from 1 July 1997—and in some cases 13 May 1997—and apply unless you are able to elect for the small shareholder exemption to apply (only applicable during the period 13 May 1997 to 30 June 1999—where your total entitlement to franking tax offset was \$2000 or less). You cannot make an election in respect of the period 13 May 1997 to 30 June 1999 where the related payments rule applies to dividends paid or credited to you.

Under the provisions a franked dividend is treated as if it were an unfranked dividend (that is, imputation credits are ignored and no franking tax offset is allowed) where, ignoring the days of acquisition and disposal, the shares are held 'at risk' for less than 45 days—or less than 90 days for preference shares.

When you are not entitled to claim a franking tax offset for a franked dividend

The general effect of the holding period rule and the related payments rule is that even if a dividend is accompanied by a dividend statement advising that there is an imputation credit attached to the dividend, you are not entitled to claim a franking tax offset. An exception applies where you were eligible to apply for the small shareholder exemption during the period 13 May 1997 to 30 June 1999.

Holding period rule (period 13 May 1997 to 30 June 1999)

The following is an explanation of the rule for shareholders whose total franking tax offsets for the year from all franked dividends, received directly or indirectly through partnerships or trusts, exceed the threshold of \$2000 in the period 13 May 1997 to 30 June 1999.

Unless they were contractually obliged to acquire them before 7.30 p.m. Australian Eastern Standard Time (AEST) on 13 May 1997, shareholders who acquired shares on or after 1 July 1997 must own them for more than 45 days—not counting the day of acquisition or disposal—before being entitled to a franking tax offset from franked dividends paid or credited on the shares. If the shares are preference shares the shareholder must hold them for more than 90 days—again not counting the day of acquisition or disposal.

The relevant holding period for shares and preference shares has to occur **during** the ‘qualification period’. The qualification period begins on the day after the shareholder acquired the shares and ends on the 45th day—or 90th day for preference shares—after the day on which the shares or interest became ‘ex-dividend’.

A share or interest in a share becomes ex-dividend on the day after the last day on which you can acquire the shares or interest in a share so as to entitle you to a dividend or distribution in respect of those shares or interest.

Example

Susan acquires shares on 5 July 1997 and the ex-dividend day is 8 July 1997. In order to be a qualified person in relation to the franked dividends paid on the shares, Susan will have to hold the shares until 20 August 1997 (45th day). That is, if Susan wants to be entitled to claim the franking tax offset arising from the franked dividends, she must not sell the shares before 20 August 1997.

You cannot buy a share and then sell it within 45 days after the day of acquisition—or 90 days for preference shares—and still be entitled to claim the franking tax offset for a franked dividend paid or credited on the share. For these purposes you will be treated as having sold the share if you sell a substantially identical share.

You have to satisfy this rule once only for each purchase of shares and the subsequent entitlement to dividends from those shares unless the related payments rule applies—see page 7.

Example

Marie has held 1000 shares in X Pty Ltd for 12 months. She then purchases an additional 500 shares 10 days before X Pty Ltd shares go ex-dividend. Twenty days after X Pty Ltd shares go ex-dividend, Marie sells 500 shares. The shares she sold are deemed to have been held for less than 45 days, based on last in first out. Marie would not be entitled to the franking tax offset on the franked dividends paid or credited on these shares.

A qualification to the holding period rule prevents the counting of days on which the shareholder has 30 per cent or less of the ordinary financial risks of loss and opportunities for gain from owning the shares.

You may reduce the financial risk of owning shares through arrangements such as hedges, options and futures.

Small shareholder exemption (period 13 May 1997 to 30 June 1999)

The holding period rule is subject to a small shareholder exemption in the period 13 May 1997 to 30 June 1999—but only where an individual shareholder elected that the exemption applies and the related payments rule does not apply. Under this exemption the holding period rule does not apply to an individual shareholder whose entitlement to franking tax offsets for the year from all franked dividends, received directly or indirectly through partnerships or trusts, would otherwise be \$2000 or less. This is roughly equivalent to receiving a fully franked dividend of \$3500.

Phasing out arrangements operate for shareholders whose franking tax offset entitlement is between \$2000 and \$2500—that is, for shareholders who receive fully franked dividends in the approximate range of \$3500 to \$4500.

The effect of these arrangements is that where a shareholder has a franking tax offset entitlement in excess of \$2000 (but not greater than \$2500), their claim must be reduced by \$4 for every \$1 of franking tax offset in excess of \$2000.

Where you are denied a franking tax offset you are allowed a deduction up to a maximum of \$2500 for the grossed-up amount of a dividend which is included in your assessable income. However, for administrative reasons, you do not have to include the grossed up amount in your assessable income and then claim a deduction. Merely reduce your assessable income by the grossed-up amount and do not claim a deduction. The ‘Sonya’ example on page 6, *Franking tax offset entitlement greater than \$2000 but less than or equal to \$2500*, demonstrates this approach.

Example

Franking tax offset entitlement \$2000 or less

Linda received fully franked dividends of \$3500 and imputation credits of \$2000. Although she had not held the shares for more than 45 days, the holding period test did not apply. She was entitled to claim the full franking tax offset of \$2000.

Linda would show the following information at item 9 on her 1998–99 tax return:

- a dividend of \$3500 as a franked amount at **T**
- an amount of \$2000 as an imputation credit at **U**.

She would receive a franking tax offset of \$2000 in her assessment.

Example

Franking tax offset entitlement greater than \$2000 but less than or equal to \$2500

Sonya received fully franked dividends of \$4000 and imputation credits of \$2250. However, because she had not held the shares for more than 45 days, she failed the holding period test. Instead of losing her full tax offset entitlement, she elected to have the small shareholder exemption apply.

To determine her entitlement, because her imputation credits are in the \$2000 to \$2500 range, she made the following calculation.

	\$
Franking tax offset entitlement (based on fully franked dividends of \$4000)	2 250
Less maximum franking tax offset allowable (due to holding period rule)	2 000
Excess	250
Maximum franking tax offset allowable (due to holding period rule)	2 000
Less reduction in franking tax offset entitlement (reduced by \$4 for every dollar the entitlement exceeds \$2000: 250×4)	1 000
Reduced franking tax offset entitlement (due to holding period rule)	1 000
Instead of getting the full benefit of the imputation credit of \$2250, Sonya is only entitled to a franking tax offset of \$1000—a result which would ordinarily flow from an imputation credit of \$1000.	
Sonya's position can be summarised as follows:	
	\$
Franked dividends	4 000
Reduced imputation credit amount	1 000
Taxable income	5 000
Reduced franking tax offset entitlement	1 000

Sonya would have shown the following information at item 9 on her 1998–99 tax return:

- a dividend of \$4000 as a franked amount at **T**
- an amount of \$1000 as an imputation credit at **U**.

Sonya would have received a franking tax offset of \$1000 in her assessment.

Example

Franking tax offset entitlement greater than \$2500

Andrew received fully franked dividends of approximately \$5000 and imputation credits of \$2750. However, because he did not hold the shares for more than 45 days he failed the holding period test.

Andrew could not elect to have the small shareholder exemption apply. He lost the benefit of the franking tax offset.

Andrew would have shown a dividend of \$5000 as a franked amount at **T** of item 9 on his 1998–99 tax return but would not have shown the amount of the imputation credit at **U**.

He would not have received a franking tax offset in his assessment.

Holding period rule (from 1 July 1999)

Under measures contained in the *New Business Tax System (Miscellaneous) Act (No. 2) 2000*, from 1 July 1999 the threshold for the holding period rule was increased to \$5000. The rule now applies only to shareholders whose total franking tax offsets for the year from all franked dividends, received directly or indirectly through partnerships or trusts, exceed the threshold of \$5000.

Unless they were contractually obliged to acquire them before 7.30 p.m. AEST on 13 May 1997, shareholders who acquire shares on or after 1 July 1997 must own them for more than 45 days—not counting the day of acquisition or disposal—before being entitled to a franking tax offset from franked dividends paid or credited on the shares. If the shares are preference shares the shareholder must hold them for more than 90 days—again not counting the day of acquisition or disposal.

The relevant holding period for shares and preference shares has to occur **during** the 'qualification period'. The qualification period begins on the day after the shareholder acquired the shares and ends on the 45th day—or 90th day for preference shares—after the day on which the shares or interest became 'ex-dividend'.

A share or interest in a share becomes ex-dividend on the day after the last day on which you can acquire the shares or interest in a share so as to entitle you to a dividend or distribution in respect of those shares or interest.

Small shareholder exemption (from 1 July 1999)

The threshold for the small shareholder exemption was increased from \$2000 to \$5000 from 1 July 1999 under measures contained in the *New Business Tax System (Miscellaneous) Act (No. 2) 2000*. Under the revised small shareholder exemption provisions the holding period rule

does not apply to an individual shareholder whose entitlement to franking tax offsets for the year from all franked dividends, received directly or indirectly through partnerships or trusts, would otherwise be \$5000 or less. This is roughly equivalent to receiving a fully franked dividend of \$9000. In addition, the related payments rule must not apply.

The effect of this provision is that where a shareholder has a franking tax offset entitlement in excess of \$5000, the full franking tax offset is lost.

You cannot buy a share and then sell it within 45 days—or 90 days for preference shares—and still be entitled to claim the franking tax offset for a franked dividend paid or credited on the share. For these purposes a shareholder will be treated as having sold the share if he or she sells a substantially identical share.

You have to satisfy this rule once only for each purchase of shares. You are then entitled to the franking tax offset attached to those shares, unless the related payments rule applies—see the next column.

Example

Lisa has held 1000 shares in X Pty Ltd for 12 months. She then purchases an additional 500 shares 10 days before X Pty Ltd shares go ex-dividend. Twenty days after X Pty Ltd shares go ex-dividend, Lisa sells 500 shares. The shares she sold are deemed to have been held for less than 45 days, based on last in first out. Lisa would not be entitled to the franking tax offset on the franked dividends paid or credited on these shares.

A qualification to the holding period rule prevents the counting of days on which the shareholder has 30 per cent or less of the ordinary financial risks of loss, and opportunities for gain, from owning the shares.

You may reduce the financial risk of owning shares through arrangements such as hedges, options and futures.

Example

Franking tax offset entitlement greater than \$5000

Mark received fully franked dividends of \$10 000 and imputation credits of \$5600. However, because he has not held the shares for more than 45 days, he fails the holding period test and loses the benefit of the franking tax offset.

Mark would show a dividend of \$10 000 as a franked amount at **T** item 11 on his 2000–01 tax return but would not show the amount of imputation credit at **U**.

He would not receive a franking tax offset in his assessment.

Related payments rule

In certain circumstances, the related payments rule prevents you from claiming a franking tax offset on franked dividends or credited on shares if a related payment is made under an arrangement entered into on or after 7.30 p.m. AEST on 13 May 1997. This rule applies if both of the following conditions are present:

- you are under an obligation to pass on the dividend to someone else and
- you are not holding the shares ‘at risk’ around the dividend period.

Under the related payments rule you must be a qualified person for the payment of each dividend or distribution. To be a qualified person in relation to a dividend or distribution, you or your associate must hold the relevant shares or interest at risk for the relevant qualification period of 45 days—or 90 days for preference shares.

Being a qualified person for the payment of current dividends or distributions does not mean that you are automatically a qualified person for future dividends or distributions. That is, the test must be satisfied for all subsequent dividends and distributions.

Disclosure in your income tax return (all years)

Where you are not entitled to a franking tax offset, show on your tax return the amount of franked dividend received at **T** *Franked amount*. Do not show the amount of any imputation credit at **U** *Imputation credit*. Where you were eligible to apply for the small shareholder exemption, the examples on pages 6 and 7 outline how to make the required calculations.

Application of the rules to interests in partnerships and trusts

If you have interests in partnerships and trusts which hold shares, the holding period rule and the related payments rule apply to your interests in the partnership or trust in the same way that the rules apply to shares you own directly. Therefore, the partner or beneficiary has to hold their interest in the partnership or trust at risk for the requisite period. The related payments rule will apply if they are not holding their interest in the partnership or trust at risk and they have an obligation to pass on their share of net income of the partnership or trust which is attributable to the franked dividend.

Deductions in relation to dividend income

If you invest in shares you may be able to claim as a deduction from assessable income certain expenditure incurred in deriving your income from those shares. The following are examples of expenses that may be deductible.

Management fees

Where you pay ongoing management fees or retainers to investment advisers you will be able to claim the expenditure as an allowable deduction. Only a proportion of the fee is deductible if the advice covers non-investment matters or relates in part to investments that do not produce assessable income. You cannot claim a deduction for a fee paid for drawing up an initial investment plan.

Interest

If you borrowed money to buy shares you will be able to claim a deduction for the interest incurred on the loan, provided it is reasonable to expect that assessable dividends will be derived from your investment in the shares. Where a loan was obtained for more than one purpose, you will only be able to claim interest incurred on that part of the loan used to acquire the shares.

FID and other taxes

State governments charge Financial Institutions Duty (FID), government duty tax (GDT) and debits tax for operating certain types of accounts held with financial institutions such as banks, building societies and credit unions. You can claim a deduction for any FID charged on the deposit of assessable dividend income into your accounts. You can also claim a deduction for that part of any GDT or debits tax charged on debits from your account used to fund deductible expenses in relation to earning dividend income. If only a proportion of the debit was used to fund deductible expenses, then only the same proportion of GDT or debits tax is deductible.

Travel expenses

You may be able to claim a deduction for travel expenses where you need to travel to service your investment portfolio—for example, to consult with a broker or to attend a stock exchange or company meeting. You can claim a deduction for the full amount of your expenses where the sole purpose of the travel relates to the share investment. Where the travel is predominantly of a private nature, only the expenses which relate directly to servicing your portfolio will be allowable.

Cost of newspapers and journals

You may be able to claim the cost of purchasing specialist investment journals and other publications which you use to manage your share portfolio.

Borrowing expenses

You may be able to claim expenses you incurred directly in taking out a loan for purchasing shares which can reasonably be expected to produce assessable dividend income. The expenses may include establishment fees, legal expenses and stamp duty on the loan. If you incurred deductible expenses of this kind totalling \$100 or more they are apportioned over 5 years or the term of the loan, whichever is less. If your expenses are less than \$100, they are fully deductible in the year you incur them.

Other deductions

Any other expenses that you incur which relate directly to maintaining your portfolio are also deductible. These could include bookkeeping expenses and postage.

Expenses that are not deductible

You cannot claim a deduction for the cost of acquiring shares—for example, expenses for brokerage and stamp duty. These will form part of the cost base for capital gains tax purposes when you dispose of the shares. For more information, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Dividends paid or credited by non-resident companies

If you were paid or credited a dividend from a non-resident company it will not be called a franked or unfranked dividend, but is likely to be referred to simply as a dividend. Non-resident companies are not subject to the imputation system and you will not be entitled to claim a franking tax offset for any tax paid by the company. However you may find that foreign tax has been deducted from the dividend so that the amount paid or credited to you is reduced.

In most circumstances you will be liable to pay Australian income tax on the dividend. You must include on your tax return the full amount of the dividend—that is, the amount you are paid or credited plus the amount of any foreign tax which has been deducted—and claim a credit for the foreign tax paid.

There are special rules which need to be satisfied for you to claim a foreign tax credit. See question 19 in *TaxPack 2001 supplement* and the publication *How to claim a foreign tax credit*. To find out how to get these publications, see the inside front cover.

Example

Emma Citizen had shares in a company resident in the United States. She was entitled to be paid a dividend of \$400. Before she was paid the dividend the company deducted \$60 in foreign tax, sending Emma the remaining \$340.

When she fills in her Australian tax return Emma should include \$400 at **M** item 19 on her tax return and she may be able to claim a foreign tax credit of \$60 at **O** item 19.

Dividends paid or credited to non-resident shareholders

Dividends paid or credited by Australian resident companies to non-residents of Australia are taxed differently from dividends paid or credited to resident shareholders.

Both Australian resident and non-resident individuals can be paid or credited franked dividends or unfranked dividends from Australian resident companies.

Franked dividends

Franked dividends are said to carry imputation credits, a credit for the tax paid by the company on its income. Franked dividends can be either fully franked—meaning that the whole amount of the dividend carries imputation credit—or partly franked—meaning that only part of the amount of the dividend carries imputation credit.

Note: If you are a non-resident of Australia, any franked dividends you are paid or credited are exempt from Australian income and withholding taxes. However, you are not entitled to any franking tax offset for franked dividends. You cannot use any imputation credit attached to franked dividends to reduce the amount of tax payable on other income and you cannot get a refund of the imputation credit. You should not include the amount of any franked dividend or any imputation credit on an Australian tax return.

Unfranked dividends

The other type of dividend a resident company may pay or credit you is an unfranked dividend. There is no imputation credit attached to these dividends.

Note: Any unfranked dividends paid or credited to a non-resident are subject to a final withholding tax. Withholding tax is imposed on the full amount of the dividends—that is, no deductions may be made from the dividends—and a flat rate of withholding tax is applied whether or not you have other taxable Australian income. Withholding tax is also deducted from the unfranked portion of any partly franked dividends that you are paid or credited.

Withholding tax is deducted by the company before a dividend is paid, so you will be paid or credited only the reduced amount. It is deducted at a rate of 30 per cent unless you are a resident of a country with which Australia has entered into a taxation agreement that varies the amount of withholding tax that can be levied on dividends.

Australia has entered into taxation agreements with more than 35 countries and the rate of withholding tax on dividends is limited to 15 per cent in most of these agreements. Details of the rates that apply to residents of specific countries can be obtained from the ATO.

The withholding tax on unfranked dividends is a final tax, so you will have no further Australian tax liability on the dividend income. Therefore, if completing an Australian tax return you should not include in your assessable income any dividends which have been subject to dividend withholding tax. If the only income you earned was dividend income which was a fully franked dividend or an unfranked amount of a dividend which was subject to withholding tax, you do not need to lodge an Australian tax return.

If you were paid or credited dividends which were not franked—and from which withholding tax was not deducted—you must include those dividends on your Australian tax return.

Deductions

You cannot claim any expenses incurred in deriving dividends which are not assessable in Australia, including any dividend which you do not need to show on your Australian tax return.

Partners who have an amount attributable to a dividend included in their net income or loss from a partnership

When calculating its net income or loss for tax purposes, a partnership that is paid or credited a franked dividend includes both the amount of the dividend and the imputation credit in its assessable income. This is subject to the partnership satisfying the holding period rule and other rules contained in the provisions dealing with franked dividends.

If a share of the net income or loss of a partnership shown at item 12 on your *2001 tax return for individuals* (supplementary section) is attributable to a franked dividend, you may be entitled to claim a franking tax offset, which is your share of the partnership's imputation credit arising from that dividend.

You are not entitled to a franking tax offset if you do not satisfy the holding period rule or related payments rule in relation to your interest in the partnership, or the partnership does not satisfy those rules in relation to the shares.

If the partnership satisfies the rules in relation to the shares and the small shareholder exemption applies to you, you do not have to satisfy the holding period rule.

For more information, read the section **When you are not entitled to claim a franking tax offset for a franked dividend** on pages 4–7.

Example		\$
Partnership		
Franked dividend		660
Imputation credit—non-cash		340
Net income of partnership	1 000	
Individual partner—$\frac{1}{2}$ share		
Taxable $\frac{1}{2}$ share of net income of the partnership		500
Other income		20 000
Total assessable income	20 500	
Gross tax— 2000–01 rates		2 530
Less $\frac{1}{2}$ of total franking tax offset		170
Net tax	2 360	

Beneficiaries who have an amount attributable to a dividend included in their net income from a trust

A trust that is paid or credited franked dividends includes both the amount of the dividend and the imputation credit in its assessable income when calculating its net income or loss for tax purposes. This is subject to the trust satisfying the holding period rule and other rules contained in the provisions dealing with franked dividends.

If there is income of a trust to which no beneficiary is entitled, the trustee of the trust is assessable on that share of the net income of the trust and will be entitled to a franking tax offset for any imputation credit included in that share of the net income.

If you are the beneficiary of a trust and the trust makes a loss for tax purposes, there is no net income of the trust and any imputation credit is lost. Trust losses cannot be distributed to beneficiaries.

If a share of the net income of a trust shown at item 12 on your tax return is attributable to a franked dividend, you may be entitled to claim a franking tax offset. This is your share of the trust's imputation credit arising from that dividend.

You will not be entitled to a franking tax offset if you do not satisfy the holding period rule or related payments rule in relation to your interest in the trust or the trust does not satisfy those rules in relation to the shares.

If the trust satisfies the rules in relation to the shares and the small shareholder exemption applies to you, you do not have to satisfy the holding period rule.

For more information, read the section **When you are not entitled to claim a franking tax offset for a franked dividend** on pages 4–7.

Special rules apply to beneficiaries of trusts—other than trusts that elect to be family trusts within the meaning of the *Income Tax Assessment Act 1936* or deceased estates—to determine whether they hold their interest 'at risk'.

Example

Trust with net income in 2000–01

Trust	\$
Franked dividend	1 980
Imputation credit—non-cash	1 020
Net income of trust	3 000
Beneficiary	
Taxable $\frac{1}{3}$ share of net income of trust	1 000
Other income	10 000
Total assessable income	11 000
Gross tax— 2000–01 rates	850
Less $\frac{1}{3}$ of total franking tax offset	340
Net tax	510

Example

Trust with loss in 2000–01

Trust	\$
Franked dividend	1 980
Imputation credit—non-cash	1 020
Total income of the trust	3 000
Less deductible expenses of the trust	4 000
Loss	(1 000)

Trust losses cannot be distributed to beneficiaries.

Joint ownership of shares

Shares may be held in joint names. If you hold shares jointly with another person, such as your spouse, it is assumed that ownership of the shares is divided equally. Shares can be owned in unequal proportions. You have to be able to demonstrate this—for example, with a record of the amount contributed by each party to the cost of acquiring the shares. Dividend income and imputation credits are assessable in the same proportion as the shares are owned.

Commonwealth Bank and Telstra 1 shares

If you purchased shares in the Commonwealth Bank of Australia (CBA) and Telstra share sales and you paid for them in 2 instalments, you would have received an 'instalment receipt' after making your first payment. The instalment receipts were issued as evidence that you owned a beneficial interest in the shares.

If you sold the instalment receipts or shares for more than the amount you paid for them, you may have to pay capital gains tax on the difference between the cost base of the instalment receipts or shares and the capital proceeds from the sale. The cost base includes indexation if you disposed of your shares or instalment receipts 12 months or more after acquiring them.

Indexation of the first instalment amount is available from the date on which you were allocated the shares. The CBA share allocation occurred on 13 July 1996 and the Telstra allocation on 15 November 1997. The final instalment is taken to have been paid and indexation applies from the date the relevant trustee received the payment on behalf of the Commonwealth as vendor.

For the CBA share sale, the trustee received the payment on or around 14 November 1997 or the earlier date on which they received a discounted sum in satisfaction of a final instalment.

For the Telstra share sale, the trustee received the payment and the transfer of the sale shares occurred on or around 17 November 1998.

For more information, see *Taxation Determination TD 98/11—Income tax: capital gains: when are shares acquired, and instalments paid, under the Commonwealth Bank of Australia (CBA) and Telstra public share offers?* or the publication *Personal investors guide to capital gains tax*. To find out how to get these publications, see the inside front cover.

Telstra 2 shares

If you purchased shares in the Telstra 2 share offer, you would have received an 'instalment receipt' after making your first payment. The instalment receipt was issued as evidence that you owned a beneficial interest in the shares.

If you sold the instalment receipts or shares for more than the amount you paid for them, you may have to pay capital gains tax on the difference between the cost base of the instalment receipts or shares and the capital proceeds from the sale.

You will not be entitled to indexation of the cost base of the instalment receipts or shares which were purchased after 11.45 a.m. AEST on 21 September 1999.

For more information, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Rights issues

Companies may periodically issue their shareholders with rights to purchase additional shares. A particular issue might

be described as a 'one-for-four' issue, meaning that you are entitled to purchase an additional share for every 4 shares you currently own. You can choose to exercise the right, sell it on the stock exchange or allow it to lapse.

Unless you deal regularly with rights issues or other similar products, the only tax consequences that may arise involve the capital gains tax measures. For information on how the capital gains tax measures apply to rights issues, see the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Options

Companies may also issue their shareholders with options. If you receive an option you have the right to acquire shares in the company at a specified price on a stipulated date. You are also able to trade these options on the stock exchange or allow them to lapse.

Options are similar to rights and the terms are often used interchangeably. The main difference between options and rights is that options can usually be held for a much longer period than rights before they must be exercised or lapse. Options may also be issued initially to both existing shareholders and non-shareholders while rights can only be issued initially to existing shareholders.

You may be familiar with a second type of option called 'exchange traded options'. These options are not created by the company but by independent third parties and are traded on the stock exchange. Exchange traded options come in 2 forms:

- call option is a contract which entitles its holder to buy a fixed number of shares in the designated company at a stated price on or before a specified expiry date or
- put option is a contract which entitles its holder to sell a fixed number of shares in the designated company at a stated price on or before a specified expiry date.

The taxation of options is similar to that of rights. Unless you deal with them regularly, the only tax consequences that may arise involve the capital gains tax measures. This is discussed in detail in the publication *Personal investors guide to capital gains tax*. To find out how to get this publication, see the inside front cover.

Share warrants

Share warrants come in many different forms—for example, equity warrants, endowment warrants, portfolio warrants, capital plus warrants and instalment warrants.

The income tax and capital gains consequences of holding, acquiring and disposing of these financial products can be quite complex.

If you have disposed of any of these products, contact your professional adviser or ring the ATO.

Keeping records

It is advisable to keep records of both income and deductions relating to your share investment for 5 years from the date you lodge your tax return.

Remember that your investment in shares or other assets such as instalment receipts may also give rise to a capital gain when you dispose of them. For capital gains tax purposes you will need to keep detailed records of any shares or other assets you acquired on or after 20 September 1985.

You must keep records setting out in English:

- the date you acquired the asset
- any amounts which will form part of the cost base of the asset
- the date you dispose of the asset and the capital proceeds from the sale.

From 1 January 1998 you can choose to enter information from your capital gains tax records into an asset register. Keeping an asset register may enable you to discard records that you may otherwise be required to keep for long periods of time. For more information, see the publication *Capital gains tax asset register: a new way of keeping records*. To find out how to get this publication, see the inside front cover.

Keep all the information that a company gives you on your shares. It may be important when calculating your capital gains tax liability after you dispose of them.

You must also keep records relating to your ownership of assets for 5 years from the date you dispose of them.

Deemed dividends

Deemed dividends from private companies

Where certain transactions between a private company and a shareholder or shareholder's associate occur after 3 December 1997, they are deemed to create an unfranked dividend assessable to the shareholder or associate. The amount of the deemed dividend is generally limited to the private company's distributable surplus.

Payments made to a shareholder or their associate in their capacity as an employee, or as an associate of an employee of the private company, are not subject to these rules.

Shareholders and their associates to whom a payment or loan is made by a private company or who have a debt forgiven by a private company will need to have regard to the rules when considering their tax liabilities. Under the rules, 'payment' has an extended meaning. For more information, read the section **Payments treated as dividends** below.

Transactions entered into before 4 December 1997 will continue to be subject to the previous law. This allows the Commissioner to treat a payment or loan by a private company as a dividend to the extent that he believes the payment or loan is a distribution of the company's profits.

Shareholders and associates

The shareholder or associate need not be a shareholder or associate at the time the transaction occurred, as long as a reasonable person would conclude that the transaction occurred because the person was a shareholder or associate at some time.

The associates of a natural person are widely defined and include:

- a relative of the person
- a partner of the person
- a partnership in which the person is a partner
- a spouse
- a child of a partner of the person
- a trustee of a trust where the person—or another entity that is an associate of the person—benefits under the trust and
- companies which are controlled or influenced by the person.

Transactions that will create deemed dividends

Payments treated as dividends

Payments made by a private company to a shareholder or associate which are treated as deemed dividends include:

- an amount paid or credited to the shareholder or associate
- an amount paid or credited on behalf of, or for the benefit of, the shareholder or associate
- a transfer of property to the shareholder or associate.

A payment does not include an amount which is a loan. The amount paid or credited is deemed to be a dividend to the extent of the private company's distributable surplus.

Example

Vanessa owns shares in a private company, X Pty Ltd. On 30 June 2001, X Pty Ltd makes a payment of \$5000 to Vanessa's father, Frank. Frank is not an employee of X Pty Ltd and he is not an associate of an employee of the company. The payment will be taken to be an unfranked dividend paid to Frank and he must include the \$5000 as assessable income at **S** item 11 on his 2000–01 tax return.

Loans treated as dividends

If a private company makes a loan to a shareholder or associate in an income year and the loan is not fully repaid by the end of that income year, generally the outstanding amount of the loan will be regarded as a non-commercial loan and treated as an unfranked dividend to the extent of the private company's distributable surplus—unless it satisfies the criteria of an excluded loan as explained in the section **Excluded loans** on page 14.

A loan includes:

- an advance of money
- a provision of credit or any other form of financial accommodation
- an amount paid for, on account of, on behalf of, or at the request of, a shareholder or associate where there is an express or implied obligation to repay the amount
- a transaction that in substance effects a loan of money.

As a general rule, loans in existence before 4 December 1997 will not be treated as a dividend under the relevant provisions unless they are altered by extending the term or increasing the amount of the loan.

Example

Vanessa is a shareholder in the private company, X Pty Ltd. Vanessa's credit card bills, totalling \$10 000, are paid with company cheques throughout the income year and debited to her loan account. Interest is not payable on the balance of the loan account.

If Vanessa repays the \$10 000 to X Pty Ltd by the end of the company's income year, no amount will be treated as a deemed dividend. If she does not repay any of the \$10 000, the full \$10 000 will be treated as an unfranked dividend. If she repays \$3000, then \$7000 will be treated as an unfranked dividend.

Forgiven debts treated as dividends

If a private company forgives, wholly or partly, a debt owed to it by a shareholder or associate, the amount forgiven will be treated as a dividend to the extent of the private company's distributable surplus at the end of its income year. This will not be the case if the debt has previously been treated as a deemed dividend.

Amounts that will not be deemed to be dividends

The following transactions will not result in a deemed dividend:

- a repayment of a debt owed by a private company to a shareholder or associate, provided the amount of the debt does not exceed the amount the company would have owed if the company and shareholder or associate had been dealing with each other at arm's length
- a loan made in the ordinary course of a private company's business on the usual terms which it applies to arm's length loans of a similar type
- a payment or loan which forms part of the assessable income of the shareholder or associate by virtue of some other provision of the *Income Tax Assessment Act 1936* or the *Income Tax Assessment Act 1997*
- a loan made during the course of winding up a company where the loan is either repaid or offset by distributions by the end of the income year following the year in which the loan is made
- a payment or loan which has been specifically excluded from the assessable income of the shareholder or associate by virtue of an exempting provision in the *Income Tax Assessment Act 1936*
- a loan made solely for the purpose of enabling the shareholder or associate to acquire shares or rights to shares under an employee share scheme to which Division 13A of the *Income Tax Assessment Act 1936* applies
- the forgiveness or release of a debt of a shareholder or associate under the *Bankruptcy Act 1966*.

Excluded loans

Loans which meet the following criteria are not treated as dividends in the year the loan is made:

- The loan must be made under a written agreement.
- The rate of interest payable on the loan must be equal to or exceed the bank variable housing loan interest rate last published by the Reserve Bank of Australia before the start of the income year in which the loan was made.

- If the loan is secured by a registered mortgage over real property, the term of the loan must be no more than 25 years and the amount of the loan must not exceed 91 per cent of the value of the property over which the security is provided—less any other liabilities for which the property also provides security.
- For all other loans the term of the loan must be no more than 7 years.

The relevant provisions require that the written agreement be in place before any amount is advanced to the shareholder or associate. However, for loans made during the 1998–99 income year, this requirement will be satisfied if the written agreement was put in place by 30 June 1999.

All loans made during a year which are not treated as dividends at the end of the year and which have the same maximum term are, for tax purposes, amalgamated to form a single loan. Shareholders or their associates are required to make a minimum yearly repayment in respect of that amalgamated loan. The minimum repayment is calculated by using the formula set out in the legislation. A failure to make such a repayment will result in the outstanding amount of the loan being treated as a deemed dividend to the extent of the private company's distributable surplus.

Example

A private company makes an unsecured loan to a shareholder on 1 July 1998. The loan is made under a written agreement which specifies that the rate of interest payable for all future years must equal or exceed the benchmark interest rate for the year. For 1999–2000 the benchmark interest rate is 6.5 per cent per annum.

The term of the loan is 5 years. For the year ended 30 June 1999, as it met the criteria for minimum interest rate and maximum term, the loan is not treated as a dividend.

If the amount of the loan not repaid at 30 June 1999 is \$100 000, the minimum yearly repayment required for the 1999–2000 income year is calculated as follows:

$$\begin{aligned} & \frac{\text{Amount of loan not repaid by}}{\text{end of previous income year}} \times \frac{\text{current year's}}{\text{benchmark interest rate}} \\ & 1 - \left\{ \frac{1}{1 + \text{current year's benchmark interest rate}} \right\}^{\text{remaining term}} \\ & = \frac{100\,000 \times 0.065}{1 - \left\{ \frac{1}{1 + 0.065} \right\}^5} \\ & = \$24\,063 \\ & = \text{minimum yearly repayment required} \\ & \quad \text{for the 1999–2000 income year.} \end{aligned}$$

If repayments made in the 1999–2000 income year equal or exceed the minimum yearly repayment, the amount of the loan not repaid at the end of the income year is not taken to be a dividend.

Deemed dividend cannot exceed distributable surplus

The private company's distributable surplus is the maximum amount that can be treated as a deemed dividend. The company that made the payment or loan or forgave the debt will have to determine how much of the payment or forgiven debt is to be treated as having come from their distributable surplus. The distributable surplus is worked out at the end of the company's year of income using the following formula:

$$\text{Net assets} - \text{non-commercial loans} - \text{paid-up share value} - \text{repayments of non-commercial loans}$$

Non-commercial loans are loans which have previously been treated as deemed dividends.

Hardship

The Commissioner has a discretion to disregard a failure to make a minimum yearly repayment. He also has a discretion to exclude a forgiven debt from being treated as a dividend. Finally, the Commissioner has the power to disregard the creation of a present liability under a guarantee provided by the private company to an entity other than a private company.

Prevention of double taxation

As a general rule, if a subsequent dividend paid by the private company is used to offset an amount that has already been subject to tax as a deemed dividend, the later dividend will be included in assessable income under the relevant provisions only to the extent that it is franked.

Example

Simone is a shareholder in a private company, Z Pty Ltd. She borrowed, on a non-commercial basis, \$500 from the company in September 1998. The loan was not repaid by 30 June 1999. Simone included an amount of \$500 as assessable income—as a deemed dividend—on her 1998–99 tax return.

In December 1999, Simone became entitled to receive an unfranked dividend of \$1100 from Z Pty Ltd. However, Simone agreed that Z Pty Ltd would offset \$500 of her entitlement against the outstanding loan and pay the balance of \$600 to her. Therefore, Simone is only required to include an amount of \$600 in her assessable income for the 1999–2000 year. This is because she had previously included the other \$500—the loan which had been treated as a deemed dividend—on her 1998–99 tax return.

Trustee loans

Where a trustee makes a loan to a shareholder or associate of a private company and the private company is a beneficiary of the trust, a deemed loan may arise if:

- the private company is or has been presently entitled to an amount from the net income of the trust estate
- the trustee has not paid the amount to the private company and
- the trustee has made a loan to a shareholder of the private company or an associate of the shareholder after the time that the private company first became presently entitled to that amount.