Friday, 2 May 2025

Pri Wijesooriya
Australian Taxation Office
By email: Pri.Wijesooriya@ato.gov.au

Dear Pri

TD 2025/D2 Income tax: disregarding certain payments under section 109R of the *Income Tax Assessment Act 1936* in determining how much of a loan has been repaid in situations where notional loans are involved

Chartered Accountants Australia and New Zealand (**CA ANZ**) and CPA Australia welcome the opportunity to provide comments on TD 2025/D2 Income tax: disregarding certain payments under section 109R of the *Income Tax Assessment Act 1936* in determining how much of a loan has been repaid in situations where notional loans are involved (**Draft TD**).

CA ANZ and CPA Australia represent over 310,000 professional accountants who work in diverse roles across public practice, commerce, industry, government and academia throughout Australia, New Zealand and internationally.

Division 7A contains some of the most complicated provisions that SMEs need to comply with and is a significant obstacle to a taxpayer's ability to effectively comply with their tax obligations.

We support addressing the mischief raised in the Draft TD, being the repayment of notional loans that arise under sections 109T and 109W of the *Income Tax Assessment Act 1936* (**ITAA**) where the repayment is dependent on another loan being made. However, we believe the way sections 109R, 109T and 109W are currently drafted does not support section 109R applying in situations where notional loans are involved. A legislative fix is urgently required to ensure that these provisions, and Division 7A more broadly, operates in an appropriate manner.

The difficulties of ensuring that Division 7A of the ITAA operates as intended have been long standing. For more than a decade, our members have been saying that the ATO is pushing its interpretation of the law beyond the policy intent of the legislation.

The Board of Taxation's 2012-2014 post-implementation review of Division 7A has resulted in numerous recommendations, some of which previous Governments have endorsed in budget announcements in 2016/17 and 2017/18.

Most recently, the Full Federal Court has unanimously decided against the ATO's position regarding unpaid present entitlements.[1]

[1] *Commissioner of Taxation v Bendel* [2025] FCAFC 15

Our members are calling for Division 7A reform to be revisited. Most of the hard work has been done by the Board of Taxation. Though these recommendations will need to be revisited given the law changes that have occurred since the Board's review in 2014.

Rather than finalising a TD which pushes the interpretation of the law beyond the text of the provisions, we would strongly support advocating for a legislative fix to Division 7A. In the meantime, the ATO could issue a Taxpayer Alert highlighting the application of Part IVA to the mischief raised in this TD.

The appendix contains more details about the application of the deeming provisions and how the TD could be enhanced to assist tax practitioners and taxpayers gain greater certainty.

If you have any queries, please contact Karen Liew at karen.liew@charteredaccountantsanz.com (CA ANZ) or Jenny Wong at jenny.wong@cpaaustralia.com.au (CPA Australia).

Sincerely,

Susan Franks
Australian Leader – Tax, Superannuation and Financial Services
Chartered Accountants Australia and New Zealand

Jenny Wong
Tax Lead – Policy & Advocacy
CPA Australia

Appendix

Legislative amendment to Division 7A is preferred

Section 109T is a deeming provision that allows Division 7A to operate as if a private company made a payment or loan to a target entity where the private company makes a payment or loan to other interposed entities. Section 109W is a deeming provision that allows Division 7A to operate as if an amount lent by the interposed entity is the amount loaned by the private company to the entity when the interposed entity made the loan to the target entity.

Caution is required when applying deeming provisions. Fisher J in *FCT v. Comber*[2] explained the limited effect of deeming provisions as follows:

> *"In my opinion deeming provisions are required by their nature to be construed strictly and only for the purpose for which they are resorted to (Ex parte Walton (1881) 17 Ch D 746 per James LJ at 756). It is improper in my view to extend by implication the express application of such a statutory fiction."*

As acknowledged in the alternative view of the Draft TD, on a literal reading of the provisions of section 109R and the provisions creating these notional loans, it is possible to conclude that section 109R does not apply to notional loans. We are of the view that section 109R cannot apply to disregard a notional loan repayment otherwise taken to have been made under subsection 109W(3). This is because for section 109R to enliven, there must be **payments to the private company**. Subsection 109W(3) only creates the assumption that the target repays an amount of the notional loan.

The position taken by the ATO in the Draft TD may be, as is stated in both paragraph 51 and 56, *"the one which best achieves the purpose or object of sections 109R, 109T and 109W and Division 7A as a whole"* but it is not supported by the words of the various provisions and judicial guidance on deeming provisions.

We acknowledge that if section 109R does not apply to notional loans, there may be the potential for circular loans and repayments to be used each year to avoid Division 7A, and this would be contrary to the purposes and objectives of Division 7A. Nevertheless, if section 109R cannot apply, Part IVA may apply, as is acknowledged in paragraph 3, to ensure the purposes and objectives of Division 7A are met.

We would recommend that legislative amendment be pursued to provide certainty that section 109R does apply to notional loans rather than trying to extend the section 109W(3) beyond its original purpose. In the meantime, the Draft TD, or a taxpayer alert, could state

[2] *FCT v. Comber* 86 ATC 4171 at 4177; (1986) 10 FCR 88 at 96; 64 ALR 451 at 458

that the Commissioner will apply Part IVA to arrangements where there are circular loans and repayments of notional loans to address the mischief.

Additional guidance needed about how the ATO will apply its view

The Draft TD could provide guidance on what situations the ATO will apply the views expressed in this TD.

An example of where the ATO has provided such guidance is TD 2011/16, where factors the ATO will consider in determining the amount of any notional loan under section 109T are listed. Similar factors that the ATO will consider in deciding whether a repayment of a notional loan will be disregarded under section 109R could be included in the Draft TD.

For example, the Draft TD could state that if a borrower can establish that it has funded its repayment from other sources and has not obtained the indirect loan to circumvent section 109R, then the repayment of the notional loan should not be disregarded by the application of section 109R.

Double Taxation

We believe some clarity of the Commissioner's order of applying these rules where double taxation applies would also be helpful.

In relation to the Commissioners position under TR 2022/11 and Subdivision EA, the Commissioner has been clear that if the UPE is appropriately treated for the purposes of Division 7A then there is no need to also put the deemed loan under Subdivision EA under similar treatment. For example, in TR 2010/3 the Commissioner states:

> *"182. Nonetheless, given the legislative context of Division 7A, an amount that has been treated as a loan and dealt with under section 109D should be regarded as a loan for all purposes of Division 7A, including Subdivision EA. Accordingly, the Commissioner will not treat a UPE that is subject to this Ruling and is considered to constitute a Division 7A loan as a present entitlement that remains unpaid for Subdivision EA purposes."*

It is clear which of these two provisions (sections 109D or EA) the Commissioner wants the taxpayer to document and repay to avoid the operation of Division 7A, and that understanding means that any potential for double taxation is removed.

This Draft TD acknowledges the potential for double taxation due to the operation of section 109R. The Draft TD states:

> *"However, we note that the potential for multiple deemed dividends to arise as a result of section 109R applying is not limited to arrangements involving notional loans arising under sections 109T and 109W. The same result may arise where loans from a private company are refinanced by actual loans from the same company."*

CHARTERED ACCOUNTANTS AUSTRALIA + NEW ZEALAND

Chartered Accountants
Australia and New Zealand
33 Erskine Street, Sydney, NSW 2000
P: +61 1 9290 1344
W: charteredaccountantsanz.com
ABN: 50 084 642 571

CPA AUSTRALIA

CPA Australia
L20, 28 Freshwater Place, Southbank
Victoria 3006
P: +1300 73 73 73
W: cpaaustralia.com.au
ABN 64 008 392 452

An example of this is:

> *A shareholder owns Co 1. Co 1 loans (Loan 1) $1 to the shareholder. This loan could be subject to Division 7A. To repay Loan 1, Co 1 takes another $1 loan (Loan 2). This loan could be subject to Division 7A. Both Loan 1 and Loan 2 and the repayment occur in the same year.*
>
> *At the end of the year, Loan 2 is a deemed dividend of $1 under section 109D. Loan 1 appears to not be a deemed dividend under section 109D as the loan has been repaid by the shareholder obtaining Loan 2 (paragraph 109D(1)(b)). However, if the repayment of Loan 1 is disregarded due to the operation of 109R, then Loan 1 will also be deemed dividend under section 109D. Both loans are subject two section 109D even though the first loan was repaid by the second.*

In paragraph 106 of TR 2022/11 the Commissioner acknowledged that, due to 109R, there may be double taxation due to a similar "refinancing" through the formalisation of a financial accommodation into a loan and the Commissioner states how he will act to ensure there is no double taxation in this paragraph so that the taxpayers were clear how to act.

Where the Commissioner identifies the possibility of double taxation, it would be helpful if the Commissioner could identify how he would expect a taxpayer to manage the arrangement so that there will be no deemed dividend by identifying which of the two loans should be appropriately documented and repaid.

However, it is unlikely that the drafters of Division 7A intended there to be the potential for any double taxation to occur. Therefore, the Commissioner should also consider approaching Treasury to amend Division 7A to ensure the potential double taxation is removed in this situation and other situations.

CHARTERED ACCOUNTANTS AUSTRALIA + NEW ZEALAND

Chartered Accountants
Australia and New Zealand
33 Erskine Street, Sydney, NSW 2000
P: +61 1 9290 1344
W: charteredaccountantsanz.com
ABN: 50 084 642 571

CPA AUSTRALIA

CPA Australia
L20, 28 Freshwater Place, Southbank
Victoria 3006
P: +1300 73 73 73
W: cpaaustralia.com.au
ABN 64 008 392 452