Finalised compliance approach – capital raised for franked distributions

The ATO has issued PCG 2025/3 which sets out the ATO's risk assessment framework and compliance approach in relation to the integrity measure in s207-159 that operates to make certain distributions by a company that are funded by a capital raising to be unfrankable. The finalised PCG is broadly in line with the draft version released in December 2024.

Key points from PCG 2025/3 are outlined below:

- The PCG applies to corporate entities that have made a distribution purporting to be frankable under s202-40 on or after 28 November 2023.
- The four criteria that must all be satisfied to make a distribution, or part of a distribution, unfrankable are:
  - The dividend payment is not consistent with established practice.
  - There is an issue of equity interests.
  - It is reasonable to conclude that:
    - The principal effect of the issue of the equity interest was the direct or indirect funding of a substantial part of the distribution (principal effect test); and
    - The issue of the equity interests was done for a purpose (other than an incidental purpose) of funding a substantial part of the relevant distribution (purpose test).
  - The issue of the equity interests was not a direct response in order to meet a requirement, direction or recommendation from APRA or ASIC.
- The ATO's risk assessment framework consists of the following 3 zones, each with examples of arrangement features:
  - White (do not need to consider risk rating) – ruling in place or low risk / high assurance rating provided.
  - Green (low risk - no cause to apply compliance resources other than to confirm scenario features exist) – distribution consistent with past practice; dividend reinvestment plan undertaken for normal commercial purposes; issue of equity interests funds < 20% of franked distributions paid; issue of equity interests to meet minimum APRA requirements; and issue of equity interests by private company to facilitate departure of one or more shareholders. Note, despite industry feedback, pre-sale dividends in a merger or acquisition were not included as a low risk arrangement, and hence s207-159 will need to be considered for any such transactions.
  - Red (high risk – likely to apply compliance resources) – close timing between issue of equity interests and declaration/payment of distribution; special dividends / unusually large dividends where no comparable increase in profits; no evidence of clear and genuine commercial purpose, no or minimal change to financial position, majority of funds raised by equity issuance used to fund distribution, artificial or contrived arrangements to release franking credits.
- The types of documents relevant to assessing risk include minutes of board and other meetings which consider the capital raise and/or payment of franked distribution; annual reports; ASX announcements; scheme implementation agreement or deed; disclosure documents lodged with regulator or ASX (e.g. scheme booklet or prospectus).
- Taxpayers may be required to report their risk rating under the PCG through the Reportable Tax Position Schedule.

All corporate taxpayers who have made franked distributions from 28 November 2023 and have or will raise capital should consider their level of risk under the finalised PCG 2025/3. Importantly, taxpayers should ensure that there is clear documentation which demonstrates the purpose of the relevant capital raise and making of franked distributions.

Note, the ATO has also released PCG 2025/3EC which notes the Commissioner's response to issues raised during the public consultation process on this matter.

Thin capitalisation test choices – approved form

The ATO have updated their guidance on the approved form when making a choice to apply the group ratio test or third party debt test pursuant to the thin capitalisation rules in Division 820 of the ITAA 1997.

The thin capitalisation test choice must be made in the approved form by the following dates:

- On or before the earlier of the day your entity:
    - Lodges its tax return for the income year
    - Is required to lodge its tax return for the income year
- A later day allowed by the Commissioner

The form is to be kept as a record of having made a valid choice and is not required to be lodged with the ATO.

We also note the ATO's guidance on requesting an extension of time for making a choice for the 2024 and 2025 income years prior to the finalisation of TR 2024/D3 and PCG 2024/D3 (i.e., revocation of choice to apply the third party debt test and/or extension of time to apply the third party debt test) remains broadly unchanged from its publication earlier this calendar year.

ATO focus areas for privately owned and wealthy groups in 2025-26

The ATO defines Privately Owned and Wealthy Groups as:

- Companies and their associated subsidiaries (often referred to as economic groups) with an annual turnover of more than $10 million and that are not public groups or foreign owned).
- Australian resident individuals who, together with their business associates, control net wealth over $5 million.

The ATO have recently published their key areas of focus for these groups in 2025-26. These are:

- Core tax and compliance issues
    - Registration, lodgement and payment
    - Reporting (including incomplete lodgements, omitted / underreported items; incorrect claiming of base rate entity status; incorrect or overclaimed deductions and credits where not entitled)
    - Capital gains tax (ineligibility for concessions or restructuring for concessions, CGT discount)
    - Trusts – distributions to lower-taxed beneficiaries where economic benefits flow elsewhere; circular trust distributions where tax hasn't been paid on some, or all, of a distribution, to ensure compliance with trustee beneficiary non-disclosure tax; family trusts distributing outside the family group, triggering family trust distribution tax; claiming of franking credits from franked distributions without meeting the 45-day holding rule (especially newly incorporated corporate beneficiaries)

- Using business assets for personal purposes, without the transactions being correctly reported or disclosed

- Tax treatment of intra-group loan and/or cash advance arrangements

- Division 7A – inadequate record keeping, unreported shareholder loans; non-complying loan agreements; failing to make minimum yearly repayments; arrangements where minimum yearly repayments are made either from another loan or subsequent reborrowing from the same company (TD 2025/5); arrangements to circumvent Division 7A through the guaranteeing by private companies of third-party loans (TA 2024/2, TD 2025/6)

- Lifestyle assets being used when a private pursuit or "hobby-like activity" is mischaracterised as a business activity

- Succession planning activities e.g. private groups restructure, disposal of assets and transfer of wealth

- Specific industry issues / activities in focus for tax advisers and professional firms, property and construction, private equity, retail, cross-border transactions, crypto assets, use of tax-exempt or concessionally taxed entities (e.g. SMSFs or not-for-profit organisations), retirement villages, GST refund fraud (TA 2025/2).

Contact

For more information and other updates, please visit our website at www.omnitax.com.au. Should you wish to discuss any matter or require any additional information, please email us on contact@omnitax.com.au.