

Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates 30 May – 1 June 2006

Question: bet 79

Topic: Dividend tainting rules

Hansard Page: E72

Senator WATSON asked:

My next question concerns what I call ‘dividend tainting rules’. By way of background, I remind the committee that, when the dividend imputation rules were replaced with the simplified imputation system in July 2002, the new rules did not replicate the share capital tainting, or dividend tainting, rules that were a feature of the previous regime. As we all know, the tainting rules are designed to prevent companies from inappropriately shifting amounts from their capital account into retained earnings and then distributing to their shareholders in tax effective ways. At the time, business was told that these issues would be dealt with later. When we look at the recently introduced Tax Laws Amendment (2006 Measures No. 3) Bill 2006, on 25 May, the dividend-tainting rules have not surfaced. I understand the Treasury has not finalised these for inclusion in that bill, so we have a bill to deal with part of the problem but not the other part. Do we acknowledge that we have been left with a legislative vacuum for the past four years. This affects many corporate taxpayers, who have been concerned about the absence of any legislation in this area. Tainting, for example, with shares a capital account can result in a company having no franking credits, and this could be disastrous. How is the Treasury progressing with the dividend-tainting rules, assuming it is proposing to recommend to government that such rules be introduced? We have tainting rules in relation to capital but not in relation to dividends?

Mr Callaghan—My understanding is that those matters are still being looked at and work is still progressing on those. I would have to check with the experts. I am not sure.

Senator Watson—Can you take the question on notice?

Mr Callaghan—I will take the question on notice.

Answer:

The dividend tainting rules were introduced in 1995 to prevent companies from entering into schemes to make tax free distributions to corporate shareholders by exploiting the inter-corporate dividend rebate. The dividend tainting rules are contained in sections 46G to 46M of the *Income Tax Assessment Act 1936*. There is no legislative vacuum as those rules remain operative.

The on-going need for dividend tainting rules in the context of the simplified imputation system is under review and raises questions of policy.