TA 2008/9 - Private company loan arrangement to obtain tax-free distributions and avoid deemed dividends

From 1 July 2009 sub section 109R(2) of the ITAA 1936 provides for a repayment of a loan not to be taken into account if a taxpayer obtained a loan of a similar or larger amount from the private company in order to make the repayment.

This document has changed over time. This version was published on *3 May 2024*

Australian Government
Australian Taxation Office

Taxpayer Alert

TA 2008/9

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Tax Office has under risk assessment.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the Tax Office has under risk assessment will be subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the Tax Office.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which the Tax Office considers give rise to taxation issues. These issues will generally require more detailed analysis to provide the Tax Office view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a Private Ruling. (It should be noted that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

TITLE: Private company loan arrangement to obtain tax-free distributions and avoid deemed dividends

This Taxpayer Alert describes an arrangement whereby a shareholder purports to make a repayment of a shareholder loan from a private company via a round robin of endorsed cheques so as to avoid the operation of Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936).

DESCRIPTION

The alert applies to arrangements having the following relevant features:

1. During a financial year the private company (the company) advances, loans or otherwise credits amounts to a shareholder that are treated as a debt owing to the company.

2. At the end of the financial year, the company makes a further loan by drawing a cheque in favour of the shareholder in the amount of the shareholder's previous debt to the company, including interest accrued.

3. The shareholder endorses the cheque in favour of a financial entity associated with the promoter of the arrangement.

4. The financial entity endorses the cheque in favour of the company.

5. The company ensures the cheque remains in 'safekeeping' for 5 years, although it is not presented or banked for payment.

6. The company treats the cheque as payment of the shareholder's debt to it, despite the cheque never having been presented or banked for payment.

7. The promoter entity advises the shareholder and the company that three conditions must be attached to the cheque, being that:

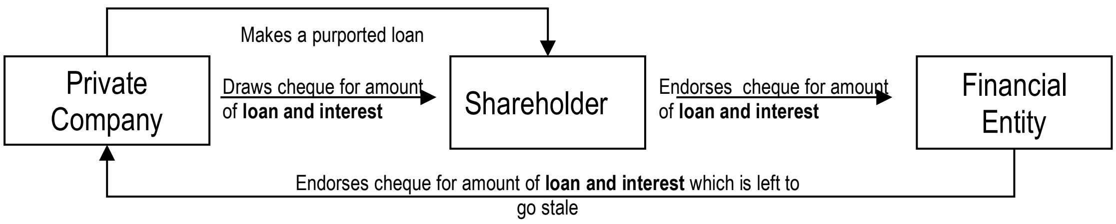
    i. the cheque will not be presented and banked for payment, and

    ii. the cheque will not form the basis of a claim or marked for payment, and

    iii. the cheque will be retained after it becomes stale.

8. Due to the deferral of tax for each year, the shareholder and the company enter into a subsequent arrangement the following year, with an ever-increasing amount of tax involved.

Diagram of typical arrangement



FEATURES WHICH CONCERN US

The Tax Office considers that an arrangement of this type gives rise to the following taxation issues that include whether:

1. such an arrangement or certain steps in it may be a sham.

2. the delivery of the endorsed cheque to the private company amounts to or gives rise to a repayment of the shareholder's debt to the private company.

3. section 109R (2) ITAA 1936 operates to disregard the repayment, which pursuant to the terms of the arrangement precedes a further loan of a similar or larger amount.

4. the general anti-avoidance provisions contained in Part IVA ITAA 1936 apply to include the amount of the distributions from the private company in the assessable income of the shareholder.

5. any entity involved in the arrangement is a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953*.

The Tax Office has reviewed this arrangement in several cases and has determined that it is not effective because of some or all of the features set out above.

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*Note 1: Penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Reductions in base penalty may be available if the taxpayer makes a voluntary disclosure to the Tax Office. If you have any information about the current arrangement, phone us on 1800 060 062. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this Alert should call 13 72 86 (Fast Key Code **3 4**).*

Note 2: Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the Taxation Administration Act 1953. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.

Amendment history

Date	Comment
3 May 2024	Updated Tax Agent tip off hotline number
19 January 2024	Updated ATO tip-off hotline numbers

subject references:
Arrangement
Negotiable instrument
Deemed Dividend
Avoidance

legislative references:
Section 109C Income Tax Assessment Act 1936
Section 109D Income Tax Assessment Act 1936
Section 109R Income Tax Assessment Act 1936
Section 44 Income Tax Assessment Act 1936
Part IVA Income Tax Assessment Act 1936
Division 290 Taxation Administration Act 1953

related taxpayer alerts: Taxpayer Alert TA 2007/5

related practice statements: Law Administration Practice Statement PS LA 2005/13

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