



PS LA 2006/2 (GA) - Operation of Division 7A of the Income Tax Assessment Act 1936 on loans that have become statute barred

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Practice Statement Law Administration (General Administration)

PS LA 2006/2 (GA)

This Practice Statement is an internal ATO document and an instruction to ATO staff.

Taxpayers can rely on this Practice Statement to provide them with protection from interest and penalties in the following way. 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 Practice Statement in good faith. However, even if they do not 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.

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| SUBJECT: | Operation of Division 7A of the <i>Income Tax Assessment Act 1936</i> on loans that have become statute-barred |
| PURPOSE: | To advise that statute-barred private company and trustee loans made prior to the enactment of Division 7A will not be treated as giving rise to a deemed dividend under Division 7A |

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STATEMENT

1. This Practice Statement advises that we have decided to take no active compliance action that would treat statute-barred private company and trustee loans made prior to the enactment of Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936) as giving rise to a deemed dividend under that Division.
2. This Practice Statement applies to private companies, trusts with private companies as beneficiaries and the shareholders and shareholder's associates of those private companies.
3. All legislative references in this Practice Statement are to the ITAA 1936, unless otherwise indicated.
4. Our view is that a loan by a private company to a shareholder or a shareholder's associate will be deemed to be a forgiven debt merely by the fact that the statutory period under the relevant Limitation Act¹ ends. This also applies to relevant loans made by trustees which become statute-barred. Subsequent

¹ The *Limitation of Actions Act 1958* (Vic), the *Limitation Act 1981* (NT), the *Limitation Act 1985* (ACT), the *Limitation Act 1969* (NSW), the *Limitation of Actions Act 1936* (SA), the *Limitation of Actions Act 1974* (Qld), the *Limitation Act 2005* (WA) and the *Limitation Act 1974* (Tas).

refreshment of a loan after the statutory period under the relevant Limitation Act ends does not create a new loan to which Division 7A applies.

5. However, this decision not to treat statute-barred loans as giving rise to a deemed dividend recognises a number of factors. These include:
 - The complexity of Division 7A and the fact that this particular issue arises from the interaction of 2 quite separate codes of law. The state and territory-based limitation of action provisions impact on parts of the income tax law (that is, the commercial debt forgiveness provisions), which in turn affect Division 7A, giving rise to an adverse tax outcome. This means that taxpayers may have been unaware of the effect of this issue on their tax affairs.
 - The complexity provided by variation in state and territory limitation of action provisions, leading potentially to differing results across Australia. It is also arguably unclear how provisions in some state and territory laws that 'revive' statute-barred debts will apply.
 - The general scheme of Division 7A to 'grandfather loans' made before its introduction and the doubt this brings to an interpretation leading to the outcome that mere inaction would cause a significantly unfavourable tax outcome.
 - This issue provides no ongoing risk to the tax system. Current provisions in Division 7A mean that a loan would be brought to account as a deemed dividend at a point in time before it could be deemed forgiven merely by expiration of the statutory period under a relevant Limitation Act.
 - Issues of inequity among taxpayers arise because of the significantly differential treatment that limitations in the operation of the amendment provisions at section 170 cause. Action to amend assessments would necessarily be limited to only a small proportion of loans taken out shortly before enactment of the provisions in Division 7A.
 - The fact that taxpayers first confronted this issue at a time when they and their tax advisers were dealing with a range of new laws of high volume and complexity. Analysis of old arrangements at this time would be difficult and involve high compliance costs for taxpayers.
6. Therefore, as a matter of practical compliance and sensible administration, we have decided to take no active compliance action on private company and trustee loans made prior to the enactment of Division 7A deemed to be forgiven in consequence of the operation of subsection 109F(3), merely because the period within which the creditor is entitled to sue for recovery of the debt ends by the operation of a statute of limitations.
7. Loans from private companies that have become statute-barred after 4 December 1997 would not, on this basis alone, meet the criteria for application of the general anti-avoidance rule at Part IVA, or constitute fraud or evasion, or be subject to amendment under section 108.

EXPLANATION

8. 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, lent or forgiven by a private company to shareholders or shareholder's associates are treated as dividends, unless they are specifically excluded.

9. Division 7A was amended by *Tax Laws Amendment (2004 Measures No. 1) Act 2004* (which received Royal Assent on 29 June 2004) to insert Subdivision EA and treat, among other things, the forgiveness of certain loans made by trustees as dividends (achieved by the interaction of sections 109XA and XB). These amendments have retrospective effect and apply where the forgiveness occurs on or after 12 December 2002. However, the amendments as they apply to forgiveness of trustee loans will usually only apply to loans made prior to 4:00 pm AEDT on 27 March 1998 where forgiveness occurs on or after 12 December 2002. This is because loans made after 4:00 pm AEDT on 27 March 1998 are likely to have already been brought within Division 7A by former section 109UB or the equivalent provisions which apply to loans in Subdivision EA.
10. Our view is that a loan by a private company to a shareholder or a shareholder's associate will be deemed to be a forgiven debt merely by the fact that the statutory period under the relevant Limitation Act ends. However, for the reasons outlined in this Practice Statement, it is also recognised that the matter is not entirely free from doubt.
11. The fact that a loan has become statute-barred may be evidenced by the writing down of the loan in the financial statements or accounts of an entity. Our view is that generally no capital or revenue loss arises in these circumstances, as the debt will generally not have arisen in the course of gaining or producing assessable income or carrying on a business. For capital gains tax purposes, such a debt is a personal use asset and any loss is disregarded in working out a net capital gain or capital loss.
12. Any taxpayer who has been assessed on a deemed dividend in consequence of a statute-barred private company or trustee loan made prior to the enactment of Division 7A may lodge an objection with us. Where necessary, the objection should be accompanied by a request that it be treated as having been lodged within time.² In appropriate cases, we may enter into an agreement or settlement³ with the taxpayer that they do not have to pay tax on the deemed dividend.

² Subsection 14ZW(2) of the *Taxation Administration Act 1953* (TAA), with subsection 14ZW(3) of the TAA requiring the request to include an explanation of why the objection was lodged late. We must decide such requests under section 14ZX of the TAA, as guided by Law Administration Practice Statement PS LA 2003/7 *How to treat a request to lodge a late objection*.

³ Law Administration Practice Statement PS LA 2015/1 *Code of settlement*.

Amendment history

19 September 2024

| Part | Comment |
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| Throughout | Content checked for technical accuracy and currency. Updated in line with current ATO style and accessibility requirements. |

12 May 2014

| Part | Comment |
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| Contact details | Updated. |

References

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| Legislative references | ITAA 1936 108 ITAA 1936 Div 7A ITAA 1936 109F(3) ITAA 1936 109UB ITAA 1936 Subdiv EA ITAA 1936 109XA ITAA 1936 109XB ITAA 1936 170 ITAA 1936 Pt IVA TAA 1953 14ZW(2) TAA 1953 14ZW(3) TAA 1953 14ZX Limitation Act 1969 (NSW) Limitation Act 1981 (NT) Limitation Act 1985 (ACT) Limitation Act 1974 (Tas) Limitation Act 2005 (WA) Limitation of Actions Act 1936 (SA) Limitation of Actions Act 1958 (Vic) Limitation of Actions Act 1974 (Qld) Taxation Laws Amendment Act (No. 3) 1998 Tax Laws Amendment (2004 Measures No. 1) Act 2004 |
| Related practice statements | PS LA 2003/7 PS LA 2015/1 |
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