



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 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: Operation of Division 7A of the *Income Tax Assessment Act 1936* 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 the Commissioner has 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 Division 7A.
2. The practice statement applies to private companies, trusts with private companies as beneficiaries, and the shareholders and shareholder's associates of those private companies.
3. The ATO 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 Limitations Act ends. This also applies to relevant loans made by trustees which become statute barred. Subsequent refreshment of a loan after the statutory period under the relevant Limitations Act ends does not create a new loan to which Division 7A of the ITAA 1936 applies.

4. 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 of the ITAA 1936 and the fact that this particular issue arises from the interaction of two 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 of the ITAA 1936 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 of the ITAA 1936 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 Limitations Act.
 - issues of inequity amongst taxpayers arise because of the significantly differential treatment that limitations in the operation of the amendment provisions at section 170 of the ITAA 1936 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.
5. Therefore, as a matter of practical compliance and sensible administration, the Commissioner has decided to take no active compliance action on private company and trustee loans made prior to the enactment of Division 7A of the ITAA 1936 deemed to be forgiven in consequence of the operation of subsection 109F(3) of the ITAA 1936, 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.
6. 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 of the ITAA 1936, or constitute fraud or evasion, or be subject to amendment under section 108 of the ITAA 1936.

EXPLANATION

7. Division 7A of Part III of the ITAA 1936 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.

8. Division 7A of the ITAA 1936 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, amongst other things, the forgiveness of certain loans made by trustees as dividends (achieved by the interaction of sections 109XA and 109XB). 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 4pm legal time in the Australian Capital Territory (ACT) on 27 March 1998 where forgiveness occurs on or after 12 December 2002. This is because loans made after 4pm legal time in the ACT on 27 March 1998 are likely to have already been brought within Division 7A by section 109UB or the equivalent provisions which apply to loans in Subdivision EA.
9. The ATO 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 Limitations Act ends. However, for the reasons outlined above it is also recognised that the matter is not entirely free from doubt.
10. 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 loss.
11. 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 of the ITAA 1936 may lodge an objection with the ATO. Where necessary, the objection should be accompanied by a request that it be treated as having been lodged within time. In appropriate cases the ATO may enter into an agreement/settlement with the taxpayer that he or she does not have to pay tax on the deemed dividend.

Amendment history

Date of amendment	Part	Comment
12 May 2014	Contact details	Updated.

Subject references	Loans Dividends Private companies Shareholder loans Trustee loans
Legislative references	ITAA 1936 Subdiv 109EA ITAA 1936 109F ITAA 1936 109G ITAA 1936 109Y ITAA 1997 8-1 ITAA 1997 108-20 ITAA 1997 Sch 2C 245-35(2) TAA 1953 Pt IVAAA Victorian Limitation of Action Act 1958 Northern Territory of Australia Limitation Act 1981 Australian Capital Territory Limitation Act 1985 New South Wales Limitation Act 1969 South Australian Limitation Of Actions Act 1936 Queensland Limitation of Actions Act 1974 Western Australia Limitation Act 1935 Tasmania Limitation Act 1974
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Other business lines consulted	OCTC, SB, Administration and Business & Personal Taxes CoE