

# Division 7A ITAA 1936 – Relevance of UPEs

September 2023

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# Division 7A ITAA 1936 – discretionary trusts and unpaid distributions to a corporate beneficiary.

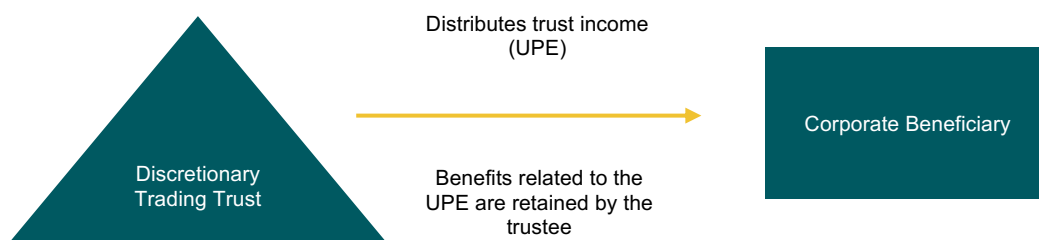
## 1. INTRODUCTION

### 1.1 OVERVIEW

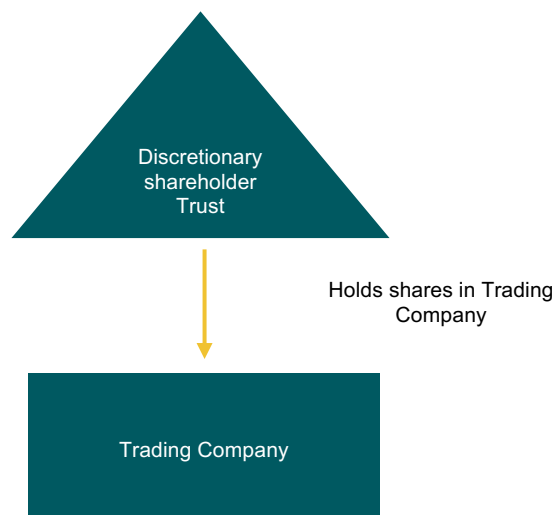
It has long been widely accepted by advisors that family based small business structuring arrangements variously utilise a structuring combination of a discretionary trust and a company, whether the company is positioned as the business entity or as a corporate beneficiary of a discretionary trust.

In addition to the immediate commercial and taxation benefits of the structuring combination in relation to the taxation of trust income at the **base rate entity tax rate**, the perceived advantage of the availability of the **Division 115 general capital gains discount** was/is a major influence with the implementation of this type of structuring combination arrangement.

#### Arrangement 1



#### Arrangement 2



More relevantly for today's discussion of the application of Division 7A to unpaid trust distributions, this paper concentrates on the taxation implications of structure arrangement 1, whereby:

- A trading business is conducted by and/or the income earning assets are held by a discretionary trust;
- the trustee distributes a proportion of the trust's income to a corporate beneficiary (application of section 97 ITAA 1936);
- The trust distribution is 'set aside' and held by the trustee as a separate trust for the 'entitled beneficiary; pursuant to the trustee's prerogative rather than being paid to the beneficiary;
- The trust income distributed to the corporate beneficiary is taxed at the prevailing corporate tax rate (more usually the base rate entity corporate tax rate); and
- The trust makes a loan to an entity that is either a shareholder or associate of a private company.

## 1.2 COMMISSIONER'S RECENT ACTIONS RE UNPAID PRESENT ENTITLEMENTS ("UPE")

Notably in more recent times, there have been significant 'pressure' applied by the Commissioner to the use of a company in a tax structuring arrangement, in particular where the company is a corporate beneficiary of a trust:

- (i) The extension of Division 7A to unpaid trust distributions 'owing' to a corporate beneficiary (including the nuanced application of Division 7A by subdivision EA) – TR 2010/3 (withdrawn) and more recently by TD 2022/11;
- (ii) The application of section 100A to unpaid trust distributions more generally<sup>1</sup> (noting the decisions in Guardian AIT<sup>2</sup> and BBlood Enterprises matter<sup>3</sup>);
- (iii) The application of Part IVA to arrangements which included a circular trust distribution to a company, the company re-distributing the income in the form of a fully franked dividend to the trust and the trust the distributing the franked dividend to a tax advantaged entity (Guardian AIT);
- (iv) The more general application of Part IVA to trust arrangements for:
  - a. personal service arrangements (Tupicoff, Gulland, Watson & Pincus<sup>4</sup>) where the taxpayer has used a trust structure;
  - b. The Commissioner's PCG 2021/4 (Profit allocation rules for professionals); and
  - c. The Commissioner's successful argument in Minerva<sup>5</sup> that a discretionary trust's distribution was based on achieving a tax benefit for the relevant taxpayer.
- (v) The Commissioner's clear tax interpretation demarcation between the term 'debt' and an 'unpaid distribution' (equitable obligation) – refer inter alia to TR 2015/4 (application of section 152-20), bad debt provision (section 25-35), section 109F (private company debt forgiveness) and the complementary application of section 109C, Division 245 ITAA 1997 (Commercial Debt Forgiveness issues); and
- (vi) The problematic use of Dividend Access Shares ("DAS") in a private company where the DAS are held by a discretionary trust (value shifting provisions - Division 745 ITAA 1997) in addition to the longer-term difficulty for shareholders who wish to satisfy the small business participation percentage criteria (section 152-70) for the purposes of accessing the Division 152 ITAA 1997 Small Business CGT Concessions.

In relation to the Commissioner's Division 7A rulings, the ATO 'enforced' view is (TD 2022/11) and has been (TR 2010/3), that a decision not to call for the immediate payment of the trust distribution (the UPE) is the 'provision of financial accommodation' in the context of the definition of a loan for the purposes of section 109D(3). This view has been challenged by the AAT in a recent<sup>6</sup> case - **Bendel and Commissioner of Taxation (Taxation) [2023] AATA 3074**

The implications of this case are separately discussed in this paper.

Suffice it to further state, that the proposed statutory changes to Division 7A mooted by Treasury<sup>7</sup> have not been enacted. This case, if not reversed on appeal might accelerate Treasury's actions.

### 1.3 OTHER FIDUCIARY TRUSTEE MATTERS

In addition to the above taxation matters, trustees have been gently 'reminded' of their fiduciary obligations when determining trust distributions (Owies<sup>8</sup>) to ensure that the trustee has both sought relevant and real information and given genuine consideration of the needs of relevant beneficiaries of the trust.

A further factor that is highly relevant to present tax structuring arrangements for family based small business entities that carry on a business is the favourable 'base rate entity' tax rate of 25% (albeit the benefit is nullified if all of the income is to be distributed).

Finally, with the concentrated focus on trusts, accountants have become more familiar with the subtle legal distinctions relating to unpaid trust distributions. Not the least of this knowledge developments are the more prevalent understanding of the importance of a trust deed (refer to Bamford) and what the trust deed actually states relevantly in relation to the treatment of unpaid distributions.

### 1.4 ACIS STANDARD DISCRETIONARY TRUST DEED

In relation to the above, note how in particular the Acis trust deed provides for the manner that a trustee can deal with the distribution to a beneficiary:

#### 4.4 Trustee makes determinations

- (a) *The Trustee may determine, in relation to all, or any part of, the Income:*
  - (i) *to pay, apply or Set Aside any amount for one or more of the Beneficiaries;*
  - (ii) *to accumulate any amount of Income.*

...

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<sup>1</sup> TR 2022/4 & PCG 2022/2

<sup>2</sup> Commissioner of Taxation v Guardian AIT [2023] FCAFC 3

<sup>3</sup> BBlood Enterprises v FCT [2022] FCA 1112 & on appeal in B&F Investments Pty Ltd atf The Illuka Park Trust v Commissioner of Taxation [2023] FCAFC 89

<sup>4</sup> Tupicoff v Commissioner of Taxation [1984] FCA 382, FCT v Gulland, Watson v. FCT and Pincus v. FCT [1985] HCA 83

<sup>5</sup> Minerva Financial Group Pty Ltd v Commissioner of Taxation [2022] FCA 1092

<sup>6</sup> 28 September 2023

<sup>7</sup> 'Targeted amendments to the Division 7A integrity rules' - Consultation Paper October 2018

<sup>8</sup> Owies v JJE Nominees Pty Ltd [2022] VSCA 142

## 4.8 Beneficiaries Rights

*Each of the Beneficiaries in whose favour the Trustee pays, applies or Sets Aside any Income (or is deemed to do so) have an immediate and indefeasible vested interest in that Income and is presently entitled to the relevant share of the Income.*

## 4.9 Amounts Set Aside

*Any amount Set Aside or held by the Trustee on behalf of a Beneficiary under this Deed, will no longer form part of the Trust Fund, but will be held by the Trustee as a separate trust fund upon trust for the relevant Beneficiary absolutely. The Trustee has the Right (but not the Obligation), pending payment to the Beneficiary, to invest or apply that amount for the benefit of the Beneficiary or deal with that fund, or any resulting Income, in any manner provided for in this Deed in relation to the Trust Fund.*

Most modern trust deeds used by other reputable law practices have not dissimilar provisions.

The Division 7A implications of the above trust deed clauses will be discussed later in greater detailed in relation to the application of the new taxation determination.

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## 2. APPLICATION OF DIVISION 7A TO UNPAID TRUST DISTRIBUTIONS

### 2.1 INTRODUCTION – DIVISION 7A CONCEPTS

The primary focus of today's Division 7A presentation is particularly the practical implication of TD 2022/11 as it applies to a corporation's unpaid trust distributions. There are however further taxation issues associated with some other statutory integrity provisions which should be noted briefly.

Without wishing to overly emphasise the underlying policy objects of the present Division 7A provisions, the purpose of Division 7A is to provide a statutory mechanism to bring to account as assessable income (deemed dividend), transactions whereby a private company transfers or causes an economic benefit to be received by shareholder or a shareholder's associate, other than by reason of an explicit distribution of a dividend.

The mechanics of Division 7A is to deem as a dividend, the transactions involving any of the following 3 circumstances. Namely where the company:

- (i) Provides a 'loan' to the relevant entity (section 109D);
- (ii) Makes a payment to the relevant entity (section 109C and section 109CA); and
- (iii) Forgives a 'debt' owed by a relevant entity (section 109F).

Relevantly (i) and (ii) are more specific to an UPE.

Note that section 109F will not apply to the forgiveness of a UPE since the UPE is not debt.

Suffice it to also add, the Division also provides some caveats to the application of the above provisions, inter alia:

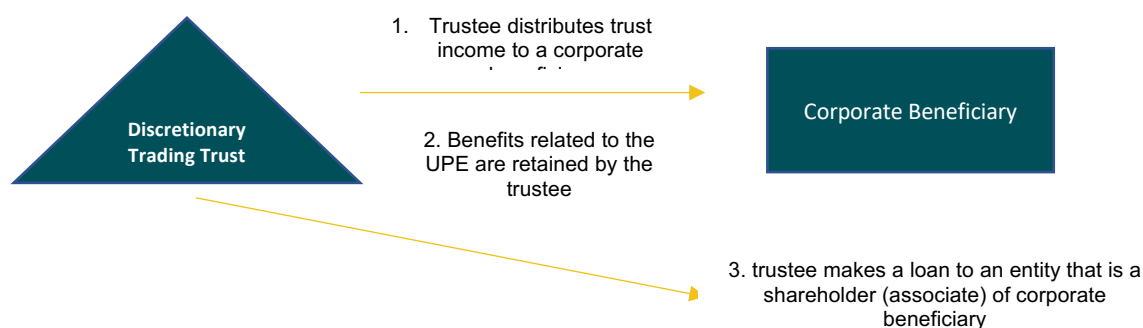
- Complying loan agreements (section 109M);
- Ordinary course of business transactions (section 109N); and
- Distributable surplus limits (section 109Y)

Further and noting that Division 7A is a specific integrity regime, there are other integrity provisions within Division 7A that are often overlooked but are of practical importance:

- Section 109E (minimum annual loan requirements);
- Section 109R (substituted loan payments);
- Section 109T (interposed entity transactions); and
- Subdivision EA which specifically deals with trustee arrangements (payments, loans, and debt forgiveness) with a company's shareholders (or associates) where the company has an unpaid present entitlement 'owed' by the trust.

The application of and relevance of subdivision EA was particularly pertinent in the Bendel matter and the AAT's reasoning.

The Subdivision EA scenario:



It is intended that today's discussion will specifically deal with Division 7A and UPE.

## 2.2. 'ASSOCIATE'

One final preliminary observation that is particularly relevant to any discussion of Division 7A and trusts concerns the definition of the term 'associate'.

Division 7A applies where the operative provisions -section 109C, section 109CA, section 109D and section 109F, are provided to a shareholder of a private company and/or the shareholder's associate. In that regard the term 'associate' is relevant.

Subsection 318(3) ITAA 1936 defines as an 'associate' of a trust, an entity, which:

*Section 318(3) [Associates of a trustee]*

*For the purposes of this Part, the following are associates of a trustee (in this subsection called the primary entity):*

- any entity that benefits under the trust;*
- if a natural person benefits under the trust — any entity that, if the natural person were the primary entity, would be an associate of that natural person because of subsection (1) or because of this subsection;*
- if a company is an associate of the primary entity because of paragraph (a) or (b) of this subsection — any entity that, if the company were the primary entity, would be an associate of the company because of subsection (2) or because of this subsection*

Notably, paragraph 318(3)(a) deems an entity to be an associate of a trustee if an entity **'benefits under the trust'**. This term is amplified by subsection 318(6)(a) in the following manner:



*Section 318(6) [Interpretation]*

*(a) a reference to an entity benefiting under a trust is a reference to the entity benefiting, or being capable (whether by the exercise of a power of appointment or otherwise) of benefiting, under the trust, either directly or through any interposed companies, partnerships or trusts; and*

The inclusion of an entity 'being capable of benefiting' generally means an associate of a trust will be all encompassing having regard to the broad definition of the term beneficiary contained in trust deeds. That is, an entity will be deemed to be an associate not only if a trust distribution has been made but also an entity that comes within the broad 'beneficiary' definition of the trust deed, even if that entity has not previously received a distribution.

## 2.3 DIVISION 7A – SECTION 109C 'PAYMENTS'

Whereas most of the present controversy deals with the Division 7A & section 100A treatment of unpaid present entitlements, it is useful to consider the taxation implications if the corporate beneficiary releases the trustee's obligation to pay the UPE.

Relevantly, the significance of the following is to be considered in the context that an UPE is not debt for the purposes of section 109F ITAA 1997 and Division 245 ITAA 1997 "Commercial Debt Forgiveness"

The term '**payment**' is defined by subsection 109C(3) in the following manner:

Section 109C(3) In this Division, 'payment' to an entity means:

- (a) a payment to the extent that it is to the entity, on behalf of the entity or for the benefit of the entity; and
- (b) **a credit of an amount to the extent that it is:**
  - (i) to the entity; or
  - (ii) on behalf of the entity; or
  - (iii) **for the benefit of the entity;** and
- (c) a transfer of property to the entity.

Note: See also section 109CA (Payment includes provision of asset).

Whereas, based on the above definition, it might seem that section 109C has limited application to UPE's, however a practical example of the application of this section to a UPE is illustrated by taxation determination **TD 2015/20**. This tax determination states that **a release** by a private company **of its unpaid present entitlement** owed by a trust is a 'payment' within the meaning of Division 7A.

The taxation determination states that if a private company releases all, or part, of its unpaid present entitlement (UPE), it does so by crediting an amount against the UPE amount owing (a debit) within the meaning of paragraph 109C(3)(b). Such a crediting is taken to be a 'payment' for the purposes of subparagraph 109C(3)(b)(iii) to the extent that the release represents a financial benefit to an entity – that is the trust. Invariably the trust will either be a shareholder of the company and/or an associate of the company's shareholder.

That is, the benefit is that the UPE is no longer payable to the company.

The application of the taxation determination is illustrated by the following example:

*Example 1 (extract from TD 2015/20)*

*ABC Pty Ltd is the trustee of ABC Trust (a discretionary trust).*

*XYZ Pty Ltd is within the class of potential objects. On 30 June 2012, ABC Pty Ltd resolved to make XYZ Pty Ltd presently entitled to \$100 of the income of the trust estate.*

*The amount to which XYZ Pty Ltd was presently entitled was not paid and, in accordance with the terms of the ABC Trust deed, was set aside separately in the accounts of the ABC Trust on terms such that the subsisting UPE was not a Division 7A loan within the meaning of Taxation Ruling TR 2010/3 and was not a debt for the purposes of section 109F.*

*On 30 June 2014, XYZ Pty Ltd entered into a deed of release, a condition of which was that the funds representing the UPE remain part of the ABC Trust estate.*

*Upon being made presently entitled, XYZ Pty Ltd accounted for the UPE by recording a debit entry against a 'trust entitlement' ledger.*

*For the purposes of accounting for the release, XYZ Pty Ltd made a credit entry in that ledger to offset the debit (reflecting the UPE ceasing to be an asset of the company). The amount so credited for the benefit of ABC Pty Ltd (in its capacity as trustee of the ABC Trust), is a payment within the meaning of subparagraph 109C(3)(b)(iii).*

*If ABC Pty Ltd is, in its capacity as trustee for the ABC Trust, a shareholder of the private company (or an associate of such a shareholder), the release will be a payment to which section 109C applies.*

Accordingly, if it was contemplated that the solution to the UPE/Division 7A issue is that the company 'forgives' its entitlement to the UPE, section 109C will apply to deem the forgiveness as a Division 7A payment.

Just for completeness and to confirm my previous comment that Division 245 ITAA 1997 (Commercial Debt Forgiveness regime) does not apply to the trust as a UPE is not 'debt'.

## **2.2 DIVISION 7A – SECTION 109D 'LOANS' – TR 2010/3**

### **2.2.1 OVERVIEW TR 2010/3**

The more topical issue for this presentation concerns the Commissioner of Taxation's recent issue of taxation determination of TD 2022/11, the practical implications of the withdrawal of both TR 2010/3 and PS LA 2010/4 as from 1<sup>st</sup> July 2022 and the differences between the various taxation rulings

To the extent that taxation determination TD 2022/11 introduces yet another 'line in the sand' for the treatment of unpaid trust distributions to a company, a brief overview of the historical developments of the application of section 109D in relation to unpaid trust distributions is relevant.

### **2.4.2 TR 2010/3 – NATURE, APPLICATION AND IMPLICATION**

The Commissioner first published the "unlegislated/non-court related" the Division 7A changes to the taxation treatment of unpaid trust distributions to a corporate beneficiary in taxation ruling TR 2010/3, where the trust distributions were either retained by the trustee (section 109D) or alternatively on-lent to shareholders or associates of the shareholder by the trustee (subdivision EA)

In that taxation ruling, the Commissioner ruled that the Division 7A 's definition of the term 'loan' provided by section 109D(3), included inter alia arrangements whereby a private company provided a shareholder or associate thereof with 'financial accommodation':

*1. This Ruling expresses the Commissioner's opinion on the circumstances in which a private company with a present entitlement to an amount from an associated trust estate makes a loan to that trust within the meaning of subsection 109D(3) of Division 7A of Part III (Division 7A) of the Income*

Tax Assessment Act 1936 in circumstances where funds representing that present entitlement remain intermingled with funds of the trust.

**Subsection 109D(3)** then and now provides that the term 'loan includes:

- (a) *an advance of money; and*
- (b) **a provision of credit or any other form of financial accommodation;** and
- (c) *a payment of an amount for, or on account of, on behalf of or at the request of, an entity, if there is an express or implied obligation to repay the amount; and*
- (d) *a transaction (whatever its terms or form) which in substance effects a loan of money*

From a practical perspective, it was paragraph 109D(3)(b) that represented the critical change in application to unpaid distributions. As noted in the ruling, the Commissioner stated that:

*19. A private company beneficiary provides financial accommodation to the trustee of a trust in respect of which it has a UPE if, under a consensual agreement:*

- *the private company supplies or grants some form of pecuniary aid or favour to the trust; and*
- *a principal sum or equivalent is ultimately payable to the private company.*

Suffice it to state, in most family-based trust arrangement, the entities that control the company are invariably the same entities (or associates thereof ) that control the trustee. Accordingly, the 'consensual agreement' element would usually be typically satisfied.

The legal rationale for the Commissioner's section 109D application was a result of the Commissioner's technical conclusion:

- (a) the equitable obligations/entitlements that arise when a beneficiary is made presently entitled to trust income.

*34. When a beneficiary is presently entitled to an amount from a trust estate, it has an equitable right to that amount. That is, the beneficiary has rights in equity and not, without more, as a result of any debtor-creditor relationship. (Commissioner of Inland Revenue v. Ward (1969) 1 ATR 287 at 313.)*

and

- (b) the company providing financial accommodation to the trustee:

*104. Accordingly, if funds representing a subsisting UPE are used for trust purposes in such a way with the knowledge and acquiescence of the private company, in allowing this to continue the private company provides a benefit to the trustee of the trust. Even if there is a sub-trust, in allowing the funds representing the UPE to be used for the trust purposes of the main trust (such as is set out in subparagraph 103(ii) of this Ruling), the private company provides a benefit to the trustee of the main trust.*

Having regard to typical tax structuring arrangements, a discretionary trust will conduct the business and/or holds income earning assets and the trustee appropriates the trust income distributions to a company.

The principal reasonings for this structure interaction using the company as a trust beneficiary, includes:

- (a) The statutory need to distribute the income of the trust on an annual basis to ensure that section 99A did not apply to the trust income and taxed at the top marginal rate of tax;

- (b) To have the income of the trust taxed at the corporate tax rate (if a business trust – base rate entity);
- (c) To retain the use of the assets within the trust structure to fund working capital requirements of the trust and/or further investment acquisitions; and
- (d) Access Division 115 to reduce any capital gains.

### 2.4.3 PRACTICAL CONSEQUENCES OF TR 2010/3

Relevantly, TR 2010/3 grandfathered UPE's that arose before 16 December 2009 with the consequence these UPE's would not cause any Division 7A issues unless there was some change made to those pre-existing December 2009 unpaid amounts, albeit subdivision EA could still apply.

Notwithstanding the TR 2010/3 change to the application of Division 7A to unpaid trust distributions payable to a corporate beneficiary, the practical implications of the taxation ruling was ameliorated by the issue of PS LA 2010/4 and Section 3 Sub-trust options.

More specifically, PS LA 2010/4 provided for a 'sub-trust' arrangement to be facilitated which negated the section 109D implications:

*49. A UPE will not be considered to be a loan to which Division 7A applies if the funds representing the UPE are held on sub-trust for the sole benefit of the private company beneficiary.*

...

*51. However, it is common for trust deeds to expressly provide that UPEs are to be held on a sub-trust and that the trustee has wide powers to invest the amount held in the sub-trust. The setting up of the sub-trust may therefore happen without any requirement for the trustee to resolve to do so.*

*52. Subject to paragraph 54 of this practice statement, the ATO will consider the following to evidence the existence of a sub-trust:*

- where the amount representing the UPE is set aside separately in the accounts of the main trust as being held on trust for the private company beneficiary*
- where separate accounts are prepared for the sub-trust, or*
- where a separate bank account is opened in the name of the trustee as trustee for the private company beneficiary in respect of the funds within the sub-trust.*

...

*55. The ATO will consider that the funds in the sub-trust are held for the sole benefit of the private company beneficiary where:*

- the trustee of the sub-trust invests the funds representing the UPE in the main trust on commercial terms pursuant to a power as trustee to do so, and*
- all the benefits from the investment flow back to the sub-trust and the private company beneficiary, and*

- *all the benefits (for example, annual return on investment) are actually paid to the private company beneficiary by the lodgment day of the tax return of the main-trust for the year in which the return arises.*

...

*58. The ATO will consider that the funds in the sub-trust are held for the sole benefit of the private company beneficiary if the funds are invested in the main trust using one of the following investment options:*

*Option 1 - invest the funds representing the UPE on an interest only 7-year loan (see paragraphs 62 to 73 of this practice statement)*

*Option 2 - invest the funds representing the UPE on an interest only 10-year loan (see paragraphs 74 to 85 of this practice statement)*

*Option 3 - invest the funds representing the UPE in a specific income producing asset or investment (see paragraphs 86 to 94 of this practice statement)*

Notably, of the options provided, only option 3 specifically required the sub-trust to be applied to a specific asset/investment. More usually, the sub-trust amount was mixed with the general trust assets.

Consequently, Options 1 or 2 – interest only loans were implemented to protect the unpaid trust distributions from the more commercially disadvantage of a companying Division 7A loan arrangement (section 109M – 7 years P & I requirement).

Accordingly, the sub-trust arrangement, other than the additional administration duties, provided a 'half-way' remedy to the implications of TR 2010/3.

## **2.3 TAXATION DETERMINATION TD 2022/11**

### **2.5.1 OVERVIEW**

TD 2022/11 introduces some critically important practical changes to the Division 7A treatment of UPE having regard to the previous provisions of TR 2010/3 and PS LA 2010/4- note there has been no tax case or statutory amendment that pre-empts the revised TD 2022/11 changes.

TD 2022/11 provides that:

- (i) The TD 2022/11 guidelines applies to trust distributions made as from 1<sup>st</sup> July 2022;
- (ii) TR 2010/3 and PS LA 2010/4 cease to have application to trust distributions made after 1<sup>st</sup> July 2022;
- (iii) Confirms the timing issues for the application of Division 7A to unpaid trust distributions;
- (iv) Clarification when and what 'sub-trust' arrangement negates the application of a section 109D deemed dividend; and
- (v) Explains when subdivision EA applies to trust loans to a company shareholder or shareholder's associates.

### **2.5.2 APPLICATION OF TD 2022/11 – TIMING ISSUES**

TD 2022/11 will only apply to trust distributions to a private company that are made after 1<sup>st</sup> July 2022 that are:

- (i) Unpaid at the relevant date (time for lodgment of company tax return);

**If:**

- (ii) Not otherwise dealt with by a section 109M complying loan agreement;
- (iii) Dealt with a by a 'compliant' sub-trust arrangement; or
- (iv) The corporate beneficiary does not have a distributable surplus (refer to section 109Y)

To the extent that transactions are pre 1<sup>st</sup> July 2022 distributions and arrangements made in accordance with TR 2010/3 and PS LA 2010/4 they will not be impacted by the requirements of TD 2022/11:

*47. TR 2010/3 and Law Administration Practice Statement PS LA 2010/4 Division 7A: trust entitlements have been withdrawn with effect from 1 July 2022 for trust entitlements arising on or after that time. Taxpayers can continue to rely on both TR 2010/3 and PS LA 2010/4 in relation to trust entitlements that arose on or before 30 June 2022.*

48. For the avoidance of doubt:

- The Commissioner will take a compliance approach of not devoting compliance resources to sub-trust arrangements conducted in accordance with PS LA 2010/4 in respect of trust entitlements arising before 1 July 2022 (see paragraphs 97 and 98 of this Determination), even though those sub-trust arrangements may commence after 30 June 2022.*
- This Determination does not apply to unpaid present entitlements arising before 16 December 2009.*

The TD reasserts the Commissioner's previous ruling in relation to what constitutes the 'provision of financial accommodation' for the purposes of subsection 109D(3) referring to the authority of Corporate Initiatives Pty Ltd v Commissioner of Taxation [2005] FCAFC 62 (**note** this case dealt with the income injection test for the purposes of schedule 2F ITAA 1936):

*72. The Full Federal Court also concluded that, by not calling for payment of funds distributed to it, the private company beneficiary with knowledge of the UPE **provided a benefit to the trustee who could continue to use the trust funds for trust purposes, and stated that (emphasis added):***

*We therefore think the Tribunal was correct in proceeding on the basis that, on demand being made by SBS as trustee for CUT, Eldersmede would have to do something to arrange funds for the payment, whether by selling, or borrowing against, available assets, which would then no longer be available for other trust purposes. Not having to do this was a benefit. Eldersmede was thus in a better or more favourable position than it would have been had it been required to fund the distributions.*

*73. After concluding that failing to call for payment of a UPE constitutes a benefit to the trustee, the Full Federal Court expressed difficulty in differentiating between the practical effect of a formally recorded loan and a beneficiary failing to call for payment of a UPE.*

Relevantly, the above authority relied in by the Commissioner is arguably simply based on the notion of whether the company received a benefit for the purposes of the injection test and not that the fact that the company by not calling for the payment of the trust distribution was the provision of financial accommodation!



A critical issue with regard to section 109D concerns the timing of a 'loan'. Subsection 109D(1) applies to a loan made during the relevant year. In relation to a trust distribution, the trustee will resolve to distribute the trust income as at 30<sup>th</sup> June whereby the beneficiary has a present entitlement as at that time.

However, unless the beneficiary has been appropriated a specific dollar amount, it is usual for the appropriation to be based on a specific percentage of the trust income. In either instance TD 2022/11 provides that the 'loan' is made in the year when knowledge of the amount of the beneficiary's entitlement.

*78. For financial accommodation to be provided, there must be a consensual arrangement between the parties. A consensual arrangement can only arise where a private company beneficiary:*

- has a UPE and has knowledge of an amount of trust income that it can demand immediate payment of from the trustee;*
- has had its present entitlement satisfied by way of a sub-trust and has knowledge of the use of a sub-trust fund.*

This requires two elements to be satisfied:

- (i) The requisite knowledge of the entitlement; and
- (ii) Knowledge of the actual amount.

With regard to the first element, it will be most unusual that this element will be not be satisfied. Note as the TD 2022/11 provides:

*83. If the same person or persons are the directing mind and will of both the relevant private company beneficiary and the trustee in respect of affairs relevant to the private company beneficiary's UPE (such as the treatment of that UPE and/or dealings with that UPE), then subject to sufficient evidence to the contrary the Commissioner takes the view that both the private company beneficiary and the trustee know what the other knows because they have this same directing mind and will.*

With regard to the second element, knowledge of the actual amount will invariably be when the financial statements for the trust are completed, albeit a fixed amount or a percentage based amount.

*88. Where there is a UPE, financial accommodation is provided at the point in time when the private company beneficiary has knowledge of an amount of trust income that it can demand immediate payment of from the trustee and does not exercise its right.*

*89. The time when the amount of a beneficiary's entitlement is known will typically arise after the end of the income year, in the following income year. This will be the case whether the entitlement is expressed as:*

- a fixed amount from the trust income*
- a percentage of trust income, or some other part of trust income identified in a calculable manner, or*
- a combination of fixed and calculable amounts.*

*90. Generally, the distributable income of a trust estate for an income year is only capable of being determined with sufficient certainty to quantify the amount of the entitlement when accounts are finalised. This will usually be after the income year has ended*

Accordingly, the section 109D timing issues will be as follows:



The above diagram illustrates the section 109D timing issues, supported by paragraph 12 tax determination: 2022/11

12. The time when the amount of a beneficiary's entitlement is known will typically arise after the end of the income year, that is, in the **following income year**, in which the entitlement arises. This will be the case whether the entitlement is expressed as:

- a fixed amount from the trust income
- a percentage of trust income, or some other part of trust income identified in a calculable manner, or
- a combination of fixed and calculable amounts.

### 2.5.3 ACIS TRUST DEED – TD 2022/11 TREATMENT OF AMOUNT SET ASIDE ON SUB-TRUST

As was referred to earlier in this paper, using the standard Acis discretionary trust deed as a reference source, that deed provided the trustee with the options to 'set aside' the trust distribution:

#### 4.9 Amounts Set Aside

*Any amount Set Aside or held by the Trustee on behalf of a Beneficiary under this Deed, will no longer form part of the Trust Fund, but will be held by the Trustee as a separate trust fund upon trust for the relevant Beneficiary absolutely. The Trustee has the Right (but not the Obligation), pending payment to the Beneficiary, to invest or apply that amount for the benefit of the Beneficiary or deal with that fund, or any resulting Income, in any manner provided for in this Deed in relation to the Trust Fund.*

That is, the Acis trust deed and the actions of the trustee in accordance with clause 4.9 is sufficient to evidence the existence of the creation of a sub-trust.

Whereas with TR 2010/3, the above process to 'set aside' the trust distributions on the sub-trust arrangement in compliance with PS LA 2010/4 negated the section 109D issues.

However, TD 2022/11 adopts a stricter application of the sub-trust rule.

The revised TD 2022/11 application of sub-trust arrangements is illustrated by Example 2:



## **Example 2 - circumstance two: sub-trust**

### *Additional facts*

32. In respect of amounts resolved to be distributed to a beneficiary, the trust deed of AB Family Trust gives Trustee Ltd the power to:

- pay such amounts to the beneficiary, or
- set aside and hold such amounts on sub-trust for the exclusive benefit of that beneficiary.

33. On 1 August 2023, after determining the net income of AB Family Trust, Trustee Ltd sets aside \$10,000 on sub-trust by:

- creating a sub-account in its bank account with a third-party deposit-taking institution
- transferring the amount of \$10,000 into the sub-account, and
- holding the ownership of this sub-account on sub-trust for the absolute benefit of X Co.

34. That is, Trustee Ltd is the legal owner of the sub-account, but in its capacity as trustee for the sub-trust. **The sub-account funds are neither intermingled with the funds of the AB Family Trust nor used to benefit the AB Family Trust** (for example, the funds are not used as security for, nor to offset, loans of the AB Family Trust).

35. The \$10,000 sub-account with the deposit-taking institution is corpus of the sub-trust and X Co, as the only beneficiary of this sub-trust, is entitled to all of the income derived in respect of that account. X Co has a new right to call for payment of the sub-trust and can call the sub-trust to an end.

36. When the sub-trust is settled, Trustee Ltd satisfies its obligation in respect of the distributed income and there is no outstanding UPE.

### *Application of Division 7A*

37. Upon settlement of the sub-trust, X Co has a new right to call for payment of the sub-trust and can call the sub-trust to an end.

38. In this example, no part of X Co's entitlement is used by Trustee Ltd for the purposes of AB Family Trust, or by or for the benefit of any other shareholder or their associate. Therefore, X Co has not provided financial accommodation to a shareholder or their associate, or made a loan to Trustee Ltd, in its capacity as trustee for AB Family Trust or the sub-trust, under the extended definition of a 'loan' in subsection 109D(3).

The critical factor (and exceptional circumstances) provided by the above example, is that the sub-trust amount is not intermingled with the funds of the trust.

Accordingly, and notwithstanding the fact that the Acis deed (and most trust deeds) provide that the unpaid distribution is set aside as a separate trust (sub-trust), as it will be more generally the instance, the fact that the sub-trust amount is 'mingled' with the other resources of the trust will result in the application of section 109D.

Consequently, and based on the application of TD 2022/11, a simple sub-trust arrangement where the relevant amount is not otherwise dealt with by the due date, by:

- (i) Paying the amount;
- (ii) Placing the sub-trust amount on a complying loan agreement; or

- (iii) Allocating funds to the sub-trust amount for the sole and absolute benefit of the corporate beneficiary,

The sub-trust amount will be a deemed dividend pursuant to section 109D.

Advisors will need to carefully consider the cash flow implications of the sub-trust changes resulting from TD 2022/11, albeit by the need to actually pay the trust distributions to the company or satisfy the unpaid trust distributions by the complying section 109M requirements – 7 year principal and interest payments.

A more fundamental strategy might also include a complete restructuring of the trust's business by transferring the business to a company (with the trust holding the shares – using a subdivision 122-A rollover for example)

#### 2.5.4 UPE - SET ASIDE ON A SUB-TRUST ARRANGEMENT

In addition to the above treatment of a sub-trust arrangement, the TD makes other significant rulings in relation to an UPE, namely:

*13. Where a private company beneficiary is made presently entitled to trust income, the trustee may be authorised to set aside an amount from the main trust and hold it on sub-trust for the exclusive benefit of the private company beneficiary. In this case, the amount set aside by the trustee ceases to be an asset of the main trust and forms the corpus of the sub-trust (the sub-trust fund). Where the trustee's obligation to pay the entitlement to trust income is discharged by the setting aside of the amount on sub-trust for the beneficiary, the trustee's obligation in respect of the entitlement to distributed income comes to an end and a new obligation arises for the sub-trustee under a separate trust.*

*14. The private company beneficiary has a new right to call for payment of the sub-trust fund and can call the sub-trust to an end. A choice by the private company not to exercise that right does not constitute financial accommodation in favour of the trustee in its capacity as trustee of the sub-trust, because the sub-trust fund is held for private company beneficiary's sole benefit.*

That is, when the UPE is set aside as a sub-trust amount, as per the Acis trust deed, the implications are:

- (i) The UPE obligation ceases to exist as it is discharged by the sub-trust arrangement;
- (ii) If the private company does not call for the payment of the trust amount, there is no provision of financial accommodation to the trust.

The implications flowing from the above are as follows:

- (i) The fact that there is no UPE existing as a consequence of the sub-trust arrangement, negates the application of subdivision EA.

Subdivision EA only applies where a trustee, inter alia:

- (a) makes a loan to an entity who is a shareholder of a private company; and
- (b) the trustee has an UPE owing to the private company.

That is, in the absence of an UPE, subdivision EA does not apply. This is confirmed by paragraph 148 TD 2022/11:

*148. As described in paragraph 13 of this Determination, where a private company beneficiary is made presently entitled to trust income and **the trustee satisfies that UPE by setting aside an amount from the main trust and holding it on sub-trust for the***

***exclusive benefit of the private company beneficiary, the present entitlement to income is paid and there is no UPE***

*In those circumstances, the conditions for Subdivision EA to operate are not satisfied.*

Further, if the unpaid distribution to the company has been made subject to section 109D and/or subjected to a section 109M loan agreement, subdivision EA will not apply:

*146. Consistent with the legislative context of Division 7A, an amount that has been treated as a loan and dealt with under section 109D (for example, a UPE that constitutes financial accommodation and is made subject to a complying loan agreement, as described in paragraphs 102 to 104 of this Determination) should be regarded as a loan for all purposes of Division 7A, including Subdivision EA. Accordingly, the Commissioner will not treat a UPE in those circumstances as a present entitlement that remains unpaid for Subdivision EA purposes. This is consistent with the position taken in TR 2010/3.*

- (ii) to the extent that the sub-trust amount is held for the absolute benefit of the corporate beneficiary, if the ‘**controlling minds**’ of the company allow by express or implied acquiescence the application of the sub trust

The concept of ‘controlling minds’ is explained by paragraph 83 in the following manner:

*83. If the same person or persons are the directing mind and will of both the relevant private company beneficiary and the trustee in respect of affairs relevant to the private company beneficiary's UPE (such as the treatment of that UPE and/or dealings with that UPE), then subject to sufficient evidence to the contrary the Commissioner takes the view that both the private company beneficiary and the trustee know what the other knows because they have this same directing mind and will.*

Finally, the sub-trust is regarded as a ‘transparent trust’ (refer to PS LA 2000/2) and as such there is no requirement for separate taxation returns to be prepared for the sub-trust.

### **2.5.5 SUB-TRUST AMOUNT DEEMED TO BE A SECTION 109D LOAN IN CERTAIN INSTANCES**

The contradiction that would appear to arise with the ruling is that a setting aside a trust distribution as a sub-trust amount, section 109D will apply where the company ‘allows’ its sub-trust amount to be applied for the use of an entity who is a shareholder or an associate of the shareholder.

This outcome will have section 109D implications if:

- (i) The company ‘allows’ its sub-trust amount to be generally used by the trustee for the trust’s benefit; and/or
- (ii) The company allows its sub-trust amount to be applied by the trustee to make a loan to a shareholder or associate of the company.

Incidentally this has the same taxation impact as if subdivision EA applied.

Whereas if the sub-trust amount is mingled with the other trust resources, with knowledge of the company, the company is deemed to have made a section 109D loan to the trustee, whether there is interest payable or otherwise.

**Note:** In either instance, it is the company that is making the financial accommodation and as such the company should facilitate the complying loan agreement to negate any section 109D application

The above is illustrated by example 3 of TD 2022/11:

***Example 3 - circumstance two: use of sub-trust fund by the trustee of AB Family Trust - no commercial rate of return***

### *Additional fact*

39. Assume the same additional facts as in Example 2 of this Determination and that Trustee Ltd uses the \$10,000 set aside on sub-trust fund for the purposes of AB Family Trust.

### *Application of Division 7A*

40. As X Co and Trustee Ltd are controlled by Ashley and Bo, X Co is taken to have knowledge that the sub-trust fund is being used by Trustee Ltd for the purposes of AB Family Trust. Trustee Ltd as trustee for AB Family Trust receives a benefit, being the use of the sub-trust funds. This is the provision of financial accommodation by X Co to Trustee Ltd as trustee for AB Family Trust.

41. X Co can call for payment of its entitlement held on sub-trust if it does not agree to those funds being used for the purposes of AB Family Trust. On the facts, there is no evidence to suggest that X Co does anything other than acquiesce to Trustee Ltd using those funds for the purposes of AB Family Trust. Accordingly, X Co allows (and is taken to agree to) the use of funds to which it is entitled for the purposes of AB Family Trust.

42. In this example, X Co has provided financial accommodation to Trustee Ltd as trustee for AB Family Trust. X Co is taken to have made a loan to Trustee Ltd under the extended definition of a 'loan' in subsection 109D(3) when the sub-trust fund was so used.

## 2.6 BENDELL [2023] AATA 3074

### 2.6.1 BACKGROUND TO CASE MATTER

Having regard to the simply facts of this case and the AAT's determination, it will be surprising if the Commissioner does not appeal the AAT's decision.

In broad terms, the AAT concluded that an unpaid present entitlement to income (or capital) of a trust estate **was not a loan** for the purpose of s 109D(3) ITAA 1936 and further that setting aside the UPE on a sub-trust arrangement does not generally end the existence of the UPE. Suffice it to say, this conclusion contradicts the Commissioner's long standing assertion that an unpaid present entitlement constituted the 'provision of financial accommodation by the company to the distributing trust.

Various, the AAT based their decision having regard to the statutory juxtaposition of section 109D(3) and subdivision EA and the relevance of a UPE to both provisions.

The facts of the case are not unduly complicated. The Commissioner asserted that...by failing to demand payment of the amounts of the trust distributions, Gleewin Investments made a 'loan' to the 2005 Trust for the purposes of section 109D.

The UPEs were not otherwise satisfied in the contemporary practical methods – that is no section 109M loan agreement, no PS LA 2010/4 treatment of the sub-trust amount, and no payment of the UPE by the due date stipulated in section 109D(1).

Note pursuant to the trust deed, the trust distributions had been set aside on a separate trust for the absolute benefit of Gleewin Investments.

Relevantly the AAT extensively discussed the statutory relationship of subdivision EA (which is reliant on an unpaid present entitlement due to a company) to the interpretation of section 109D(3), particularly as they noted that subdivision EA amended to previous section 109UB.

As an aside, the Commissioner's calculation of the deemed dividend generously did not apply the FIFO method of allocating offsets – that is amounts that reduce the outstanding obligations did a not

adopt the FIFO principle applied in some settings to the effect that the earliest obligation ought to be the first satisfied.

The period of time during which the transactions were made occurred during the 2013 to 2017 year of income.

The trust deed provided for various methods to satisfy the trust distributions and further provided that:

*(5) Any amount set aside for any beneficiary ...shall cease to form part of the Trust Fund and upon such setting aside ... shall thenceforth be held by the Trustee on a separate trust for such person absolutely with power to the Trustee pending payment over thereof to such person to invest or apply or deal with such Fund or any resulting income therefrom or any part thereof in the manner provided for in Clause 6 (5) hereof.*

This form of trust deed provision is the same as the Acis deed and most other modern standard trust deed precedents.

Importantly for an analysis of the TD 2022/11's treatment of sub-trust amounts, the facts in the Bendel case were that:

*Gleewin did not report any asset held separately, did not purport to alienate or create any interest in any identified asset to meet or correspond with Gleewin Investments' unpaid present entitlements, and did not report or account for any separate trust.*

## 2.6.2 ARGUMENTS OF THE PARTIES

The **taxpayer's arguments** were that:

- (i) The term loan used in section 109D does not extend to an amounts of trust income set aside on a separate trust:

*The statutory context and purpose of s 109D indicates that the definition of loan does not extend to amounts **of trust income which are either set aside for a beneficiary on a separate trust** or to which a beneficiary is presently entitled. Statutory context must be considered, particularly because that context might show that a word or words are used with some meaning other than their ordinary meaning. That is especially the case where the relevant words, here 'credit' and 'financial accommodation', do not have a fixed ordinary meaning but can have a wide range of meanings depending on context.*

- (ii) The assessing duplication that would occur having regard to both section s.109D and subdivision EA:

*A construction of s 109D(3) that includes unpaid present entitlements to companies as loans would lead to absurd and unintended results from the dual operation of s 109D and Subdivision EA. Such a result is to be avoided if possible.*

...

*It is immediately apparent that those provisions would have little, if any, work to do if the unpaid present entitlement to the company gave rise to a loan, and therefore a deemed dividend under s 109D, as the Commissioner contends. Instead, the dual operation of s 109D and Subdivision EA would lead to the multiple taxation of the same event or amount. There is no indications [sic] from the extrinsic material that such an absurd and punitive outcome was intended.*

*Indeed, the expressed reason for including the predecessor to Subdivision EA, s 109UB, in the Act that originally introduced Division 7A was to deal with the situation in which a company's present entitlement to trust income is left unpaid, including where the income is held on a separate trust. Concerns had been raised that Division 7A did not otherwise deal with that situation.[32]*

- (iii) A beneficiary does not make a loan to a trust where an amount of trust income is set aside and held on a separate trust for the beneficiary. That is, the entitlement to income was a function of a trust relationship and not a debtor and creditor relationship. In essence the taxpayer's argument was that:

*... there is a fundamental distinction between a trust relationship and a debtor/creditor relationship as is implied by a loan or credit or other financial accommodation.*

- (a) *Where the recipient of money is required to hold the money for the benefit of the other party (or a third party), there is a trust but not a debt.*
- (b) *Where the recipient is only required to repay the same amount of money at a future time and is free to use the money as his or hers in the meantime, there is a debt but not a trust.*

More broadly, the taxpayer argued that *... "it could never be suggested that a company that gives money to a trustee to be held on trust for the benefit of either the company or some third party or parties thereby makes a loan to the trustee, even under the extended definition in s 109D(3).*

The **Commissioner's counter arguments** were based on:

- (i) the view that an unpaid present entitlement constituted the provision of financial accommodation. That is:

*The phrase 'any other form of financial accommodation' covers a consensual arrangement where a beneficiary does not require the amount of a distribution to be paid, or does not exercise a power to bring a trust to an end, and in consequence a trustee retains the use of funds but remains obligated to pay the amount of the distribution in the future. ...*

- (ii) "...nothing was ... set aside and then transferred to a separate bank account, for example." (which replicates the Commissioner's position in the TD 2022/11.

- (iii) Subdivision EA does not duplicate the taxing point because once the UPE was set aside on a sub-trust arrangement, the beneficiary's entitlement were paid.

## 2.6.3 OBSERVATIONS OF THE AAT

### 2.6.3.1 AMOUNTS SET ASIDE ON SUB-TRUST

In the first instance the AAT considered the legal and equitable consequences when a trustee makes a beneficiary presently entitled to the income of the trust and that entitlement is set aside by the trustee.

As the AAT noted in relation to the setting aside the entitlement:

In circumstances where an 'entitlement to some part of a fund of property that is held on trust [is] **not ... reflected in an absolute beneficial entitlement to the whole or some part of any specific asset within that fund**', as is the case presently, the beneficiary's interest in the income of the trust **is thus 'an equitable obligation' on and of the trustee.**

That equitable obligation reflecting the beneficiary's interest in the income of the trust is not property the trustee owns or controls. Income is not property. At times income is a character given to a receipt, entitlement, or profit. And, at other times it is a measure of performance, of a fund divisible among a class, or of an entitlement. Cash or money, receivables, trading stock or some other blend of assets that represents the income are property. If any property



is created by the resolution to distribute or vest entitlements to income, it is the property of the beneficiary, namely the right to be paid. Such a resolution does not create property held by the trustee. **The trustee has an obligation, with corresponding rights of indemnity or exoneration.**

And the following determination (which accords with the accounting practice with most trust UPE's):

*In the present circumstances, where it is not possible to identify any asset or property held on any separate trust as conventionally understood, notwithstanding the acceptance of the parties that a separate trust was created, **what was created upon passing resolutions to distribute Gleewin's income was a right or entitlement for the beneficiary coupled with the corresponding obligation of the trustee of a nature contemplated by what Gageler J said in Fischer v Nemeske.***

The AAT's conclusion in relation to the above represents a fundamental change in the traditional taxation position of setting aside amounts on sub-trust:

*81. Each party's contentions that were based on the concept of a separate trust having the effect that the entitlements to income were discharged or paid are not accepted.*

### 2.6.3.2 SECTION 109D(3) DEFINITION OF A 'LOAN'

It is apparent that the AAT were mindful that using other statutory context to define the term 'loan' needed to recognise those other statutory contexts did not have an equivalent section 109UB or a subdivision EA.

Interestingly, and forcefully, the AAT rejected the Commissioner's contentions because:

*... the Tribunal cannot accept the contention that Subdivision EA does not apply in the present circumstances because the relevant unpaid present entitlements were held on a separate trust, with the entitlement to Gleewin's income being satisfied or paid.*

- (i) *As noted above, the Tribunal is not satisfied that there was any separate trust in the conventional sense.*
- (ii) *Secondary trust circumstances are specifically contemplated as within the Subdivision EA ambit: they referred to in the EM.[59] Even in a secondary trust circumstance, **the party intended to be taxed is the party in receipt of the in-substance loan funds, here Mr Bendel, through the Subdivision EA mechanism because, in substance, corporate profits are being provided by way of loan to a shareholder via the trust.***

Having rejected the Commissioner's position in relation to the interaction of section 109D and subdivision EA, the AAT then provided a statutory analysis of section 109D(3).

Section 109D(3) as thus.

Division 7A is an integrity regime:

- "...The evident purpose of Division 7A is to ensure that shareholders of private companies are not able to enjoy effective distributions of company profits in a tax-free form."*
- The former section 109UB (now subdivision EA) was introduced to cover the following situation:

*Trust distributions to corporate beneficiaries: It has been argued that the proposed legislation does not apply to arrangements where a corporate beneficiary has become presently entitled to net income of a trust and the amount is not paid by the trustee to the corporate beneficiary, but*

*continues to be held by the trustee who then provides a loan to a shareholder (or their associate) of the corporate beneficiary. These sorts of arrangements should be caught by Division 7A because, in substance, a loan of money from the private company to the shareholder (or their associate) has been effected via the trust. The proposed legislation will be amended to deal with this situation.*

As the AAT noted:

*Former s 109UB and Subdivision EA particularly focus on a situation with two features:*

- (i) an entitlement to trust income vested in a corporate beneficiary; and*
- (ii) a contemporaneous loan to a shareholder (or an associate of a shareholder) of the corporate beneficiary made by the trustee bearing the outstanding obligation to the corporate beneficiary.*

*These provisions (subdivision EA ) address a situation of the corporate beneficiary being regarded as in substance lending corporate funds to a shareholder (or associate) of the company.*

Of concern to the AAT was the spectrum that double taxation of the same amount:

*To accept the Commissioner's proposition that there is a loan to the Trustee meeting the terms of s 109D(3) feeding into an assessable dividend through the combined operation of Division 7A and s 44 and Division 6 of the 1936 Assessment Act, raises the spectre of taxing two people in respect of precisely the same underlying circumstance, namely the same UPE.*

*Two people would be taxed, one through Division 6 and the other through Division 7A, where a trustee has an unpaid present entitlement to a corporate beneficiary of the trust and within the prescribed time frames the trustee has lent money to a shareholder of that corporate beneficiary (or to an associate of such a shareholder).*

*If that same shareholder or shareholder's associate were the relevant beneficiary of the trust, and properly taxed under Division 6, that person would have two amounts included in assessable income, and, for the reasons set out in relation to Issue 2 below, would not be saved by s 6-25.*

...

*The Subdivision EA pathway to a Division 7A assessable dividend was not intended to create a second taxable dividend in addition to a s 109D dividend arising out of the same unpaid present entitlement. Nor is Subdivision EA expressed or intended to operate in a limited way, only taxing those circumstances that fall within its terms which do not otherwise fall within s 109D, for example because the corporate beneficiary is unaware of the UPE and therefore cannot be said to have taken any step that might be said to be a loan attracting s 109D.*

In conclusion, the AAT determined that:

101. *Having regard to:*

- (a) the policy of Division 7A to tax those who in substance enjoy the benefit of corporate profits without bearing taxation that would arise had the company paid dividends in the usual way;*
- (b) statutory construction principles that call for:*
  - (i) regard to statutory context and legislative history; and*
  - (ii) potentially competing provisions to be construed in a manner which 'gives effect to harmonious goals';*



- (c) *there being no tiebreaker provision which mandates which of two competing assessing provisions would apply if an unpaid present entitlement constituted a loan within the meaning of s 109D(3);*
- (d) *the s 109RB discretion not being designed to allow relieving discretions to be exercised outside the s 109RD(1)(b) gateways of honest mistakes and inadvertent omissions and thus not a discretion that would relieve inappropriate double taxing;*
- (e) *Subdivision EA being a specific, and therefore lead, provision containing an express set of rules that can be regarded as a particular path has been chosen to deal with the taxation effect of unpaid present entitlements in favour of corporate beneficiaries in prescribed circumstances;*
- (f) *the lack of clarity as to the nature of an unpaid present entitlement and the separate trust concept often broached in conjunction with the unpaid present entitlement topic;*
- (g) *the expressed explanation accompanying s 109UB, the predecessor of Subdivision EA, to the effect:*
  - (iii) *that an unpaid present entitlement in favour of a corporate beneficiary and a contemporaneous loan by the trustee to a shareholder in the corporate beneficiary (or associate) is in substance a loan by the company to the shareholder; and*
  - (iv) *that an amount to which a company is entitled 'held on a secondary trust for the benefit of the company' is regarded as unpaid and within the ambit of s 109UB;*
- (h) *the operation of Subdivision EA which taxes the shareholder in the foregoing circumstances as if the company had lent money directly to that shareholder which falls squarely within the Division 7A policy framework;*
- (i) *there being no provision in either of the Assessment Acts that anyone points to that expressly allows assessment of two people arising out of the same circumstance with one of those people potentially not enjoying any benefit of the corporate profits that are the underlying cause of the assessment,*

***the necessary conclusion is that a loan within the meaning of s 109D(3) does not reach so far as to embrace the rights in equity created when entitlements to trust income (or capital) are created but not satisfied and remain unpaid. The balance of an outstanding or unpaid entitlement of a corporate beneficiary of a trust, whether held on a separate trust or otherwise, is not a loan to the trustee of that trust.***

The above conclusion of the AAT is at variance to the Commissioner's long standing view, as noted in both TR 2010/3 and more recently in TD 2022/11.

The importance of this decision cannot be under-estimated having regard to the essence of the Commissioner's substantial Division 7A compliance regime whereby the Commissioner's treatment of UPE is founded on the proposition that by not calling for immediate payment of the trust distribution constituted the provision of financial accommodation.

The Commissioner will most certainly appeal!

However, of more immediate practical interest/concern for most taxation advisors will be the nature of advices to be provided to their clients in relation to the Division 7A treatment of UPE.

#### 2.6.4 POST AAT DECISION

Based on the AAT's determination, the following would be the taxation consequences for a corporate beneficiary in relation to UPE's:

- (i) a trustee's distribution of trust income to a corporate beneficiary is assessable pursuant to the application of section 97 to the extent that the corporate beneficiary is presently entitled to a share of the trust income;
- (ii) If the trust distribution is unpaid (UPE), the unpaid amount is not a 'loan' for the purposes of section 109D(3), **unless** there are separate arrangements between the trustee and the corporate beneficiary to put the amount on a debtor/creditor relationship;
- (iii) If the amount is set aside on a sub-trust arrangement pursuant to the powers of the trust deed, the UPE has not been paid, **unless** the trustee specifically allocates a trust asset to the beneficiary in settlement of the unpaid trust distributions (i.e., makes the beneficiary absolutely entitled to a trust asset); and
- (iv) If the trustee makes a loan to a shareholder or an associate thereof, at a time when the trustee has an UPE owing to a company, subdivision EA will apply and the loan recipient will be assessable pursuant to section 109XA.

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