PS LA 2011/29 - Exercise of the Commissioner's discretion under section 109RB of Division 7A of Part III of the Income Tax Assessment Act 1936 to either disregard a deemed dividend or to permit a deemed dividend to be franked

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Australian Taxation Office

Practice Statement Law Administration

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This practice statement is issued under the authority of the Commissioner of Taxation and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by tax officers unless doing so creates unintended consequences or where it is considered incorrect. Where this occurs tax officers must follow their business line's escalation process.

Taxpayers can rely on this 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 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: **Exercise of the Commissioner's discretion under section 109RB of Division 7A of Part III of the *Income Tax Assessment Act 1936* to either disregard a deemed dividend or to permit a deemed dividend to be franked**

PURPOSE: **To provide guidance to tax officers on:**

(a) **when the condition under paragraph 109RB(1)(b) has been satisfied**

(b) **matters that the Commissioner must have regard to in making a decision under subsection 109RB(2) (or refusing to make such a decision)**

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BACKGROUND

1. Section 109RB of the *Income Tax Assessment Act 1936* (ITAA 1936)[1] was one of the amendments introduced by the *Tax Laws Amendment (2007 Measures No. 3) Act 2007* to provide relief to taxpayers who inadvertently trigger a deemed dividend as a result of an honest mistake or inadvertent omission. It confers on the Commissioner, in certain circumstances, a discretion to decide in writing to disregard a deemed dividend that arises under Division 7A of Part III of the ITAA 1936 (Division 7A) or allow the dividend to be franked.[2]

2. Parliament provided the Commissioner with a discretion in recognition that the application of Division 7A is widely misunderstood by taxpayers, resulting in frequent inadvertent breaches of the provisions.[3]

Interpretation

3. For the purposes of this practice statement, unless context otherwise dictates:

   - ***Division 7A deemed dividend*** means the amount of dividend that the private company is taken to have paid to an entity or the amount that is included, as if it were a dividend, in the assessable income of an entity under Division 7A.
   - ***Explanatory Memorandum*** means the Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No. 3) Bill 2007
   - ***Section 109N complying loan*** means a loan that satisfies the requirements of section 109N
   - ***tax officer*** means a person employed by the Australian Taxation Office (ATO)
   - references to a ***decision*** under section 109RB includes a decision that is subject to conditions and a refusal to make a decision.

4. Where the context dictates, references to a private company include its officers and directors.

STATEMENT

5. An exercise of the discretion in section 109RB involves the following two step process:[4]

   - establishing that the Commissioner is empowered to exercise his discretion under subsection 109RB(2) because the deemed dividend arose, on the balance of probabilities, as a result of an 'honest mistake' or 'inadvertent omission' (Step 1); and
   - if the Commissioner is empowered to exercise this discretion, deciding whether the discretion should be exercised having regard to the matters outlined in subsection 109RB(3) and, if so, what conditions, if any, should be imposed (Step 2).

[1] All legislative references are to the ITAA 1936, unless otherwise indicated.
[2] The Explanatory Memorandum at paragraph 1.90.
[3] The Explanatory Memorandum at paragraph 1.81.
[4] The Explanatory Memorandum at paragraph 1.32.

6. In forming an opinion under section 109RB, tax officers must adhere to administrative law principles. The main obligations are as follows:

   - tax officers must not apply this practice statement in a rigid or inflexible way
   - each case must be considered on its merits, having regard to the objects of Division 7A in general and section 109RB in particular
   - tax officers must take into account all relevant considerations, and must not take into account any irrelevant considerations. In the context of the Commissioner's discretion under subsection 109RB(2), there are specific matters outlined in subsection 109RB(3) that must be considered in each case. Paragraph 109RB(3)(d) allows the Commissioner to consider 'any other matters that the Commissioner considers relevant'. In determining whether a matter can be considered under paragraph 109RB(3), tax officers should have regard to the subject matter, scope and purpose of the Act
   - the decision must be made in good faith and without bias
   - the decision must be made independently and must not be made at the direction of another person
   - the decision must not be so unreasonable that no reasonable person could have reached the same decision.

7. It should be emphasised that the guidelines provided in this practice statement are not intended to restrict the Commissioner or his delegate in the exercise of the discretion under subsection 109RB(2) and the conditions that may be imposed under subsection 109RB(4). It is essential that tax officers deal with each case on its own merits and retain the flexibility necessary to do so. The guidance contained within this practice statement does not fetter the exercise of the discretion when it is applied to the circumstances of a particular case; it merely provides guidance as to when and the manner in which the discretion might generally be exercised, and thus enhances consistency in the ATO treatment of taxpayers with similar circumstances. These matters were usefully summarised by Hely J in *Elias v. Federal Commissioner of Taxation*:[5]

   > The Commissioner is entitled to adopt a policy to provide guidance as to the exercise of the discretion, provided the policy is consistent with the statute by which the discretion is conferred. Thus if the statute gives a discretion in general terms, the discretion cannot be truncated or confined by an inflexible policy that it shall only be exercised in a limited range of circumstances. A general policy as to how a discretion will 'normally' be exercised does not infringe these principles, so long as the applicant is able to put forward reasons why the policy should be changed, or should not be applied in the circumstances of the particular case. See *Re Drake v. Minister for Immigration & Ethnic Affairs (No 2)* (1979) 2 ALD 634 at 640-641; *Chumbairux v. Minister for Immigration & Ethnic Affairs* (1986) 74 ALR 480 at 492-493.

8. There is an overlap in the matters that are relevant for Step 1 and Step 2. Whilst Step 1 is looking at whether there was an honest mistake or inadvertent omission, Step 2 is concerned with considering the circumstances that lead to that mistake or omission. Many of the factors that are relevant in determining whether a mistake or omission was honestly or inadvertently made will also be relevant in determining whether it is appropriate for the discretion to be exercised. As a general proposition, evidence gathered to establish honesty or

[5] (2002) 123 FCR 499; 2002 ATC 4579; (2002) 50 ATR 253.

inadvertence will also be relevant when deciding whether the discretion should be exercised. However, a broader range of facts and circumstances will be considered in deciding whether to exercise the discretion. For example, Step 2 is not limited to looking at acts or omissions that caused or contributed to the Division 7A deemed dividend.

9. Tax officers, when considering the factors in Step 2, must also have regard to the objects of Division 7A as a whole, which is an integrity provision aimed at preventing the tax-free distribution of company profits. This means that not all honest mistakes or inadvertent omissions will result in the exercise of the Commissioner's discretion.

10. In considering Step 2 tax officers must consider the factors against exercising the discretion as well as those for exercising it. There is no presumption that the discretion should be exercised (or not exercised).

11. Taxation Ruling TR 2010/8[6] outlines what constitutes an honest mistake or an inadvertent omission. This practice statement must be read in conjunction with TR 2010/8. It provides practical guidance to determine whether the Commissioner can make a decision under section 109RB. In addition, when it is established that the Commissioner has the discretion to make a decision under section 109RB, this practice statement provides guidance in determining whether the discretion should be exercised.

12. The Commissioner considers that the discretion in section 109RB is integral to the substantive operation of Division 7A. This means that the exercise (or non-exercise) of the discretion goes directly to the question of whether a dividend is taken under that Division 7A to have been paid. It is expected that tax officers conducting compliance activity involving Division 7A will, before any assessment or amendment is made, notify taxpayers of the potential availability of the discretion and invite their submissions on its operation. In some cases, it will be in the interests of administrative efficiency to address the potential application of the discretion at an early stage of the compliance activity.

EXPLANATION

Overview of principles in section 109RB

13. The following table provides an overview of the principles in section 109RB.

In determining whether the Commissioner can exercise the discretion in section 109RB, tax officers should consider: • what event or events gave rise to the Division 7A deemed dividend, • who made the mistakes or omissions, and • what evidence or explanation is available to support the assertion that there was an honest mistake or inadvertent omission. The result that Division 7A applies must arise *because* of the honest mistake or inadvertent error of a person. It is thus necessary that the relevant mistake or omission causes the result that the Division applies. Once you are satisfied that the honest mistake or inadvertent omission gave rise to the Division 7A deemed dividend, you then determine whether or not the Commissioner will exercise his discretion and what conditions will be imposed, if any. This table summarises the process required by section 109RB.	
Step 1	Has Division 7A been triggered? (Yes / No)

[6] Taxation Ruling TR 2010/8: Income tax: application of subsection 109RB(1) of the *Income Tax Assessment Act 1936.*

	If yes, what were the mistakes or omissions that **contributed to** Division 7A being triggered? The relevant mistakes or omissions that caused or contributed to the application of Division 7A must have been made honestly or inadvertently.
	Who made the mistake or omission? Are there matters particular to that party which may be relevant to a finding of honesty or inadvertence?
	In determining whether a mistake was honestly made or the omission was inadvertent, have regard to: • definitions of honest mistake and inadvertent omission • nature of the transactions • types of evidence available • the knowledge and experience of the private company and the recipient • recording of transactions and accounting systems in place • conduct of all entities involved, including entities other than the recipient or the private company • complexity of Division 7A provisions • availability of guidance material for which there is an ATO view, and • indicators of having acted honestly or inadvertently.
Having regard to the above, has the taxpayer provided sufficient evidence or explanation demonstrating that the application of Division 7A arose because of an honest mistake or inadvertent omission? (Yes / No)	
If yes, go to Step 2.	
Step 2	Should the discretion be exercised? Evidence gathered at Step 1 is relevant to applying the factors in Step 2. However, Step 2 may require an examination of a broader range of facts and circumstances.
	In making this determination, have regard to: • the circumstances that led to the mistake or omission • the extent to which any of the entities have taken corrective action, and if so, how quickly • whether Division 7A has applied previously to any of the entities, and • any other relevant matters.
Having regard to the above, will the Commissioner exercise his discretion (subject to conditions if necessary to achieve the objects of Division 7A)? (Yes / No)	

Explanation of principles in section 109RB

Step 1

14. Division 7A applies to payments made, loans made and debts forgiven. A mistake in the context of Division 7A is an incorrect view or opinion or misunderstanding about how Division 7A operates; about facts that are

relevant to its operation; or about other matters that affect its operation. An omission is a failure to take action that is relevant to, or affects, the operation of Division 7A.

15. Before the Commissioner may make a decision to disregard the result of the operation of Division 7A the two conditions in subsection 109RB(1) need to be satisfied.

16. The first condition in paragraph 109RB(1)(a) is that Division 7A has operated with the result that:

    (i) a private company is taken to pay a particular dividend to a particular entity (the **recipient**) under Division 7A; or

    (ii) a particular amount is included, as if it were a dividend, in the assessable income of a particular entity (also the **recipient**) in relation to a private company under Subdivision EA.

17. The second condition in paragraph 109RB(1)(b) is that the result from the operation of Division 7A arises because of an honest mistake or inadvertent omission by any of the following entities:

    (i) the recipient

    (ii) the private company

    (iii) any other entity whose conduct contributed to that result.

18. Whether Division 7A operates because of an honest mistake or inadvertent omission is an objective question to be determined by reference to all the relevant facts and circumstances. Some of the factors that are likely to influence this determination are discussed below.

19. Whilst taxpayers bear the onus of demonstrating that the Division 7A deemed dividend arose as a result of an honest mistake or inadvertent omission, tax officers should give them every opportunity to expand or clarify their submissions. This will mean that additional information may need to be requested from the affected entity.

Step 2

20. Once it has been determined that the Commissioner is empowered to exercise his discretion under subsection 109RB(2), the Commissioner must have regard to the matters set out in subsection 109RB(3).

21. The matters set out in subsection 109RB(3) comprise specific matters (paragraphs 109RB(3)(a) to 109RB(3)(c)) and a wide range of other relevant matters (paragraph 109RB(3)(d)).

22. Although the Commissioner can have regard to a wide range of other relevant matters in deciding whether or not to exercise his discretion, regard must be given to the subject-matter, scope and purpose of the Act conferring the discretion: *Minister for Aboriginal Affairs v. Peko Wallsend Ltd* 162 CLR 24 per Mason J at 39. The relevant provisions are Division 7A generally and section 109RB in particular.

Subject matter, scope and purpose of Division 7A

23. In considering the subject matter, scope and purpose of Division 7A and section 109RB, tax officers should have particular regard to the following:

    - Division 7A is an integrity measure aimed at preventing private companies from making tax-free distributions of profits to shareholders (and their associates) in the form of payments, loans or debt forgiveness (see paragraph 9.2 of the *Explanatory Memorandum* to *Taxation Laws Amendment Bill (No. 3) 1998* and paragraphs 1.3 and

1.78 of the *Explanatory Memorandum* to *Tax Laws Amendment (2007 Measures No. 3) Bill 2007*). In other words, Division 7A aims to prevent disguised distributions of profit

- Division 7A was inserted to overcome the deficiencies of the former section 108 which only applied when the Commissioner formed the opinion that an amount loaned, paid or credited represented a distribution of profits (see paragraphs 9.10 and 9.11 of the *Explanatory Memorandum* to *Taxation Laws Amendment Bill (No. 3) 1998* and paragraph 1.82 of the *Explanatory Memorandum* to *Tax Laws Amendment (2007 Measures No. 3) Bill 2007*)
- Division 7A is a self executing provision and does not depend on the Commissioner forming an opinion for its operation
- section 109RB was introduced together with other measures in 2007 to reduce the extent to which taxpayers can trigger a deemed dividend inadvertently. The provision is to allow the Commissioner to appropriately handle the situation where taxpayers have triggered a deemed dividend inadvertently because of a past mistake or omission (paragraphs 1.5 and 1.8 of the *Explanatory Memorandum* to *Tax Laws Amendment (2007 Measures No. 3) Bill 2007*)
- the discretion in subsection 109RB(2) is an exception to an integrity provision. Generally speaking it will not be appropriate to make a decision if in the circumstances it is clear that loans and other payments have been made as a means of avoiding tax on dividends. It should not be applied in a manner inconsistent with the integrity aims of Division 7A
- the discretion is intended to provide the Commissioner with the ability to excuse taxpayers (with or without additional conditions imposed) from the consequences of Division 7A if it has been triggered because of an honest mistake or inadvertent omission. It does not mean that every honest mistake and/or inadvertent omission will justify the exercise of the discretion
- each case must be considered on its merits in deciding whether the discretion ought to be exercised.

24. This practice statement is intended to provide guidance to tax officers when determining whether to exercise the discretion under subsection 109RB(2). The guidelines in this practice statement are not to be applied inflexibly without regard to the merits of the particular case. In *MLC Investments Ltd v. Commissioner of Taxation* (2003) 137 FCR 288; 2003 ATC 5133; (2003) 54 ATR 671, a refusal by the Commissioner to grant the taxpayer the permission to adopt a substituted accounting period was held to be unlawful because the decision maker applied the policies contained in Taxation Rulings IT 2360 and IT 2497 inflexibly which failed to have proper regard to the merits of the particular case.

25. Tax officers must therefore be open to the possibility that there may be circumstances in a particular case that will justify the application of these guidelines differently.

Step 1 – Determining that the Division 7A deemed dividend arose due to an honest mistake or inadvertent omission

Whose mistake?

26. From a practical point of view, tax officers should first consider the conduct of the private company and the recipient to determine if the requirements of subsection 109RB(1) are met. Where the recipient and private company acted on professional advice, the absence of an honest mistake or inadvertent

omission on the adviser's part will not necessarily deprive the Commissioner of his ability to exercise the discretion.

27. In practice, tax officers should not accept unsupported assertions from taxpayers that they were merely acting on professional advice or claims that they were ignorant of the operation of Division 7A.

28. If the evidence does not support a conclusion that the deemed dividend was caused by honest mistakes or inadvertent omissions of the recipient and the private company, it is then necessary to consider the conduct of other entities such as agents and advisers. An honest mistake or inadvertent omission of another entity is only relevant if the conduct of that entity contributed to the application of Division 7A.

29. In determining whether the Commissioner has the discretion to make a decision under section 109RB, an entity's individual circumstances may be relevant to determining whether there was an honest mistake or inadvertent omission. This means, for example that a person who holds himself as having professional expertise in matters of business tax compliance (that is, a tax adviser) will need to provide more detailed evidence to support the claim that they made an honest mistake or inadvertent omission. By contrast, a self-preparer who has consulted the relevant ATO guides (for example. Taxpack or the company tax return instructions) and attempted to follow the instructions provided will, in the absence of information to the contrary, be looked upon more favourably.

30. An honest mistake in relation to the application of law is more likely to arise where it is made prior to the publication of an ATO view that clarifies the operation of particular provisions, however it will be necessary to consider all of the facts and circumstances of the case. Generally speaking, if a technical product outlining the ATO view on an area of Division 7A has been published, it would be a factor that may tend to weigh against the Commissioner being satisfied that an honest mistake or inadvertent omission was made after the publication date. This is especially so in cases where tax agents are involved and the taxpayer does not provide any explanation for the events that lead to the alleged error which produced the Division 7A result. However, the taxpayer may provide additional information which may override this factor. This may include a persuasive argument as to why the ATO view does not apply to their particular circumstances or that the alleged honest mistake or inadvertent omission has nothing to do with the technical product. If so, an honest mistake may be demonstrated.

Types of mistake and omission that result in a Division 7A deemed dividend

31. For section 109RB purposes there are broadly two types of mistake that tax officers may encounter. These are mistakes of law and mistakes (or omissions) when implementing and recording a dealing.

32. A mistake of law may range from total ignorance of the requirements of Division 7A through to a general observance of Division 7A requirements but failure to comply with a particular requirement. Where a mistake of law occurs tax officers should have regard to the level of knowledge and expertise of the person who made the mistake. It is important to note however, that ignorance of the law does not, in and of itself, evidence the making of an honest mistake or inadvertent error.

33. The second type of mistake or omission may occur when implementing and recording the transaction that resulted in the Division 7A deemed dividend.

34. The following are illustrative of situations that tax officers may encounter in matters involving a potential application of the discretion in section 109RB:

- using a company cheque book instead of a personal one
- mixing together company and personal transactions
- keeping and maintaining inadequate financial records
- mistakes in the recording of transactions, for example transposition errors, miscoding, incorrect data entry and so on
- entering into complex arrangements within complex structures where the deemed dividend character of the transaction is not readily apparent; this is particularly common when long standing professional advisers familiar with the taxpayer's business model are replaced
- business to business transactions within structures of grouped entities
- complex interaction with other parts of the income tax law
- error in drafting written loan agreements such as in the term of the loan or the rate of interest charged
- written loan agreements not executed correctly
- complete failure to make any payments over a long period of time
- repayment made after its required due date
- error in calculating the minimum yearly repayment required in a particular year
- mistaken interpretation of the effect of the more complex elements of Division 7A
- misunderstanding of the definition of associates
- misunderstanding of the interaction of Division 7A with other areas of taxation law, for example, fringe benefits tax (FBT)
- unforseen circumstances such as personal and family illness, disasters.

35. It must be emphasised that in each case, it is a matter of fact and circumstance as to whether an honest mistake or inadvertent omission exists and has been demonstrated.

Facts and circumstances that may be relevant to a finding of honest mistake or inadvertent omission

36. Paragraphs 37 and 38 of this practice statement set out some common indicators for and against a finding of honest mistake or inadvertent omission. These lists are intended as a guide only and are by no means exhaustive. Tax officers should, in all cases, have regard to the particular facts of each case. Moreover, no single factor is ever determinative of the question of whether the application of Division 7A arose because of an honest mistake or inadvertent omission.

Factors that are consistent with a conclusion of honest mistake or inadvertent omission by a relevant party

37. Examples of relevant facts and circumstances which may favour a finding that the application of Division 7A has been caused by an honest mistake or inadvertent omission include:

- the party would not be expected to have relevant professional expertise in specialist business tax matters, including the application of Division 7A

- the relevant transactions are commercial in nature, albeit that they cause an application of Division 7A
- attempts were made to ensure that transactions were accurately and completely recorded
- transactions have been submitted to independent review
- the relevant transactions were undertaken as a result of direction from arm's length third parties such as financial institutions
- the applicable Division 7A provisions involved are complex
- the applicable Division 7A provisions are new or have recently been amended
- the application of Division 7A involves novel or contentious issues of tax law interpretation
- there is no precedential ATO view covering the type of arrangement involved or the relevant interpretative issues[7]
- the prevailing understanding and interpretation of the Division 7A provision among the tax profession at the time the mistake was made, as evidenced by misunderstanding or industry practice, as evidenced by views expressed in journal articles and other tax guidance material
- the party can demonstrate genuine attempts to comply with Division 7A both in general and in respect of the specific matter.

Factors that are inconsistent with a finding of honest mistake or inadvertent omission by relevant party

38. Examples of relevant facts and circumstances which may discourage a finding that the application of Division 7A was caused by an honest mistake or inadvertent omission and where no other information is forthcoming to support a finding of honest mistake or inadvertent omission include:
    - the entity held itself out as having professional expertise in specialist business tax matters
    - the transactions are not commercial in nature
    - there were inadequate attempts to ensure that transactions were accurately and completely recorded
    - transactions have not been submitted to proper independent review or there has been a general lack of transparency or openness
    - the mistake is a mistake of law involving the application of a provision in Division 7A that is less complex
    - there is a published ATO view for the relevant issues of interpretation
    - ATO education activities–such as webcasts, bulk mail-outs and the publication of fact sheets–have been undertaken in relation to the relevant tax law requirements
    - the party has a poor compliance history in respect of any one or more of lodgment of tax returns and other documents, payment of accounts,

[7] A precedential ATO view is the ATO's documented interpretation of the tax laws administered by the Commissioner in relation to a particular interpretive issue, see Law Administration Practice Statement PS LA 2003/3. The types of documents which set out ATO views are listed at paragraph 3 of PS LA 2003/3 and in the Schedule of documents containing precedential ATO views.

receipt of income and being subject to tax adjustments as a result of ATO audit or review.

Specific Issues

39. The following is a discussion of some of the specific issues tax officers may encounter when assessing whether, in a given set of circumstances, the Commissioner has a discretion to make a decision under section 109RB.

Ignorance

40. TR 2010/8 accepts that a mistake or omission can result from ignorance. Tax officers will need to consider the evidence closely to determine whether it is persuasive in establishing that the relevant entity's ignorance led to the honest mistake or inadvertent omission relevant to subsection 109RB(1) and as a result Division 7A operated.

41. Ignorance of Division 7A cannot be the mistake or omission but can sometimes be the reason for the mistake or omission. The interaction of the Division with other taxation provisions (especially in more complex arrangements) is another area in which there may be a lack of awareness or understanding. Ignorance of Division 7A is more common with taxpayers than with tax professionals. Tax officers should approach applications for exercise of the discretion based on ignorance with great care and should ascertain the reasons for ignorance. Shareholders and their associates who know (or could reasonably be expected to know) that they are using company funds for their own private use are unlikely to be able to establish that this core breach of Division 7A was the result of an honest mistake or inadvertent omission without more. Further information will be required to understand the circumstances in relation to that ignorance and the taxpayer's specific circumstances and history may be relevant.

42. Ignorance of the core provisions of Division 7A (such as its potential application to loans made to shareholders) is usually not expected from a registered tax agent. An assertion of ignorance as the reason for the alleged mistake without more is not likely to be accepted as having demonstrated that the case for an honest mistake has been made out.

43. Once again it is important to obtain from the taxpayer as much evidence which supports the facts and circumstances asserted by the taxpayer or relevant party as possible. Tax officers may also wish to examine ATO records of previous dealings with the taxpayer to determine whether Division 7A has been at issue in the past, taking special notice of mail outs relating to Division 7A and other dealings with the taxpayer and or tax agent, before accepting that it has been demonstrated that a particular mistake or omission was the result of ignorance. This information should not be used with the intention of denying the discretion but to gather information to enable the correct decision to be made.

44. In all cases, tax officers should consider whether the entity's ignorance caused the result produced by the operation of Division 7A. In considering this question, the terms of engagement of an agent or adviser may be relevant. For example, if compliance with Division 7A matters is outside the scope of an entity's engagement, its level of ignorance of Division 7A is not material.

Lack of evidence

45. A lack of evidence, particularly in relation to inadvertent omissions, is not necessarily fatal to a successful application for an exercise of the Commissioner's discretion. In the absence of evidence to support the assertion that an honest mistake or inadvertent omission occurred, tax officers

should give taxpayers an opportunity to provide full particulars of their claim and to explain the lack of evidence.

46. Some of the issues that tax officers should consider when there is a lack of evidence are:

- Taxpayers' Charter
- common mistakes
- recurring mistakes
- attempts to comply with Division 7A
- the consistency of the taxpayer's conduct and the claims in the application, and
- events occurring after the mistake or omission.

Taxpayers' Charter

47. The Taxpayers' Charter describes the overarching relationship that the ATO has with taxpayers. It acknowledges that, despite their good intentions, taxpayers sometimes make mistakes and omissions. Under the Charter, we assume that taxpayers are honest in their dealings with us unless we have reason to think otherwise.

48. A taxpayer applying for a decision under section 109RB will not be presumed to be dishonest. However, this does not relieve a taxpayer of the burden of identifying the honest mistake or inadvertent omission that has caused Division 7A to apply.

Common mistakes

49. Common mistakes that could cause Division 7A to operate include:

- loans from private company to associated trusts for business purposes
- misunderstanding of unpaid present entitlements from trusts to private company beneficiaries and subsequent breaches of Division 7A in relation to unpaid present entitlements
- intra group loans to associates as defined for the purpose of Division 7A, and
- mistaken understanding of the effect of particular Division 7A provisions.

50. The entity should provide evidence demonstrating that the mistake or omission was of a type that was commonly made at the time, having regard to the prevailing understanding and interpretation of the Division 7A provision among the tax profession at the time the mistake was made. For example, the entity may be able to cite tax publications or expert commentary which is consistent with the approach taken.

Recurring mistakes

51. If Division 7A had previously been applied to any of the entities involved, especially in similar facts and circumstances to those in the current situation, then it is less likely that the Commissioner would accept that the entity had demonstrated that the breach of Division 7A arose because of an honest mistake.

52. It is reasonable to expect that where previous inadvertent omissions have been detected an entity would take greater care in the future.

53. This is not to say, however, that the Commissioner could not accept that a mistake or omission that has recurred cannot be demonstrated to have been

an honest mistake or inadvertent omission. For example, where a mistake is made in one year, it will be likely to recur in subsequent years until it is discovered. To this end, applications for the exercise of the discretion will often cover several years and the fact that the same mistake or omission recurred in all those years is not relevant to the decision making process unless there is some evidence of an earlier awareness of the mistake.

Attempts to comply with Division 7A

54. Evidence of an attempt to comply with the intent or requirements of Division 7A at the relevant time will lend support to the taxpayer's assertion that the breach occurred because of an honest mistake or inadvertent omission. The examples in the Explanatory Memorandum and Law Administration Practice Statement PS LA 2007/20[8] show that attempts to comply are relevant in determining if there has been an honest mistake or inadvertent omission.

55. The ATO expects that taxpayers and tax agents will exercise reasonable care with their taxation affairs. It also expects that self-preparers read relevant ATO publications and instruction booklets.

Events occurring after the mistake or omission

56. Evidence of events that happened after the mistake or omission can be taken into account but only to the extent that they shed light on a party's subjective state of mind at the time of the mistake or omission. For example, in the absence of conflicting evidence, demonstration of a willingness to take timely corrective action once a mistake or omission is discovered can be a strong indicator that the mistake or omission was honestly made or inadvertent. It should be noted, however, that corrective action instituted by a party who was not involved in the relevant mistake or omission (for example, a newly appointed tax agent) would not generally be determinative.

Evidence of the existence of an honest mistake or inadvertent omission

57. The obligation of a party to demonstrate that an honest mistake or inadvertent omission was made is consistent with record keeping obligations that apply to businesses generally.

58. Paragraph 1 of Taxation Ruling TR 96/7 provides that:

> Section 262A of the *Income Tax Assessment Act 1936* ('the Act') requires a person carrying on a business to keep records that record and explain all transactions and other acts engaged in by the person that are relevant for any purpose of the Act. The records to be kept include any documents which are relevant for the purpose of ascertaining the person's income and expenditure and any documents that contain particulars of any elections, estimates, etc., made by the person under the Act.

59. Law Administration Practice Statement PS LA 2006/12 provides, at paragraph 40, that:

> As a general statement, the type of documentation that will need to be maintained by a taxpayer in order to satisfy the taxpayer's **record keeping** obligations will depend on the nature of the taxpayer's business and on the size and type of adjustment the taxpayer needs to make…

[8] Exercise of the Commissioner's discretion under section 109RB of Division 7A of Part III of the ITAA 1936 to disregard a deemed dividend in respect of the 2001-02 to 2006-07 income years.

60. When presented with incomplete or conflicting evidence it can be difficult to ascertain whether what actually resulted is due to an honest mistake or inadvertent omission. As a general proposition, the presence of contemporaneous documentary evidence is optimal. However, adverse inferences should not necessarily be drawn from an absence of contemporaneous documentary evidence, especially in relation to smaller enterprises. Direct evidence is also preferable to indirect evidence.

61. In providing guidance on the types of documentation the Commissioner would expect to see in place, the Commissioner is not seeking to prescribe in detail the documents that need to be maintained. The onus rests upon a taxpayer to show how the Division 7A deemed dividend arose due to an honest mistake of inadvertent omission by a relevant entity.

62. Without attempting to exhaustively list the types of evidence that may support the explanation of, and to demonstrate the circumstances that resulted in, the honest mistake or inadvertent error, the following are examples of relevant evidence:

- written and oral statements from each entity whose acts or omissions contributed to the application of Division 7A
- accounting records including ledger accounts recording transactions
- journal entries and documents that support those entries
- minutes of meetings
- correspondence
- copies of loan agreements
- trustee resolutions
- director's resolutions
- Division 7A working papers
- tax return related questionnaires relevant to Division 7A
- invoices or other source documents in respect of payments, or
- scope of engagement of entity preparing the income tax returns.

63. Evidence that directly explains a person's state of mind is preferable to indirect or circumstantial evidence. The types of evidence listed in the paragraph above are examples of direct evidence. Indirect evidence would include matters such as the taxpayer's compliance history and corrective actions taken after the event. Whilst direct evidence is preferable to indirect evidence, indirect evidence should be considered if direct evidence is not available after reasonable efforts have been made to obtain such evidence.

Adverse finding at Step 1

64. Where it has been determined that there was insufficient evidence to support a finding that the Division 7A deemed dividend arose from an honest mistake or inadvertent omission then the Commissioner is not empowered to make a decision under subsection 109RB(2).

Favourable finding at Step 1

65. Where it has been accepted on the evidence provided that the Division 7A deemed dividend arose from an honest mistake or inadvertent omission, the Commissioner is empowered to make a decision under subsection 109RB(2). Before exercising this discretion he must have considered the factors outlined in Step 2. (Paragraphs 66 to 69 of this practice statement.)

Step 2 – Applying the factors in subsection 109RB(3) to determine whether the discretion should be exercised

66. When a tax officer has determined that the particular breach of Division 7A has been the result of an honest mistake or inadvertent omission (as per paragraph 109RB(1)(b)), then a consideration of the relevant contributing factors (as set out in subsection 109RB(3)) must be undertaken before a decision is made to exercise the discretion. It does not follow automatically that, because the application of Division 7A has been accepted as being caused by an honest mistake or inadvertent omission, that the discretion will be exercised.

67. In determining whether the discretion should be exercised tax officers need to have regard to:

    (a) the circumstances that led to the mistake or omission

    (b) the extent to which any of the entities have taken corrective action, and if so, how quickly

    (c) whether Division 7A has applied previously to any of the entities, and

    (d) any other relevant matters.

68. Subsection 109RB(3) requires a wide ranging enquiry. In practice, all the matters taken into account in concluding that the Commissioner has the discretion to make a decision under section 109RB will also be relevant in deciding whether the discretion should be exercised.

69. Where an entity is able to establish that the honest mistake or inadvertent omission satisfies subsection 109RB(1), tax officers must consider the factors against exercising the discretion as well as those for exercising it. There is no presumption that the discretion should be exercised (or not exercised). Tax officers should be alert to the fact that there are acceptable and unacceptable circumstances that led to the mistake or omission.

The circumstances that led to the mistake or omission

70. There is a wide range of possible mistakes or omissions that would result in Division 7A applying. Tax officers need to review all the relevant issues and circumstances, weighing them up to determine whether they support a finding to exercise the Commissioner's discretion.

71. The requirement to consider the circumstances that led to the mistake or omission directs the Commissioner to look broadly at the context in which the mistake or omission arose. This would include looking at matters beyond the conduct of the person who made the relevant mistake or omission and to look at the conduct of all of those who were involved.

72. Failure to take reasonable care is also a relevant consideration and may be a factor that could weigh against the exercise of the discretion. Where the entity is careless because its attitude towards Division 7A is one of indifference and without care, that would weigh against the exercise of the discretion.

73. Where, in the circumstances, it would not have been unreasonable for the recipient or the private company to obtain professional tax advice but the recipient or private company abstains from obtaining or did not obtain that advice, this would be a factor weighing against the exercise of the discretion. It would be relevant to inquire into the reasons for not obtaining professional advice. The complexity of the transaction would be relevant in assessing whether it would have been reasonable to expect professional advice to have been obtained. It would not be unreasonable to also expect an entity to obtain professional tax advice in a highly complex transaction. Similarly, it would not

be unreasonable to expect a person who is not very knowledgeable to have obtained professional tax advice.

74. The causal relationship between the conduct of the relevant entity making the mistake or omission and the result that is caused by Division 7A is also relevant. If the contribution of the relevant person making the mistake or omission is relatively small compared to others who are involved in the transaction, this may not justify the exercise of the discretion. For example, if in carrying out an elaborate scheme to avoid the imposition of income tax on company distributions a relatively minor technical breach was committed by a relevant person involved in that scheme, this would not justify the exercise of the discretion.

75. As noted above, the factors that are relevant to determining whether a mistake or omission was honestly made or inadvertent are also relevant in determining whether it is appropriate for the discretion to be exercised. However, a broader range of facts and circumstances will also be considered under this factor in deciding whether to exercise the discretion.

76. Other key matters which are relevant under paragraph 109RB(3)(a) include:

- the level of knowledge and expertise of the relevant parties – where the relevant parties have a relatively low level of expertise and knowledge in relation to the provisions of Division 7A but professional advice was not obtained in circumstances where it was reasonable to do so, that would weigh against the exercise of the discretion
- whether there has been a long standing uncertainty in the interpretation of relevant provisions of Division 7A – where the interpretative issues are not contentious that would weigh in favour of the exercise of the discretion
- whether it was reasonable to expect that the mistake should have been detected based on available information, systems and sophistication of entities
- evidence that the taxpayer has attempted to comply with Division 7A but had still committed the breach would be a factor that would weigh in favour of the exercise of the discretion
- the level of case law and ATO binding precedential materials on the application of the relevant Division 7A issue – where guidance materials are available for the intended audience prior to the breach, that would weigh against the exercise of the discretion,
- the extent of disclosure and non-disclosure of relevant transactions in the financial statements – deliberate concealment or misdescription of transactions that are relevant to Division 7A would weigh against the exercise of the discretion.

77. In relation to the first of these matters (the level of knowledge and expertise of the relevant parties) it should be noted that situations will arise where the Commissioner has the power to make a decision under section 109RB on the basis that the taxpayer has acted on professional advice even though the conduct of the adviser failed to meet the standard for being honest or inadvertent. However, while the discretion may exist in these circumstances, the state of knowledge of the adviser is a material consideration pointing against exercising the discretion.

78. If the adviser has not made an honest mistake or inadvertent omission then generally speaking a decision should not be made to exclude (or modify) the operation of Division 7A. A favourable exercise of the discretion in these circumstances would generally be contrary to the objects of the Division,

especially where there is evidence of deliberate conduct to avoid taxation liabilities. The nature of the relationship between the adviser and the relevant taxpayer, and the appropriateness of the conduct of the taxpayer in regard to the advice and adviser, will be relevant considerations and should be examined closely. Section 109RB is not intended to provide relief to taxpayers who act on professional advice in circumstances where they know (or ought to know) that it has been provided by an adviser who is prepared to disregard the requirements of Division 7A.

79. Generally speaking an appropriate case for a favourable exercise of the discretion will involve a misunderstanding by the relevant taxpayer of the advice provided, not a mere omission to make adequate (or any) enquiries.

The extent to which any of the entities have taken action to try to correct the mistake or omission and if so, how quickly that action was taken

80. No action by a taxpayer can alter the application of Division7A once it has operated to deem a dividend to have been paid to a taxpayer. However, it is open to the taxpayer to correct that mistake or omission. This factor looks at and expects a positive action by the relevant entities. The legislature expects corrective action to have been taken and where it was taken quickly to correct the honest mistake or inadvertent omission, it will be a relevant factor in favour of exercising the discretion. Taxpayers should explain in their application when the error occurred, when the error was identified and when the corrective action, if applicable, was taken.

Corrective action

What is corrective action?

81. The term corrective action is not a defined term for the purposes of Division 7A. As a general proposition, adequate corrective action should put the parties in the position that they would have been in had the application of Division 7A not been triggered.

82. Practice Statement PS LA 2007/20 sets out what the Commissioner considers to be sufficient corrective action in the context of applications of Division 7A triggered by loans, payments and debt forgiveness. The actions necessary to constitute 'corrective action' under PSLA 2007/20 include:

- converting payments into loans that comply with the requirements of section 109N
- putting non-complying loans on a footing that complies with the requirements of section 109N
- treating the amount of debt forgiven as the principal on a loan that complies with the requirements of section 109N, and
- making payments equal to the sum of the minimum yearly repayments that would have been payable had the loan existed from the start of the period that began in the year in which the deemed dividend arose (with interest compounded to reflect non-payment in earlier years), or
- if Division 7A has been triggered by failure to comply with the terms of a loan that complies with section 109N, making up the shortfall between the payments made by the borrower and the minimum yearly repayments required by the loan (with interest compounded to reflect non-payment in earlier years).

83. PS LA 2007/20 defined ‘corrective action’ restrictively on the basis that the Practice Statement relates to the limited range of circumstances where it was appropriate taxpayers treat section 109RB as having been exercised without applying for the Commissioner to exercise his discretion. By contrast, each application dealt with under this Practice Statement is considered on its own merits. In considering these applications, it will sometimes be appropriate for

the Commissioner to take a broader view of what constitutes sufficient corrective action. However, in the absence of special circumstances, the presumption will be that the methods prescribed by PS LA 2007/20 are reasonable and appropriate.

Time at which corrective action should be taken

84. The Commissioner does not accept that, as a general principle, it is sufficient for an applicant merely to demonstrate a willingness to take corrective action as a condition of the discretion being exercised favourably. It is expected that taxpayers should implement corrective action unilaterally unless it can be shown that, by doing so, they would incur undue cost or inconvenience. For example, undue cost or inconvenience may arise if the parties propose to finance the corrective action in a way that would lead to an oppressive tax outcome if the discretion is not exercised favourably. This contingency might arise if a private company proposes to 'fund' corrective action by paying a dividend to the affected shareholder or associate.

85. Where it is appropriate for a taxpayer to have taken unilateral corrective action and they decide not to actually take the corrective action, then this will weigh against exercising the discretion. For example, where a taxpayer is only willing to put in place a valid section109N complying loan agreement and make the minimum required annual payment (including catch up payments) if the Commissioner exercises his discretion under section 109RB, that is likely to weigh against the exercise of the discretion.

86. Corrective action taken before any audit activities undertaken by the ATO will weigh more favourably than where the corrective action was taken after an ATO audit. However, tax officers must also be open to the possibility that the taxpayer may not be aware of the breach until after the audit commenced. In that case, prompt corrective action is more likely to be viewed favourably.

87. A taxpayer who believes that corrective action as defined in PS LA 2007/20 is not warranted, or that corrective action should be conditional on a favourable exercise of the discretion, should bring these concerns to the timely attention of the ATO. Where this is done, and the taxpayer's concerns are based on reasonable grounds, the failure to implement corrective action will not be regarded as a factor weighing against the exercise of the discretion.

88. For the avoidance of doubt, the Commissioner will not draw any negative inference from a failure to take corrective action before 21 June 2007, the date of enactment of section 109RB. There is nevertheless an expectation that corrective action will be undertaken for the income year ending 30 June 2007 and earlier income years.

Whether Division 7A has operated previously in relation to any of the entities, and if so, the circumstances in which this occurred

89. This factor focuses on previous breaches of Division 7A and should be distinguished from applications involving more than one income year. Previous compliance behaviour in relation to Division 7A is relevant as one of the factors to weigh up in making a decision whether or not to exercise the discretion. In particular, where Division 7A has previously applied, that would weigh against the exercise of the discretion unless there has been a major change in the provisions of Division 7A. Regard must be given to the degree of similarity between the previous Division 7A breaches.

90. If Division 7A is breached (and the breach was already known to the parties prior to the next breach) in substantially the same circumstances as in the past, it will also be difficult to accept that the taxpayer has established

sufficient reason for the discretion to be exercised in the taxpayer's favour.[9] For example, a taxpayer who has been assessed on a deemed dividend under Division 7A in previous income years would be expected to show greater vigilance in relation to Division 7A generally. Demonstrated carelessness on the part of such a taxpayer would weigh against the exercise of the discretion. Where the specific breach is in substantially the same circumstances, greater weight would be placed on this factor.

Any other matters that the Commissioner considers relevant

91. The scope of 'any other matters' is very wide ranging. However, in considering the matters that are relevant, regard must be had to the purpose of Division 7A as an integrity provision aimed at preventing the tax-free distribution of profits. Matters that are relevant are those that shed light on whether the relevant mistake or omission is one that deserves an exercise of the discretion.

92. One of the 'other matters' that may be relevant concerns situations where Division 7A had been triggered by an honest mistake or inadvertent omission, but after the breach had been identified, the taxpayer or tax agent decided to turn a blind eye to it. In these circumstances tax officers are entitled to weigh this against exercising the discretion. The longer the period of inaction without a satisfactory explanation the greater the weight that will be given to the inaction. For example, if a taxpayer or tax agent identified a Division 7A breach but had not, prior the breach being discovered by the ATO, either:

    - taken corrective action on or before 30 June 2008, as afforded by Practice Statement PS LA 2007/20
    - self assessed the deemed dividend, or
    - applied to the Commissioner for him to exercise his discretion,

    then the Commissioner would be entitled to view that delay as a relevant factor weighing against the exercise of his discretion.

93. It would be relevant, under this factor, to look at matters beyond the conduct of the person who made the relevant mistake or omission and to look at the conduct of all of those who were involved in the mistake or omission. It would be relevant to inquire into what those who did not make the mistake or omission but were involved in the transaction knew. If looking at the circumstances as a whole most of those involved understood their actions and were carrying out the relevant transaction to achieve a de facto distribution of company profits, this factor is likely to weigh against the exercise of the discretion notwithstanding that there may be one person involved in that process who may have made a mistake or omission and may therefore be able to technically satisfy the threshold test in subsection 109RB(1). The person who purportedly made the mistake or omission would need to establish a compelling case to favour the exercise of the discretion.

94. The fact that the relevant person is deliberately making loans or payments as a means of avoiding tax on dividends is a powerful factor against exercising the discretion even if another person is ignorant.

95. Particular personal factors that may have affected the taxpayers' ability to comply with Division 7A may also be relevant. There may be unforseen circumstances, such as sudden illness, which has affected the ability of one of the entities mentioned in paragraph 109RB(1)(b) to comply. It would be expected that in this circumstance the taxpayer would raise such a matter when making the application for the exercising of the discretion.

[9] TR 2010/8 at paragraph 98.

96. The ATO initiative to allow taxpayers to self correct Division 7A errors or omissions, contained in PS LA 2007/20, encouraged taxpayers and tax agents to review relevant income tax returns for the 2001-02 to 2006-07 income years. It is expected that, in most cases, any Division 7A breaches in relation to those income years should have been picked up and appropriate corrective actions taken. In the absence of exceptional circumstances, inaction by taxpayers in relation to those income years would weigh against the exercise of the discretion. This initiative was very widely publicised by both the ATO and various professional bodies. Accordingly, statements that a tax professional was unaware of the practice statement should be considered carefully.

97. Where ATO guidance appropriate to the target audience in relation to the particular provision of Division 7A is available, a breach of those provisions by the relevant entity is likely to weigh against the exercise of the discretion. This is particularly so where the issue has been widely publicised.

98. A good compliance history in relation to Division 7A would also weigh in favour of the exercise of the discretion.

99. It is also relevant to consider any conditions that may be imposed pursuant to subsection 109RB(4) in deciding whether to exercise the discretion.

Exercising the discretion

100. The decision is to be made after a careful consideration of all the factors involved in the particular case and weighing them all to arrive at a conclusion.

101. Where the factors supporting exercising the discretion and those not supporting it are evenly balanced, the discretion ought to be exercised.

Conditions to be attached to the exercise of discretion

102. Subsection 109RB(4) authorises the Commissioner to exercise the discretion subject to the following kinds of conditions:

- a condition that the recipient or other entity must make specified payments to the private company or another entity within a specified time
- a condition that a specified requirement in this Division must be met within a specified time.

103. These conditions allow the taxpayer to take corrective action to put them in the same position as if Division 7A had been complied with. This consideration will dictate which are the conditions that are imposed. Usually when applications for the exercise of the Commissioner's discretion are made they will include details of corrective action taken or proposed to be taken. In an exceptional case, the Commissioner may conclude that compliance can be achieved without imposing conditions.

104. One of the factors that the Commissioner may take into account in determining what conditions to impose (if any), is whether he will have an adequate remedy in the event that the conditions are not complied with. For example, he may consider whether periods of review would preclude an amendment to the taxpayer's assessment to include a deemed dividend.

105. Where conditions are imposed, tax officers should negotiate with the taxpayer to arrange an acceptable timeframe for them to satisfy the conditions.

106. The Commissioner will be taken to not to have made a decision to disregard the application of Division 7A if the conditions imposed are not satisfied.

Review of assessments involving the operation of section 109RB

107. Whether Division 7A and section 44 include an amount in a taxpayer's assessable income depends, in part, on whether the Commissioner decides under section 109RB that the operation of the rest of the Division should be disregarded. Accordingly, the Commissioner must consider whether to apply section 109RB when making an assessment under Part IV of the ITAA 1936 affected by the operation of Division 7A. ATO officers will advise taxpayers, who are the subject of review for compliance with Division 7A, of the existence of the discretion in section 109RB, and taxpayers will have the opportunity to make submissions about its operation. ATO officers will then ensure that any audit position papers, or similar documents issued by the ATO, address the application of section 109RB.

108. If taxpayers are dissatisfied with assessments based on the operation of Division 7A, they will be informed of their entitlement to object to the assessment, and can object to the assessments under section 175A of the ITAA 1936 in the manner set out in Part IVC of the Taxation Administration Act 1953 (TAA). A ground of objection can include the claim that the discretion in section 109RB was not properly exercised by the Commissioner.

109. If an objection to an assessment includes a ground relating to the operation of section 109RB, the Commissioner will consider that ground as part of deciding the objection. If a taxpayer is dissatisfied with the objection decision, the taxpayer can either apply to the Administrative Appeals Tribunal (AAT) for review of the decision or appeal to the Federal Court against the decision (section 14ZZ of the TAA).

110. The Commissioner accepts that there is an alternative view that decisions made under section 109RB may not properly be reviewed in objection decisions, and in later reviews by the AAT or appeals to the Federal Court under Part IVC, relating to assessments based on the operation of Division 7A. That view considers that the proper jurisdiction for the review of decisions made under section 109RB is in the High Court under section 75(v) of the Constitution, or in the Federal Court under either section 39B of the Judiciary Act 1903 or, possibly, under the Administrative Decisions (Judicial Review) Act 1977 (ADJR Act).

111. However, the Commissioner will take the view that the consideration of section 109RB in an objection decision is properly the subject of review in any AAT review or Federal Court appeal under Part IVC against the decision. On this view, a taxpayer is entitled to have the AAT review the Commissioner's decision on its merits, a course of action not available under the ADJR Act. If any jurisdictional difficulty arises in the AAT or the Court, the Commissioner will co-operate with the taxpayer to have the issue properly tested.

Part IVC of the Taxation Administration Act 1953

112. Part IVC of the TAA contains the objection, review and appeal procedures to be followed if a person who is dissatisfied with a "taxation decision" wants to challenge that decision.

113. The decisions that are subject to objection, and then to review or appeal, under Part IVC of the TAA, are (absent a specific deeming provision) only those decisions:

- that fall within the definition of 'taxation decision' in section 14ZQ of the TAA ('the assessment, determination, notice or decision against which a taxation objection may be, or has been, made'); and
- in relation to which 'a provision of an Act or of regulations provides that a person who is dissatisfied with an assessment, determination, notice or decision ... may object against it in the manner set out in [Part IVC]': section 14ZL of the TAA.

114. While there is no provision of any Act or regulations which provides that a decision under section 109RB can, in and of itself, be the subject of review under Part IVC, section 175A of the ITAA 1936 provides that a taxpayer can object against any assessment under Part IV that is based on the operation of Division 7A, including section 109RB.

115. An assessment under section 166 that includes as one of its particulars an item of assessable income under section 44 resulting from the deeming effected by Division 7A is, like any other assessment, subject to rights of objection, review and appeal under Part IVC. A decision by the Commissioner to exercise, or refuse to exercise, his discretion under subsection 109RB(2), or to exercise it subject to conditions, is an essential part of the process by which the taxpayer's taxable income, and the amount of tax payable thereon, is ascertained. That is, it is a decision that goes directly to whether the taxpayer's assessable income properly includes a dividend under section 44.

Time limits for exercising review rights under Part IVC of the TAA

116. A person who objects against an assessment involving the inclusion in assessable income of a deemed dividend under Division 7A must do so within the time limits prescribed in section 14ZW of the TAA. Generally, the time limit is two or four years from when the notice of assessment or amended assessment is given to the taxpayer.

117. An application to the AAT for a review of an objection decision must be lodged with the AAT within 60 days after the person making the application is served with notice of the decision (section 14ZZC of the TAA) The Tribunal may agree to extend the time for making an application under section 29 of the Administrative Appeals Tribunal Act 1975.

118. An appeal to the Federal Court against an objection decision must be lodged with the Court within 60 days after the person appealing is served with notice of the decision (section 14ZZN of the TAA).

Alternative avenues for review of decisions under section 109RB

119. As the Commissioner considers that he must consider the application of section 109RB when making an assessment based on the operation of Division 7A, and in deciding any objection that raises the proper application of section 109RB, he considers that decisions made under section 109RB are not decisions to which the ADJR Act applies (see Schedule 1(e) to that Act). Similarly, subject to the operation of the principles set out in FCT v. Futuris Corporation Ltd (2008) 237 CLR 146, the Commissioner considers that decisions under section 109RB that are made when making an assessment are not reviewable under section 75(v) of the Constitution or under section 39B of the Judiciary Act because of the operation of sections 175 and 177 of the ITAA 1936.

120. However, as there is an alternative view about avenues for judicial review of decisions under section 109RB, the Commissioner recognises that some taxpayers may seek to obtain such review. As with any jurisdictional challenges that may be made in Part IVC proceedings, the Commissioner will co-operate with taxpayers to test whether those alternative avenues for judicial review are available.

Examples

Example 1 – ignorance of Division 7A

121. Carolyn is a self employed human resource (HR) consultant. She has no background in financial or taxation matters. She is accustomed to drawing funds from her business bank account for both business and private use. She draws a weekly sum for her living expenses and draws cheques for rates,

power and so on. She prepares and lodges her own income tax returns. Her business becomes quite successful.

122. Carolyn is part of a network of HR practitioners. Over dinner one night, her fellow HR practitioners expressed surprise that she is operating her business as a sole trader. They pointed out that she could operate her business through a corporate structure where she would be able to limit her tax rate to 30% and have asset protection.

123. Carolyn decided to incorporate following the advice from her fellow HR practitioners. She obtained some basic information from the ASIC website and registered the company through a shelf company services business. Her company was successfully registered in May 2009.

124. Carolyn has no appreciation that the company is a separate legal entity.

125. While she was a sole trader, Carolyn had worked out her income and expenses by analysing her bank statements and cheque butts. She continued this practice after the business began trading as a company.

126. In October 2009, Carolyn personally prepared the company tax return. At the time she was under a great deal of pressure. The return had to be lodged quickly and it was the busiest time of the year for the business. She was scheduled to give a key note address at a HR convention the next day and her father (whom she cares for) was also very ill. She read the instruction booklets to the return and attempted to comply with it. She has also sought Ally's (a good friend studying commerce at university) assistance to help her complete the company's first tax return.

127. Carolyn's business continued to grow to such an extent that Carolyn employed another consultant and administrative staff. She decided that she now needed a tax professional to handle her accounting work and to prepare and lodge the company's tax returns.

128. Carolyn asked her tax agent to review the company's 2008-09 tax return as well as prepare the company's 2009-10 tax return. Her tax agent quickly identified the drawings and advised Carolyn about Division 7A, in particular, section 109C. Carolyn was horrified and asked if anything can be done to fix it on the basis that she had no knowledge at all of Division 7A.

129. Her tax agent advised her about the Commissioner's discretion under section 109RB. Following advice received from her tax agent, Carolyn converted the payments to a loan and immediately prepared a section 109N complying loan. Carolyn also made a 'catch-up' payment to the company of the amount of principal and interest that she would have paid had Division 7A been complied with. Finally, Carolyn made a voluntary disclosure to the ATO of the deemed dividends together with an application requesting the section 109RB discretion to be exercised.

130. Carolyn stated the following in her submission to the Commissioner to exercise his discretion under section 109RB:

- she does not have a background in financial and taxation matters
- she has only limited working experience in financial and taxation matters
- she did not really understand the nuances of trading through a corporate structure and had only decided to incorporate for asset protection reasons
- she mistakenly believed that she did not need professional accounting advice when she prepared and lodged the 2008-9 return for the company.

131. Joe is the tax officer considering the voluntary disclosure lodged by Carolyn. He notes that he must first consider whether Carolyn has demonstrated that the operation of Division 7A arose because of an honest mistake or inadvertent omission.

132. Joe also notes that paragraph 13 of TR 2010/8 states as follows:

> A mistake or omission can be the result of ignorance. However, it would need to be established that the relevant entity's ignorance led to the honest mistake or inadvertent omission relevant to subsection 109RB(1) and that the result of the operation of Division 7A arose because of it.

133. After considering Carolyn's submission, Joe concludes that the operation of Division 7A arose because of an honest mistake or inadvertent omission resulting from Carolyn's ignorance of the provisions of Division 7A. Joe also concludes that Carolyn's ignorance was not caused by wilful blindness or deliberate indifference on her part. It is important to note that Carolyn's ignorance of Division 7A alone is insufficient for the purposes of the test in subsection 109RB(1). What is relevant is that her ignorance directly contributed to the making of the honest mistake or inadvertent omission. Accordingly, subsection 109RB(1) has been satisfied.

134. Having determined that Division 7A arose due to an honest mistake or inadvertent omission, Joe now undertakes the task of determining whether the Commissioner will exercise his discretion.

135. Joe considers the contributing factors in subsection 109RB(3). Joe considers the evidence provided by Carolyn and concludes that the following contributing factors are relevant in deciding whether the Commissioner should exercise his discretion under subsection 109RB(2):

- Carolyn is not professionally trained in taxation matters. She also does not have wide experience in business and has very little awareness of company tax matters. However, as she is sophisticated enough to utilise a company to operate her business, it is not unreasonable to also expect that she should realise that she needed to obtain professional advice in setting up the company and in the preparation of the company's first income tax return. Instead, she sought advice from Ally who lacked the appropriate expertise. This would be a factor weighing against the exercise of the discretion
- the fact that Carolyn sought tax professional assistance when her business continued to grow and that professional assistance was sought shortly after the first year is a factor that weighs in favour of the exercise of the discretion
- the fact that she promptly took corrective action by converting the payments into a loan and entered into a complying section 109N loan agreement (upon receiving advice from her tax agent) would weigh in favour of the exercise of the discretion. Furthermore, as the corrective action was taken prior to any ATO audit and prior to approaching the Commissioner also weighs favourably towards the exercise of the discretion
- the fact that the amount of the deemed dividend was relatively insignificant may also weigh in favour of the exercise of the discretion.

136. After taking all the contributing factors into account, Joe concludes that it would be appropriate to exercise the Commissioner's discretion under subsection 109RB(2) to disregard the deemed dividend. Joe also concludes that there is no need to impose conditions pursuant to subsection 109RB(4) as Carolyn has already taken appropriate corrective action.

Example 2 – tax agent accepts summary information received and makes enquiries about Division 7A

137. A private company located in a medium sized regional town has a number of employees. Its business operations are marked by seasonal peaks and troughs. To help their employees make ends meet the company offers them low interest loans. All employees are eligible and the company pays FBT on the loans.

138. The company has a small team which keep the business records. The team includes a financial controller (Billy-Ray) and his assistant (Jed). Jed is also a shareholder of the company and is the brother of the controlling shareholder. In addition to keeping business records, this team also prepares the FBT accounts.

139. The company also retains a firm of accountants in the capital city. At tax time each year, the company provides the accountants with a summary from which the income tax returns are prepared. The accountants have explained to the office staff that Division 7A would apply where payments, loans or debt forgiveness are provided to shareholders or associates. The arrangement has worked well over the years and the company has a perfect compliance record.

140. Unknown to the accountants, Jethro, Jed's son, has been working for the company. He takes out a small loan from the company, which is included in the company's FBT accounts along with the other loans made to employees. The FBT accounts given to the accountants merely displayed a summary of the loans provided to employees.

141. Later Julia, a tax officer, inspects the accounts of the company while undertaking a review. She identifies the loan to Jethro as being subject to Division 7A and also draws the company's attention to the Commissioner's discretion under section 109RB. Jethro has been making payments of interest on his loan at the FBT statutory interest rate but no repayments of capital have been made.

142. Also, in respect of the loan made to Jethro there was no written loan agreement.

143. In discussing the matter with the company, Julia ascertains that Billy-Ray has an understanding of Division 7A as he has been briefed by the accountants. However, he does not have much of an idea about how Division 7A applies to associates. His assistant, Jed, has no knowledge about Division 7A but understands FBT quite well. Jed's FBT treatment of the loan to Jethro would have been correct had Jethro not been his son.

144. The accountants advise Julia that they had previously explained the operation of FBT and Division 7A to Billy-Ray. The accountants used to check and sign off on Billy-Ray's summary but after a year they were confident in the accuracy of his work and happily relied on his summaries. The accountants state that they had no reason to question the accuracy of the summaries or whether Division 7A had been breached. They believe that the team preparing the summaries have an appropriate degree of knowledge of the provisions of Division 7A as would be expected of them.

145. Julia notes that, in considering whether the Commissioner should exercise the discretion under section 109RB, she must first consider whether she has sufficient evidence that the operation of Division 7A arose because of an honest mistake or inadvertent omission. Julia considers the following:

- why was Division 7A triggered? Julia concludes that Division 7A was triggered as a result of the company making loans to Jethro that were not section 109N complying loans
- the extent to which an honest mistake about the correct characterisation of the loan was caused by an imperfect understanding of the definition of associate in section 318 by Billy-Ray and Jed. They mistakenly believed that the loan was, as all of the other employee loans, subject to FBT, and
- did the accountants make an honest mistake or inadvertent omission? It does not appear that the accountants have made a mistake or omission which caused the deemed dividend. It is considered that the deemed dividend was caused by the loan to Jethro and the failure to enter into a section 109N complying loan agreement. That failure to enter into a valid section 109N complying loan agreement was caused by the honest mistake made by Billy-Ray and Jed because they were unaware of the requirements of Division 7A where loans were made to associates.

146. Having considered the above, Julia concludes that the operation of Division 7A arose because of an honest mistake or inadvertent omission. Accordingly, the requirements in subsection 109RB(1) have been satisfied.

147. Julia then considers the contributing factors in subsection 109RB(3). Julia considers the evidence and concludes that the following contributing factors are relevant in deciding whether the Commissioner should exercise his discretion under subsection 109RB(2):

(a) the accountants

- the accountants have an appropriate level of knowledge and awareness of Division 7A including the definition of an 'associate'
- the accountants have set procedures that a partner from the firm would meet with the office staff of a new private company client shortly after the firm is engaged to provide professional services to the client. During the meeting, the partner would brief the office staff of the new client about their responsibilities, especially Division 7A. The accountants confirmed that this meeting took place, and
- during the first year of their engagement the accountants closely checked Billy-Ray's work and found that it was quite competent. The parties agreed that in future this close checking and verification would no longer be necessary and that summary information only needed to be provided.

Julia concludes that the accountants have acted responsibly and there is nothing about the conduct of the accountants that would weigh against the exercise of the discretion.

(b) the company

- given that the company had previously been briefed on Division 7A, it would generally be expected that great care should have been taken to ensure that Division 7A has been complied with. This factor would tend to weigh against the exercise of the discretion
- however, the circumstances established that neither Billy-Ray nor Jed was consciously engaging in conduct which resulted in a de facto distribution of company profits and believed that the

loan to Jethro was subject to FBT and therefore complied with the requirements of the FBT provisions (by paying interest). This would be a factor that weighs in favour of the exercise of the discretion

- within two weeks of Julia informing them of the Division 7A issue, the private company put in place a section 109N complying loan agreement in respect of the loan to Jethro. The company also made a 'catch-up' payment equivalent to the shortfall between the minimum yearly repayment and the interest rate charged. These factors would tend towards the exercise of the discretion, and
- the fact that the company has a good compliance history, with all lodgments and account balances up-to-date, and has no prior Division 7A breaches would tend to favour an exercise of the discretion.

Based on these facts and circumstances Julia makes a decision to exercise the Commissioner's discretion under section 109RB.

Example 3 – tax agent accepts summary information received each year without making enquiries about Division 7A transactions

148. John is the sole shareholder and director in a private company which receives a significant proportion of its income in cash. Over a number of years, John has extracted various amounts of cash from the company's takings, before it is entered into the company's accounts, which he uses to fund his extensive gambling activities. John believes he is entitled, as sole director and shareholder of the private company, to make loans on the company's behalf. He therefore treats the cash he takes from the company as loans from the company and makes repayments (re-instating cash into the cash holdings) when he has the capacity – usually after big gambling wins. There are no written loan agreements in place and he pays no interest to the company on the money he has borrowed from it.

149. Each year the private company is taken by section 109D to have paid the shareholder a dividend in respect of the loans not repaid before the company's lodgment day.

150. John relies on a tax agent for his and the company's taxation obligations. There are no conditions or limitations placed on the tax agent's engagement.

151. The tax agent is well aware of Division 7A. He is not involved in maintaining the private company's accounting records and at year end receives summary information from the private company which he uses to prepare the private company's and John's tax returns. There are no details of any transactions between John and the private company in this information. John's only noted assessable income is the modest salary he receives from the private company.

152. The tax agent simply accepts the accuracy of the information he is given and makes no enquiries about any possible financial dealings between John and the private company.

153. The private company's accounts are prepared by an employee book-keeper. The book-keeper is not aware that John has been taking cash from the company, and would have raised this with John and the tax agent as a problem had he been aware of the situation.

154. Later the ATO commences a comprehensive risk review of the private company. Bruce, the case officer, quickly discovers the cash transactions. He meets with John and the tax agent tells them that because of the series of John's cash withdrawals from the company, the company is deemed to have paid John dividends. John and the company apply for the exercise of the Commissioner's discretion under section 109RB. Bruce obtains the following information about the circumstances:

- the tax agent is well aware of the provisions of Division 7A
- he has not discussed the potential impact of Division 7A on the private company's affairs with John
- the tax agent says that he has no reason to doubt the accuracy of the summary information given to him by the private company
- the tax agent agrees that he sought no further information on any possible financial dealings between John and the private company
- the tax agent proposes that they be allowed to either frank the deemed dividends or put in place section 109N complying loan agreements and make repayments of capital and interest equal to the total of the minimum yearly repayments that would have been payable had they complied
- John says he was not aware that payments to him by the private company led to the private company being taken to have paid him dividends
- Bruce has also found that a booklet from the ATO on Division 7A – *Division 7A – Separating your personal and company money* had been sent to the private company several months before the company's lodgment day. There is no information as to whether anyone in the private company, including John, had paid any attention to the booklet.

155. Bruce considers the potential application of section 109RB. First he asks himself what was the mistake and/or omission of the private company or recipient that caused the deemed dividend? At first instance, consideration has to be given to the mistake or omission with the closest causal connection to the deemed dividend arising. Bruce concludes that the proximate causes of the deemed dividend were that the borrowings by John were not repaid by the company's lodgment date or that they were not put on a Division 7A compliant footing by that date.

156. Bruce next has to consider whether the mistakes or omissions of the private company or John (as the recipient of the loans) were honest or inadvertent. He notes that:

- leaving aside any borrowings after the Division 7A booklet was delivered to the private company's offices (which John may have read, or not), there is no evidence to suggest that John is aware of the requirements of Division 7A. He ensures that the company has a book-keeper to keep the company's accounts and that tax affairs are dealt with by a tax agent
- the loans were not recorded and the company omitted the amounts from its income
- the private company (through its book-keeper) was unaware of the loans and therefore could not include any information about this in the company's accounts which were provided to the tax agent
- the tax agent was unaware of the loans and therefore could not address any Division 7A implications.

157. TR 2010/8 states that ignorance may bring about a mistake or omission but that ignorance of Division 7A 'does not of itself establish that the loan itself was a mistake, the fact that it was not repaid was an honest mistake or inadvertent omission or that the absence of a complying written loan agreement was an inadvertent omission'. It is necessary to make further enquiries about the circumstances surrounding the ignorance to determine whether an honest mistake or inadvertent omission in fact occurred and that it caused Division 7A to operate with the particular relevant result.

158. While it could be assumed in the circumstances that John was unaware of Division 7A, John's own circumstances and behaviour must be taken into account. The loans were not recorded. He repaid the borrowings only when he had the capacity to make repayments and that was entirely sporadic and unpredictable given repayments were made from occasional gambling winnings. Even had John been aware of the requirements of Division 7A, it would be impossible for the Commissioner to be satisfied that John would have had the capacity to repay the loans outright before lodgment date or meet the repayment requirements of a compliant loan. Therefore, even though John was ignorant of Division 7A, it could not be concluded that his conduct would have been different even if he was aware of his obligations under the provisions. John's ignorance of the provisions of Division 7A is not the reason why Division 7A was triggered as even if he was aware of the requirements of Division 7A, it would not have been complied with.

159. Bruce determines that there is insufficient evidence to conclude that the deemed dividends attributable to the period before the Division 7A booklet was delivered arose because of an honest mistake or inadvertent omission on John's part.

160. After the booklet was delivered, John potentially had access to information on Division 7A. However, as any mistake or omission he made in relation to borrowings before the booklet was delivered has not been accepted as an honest mistake or inadvertent omission, it would not be concluded that John had made an honest mistake or inadvertent omission after the booklet was delivered.

161. Bruce is instructed by TR 2010/8 that only where the deemed dividend has not been caused by an honest mistake or inadvertent omission of the private company or recipient that there is a need to have regard to the circumstances involving another entity. He is therefore required next to consider the conduct of any other entities whose conduct contributed to the application of Division 7A.

162. John and the company submit that the tax agent could be said to have contributed to the application of Division 7A as he did not advise John to put in place a valid section 109N complying loan agreement or repay the loan by the relevant time.

163. Bruce determines on the evidence that even if the tax agent requested the relevant information from John or the company and would have been in the position to advise John and the company appropriately in relation to Division 7A, it is unlikely that the Division 7A result would have been avoided. This is because Bruce has formed a view based on the evidence that it is unlikely that John would have provided the relevant information or details of the undocumented transactions if requested or that even if advised appropriately in relation to Division 7A, John would not have put in place a valid section 109N complying loan agreement and/or made the required minimum repayments. John clearly kept all transactions off the books. Bruce concludes that, on balance, the contributing actions of the tax agent did not cause the result produced by the operation of Division 7A.

164. Bruce next considers the conduct of the bookkeeper and reaches the same conclusion.

165. Bruce therefore concludes that the Commissioner has no discretion to make a decision under section 109RB.

166. If, in the alternative, the evidence was such that Bruce concluded that the Commissioner had a discretion to make a decision under section 109RB, he would next consider the contributing factors in subsection 109RB(3). Bruce considers the evidence and concludes that the following contributing factors are relevant in deciding whether the Commissioner should exercise his discretion under subsection 109RB(2):

- cash is taken out of the business that was not recorded in the company accounts. As such the bookkeeper was unable to ascertain the existence of such a loan. Furthermore the tax practitioners who were reliant upon the records prepared and provided by the employee were not able to identify the existence of cash borrowings. This would weigh against the exercise of the discretion
- John and the company are merely proposing to take corrective action as opposed to having taken those actions. This would weigh against the exercise of the discretion as no corrective action has been taken. Furthermore, a proposal was developed only after the ATO identified the Division 7A non compliant action. This also weighs against the exercise of the discretion, and
- John's conduct in accessing company funds, prior to the funds being recorded as company income was an act that is clearly intended to circumvent the incidence of tax on the company's profits and avoiding tax on the company's distribution of those profits. This factor would weigh against the exercise of that discretion.

167. After taking all the contributing factors into account, Bruce concludes that it would not be appropriate to exercise the Commissioner's discretion under subsection 109RB(2) to disregard the deemed dividend.

Example 4 – tax agent taking on a new client and discovering breach of Division 7A in earlier year – return prepared by another firm

168. Fred and his wife, Wilma, jointly hold all the shares in Iron Age Pty Ltd, a small private company carrying on metal fabrication work. Fred and Wilma also operate a separate raised metal garden bed business through a partnership structure. Both Fred and Wilma are in their early 70's.

169. Fred recently engaged Nik, a tax agent, to review the tax affairs of Iron Age Pty Ltd. Fred tells Nik that since starting the business he entrusted all his accountancy work to Wilma's brother, Barney. Over the last few years, Barney has been very unwell and after a series of strokes he was incapacitated and is now living permanently in a high care nursing home.

170. Fred and Wilma are concerned that, because of Barney's failing health, he may have made mistakes with the private company returns. Nik advises that, given the smallish scale of their business, the ATO is not likely to review those tax returns. However, Fred says that he can't rest easy and that he instructs Nik to review the last three tax returns to make sure that they are correct as well as preparing their current tax returns.

171. As he reviews Barney's working papers, Nik observes that Barney has made many mistakes with his calculations and has often wrongly classified items. At first it is clear that Barney has self-corrected the mistakes on subsequent review of his own work, however, as Nik works through the successive years accounts he can see that Barney's ability to recognise the mistakes has reduced.

172. Nik discovers a loan that the company made to Fred and Wilma's partnership. Fred explains that the loan was to provide working capital during the early stages of the partnership. At the time, Barney suggested that the partnership borrows the required funds from the company, telling Fred and Wilma that it was fine because it was to help the partnership earn income. Fred tells Nik that the loan had been repaid, with no interest charged. Nik advises Fred and Wilma that the loan was subject to Division 7A, and that a deemed dividend should have been declared as the loan was not placed on Division 7A complying loan terms. Nik advises Fred and Wilma to apply for the Commissioner's discretion under section 109RB to disregard the deemed dividend.

173. Fred and Wilma instruct Nik to lodge a request to amend the relevant prior year returns and a request to exercise the Commissioner's discretion under section 109RB. At the time of applying for the discretion, Fred and Wilma also made back payment for interest forgone to the company. The interest was calculated based on the amount that would have accrued had a compliant section 109N loan agreement was in place.

174. Cienna is the tax officer considering the submissions lodged by Nik as the tax agent for Fred and Wilma. She considers the request to amend the relevant prior year returns where Nik has fully outlined the circumstances, including some photocopies of Barney's working papers. As the explanation provided by Nik is consistent with the working papers Cienna has no reason to doubt the results of Nik's analysis and plans to make the necessary amendments.

175. Cienna then considers the request to exercise the Commissioner's discretion under section 109RB. Cienna notes that, in considering whether the Commissioner should exercise the discretion under section 109RB, she must first consider whether the operation of Division 7A arose because of an honest mistake or inadvertent omission. Cienna considers the following:

- that she cannot seek clarification directly from Barney given his poor health, however, she can discuss the circumstances with Fred, Wilma and Nik
- Nik's analysis of the working papers chart a progressive decline in Barney's professional capability, and
- there was a degree of confusion in some areas of the tax profession around the time the loan was made that private company loans to non-individual entities for business purposes were not subject to Division 7A. It is possible that Barney believed that to be the case. This conclusion is supported by the fact that Iron Age Pty Ltd had previously made personal loans to Fred and that Barney had drawn up section 109N complying loan agreements and that minimum yearly repayments were made.

176. In light of the fact that Fred, Wilma and Nik's account of the circumstances surrounding the mistake or omission accorded with the evidence they provided to the ATO, and given the progressive nature of Barney's condition, Cienna concludes that Barney's failure to account for the loan was, on the balance of probability, due to an honest mistake or inadvertent omission. She is now able to decide whether the Commissioner will exercise his discretion.

177. To do this Cienna identifies and considers the contributing factors in subsection 109RB(3). She considers the evidence and concludes that the following contributing factors are relevant in deciding whether the Commissioner should exercise his discretion under subsection 109RB(2):

- Fred and Wilma have been proactive in instructing Nik to review the prior year returns as they were concerned with Barney's ability to carry out his duties. This factor would weigh in favour of the exercise of the discretion
- Fred and Wilma instructed Nik to notify the ATO as soon as they were made aware of the Division 7A loan. This factor also weighs in favour of the exercise of the discretion
- they have paid the net tax due with the exception of the deemed dividend. They have also taken corrective action regardless of the outcome the section 109RB decision from the ATO. This would weigh favourably towards the exercise of the discretion
- Iron Age Pty Ltd had previously made personal loans to Fred and that Barney had drawn up section 109N complying loan agreements and that minimum yearly repayments were made so attempted compliance with Division 7A was demonstrated. This factor weighs in favour of the exercise of the discretion
- there have been no other occasions where Division 7A has operated. This factor weighs in favour of the exercise of the discretion, and
- although Fred, Wilma and the company seem to be knowledgeable about Division 7A and therefore it would not be unreasonable to expect that care should have been taken to ensure that this particular loan did not breach Division 7A, this does not necessarily weigh against the exercise of the discretion as Cienna also took note of the fact that there appears to be a degree of confusion in some areas of the tax profession around the time the loan was made that private company loans to non-individual entities for business purposes were not subject to Division 7A. It is possible that Barney believed that to be the case and therefore failed to advise them accordingly.

178. Having considered all of the relevant factors Cienna concludes that the Commissioner will exercise his discretion. As corrective action has already been taken, the Commissioner does not see a need to impose any conditions to the exercise of the discretion.

Subject references	Commissioner's discretion Deemed dividends Dividend income
Legislative references	ITAA 1936 ITAA 1936 108 ITAA 1936 44 ITAA 1936 Pt III Div 7A ITAA 1936 109C ITAA 1936 109D ITAA 1936 109N ITAA 1936 109RB ITAA 1936 109RB(1) ITAA 1936 109RB(1)(a) ITAA 1936 109RB(1)(b) ITAA 1936 109RB(2) ITAA 1936 109RB(2)(a) ITAA 1936 109RB(2)(b) ITAA 1936 109RB(3) ITAA 1936 109RB(3)(a) ITAA 1936 109RB(3)(b) ITAA 1936 109RB(3)(c) ITAA 1936 109RB(3)(d) ITAA 1936 109RB(4) ITAA 1936 109RB(5) ITAA 1936 109RB(7) ITAA 1936 166 ITAA 1936 175A ITAA 1936 262A Tax Laws Amendment (2007 Measures No. 3) Act 2007 ITAA 1997 292-465 TAA 1953 Part IVC TAA 1953 14ZL TAA 1953 14ZQ TAA 1953 14ZW TAA 1953 14ZZ TAA 1953 14ZZC TAA 1953 14ZZN ADJR 1977 3 ADJR 1977 5 ADJR 1977 6 ADJR 1977 7 ADJR 1977 13 ADJR 1977 16 ADJR 1977 13(5)(b) Judiciary Act 1903 39B Judiciary Act 1903 39B(1) Judiciary Act 1903 39B(1A)(c) Administrative Appeals Tribunal Act 1975 29

Related public rulings	TR 96/7 Income tax: record keeping - section 262A - general principles TR 2010/8 Income tax: application of subsection 109RB(1) of the *Income Tax Assessment Act 1936*
Related Practice Statements	PS LA 2003/3 Precedential ATO view PS LA 2006/12 Thin Capitalisation - Australian equivalents to International Financial Reporting Standards ('AIFRS') - Transitional Provision PS LA 2007/20 Exercise of the Commissioner's discretion under section 109RB of Division 7A of Part III the *Income Tax Assessment Act 1936* to disregard a deemed dividend in respect of the 2001-02 to 2006-07 income years
Case references	*Minister for Aboriginal Affairs v. Peko Wallsend Ltd* (1986) 162 CLR 24 *MLC Investments Ltd v. Commissioner of Taxation* (2003) 137 FCR 288; 2003 ATC 5133; (2003) 54 ATR 671 *Elias v. Federal Commissioner of Taxation* (2002) 123 FCR 499; 2002 ATC 4579; (2002) 50 ATR 253 *Australian Broadcasting Tribunal v. Bond* [1990] HCA 33; (1990) 170 CLR 321 *Re Refugee Review Tribunal; Ex parte Aala* [2000] HCA 57; (2000) 204 CLR 82 *Commissioner of Taxation v. Administrative Appeals Tribunal* [2011] FCFCA 37 *Re Drake v. Minister for Immigration & Ethnic Affairs (No 2)* (1979) 2 ALD 634 *Chumbairux v. Minister for Immigration & Ethnic Affairs* (1986) 74 ALR 480
Other references	CEI 2014/06/04 *Respecting Clients' Rights of Review* (internal link only) Explanatory Memorandum to the Taxation Laws Amendment Bill (No.3) 1998 Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No. 3) Bill 2007 Order 54A of the Federal Court Rules
File references	1-1OH3MV0
Date issued	24 November 2011
Date of effect	The practice statement will apply to the administration of the discretion for deemed dividends that arise in income years both before and after publication of the practice statement.
Other Business Lines consulted	Small Medium Enterprises, Large Business and Internal, Micro Enterprises and Individuals