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Division 7A - UPEs

The Red Wine Experiment

Written and presented by:

Ron Jorgensen
Principal
Harwood Andrews Lawyers

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INTRODUCTION

Abstract

To test if cabernet sauvignon improves comprehension and acceptance of the Commissioner of Taxation's views in *Ruling* TR 2010/3 and *Practice Statement* PSLA 2010/4 on Division 7A loans: trust entitlements.

Introduction

In 2009, Deputy Commissioner Mr Konza revealed a quantum change to the orthodox application of Division 7A of Part III ITAA 1936 (**Division 7A**) to unpaid present entitlements between a trust and a private company beneficiary.¹

The Commissioner's view that an unpaid present entitlement (**UPE**) was or became a Division 7A loan was extensively criticised as unsupportable and inconsistent with the original policy intent.²

The Commissioner's views on UPEs in TR 2010/3 are controversial and have significantly affected private client structuring and tax planning. The Commissioner's administrative solutions in PSLA 2010/4 are poorly explained and not supported by legislation. The Commissioner's approach does not address many collateral technical issues so is difficult to analyse and to apply.

This paper reviews and analyses:

1. the controversial aspects of the Commissioner's technical analysis and administrative solutions;
2. the impact on past and future distributions to private company beneficiaries;
3. the impact on drafting trust deeds, distribution resolutions and trust accounts;
4. drafting complying loan and sub-trust arrangements;
5. self-assessed corrective action options and applications to the Division 7A Panel; and
6. the choice of entity structures and entity restructuring options.

This paper revises and expands the writer's published views³ in response to the publication of TR 2010/3 and PSLA 2010/4.

This paper does not propose to reproduce all the criticism of the Commissioner's views which are detailed in the TR 2010/3 Compendium. However, some of the views are reproduced to identify and explain issues not sufficiently addressed by the Commissioner or arising when implementing the views in TR 2010/3 and administrative practice in PSLA 2010/4.

This paper assumes the reader has a strong working knowledge of Division 7A and the Commissioner's views in TR 2010/3 and PSLA 2010/4.

Legislative references are to the *Income Tax Assessment Act 1936* (**ITAA 1936**), the *Income Tax Assessment Act 1997* (**ITAA 1997**), the *Taxation Administration Act 1953* (**TAA 1953**), the *A New Tax System (Goods and Services Tax) Act 1999* (**GSTA 1999**) and the *Corporations Act 2001* (**CA 2001**).

¹ M Konza, 'Is the Tax Office widening its crackdown on lawyers and accountants presentation?', Taxation Institute of Australia, 31 March 2009, Canberra.

² ICAA, CPA, NTAA, TIA, LCA and TAI Joint Submission on Draft Taxation Ruling TR 2009/D8. 19 February 2010 and Joint Statement Tax experts challenge ATO on unpaid trust distributions 18 October 2010.

³ R Jorgensen, 'Unpaid present entitlement or loan – a Division 7A analysis', (2009) 13/1 *The Tax Specialist*, 2.

Overview of the Commissioner's view

According to the Commissioner, a UPE from a trust to a private company beneficiary which remains intermingled with the funds of the trust may be or become an expressed or implied 'ordinary loan' by expressed agreement, by mutual book entries or by trust book entries with knowledge and acquiescence by the private company beneficiary.⁴

Where the trust and the private company beneficiary form part of the same family group, the private company beneficiary will be presumed to have knowledge of and have acquiesced to the treatment in the absence of sufficient contrary evidence.⁵

The Commissioner calls these 'ordinary loans', 'section 2 loans' or 'type 2 loans'. The Commissioner's views apply to ordinary loans before and after 16 December 2009 (the date draft *Ruling* TR 2009/D8 was published).

According to the Commissioner, a 'subsisting UPE' (which has not been converted into an ordinary loan) may be or become an 'extended definition loan' (the consensual provision of financial accommodation or an in-substance loan) where the subsisting UPE is not held on sub-trust or is held on sub-trust but is not held and used for the sole benefit of the private company beneficiary.

A subsisting UPE held on sub-trust will be considered held and used for the sole benefit of the private company beneficiary where.⁶

1. **Option 1 – 7 year loan** at the variable 'benchmark interest rate' (7.4%)⁷ with interest paid annually and principal repaid at the end of the loan;
2. **Option 2 – 10 year loan** at the variable Reserve Bank of Australia 'prescribed interest rate' (10.3%)⁸ with interest paid annually and principal repaid at the end of the loan;
3. **Option 3 – sub-trust** with annual distributions of a share of the net income (including any net capital gain)⁹ derived from the investment with principal repaid or reinvested at the time of disposal of the investment; or
4. **Other ordinary loan equivalent** – the payment of an annual return at least equal to a repayment on an ordinary loan not disregarded under s. 109R ITAA 1936.¹⁰

The head trust and the sub-trust must choose Option 1 (7 year loan) or Option 2 (10 year loan) under an 'investment agreement'.¹¹ A choice cannot be swapped,¹² but different options can apply to different UPEs in subsequent years.¹³ The sub-trust does not have to prepare separate accounts or lodge separate income tax returns under Option 1 (7 year loan) or Option 2 (10 year loan).¹⁴

The Commissioner calls these 'extended definition loans', 'section 3 loans' or 'type 3 loans'. The Commissioner's views apply to any UPE that arose on or after 16 December 2009.

The Commissioner will permit taxpayers to self correct pre-16 December 2009 UPEs incorrectly recorded as a loan or which were recorded as loans as the result of an honest mistake or inadvertent omission by 31 December 2011 if certain preconditions are satisfied. Taxpayers that cannot satisfy these requirements may apply to the Commissioner for discretionary corrective action.¹⁵

⁴ PSLA 2010/3 at [10].

⁵ TR 2010/3 at [26].

⁶ PSLA 2010/4 at [51].

⁷ Year ended 30 June 2011; TD 2010/18.

⁸ Year ended 30 June 2011; see Table F5 at www.rba.gov.au/statistics/tables/index.html.

⁹ PSLA 2010/4 at [64].

¹⁰ PSLA 2010/4 at [60]-[61].

¹¹ PSLA 2010/4 at [69] and [81].

¹² PSLA 2010/4 at [64].

¹³ PSLA 2010/4 at [65].

¹⁴ PSLA 2010/4 at [77] and [89].

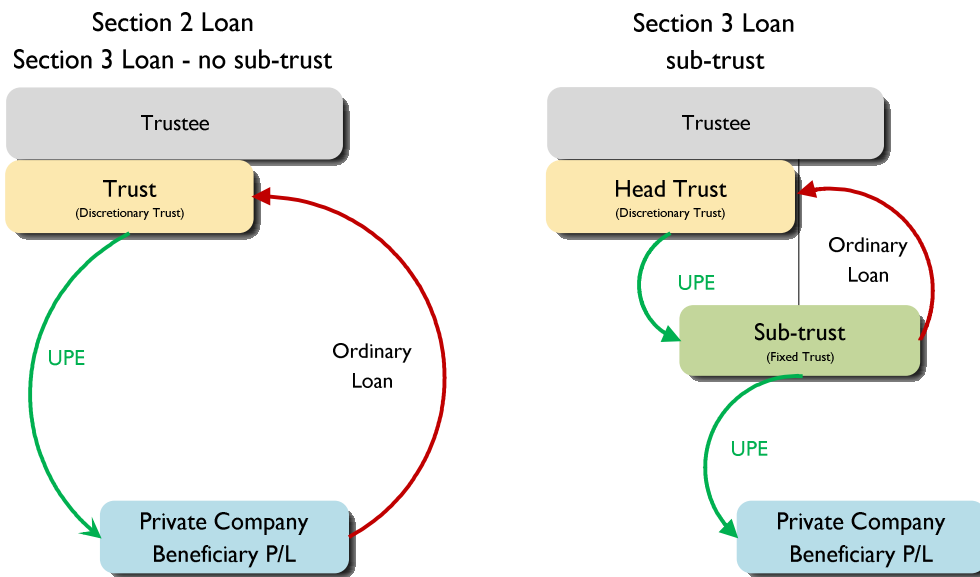
¹⁵ Section 109RB ITAA 1936; TR 2010/8 (and the proposed PSLA).

The Commissioner considers that s. 109D ITAA 1936 can apply concurrently with Subdivision EA ITAA 1936 (**Subdivision EA**) and the Commissioner will apply s. 109D to the exclusion of Subdivision EA on an administrative basis to correct any unintended taxation consequences.¹⁶

Conclusion

The analysis of Division 7A and TR 2010/3 and PSLA 2010/4 will depend on whether the UPE is an ordinary loan or an extended definition loan and whether or not there is a sub-trust under the extended definition loan.

The following diagrams represent the alternate treatments:



FOUNDATIONS OF DIVISION 7A

Introduction

It is necessary to understand the structure of Division 7A to discuss the controversial aspects of the Commissioner’s views and to consider structuring to address those views. Below is a non-exhaustive summary of the relevant provisions to assist with the analysis in this paper.

From 4 December 1997,¹⁷ the amount of a payment or a loan¹⁸ made or a debt forgiven¹⁹ by a private company to or for the benefit of a shareholder (or an associate) is a deemed dividend to the shareholder (or the associate)²⁰ to the extent of the private company’s distributable surplus²¹, unless exempt,²² fully repaid within the required time or the Commissioner exercises a discretion to ignore or modify the operation of the provisions.²³

A payment or a loan made or a debt forgiven by a trust to a shareholder (or associate) of a private company beneficiary where there is or there becomes a UPE to a private company beneficiary is treated as a dividend to the shareholder (or associate) under Subdivision EA.

¹⁶ TR 2010/3 at [185].
¹⁷ The effective date of *Taxation Laws Amendment (No. 7) Act 1997*.
¹⁸ Pre- 4 December 1997 loans may become subject to Division 7A where varied.
¹⁹ Forgiven after 4 December 1997 regardless of when the debt was created.
²⁰ S. 44 ITAA 1936.
²¹ S. 109Y ITAA 1936.
²² S. 109G – 109R ITAA 1936.
²³ S. 109RB – 109RD ITAA 1936.

The deemed dividend occurs at the end of the income year in which the private company makes the loan, advance or payment (usually 30 June).

The amount of the deemed dividend is limited to the profit and unrealised gains distributable surplus of the private company.²⁴

The deemed dividend is not franked,²⁵ but the franking credit is debited from the private company's franking account²⁶ so cannot be utilised to frank future dividends.

Private Company & Associates

Division 7A applies to private companies and private company shareholders (and associates).

A 'private company' does not include a public company listed on a stock exchange unless the public company is closely held or controlled.²⁷

From 1 July 2009, Division 7A also applies to closely-held corporate limited partnerships²⁸ and non-resident private companies²⁹ which were used to avoid the application of Division 7A.

The provisions apply to shareholders. Division 7A applies to certain non-share equity interests and equity holder's interests which were share equivalents.³⁰

The provisions apply to a shareholder's 'associates' within the wide definition of s. 318 ITAA 1936.³¹

An 'associate' of a shareholder will potentially include all applicable entities for Division 7A planning purposes including a relative of a shareholder, a trust in which the shareholder is a beneficiary, the beneficiary of a trust which is a shareholder in the private company, the relative of a beneficiary of a trust which is a shareholder in the private company and a partner in a partnership in which a shareholder is also a partner.

The provisions apply to current shareholders and associates and former or future shareholders and associates where a reasonable person would conclude that the payment, loan or forgiveness occurred because of that relationship existing at some time.³²

These extended concepts expand the operation of and make application of Division 7A very complex.

Payment, Loan or Forgiveness

Division 7A distinguishes between a payment (s. 109C ITAA 1936), a loan (s. 109D ITAA 1936) and a forgiveness of a debt (s. 109F ITAA 1936). Specific provisions apply to guarantees which are not discussed in this paper.

The concept of 'payment' is extended to include payments and crediting of an amount to, for or on behalf of the entity and transfers of property³³ and third party payments will constitute relevant payments to the shareholder (or associate).

There is some uncertainty surrounding journal entry payments. On a literal interpretation, journal entries will constitute relevant 'payments' to the shareholder (or associate). However, mere book entries do not

²⁴ S. 109Y ITAA 1936.

²⁵ S. 202-24(g) ITAA 1997.

²⁶ S. 205-30, Item 8, ITAA 1997.

²⁷ S. 103A ITAA 1936.

²⁸ S. 109BB ITAA 1936.

²⁹ S. 109BC ITAA 1936.

³⁰ S. 109BA ITAA 1936.

³¹ S. 109ZD ITAA 1936.

³² e.g. S. 109C(1)(b) ITAA 1936.

³³ S. 109C(3) ITAA 1936.

establish 'payment' unless underpinned by a valid agreement or transaction³⁴ or without the assent of the recipient.³⁵ An agreed set off will constitute a payment.³⁶ The Commissioner appears to be aligning the rules for when a book entry will constitute a loan with when it will constitute a payment.

The concept of 'loan' is extended.³⁷ Much of the Division 7A controversy concerns the interpretation of 'loan' (discussed below). Multiple loans to an entity on similar terms during a year constitute an 'amalgamated loan'.³⁸

A debt is forgiven if formally or effectively waived or otherwise extinguished, becomes statute barred, transferred to a related entity or exchanged for shares under the commercial debt forgiveness rules.³⁹

A loan that has not otherwise constituted a dividend or deemed dividend may become a deemed dividend in the income year the 6 year limitation period expires or the private company alters its intention not to require or enforce repayment.⁴⁰

Where loans are transferred intra-group during restructuring, the loans may constitute a 'debt park' debt forgiveness.⁴¹ Division 7A has priority over the debt forgiveness rules.⁴²

Again, these extended concepts expand the operation of Division 7A and make restructuring very complex.

Interposed entities

A payment or a loan made through interposed entities can be traced to the target shareholder (or associate).⁴³ Accordingly, a payment or loan from a private company to an interposed entity which then makes a payment or loan or forgives an amount to shareholder (or associate) of the private company will be a deemed dividend.

Careful consideration and detailed knowledge of intra-group transactions is required to ensure that an indirect payment, loan or forgiveness is not inadvertently made, especially during restructuring, which may contravene Division 7A.

Exemptions

Exempt transactions include inter-private company loans,⁴⁴ forgiveness of intra-private company debts or forgiveness arising upon bankruptcy or undue hardship and loans previously treated as deemed dividends,⁴⁵ arm's length discharge of an obligation of a private company (s. 109J ITAA 1936), amounts taxable under another provision,⁴⁶ amounts subject to a written complying loan (s. 109N ITAA 1936), employee share scheme loans, or demerger dividends.

A loan will be an exempt s. 109N complying loan if made in writing⁴⁷ with annual principal and interest repayments at the variable 'benchmark interest rate' with a maximum term of 7 years or 25 years if secured by a mortgage over real property with a loan to value ratio (**LVR**) of no more than 90%.

³⁴ *FCT v P Iori & Sons P/L* (1987) 19 ATR 201 at 216-217 – Deduction by private company for journal entries as contribution to a superannuation fund which were retained by the private company and described as loans where there were common directors of the private company with the trustees and members of the superannuation fund.

³⁵ *Manzi v Smith* (1975) 132 CLR 671 at 674 – Preference payment claim by liquidator for private company journal entries recording loans to DM, MM, AM and MD where DM, MM and AM were directors and DM, MM, AM & MD were shareholders.

³⁶ *Whim Creek Consolidated (NL) v FCT* (1977) 8 ATR 154 – Allotment of shares setoff against loan by shareholder by agreement inferred by correspondence between the company and the shareholder.

³⁷ S. 109D(3) ITAA 1936.

³⁸ S. 109E ITAA 1936.

³⁹ Schedule 2C ITAA 1936.

⁴⁰ S. 109F(1) ITAA 1936.

⁴¹ S. 245-35(4) Schedule 2C ITAA 1936.

⁴² S. 109G ITAA 1936; S. 245-15(3) Schedule 2C ITAA 1936.

⁴³ S. 109T, 109V and 109W ITAA 1936.

⁴⁴ S. 109K ITAA 1936.

⁴⁵ S. 109GITAA 1936.

⁴⁶ S. 109L ITAA 1936.

⁴⁷ TD 2008/8.

Repayment, redrawing and refinancing is regulated to ensure the annual principal and interest repayment requirements are not circumvented.⁴⁸

An exempt complying s. 109N loan must be cash flowed and repaid, limiting the benefit of loans as a means for the ultimate owners accessing the private company's value.

A loan made by the private company in the ordinary course of the private company's business⁴⁹ on the usual terms made to arm's length parties is exempt.⁵⁰ The exemption is most relevant for trade debtors which include associate trade debtors.⁵¹

Subdivision EA

Subdivision EA applies to a payment, loan or debt forgiveness by a trustee to a shareholder (or an associate) of a private company beneficiary where there is a UPE from the trust to the private company beneficiary - the present entitlement to the private company beneficiary being effectively extracted from the trust.⁵²

Accordingly, the orthodox view was that Subdivision EA applied exclusively to UPEs and was triggered when the present entitlement was extracted. Subdivision EA was considered to be engaged but not triggered where a trust has a UPE to a private company beneficiary and the money was retained by the trust on the terms of the trust and reinvested in assets owned by the trust.

Much of the Division 7A controversy concerns the construction of the relationship between s. 109D and Subdivision EA.⁵³

Distributable surplus

The deemed dividend is limited to the amount of the private company distributable surplus⁵⁴ calculated as:

net assets + Division 7A amounts – non-commercial loans – paid up share value – repayment of non-commercial loans

'Net assets' means the amount (if any) at the end of the income year by which the private company's assets exceeds the sum of third party legal obligations and provisions for depreciation, annual and long service leave, amortisation for intellectual property and trademarks and other prescribed amounts appearing in the books. However, the Commissioner can revalue the assets where the assets are under or over values.

It is unclear whether the Commissioner will include internally generated goodwill (which is often the only significant off book asset for a family group) in distributable surplus upon revaluation.

The private company must give a Division 7A statement regarding any deemed dividends.

Corrective action

The Commissioner has a discretion to disregard a deemed dividend or to frank the deemed dividend where the failure to comply with Division 7A was the result of an honest mistake or inadvertent omission by the trustee, the private company beneficiary or another person (s. 109RB ITAA 1936).

PSLA 2007/20 provided self-corrective action for taxpayers for the year ended 30 June 2008. After that time, taxpayers have to apply to the Commissioner. Broadly, the Commissioner may disregard a deemed

⁴⁸ S. 109R ITAA 1936.

⁴⁹ As opposed to the ordinary course of a business of money lending or investment activities; *Franklin's Selfservice P/L v FCT* (1970) 125 CLR 52.

⁵⁰ S. 109M ITAA 1936.

⁵¹ TD 2008/1.

⁵² s. 109XA & 109XB ITAA 1936.

⁵³ See ICAA, CPA, NTAA, TIA, LCA and TAI Joint Submission on Draft Taxation Ruling TR 2009/D8, 19 February 2010 for a detailed history of the provisions and criticisms.

⁵⁴ S. 109Y ITAA 1936.

dividend of honest mistake or inadvertent admission and the taxpayer effects a complying s.109N loan and makes catch up payments of annual interest and principal.

TR 2010/8 expresses the Commissioner's views on exercise of the s. 109RB discretion. A Practice Statement is to be released. The Commissioner's view have be criticised because of the narrow and restrictive interpretation of what constitutes 'honest mistake or inadvertent omission'.⁵⁵

Conclusion

Division 7A is an extremely complex provision to apply even in simple arrangements. The Commissioner's views add to the complexity and uncertainty for advisers.

It is at this stage cabernet sauvignon should be administered.

REVIEW OF COMMISSIONER'S TECHNICAL ANALYSIS

Introduction

The Commissioner's view that a UPE was or became a Division 7A loan has been extensively criticised because the interpretation contradicts the underlying legislative purpose of the provisions, is supported by legally flawed arguments, renders the operation of Subdivision EA effectively redundant and creates adverse taxation consequences, including double taxation.

Paraphrased, s. 109D provides that a private company is taken to pay a dividend to an entity at the end of the private company's year of income (current year) if:

- the private company makes a loan to the entity during the current year; and
- the loan is not fully repaid before the lodgement day for the current year; and
- the entity is a shareholder or an associate of the shareholder in the private company when the loan is made; or
- a reasonable person would conclude that the loan is made because the entity was a shareholder or associate at some time; and
- an exclusion does not apply.

If the Commissioner's extended view of s. 109D is subsequently found to be incorrect by a Tribunal or Court, adopting the Commissioner's approach will be difficult for taxpayers to reverse or may result in Subdivision EA problems.

Ordinary loan flawed arguments

A s. 109D loan includes:⁵⁶

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

The Commissioner accepts that a UPE is not an ordinary loan,⁵⁷ but considers a UPE may be effectively replaced by an ordinary loan from the private company beneficiary to the trust.

The Commissioner considers that an ordinary loan may be made by an expressed agreement between the private company beneficiary and the trust. A written agreement, trust resolution or other documents are identified as express loan agreements.⁵⁸

⁵⁵ A O'Bryan, Division 7A Strategies, TIA Victorian Convention, 7 October 2010 at 34.

⁵⁶ Section 109D(3) ITAA 1936.

⁵⁷ TR 2010/3 at [7].

⁵⁸ PSLA 2010/4 at [20].

A written agreement may be insufficient to create an ordinary loan. A formal deed may be required to constitute good consideration and create a binding agreement.⁵⁹ Traditionally, the performance of an existing duty is not consideration sufficient to form a contract. Under the traditional concept of consideration, the trustee is already under a duty to pay the private company beneficiary the UPE, so without assuming further obligations (such as interest) or obtaining a concession (such as payment other than on demand) there is arguably no consideration to perfect a debt contract.⁶⁰

Some trust deeds specifically state that a distribution is to constitute an interest free loan repayable on demand from the beneficiary to the trust (or some variation on this approach). The trust deed may require amendment so that a UPE is not automatically converted to an ordinary loan or is converted to a complying s. 109N loan.

The trustee is usually provided the power to pay, apply or set aside an amount, each concept having a different basis and result. Accordingly, the trustee's resolution should make it clear that the distribution is set aside to avoid any loan inference that the money was paid and lent back or applied for the private company beneficiary by lending it to the trustee.

The Commissioner has arguably extended the scope of an ordinary loan by including implied agreements by family groups where there is knowledge and acquiescence with the purported loan treatment.⁶¹

The Commissioner considers that an ordinary loan is created pursuant to an implied agreement between the private company beneficiary and the trust where the private company beneficiary has knowledge (or imputed knowledge being part of a family group) that the trust has credited the amount as a loan in the trust accounts and the private company acquiesces to and has not acted inconsistently with that treatment.⁶²

The Commissioner's view of implied agreement in TR 2010/4 appears more limited than the original public statement by Deputy Commissioner Konza being limited to circumstances where the trust and the private company beneficiary both record the UPE as a loan in their accounts.⁶³

The Commissioner's view that imputed knowledge of the loan to the private company by being part of a family group is unclear and difficult to apply. The definition of 'family group' includes related entities that share the same directing minds and will; have the same entities or persons with the practical ability, or capability to control the family group.⁶⁴

For example, it is unclear whether it is a precondition that the entities satisfy the related entities test in the tax act⁶⁵ or the Corporations Law⁶⁶ in addition to the associates test. The tax act definition of related entity refers to individual relatives and partnership relationships. The Corporations Law definition refers to promoters, directors, shareholder and relatives of these people and a beneficiary or relative of a beneficiary of a trust of which the company acts as trustee. Arguably, the reference to related entity is unnecessary and irrelevant.

Also, it is unclear whether one considers the directors or shareholders of the corporate trustee or the appointors or guardians of the discretionary trust⁶⁷ or unit holders of a unit trust. Where these are different people, it is unclear how to resolve the issue of diffused control. Collateral documents such as shareholders' agreements, options to purchase interests and powers of attorney may be relevant in determining control.

The examples in the TR 2010/3 and PSLA 2010/3 rely upon very closely held common control. At least theoretically, it may be possible to sufficiently diffuse control of the group including by the appointment of

⁵⁹ N Seddon & M Ellinghaus, *ibid*, at [4.1] fn 5.

⁶⁰ N Seddon & M Ellinghaus, *ibid*, at [4.32] and [4.33].

⁶¹ TR 2010/3 at [60].

⁶² TR 2010/3 at [10]-[12].

⁶³ TR 2010/4 at [73]-[76].

⁶⁴ TR 2010/3 at [3].

⁶⁵ S. 26-35 ITAA 1997.

⁶⁶ S. 9 definition of 'related entity' CA 2001

⁶⁷ The Commissioner considers the appointor or guardian controls a discretionary trust for the purposes of the CGT small business concessions; TD 2006/67.

independent directors, shareholder, appointors or guardians so that the Commissioner's presumptions about knowledge and acquiescence do not apply.

In-substance loan flawed arguments

The Commissioner distinguishes between an ordinary loan and an extended definition loan (credit or other form of financial accommodation or in-substance loan). The Commissioner has arguably incorrectly extended the definition of loan by expansively construing 'other form of financial accommodation' and 'in substance effects a loan of money' rather than limiting them to forms of debt.⁶⁸

Arguably, the statutory definition of loan reflects the ordinary concept of loan but is extended by paragraph (b) to include transactions based on the common law concept of debt such as instalment payment terms and sale and lease backs (which do not contain an element of repayment)⁶⁹ and by paragraph (d) to include bills of exchange and promissory notes that are not themselves credit but are used as credit substitute which in substance effects credit transactions.

Paragraph (b) is a composite phrase with 'credit' arguably informing and limiting the other forms of financial accommodation.⁷⁰ The Commissioner analyses 'any other form of financial accommodation' independently of the concept of credit⁷¹ to include within the concept of loan the supply or grant of some form of pecuniary aid or favour. The Commissioner then cites *Corporate Initiatives P/L v FCT*⁷² as authority that not demanding payment of a UPE is a 'benefit' and being within the concept of loan, there being no practical difference to a loan.

This broader approach is not justified or would only be justified if 'any other form of financial accommodation' was a separate paragraph in the definition. Further, *Corporate Initiatives P/L v FCT* should be limited to its statutory context of Schedule 2F ITAA 1936 trust loss provisions.

The Commissioner has indicated that a test case is desirable to clarify these issues.⁷³ Accordingly, the approach adopted in applying, managing or restructuring should (if possible) ensure that a taxpayer is not disadvantaged if a Tribunal or Court rejects the Commissioner's views.

Sub-trust flawed arguments

The Commissioner considers that a 'subsisting UPE' (which has not been converted into an ordinary loan) may be or become an 'extended definition loan' (the consensual provision of financial accommodation or an in-substance loan) where the subsisting UPE is not held on sub-trust or is held on sub-trust but is not held and used for the sole benefit of the private company beneficiary.

PSLA 2010/4 provides Option 1 (7 year loan), Option 2 (10 year loan), Option 3 (sub-trust) and other ordinary loan equivalent approaches to managing extended definition loans.

Subject to the discussion below, to access the Option 1 (7 year loan), Option 2 (10 year loan), Option 3 (sub-trust) and other ordinary loan equivalent approaches it is necessary to establish that the UPE is held on a subsisting sub-trust.

The Commissioner's view regarding the existence and scope of a sub-trust is unclear, difficult to apply and requires further technical analysis. The Commissioner does not discuss the circumstances in which a subsisting UPE would not be held on sub-trust.

⁶⁸ Construed *noscitur a sociis* (the words are construed by the company they keep) within paragraphs (a) – (d). The author's original article and the Compendium to TR 2010/3 to D.1 refers to the *ejusdem generis* rule. Where all sub-paragraphs of the definition are taken as a genus the *ejusdem generis* rule would apply. Alternatively, the correct rule of construction within a sub-paragraph of the definition is *noscitur a sociis* which operates in a similar fashion: DC Pearce & RS Geddes, *Statutory Interpretation in Australia*, 6th ed LexisNexis 2006 at [4.20].

⁶⁹ *Prime Wheat Association Ltd v CSR (NSW)* (1997) 42 NSWLR 505 at 512; *Eastern Nitrogen Ltd v FCT* (2001) 108 FCR 27 at 39.

⁷⁰ It is not satisfactory at arriving at the meaning of a compound phrase to sever it into its several parts and to construe it by reference to the separate meaning of those several parts: *DSS v Ekis* (1988) FCR 382 at 385.

⁷¹ TR 2010/3 at [89].

⁷² *Corporate Initiatives P/L v FCT* [2005] 142 FCR 279 – concerned the provision of a benefit by not calling for a UPE under the trust loss injection rules in s. 270-15 ITAA 1936, benefit being defined very expansively to include (f) anything that, disregarding the receding paragraphs, is a benefit or advantage.

⁷³ National Tax Liaison Group Minutes 18 October 2010 at 7.

The Commissioner accepts the orthodox view that a beneficiary has an equitable right to the amount of a UPE which is not a debtor-creditor relationship.⁷⁴ There is, however, a contrary view that a UPE creates a debtor-creditor relationship where the trustee has an immediate and unconditional duty to pay the UPE to the beneficiary under an action for money had and received.⁷⁵

The Commissioner reasons that:

1. a UPE creates a sub-trust by the terms of the trust deed or by operation of law;⁷⁶
2. the funds remain intermingled with those of the head trust for the purposes of the head trust;⁷⁷ and
3. any income derived from the investment of the corpus of the sub-trust (for example, by the sub-trust lending funds to the head trust) is properly the income of the sub-trust and not the head trust.⁷⁸

The Commissioner's reasoning does not arguably have universal application to all forms of sub-trust.

The Commissioner's reasoning is founded on cases of a UPE to infant beneficiaries where the sub-trustee must have active duties during the infant beneficiaries' minority.⁷⁹ A sub-trust may not exist where it is a bare sub-trust to a private company beneficiary or the private company beneficiary is absolutely entitled to the underlying asset.

A sub-trust is created by declaration of trust over or equitable assignment of an equitable interest of the head trust.⁸⁰ The trust property of the sub-trust is distinct from the trust property of the head trust from which the sub-trust is derived.⁸¹ The interest of the sub-trust beneficiary is a subsidiary equitable interest to that of the head trust.⁸²

However, the 'illusory sub-trust doctrine' treats sub-trusts where the sub-trustee has no active duties to perform as circular and equivalent to an assignment to the sub-trust beneficiary.⁸³ The sub-trust relationship is ignored and a direct relationship exists between the head trustee and the sub-trust beneficiary.⁸⁴ Whether the illusory bare sub-trust doctrine exists in Australia is unclear.⁸⁵

A bare trust arises where the trustee holds property without any interest in the property other than that existing by being a trustee and having legal title and without any duty or further active duty to perform except to convey it to the beneficiaries. An active duty means duties bare or naked of the duties decreed by the settlor.⁸⁶ The trustee, however, retains its duties including of ownership, reasonable care and proper administration. *Jacobs' Law of Trusts in Australia* relevantly states:⁸⁷

[315] The term 'bare trust' is often used to describe a trust in which the trustee has no 'active duties' to perform. However, in *Corumo Holdings Pty Ltd v C Itoh Ltd* it was pointed out that as a matter of strict logic almost no situation could be postulated where a trustee in some circumstances does not have active duties to perform by, for example, being immediately bound to transfer the trust property to the beneficiary who was absolutely entitled. Furthermore, a trustee may be entitled by statutory provision or the terms of a trust instrument or court order to charge fees and may have a lien or charge upon the trust assets for those fees. The trustee may also have a lien upon the assets for costs properly incurred in the performance of an obligation to safeguard the trust property. Yet it may still be appropriate to

⁷⁴ TR 2010/3 at [34]; *Tindon P/L v Adams* [2006] VSC 172 relying upon *Re Baron Vestey's Settlement*; *Lloyds Bank Ltd v O'Meara* [1951] Ch 209; *IRC(NZ) v Ward* (1969) 1 ATR 287; *Euroasian Holdings P/L v Ron Diamond Plumbing (in liq)* (1996) 64 FCR 147.

⁷⁵ Referred to in passing without sufficient analysis at TR 2010/3 at [87]; see *Chianti P/L v Leume P/L* [2007] WASCA 270 at [77] relying upon *Edwards v Lowndes* (1852) 1 E & B 81; (1852) 118 ER 367 at 370; *R v Brown* (1912) 14 CLR 17 at 25; *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516 at [67].

⁷⁶ TR 2010/3 at [36].

⁷⁷ TR 2010/3 at [32] & [35].

⁷⁸ TR 2010/3 at [37].

⁷⁹ *Case 83* (1987) 18 ATR 3602 & *Case 108* (1987) 18 ATR 3772 – Distribution to infant beneficiary under sub-trust retained by the head trust as a loan with interest payable for the loan.

⁸⁰ *CSR (Vic) v Howard-Smith* (1936) 54 CLR 614 at 621-622 – H-S directed the trustees of his residuary beneficial interest under the Will of his wife to pay out directly to specified persons but his was insufficient to create a sub-trust over the equitable property.

⁸¹ Dr J Glover, 'Dissecting trusts and trusteeship: CGT an stamp duty consequences', (2007) 36 AT Rev 201 at 211

⁸² P Baker, 'The Benefit of Restrictive Covenants' (1958) 74 LQR 180.

⁸³ *Corin v Patton* (1990) 169 CLR 540; Dr J Glover, 'Dissecting trusts and trusteeship: CGT an stamp duty consequences', (2007) 36 AT Rev 201 at 211

⁸⁴ *Grainge v Wilberforce* (1889) 5 TLR 436; T held the trust for B as sub-trustee (without active duties) who held for D in an action for specific performance. *Re Lashmar* [1891] 1 Ch 258 – P held revisionary interest in land for B and B devised his interest to his executor on trust for his wife's life with the remainder to his son.

⁸⁵ Discussed extensively in *ISPT Nominees P/L v CSR (NSW)* (2003) 53 ATR 527.

⁸⁶ *Herdegen v FCT* (1988) 20 ATR 24 at 32-33.

⁸⁷ J. Heydon & M. Leeming, *Jacobs' Law of Trusts in Australia*, 7th ed, LexisNexis Butterworths Australia, 2006.

describe this as a 'bare trust'. ***Thus a more precise use of the term 'bare trustee' is to identify a trustee who has no interest in the trust assets other than that exist by reason of the office of trustee and the holding of the legal title, and who never has active duties to perform or who has ceased to have those active duties which the result that in either case the property awaits transfer to the beneficiaries or at their direction. [emphasis added]***

Where the trustee resolves to set aside income to a discretionary private company beneficiary under the normal power of appointment in a trust deed and no expressed obligations are imposed on the sub-trustee by the resolution or trust deed, a bare sub-trust would arguably arise and be ignored under the illusory sub-trust doctrine. An example trust deed clause would include:⁸⁸

"Set aside" in relation to a Beneficiary includes placing sums to the credit of such Beneficiary in the books of the Trust Fund.

Arguably, the sub-trust preconditions in TR 2010/3 and PSLA 2010/4 would not exist so the preconditions for a section 3 loan would not be satisfied.

The Commissioner requires (or presumes) that the private company beneficiary is entitled in possession to income and capital growth on the UPE and failure to pay those amounts constitutes financial accommodation.⁸⁹ While this is the equitable position, it is subject to alteration by the terms of the sub-trust.

The trustee's powers of investment presume that the investments are not wasting, are authorised and are vested in possession and preserved for the successor estates unless the trust terms states otherwise (the presumption in *Howe v Lord Dartmouth*).⁹⁰ Accordingly, unless the trust terms states otherwise, the beneficiary is entitled in possession to income and capital growth on the UPE corpus of the sub-trust fund.

Where the terms of the sub-trust arise by operation of law and do not incorporate the terms of the head trust deed⁹¹ the presumption in *Howe v Lord Dartmouth* would arguably apply and the failure of the private company beneficiary to receive income and capital growth could constitute a financial accommodation or in substance loan as defined by the Commissioner.

However, the terms of the sub-trust may authorise investment in wasting assets (that have no income or capital growth) and may vest the UPE in interest rather than possession (discussed below). Where the sub-trust incorporates the terms of the head trust that includes exclusion of the presumption in *Howe v Lord Dartmouth* arguably the private company beneficiary has no right to a return on the UPE or no right to demand immediate payment (discussed below) such that would constitute a financial accommodation or in substance loan as defined by the Commissioner.

The Commissioner's sub-trust examples in PSLA 2010/4 presume an expressed power to create a sub-trust in the manner provided for in the trust deed of the head trust in the following terms:⁹²

Clause 6: amount set aside for the Beneficiaries

Any amount set aside for any Beneficiary or held for a Beneficiary pursuant to Clause 5 shall not form part of the Trust Fund but shall upon such setting aside or upon the thirtieth day of June be held by the Trustee as a separate Trust Fund upon trust for such Beneficiary absolutely to invest or apply for the benefit of such Beneficiary or deal with such fund or any resulting income there from or any part thereof in the manner provided for in this Deed in relation to the Trust Fund.

The cited pro forma provisions do not refer to the typical provisions that exclude the presumption in *Howe v Lord Dartmouth* such as:⁹³

- (b) To apply all moneys at any time forming part of the Trust Fund in such investments or property whether involving liabilities or not or upon personal credit with or without security and upon such terms and conditions as the Trustee shall in its absolute discretion think fit...and notwithstanding that the same may be wasting or speculative or not income producing...

⁸⁸ Y. Grbich, G. Munn and H. Reicher, *Modern Trusts and Taxation*, Commercial Law in Context Series, 1978 at 285.

⁸⁹ TR 2010/3 at [21]-[25].

⁹⁰ *Howe v Lord Dartmouth* (1802) 7 Ves Jun 137 at 1848; 32 ER 56 at 60.

⁹¹ PV Baker and P St J Langhan, *Snell's Equity Sweet & Maxwell*, 29th ed, 1990 at 103.

⁹² PSLA 2010/4 at [124].

⁹³ Y. Grbich, G. Munn and H. Reicher, *Modern Trusts and Taxation*, *ibid* at 288.

Arguably, where the head trust (and the sub-trust by incorporation of the terms) has one of these *Howe v Lord Dartmouth* provisions, the sub-trust has no equitable right to any return other than payment of the UPE so does not provide any financial accommodation or in substance loan.

The Commissioner’s views should be revised to address the consequences of sub-trusts with provisions that preclude the private company beneficiary having any equitable entitlement to income and capital growth on the UPE corpus of the sub-trust fund.

Options 1 to Option 3

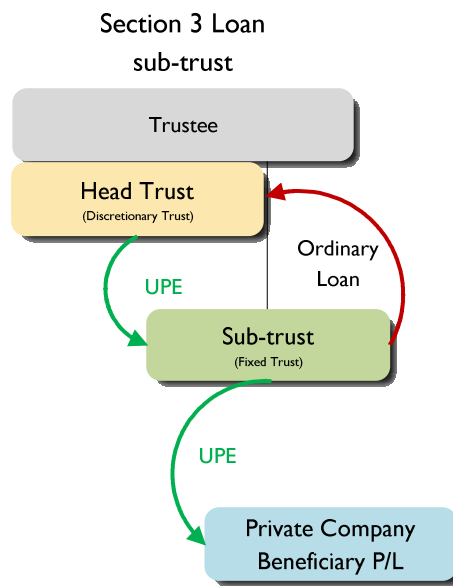
Option 1 (7 year loan), Option 2 (10 year loan), Option 3 (sub-trust) and other ordinary loan equivalent approaches apply where there is a sub-trust held for the ‘sole benefit of the private company beneficiary’.⁹⁴

The options are poorly drafted and inconsistent or contradictory changing between expression as a ‘loan’ and as a sub-trust investment.

Option 1 (7 year loan), Option 2 (10 year loan) and other ordinary loan equivalent are expressed as a loan with deductible interest payable and the principal repayable at the end of the loan term. A legally binding investment agreement must be entered into.

Broadly, Option 1 (7 year loan), Option 2 (10 year loan) and other ordinary loan equivalent constitute a loan by the sub-trust to the head trust and provided the interest and repayment of principal occurs as required, the UPE from the sub-trust to the private company beneficiary will be treated as not constituting a financial accommodation.

The Commissioner’s view on section 3 loans can be summarised in the following diagram:



It is unclear why a UPE between the head trust and the sub-trust is not converted into an ordinary loan under Option 1 (7 year loan), Option 2 (10 year loan) and other ordinary loan equivalent. Arguably, the loan between the head trust and the sub-trust would constitute a deemed dividend under Subdivision EA unless it is put on complying s. 109N loan terms.

The sub-trust nature of the Option 1 (7 year loan), Option 2 (10 year loan) and other ordinary loan equivalent approaches would be preserved if the investment agreement required the trustee to make a

⁹⁴ PSLA 2010/4 at [60].

trust distribution equivalent to the benchmark interest rate or prescribed interest rate and to pay out the UPE at the expiry of the term.

The head trustee and the sub-trustee (being the same entity in different capacities) must choose the options for each UPE and may choose an option 'in respect of the UPE in one particular year, and another option in respect of a new UPE arising in the following year'.⁹⁵ It is unclear whether different options can be chosen for different UPEs in the same year.

The investment agreement for the Option 1 (7 year loan), Option 2 (10 year loan) and other ordinary loan equivalent approaches must be legally binding. The form of the agreement is unclear (discussed below).

Under Option 3 (sub-trust) the trustee in the capacity of the head trust and the sub-trust must invest the funds representing the UPE in specific investments such as an interest bearing account or the acquisition of an interest in an income producing asset. This requirement may cause the private company beneficiary to be absolutely entitled to the specific assets altering the Commissioner's anticipated taxation of the arrangement.

Absolute entitlement

The Commissioner's administrative approach under the section 3 loans appears inconsistent with TR 2004/D25 in a number of respects. If not inconsistent, the Commissioner should clearly reconcile the views in PSLA 2010/4.

Option 1 (7 year loan), Option 2 (10 year loan) and other ordinary loan equivalent approaches create a loan asset of the sub-trust which would appear to create an absolute entitlement in the loan asset.⁹⁶

Option 3 (sub-trust) requires the trustee to allocate a 'specific investment' to the UPE which would appear to create an absolute entitlement in the asset through the chain of trusts.

Relevantly, PSLA 2010/4 states:

96. The investment must be documented in the tax return working papers of the main trust and the sub-trust and where the funds are used to acquire part of an asset, must clearly identify the percentage of the specific asset acquired using funds from the sub-trust.

Relevantly, TR 2004/D25 states:

10. The core principle underpinning the concept of absolute entitlement in the CGT provisions is the ability of a beneficiary, who has a vested and indefeasible interest in the entire trust asset, to call for the asset to be transferred to them or to be transferred at their direction. This derives from the rule in *Saunders v. Vautier* applied in the context of the CGT provisions (see Explanation paragraphs 41 to 50). The relevant test of absolute entitlement is not whether the trust is a bare trust (see Explanation paragraphs 33 to 40).
20. The most straight forward application of the core principle is one where a single beneficiary has all the interests in the trust asset. Generally, a beneficiary will not be absolutely entitled to a trust asset if one or more other beneficiaries also have an interest in it.
23. If there is more than one beneficiary with interests in the trust asset, then it will usually not be possible for any one beneficiary to call for the asset to be transferred to them or to be transferred at their direction. This is because their entitlement is not to the entire asset.
24. There is, however, a particular circumstance where such a beneficiary can be considered absolutely entitled to a specific number of the trust assets for CGT purposes. This circumstance is where:
- the assets are fungible;
 - the beneficiary is entitled against the trustee to have their interest in those assets satisfied by a distribution or allocation in their favour of a specific number of them; and
 - there is a very clear understanding on the part of all the relevant parties that the beneficiary is entitled, to the exclusion of the other beneficiaries, to that specific number of the trust's assets.
25. Because the assets are fungible, it does not matter that the beneficiaries cannot point to *particular* assets as belonging to them. It is sufficient in these circumstances that they can point to a specific number of assets as belonging to them. See Explanation paragraphs 80-126

Under Option 1 (7 year loan), Option 2 (10 year loan) and other ordinary loan equivalent approaches the private company beneficiary may have an absolute entitlement to the sub-trust loan asset.

⁹⁵ PSLA 2010/4 at [65].

⁹⁶ *Kafataris v DCT* [2008] FCA 1454.

Under Option 3, if the specified investment allocated to a private company beneficiary is a fungible asset (such as a share) or the sole interest in the asset, the private company beneficiary may be absolutely entitled to the asset.

The Commissioner considers that under Option 3 (sub-trust) as the sub-trust will acquire an interest in a specific investment or income producing asset, the normal tax laws, such as capital gains tax upon the disposal, may be applicable.⁹⁷ This view appears inconsistent where the private company beneficiary is absolutely entitled to specific investment allocated under the sub-trust.

If a beneficiary is absolutely entitled to a CGT asset as against a trustee (disregarding any legal disability), the CGT provisions apply to an act done by the trustee in relation to the asset as if the beneficiary had done it.⁹⁸ Broadly, the beneficiary is taxable rather than the trustee. Where a trust is a transparent trust (the beneficiary has an absolute, indefeasible entitlement to the capital and the income of the trust) the trustee does not have to lodge an income tax return.⁹⁹

Relevantly, TR 2004/D25 states:

26. If there is a chain of trusts (for example, the beneficiary of the head trust holds their interest on a sub trust for others) then the CGT provisions require absolute entitlement to be tested at the level of each trust in the chain.
27. If there is absolute entitlement in respect of each trust in the chain then the beneficiary of the sub trust would be entitled to obtain the sub trust's interest in the head trust and, if they did, then they would also be entitled to obtain the assets of the head trust. Having followed absolute entitlement through each trust in the chain it can be said then that for the purpose of the CGT provisions the beneficiary of the sub trust is absolutely entitled to the assets of the head trust (see Explanation paragraphs 127 to 132).
132. For example, if there was absolute entitlement in respect of each trust in the chain, then the beneficiary of the sub trust would be entitled to obtain the sub trust's interest in the head trust and, if they did, then they would also be entitled to obtain the assets of the head trust. Having followed absolute entitlement through each trust in the chain it can then be said that for the purpose of the CGT provisions the beneficiary is absolutely entitled to the assets of the head trust. Tracing would be more difficult where there were multiple beneficiaries and assets.

However, the Commissioner's view is that the sub-trust must record the assets, liabilities and income and capital gains in the sub-trust accounts, make annual distributions to the private company as sole beneficiary and prepare a sub-trust income tax returns (presumably under Division 6 ITAA 1936) appears inconsistent with the above analysis.¹⁰⁰

Although it is arguable that TR 2004/D25 is limited to CGT, the reasoning would appear to have broader application, including to Division 7A. It is unclear how PSLA 2010/4 and TR 2004/D25 should be (or can be) reconciled.

The interpretation renders the operation of Subdivision EA effectively redundant

Much of the Division 7A controversy concerns whether a trust UPE to a corporate beneficiary constitutes a s. 109D loan or is solely regulated by Subdivision EA.

Paraphrased, s. 109XB ITAA 1936 applies if:

- a trustee makes a payment or loan to or forgives a debt from a shareholder (or an associate) of a private company (that is not a company) (actual transaction) (amongst other things); and
- the company is presently entitled to an amount from the net income of the trust estate at the time the actual transaction takes place and the whole of that amount has not been paid to the company before the earlier of the due date for lodgement and the date of lodgement of the trustee's return of income for the trust for the year of income of the trust in which the actual transaction takes place;
or¹⁰¹
- the company becomes presently entitled to an amount from the net income of the trust estate after the actual transaction takes place but before the earlier of the due date for lodgement and the date for lodgement of the trustee's return of income for the trust for the year of income in which the

⁹⁷ PSLA 2010/4 at [94].

⁹⁸ S. 106-50 ITAA 1997.

⁹⁹ PS 2000/2: An exemption for the trustees of some trust estate from the requirement to furnish a tax return on behalf of the trust estate.

¹⁰⁰ PSLA 2010/4 at [96]-[98].

¹⁰¹ This condition applies on and after 12 December 2002.

actual transaction takes place, and the whole of that amount has not been paid to the company before the earlier of those dates.¹⁰²

The Commissioner limits the application of Subdivision EA to circumstances where there is a sub-trust and considers that Subdivision EA can apply concurrently with s. 109D because the provisions do not contain any anti-overlap rules.¹⁰³

Nothing in Subdivision EA refers to a sub-trust. However, extrinsic material in respect of the predecessor s. 109UB ITAA 1936 state that the persuasive opinion was that Division 7A would not apply to a loan by a trustee where an amount was held by the trustee under a separate trust for the benefit of the corporate beneficiary because the amount held on sub-trust had not actually been lent to by the private company to the trust.¹⁰⁴

Broadly, when construing legislation:

1. the apparent scope of a provision may be read down in a way that will be complementary with another;¹⁰⁵
2. the specific provision will have priority over a general provision where they same subject matter is specifically dealt with;¹⁰⁶ and
3. the later provision appearing in legislation prevails over the earlier provision where the two provisions cannot be reconciled.¹⁰⁷

Arguably, under the above rules of construction Subdivision EA has priority over s. 109D. Subdivision EA is engaged at the time of creating the present entitlement to the exclusion of s. 109D.

The Commissioner's construction purportedly reconciling the provisions and limiting the application of Subdivision EA by reference to the extrinsic material is arguably not appropriate.

The interpretation creates adverse taxation consequences, including double taxation

The Commissioner considers that a section 3 loan will continue to be a UPE so Subdivision EA will apply.¹⁰⁸ However, the Commissioner will administratively treat a section 3 loan as having been satisfied so there is no UPE for the purposes of engaging Subdivision EA.¹⁰⁹ If the sub-trust does not pay annual returns, the private company beneficiary will make a deemed distribution.

Accordingly, double taxation would occur where:

1. the head trust makes a payment, loan or forgiveness to a shareholder (or associate) under Subdivision EA; and then
2. the sub-trust fails to make a payment to the private company beneficiary under s. 109D.

Arguably, the potential for double taxation without a tie-breaker rule indicates that the Commissioner's interpretation is flawed.

Administrative protection limitations

The demarcation between TR 2010/3 (binding on ordinary loan and non-sub-trust extended definition loans) and PSLA 2010/4 (sub-trust extended definition loan) does not protect a taxpayer from primary tax if the taxpayer relies on Option 1 (7 year loan), Option 2 (10 year loan), other ordinary loan or Option 3 (sub-trust) should a Tribunal or Court determine that the Commissioner's views are incorrect.

¹⁰² This condition applies on and after 19 February 2004.

¹⁰³ TR 2010/3 at [172]-[182].

¹⁰⁴ TR 2010/3 at [173].

¹⁰⁵ DC Pearce & RS Geddes, *Statutory Interpretation in Australia*, *ibid* at [4.3].

¹⁰⁶ DC Pearce & RS Geddes, *Statutory Interpretation in Australia*, *ibid* at [4.32]; *generalia specialibus non derigant*.

¹⁰⁷ DC Pearce & RS Geddes, *Statutory Interpretation in Australia*, *ibid* at [4.33].

¹⁰⁸ PSLA 2010/4 at [112] contains an inconsistency or contradiction. The question concerns where subdivision EA can apply if the UPE is placed on sub-trust for the sole benefit of the private company beneficiary. However, the relevant option referred to is Option 1 (which is a section 3 loan).

¹⁰⁹ TR 2010/3 at [182]; PSLA 2010/4 at [108].

A public ruling protects a taxpayer from paying underpaid tax, penalty or interest in respect of the matters covered by the public ruling where the taxpayer has acted or omitted to act in accordance with the public ruling.¹¹⁰ Other publications, including practice statements, may be expressly published to be a public ruling.¹¹¹ Only the public ruling part is binding so the explanatory part and examples which are usually outside the part are not binding. If there is an inconsistency between two public rulings, the entity may apply either ruling.¹¹² A draft public ruling represents the administrative practice of the Commissioner¹¹³ and the Commissioner will not assess contrary to the draft public ruling where there is good or substantial reasons.¹¹⁴

A practice statement must be followed by a tax officer.¹¹⁵ A taxpayer that relies on a practice statement will remain liable for any tax shortfall (but not penalty or interest) if the practice statement is incorrect or misleading.¹¹⁶

The ruling part of TR 2010/3 does not address any of the options provided in PSLA 2010/4. PSLA 2010/4 has not been expressly published as a public ruling. Accordingly, adoption of the options in PSLA 2010/4 does not provide binding protection.

Since the Commissioner's view on sub-trusts was a change to a long held administrative practice and is considered controversial, the Commissioner should, arguably, have declared the options in PSLA 2010/4 to be a public ruling to protect taxpayers from primary tax should the proposed test case establish the Commissioner's views are incorrect.

Conclusion

The Commissioner's views add to the complexity and uncertainty for advisers.

Administering cabernet sauvignon regularly through the previous part of this experiment improved comprehension of the Commissioner's views but did not provide an appreciable improvement in certainty or acceptance.

It is at this stage autonomic drinking of cabernet sauvignon commenced.

IMPACT ON PAST AND FUTURE CORPORATE BENEFICIARY DISTRIBUTIONS

Introduction

Most taxpayers and advisers will seek to comply with the Commissioner's views. However, the uncertainty surrounding those views and the administration of those views will make compliance uncertain.

Taxpayers may decide the uncertainty is unreasonable or compliance is too expensive or onerous and will restructure to limit or avoid the issues.

¹¹⁰ TR 2006/10.

¹¹¹ TR 2006/10 at [26].

¹¹² TR 2006/10 at [53].

¹¹³ TR 2006/10 at [71].

¹¹⁴ TR 2006/10 at [39].

¹¹⁵ PSLA 1998/1 at [6].

¹¹⁶ PSLA 1998/1 at [19].

Impact on Pre 16 December 2009 Distributions

TR 2010/3 does not apply to a UPE that arose¹¹⁷ or was in existence before 16 December 2009.¹¹⁸ 'Arose' or 'in existence' is not defined but presumably means that a present entitlement must be legally created before 16 December 2009. Accordingly, advisers will have to determine if a UPE was created before 16 December 2009 to determine if it is subject to the Commissioner's views.

Present entitlement for the purposes of Division 6 ITAA 1936 must be made before the end of the income tax year in which it related in the sense of its year of derivation.¹¹⁹ The creation of a present entitlement is generally effective for the total income for the accounting period as determined at the end of the income year. Accordingly, few trusts will have effectively created present entitlements for the year ending 30 June 2010 prior to 16 December 2009.

Most trust deeds create a present entitlement by reference to the end of the accounting period. A sample clause could be:

The trustee will immediately before the end of each accounting period hold the net income (if any) and each class of income or capital of the trust fund of that accounting period that has not been the subject of an effective appointment or accumulation in trust successively for the default beneficiary or default beneficiaries, and if more than one, in equal shares as tenants-in-common.

Some unit trusts specifically provide for interim distributions. Few discretionary trusts provide for interim distributions, so it is unclear whether the trustee has a general power to make interim distributions other than by actual payment.

To have a pre-16 December 2009 UPE the trustee would have to pass a resolution or actually pay an amount to or for the benefit of the private company beneficiary before 16 December 2009 and not to pass any inconsistent resolution on or before 30 June 2010.

A present entitlement is usually created by resolution.¹²⁰ A written declaration or resolution will create the necessary present entitlement where the amount is not actually paid to or for the benefit of the beneficiary.¹²¹ The actual payment of an amount into a bank account in the name of the beneficiary will create the necessary present entitlement, unless there is some evidence to the contrary.¹²²

IT 329 states that present entitlement is created as follows:¹²³

9. The decisions are seen as confirming what was said in paragraph 19 of IT 328 see paragraph 3 supra. A declaration, resolution or other act of a trustee in an effective exercise of his discretion will amount to an application of income of a trust estate for the benefit of a beneficiary where :-
 - (a) a specific ascertainable portion of the income of the year in question is thereby immediately and absolutely vested in the beneficiary so that even though it might not be immediately paid to the beneficiary it becomes his absolute property and would form part of his estate in the event (sic) of his death;
 - (b) the declaration, resolution, etc, is final and irrevocable.
10. To the extent that a resolution conforms to these requirements it will be accepted that it evidences an application of trust income for the benefit of a beneficiary within the meaning of section 101.

Accordingly, if there was a written declaration or resolution entered into and signed prior to 16 December 2009 dealing with the income up to 16 December 2009 the trust deed could allow for the creation of a present entitlement to that income before 16 December 2009. The 30 June 2010 resolution would have to specifically deal with the balance of the income for the year without contradicting the previous resolution. A resolution that contradicted the pre-16 December 2009 resolution may override the pre-16 December 2009 resolution.

¹¹⁷ TR 2010/3 at [28].

¹¹⁸ PSLA 2010/4 at [13].

¹¹⁹ *Pearson v IRC* [1981] AC 753 at [23].

¹²⁰ TR 2010/3 at [33].

¹²¹ IT 328 at [19] and IT 329 at [9]-[10].

¹²² IT 328 at [22]-[23].

¹²³ IT 329

If there was no written declaration or resolution entered into and signed prior to 16 December 2009 it is arguable that actual payment of the amount into a bank account in the name of a beneficiary prior to 16 December 2009 would create a relevant present entitlement before 16 December 2009.¹²⁴ Again, the 30 June 2010 resolution would have to not contradict the pre- 16 December 2009 payment.

Quarantining Pre 16 December UPEs

A pre-16 December 2009 UPE will not be subject to s. 109F (debt forgiveness) because the UPE is not a loan.

Care is required in quarantining pre-16 December 2009 UPEs to ensure that they do not constitute a reimbursement agreement (s. 100A ITAA 1936). The application of the reimbursement agreement is not discussed in TR 2010/3 or PSLA 2010/4.

The Commissioner is considering the scope of s. 100A in priority technical issue PTI 1232.¹²⁵

S. 100A is an anti-avoidance provision that cancels the taxation of a beneficiary on certain trust distributions that are effectively diverted to a third party and then taxes the trustee on the trust distributions at the 46.5% rate.

S. 100A deems a beneficiary otherwise presently entitled by operation of the trust deed or by tax law¹²⁶ not to be so presently entitled. Division 6, Part III ITAA 1936 applies in the normal manner so that since is no presently entitled beneficiary the trustee is taxed under s. 99A ITAA 1936.

S. 100A applies to chains of interposed trusts taxing the trustee of the penultimate trust in the chain of successive distribution.¹²⁷ If the Commissioner's sub-trust analysis is correct, it would presumably apply to pre-16 December 2009 UPE and the sub-trust would be the penultimate trust subject to assessment. The Commissioner might experience practical difficulties in enforcing the assessment against the sub-trustee.

S. 100A is most obviously applicable to trust stripping arrangements¹²⁸ and loss trust injection arrangements¹²⁹, although other arrangements may be caught.

A 'reimbursement agreement' is defined broadly to include any formal or informal, expressed or implied or enforceable or unenforceable agreement, arrangement or understanding whenever entered into but does not include such entered into in the course of ordinary family or commercial dealings.¹³⁰

Each of the words agreement, arrangement or understanding entered into arguably requires at least two parties. Arguably, an arrangement between the directors of the company to pass a resolution constitutes a sufficient arrangement.¹³¹

A reimbursement agreement may provide for:¹³²

- the payment of money, including by way of a loan¹³³ or by release, failure to demand or to postpone payment of a debt;¹³⁴
- the transfer of property, including a chose in action or legal or equitable estate, interest, right or power in or over property;¹³⁵
- the provision of services or other benefits

¹²⁴ IT 328 at [22]-[23].

¹²⁵ <http://www.ato.gov.au/corporate/content.asp?doc=/content/00261214.htm>

¹²⁶ Section 101 ITAA 1936.

¹²⁷ Sections 100A(3A),(3B) and (3C) ITAA 1936.

¹²⁸ *Idlecroft P/L v FCT* (2005) 60 ATR 224.

¹²⁹ *Raftland v FCT* (2007) 65 ATR 336 (appeal reserved in High Court).

¹³⁰ Section 100A(13) ITAA 1936.

¹³¹ *Lutovi Investments P/L* 78 ATC 4708; but cf *East Finchley P/L v FCT* (1989) 20 ATR 1623 at 1639.

¹³² Section 100A(7) ITAA 1936.

¹³³ Section 100A(1) ITAA 1936.

¹³⁴ Section 100A(12) ITAA 1936.

¹³⁵ Section 100A(13) ITAA 1936.

to or for a person other than the beneficiary or for a group of person including the beneficiary.

It is unclear whether an understanding between the trustee and the private company beneficiary (or the controllers of those entities) that the private company beneficiary will delay demanding payment of a UPE constitutes a reimbursement agreement.

*East Finchley P/L v FCT*¹³⁶ concerned whether the appointment of \$585 of distributable income by a discretionary trust to each of 126 foreign beneficiary relatives constituted a reimbursement agreement. The court relevantly held:

It is sufficient for present circumstances to say that in a case where all that has happened is that a trustee has resolved to distribute to a beneficiary in circumstances where that beneficiary becomes presently entitled and thereafter enters into an arrangement with the beneficiary for a payment to be made by the beneficiary those facts alone will not bring the arrangement within the meaning of s 100A of the Act. And in my view it matters not that the trustee has some expectation that he could reach an arrangement with the beneficiary for reimbursement in the future.

Of course it would be a different case if the tribunal had concluded on the evidence before it that there was some arrangement reached between the trustee and the beneficiaries through the agency of Dr Thomas or his wife prior to the resolution of 23 June 1983. However, in the absence of any such specific finding and on the assumption that what the tribunal really meant to do was to find that the arrangement was the agreement for loan entered into after 30 June 1983, I think it must follow that the provisions of s 100A could have no application.

Arguably, an excluded reimbursement agreement must be entered into in the course of ordinary family or commercial dealing, but need not constitute ordinary family or commercial dealings. The agreement is not a reimbursement agreement if the wider context of the arrangement constitutes ordinary family or commercial dealings.

The scope of what constitutes ordinary family or commercial dealings is likely to be contentious.¹³⁷ Arguably, the exemption should apply where the payment does not exit control of and availability for the same economic unit. For example, husband and wife are an economic unit so movement of income between them is explicable by family dealings.¹³⁸ Where the third party is not of the same economic unit it is more likely that the arrangement will not be explicable by ordinary family or commercial dealings.¹³⁹

Accordingly, it may be necessary for pre-16 December 2009 UPEs to be paid down over time to reduce the risk of s.100A applying. More guidance may be provided by the Commissioner upon issue of the proposed PTI 1232 publication.

Impact on Post 16 December 2009 Distributions

Most taxpayers will not wish to act contrary to TR 2010/3 and PSLA 2010/4. Taxpayers will either seek to comply with the administrative safe harbours or restructure to limit or avoid the issues.

Option 1 (7 year loan) and Option 2 (10 year loan) are superficially attractive because they do not require any annual capital repayment as would a complying s. 109N loan. Further, any capital gain made on the disposal of trust assets can be distributed to individuals and not to the private company beneficiary, which would not be entitled to apply the CGT discount¹⁴⁰. Since the annual payment is a loan, it is an expense and payable regardless of whether the trust has distributable income or is in losses. These options are attractive for assets which will appreciate significantly.

In contrast, Option 3 (sub-trust) does not require a capital repayment within any prescribed time (other than on sale). Since the annual payment is a trust distribution, it is only payable to the extent the trust has distributable income or is not in losses. However, any capital gain made on the allocated asset must be distributed to the private company beneficiary, which is unable to apply the CGT discount. This option is attractive for income producing assets which do not appreciate significantly.

¹³⁶ *East Finchley P/L v FCT* (1989) 20 ATR 1623.

¹³⁷ For example, consider *Newton v FC of T* (1958) 98 CLR 1, *Peacock* (1976) 6 ATR 677 and *Jones* (1977) 7 ATR 229 in the context of s. 260 ITAA 1936.

¹³⁸ *Peacock* (1976) 6 ATR 677 and *Jones* (1977) 7 ATR 229.

¹³⁹ *Raftland P/L v FCT* (2007) 65 ATR 336.

¹⁴⁰ S. 115-10 ITAA 1997.

As discussed above, there are real risks with applying these options. Option 1 (7 year loan) and Option 2 (10 year loan) lock the taxpayers into a loan arrangement which may prove unnecessary and not reversible if a Tribunal or Court rejects the Commissioner's views.

Option 3 (sub-trust) maintains the existing UPE structure with the trustee managing distribution of net income sufficient to satisfy PSLA 2010/4. If a Tribunal or Court rejects the Commissioner's views, the requirement to pay a proportion of income and capital gain attributed to the specified assets could be effectively reversed.

The private company beneficiary may enter into a written loan (such as a complying section 109N loan) to obtain certainty in the application of Division 7A to avoid the uncertainty of complying with TR 2010/3 and PSLA 2010/4 discussed in this paper.

Assuming that the head trust did its 30 June 2010 resolution correctly, choice of options and compliance with the PSLA 2010/4 must occur by 30 June 2011.¹⁴¹

IMPACT ON TRUST DEED, RESOLUTIONS & ACCOUNTS

Impact on Drafting Trust Deed

The Commissioner consider that the mere setting aside of an amount to or for the benefit of the private company beneficiary is sufficient to create a suitable sub-trust for section 3 loans.

However, the examples in PSLA 2010/4 all assume that the sub-trust is created by incorporating the investment terms of the trust deed of the head trust into the sub-trust.¹⁴² As discussed above, some modern trust deeds incorporate all the terms of the head trust into the sub-trust, including the rights of wasting assets. The effect of this on the Commissioner's views is unclear.

To minimise the risk that a UPE put on sub-trust is a bare trust or the private company beneficiary has an absolute entitlement as against the head trust, the trust deed should contain a sub-trust clause that incorporates all the terms of the head trust. The incorporation of these terms may also support the argument that the sub-trust does not have an equitable right to income or capital growth of the underlying assets so there is no financial accommodation or in substance loan by the private company beneficiary.

The Commissioner also considers that there should only be one sub-trust per corporate beneficiary.¹⁴³ Arguably, each UPE for a year and for each subsequent year constitutes a separate sub-trust or needs to be accounted for as a separate sub-trust under the different options. Accordingly, it may be prudent to include powers allowing segregation, joining, mixing and allocation of sub-trusts corpus.

Impact on Drafting Trustee Resolutions

Care was required to ensure that any 30 June 2010 trust resolutions did not contradict that a present entitlement by payment or resolution occurred before 16 December 2009 in respect of pre-16 December 2009 UPEs. A pre-16 December UPE may become a post 16-December UPE and subject to the Commissioner's views if incorporated into a general 30 June 2010 resolution applying for the entire accounting period.

On and from 16 December 2009, trust resolutions will have to clearly distinguish between 'applying' an amount (which would be an ordinary loan) and 'setting aside' an amount on sub-trust (which would be an extended definition loan) to access Option 1 (7 year loan), Option 2 (10 year loan), other ordinary loan equivalent or Option 3 (sub-trust). It may be necessary to refer to the different clauses of the trust deed that apply or set aside an amount.

If it is possible to apply Option 1 (7 year loan), Option 2 (10 year loan), other ordinary loan equivalent or Option 3 (sub-trust) to different UPEs in the same income year (based on an amount specified in the

¹⁴¹ PSLA 2010/4 a5 [50] extension until 30 June 2011 but usually lodgement of the trusts income tax return or 15 May of the following year.

¹⁴² PSLA 2010/4 at [124] – clause 6.

¹⁴³ PSLA 2010/4 at [56].

resolution or on class of income) then the resolutions will have to clearly segregate and set aside these amounts.

The trustee's resolution should make it clear that the distribution is set aside to avoid any loan inference that the money was paid and lent back or applied for the private company beneficiary by lending it to the trustee.

The trustee's resolution should separately deal with setting aside separate UPEs (based on source or amount) in the same income year so that they will correlate with the amounts to which will be on the different options.

Separate resolutions should be prepared for the head trust and the sub-trust to ensure that a present entitlement is created in respect of income of the sub-trust even if the Commissioner accepts that separate accounts or tax returns need not be prepared.

Impact on Drafting accounts

The accounts of the head trust will have to clearly segregate the ordinary loans and UPEs for each income year and for each beneficiary (although it is only required by PSLA 2010/4 that this be done for the private company beneficiary). Under Option 3 (sub-trust), these amounts are to be separately identified in the owner's equity part of the accounts.

If it is possible to apply Option 1 (7 year loan), Option 2 (10 year loan), other ordinary loan equivalent or Option 3 (sub-trust) to different UPEs in the same income year each income year will have to have sub-account allocations so that it is clear which option applies to the UPE.

Under Option 3 (sub-trust), the investment agreement will have to allocate the specific asset of the head trust to the private company beneficiary. It is unclear whether this allocation is sufficient, or whether the accounts of the head trust and sub-trust will have to identify the specific assets.

When preparing accounts, it may be prudent to separate out historic UPEs into sub-accounts so that it is clear which UPEs are being paid out.

Under Option 1 (7 year loan), Option 2 (10 year loan), other ordinary loan equivalent or Option 3 (sub-trust)¹⁴⁴ the sub-trust must be recognised in the equity section of the head trust accounts.¹⁴⁵

PREPARING COMPLYING SUB TRUSTS & LOANS

Option 1 and Option 2 loans

The Commissioner requires a taxpayer adopting Option 1 to document the terms of the investment agreement. The investment agreement must be legally binding, but the document evidencing that agreement may be prepared as part of the tax return working papers.¹⁴⁶

The head trustee could do the investment agreement as an irrevocable resolution of the head trust or as a bipartite agreement or deed by the trustee as trustee of the head trust and of the sub-trust.

It appears the Commissioner will require a bipartite agreement or deed. However, arguably the requirements for a complying s. 109N loan should be sufficient to satisfy the requirement for an agreement.¹⁴⁷ For example, a trust resolution by the trustee of the head trust and sub-trust should be sufficient.

To ensure the investment agreement is binding, it may be prudent to execute it as a deed.

¹⁴⁴ This appears optional under PSLA 2010/4 at [59] since the Commissioner considers an Option 3 (sub-trust) arrangement must prepare separate accounts.

¹⁴⁵ PSLA 2010/4 at [59].

¹⁴⁶ PSLA 2010/4 at [69] and [81].

¹⁴⁷ TD 2008/8.

The private company beneficiary need not and should not be a party to the investment agreement as it may arguably convert the UPE between the sub-trust and the private company beneficiary into a loan.

The terms of the bipartite investment agreement must require:¹⁴⁸

1. a mandatory obligation for the head trust to pay the sub-trust interest at the benchmark interest rate or prescribed interest rate;
2. details of the amount of the loan, the start date and the end date of the term of the 7 or 10 year loan;
3. a mandatory obligation to repay the principal back at the relevant end date of the term.

The investment agreement will resemble the current s. 109N loan agreement but without the obligation to pay principal annually.

It may be possible to prepare a master investment agreement with the terms of the Option 1 and Option 2 loan that has schedules prepared for each loan that identifies the relevant loan terms.

If one accepts that Option 1 and Option 2 requires a loan with deductible interest, then it is not possible to have a priority income distribution arrangement equal to the benchmark interest rate or prescribed interest rate.

Section 3 Loans

The investment must be documented in the tax return working papers of the head trust and the sub-trust and must clearly identify the asset or part of an asset (by percentage) acquired using the trust fund assets.¹⁴⁹

A modified asset register should be sufficient for this purpose. A written bilateral agreement should not be used as this may convert the UPE into an ordinary loan.

A written agreement should be avoided to mitigate the risk that the arrangement is an ordinary loan.

CORRECTIVE ACTION

Introduction

PSLA 2010/4 provides the taxpayer with an opportunity to self correct UPEs incorrectly described in the accounts as loans on or before 31 December 2011.

PSLA 2010/4 also provides small business entity taxpayers with an opportunity to self correct section 2 loans (ordinary loans) on or before 31 December 2011 under s. 109RB.

Other taxpayers will have to apply for exercise of the Commissioner's discretion under s. 109RB in accordance with TR 2010/8 and the proposed PSLA.

Each form of corrective action is problematic.

Self Correction UPEs described as loans

A UPE that has been incorrectly recorded as a loan can be self corrected on or before 31 December 2011.

The trust or private company beneficiary can self correct if:

1. All available evidence other than the accounts support that the amount is a UPE.
2. The private company has never reported that amount as a loan to shareholders and their associates in its income tax return.
3. The trust has never credited or paid any interest in respect of the amount.

¹⁴⁸ PSLA 2010/4 at [70] and [82].

¹⁴⁹ PSLA 2010/4 at [96].

4. The loan account in which the amount is comprised does not include unrelated transactions.
5. On or before 31 December 2011, the financial accounts of all relevant entities are amended to properly classify the amount as a UPE.
6. On or before 31 December 2011, the trustee or public officer of a corporate trustee or private company beneficiary signs and dates a declaration declaring that the above conditions are true and correct.

Providing the necessary declaration will be problematic. Any misrepresentation may constitute a taxation offence.¹⁵⁰

The declaration requires the above to be true and correct and not merely to the person's best information and belief. Consequentially, the costs to conduct the investigation to make the necessary declaration in respect of item 1 and item 4 properly will be prohibitive.

It is unclear whether the correction to the financial accounts required by item 5 can occur to the 30 June 2009 or 30 June 2010 accounts or whether all historical accounts (at least back to 4 December 1997 when Division 7A was enacted must be corrected.

The Commissioner should clarify these issues.

Under the former corrective action amnesty in PSLA 2007/20 a statutory declaration was not required. Accordingly, where a taxpayer cannot make the necessary declaration, a further amnesty to put the amounts on complying s. 109N loan terms should be considered by the Commissioner.

Self Correction Small Business Entities

Small business entity taxpayers may be entitled to self correct section 2 loans (ordinary loans) on or before 31 December 2011 under s. 109RB.¹⁵¹

The trust or private company beneficiary can self correct if:

1. The failure to comply with Division 7A was the result of an honest mistake or inadvertent omission of the trustee, the private company beneficiary or other relevant party.
2. The trust and private company beneficiary are small business entities.¹⁵²
3. The loan funds have been retained by the trust and used for carrying on the business of the trust.
4. Corrective action by placing the amount on complying s. 109N loan terms and paying outstanding annual interest and principal amounts on or before 31 December 2011.
5. All trust and private company tax returns have been lodged.
6. The trust, the private company beneficiaries and their associates have a good tax compliance history.
7. The trustee of the trust is not a shareholder of the private company beneficiary.

The difficulties of establishing the preconditions of honest mistake or inadvertent omission are discussed below.

The definition of 'associate' is very broad and arguably requires a detailed investigation of the tax affairs of relatives and related entities to satisfy the requirement. Small business entities may be pragmatic and adopt self corrective action without a detailed investigation. Should an audit conclude that the self corrective action did not apply, a subsequent application under s. 109RB could be made.

s.109RB Discretion

The Commissioner has a discretion to disregard a deemed dividend where the failure to comply with Division 7A was the result of an honest mistake or inadvertent omission by the trustee, the private company beneficiary or another person (s. 109RB).¹⁵³

¹⁵⁰ S. 8C TAA 1953.

¹⁵¹ TR 2010/4 at [34].

¹⁵² See s. 328-10 ITAA 1997 – with a CGT affiliate and connected entity turnover of less than \$2,000,000.

¹⁵³ TR 2010/8 and Compendium to TR 2010/8.

The Commissioner considers that:

1. honest mistake means an incorrect view, opinion or understanding about how Division 7A operates and the facts or other matters relevant to the operation of Division 7A;
2. inadvertent omission means the inadvertent failure to take action that is relevant to or affects the operation of Division 7A;
3. ignorance of Division 7A must lead to the honest mistake or inadvertent omission relevant to s. 109RB and that the result of the operation of Division 7A arose because of it;
4. acts or omissions made to circumvent Division 7A do not satisfy the requirements;
5. the above rules apply to the mistakes and omissions of third parties; and
6. recurrent mistakes or omissions will qualify if it has occurred for the same qualifying reasons as the original mistake or omission.

The Commissioner requires there to be a direct nexus between the mistake or omission and the Division 7A consequence. It is vital to correctly identify the source/cause of the Division 7A consequence.

In example 1 of PSLA 2010/8, the client has not provided sufficient information about the private company transactions and the accountant has prepared the return without clarifying whether there are transactions. The Division 7A consequences arise from the private company transaction not the failure of the client to provide or the accountant to ask for the required information.

In example 2, the accountant had all the necessary information and understood the Division 7A issues but made an arithmetic error in calculating the minimum yearly repayments under the complying s. 109N loan.

In example 3, Jill mistakenly used the private company cheque book to buy furniture (which could have been office furniture) so the accountant did not identify (and was not at fault in not identifying) the error. The cause of the Division 7A problem was the payment erroneously using the cheque book.

The direct nexus means that post transaction errors by the advisers will seldom have the necessary nexus with the payment, loan or forgiveness that causes the Division 7A problem which will be in the control of the client. However, where the adviser has effected the payment, loan or forgiveness (such as by preparing the resolution, loan agreement or waiver deed) the relevant nexus arguably exists.

The Commissioner considers that the onus of proof¹⁵⁴ on the taxpayer is a positive obligation to prove honestly in the mistake or inadvertence in the omission.¹⁵⁵ The onus means that the taxpayer can not rely on any presumption of honesty or inadvertence. Proving honesty or inadvertence is difficult other than by inductive reasoning (proving the person is not dishonest or is ignorant of the issue). The taxpayer will have to assert subjective honesty or inadvertence and corroborate it with objective circumstances and evidence (such as age, health, background, education, business experience, systems and procedures, investigation and advice).

Division 7A Panel

It is not the usual practice for taxpayers or advisers to appear and make submissions to the Division 7A Panel. Information regarding the Division 7A Panel is limited.

On 10 March 2010, the Commissioner advised the NTLG Division 7A Working Party that the Division 7A Panel had heard 63 cases with the discretion being exercised favourable in 33 cases, not exercised in 21 cases and in 9 cases it was decided that Div 7A was not applicable.

Further, the Commissioner agreed to provide a summary of information from the Division 7A Panel's cases outlining the factors that the Division 7A Panel has considered in exercising the Commissioner's discretion in those cases.¹⁵⁶

Accordingly, it is likely that there will be greater transparency surrounding the deliberations of the Division 7A Panel.

¹⁵⁴ Ss 14ZZK and 14AAO TAA 1953.

¹⁵⁵ PSLA 2010/8 at [67].

¹⁵⁶ <http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/00251872.htm&page=5&H5>

CHOICE OF ENTITY & RESTRUCTURING

Introduction

Most taxpayers will not wish to act contrary to TR 2010/3 and PSLA 2010/4. Taxpayers will either seek to comply with the administrative safe harbours or restructure to limit or avoid the issues.

There are a number of administration and management planning opportunities that could be considered to restructure to limit or avoid the application of Division 7A and TR 2010/3 and PSLA 2010/4. These options are presented to promote discussion with clients and amongst the profession and with the Commissioner.

The planning options proceed on the assumption that the investment, asset protection and succession strategy for the family group is to retain as much of the income and capital growth earned by the trust within the trust.

This paper does not advocate acceptance of any particular approach. Advisers should also consider the application of the general anti-avoidance provision.¹⁵⁷

Arm's length discharge of an obligation of a private company (s. 109J)

A payment to a shareholder in excess of an arm's length value would be an ordinary dividend.¹⁵⁸

A payment to a shareholder or an associate that is not an ordinary dividend is a deemed dividend (s. 109C).

However, an arm's length payment by a private company to a shareholder (or associate) pursuant to an obligation on the private company to pay money to the shareholder (or associate) is not a deemed dividend.¹⁵⁹

109J A private company is not taken under section 109C to pay a dividend because of the payment of an amount, to the extent that the payment:

- (a) discharges an obligation of the private company to pay money to the entity; and
- (b) is not more than would have been required to discharge the obligation had the private company and entity been dealing with each other at arm's length.

A transfer of property (not money) to a spouse under Family Court order is not an exempt payment. The private company must be a party to the proceedings and expressly obliged to transfer the money under Family Court Order. ATOID 2004/462 states:

The term 'obligation' is not expressly defined for the purposes of section 109J of the ITAA 1936 and therefore adopts its ordinary meaning. The *Macquarie Dictionary* 2003 rev. 3rd edn, The Macquarie Library Pty Ltd, NSW defines 'obligation' as follows: a binding requirement as to action; the binding power or force of a promise, law, duty, agreement, etc. ; a binding promise or the like.....

There are two elements to paragraph 109J(a) of the ITAA 1936, both of which need to be met for section 109J of the ITAA 1936 to exclude a payment from the operation of section 109C of the ITAA 1936. These elements are:

- the payment must discharge an obligation of the private company, and
- that obligation must be to pay money to the entity.

Addressing first element, there is no obligation on the part of the private company to the taxpayer. This is because an order under section 79 of the FLA 1975, although it may seek action on the part of a third party, only 'binds' a party to the proceedings who is subject to the order: *In the Marriage of Prince* (1984) F.L.C. 91-501. In the circumstances here the private company was not a party to the proceedings and not subject to the order. Hence, there is no, 'binding requirement as to action ..etc' on the part of the private company that would constitute an obligation within the *Macquarie Dictionary* ordinary meaning of that word."

For example, in *Private Binding Ruling 54305*, the rulee was a director and an associate of the sole shareholder of a private company. As part of the divorce settlement, the rulee proposed that the Family Court be requested for an explicit court order directing the company to make a cash payment to her. The company was a party to the Family Court proceedings and the court order was to be binding on all parties,

¹⁵⁷ Part IVA ITAA 1936.

¹⁵⁸ S. 44(1) ITAA 1936; *Case D97* (1954) 4 TBRD 500 at 505.

¹⁵⁹ S. 109J ITAA 1936.

including the private company. The Commissioner ruled that provided that the Family Court order binding the company as a party to the proceedings was an explicit order binding the company to specifically pay cash to the rulee, and not some other alternative obligation, the payment would not be considered a dividend by virtue of s. 109J.¹⁶⁰

Private Binding Ruling 85827 states that a payment made as a consequence of an obligation under Family Court Orders would not exceed the arm's length amount required to discharge that obligation for the purposes of s. 109J(b).

Accordingly, s. 109J may permit the payment of the retained earnings of a private company beneficiary during relationship breakdowns without Division 7A applying or top up tax being paid on a dividend. Franking credits on the retained earning may become trapped in the company.

Deferred Payment Beneficiary Entitlements

In estates it is common for a gift to be made to a child upon attaining 21 years of age. A deferred entitlement to call for transfer of the UPE is effective to create a deemed present entitlement to the amount for the purposes of Division 6, but entitlement to call for the transfer of the UPE is deferred until 21 years of age.

Arguably, if the trustee resolved to pay a private company beneficiary an amount with payment deferred for say 50 years, the private company beneficiary does not have a right to call for payment so has not provided financial accommodation or in substance loan for the purposes of s. 109D.

A beneficiary is presently entitled to a share of the income of a trust estate if the beneficiary has an interest in the income which is both vested in interest and vested in possession and the beneficiary has a present legal right to demand and receive payment of the income.¹⁶¹

*Harmer v FCT*¹⁶² described present entitlement as:

The parties are agreed that the cases: see in particular, *FCT v Whiting* (1943) 68 CLR 199 at 215-16, 219-20; 2 AITR 421; *Taylor v FCT* (1970) 119 CLR 444 at 450-52; 1 ATR 582; *Totledge Pty Ltd v FCT* (1980) 11 ATR 181; 31 ALR 657 at 661, 664; *FCT v Totledge Pty Ltd* (1982) 12 ATR 830; 40 ALR 385 at 394-6; 60 FLR 149 22 ATR 730 at 159-61. Establish that a beneficiary is "presently entitled" to a share of the income of a trust estate if, but only if:

- (a) the beneficiary has an interest in the income which is both vested in interest and vested in possession; and
- (b) the beneficiary has a present legal right to demand and receive payment of the income, whether or not the precise entitlement can be ascertained before the end of the relevant year of income and whether or not the trustee has the funds available for immediate payment.

That being so, the question on the appeal is whether any one or more of the claimants either were "presently entitled" in that sense to the interest earned on the funds deposited with the Building Society or had a "vested and indefeasible interest" in that interest. That question must be answered as at the time when the interest was derived, that is to say, during the tax years. The fact that orders were subsequently made for payment of the interest earned in the tax years to one or other of the claimants does not assist the appellants unless those orders represented a judicial recognition of a present or relevantly vested beneficial entitlement to the interest which existed at the time when the interest was derived, that is to say, which existed independently of the actual order.

IT 329 states that present entitlement is created as follows:

- [9] ... A declaration, resolution or other act of a trustee in an effective exercise of his discretion will amount to an application of income of a trust estate for the benefit of a beneficiary where :-
- (a) a specific ascertainable portion of the income of the year in question is thereby immediately and absolutely vested in the beneficiary so that even though it might not be immediately paid to the beneficiary it becomes his absolute property and would form part of his estate in the event (sic) of his death;
 - (b) the declaration, resolution, etc, is final and irrevocable.

A deferred payment present entitlement is a vested and indefeasible interest but is vested in interest (future) and not in possession. However, for the purposes of creating a present entitlement to the income

¹⁶⁰ See also PBR 85827, PBR 54305, PBR 54306, PBR 61876, PBR 46679, PBR 46680, PBR 69302 and PBR 1011509693406.

¹⁶¹ *Harmer v FCT* (1991) 22 ATR 726; *Richardson v FCT* (2001) 46 ATR 285 at [8].

¹⁶² *Harmer v FCT* (1991) 22 ATR 726.

of the trust estate, s. 95A ITAA 1936 will deem the private company beneficiary to be presently entitled to a vested and indefeasible amount vested in interest.¹⁶³ S. 95A states:

95A Special provisions relating to present entitlement

(1) ...

(2) For the purposes of this Act, where a beneficiary has a vested and indefeasible interest in any of the income of a trust estate but is not presently entitled to that income, the beneficiary shall be deemed to be presently entitled to that income of the trust estate.

Arguably, since the private company beneficiary cannot call for the immediate payment of the amount, there has not been the provision of financial accommodation or an in substance loan.

However, the deferral of payment may be illusory if the private company beneficiary is absolutely entitled to the asset as against the trustee under the rule in *Saunders v Vautier*¹⁶⁴ and TR 2004/D25. TR 2004/D25 has not been finalised because the NTLG Trust Consultation Group is considering the impact of *CPT Custodian P/L v CSR (Vic)*.¹⁶⁵

In summary, if all the capital beneficiaries of an ascertainable class are adults and no other person has a prior estate then the capital beneficiaries can jointly enforce the transfer of the property to themselves regardless of any trust term that they not receive it until a later specified age.¹⁶⁶

Accordingly, the failure of the private company beneficiary to exercise its power under the rule in *Saunders v Vautier* to collapse the sub-trust or head trust may be the act that satisfies the requirement of a financial accommodation or in substance loan within the Commissioner's view of s. 109D.

In *CPT Custodian P/L v CSR (Vic)* the High Court held that during the continuance of an unsatisfied trustee's right of indemnity, expressed as an actual liability, the trustee had an interest in the due administration of the trust so that the beneficiaries could not unilaterally vest the trust.

However, the conclusion that that right of indemnity precludes the operation of the rule in *Saunders v Vautier* is not obvious as it merely affects the quantum of the beneficiaries' entitlement not the nature of the beneficiaries' entitlement. This is perhaps what *CPT Managers Ltd v CSR (NSW)*¹⁶⁷ meant when it held that there is nothing in *CPT Custodian P/L v CSR (Vic)* or in *Halloran v Minister ANPW Act 1974*¹⁶⁸ that suggest that the holder of a unit in a unit trust lacks an equitable interest in the trust property.

Accordingly, it is unclear whether the Commissioner's view on section 3 loans will apply to a deferred payment beneficiary entitlement to a private company beneficiary.

Sub-trust Entitlements

As discussed above, where the sub-trust incorporates the terms of the head trust that includes exclusion of the presumption in *Howe v Lord Dartmouth* arguably the private company beneficiary has no right to a return on the UPE such that it would constitute a financial accommodation as defined by the Commissioner.

Arguably, where the sub-trust includes a provision that the sub-trust may invest in assets that are wasting or speculative or not income producing, the sub-trust has no equitable right to any return other than payment of the UPE so does not provide any financial accommodation.

By a combination of a deferred payment beneficiary entitlement and the power to invest in a wasting or non-income producing assets, there is no financial accommodation or in-substance loan for the purposes of s. 109D.

¹⁶³ *Dwight v FCT* (1992) 23 ATR 236.

¹⁶⁴ *Saunders v Vautier* (1841) 4 Beav 115; 49 ER 282.

¹⁶⁵ National Tax Liaison Group Losses and CGT Subcommittee minutes, 7 June 2006 Appendix D.

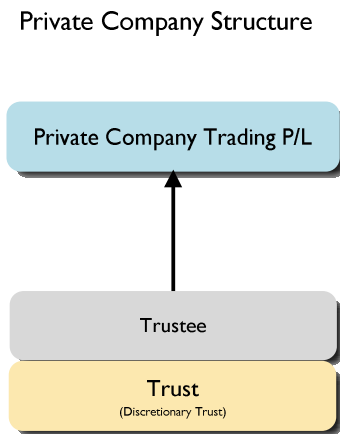
¹⁶⁶ *Gosling v Gosling* (1859) Johns 265 at 272; 70 ER 423 at 426.

¹⁶⁷ *CPT Managers Ltd v CSR* (2006) 64 ATR 654.

¹⁶⁸ *Halloran v Minister ANPW Act 1974* [2006] HCA 3.

Private Company Investment or trading vehicle

A private company owned by a discretionary trust is often touted as the appropriate structure to permit retention of income and to manage the Commissioner's views on UPEs. The structure is represented by the following diagram:



A private company will permit the retention of income at the 30% corporate tax rate and reinvestment into the business. A company provides a high degree of insolvency protection and has a well defined corporate governance process.

However, disclosure requirements and rules protecting minority shareholders under CA 2001 may make use of a private company unattractive.

A company has extensive tax treatment that must be managed including:

1. a company cannot distribute tax losses to shareholders;
2. a company is subject to restrictions on the deductibility of losses and bad debts;¹⁶⁹
3. a company has restrictions on dividend policies;¹⁷⁰
4. restrictions on share buy-back and share issue transactions;¹⁷¹
5. ineligibility for the CGT 50% discount;¹⁷²
6. restrictions on access to the CGT small business concessions;¹⁷³
7. regulation of share value shifting activities;¹⁷⁴ and
8. regulation of debt/equity interests.¹⁷⁵

The loss of the CGT 50% discount and the restrictions on flexible dividend streaming¹⁷⁶ are significant disincentives for using a company.

The dividend streaming flexibility can largely be addressed by having a discretionary trust own the shares in the private company.

A single tier private company structure means that any retained earnings are exposed to the creditors of the private trading company. Accordingly, it may be appropriate to include a holding private company to which retained earnings can be paid to and held separate from the private trading company.

¹⁶⁹ Division 36 ITAA 1936 (prior year losses); Division 165 ITAA 1997 (current year losses and bad debt deductions); Division 175 (current year deductions); Division 170 ITAA 1997 (intra company loss transfers)

¹⁷⁰ Division 7A ITAA 1936 (deemed dividends); S. 109 ITAA 1936 (excessive remuneration); Divisions 202-207 ITAA 1997 (imputation credits); s. 160APHC-160APHU ITAA 1936 (45-day holding period rules); Division 197 ITAA 1997 (share tainting rules)

¹⁷¹ Division 16K ITAA 1936; PSLA 2007/9 (buy-backs); TR 2008/5 (share allotments); Chapter 2J CA 2001.

¹⁷² S. 115-10 ITAA 1997.

¹⁷³ S. 152-10(2) ITAA 1997.

¹⁷⁴ Division 138-140 ITAA 1997.

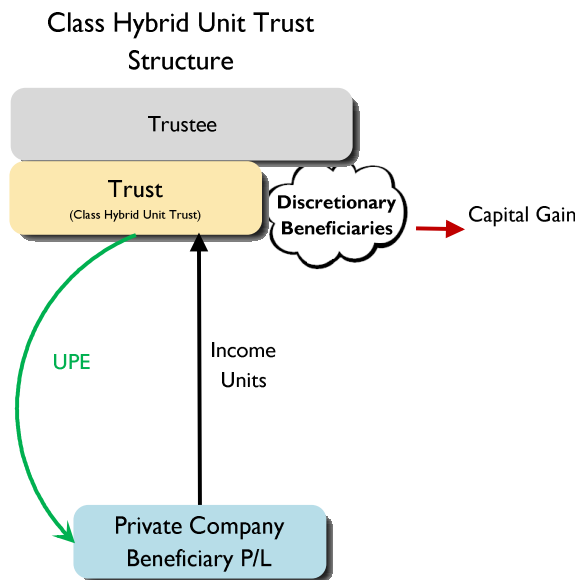
¹⁷⁵ Division 974 ITAA 1997.

¹⁷⁶ See P Sokolowski, 'Unlocking value from private companies', TIA South Australian Convention, 7 May 2009.

Class Hybrid Unit Trust Reinvestment Program

A class hybrid unit trust may permit a private company beneficiary to reinvest a UPE as a subscription of income units so that there is no UPE for the purposes of s. 109D and Subdivision EA. Capital gains can be distributed to a discretionary class beneficiary without CGT event E4 applying.

The structure is represented by the following diagram:



A class hybrid unit trust is similar to a unit trust where the unit holders are entitled to a proportionate share of both income and capital except to the extent that the trustee exercises a discretion to distribute all or part of the income and capital to a discretionary class or classes of beneficiaries (and as between the members of those classes).

Some advantages of a class hybrid unit trust include:

1. flexible income distributions to the class of beneficiaries and in default, proportionately to the unit holders;
2. the potential to negatively gear the units if the units have a sufficient right to income or to income and capital;¹⁷⁷
3. taxable and non-assessable capital gains distributions to the class of beneficiaries so that CGT event E4 does not apply;¹⁷⁸
4. units can be issued to capitalise the trust;
5. units can be transferred to existing or new participants; and
6. asset protection for trust assets where the unit holders only have a right for return of subscribed capital.

Some disadvantages of a class hybrid unit trust include:

1. difficulties in satisfying the CGT small business concession participation percentages for the stakeholder tests;¹⁷⁹
2. difficulties in satisfying the trust loss provisions or family trust election requirements;¹⁸⁰
3. difficulties in satisfying the 45 day holding period rules for distributing franked dividends;¹⁸¹ and

¹⁷⁷ R Jorgensen, 'Deductibility of Interest and Taxpayer Alert TA 2008/3', (2008) 42(11) TIA 656 updated for TD 2009/17 but the analysis is unchanged.

¹⁷⁸ TD 2003/28 and NTLG CGT Sub-committee Minutes dated 11 June 2001 at [8.1] <http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/40685.htm&page=19&H19>

¹⁷⁹ S. 152-70 ITAA 1997.

¹⁸⁰ Schedule 2F ITAA 1936.

¹⁸¹ S. 160APHL ITAA 1936.

4. difficulties in superannuation funds investing and satisfying the non-arms length income provisions.¹⁸²

When a private company beneficiary subscribes for units in a class hybrid unit trust, the private company beneficiary pays an amount to the class hybrid unit trust for the purposes of s. 109C(1).¹⁸³ The amount of the deemed dividend is equal to the amount paid but is reduced by the value of the units received under S. 109J (discussed above).

Accordingly, if the private company pays not more than an arm's length price for the units, there is no deemed dividend under s. 109C.

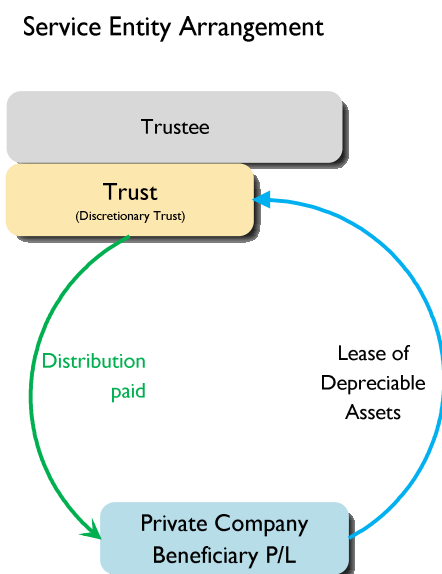
Assuming that the units are issued for \$1.00 per unit, the market value of the unit must at least equal \$1.00 per unit. If the unit is worth less than \$1.00 per unit then there is a discount which will constitute a s. 109C deemed dividend.

The rights attaching to the unit will determine its value. The market value of an income unit with a proportionate right to all distributable income and the return of the paid up is unclear. A market valuation may need to be obtained. It is unclear whether an income unit of this type would be considered a wasting asset. Accordingly, it may be necessary of the income units to have a right to return of the paid up price plus consumer price index. However, this would result in a capital gain to the private company beneficiary which would not be subject to the CGT discount.

Corporate Beneficiary Service Trust

A trust may determine to pay the UPE to the private company beneficiary and the private company beneficiary acquires assets for lease back¹⁸⁴ to the trust under a service entity arrangement. The UPE is paid down each year to acquire assets indirectly retained for use in the trust achieving the effective retention of the assets and reducing the expose of the structure to Division 7A.

The arrangement is represented by the following diagram:



The Commissioner views on service entity arrangement are TR 2006/2¹⁸⁵ and the accompanying *Guide*¹⁸⁶ TR 2006/2 and the *Guide* have been extensively criticised by commentators.¹⁸⁷

¹⁸² Division 295 ITAA 1997 and TR 2006/7.

¹⁸³ Refer by analogy to PBR 80565 (s. 109C) and PBR 89898 (Subdivision EA) where a subscription for shares in a private company constituted a payment.

¹⁸⁴ *Eastern Nitrogen Ltd v FCT* (2000) 46 ATR 474; *Metal Manufacturers Ltd* (1999) 43 ATR 375.

¹⁸⁵ TR 2006/2 Income Tax: deductibility of service fees paid to associated service entities: Phillips arrangements (20 April 2006) formerly.

It is assumed that the proposed service entity arrangement complies with the Commissioner's views. This paper does not discuss these compliance issues.¹⁸⁸

The CGT discount will not be available in respect of any capital appreciating assets acquired by the private company beneficiary. Accordingly, the private company beneficiary is likely to acquire depreciating assets and to lease them to the trust at arm's length rates.¹⁸⁹

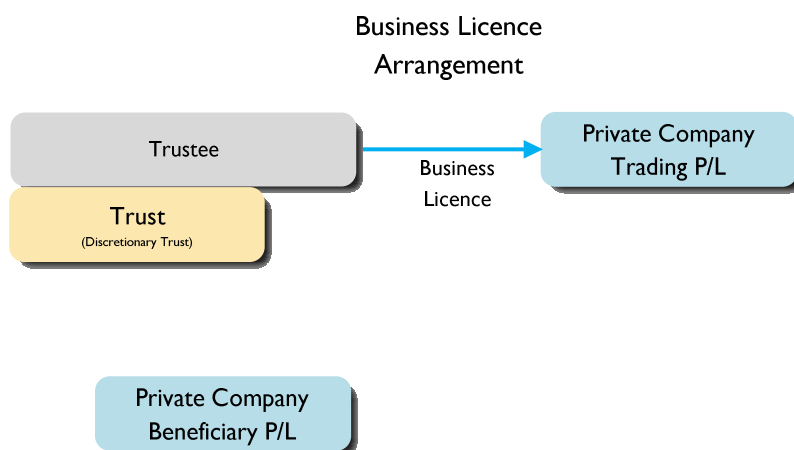
Under this arrangement there will be no UPE for the purposes of Division 7A subject to TR 2010/3 and PSLA 2010/4. The rental for the leased equipment must be a market value that satisfies not only Division 7A but also TR 2006/2 and the *Guide*. It is unclear whether using the safe harbour rates in TR 2006/2 and the *Guide* will satisfy the requirement of Division 7A.

The major criticism of the safe harbour rates in TR 2006/2 and the *Guide* was that the rates were too low to produce a viable return to the service entity. However, in the context of planning for Division 7A, the reduced rates may be attractive. The *Guide* provides a hiring fee that results in the service entity deriving a return on assets not exceeding 7.5% of the opening written down value of the assets used in the hiring activity.¹⁹⁰

Accordingly, limited service entity arrangement may once again become fashionable.

Business Licensing to Company

A trust may licence its business to a private company wholly owned by a discretionary trust so that business income is earned and by the private company as working capital of the business.



The owner of the business leases or grants a right to the private company to conduct the business without disposing of the goodwill of the business. Working capital can be retained by the private trading company.¹⁹¹ The private trading company pays a licence fee calculated as a percentage of turnover and payable monthly or quarterly.¹⁹²

Care is required to ensure that the goodwill is not transferred to the private trading company by the licence or by organic growth of a separate goodwill in the private trading company.

¹⁸⁶ Australian Taxation Office, 'Your service entity arrangements', NAT 130086-04.2006

¹⁸⁷ For example, W. Thompson, 'Should you be moving on from Service Trusts', 21st National Convention, TIA, 2006; J. de Wijn QC, 'Service Trusts: Basic Elements of Deductibility Revisited', Tasmanian State Convention, TIA, 2005.

¹⁸⁸ Refer to: K Harvey, *A Practical Guide to Service Entity Arrangement*, Thompson, 2006.

¹⁸⁹ The lease of the assets at less than an arm's length value may constitute a payment under s. 109C; PSLA 2010/4 at [92].

¹⁹⁰ *Guide* at page 13.

¹⁹¹ The private trading company may be owned by a discretionary trust to permit streaming of dividends.

¹⁹² See J de Wijn QC, 'Can you lease your business to a related entity?', *NTAA Voice*, August 1999 at page 7.

To achieve this, as much of the original trading activity is retained by the owner of the business. For example:

1. the Licence will retain ownership of all improvements to intellectual property;
2. all plant and equipment is retained or purchased by the owner and stock is acquired by the owner and on-sold to the private trading company;
3. upon termination of the Licence the private trading company has commercial restraints of trade.

Some of the issues that require consideration include:

1. the CGT consequences of the Licence on the goodwill of the business;¹⁹³
2. the income tax consequences of the Licence on the intellectual property;¹⁹⁴
3. the income tax consequences of any transfer or consignment of trading stock;¹⁹⁵
4. the income tax consequences of the transfer or consignment of debtors;¹⁹⁶
5. the income tax consequences of the of the transfer of work in progress;¹⁹⁷
6. whether the license agreement would be a deemed franchise agreement;¹⁹⁸
7. the business stamp duty consequences under the licence.

Provided the licence fee does not exceed an arm's length amount, the licence fee will not be a deemed dividend under s. 109C.

Incorporation and Trust to Company Rollover

A trust may wish to transfer the business of the trust into a wholly owned private company subsidiary to achieve the private company investment or trading vehicle discussed above.

A trustee may transfer the trustee's interests in a business or the assets of a business to a private company in return for the issue of shares or the issue of shares and the company assuming liabilities and may choose to disregard any capital gain that would otherwise occur.¹⁹⁹

To satisfy the preconditions for rollover relief:

- the consideration for the transfer of the business or business assets must only be non-redeemable shares and the undertaking by the private company to discharge any liabilities;
- the market value of the shares issued and the interest in the business transferred must be substantially the same less the liabilities assumed by the private company;
- the transferring entity must own the shares issued in the company in the same capacity as the interest in the business was owned before the transfer;
- the assets rolled over must not be personal use, collectible or precluded assets or become trading stock of the private company;
- the private company cannot be an exempt entity;
- special rules apply where the private company assumes liabilities; and
- special rules apply where the trust or private company is a non-Australian resident for tax purposes.

Where the business of the trust is transferred it is unclear how the transferred UPE liability owned to the private company beneficiary is treated. A private company cannot have a UPE. Accordingly, the UPE on rollover either constitutes a loan or an obligation to pay an amount. To transfer the UPE it may be necessary to firstly convert the UPE to a loan or a complying s.109N loan which would become subject to Division 7A or by under the Commissioner's view it may become an ordinary loan.²⁰⁰ To avoid resolving the issue, a business asset rollover excluding the assumption of the UPE liability could be used.

¹⁹³ TR 1999/16; *FCT v Murry* (1998) 39 ATR 129 and *FCT v Just Jeans P/L* (1987) 18 ATR 775.

¹⁹⁴ Division 40 ITAA 1997.

¹⁹⁵ S. 70-90 ITAA 1997 deemed market value disposal provisions.

¹⁹⁶ S. 23-35 ITAA 1997.

¹⁹⁷ S. 15-50 ITAA 1997.

¹⁹⁸ *Competition and Consumer Act 2010*.

¹⁹⁹ Subdivision 122-A ITAA 1997.

²⁰⁰ If converted to a non-complying loan the transfer may be a deemed dividend under s. 109D ITAA 1997. If converted to a complying s. 109N loan it would have to be repaid. The Division 7A exemption for company to company loans may not apply

The rollover will also have choose rollover for depreciating assets²⁰¹ and the GST going concern concession.²⁰²

The taxpayer may choose not to apply the rollover relief and pay the tax or manage the taxation consequences under the CGT small business concessions.²⁰³

CONCLUSION

Moderate consumption of cabernet sauvignon does improve comprehension but excessive consumption is required to achieve improved acceptance of the Commissioner's views on UPEs. Autonomic drinking commenced in response to considering the consequences of the Commissioner's views. Total acceptance of the Commissioner's view was not achieved prior to the test subject entering stupor.

The Commissioner's views in TR 2010/3 are not the most compelling interpretation of Division 7A. The Commissioner's administrative practice and safe harbours are difficult to apply with sufficient certainty. Pragmatic taxpayers will seek to comply with the requirements or restructure to reduce the application of the Commissioner's views.

To achieve total acceptance of the Commissioner's views a test case will be required or a further experiment conducted. The working title is 'Division 7A – UPEs – The LSD Experiment'.

25 February 2011.

Ron Jorgensen

Principal

Accredited Specialist in Tax Law

T 03 9611 0102

M 0414 967 411

F 03 9620 9288

A Level 13, 15 William Street, Melbourne, VIC, 3000

E rjorgensen@harwoodandrews.com.au

W www.harwoodandrews.com.au

²⁰¹ S. 40-340 ITAA 1997.

²⁰² Division 38-J GSTA 1999.

²⁰³ Division 152 ITAA 1997.