

By email: taxboard@treasury.gov.au

The Board of Taxation
c/ The Treasury
Langton Crescent
PARKES ACT 2600

22 February 2012

Dear Sir/Madam

POST IMPLEMENTATION REVIEW OF DIVISION 7A

We refer to the invitation by the Board of Taxation to submit comments on its Discussion Paper on the post implementation review of Division 7A of Part III of the ITAA 1936 (Division 7A), which was released on 20 December 2012. Our comments below are designed to assist the Board or Taxation in its review. In the attached Appendix we have given our answers to some of the questions in the discussion paper.

We support the review of Division 7A but caution that any amendments to Division 7A must not add to the complexity of the tax system but should instead preferably reduce the complexity.

The current Division 7A has been in existence, with various amendments, for over 15 years and it has taken that long for many taxpayers and tax agents to have a basic understanding of how it works. While universal understanding of the provision cannot be expected, it appears that most tax agents now have a rudimentary understanding of the provisions and therefore care must be taken in making changes to the provisions as those changes may take some time to be understood by the taxpayer and tax agent community.

In view of the length of time it has taken some tax agents to understand the current provisions we recommend that any amendments to Division 7A either:

- fix the obvious problems with the existing provisions without changing the structure of the provisions too much; or
- replace Division 7A with a substantially simplified alternative system that will be easier for taxpayers and tax agents to understand.

Whatever amendments or replacements are made to Division 7A we submit that the current uncertainty surrounding the interaction between Division 7A and unpaid present entitlements (UPEs) should be resolved by either:

- deeming UPEs not to be Division 7A loans and thus allowing Subdivisions EA and EB of Division 7A to apply in the manner in which they were originally intended to apply; or
- allow a “safe harbour” such that trusts be allowed to retain UPEs of companies without minimum repayments to the extent that such UPEs were used to fund working capital of such trust estates.



Should you have any questions, or wish to discuss any of the comments made in the attached submission, please do not hesitate to contact Lance Cunningham on 02 9240 9736 or lance.cunningham@bdo.com.au or Matthew Wallace on 02 9240 9760 or matthew.wallace@bdo.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Lance Cunningham', written in a cursive style.

Lance Cunningham
BDO National Tax Director

A handwritten signature in black ink, appearing to be 'Matthew Wallace', written in a cursive style.

Matthew Wallace
BDO National Tax Counsel

APPENDIX

Unless otherwise indicated, statutory references are to the *Income Tax Assessment Act 1936* (ITAA 1936). References to the ITAA 1997 are to the *Income Tax Assessment Act 1997*.

This document sets out answers by BDO to some of the questions posed by the Board of Taxation in its discussion paper on the post implementation Review of Division 7A of Part III of the ITAA 1936.

Question 2.2 - Integrity of the Tax System

We understand the need for an integrity provision that deals with the inappropriate distribution of company profits to a company's shareholders and their associates. The use of the company's funds for the shareholders or their associates without a commercial return on those funds being provided to the company creates a risk to the integrity of the current tax system. However, there are situations where the requirement for a commercial return on the use of the funds may not be needed to protect the integrity of the tax system and may just cause additional and unnecessary compliance costs.

For example the interest or other return on unpaid present entitlements (UPE) of a company from a trust where the funds are used for working capital of the trust, would be tax deductible to the trust and assessable to the company. If an otherwise deductible rule were to apply in these situations the compliance costs would be avoided without causing a risk to the integrity of the tax system.

Question 4.2 - Family Court

We agree that the Family Court and litigants before it need to be made aware of the problems that the Family Court's rulings can cause if it doesn't take into account Division 7A. We also note this is not just a problem for Division 7A but is also a problem with the Family Court's lack of understanding of a number of other tax provisions such as those dealing with CGT.

Questions 4.3 and 5.1 - Subdivisions EA & EB

We are of the view that Subdivisions EA and EB provide appropriate outcomes in respect of UPEs. The money retained by trusts in respect of UPEs is often used as working capital by such trusts. To this end, we recommend that UPE's not be treated as loans or financial accommodation for the purposes of Division 7A. Instead reliance should be placed on the operation of Subdivisions EA and EB to ensure the integrity of the tax system in respect of such amounts.

Question 5.2

In light of the difficulties that taxpayers have experienced in applying Division 7A, it is desirable that a general relieving discretion continues to be available to the Commissioner.

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