



# ***TA 2011/1 - Loans to members of companies limited by guarantee and the operation of Division 7A***

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# Taxpayer Alert

TA 2011/1

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**TITLE: Loans to members of companies limited by guarantee and the operation of Division 7A**

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*Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Australian Taxation Office (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.*

*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 ATO has under risk assessment will be the 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 ATO. In these latter cases the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.*

*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 are of concern to the ATO. These issues will generally require more detailed analysis to provide the ATO 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 (noting 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 Taxpayer Alert and/or obtain their own advice.*

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

## Overview

This Taxpayer Alert describes an arrangement where a company limited by guarantee (LBG company) is established to receive trust distributions. The LBG company members and directors usually control the trust and are also beneficiaries of the trust. The distributions from the trust are loaned by the LBG company to its members and directors or their associates for minimal or no interest. The loan amounts are not returned as income by the members and directors or their associates. The stated purpose of the LBG company is to protect its assets, however the only assets held are these loans.

The arrangement does not involve not for profit entities whose ordinary or statutory income is exempt under Division 50 of the *Income Tax Assessment Act 1997* (ITAA 1997).

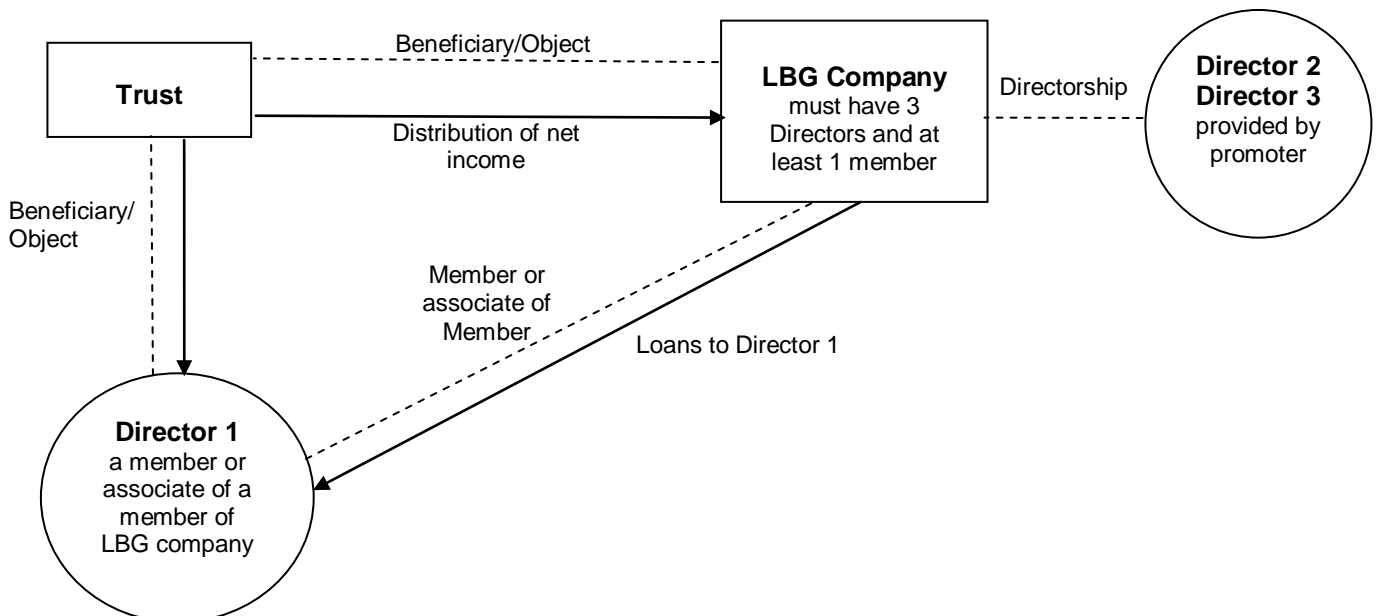
## Description

The alert applies to arrangements with features substantially equivalent to the following.

1. A company limited by guarantee (the LBG company) is set up and becomes a beneficiary or an object of a trust (the Trust).
2. The Trust distributes net income to beneficiaries including the LBG company. The distribution to the LBG company may have franking credits attached.
3. The LBG company pays tax on the distributions at the company tax rate (30%).
4. The LBG company makes loans to directors, members or associates of the LBG company or related parties to the directors, members or associates (the borrower).
5. The borrower does not include the value of the loans in their assessable income in the year in which they are received.
6. The borrower pays minimal or no interest to the LBG in relation to these loans.
7. Aside from the perceived beneficial tax treatment, there is little or no commercial reason for the establishment of a limited by guarantee company.

## Diagram of arrangement

The basic structure of the arrangement can be summarised diagrammatically as follows:



## Features which concern us

The ATO considers that an arrangement of the type described above gives rise to taxation issues that include whether:

- (a) the LBG company may be a public company or private company under the income tax law,
- (b) the members of the LBG company are shareholders for the purposes of the *Income Tax Assessment Act 1936* (ITAA 1936), the *Income Tax Assessment Act 1997* (ITAA 1997) and Division 7A of the ITAA 1936,
- (c) any amounts received by members of the LBG company under the arrangement may be ordinary income under section 6-5 of the ITAA 1997,
- (d) any amounts received by members of the LBG company under the arrangement may be dividends under section 6(1) and section 44(1) of the ITAA 1936,
- (e) any loans or other benefits provided to shareholders (or associates of such shareholders) of the LBG company under the arrangement may be deemed to be dividends, through the operation of Division 7A of the ITAA 1936,
- (f) section 100A of the ITAA 1936 may apply to the trust distributions made in connection with or as a result of reimbursement agreements,
- (g) the general anti-avoidance provisions in Part IVA of the ITAA 1936 may apply to the arrangement,
- (h) the loan may be a fringe benefit for the purpose of the *Fringe Benefit Tax Assessment Act 1986*, and
- (i) any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Tax Administration Act 1953*.

The ATO is currently reviewing these arrangements.

**Note 1:** *Base penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where you make a false and misleading statement to the Commissioner. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the ATO. If you have any information about the current arrangement, phone us on **1800 177 006**. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this alert should also call **1800 177 006**.*

**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.*

**Note 3:** *In appropriate cases possible sanctions under criminal law may also apply. Where a taxpayer makes a voluntary disclosure and that disclosure indicates possible criminal offences, the Commonwealth Director of Public Prosecutions has indicated that*

*favourable consideration will be given to granting an indemnity from criminal prosecution in relation to the taxpayer's involvement in the scheme where:*

- *the case does not exhibit a significant degree of criminality by the taxpayer*
- *the taxpayer provides information about how the arrangements worked, including the role and identity of the promoter, and*
- *the taxpayer co-operates with the investigation and consequential proceedings.*

**Note 4:** *Where appropriate, section 167 of the ITAA 1936 may be used to determine the amount of taxable income upon which the taxpayer should be assessed, see Law Administration Practice Statements, PS LA 2007/7 and PS LA 2007/24.*

**Note 5:** *The Commissioner may amend an assessment at any time where he is of the opinion there has been fraud or evasion. See Law Administration Practice Statement PSLA 2008/6.*

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## References

*Subject references:*

- Limited by Guarantee Company
- Division 7A

*Legislative references:*

- Income Tax Assessment Act 1936
  - [Division 7A](#)
  - [Division 6](#)
  - [Part IVA](#)
- Income Tax Assessment Act 1997
  - [Division 50](#)
- Taxation Administration Act 1953
  - [Schedule 1](#)

*Related Practice Statements:*

- [PS LA 2008/15 - Taxpayer Alerts](#)

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