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DISCRETIONARY DIVIDEND SHARES

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Discretionary dividend shares or dividend access shares have been used by many clients for a variety of reasons, including asset protection and estate planning.

The ATO has for a number of years accepted the use of such shares (including through the issue of a number of private rulings) provided they are properly implemented, including not causing a value shift or triggering any of the tax implications referred to in the Taxpayer Alert.

Some have implemented dividend access shares by the simple issue of a different class of share to existing ordinary shares. Implemented in this manner it will usually cause a value shift, triggering a taxing event for capital gains tax purposes.
Discretionary dividend shares are a special form of dividend access shares recommended by us. They are supported by legal opinion that the tax implications referred to are not triggered.

The tax implications of the use of dividend access shares have been highlighted by the recent release of Taxpayer Alert TA2012/4. Those implications are in relation to:

- Value shifting;
- Debt/equity;
- Dividend streaming;
- Dividend stripping; and
- Part IVA.

These are well traversed by us and with the ATO.
The issue of the Taxpayer Alert does not signify a change in law but instead highlights to the wider tax community that the future use of such shares must be done with a better appreciation of the tax implications.

The purpose of a Taxpayer Alert is simply to put taxpayers and tax advisers on notice that the ATO is looking into a particular issue. Following the issue of a Taxpayer Alert, the ATO will determine its position which may result in no action being taken if they decide the issues outlined are not breached. On the other hand, if they decide there are some tax issues in relation to the particular arrangement, they will issue a tax ruling or tax determination.

The issue of the Taxpayer Alert (if confirmed) is a change in the long-held view of the ATO, similar to their change in position on Service Trusts and Unpaid Trust Entitlements.

One of the main concerns is whether there is a share value shift. A share value shift may arise either on issue of the share or payment of a dividend. The issues raised under the Taxpayer Alert are concerned with a value shift that can arise on the issue of a share. Similar to its position on Service Trusts and Unpaid Trust Entitlements, it is likely that any change of the ATO position will only apply to shares issued after the date of issue of a draft tax ruling or tax determination, or the date of issue of the Taxpayer Alert.
The ATO concern appears limited to circumstances where funds are obtained in a tax-free form (paragraph 11 of the Alert). Uses of the more traditional kind may be unaffected by any change in view.

A separate issue that has been raised by some advisers following the decision in Lawrence's case is whether the payment of a dividend under a dividend access share or discretionary dividend share causes a dividend strip (also referred to in the Taxpayer Alert). Although the decision in Lawrence's case extended the reach of a dividend strip, it still requires that the original shareholders (or associates) receive a capital sum and the arrangement is entered into for the purpose of tax avoidance. The simple payment of a dividend does not involve the receipt of a capital sum. It is therefore our view that the simple payment of a dividend on discretionary dividend shares does not cause a dividend strip.

Discretionary dividend shares are and will continue to be a planning tool to be used in appropriate circumstances, such as asset protection and succession planning exercises, most of which, with proper implementation, would fall outside the areas of ATO concern set out in the Taxpayer Alert.