

## Senate Standing Committee on Economics

### ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

31 May – 2 June 2011

Question No: BET 97

Topic: ATO – Division 7A – Unpaid Present Entitlements (“UPEs”)

Hansard Page: Written

Senator Bushby asked:

During 2009 and 2010 the ATO announced a quantum change to the previously understood application of Division 7A of Part III of the Income Tax Assessment Act 1936 to unpaid UPEs between a trust and a private company beneficiary.

The ATO’s view that a UPE turns into a Division 7A loan was widely criticised and challenged by the professional bodies as being legally incorrect and inconsistent with the original policy intent of Division 7A.

Despite this, the ATO published its final view in Taxation Ruling, TR 2010/3 on 2 June 2010, and provided difficult to understand administrative solutions in its Practice Statement Law Administration, PS LA 2010/4, on 14 October 2010.

Because none of this changed ATO view is supported by legislation, we now have small business owners trying to work with provisions that are difficult to analyse and apply. This is made worse by the possibility of a future Court decision following the legislation rather than the ATO’s view, when the small business owner has tried to follow the ATO’s currently published view.

Section 109RB of Division 7A allows the Commissioner of Taxation to exercise his discretion to disregard the operation of Division 7A in certain circumstances where there has been “an honest mistake or inadvertent omission”.

The ATO has issued its views in Taxation Ruling, TR 2010/8 on 15 December 2010, but is still finalising its administrative solutions in draft Practice Statement Law Administration, PS LA 2843 (draft), which was issued on 31 March 2011. The time that this is taking demonstrates the difficulty that even the ATO is experiencing.

Small business owners and their advisers are now trying to deal with the fall out of the ATO’s administrative pronouncements, where certain actions are required by 30 June 2011, the date when 30 June 2010 UPEs convert to a Division 7A loan unless certain steps are taken.

These administrative pronouncements have had, and continue to have, significant impacts on small business structuring, tax planning and tax compliance.

If the ATO’s view regarding UPEs is correct, then why is the legislation not changed to clearly reflect this?

Answer:

1) Taxation Ruling TR 2010/3 is broadly consistent with the general integrity policy rationale for Division 7A of Part III of the *Income Tax Assessment Act 1936*, which treats certain private company loans and payments to shareholders (or a shareholder's associate) as deemed dividends if the company has a distributable surplus (broadly, that is realised or unrealised profits).

The Government is not currently considering amending the Division 7A rules in relation to unpaid present entitlements. However, if it becomes evident that the Australian Taxation Office's (ATO) view of the law imposes unnecessary compliance costs or cash flow burdens on small businesses the Government will consider appropriate measures at that time.

Further, although the ATO is confident that their view of the law is the correct interpretation (i.e. is supported by the legislation), they have been working with members of various professional bodies to identify a suitable test case as a way of providing judicial certainty on the view expressed by the Commissioner of Taxation in TR 2010/3.