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Public advice and guidance compendium – TD 2018/13

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2017/D3 *Income tax: Division 7A: can section 109T of the Income Tax Assessment Act 1936 apply to a payment or loan made by a private company to another entity (the 'first interposed entity') where that payment or loan is an ordinary commercial transaction?*

This compendium of comments has been edited to maintain the anonymity of entities that have commented.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	The diagrams are confusing, especially because H Unit Trust (in Example 3) sits underneath its owner (when, in all other diagrams, owners sit above the entity).	Modifications made for consistency.
2	Because of the complexity in applying section 109T, the final taxation determination should apply prospectively from the date of issue.	The Commissioner does not agree. The views expressed in this taxation determination reflect the view published in ATOID 2011/104 (withdrawn on the date of issue of draft Taxation Determination TD 2017/D3). The view articulated in this taxation determination is not a change in administrative approach that would justify a 'prospective-only' approach.
3	The label in each diagram titled 'deemed dividend' should be changed to whichever is relevant of 'notional payment' or 'notional loan', to reflect the application of 109T.	Agreed. Labels changed.
4	The interpretative position taken (that is, that section 109T can apply where the first limb of a potential 109T arrangement is the payment of a dividend to which section 44 applies) is not within the scope of the policy rationale for Division 7A. Nothing in the Explanatory Memorandum supports the conclusion that the payment of an actual dividend can enliven section 109T, and scenarios where an interposed private company has no distributable surplus are not	The Commissioner does not agree. Paragraph 9.1 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1998 (EM) states that Division 7A applies to all distributions of profit 'unless they come within specified exclusions'. There is no provision that excludes (specifically or otherwise) a payment of a dividend to which section 44 applies from forming part of an arrangement to which section 109T applies.

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	realistic.	<p>It has been the Commissioner's longstanding view expressed in Taxation Determinations TD 2009/5, TD 2012/10 and TD 2015/18, that Division 7A is an anti-avoidance or 'integrity' provision, directed to ensuring that disguised or informal distribution of company profits to shareholders or their associates should be included in the assessable income of the shareholders or associates.</p> <p>The statutory context is that Division 7A is an integrity safeguard to section 44 and that Subdivision E of Division 7A is an integrity safeguard to sections 109C and 109D.</p> <p>In the Commissioner's view, section 109T arrangements involving an ordinary dividend as the first leg of an arrangement, and which achieve a disguised or informal distribution to a shareholder or their associate, are within this overarching object of Division 7A.</p> <p>Subsection 109X(1) expressly includes, within the scope of section 109T, transactions that are included in the interposed entity's assessable income.</p> <p>On the second point, sections 109U and 109UA were enacted to respectively mirror section 109T in relation to, and bring within the scope of section 109T, certain arrangements where a private company guarantees third party loans to a shareholder (or associate). In relation to those sections, Paragraphs 9.70 and 9.71 of the EM recognise that interposition of a private company with no distributable surplus, or distributable surplus that is less than the payment or loan made to the shareholder (or associate) of the first entity, could effectively circumvent Division 7A.</p> <p>In the Commissioner's view, it would be anomalous for Parliament to have specifically recognised and dealt with schemes associated with such interposed private companies in relation to the specific arrangements under consideration therein, but not have contemplated the same schemes in relation to the general operation</p>

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		<p>of section 109T.</p> <p>The Commissioner also notes that subsection 109UA(4) (in relation to which Parliament has explicitly brought within the scope of section 109T in the context of such schemes) states that section 109UA does not limit the operation of section 109T.</p>
5	<p>The application of section 109T should not result in double taxation, as it is contrary to the purposes of Division 7A and established principles of statutory interpretation.</p>	<p>As noted in the response to Issue 4, subsection 109X(1) expressly includes, within the scope of section 109T, transactions that are included in the interposed entity's assessable income.</p> <p>However, the Commissioner has the broad power in sections 109V and 109W to take into account relevant factors when determining the amount of a deemed payment or notional loan taken to have been made by a private company because of section 109T. <u>Taxation Determination TD 2011/16</u> explains a number of factors the Commissioner will take into account.</p> <p>While the reasonable person test in paragraph 109T(1)(b) requires that every case be considered having regard to its facts and circumstances, the Commissioner agrees with the general proposition that the total tax payable on the relevant amount of private company profits should be limited to the amount payable if assessed at the target entity's marginal tax rate. However, the Commissioner reserves the right to apply Division 7A on a different basis depending on the nature of the arrangement under consideration.</p> <p>As stated in paragraph 64 of Draft Taxation Determination TD 2017/D3, in appropriate cases, the Commissioner may consider (having regard to the intended purpose of Division 7A) the extent to which tax is otherwise payable because of the structure used in the arrangement.</p>
6	Concerns raised about a number of 'ordinary family transactions'	As noted in the response to Issue 5, every case is required to be

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	that are variants of Example 2 in Draft Taxation Determination TD 2017/D3. The distinction between these hypothetical variants and Example 2 is not obvious, and a similar application of section 109T would result in anomalous outcomes.	considered having regard to its own facts and circumstances (in the context of both the 'reasonable person test' in paragraph 109T(1)(b) and sections 109V and 109W). However, to help taxpayers understand the Commissioner's approach to applying section 109T in the kinds of scenarios identified, we have included examples 6 and 7 to address situations where the Commissioner would reduce the amount of the notional payment or loan under sections 109V or 109W due to the facts of the arrangement.
7	The heading to Draft Taxation Determination TD 2017/D3 indicates that the determination addresses situations where the first transaction is an 'ordinary commercial transaction'. However, Examples 3, 4 and 5 involve arrangements that are not commercial in nature.	As correctly identified, Draft Taxation Determination TD 2017/D3 explains the Commissioner's view that section 109T is capable of applying where the payment or loan <u>from the private company to the first interposed entity</u> is an ordinary commercial transaction. In Example 3, the first transaction is the subscription for units in a unit trust. In Examples 4 and 5, the first transaction is the payment of a fully franked dividend. Each of these kinds of transaction is considered to be an ordinary commercial transaction which may be the first transaction in an arrangement to which section 109T may apply. The commercial nature, or otherwise, of the resultant transactions in an arrangement will form part of the consideration necessary for both the 'reasonable person test' in paragraph 109T(1)(b) and sections 109V and 109W.
8	The Commissioner should explain why he considers that the 'reasonable person test' in paragraph 109T(1)(b) is satisfied in respect of the examples described in Draft Taxation Determination TD 2017/D3.	As stated in paragraph 3 of Draft Taxation Determination TD 2017/D3, the Commissioner considers that a reasonable person would make the relevant conclusion having regard to all the circumstances in each example. That is, having regard to the form and the substance of each example and the outcome that results from each example, the Commissioner considers that a reasonable

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		person would make the conclusion described in paragraph 3.
9	Paragraph 4 of Draft Taxation Determination TD 2017/D3 should include reference to the Commissioner determining notional loans under 109W in respect of Examples 1, 2 and 3.	Agreed and updated.