

December 2011

## A reminder for unpaid present entitlements – 31 December 2011 is the last day to correct past errors

As discussed in a previous *Tax Flash*, where you have mistakenly treated an unpaid present entitlement (UPE) as a loan rather than as a UPE in the trust and/or company's accounts or you have failed to deal with UPEs that have been converted to loans (under Division 7A), you only have until 31 December 2011 to take advantage of the Tax Office's solutions detailed in PSLA 2010/4.

### Two corrective options

There are two corrective options outlined in PSLA 2010/4. They apply to both pre and post- 16 Dec 2009 UPEs:

- Where the financial statements of the trust and/or the company have incorrectly recorded UPEs as a loan, corrective action may be taken to properly reclassify the amount as a UPE.
- If option 1 is not possible, taxpayers can have the Division 7A deemed dividend disregarded on the basis that such a dividend arose due to an honest mistake or inadvertent omission on the taxpayer's behalf, and corrective action has been taken.

#### Option 1

Under option 1, the UPE has been mistakenly classified as a loan in the accounts of the trust and/or the private company. The following must be satisfied:

- The financial accounts of the company and/or trust have incorrectly classified the UPE as a loan but all other evidence indicates the amount is a UPE, the trust has not credited/paid any interest on the loan and it has not been reported as a loan in a tax return and
- Corrective action must be taken before 31 December 2011 – the accounts of all relevant entities are amended or restated to classify the amount as a UPE.

It is also a requirement of the Tax Office that the trustee and public officer of the company sign a declaration stating all of the following conditions have been satisfied:

- The accounts of the trust and/or private company have incorrectly classified the amount, which is a UPE, as a loan from the company to the trust;

- With the exception of the financial accounts and their underlying working papers, including the journal entries, accounting ledgers and/or trial balance, all available evidence supports the view that the amount is in fact a UPE
- The private company has never included that amount in calculating the amount of loans reported at Label 8N of the private company's income tax return ('loans to shareholders and associates')
- The trust has not paid or credited any interest on or in respect of that amount;
- The loan account in which the amount is included is entirely comprised of amounts correlating to UPEs and repayments of such UPEs between the trust and the private company (that is, its balance is not affected by any unrelated transactions) and
- On or before **31 December 2011**, the accounts of all relevant entities are amended or restated to properly classify the amount as a UPE.

It is essential that the declaration be completed and the accounts corrected prior to 31 December 2011. The declaration should state that the trust and/or company is seeking to apply this option under the PSLA, and state that each of the conditions have been satisfied.

It is also essential that the accounts be corrected before 31 December 2011. Where the 30 June 2011 accounts will be completed before 31 December 2011, the loans must be restated as UPEs in those accounts.

Where the 30 June 2011 accounts will not be completed by 31 December 2011, it is essential that the last issued accounts be restated to classify the loans as UPEs.

## Option 2

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If the amount has been correctly classified as a loan, but it does not comply with Division 7A requirements (loan agreement, benchmark interest rate and minimum loan repayments), the Tax Office has a discretion under Section 109RB to disregard the breach of Division 7A.

If the taxpayer is a small business entity (turnover less than \$2 million), they can self assess the discretion where they satisfy the following:

- Non-compliance with Division 7A was due to an honest mistake or inadvertent omission
- The loan funds were used by the trustee only for carrying on of the business of the trust
- The private company and trust have lodged all required income tax returns up to and including the 2009-10 income year;
- The private company, trust and associates have a history of good compliance over the last four years

- The trustee is not a shareholder of the private company and
- Corrective action is taken before 31 December 2011 as outlined in PSLA 2010/4 - broadly this means:
  - The trustee/public officer must sign the relevant declarations stating an honest mistake/inadvertent admission has been made;
  - The loan must be put on a Division 7A complying loan (see section 109N); and
  - The minimum repayments that would have been payable under the Division 7A loan must be made i.e. catch up payments need to be made.

This action must be taken prior to 31 December 2011.

Where the entity is not a small business entity, or it is a small business entity but cannot satisfy the conditions for self assessment, they must make a written request to the Tax Office requesting the discretion under Section 109RB be exercised in the circumstances.

Should you require assistance or additional information, please contact your PKF Tax Adviser

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