IT 2637 - Income tax: private companies : loans or advances which represent distributions of profits

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TAXATION RULING IT 2637

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I 1012664	**PRIVATE COMPANY LOANS** **DEEMED DIVIDENDS** **PRE-LIQUIDATION LOANS**	**47** **108**

OTHER RULINGS ON THIS TOPIC: 2473

TITLE: INCOME TAX: PRIVATE COMPANIES : LOANS OR ADVANCES WHICH REPRESENT DISTRIBUTIONS OF PROFITS

: . Income Tax Rulings do not have the force of law.

. Each decision made by the Australian Taxation Office is made on the merits of each individual case having regard to any relevant Ruling.

PREAMBLE

Private companies and their shareholders are taxed under the Income Tax Assessment Act 1936 ("the Act") separately on their respective taxable incomes.

2. Section 108 of the Act is an anti-avoidance provision designed to prevent a private company, its shareholders and their associates from avoiding the income tax that would ordinarily be payable by the shareholders or their associates if certain payments, advances, loans and credits made by the company were actually distributed to them as dividends. The effect of section 108, in circumstances where it applies, is to deem the payment etc., to be a dividend paid by the company out of profits to the recipient as a shareholder.

3. The purpose of this Ruling is to examine some issues arising out of the amendments made to section 108 of the Act in 1987 (Act No. 108 of 1987). More particularly, this Ruling:

(a) considers the present scope of section 108 of the Act;

(b) provides guidance on the meaning of the expression "a distribution of profits" in subsection 108(1);

(c) discusses some of the factors to be considered in forming the requisite opinion in subsection 108(1); and

(d) considers how section 108 applies in relation to pre-liquidation loans.

RULING

A. Scope of Section 108

4. For section 108 to apply, a private company (i.e. a company which is not a "public company" in terms of section 103A of the Act) must either:

(a) pay an amount to an "associated person" (i.e. a shareholder or an "associate" of a shareholder as widely defined in section 26AAB of the Act - see paragraph 108(3)(c) of the Act) by way of an advance or loan; or

(b) pay or credit an amount on behalf of, or for the individual benefit of, an associated person.

5. Section 108 is no longer limited to purported loans or advances to, or payments by a company on behalf of, or for the individual benefit of, actual shareholders. It now extends to relevant amounts paid or credited by a company to an "associated person" and this term includes:

(a) an actual shareholder in the company;

(b) a person who indirectly holds a beneficial interest in shares in the company; and

(c) a relative of a shareholder in the company.

The person concerned must be an "associated person" as defined at the time that the relevant amount is paid or credited.

6. To the extent that the payment or crediting of an amount, in the circumstances stated in subsection 108(1) of the Act represents, in the opinion of the Commissioner, a distribution of profits, it is deemed by that subsection to be a dividend (other than for withholding tax purposes).

7. The expression "payment of an amount" is given an extended meaning by paragraph 108(3)(a) of the Act; a transfer of property is deemed to be the payment of an amount equal to the property's value. Thus, to the extent that a transfer of property in the circumstances stated in subsection 108(1) of the Act represents, in the opinion of the Commissioner, a distribution of profits, it is also deemed by that subsection to be a dividend (other than for withholding tax purposes). This ensures that a disguised distribution of profits effected by an asset transfer is within the scope of the subsection.

8. The new section 108 applies to relevant payments or credits made on or after 5 June 1987. It was inserted to remedy technical deficiencies that had become apparent over the years in applying the former section 108. The new section applies to a greater range of circumstances than the former section did.

Disguised Distributions of Profits

9. In removing the technical deficiencies in the former section, the scope of the new section 108 has not been extended beyond the original underlying intention of the section. It will apply only in relation to amounts which, in the Commissioner's opinion, represent disguised distributions of profits by private companies. In other words, the section will apply where profits made by a private company are bestowed on shareholders in the guise of loans or advances or credits but these are in substance dividends paid by the company.

10. Beaumont J in the MacFarlane case said (86 ATC at 4492; 17 ATR at 826):

> "The mischief aimed at by sec. 108(1) was the avoidance of tax on informal or 'de facto' dividends - payments disguised as a different transaction but, in substance, dividends, because the payments in fact made over profits or income of the company."

Shams

11. As the Supreme Court of Victoria (Ormiston J) pointed out in Kenneth A. Summons Pty Ltd & Ors v. F.C. of T. 86 ATC 4979 at 5007; (1986) 18 ATR 235 at 266, however, if a distribution is truly disguised as an advance or a loan it would be a sham (see the definition of "sham" by Diplock L.J. in Snook v. London and West Riding Investments Ltd [1967] 2QB 786 at 802). Being a sham, its form could be ignored by the Commissioner in determining whether it is a "dividend" as defined in subsection 6(1) for the purposes of subsection 44(1) of the Act. Thus, advances and loans which are mere book entries and which are not intended to reflect the parties' real acts would be shams. Section 108 would not apply as it is not necessary to resort to that provision. Rather the question is whether the real acts give rise to a dividend under the ordinary provisions of the law.

Disguised Distributions that are Not Shams

12. Ormiston J gave a good example in the Kenneth A. Summons Pty. Ltd. case ATC at 5007; ATR at 266-7 of circumstances where the Commissioner might fairly foresee the requisite opinion in subsection 108(1) of the Act. His example is one where advances and loans are made which effectively put the money in the hands or bank accounts of the shareholders to be drawn as and when they wish without having included the amount of the moneys in their assessable income. As his Honour said, the benefit of the distributions in this situation are received by the shareholders before any formal dividends are declared.

13. If an advance or a loan is found not to be a sham, an opinion may be formed under subsection 108(1) that the advance or loan represents a distribution of profits. The possibility must be recognised of there being an underlying objective or intention, or an ulterior motive, to an apparently genuine loan. Such an

underlying objective or intention, or ulterior motive, deduced from all the relevant circumstances might be an indication of a disguised distribution of profits warranting the formation of an opinion under subsection 108(1) of the Act. Where, for instance, there is evidence to establish that the parties did not intend or arrange to repay an ostensible advance or loan, there may be grounds to form the requisite opinion (compare the decision of the Supreme Court of New South Wales (Lusher J) in Black v. F.C. of T. 86 ATC 4113 at 4116; (1986) 17 ATR 331 at 334).

What Constitutes a Payment

14. The question may arise in particular cases whether there can be said to be a "payment" by a company for the purposes of paragraph 108(1)(a) or 108(1)(b) of the Act. The Federal Court of Australia (Beaumont J.) in MacFarlane v. F.C. of T. 86 ATC 4477; (1986) 17 ATR 808 considered this issue in relation to the former section 108. His Honour rejected a contention that the situation there should be characterised as an appropriation (perhaps even a misappropriation) of the company's property on the shareholder's part rather than a payment made by the company for the shareholder's individual benefit. Beaumont J, relying on F.C. of T. v. Blakely (1951) 82 C.L.R. 388, took the view that payments were made by the company out of its funds which were for the individual benefit of one of its shareholders. That was sufficient, he considered, to satisfy the opening words of the former subsection 108(1), whatever significance the conduct of those involved may have had in other legal contexts (e.g. misfeasance or breach of directors' fiduciary duties to creditors). A contrary view has been expressed in the United Kingdom decision Stephens v. Pittas Ltd (1983) BTC 367. However, the approach taken in the MacFarlane case is considered to be the preferable and the more authoritative view in Australia.

Phrase "By Way of an Advance or Loan"

15. The phrase "by way of an advance or loan" used in paragraph 108 (1)(a) of the Act needs to be clarified. The words "advance" or "loan" in this context bear their ordinary meaning. The word "advance" normally means the furnishing of money for some specified purpose (Burnes v. Trade Credits Ltd (1981) 34 A.L.R. 459 at 461) although it may refer to prepayments of what would become due in the future (Lincolnshire Sugar Co. Ltd v. Smart (1937) A.C. 697 at 704).

16. The amount need only be paid, however, "by way of" an advance or loan for paragraph 108(1)(a) of the Act to be satisfied. The expression "by way of" is significantly wider than the word "as" or even the phrase "under a contract of." (see Goldsbrough Mort & Co. Ltd v. F.C. of T. 76 ATC 4343 at 4348; (1976) 6 ATR 580 at 586).

The Word "Benefit"

17. Paragraph 108(1)(b) of the Act refers to the payment or crediting of an amount "on behalf of, or for the individual benefit of", an associated person. The meaning of the word

"benefit" in paragraph 108(1)(b) was considered in Case W115 89 ATC 899 at 913;20 ATR 4063 at 4078. The Administrative Appeals Tribunal stated that a release or forgiveness of debt "whether by deed under seal or by any agreement for which consideration was given" constituted an immediate financial benefit. The Tribunal also found that the mere writing off of a loan in the company's books of account did not constitute a benefit for the purposes of section 108. Upon appeal to the Federal Court in D.F.C. of T. v. Black 90 ATC 4699;21 ATR 701 Sweeney J referred to the Tribunal's findings without finally deciding the scope of the word "benefit". Instead his Honour decided the case on the basis that "[i]t is not open to regard the forgiveness of the taxpayer's debt as a payment made by the company on behalf of, or for the individual benefit of, the taxpayer within the meaning of the section"(emphasis added).

18. This Office takes the view that the writing off of a debt in a company's books when accompanied by an intention, on the company's part, not to seek to recover the debt constitutes a "benefit" for the purposes of section 108. In this respect, this Office does not agree with the views expressed by the Tribunal in Case W115. Support for this Office's view is found in St. Aubyn and Others v. Attorney-General [1951] AC 15.

19. In the St. Aubyn case a company paid a series of loans or advances to one of its shareholders and the question was whether those loans or advances constituted a benefit for the purposes of the United Kingdom Finance Act 1940. The House of Lords held that, notwithstanding the fact that the loan or advance must be repaid, the loans or advances were a "benefit" to the shareholder. In the words of Lord Simmons the shareholder "...had the beneficial use of what he receives and can fairly be said to have received it for his own benefit".

20. If the making of a loan is a "benefit" then, equally, the writing off of that loan in the company's books when accompanied by an intention not to seek to recover that debt must also be a "benefit". Support for this view is also found in the ordinary meaning of the word "benefit" which, according to the Macquarie Dictionary (1981 edition), includes "anything that is for the good of a person". Clearly, the writing off of the debt is for the good of the shareholder or associate. Consequently, it is the view of this Office that both the forgiveness of a debt, whether under seal or for consideration, and the writing off of the debt with the intention of not seeking to recover the debt, constitute a "benefit" for section 108 purposes.

Crediting of an Amount

21. The scope of section 108 has been extended by the 1987 amendments so that paragraph 108(1)(b) now applies to an amount paid or "credited". This Office takes the view that both the formal forgiveness of a debt and the writing off of a debt in a company's books constitute a crediting of an amount. Support for this view is found in Black where Sweeney J held (at ATC 4705;21 ATR 707) that the forgiveness of a debt constituted an amount "credited". His Honour added that the shareholder was credited in

his capacity as a debtor rather than in his capacity as a shareholder as required by paragraph 6(1)(b) of the definition of "dividend". However, as section 108 does not require the shareholder to receive the benefit, etc., as a shareholder, this latter finding is not relevant for present purposes. Additional support can also be found in the New Zealand case of Campbell and Anor v. Commissioner of Inland Revenue (N.Z.) (1967) 14 ATD 551 at 554.

Distribution of Profits

22. For subsection 108(1) of the Act to apply, the Commissioner must form the opinion that some part of the relevant amount paid or credited represents a "distribution of profits." A distinction might need to be drawn in some cases between a distribution of profits and a distribution out of profits. It is not sufficient, for example, where a distribution is made by a company of a mass of assets which might contain profits, that an opinion be formed that the payment was made by the company out of its profits. For practical purposes, however, a distribution out of profits would ordinarily constitute a distribution of profits.

23. The expression "distribution of profits" in subsection 108(1) of the Act is used in its ordinary sense. The ordinary meaning of the word "distribute", according to the Macquarie Dictionary (1981 edition), is to "divide and bestow in shares; deal out; allot" (see also D.C. of T. v. Black ATC at 4705; ATR 707). Given that the word "distribution" means "that which is distributed", the expression "distribution of profits" in subsection 108(1) is considered to mean shares or portions of profits that are dealt out or bestowed on recipients.

Profits

24. The term "profits" is now used in subsection 108(1) of the Act, rather than the word "income" in the former subsection. It is necessary therefore to clarify the meaning of the term "profits" for the purposes of subsection 108(1). In its ordinary sense, the word profit means "the pecuniary gain resulting from the employment of capital in any transaction" (The Macquarie Dictionary 1981 edition).

25. The meaning of the word "profits" in subsection 108(1) has not yet been judicially considered. However, the High Court of Australia in F.C. of T. v. Slater Holdings Ltd (No.2) (1984) 56 ALR 306, considered the meaning of the word "profits" in its context in subsection 44(1) of the Act.

26. Gibbs CJ (with whom Mason, Brennan, Deane and Dawson JJ agreed) saw as a starting point in defining the word "profits" its "fundamental meaning" given by Fletcher Moulton LJ in In re Spanish Prospecting Company Ltd (1911) 1 Ch. 92 at 98:

> "'Profits' implies a comparison between the state of a business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of

> gain made by the business during the year. This can only be ascertained by a comparison of the assets of the business at the two dates."

27. The Chief Justice said that this dictum of Fletcher Moulton LJ is not of universal application and each case must depend on its own circumstances. According to Irwine CJ in In Re Income Tax Acts (No.2) (1930) V.L.R. 233, the definition of "profits" given by Fletcher Moulton LJ is in the nature of a "conventional rule" to be applied when circumstances permit its application. Taking the definition of Fletcher Moulton LJ as a guide, Gibbs CJ concluded that the amount of the gift made to the company in the Slater Holdings case contributed to an increase in assets and represented a profit.

28. Although it was argued, relying on F.C. of T. v. Williams (1972) CLR 226, that a gift is not ordinarily regarded as a profit, Gibbs CJ said that the Williams case is not authority for the proposition that moneys received as a gift cannot properly be treated by a company as a profit out of which a dividend may be declared.

28. In MacFarlane v. F.C. of T. 86 ATC 4477; (1986) 17 ATR 808 the Full Federal Court of Australia considered the interaction between sections 44 and 108 of the Act and the meaning of "profits". Fisher J after outlining the approach taken by Gibbs J in Slater Holdings went on to state (ATC at 4482 - 4483; ATR at 815) that:

> "There are in my opinion a number of indications in the Act which confirm my view that there is no justification for attributing a narrow or accounting meaning to the word 'profits'. I consider that the circumstances here permit the application of the conventional rule".

30. And later, Fisher J again in relation to the word "profits" in subsection 44(1) (ATC at 4483; ATR at 815), said that:

> "There is nothing to indicate that the legislature had in mind designating the nature of these profits, i.e., net profits, divisible profits, after tax profits etc."

31. Fisher J concluded (ATC at 4484; ATR at 816) that:

> "So long as there are profits, any portions thereof distributed to shareholders are liable to be deemed to be dividends and are assessable as such."

32. Beaumont J, in the MacFarlane case, adopted a similar approach, deciding that "profit" for tax purposes is not limited to the restricted company law concept of "profits". His Honour said ATC at 4492 - 4493 that:

> "It could be no answer to the application of sec. 108(1) that the payment in question did not satisfy the technical demands of company law for the proper payment of a dividend: if the

> payments in question represented a distribution of the company's 'income' (to use the language of the Act) or its 'profits' (to use the words of the explanatory note), the relevant requirement of sec. 108(1) would be satisfied even if, under the companies legislation, there were insufficient profits available lawfully to pay a dividend in that amount."

33. While the word "profits" in the Act is not limited to the company law concept of "profits", this does not mean that company law cases on what constitutes a profit are irrelevant. Merely because there is no profit which can be distributed under the company law does not mean that there is no profit for tax purposes. A profit for company law purposes must also be a profit for taxation purposes because profit for tax purposes is a wider concept than for company law purposes. For this reason company law cases are of assistance in determining whether "profits" have been distributed.

34. While the Slater Holdings and MacFarlane cases were concerned with revenue profits, the definition of "profit" adopted by those cases is broad enough to cover both revenue and capital profits. As Ormiston J said in the Kenneth A. Summons Pty Ltd case 86 ATC at 5008; 18 ATR at 268:

> "Likewise there was no basis for considering that 'profits' in sec. 44 referred only to profits of a revenue or income nature and, as Gibbs CJ said in the Slater Holdings case (at ATC p.4886; CLR p 454) 'there is no reason to doubt that the word includes 'capital profits'".

See also Mara Developments Ltd v. Bn Wn Rofe Pty Ltd (1977) 2 NSWLR 616 at 629.

35. The word "profits" also covers unrealised capital profits provided the asset has been revalued in the company's books or the increase in value has otherwise been recognised (Mara Development's and Dimbula Valley (Ceylon) Tea Co. Ltd v. Laurie [1961] Ch 353 at 371.) Section 108 is concerned with whether a distribution of profits, either capital or income, has occurred and not with whether those profits have been assessed as income to the company. Consequently, the profits covered by section 108 also include capital profits realised on all assets whether purchased before or after the introduction of Part IIIA (the Capital Gains Tax provisions).

Profits of Previous Years

36. A question arises whether section 108 applies to distributions of profits earned in previous years. The High Court (Dixon J) in F.C. of T. v. Miller, Anderson Limited (1945-46) 73 CLR 341 considered the meaning of the phrase "accumulated profits" in subsection 24(1) of the War-time (Company) Tax Assessment Act 1940. His Honour stated, at 373 - 374 that:

> "Broadly speaking, the legislature may be taken to be alive to the distinction between the two courses that a company may

> follow with reference to profits which have accrued but which it does not desire immediately to distribute or withdraw from its business. The directors may in some way earmark the profit or part of it as a reserve or provision for a special purpose and thus distinguish it by placing it in an accounting category so that to withdraw it and make it available for distribution would require a new and affirmative decision. On the other hand, they may carry it forward in the company's account in such a way that, subject to the increment or diminution the trading of the next period or later periods may bring, it still awaits the decision of the directors to distribute it, to earmark it as a reserve, or otherwise to dispose of it. If the latter course is followed the profit will, according to the usual practice, stand as a credit to an appropriation account".

37. Dixon J was specifically concerned with the phrase "accumulated profits". That expression must by its very nature, however, include profits earned in previous years. The language used by Dixon J clearly indicates that his Honour was making a general observation on the interpretation of the word "profits" rather than simply commenting on the meaning of "accumulated profits". Support for this view is to be found in the judgment of Mahoney JA in Mara Developments where he cited (631) the above comments of Dixon J as authority for the proposition that "... a company may retain revenue profits from past periods in such a form as will leave them immediately available to base a dividend." Thus the term "profits" is considered to include retained earnings comprised of profits earned in previous years.

Apportionment Under Subsection 108(1)

38. Subsection 108(1) of the Act applies to "so much (if any) of the amount paid or credited as, in the opinion of the Commissioner, represent a distribution of profits" (Emphasis added).

39. Consequently, for the purposes of subsection 108(1) the requisite opinion may be formed that the whole, or part only, of the relevant payment or credit in favour of an associated person represents a distribution of profits.

40. In the Kenneth A. Summons Pty Ltd case, Ormiston J considered, but rejected, an argument in relation to the former subsection 108(1) that the sums in question there represented only a balance of account and therefore were not advances or loans in terms of the subsection. His Honour said (86 ATC at 5008; 18 ATR at 267):

> "I do not accept that argument, for the sums so treated by the Commissioner were calculated after deducting from sums in fact advanced or lent other sums which the Commissioner was prepared to set off for this purpose. The taxpayers were not disadvantaged by this procedure and it seems consistent with the purpose of the section."

41. Similarly, where a series of transactions occur, the facts may suggest that only some of the advances or loans represent distributions of profit.

C. Forming an Opinion under Subsection 108(1)

42. Subsection 108(1) of the Act deems certain payments, credits and transfers of property to be dividends paid by a private company but only when, in the opinion of the Commissioner, the payment, credit or transfer represents a distribution of profits.

43. Consideration has been given to the factors that might be taken into account by the Commissioner in forming the requisite opinion in subsection 108(1). Nothing in the following paragraphs is intended to restrict Deputy Commissioners of Taxation and authorising officers in forming the opinion in the subsection. It is essential that Deputy Commissioners and authorised officers retain the flexibility to deal with each particular case in the light of all the surrounding circumstances and on its own merits.

44. The formation of the opinion required by subsection 108(1), involving as it does the exercise of a discretion, must be formed reasonably. Such a discretion is conferred so that it can be used to promote the policy and objects of the Act. The factors that may be taken into account in forming the requisite opinion are not stated in the Act. Clearly, considerations which are irrelevant to the matter to be considered must be excluded. Broadly speaking, the subject-matter, scope and purpose of the Act should be borne in mind in determining what considerations are relevant and may be taken into account.

45. The requisite opinion in subsection 108(1) must not be formed for an improper collateral purpose i.e., a purpose which the statute does not authorise. As indicated above, the purpose of section 108 according to the explanatory memorandum which accompanied Act No. 108 of 1987 is to prevent avoidance of tax by private companies and their shareholders through the use of disguised dividend distributions.

46. Without wishing to limit the matters which the circumstances of a particular case might warrant being taken into account, the relevant considerations include:

(a) Intention of the Parties

What the relevant parties (i.e. the company, its shareholders and any associates of the shareholders) intend in:

(i) paying an amount or transferring property to an associated person by way of an advance or loan; or

(ii) paying an amount, transferring property or crediting an amount on behalf of, for the individual benefit of, an associated person, will be relevant in determining, for instance, whether the payment, credit or transfer constitutes a genuine advance or loan or a disguised

dividend distribution (c.f. Kenneth A. Summons Pty Ltd case 86 ATC at 5007; 18 ATR at 266.)

In (1950) 1 T.B.R.D. Case 69 (which was cited with approval in D.C. of T. v. Black) the Board of Review considered an opinion formed under the former subsection 108(1):

> "The mere fact that a shareholder in a private company has become indebted to it is not, in itself, justification for the formation of an opinion that there has been what represents a distribution of income to him. If the debt is good, it is an asset of the company and the profits available for distribution are not affected. There must, in our opinion, be more in a case than that in order to justify the formation of such an opinion. For a thing to be, or to represent, a distribution of income there must be, to our minds, a getting of money into the hands of a shareholder with no idea of repayment. There must be something that goes beyond a mere debit automatically arising upon a taking of accounts and which points to a subterfuge whereby a payment which, upon examination, is found to relate to the income of the company and to represent a distribution thereof, is made to appear to be a loan or advance."

The present subsection 108(1) differs from the former subsection in that the present subsection requires the Commissioner to form an opinion that the amount in question represents a "distribution of profits" whereas the former subsection required the formation of an opinion that it represented a "distribution of income." Notwithstanding this difference, however, the reasoning of the Board of Review in Case 69 is considered to apply equally to the opinion to be formed in the present subsection.

(b) Description Given by the Parties is Not Conclusive

The parties' description of the payment, credit or transfer by the company, needs to be considered. However, this description is not necessarily conclusive of the proper characterisation of the payment, etc.

(c) Form and Substance of the Transaction

Subsection 108(1) is primarily concerned with the substance of the relevant transaction rather than with its form (MacFarlane case 86 ATC at 4492; 17 ATR at 826 and see 19 CTBR (NS) Case 109).

(d) Documentation Evidencing the Transaction or Associated Transactions

Contemporaneous documents or statements by the parties may assist in determining the parties' intention and the substance of the transaction. They may also provide evidence of an arrangement on the part of the recipient to repay.

(e) Terms of Any Advance or Loan

Where the terms and conditions used in the advance or loan are comparable with the commercial terms and conditions ordinarily used in advances or loans between parties dealing at arms length, that would, in the absence of any evidence to the contrary, support the view that the transaction was not intended to be a "distribution of profits." Conversely, a loan granted on interest-free terms and repayable on demand might warrant closer examination. This was particularly so where money is put in the hands or bank account of a shareholder and may be drawn on as and when the shareholder wishes.

(f) The Nature of the Payments

According to The Macquarie Dictionary, the word "represent" has a large variety of meanings. The meaning considered most appropriate in the context of subsection 108(1), "represents a distribution of profits," appears to be "to be the equivalent of; correspond to." (c.f. 15 C.T.B.R. (0.S.) Case 72).

There need not therefore be in form a distribution of profits but there must be an equivalent of one; the payment made by the company must be the equivalent of, or correspond to, a distribution of the company's profits (c.f. Case B38, 70 ATC 194; 15 C.T.B.R. (NS) Case 100)

The nature or character of the relevant payment, credit or transfer may be significant especially in the case of a transfer of property. The transfer of certain types of property, such as a family home or car, may need to be further explored to determine whether repayment was not intended.

(g) Likelihood of Repayment

Inability on the part of a shareholder to repay, bearing in mind the shareholder's financial position and the size of the advance or loan, may indicate that repayment is unlikely and may not have been intended. On the other hand, the fact that similar advances or loans have been made and repaid in the past may also be relevant.

(h) How Much Represents a Distribution of Profits

Subsection 108(1) requires the formation of an opinion of how much (if any) of the relevant payment, credit, advance or loan represents a distribution of profits. Where the value of any distributed property exceeds the available profits of the company, the opinion may be formed that the deemed dividend is limited to the amount of those profits.

D. Loans Made Before a Winding-Up

47. Section 108 may apply to a transaction entered into prior to commencement of a winding-up, particularly where the amount involved is greater than the amount likely to be distributed to the relevant person on the winding-up. In such a case there may be an inference that the transaction was entered into with the intention of distributing profits.

48. In addition to the factors mentioned above that may be taken into account in forming the requisite opinion in subsection 108(1), the Commissioner may need to take the following matters into account:

- a loan is made, or repayment of a loan is outstanding for a significant period prior to commencement of the liquidation of the company; and
- the winding-up proceedings are delayed as a consequence of action or inaction on the part of either the company's officers, the liquidator or both.

49. Section 108 has no application where a winding-up has commenced (e.g. by company resolution or court order) and the liquidator makes a distribution. Instead, section 47 applies because the distribution will be "in the course of winding up the company". In such cases the company may continue to seek an opinion from this Office on whether the loans will be treated as a distribution of income for the purposes of subsection 47(1) of the Act.

Section 108 and Fringe Benefits

50. A payment to which subsection 108(1) applies may also constitute the provision of a benefit to the taxpayer in his or her capacity as an employee. However, where the payment has been deemed, under section 108 to be a dividend, the payment does not constitute a fringe benefit (see paragraph (n) of the definition of "fringe benefit" in subsection 136(1) of the Fringe Benefits Tax Assessment Act 1986 (the FBTAA)).

51. Where the benefit is not a deemed dividend under subsection 108(1), the benefit falls for consideration under the FBTAA.

Imputation

52. It should be noted that a deemed dividend under subsection 108(1) is not a frankable dividend for the purposes of the dividend imputation provisions of the Act.

Examples

53. The following are examples of the operation of section 108:

(a) The majority shareholder in a private company sells company assets and retains the proceeds without recording the transaction in the company's books and records. The company then acquiesces to this transaction. This Office may form the opinion that the retention of the proceeds of the sale by the majority shareholder constitutes, to the extent to which there are profits in the company, a distribution of profits to the majority shareholder. Section 108 will apply.

(b) A shareholder has made a loan to a company. The company pays some of the private expenses of the shareholder. There is no corresponding reduction in the amount of the outstanding loan nor does the shareholder forgive any part of the debt. In these circumstances an opinion may be formed that the payment of the private expenses is not a repayment of the loan but rather is the paying of an amount on behalf of, or for the individual benefit of, the shareholder to which section 108 applies. However, if the company was to debit the loan account or the shareholder was to forgive an amount equal to the expenses paid then section 108 would not generally apply.

(c) A company lends money to a shareholder. The shareholder uses that money to purchase from the company land and or buildings owned by the company. If there is neither an intention nor an ability to repay the loan then this Office would be likely to form an opinion that the loan is a distribution to which section 108 applies. If, however, the intention of the parties is that the loan to the shareholder is to be repaid on demand and is secured by a charge over the property equivalent to the value of the property, section 108 would not generally apply.

COMMISSIONER OF TAXATION
6 June 1991

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