


IT 2182 - Taxation (unpaid company tax) legislation : elections under section 16 and section 17.

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TAXATION RULING NO. IT 2182 (as amended 12/9/85)

TAXATION (UNPAID COMPANY TAX) LEGISLATION : ELECTIONS
UNDER SECTION 16 AND SECTION 17.

F.O.I. EMBARGO: May be released

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I 1123975	T(UCT) RECOUPMENT TAX LEGISLATION ELECTIONS UNDER SECTIONS 16 & 17	T(UCT)AA S.16 S.17

PREAMBLE

This ruling provides guidelines regarding certain aspects of sections 16 and 17 of the Taxation (Unpaid Company Tax) Assessment Act.

RULING

2. The general purpose of section 16 is to give the vendor-shareholders, who would otherwise be liable to pay recoupment tax based on the unpaid undistributed profits tax of a stripped company, the right to request that they be assessed to pay income tax as though the stripped company had paid enough in dividends to eliminate the liability of the company to tax under Division 7 of Part III of the Income Tax Assessment Act (ITAA).
3. The election should be made by the former directors of the stripped company or, failing that, by all of the vendor-shareholders.
4. The section 16 request may be granted or refused having regard to the matters listed in sub-section 16(4). Broadly, these relate to the likelihood that the persons concerned will pay tax on the amount to be included in their assessable incomes.
5. Where the section 16 request is granted, the stripped company's liability to Division 7 tax, and thus the vendor-shareholder's liability to recoupment tax in respect of that liability, is eliminated. The stripped company is deemed to have paid the appropriate dividend to the vendor-shareholders on the last day of the prescribed distribution period in relation to the year of the strip. Where a vendor-shareholder is a trustee of a trust estate, a further election is available under section 17 to treat the deemed dividend income of the trust estate under the earlier election as a distribution to the beneficiaries of that trust. A similar effect in relation to shareholders in a company vendor-shareholder can be achieved by the application of sub-section 46(3) and section 105AA of the ITAA (see paragraph 24 and 25 below).

6. In a practical sense persons would generally make elections under section 16 or 17 only where the tax applicable to the dividend deemed to have been received by the vendor-shareholders, or the beneficiaries in a trust that formerly owned shares in a stripped company, is less than the Division 7 tax otherwise payable by the company.

Time Limit for Section 16 Requests

7. The Taxation (Unpaid Company Tax) Assessment Act does not specify a time limit within which a section 16 request may be made, nor is there any apparent intention in the legislation that a section 16 request should be made at an early time. Indeed it is notable that a section 16 request cannot be made until a primary taxable amount exists.

8. For these reasons and as section 16 is a concession to vendor-shareholders it is accepted that a request under section 16 may be made at any time. Paragraph 16(4)(b) should not be used to implement any arbitrary time limit. That paragraph applies in this context only in relation to special cases (e.g. - where the section 16 request is mischievous or where the grounds of appeal are merely colourable).

Paragraph 16(4)(a) - Likelihood that tax will be paid

(a) Non-Resident

9. A section 16 request is unlikely to be granted where a vendor-shareholder is a non-resident unless satisfactory arrangements are made for the payment of the non-resident's potential liability in respect of the deemed dividend (i.e. up-front payment of the non-resident's share).

(b) Whereabouts unknown

10. Where a vendor-shareholder's whereabouts is unknown, a similar approach to that outlined in paragraph 9 above is to be followed.

(c) Company Without Assets

11. If the vendor-shareholder is a company without assets it will not be able to pay the tax in respect of the deemed dividend. An additional period under section 105AA will not assist the company because, the company having no funds, it will not be in a position to satisfy the requirements of Division 7 by the payment of an actual dividend.

12. As only the former directors of the stripped company or the primary level vendor-shareholders are able to request the benefit of section 16, it is not possible to accept a section 16 request made by the secondary level taxpayers. However, if the vendor-shareholder company is still in existence and a valid section 16 request is made, that request may be granted provided satisfactory payment arrangements are also made in respect of

that company's potential Division 7 liability (e.g. payment up-front).

13. A section 16 request will be refused if the vendor-shareholder company is no longer in existence.

(d) Trusts Without Assets

14. Where a vendor-shareholder is a trust estate without assets, any section 16 request should not be granted unless the trustee and the beneficiaries of the trust estate have also lodged a section 17 request. It should also be kept in mind that it is not possible for any valid request within the terms of section 17 to be made if the trust is no longer in existence.

Paragraph 16(4)(b) - Any other matters considered relevant

15. Section 16 requests may be granted notwithstanding that the recipients of the deemed dividend intend to object against their amended assessments.

16. Similarly, section 16 requests may be granted notwithstanding that the taxpayer in receipt of the deemed dividend is non-taxable or possesses legitimate carry forward losses.

Change in Shareholders/Beneficiaries

17. If the discretion in sub-section 6(2) is likely to be exercised, a section 16 request is to be refused under paragraph 16(4)(b) as liability for the deemed dividend would otherwise fall on persons other than those that benefited from the pre-tax profit stripping scheme.

Deceased Vendor-Shareholder

18. Even though a vendor-shareholder may have died prior to the company assessment being finalised, a section 16 request may still be made by the remaining vendor-shareholder/s. This is because a primary taxable amount does not exist in respect of a deceased vendor-shareholder in these circumstances: see sub-section 16(1).

19. The question then arises of the extent of the liability of the remaining vendor-shareholders.

20. Where a section 16 request is granted, the effect of paragraph 16(5)(a) is that the relevant company is deemed to have made a sufficient distribution - the Division 7 liability of the company is therefore fully extinguished. Under paragraph 16(5)(b) the stripped company is also deemed to have paid to each surviving vendor-shareholder a dividend of an amount equal to their share of the company's undistributed amount. This share is calculated by reference to the "apportionment factor", defined in sub-section 3(1). For each person the deemed dividend therefore reflects only that proportion of the company's undistributed profits tax liability that he would, apart from the election,

have borne by virtue of section 5.

Carry Forward Losses

21. In cases where carry forward losses are not taken into account in relation to the company's assessment (see Ruling IT 2013), the deemed dividend under section 16 must relate to the whole of the company's Division 7 liability undiminished by the carry forward losses. This is because the term "undistributed amount" in sub-paragraph 16(5) (b) (i) takes its sub-section 3(1) meaning, i.e. the undistributed amount for the purposes of Division 7.

Income Derived After Sale

22. Similarly, the deemed dividend must take into account any income derived after the sale of the shares in the relevant year. This is so because, although sub-sections 3(10) and 5(9) provide that income derived after sale is to be disregarded in calculating the Division 7 tax payable by the company, the reference in sub-section 16(5) is to the "undistributed amount" and not to the Division 7 tax to which a primary taxable amount relates.

23. In the circumstances outlined in paragraph 21-22 above, vendor share-holders who make a section 16 request are to be advised of the consequences and may withdraw their request.

Section 105AA

24. Where a primary level vendor-shareholder is a company it may make a request under section 105AA of the ITAA for an additional period in which it may make a sufficient distribution in connection with the deemed dividend. The request under section 105AA will usually be granted provided the requirements of that section are met and the company has the ability to make an actual payment of the dividend.

25. Where a section 105AA additional period is granted, the ultimate recipient of the dividend is assessable in the year in which the dividend is actually paid or credited to him.

Group Sale Situation

26. In a situation where shares in a holding company are sold, the vendor will be liable to recoupment tax in relation to the unpaid company tax of a subsidiary stripped of pre-tax profits. In such cases the vendor of the holding company shares is regarded as the primary level shareholder (i.e. "the relevant person") in respect of the subsidiary company.

Assessment - Deemed Dividend

27. Normal assessing adjustments are to be made when giving effect to a section 16 request. That is to say, the provisions of the ITAA are to be applied fully where the inclusion of a deemed dividend affects concessional dividends, rebates or other

items.

Issue of Assessments/Amendments

28. The following assessments/amendments are necessary to give effect to a section 16 election:

- (a) the stripped company's Division 7 assessment is reduced to nil;
- (b) vendors recoupment tax assessments (VRTA's) in relation to the stripped company's Division 7 liability are reduced to nil; and
- (c) assessments are to be raised or amendments are to be made in relation to "the relevant persons" to include the deemed dividends.

29. Sub-section 4(6) provides that nothing in section 170 of the ITAA prevents the amendment of an assessment, at any time, to give effect to section 16 or 17.

Relationship between sections 16 and 19

30. Arrangements under section 19 may be solely in relation to ordinary company tax and need not include undistributed profits tax.

Relationships between sections 16 and 21

31. Vendor-shareholders may wish to make a section 16 request and to enter into a section 21 arrangement at a time before the objection rights to the Division 7 assessment have expired. A section 16 request cannot be granted until a primary taxable amount exists. On the other hand, a section 21 arrangement is available only if it covers all of the unpaid tax, including the Division 7 tax that would be the subject of a section 16 request.

32. This problem is to be resolved by deferring consideration of the section 16 request until the expiration of the company's objection period, and the acceptance of section 21 arrangements structured in such a way that the unpaid undistributed profits tax is added to the last instalment. An undertaking is to be given to the vendor-shareholders that, on the expiration of the company's objection period, the last instalment will be reduced by the amount of the Division 7 tax that will then have been eliminated under section 16.

Refunds

33. Payments made by promoters in relation to a stripped company's Division 7 liabilities are eventually to be refunded to the persons to whom the dividends are deemed to have been paid.

