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Ruling Compendium – TD 2008/28

This is a compendium of responses to the issues raised by external parties to draft TD 2008/D8 – Income tax: when is income tax of a private company a ‘present legal obligation’ for the purposes of the distributable surplus calculation under subsection 109Y(2) of Division 7A of Part III of the *Income Tax Assessment Act 1936*?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft determination.

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1	The position taken in TD 2008/D8 is at odds with the only case on point being <i>Fresta v. FC of T</i> 2002 ATC 2061, 49 ATR 1212 (<i>Fresta</i>).	Absent of any conflicting statement of principle by a Court, the Tax Office would be guided by decision of the Administrative Appeals Tribunal to the extent such decisions are not confined to their facts. However, as explained below, the Tax Office believes that there is a conflicting statement of principle which goes to heart of the matter in the majority judgement of the High Court in <i>Clyne v. Deputy Commissioner of Taxation</i> : 81 ATC 4429; 12 ATR 173. For that reason, the Tax Office has not followed <i>Fresta</i> in TD 2008/D8.
2	The approach in TD 2007/D9 was the correct interpretation of the law. The approach in TD 2008/D8 is wrong. <i>Clyne v. Deputy Commissioner of Taxation</i> : 81 ATC 4429 does not provide any justification for the view in TD 2008/D8.	The Tax Office disagrees. The word obligation in the phrase ‘present legal obligation’ is qualified by the word ‘legal’. The obligation must therefore arise and be enforceable under some operation of law. Both words are then further qualified by the word ‘present’ which must have an intended temporal affect. The effect is that the obligation must have come home in the sense of at least being owing.

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3	TD 2008/D8 does not make any distinction between obligation, liability and debt. The phrase 'present legal obligation' should be construed as an obligation founded in law even though liability to pay on the legal obligation has not arisen.	Despite differing statements in the authorities over a period of time, the Tax Office considers the majority judgement of the High Court in <i>Clyne</i> has put to rest the notion that derivation of taxable income of itself causes an amount of tax to be owing. In <i>Clyne</i>, the majority judgment of Mason, Aickin and Wilson JJ with Brennan J agreeing on point says: However, the correct view in my opinion is that income tax is due when it is assessed and notice is served of that assessment and that the tax does not become payable before the date fixed by sec. 204. ... I recognise that on other occasions members of this Court have said that 'tax is a debt due and owing', although not payable, notwithstanding that no assessment has been made ... This approach can be traced back to the majority decision of this Court in ... (Mortimer Kelly's case) ... I think that the decision is to be explained on the footing that it was held that for a debt for income tax not assessed until after the deceased's death was a 'debt due by the deceased' 'for the purposes of Acts imposing death and probate duties.' (emphasis added) Mason J is saying the decision in <i>Commissioner of Stamps (WA) v The Western Australian Trustee Executor and Agency Co Ltd (Mortimer Kelly's case)</i> (1925) 36 CLR 98 (<i>Mortimer Kelly's Case</i>) turned on the construction of relevant provisions in Acts imposing death and probate duties as opposed to construction of provisions causing tax to be owing under the ITAA 1936. The line of authority including <i>Mortimer Kelly's Case</i> is therefore distinguished for present purposes.
4	For transparency and clarity the shift in position from TD 2207/D9 to TD 2008/D8 should be explained.	Noted. Additional text has been inserted into TD 2008/28 to provide greater clarity of the Tax Office's revised position.

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Issue No.	Issue raised	Tax Office Response/Action taken
5	The taxable income derived by a company for a particular year will generally result in an increase in the net assets of the company. However, the amount of this income that can be distributed to shareholders needs to be reduced by the amount of tax payable on that taxable income. To do otherwise would result in an economic distortion when calculating the amount available for distribution to shareholders.	Noted. Absent any specific design feature to deliver this outcome, the law operates as drafted. Division 7A has replaced the former section 108 of the ITAA 1936 as the relevant integrity provision for disguised private company distributions. Under the former section 108, a similar 'before tax' approach was taken to the calculation of profits where no tax had in fact been paid <i>Masterman and Macfarlane v. FC of T</i> 85 ATC 4015. It should be noted the ATO view in TD 2008/D8 can produce favourable outcomes for taxpayers where credit amendments issue to the private company in later years. The reduction in tax payable will not increase distributable surplus for the income year subject to the credit amendment meaning the quantum of any deemed dividend that has been taken to be paid will not be increased.
6	From a practical perspective the distributable surplus calculation has been seen to generally equate to the net asset position in the financial statements for most private companies that have fairly simple accounts. Compliance costs will arise as a result of excluding the tax liability from this calculation.	Noted. However, the Tax Office would consider the additional compliance costs as being small at the individual company level. Only one reconciliation item adjustment is required each year if the distributable surplus calculation needs to be performed.