PS LA 2007/20 (Withdrawn) - Exercise of the Commissioner's discretion under section 109RB of Division 7A of Part III the Income Tax Assessment Act 1936 to disregard a deemed dividend in respect of the 2001-02 to 2006-07 income years.

This practice statement is withdrawn as it applies only up to 30 June 2008.

This document has changed over time. This version was published on *22 May 2015*

Australian Government
Australian Taxation Office

Practice Statement Law Administration

PS LA 2007/20

This practice statement is withdrawn as it applies only up to 30 June 2008.

This law administration practice statement is issued under the authority of the Commissioner and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. ATO personnel, including non ongoing staff and relevant contractors, must comply with this law administration practice statement, unless doing so creates unintended consequences or is considered incorrect. Where this occurs, ATO personnel must follow their business line's escalation process.

Taxpayers can rely on this law administration practice statement to provide them with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty. Nor will they have to pay interest on the underpayment provided they reasonably relied on this law administration practice statement in good faith. However, even if they don't have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.

SUBJECT:	**Exercise of the Commissioner's discretion under section 109RB of Division 7A of Part III the *Income Tax Assessment Act 1936* to disregard a deemed dividend in respect of the 2001-02 to 2006-07 income years.**
PURPOSE:	**To provide guidance to ATO personnel on how to treat specific 'corrective action' taken by taxpayers in respect of the 2001-02 to 2006-07 income years when considering whether or not to exercise the Commissioner's discretion to disregard a deemed dividend where that 'corrective action' was taken prior to 1 July 2008.**

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BACKGROUND

1. Changes have recently been made to Division 7A of Part III of the *Income Tax Assessment Act 1936*[1] to reduce both the extent to which taxpayers are inadvertently caught by Division 7A and the punitive nature of the provisions. Included in these changes are amendments to provide the Commissioner with a discretion to enable him to provide relief for deemed dividends that have arisen under Division 7A because of an honest mistake or inadvertent omission.

2. This practice statement outlines the Commissioner's approach during an initial transitional period where taxpayers take specific 'corrective action' to put themselves in a position that complies with the present Division 7A requirements. During this period, taxpayers will not be required to make a written request for the Commissioner to exercise his discretion, thereby making it easier and cheaper to comply. ATO personnel are required to have regard to this practice statement in respect of all taxpayers who have derived a deemed dividend as a result of an honest mistake or inadvertent omission.

STATEMENT

3. Under section 109RB the Commissioner may in certain circumstances disregard a deemed dividend that arises under Division 7A of Part III. ATO personnel must consider the individual circumstances of each taxpayer when deciding whether or not to exercise this discretion. The decision making process requires a careful consideration of the factors set out in section 109RB. In the context of such a decision making process if the conditions set out in paragraph 4 of this practice statement are satisfied then in most cases it would not be unreasonable for ATO personnel to conclude that the Commissioner's discretion should be exercised in the taxpayer's favour.

4. Paragraph 3 of this practice statement only applies where the following conditions have been satisfied:

   - it is clear from all the circumstances currently within the Commissioner's knowledge that the failure to comply with one or more of the provisions of Division 7A was the result of an honest mistake or inadvertent omission[2] by the taxpayer, private company, or other relevant party
   - 'corrective action' as defined in this practice statement has been taken by the taxpayer on or before 30 June 2008
   - the deemed dividend under Division 7A arose in respect of a transaction or action that occurred after 30 June 2001 and by the end of the 2006-07 income year, and
   - the taxpayer has lodged all required income tax returns for the 2001-02 to 2006-07 income years if necessary.

5. If the conditions in paragraph 4 of this practice statement are satisfied, taxpayers do not need to apply to the Commissioner in writing to exercise his discretion to disregard each deemed dividend that has arisen from the application of Division 7A.

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[1] All references are to the *Income Tax Assessment Act 1936* unless otherwise stated.
[2] Refer to examples in Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No. 3) Bill 2007.

6. If:

- the conditions in paragraph 4 of this practice statement are satisfied, and
- ATO personnel consider that there are other circumstances that outweigh the 'corrective action' and which might result in the discretion to disregard the deemed dividend not being exercised,

then the matter must be referred to either the Division 7A Case Panel or an Assistant Commissioner for advice before any decision is made on the exercise of the Commissioner's discretion.

7. For the purposes of paragraphs 3 and 4 of this practice statement it is irrelevant whether the 'corrective action' taken by a taxpayer occurred as the result of:

- a review by the taxpayer of their own affairs
- self assessment by the taxpayer
- a voluntary disclosure by the taxpayer
- a review or audit action by the ATO, or
- some other activity.

Where a deemed dividend has already been assessed, it will be necessary for the taxpayer to lodge an objection[3] to the assessment requesting that the Commissioner exercise his discretion to disregard the deemed dividend. The request should include sufficient information to demonstrate to the Commissioner that the failure to comply with Division 7A was the result of an honest mistake or inadvertent omission.[4] Taxpayers should also provide details of the ''corrective action' taken.

8. If prior to 1 July 2008 ATO personnel identify a potential Division 7A deemed dividend during an audit or review of the taxpayers 2001-02 to 2006-07 income tax returns, then in the interests of equity and fairness, ATO personnel must advise the taxpayer of the opportunity to take advantage of the arrangements described in this practice statement. No action should be taken in respect of the deemed dividend under Division 7A until the taxpayer has had a reasonable opportunity to take 'corrective action'.

Corrective action

9. For the purposes of this practice statement 'corrective action' taken by the taxpayer has the meanings set out in paragraphs 10 to 15 of this practice statement.

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[3] If the period for lodging a taxation objection has expired, the objection should be accompanied by a request that it be treated as having been lodged within time. The Commissioner's discretion under section 14ZX of the *Taxation Administration Act 1953* to extend the period within which an objection can be lodged is explained in Law Administration Practice Statement PS LA 2003/7 (particularly paragraphs 5 to 26).

[4] If necessary additional information should be requested from the taxpayer prior to making this decision.

10. If the deemed dividend arose in respect of a payment under section 109C then 'corrective action' means:

- the full amount of the payment has been converted into a loan and a loan agreement has been entered into that complies with all the requirements of section 109N that now exist and all requirements that existed at any time during the period that began with the year in which the deemed dividend arose, and
- the taxpayer has made a payment, or payments, equal to the total of minimum yearly repayments that would have been payable had the loan existed from the start of the period that began with the year in which the deemed dividend arose.[5]

11. If the deemed dividend arose in respect of a loan under section 109D then 'corrective action' means:

- now having in place a loan agreement that complies with all the requirements of section 109N that now exist and all requirements that existed at any time during the period that began with the year in which the deemed dividend arose, and
- the taxpayer has made a payment, or payments, equal to the total of minimum yearly repayments that would have been payable had the loan existed from the start of the period that began with the year in which the deemed dividend arose.[6]

12. If the deemed dividend arose in respect of section 109E or section 109E as modified for Subdivision EA, then 'corrective action' means that the taxpayer has made a payment, or payments, equal to the total of minimum yearly repayments under the loan that were required from the commencement of the loan.[7]

13. If the deemed dividend arose in respect of a debt forgiveness under section 109F then 'corrective action' means:

- the amount of the debt forgiven is treated as the principal of a loan and a loan agreement has been entered into that complies with all the requirements of section 109N that now exist and all requirements that existed at any time during the period that began with the year in which the deemed dividend arose, and
- the taxpayer has made a payment, or payments, equal to the total of minimum yearly repayments that would have been payable had the loan existed from the start of the period that began with the year in which the deemed dividend arose.[8]

14. If the deemed dividend arose in respect of an assessable amount under section 109XB then 'corrective action' means:

- in the case of a subsection 109XA(1) payment – that the subsection 109XA(4) amount involved in the actual transaction has been converted into a loan and a loan agreement is entered into between the taxpayer and the trustee that complies with all the requirements of section 109N that now exist and all requirements that existed at any time during the period that began with the year in which the deemed dividend arose

[5] This will ensure that the taxpayer's actual loan balance is equivalent to what it would have been if the taxpayer had complied with the requirements of Division 7A through out the period.
[6] Ibid.
[7] Ibid.
[8] Ibid.

- in the case of a subsection 109XA(2) loan – entering into a loan agreement between the taxpayer and the trustee for the subsection 109XA(4) amount that complies with all the requirements of section 109N that now exist and all requirements that existed at any time during the period that began with the year in which the deemed dividend arose
- in the case of a subsection 109XA(3) forgiven debt – the subsection 109XA(4) amount involved in the actual transaction is treated as the principal of a loan and a loan agreement is entered into between the taxpayer and the trustee that complies with all the requirements of section 109N that now exist and all requirements that existed at any time during the period that began with the year in which the deemed dividend arose, and
- in any of the situations covered by the three preceding dot points the taxpayer has made a payment, or payments, equal to the total of minimum yearly repayments that would have been payable had the loan existed from the start of the period that began with the year in which the deemed dividend arose.[9]

15. If a taxpayer has taken 'corrective action' in the form of a payment or payments that in total equal the total amount of the minimum yearly repayments that would have been payable had the taxpayer made minimum yearly repayments throughout the period that began with the year in which the deemed dividend arose, then that payment, or the total of those payments, has two components:
    - Capital component – an amount equalling the difference between the original amount of the loan and the carried forward loan balance on 1 July 2008 if all complying minimum yearly repayments had been made (less any actual capital repayments made prior to 1 July 2008), and
    - Interest component – an amount equalling the sum of the annual interest that would have accrued on the loan from the date the loan should have commenced with interest compounding (less any interest actually paid prior to 1 July 2008).

16. Where appropriate, ‘corrective action’ may be taken by the taxpayer on a cumulative basis that covers all honest mistakes and inadvertent omissions made in any of the years of income covered by this practice statement. For example, a single payment can be made by the taxpayer to the company or trustee representing the full amount of all the minimum yearly repayments that should have been made under the loan or the amount treated as a loan. Appropriate journal entries will need to be made to accounts recording payments at the time the ‘corrective action’ is taken.

17. Payments made as part of ‘corrective action’ will not be taken to be payments to which section 109R applies.

18. Actions undertaken by a taxpayer that do not fall within the definition of 'corrective action' set out above may nevertheless be relevant when considering the exercise of the Commissioner’s discretion. Taxpayers may request in writing that the Commissioner exercise his discretion under section 109RB. Taxpayers should include all relevant information.

19. Taxpayers should retain all relevant documentation and other evidence that supports either a conclusion that the conditions set out in paragraph 4 of this practice statement have been satisfied, or the favourable exercising of the Commissioner’s discretion.

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[9] Ibid.

Other matters

20. This practice statement applies to any taxpayer that would otherwise be affected by Division 7A where the relevant conditions are satisfied in paragraph 4 of this practice statement.

21. Nothing in this practice statement should be viewed as preventing a taxpayer from requesting in writing that the Commissioner exercise his discretion under section 109RB to disregard a deemed dividend or allow a dividend to be franked.

EXPLANATION

22. Division 7A was inserted by the *Taxation Laws Amendment Act (No. 3) 1998* and applies on and after 4 December 1997. Broadly, under this Division, amounts paid or lent or debts forgiven by a private company to shareholders or shareholder's associates are treated as dividends, unless they are specifically excluded.

23. Division 7A was amended by the *Taxation Laws Amendment (2004 Measures No. 1) Act 2004* to insert Subdivision EA which has application to certain trustee payments, loans and debt forgiveness that occur on or after 12 December 2002.

24. Division 7A was further amended by *Tax Laws Amendment (2007 Measures No. 3) Act 2007*. The amendments provide that where a deemed dividend arises under Division 7A because of an honest mistake or inadvertent omission by a taxpayer, the Commissioner has a discretion to either disregard the deemed dividend subject to certain specified conditions being complied with or allow the private company taken to have paid the dividend to choose to frank the dividend. The Commissioner's discretion applies in respect of assessments for the 2001-02 income and later income years.

25. This practice statement provides a simpler way for most taxpayers to get on a compliant footing going forward. Taxpayers can do this through taking the necessary 'corrective action' by 30 June 2008 rather than applying directly to the Commissioner in writing to exercise his discretion to disregard each deemed dividend that has occurred.

26. Taxpayers that take action to correct previous honest mistakes and/or inadvertent omissions will be in a position to continue to comply with the requirements of Division 7A in future years of income.

Date of effect

27. These arrangements will have effect for certain transactions or actions that occurred in the 2001-02 to 2006-07 years of income that give rise to a deemed dividend under Division 7A.

Examples

Example 1

28. A private company made a loan to a shareholder in the 2004-05 income year. There was no written loan agreement. The shareholder has not made any repayments. A deemed dividend is taken to arise to the shareholder in that year.

    Neither the company nor the shareholder used the services of a tax agent and neither was aware of the requirements of Division 7A until September 2007.

'Corrective action' was then taken which involved:

- the company and the shareholder entering into a loan agreement in September 2007 that complies with all the requirements of section 109N that existed at any time during the period that began in the 2004-05 year, and
- the shareholder making a payment in June 2008, of an amount equal to the total of the capital and interest components as defined in paragraph 15 of this practice statement.

The shareholder does not need to apply for the Commissioner to exercise his discretion to disregard the deemed dividend. If ATO personnel subsequently reviews the shareholder's return of income then, provided that the deemed dividend is the result of an honest mistake or inadvertent omission, it would not be unreasonable for that officer to conclude that the Commissioner's discretion should be exercised in the taxpayer's favour.

Example 2

29. In the 2004-05 income year a private company pays the car expenses of a vehicle owned by a shareholder and there is no express or implied agreement for the shareholder to repay the amount to the private company. A deemed dividend is taken to arise to the shareholder in that year.

In reviewing the accounts in January 2008, the company realises the mistake and takes 'corrective action' which involves:

- converting the payments into a loan
- the company and the shareholder entering into a loan agreement that complies with the requirements of section 109N, and
- the shareholder making a payment before 30 June 2008 equal to the total of the capital and interest components as defined in paragraph 15 of this practice statement.

The shareholder does not need to apply for the Commissioner to exercise his discretion to disregard the deemed dividend. If ATO personnel subsequently review the shareholder's return of income then, provided that the deemed dividend is the result of an honest mistake or inadvertent omission, it would not be unreasonable for ATO personnel to conclude that the Commissioner's discretion should be exercised in the taxpayer's favour.

Example 3

30. During the 2004-05 income year a private company made a loan to a shareholder which is a trust, to help finance the purchase of income producing property. No qualifying section 109N written loan agreement was put in place because the company's tax agent mistakenly believed that only loans to individuals would be subject to Division 7A. No loan repayments have been made since the funds were advanced.

In June 2007, the company's tax agent became aware that the loan made by the private company to the trustee was subject to section 109D and resulted in the company being taken to pay a dividend to the trust at 30 June 2005.

'Corrective action' was taken during the 2007-08 income year which involved:

- the company and the trustee entering into a loan agreement on 1 July 2007 that complies with the requirements of section 109N, and
- the trustee making a payment on 29 June 2008, of an amount equal to the total of the capital and interest components as defined in paragraph 15 of this practice statement.

The trustee does not need to apply for the Commissioner to exercise his discretion to disregard the deemed dividend. If ATO personnel subsequently review the shareholder's return of income, then, provided that the deemed dividend is the result of an honest mistake or inadvertent omission, it would not be unreasonable for ATO personnel to conclude that the Commissioner's discretion should be exercised in the taxpayer's favour. In this context it should be noted that a significant number of tax agents have made similar mistakes as there has been a degree of confusion as to the correct application of Division 7A to transactions between private companies and entities such as trusts.

Example 4

31. In May 2005, a trustee made a payment to a shareholder of a private company of $25,000. The payment discharged a present entitlement of the shareholder (as a beneficiary of the trust) to an amount that was an unrealised gain.

At the time the payment was made the private company had a present entitlement to $20,000 of the net income of the trust estate that remained unpaid. The company's distributable surplus at 30 June 2005 exceeded $50,000.

In June 2007, the tax agent became aware that the payment made by the trustee to the shareholder was subject to Division 7A and in particular sections 109XA and 109XB.

The tax agent and shareholder had mistakenly believed that Division 7A only applied to private company loans, payments and debts forgiven. It did not occur to them that Division 7A applied to certain trustee transactions.

'Corrective action' was taken during in the 2007-08 income year which involved:

- the subsection 109XA(4) transaction amount being converted into a loan; and
- the trustee and the shareholder entering into a loan agreement on 1 July 2007 that complies with the requirements of section 109N, and
- the shareholder making a payment on 29 June 2008 to the trustee equal to the total of the capital and interest components as defined in paragraph 15 of this practice statement.

The shareholder does not need to apply for the Commissioner to exercise his discretion to disregard the deemed dividend. If ATO personnel subsequently review the shareholder's return of income, then, provided that the deemed dividend is the result of an honest mistake or inadvertent omission, it would not be unreasonable for ATO personnel to conclude that the Commissioner's discretion should be exercised in the taxpayer's favour.

Example 5

32. A private company made a loan to a shareholder in the 2001-02 income year. A written loan agreement that complies with section 109N was in place. Due to an oversight, the shareholder failed to make the minimum yearly repayment for the 2005-06 year. The shareholder has made minimum yearly repayments in all the other years of income since the loan was made.

In December 2007, whilst reviewing his accounts for the 2006-07 income year, the shareholder noticed the error and takes 'corrective action' which involved the shareholder making a payment in January 2008, of an amount equal to the total of the capital and interest components as defined in paragraph 15 of this practice statement.

The shareholder does not need to apply for the Commissioner to exercise his discretion to disregard the deemed dividend. If ATO personnel subsequently reviews the shareholder’s return of income, then, provided that the deemed dividend is the result of an honest mistake or inadvertent omission, it would not be unreasonable for ATO personnel to conclude that the Commissioner’s discretion should be exercised in the taxpayer’s favour.

Amendment history

Date of amendment	Part	Comment
13 May 2014	Contact details	Updated.
2 September 2009	Contact details	Updated.

Subject references	Division 7A Commissioner's discretion
Legislative references	ITAA 1936 Pt III Div 7A ITAA 1936 109C ITAA 1936 109D ITAA 1936 109E ITAA 1936 109F ITAA 1936 109N ITAA 1936 109R ITAA 1936 109RB ITAA 1936 Pt III Div 7A Subdiv EA ITAA 1936 109XA(1) ITAA 1936 109XA(2) ITAA 1936 109XA(3) ITAA 1936 109XA(4) ITAA 1936 109XB TAA 1953 14ZX Taxation Laws Amendment Act (No. 3) 1998 Taxation Laws Amendment (2004 Measures No. 1) Act 2004 Tax Laws Amendment (2007 Measures No. 3) Act 2007
Related practice statements	PS LA 1998/1 PS LA 2003/7
Other references	Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No. 3) Bill 2007
File references	07/7661
Date issued	30 July 2007
Date of effect	Applies to certain transactions or actions in 2002 to 2007 income years and 'corrective action' taken from 1 July 2007 to 30 June 2008.
Other business lines consulted	All