Can dividends flowing through interposed trusts and partnerships ever be non-portfolio dividends?

Non-portfolio dividends are excluded from the definition of BRE passive income. The term *non-portfolio dividend* is defined in s. 317 of the *ITAA 1936* as meaning a dividend paid to a company where that company has a voting interest, within the meaning of s. 334A(1)[55] of the *ITAA 1936*, amounting to at least 10 per cent of the voting power of in the company paying the dividend. This means that a dividend paid to a company, in its capacity as a trustee of a trust, is **not** a non-portfolio dividend as defined in s. 317.

Accordingly, dividends received by the trust — regardless of the trust's voting interest in the company — are BRE passive income.[56] Dividends flowing through a trust will therefore be BRE passive income even where the trustee owns all of the shares in the company paying the dividend and the trustee holds the shares solely for the benefit of, and distributes the dividends to, a corporate beneficiary.[57]

Implications for corporate beneficiaries

In order to determine which of the two corporate tax rates applies to its taxable income, a corporate beneficiary that receives a trust distribution will have to dissect the trust distribution into two categories comprising income that is attributable to:

- BRE passive income in the hands of the trust; and
- income which is not BRE passive income in the hands of the trust.

Presumably, new labels in the 2018 tax returns will allow the trustee to distinguish between these two types of income, or perhaps the trustee will be required to notify its corporate beneficiary of the make-up of a distribution, so that the corporate beneficiary can correctly determine whether it satisfies the 80 per cent passive income test.

The simple case

Income that is BRE passive income in the hands of a trust will also be BRE passive income to:

- successive trusts to which the income is distributed; and
- a corporate beneficiary at the end of the chain of distribution.

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[55] Section 334A(1) provides that a company shall be taken to have a voting interest in another company, if the first-mentioned company is the ***beneficial owner*** of shares in the other company that carry the right to exercise any of the voting power in that other company, and there is no arrangement in force which would allow any person to affect those rights. The phrase ***beneficial owner*** is not defined for the purposes of s. 334A. Note that the High Court in *FCT v Angus* [1961] HCA 18 took the view that the income which a beneficiary receives from a trust which received dividends is received as a share of trust income and not dividends.

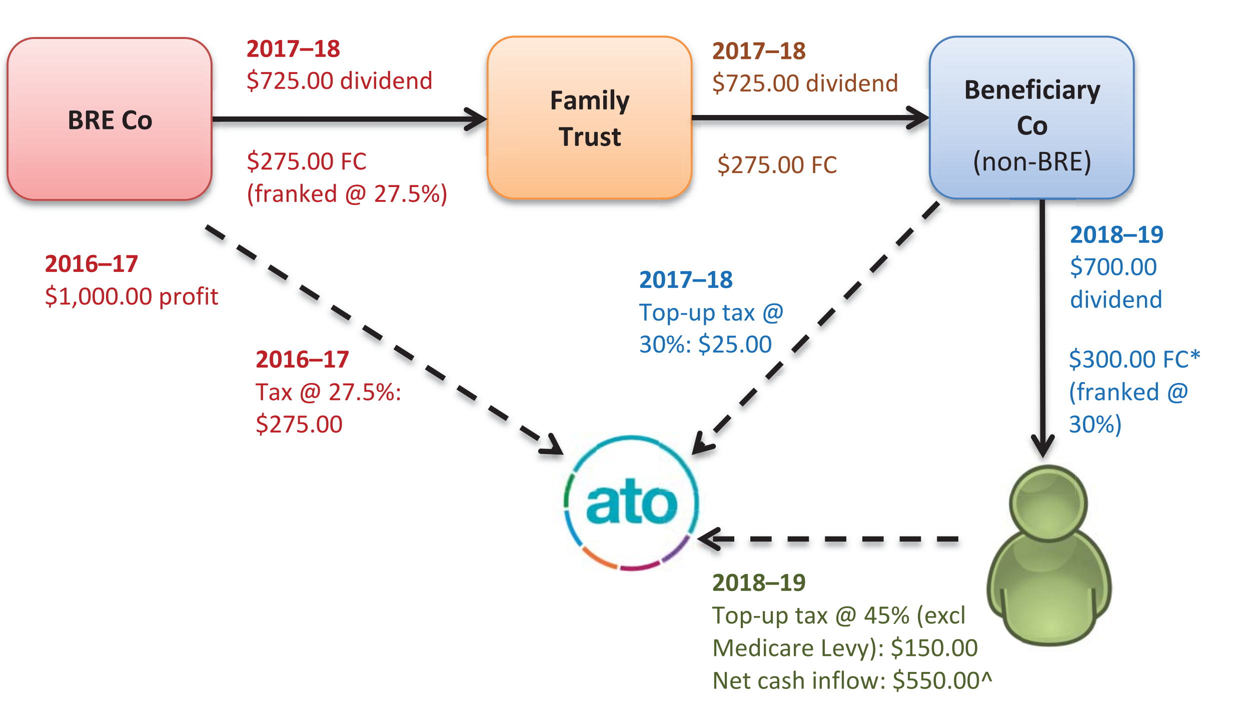
[56] Disregarding the fact that the BRE passive income test does not apply to trustees.

[57] See for example TD 2008/25 in which the Commissioner explains — albeit in the context of s. 23AJ of the *ITAA 1936* — why such a dividend does not qualify as a non-portfolio dividend.

Case Study 6A — Interposed discretionary trust and corporate beneficiary

Dividend trail through the chain

The following diagram shows the flow of the distribution and the franking credits from the income company through a discretionary trust, a corporate beneficiary and ultimately to the shareholder of the corporate beneficiary.



* No excess FCs trapped in Beneficiary Co.
^ Effective tax rate of 45% on BRE Co's $1,000 pre-tax profit.
This is equal to the top marginal rate as no FCs have been trapped.

Note: For illustrative purposes it is assumed that BRE Co was an SBE in 2016–17. While its 2016–17 SBE/non-SBE status does not have an impact on its 2017–18 franking rate or the outcomes for the interposed trust, the corporate beneficiary and the ultimate shareholder, it does affect the after-tax profit available for distribution.

The dividend and associated franking credits which BRE Co pays to the Family Trust is in the nature of BRE passive income. This is because the dividend does not meet the definition of a non-portfolio dividend on the basis that the recipient is not a company[102] — see **page 23**.

When the Family Trust streams the dividend and franking credits to Beneficiary Co, those amounts are characterised as BRE passive income in the hands of Beneficiary Co as they retain their character when flowed through the trust. In this case study, assume that in 2017–18:

- the Family Trust distributes or streams 100 per cent of its franked distributions to Beneficiary Co; and
- the Family Trust does not distribute any other income to Beneficiary Co.

[102] Other than possibly a corporate trustee of the Family Trust — which does not count as a 'company' for these purposes.

Assume the following facts about Beneficiary Co:

- its aggregated turnover in 2017–18 is less than $10 million; and
- it has no source of income other than distributions from the Family Trust.

Beneficiary Co's BRE passive income is more than 80 per cent (being 100 per cent) of its assessable income for the income year. On that basis, it is not a BRE and it is subject to the 30 per cent tax rate.

Impact on Beneficiary Co's franking account

This is an excerpt of the franking account of Beneficiary Co for the relevant period:

Beneficiary Co — Franking account (excerpt)				
Date	**Description**	**DR $**	**CR $**	**Balance $**
1 July 2017	Balance forward			0.00
30 April 2018	Family Trust distribution comprising fully franked dividend of $725		275.00	275.00
1 July 2017	Balance forward			275.00
15 May 2018	Income tax paid for 2016–17		25.00	300.00
30 June 2018	Franked distribution to shareholder	300.00		0.00
1 July 2018	Balance forward		No FCs trapped	0.00

Implications — Family Trust is a mere conduit

The outcome for the individual shareholder is the same as it was in Case Study 2 — i.e. where the non-BRE company directly owned the BRE company. The Family Trust merely acts as a flow through conduit for the dividend and franking credits.