



Ruling Compendium – TD 2025/6

❗ Relying on this Compendium

This compendium of comments provides responses to comments received on draft Taxation Determination TD 2024/D3 *Income tax: Division 7A – does section 109U of the Income Tax Assessment Act 1936 only apply to arrangements where a private company gives a guarantee to another private company?* It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

All legislative references in this Compendium are to the *Income Tax Assessment Act 1936*, unless otherwise indicated

Issue Number	Issue raised	ATO response
1	Additional guidance for guarantors The scope of the final Determination should be expanded to address factors that the Commissioner will consider when determining the amount of a notional payment that arises under sections 109U and 109V, rather than focusing only on the question of whether the first interposed entity is required to be a private company. The final Determination should refer to the factors set out in paragraph 2 of Taxation Determination TD 2011/16 <i>Income tax: Division 7A - payments and loans through interposed entities - factors the Commissioner will take into account in determining the amount of any deemed payment or notional loan arising under section 109T of the Income Tax Assessment Act 1936</i>, or should provide a similar list of factors that will be taken into account in the context of section 109U.	TD 2011/16 deals specifically with the application of section 109V. In contrast, this Determination deals with the interpretation of section 109U. It is beyond the scope of the Determination to discuss the interpretation of section 109V in any detail. Notwithstanding this, the final Determination provides (at Note 2 to paragraph 6 and new footnote 5) that: - the mischief to which section 109U is directed is a factor in the exercise of the discretion under section 109V - if, on an objective assessment, none of the parties to the arrangement entered into or carried out the arrangement with a view to circumventing Division 7A, this would weigh in favour of the conclusion that the amount of the payment should be determined to be 'nil' (consistent with the view expressed in paragraph 2(h) of TD 2011/16).

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		Additionally, the final Determination includes a compliance approach concerning where a genuine section 109N compliant loan is made to the target entity.
2	Circumventing Division 7A The draft Determination states that compliance resources will be applied to arrangements including those entered into with a view to circumventing Division 7A. However, an arrangement such as the example provided in the draft Determination does not circumvent Division 7A, because Division 7A would not apply if Orchard Co had guaranteed a loan directly from the bank to Sarah.	In Example 1 of the Determination, Sarah receives \$100,000 as a payment from the interposed entity, Apple Co. The example does not result in Sarah being liable to repay that amount to the bank or anyone else. An alternative in which Sarah borrows from a bank would not produce the same outcome. If the group wanted to bring about the same result of paying \$100,000 to Sarah without interposing Apple Co, their options would have included Orchard Co borrowing from the bank to fund the payment, or Orchard Co making the payment from retained earnings. In either of those scenarios, Division 7A would apply to the payment from Orchard Co to Sarah.
3	Section 109N complying loans The final Determination should provide guidance or an example demonstrating the Commissioner's approach where the final leg of the arrangement is a loan to the shareholder or associate that complies with section 109N. The Commissioner should determine the amount under section 109V to be nil in this scenario.	The Determination includes a compliance approach concerning where a genuine section 109N compliant loan is made to the target entity.
4	Conduit financing arrangements The final Determination should state that it does not apply to a genuine conduit financing arrangement used for thin capitalisation purposes. The ATO view prevents middle market taxpayers from relying on the conduit financing test under Division 820 of the <i>Income Tax Assessment Act 1997</i> in cases where the financing entity is a company and the borrower is a trust.	The Determination includes a compliance approach concerning where a genuine section 109N compliant loan is made to the target entity. This does not mean that other cases will necessarily be 'high risk' as now articulated in paragraph 28 of the final Determination. However, we do not consider it appropriate to provide an explicit compliance approach for the suggested arrangements without appropriate regard to the particular facts of any given case. In keeping with paragraph 6 of the Determination (see our response to Issue 1 of this Compendium), if an arrangement is not, on an objective assessment, entered into or carried out with a view to circumventing Division 7A, this would weigh in favour of the conclusion that the amount of the payment that is deemed to have been made under section 109U would be 'nil'.

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5	Paragraph 109U(1)(b) in complex arrangements The final Determination should provide an example involving cross-guarantees with respect to borrowing facilities, where a reasonable person might not conclude that a particular guarantee was given solely or mainly as part of an arrangement involving the eventual payment or loan to the target entity.	The focus of this Determination is on whether section 109U can only apply to arrangements where a private company gives a guarantee to another private company. Note 1 of paragraph 6 of the Determination notes that section 109U can only apply if the 'reasonable person test' in paragraph 109U(1)(b) is satisfied. It is beyond the scope of the Determination to discuss how that test may apply in any given case (which will depend on the facts of that case).
6	Arrangements involving court-ordered payments The final Determination should address a situation in which a private company gives a guarantee for a bank loan as part of an arrangement intended to satisfy a court-ordered payment obligation of a shareholder.	We do not consider a court-ordered payment to raise significantly different considerations from other scenarios. This situation would be considered based on the circumstances of the particular case.
7	Interaction between sections 109U and 109UA Section 109U is intended to be limited to guarantees provided to private companies. Where guarantees are provided to other entities (for example, banks), these arrangements are expressly dealt with under section 109UA. It is not intended that Division 7A apply to a bank loan to a shareholder, even if it passes through an interposed company, unless a payment is required to be made by a private company under a guarantee given to the bank.	We disagree that section 109U is limited in the manner contended. Section 109UA provides for the application of Division 7A to guarantees given by private companies to other entities, such as a bank, where there is a default on the loan made to the target entity such that an actual liability under the guarantee to make a payment comes into existence. However, it does not follow that section 109UA constitutes an exclusive code for the application of Division 7A to guarantees given by a private company to an entity that is not a private company (such as a public company bank). It also does not follow that section 109UA evidences an intention that such a guarantee would only be brought within Division 7A if the guarantee is called upon (or an actual liability resulting from the guarantee otherwise comes into existence). The Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1998 contemplates that there would be situations (reflected in section 109U) where the giving of a guarantee itself would have consequences under Division 7A even if it had not yet been called upon. See, for example, paragraph 9.76 which, in discussing section 109UA, states (emphasis added): Other than in the circumstances to which new section 109U applies, a guarantee given by a private company for a loan by a third party to a shareholder (or their associate) is treated as a payment by the company

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		directly to the shareholder (or associate) only where a liability (other than a contingent liability) is actually incurred by the private company as a result of providing the guarantee or security. Parliament recognised that there may be overlap between section 109U and section 109UA. Where this occurs, section 109U is intended to have priority. This is achieved through subsection 109UA(2) which specifies that the amount of the payment under that subsection is to be reduced by any amount treated as a dividend as a result of the operation of section 109U.
8	Correctness of ATO interpretation Contrary to the ATO's interpretation, section 109U only applies to arrangements in which the recipient of the guarantee (that is, the 'first interposed entity') is a private company. The second reference to 'private company' in subparagraph 109U(1)(c)(ii) is a reference to the private company mentioned in subparagraph 109U(1)(c)(i) rather than the company that gave the guarantee in paragraph 109U(1)(a).	We disagree with the proposed construction under which the first interposed entity would be required to be a private company in scenarios covered by subparagraph 109U(1)(c)(ii). No such requirement is contained in the text of the legislation. Section 109U uses the phrase 'the private company' consistently to refer to the private company that gives the guarantee. This is consistent with the drafting of other provisions, such as section 109T, which also begins with the phrase 'this Division operates as if a private company makes a payment' and proceeds to use the phrase 'the private company' exclusively to refer to that entity. Section 109U also uses the phrase 'first interposed entity' consistently to refer to the recipient of the guarantee, including in subparagraph 109U(1)(c)(i). If the view expressed in this comment were to be correct, it would be expected that subparagraph 109(1)(c)(ii) would also use the term 'first interposed entity' consistent with subparagraph 109U(1)(c)(i). Our interpretation is also consistent with the fact that paragraph 109U(1)(a) only requires the guarantee to be given to 'another entity', not 'another private company'.
9	Inconsistent outcomes The ATO's proposed interpretation results in an inconsistent and unintended application of section 109U. The proposed interpretation does not apply to cases where a private company guarantees a loan directly from a third-party bank to a shareholder or associate, but does apply where a private company with inadequate distributable surplus is interposed between the bank and the target entity.	It is correct that the outcome under section 109U will differ between the scenarios where a private company guarantees a loan directly from a bank to a target entity, and where a private company is interposed between the bank and the target entity. However, we disagree that this difference is unintended or inappropriate. The differentiation based on the identity of the entity that makes the payment or loan to the target entity is clearly expressed in the legislation. This distinction reflects the fact that a private company with little or no distributable

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		surplus may make non-complying loans or payments to a target entity, sourced from external funding such as guaranteed bank loans.
10	In-house financing arrangements The final Determination should contain a safe harbour that applies to in-house financing arrangements in which the group's finance or treasury company on-lends money it borrows from a bank on terms that mirror the bank loan (or with a small margin).	The Determination includes a compliance approach concerning where a genuine section 109N compliant loan is made to the target entity. We do not consider it appropriate to provide an explicit compliance approach for the suggested arrangements without appropriate regard to the particular facts of any given case. In keeping with paragraph 6 of the Determination (see our response to Issue 1 of this Compendium), if an arrangement is not, on an objective assessment, entered into or carried out with a view to circumventing Division 7A, this would weigh in favour of the conclusion that the amount of the payment that is deemed to have been made under section 109U would be 'nil'.