



TA 2011/4 - Deductibility of unpaid directors fees

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Taxpayer Alert

TA 2011/4

FOI status: may be released

TITLE: Deductibility of unpaid directors fees

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 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 In these latter cases, the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.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 give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and 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 claims a deduction for directors fees notwithstanding that there is no payment to the directors of these fees in the current income year and/or subsequent income year(s). There is no intention to ever make this payment in full or at all even though the company passed a resolution that directors fees of a specific amount be paid at some future time.

The ATO is not concerned with normal business practice where a company passes a resolution that creates an unconditional commitment to pay directors fees and the payment occurs within a reasonable time period which could extend outside the immediate year of income.

Context for the arrangement

Taxation Ruling IT 2534 Income tax: taxation treatment of directors fees, bonuses, etc., provides the ATO view for the taxation treatment of directors fees. The ruling states that to qualify for a deduction a company must, before the end of the year of income, become definitively committed to the payment of a quantified amount of directors fees, bonuses or other such payments.

The ruling also states that income such as directors fees are considered to have been derived for income tax purposes at the time the income is paid or otherwise made available to the director although it is acknowledged that amounts may not be paid until some months into the following income year.

Description

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

1. Prior to 30 June of an income year, a directors meeting of a private company is held to consider the remuneration of the directors for that year.
2. The meeting resolves that directors fees of a specific amount be made payable to the directors of the company and the minutes reflect that the company is immediately, definitively and irrevocably committed to the liability in respect of these directors fees.
3. The meeting qualifies this resolution by further resolving that the directors fees be paid at a time to be determined having regard to future cash flow and that amounts be held in a directors fees payable account until payment is or can be made.
4. The company claims a deduction for the directors fees in the year of resolution but makes no payment to directors.
5. The directors do not include any amount in their assessable income until such time as the company pays an amount to them.
6. In the following year, the company makes nil or minimal payments to directors despite the company declaring profits and, in some instances, making loans to the director(s).
7. This practice may continue in later income years.

Features which concern us

The ATO considers that arrangements of this type give rise to the following issues relevant to taxation laws, being whether:

- (a) such an arrangement or certain steps within it may be a sham;
- (b) a liability to pay directors fees is 'incurred' for the purposes of section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) when the resolution for the directors fees is subject to satisfaction of a condition precedent;
- (c) the directors fees are never paid and included as assessable income under section 6-5 of the ITAA 1997;
- (d) the anti-avoidance provisions of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) may apply to the arrangement or to any part of it; and
- (e) 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 *Taxation*

Administration Act 1953 (TAA 1953).

The ATO is currently reviewing these arrangements.

The ATO view regarding taxation treatment of directors fees, bonuses is contained in Taxation Ruling IT 2534.

- Note 1:** *If you have received a private ruling in respect of your arrangement, you can rely on that private ruling. A private ruling is legally binding on the Commissioner who will be bound to act in the way set out in the ruling, even if the private ruling is later found to be incorrect. However, a private ruling only applies to the particular entity identified and the particular scheme described in the ruling. If there is a material difference between the scheme described in the ruling, and the scheme that was actually implemented, the private ruling will not be legally binding on the Commissioner. Also, other entities cannot rely on a private ruling issued in respect of a different entity.*
- Note 2:** *If you have received a private ruling in respect of your arrangement, please check that the application of Part IVA of the ITAA 1936 is considered in that ruling. The applicant may not have sought for us to rule on the application of Part IVA to the arrangement ruled upon, or to an associated or wider arrangement of which that arrangement is part. If you want us to rule on whether Part IVA applies to your arrangement, we will first need to obtain and consider all the relevant facts about the arrangement, including (if relevant) the manner in which it has actually been implemented.*
- Note 3:** *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 call **1800 177 006**.*
- Note 4:** *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 TAA 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 5:** *A registered tax agent may have their registration cancelled or suspended by the Tax Practitioners Board under the Tax Agent Services Act 2009 for breach of a condition of registration including being penalised for being a promoter of a tax exploitation scheme.*
- Note 6:** *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.*

References

Subject references:

- Assessable income
- Deductions and expenses
- Directors
- Incurred
- Part IVA

Legislative references:

Income Tax Assessment Act 1936

- [Part IVA](#)

Income Tax Assessment Act 1997

- [Section 6-5](#)
- [Section 8-1](#)

Taxation Administration Act 1953

- [Division 290](#)

Related Practice Statements:

- [PS LA 2008/15](#)

Rulings:

- [IT 2534](#)

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