

TD 2011/16EC - Compendium

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Ruling Compendium – TD 2011/16

This is a compendium of responses to the issues raised by external parties to Draft Taxation Determination TD 2010/D10 – 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*.

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1.	Same principles should apply to Subdivision EB	
	The Commissioner should confirm by way of Determination, (in either the finalised version of this draft Determination or in another separate future draft Determination), that an analogous approach to that which has been adopted in this draft Determination will also be adopted in relation to the determination of a deemed payment or loan under the recently introduced provisions under subsection 109XH(1) of Subdivision EB of the <i>Income Tax Assessment Act 1936</i> (ITAA 1936) ¹ . Taxpayers equally require the same comfort in relation to similar issues arising out of the application of subsection 109XH(1).	The Commissioner agrees that the same principles should apply to determining the amount of any deemed payment or notional loan arising under sections 109XF and 109XG. As Determinations are 'short form' rulings on a specific issue this cannot be confirmed in the finalised version of the draft Determination. The Commissioner will provide guidance in a future product.
2	Relevant factors occurring after lodgment date	
	Paragraph 1 of the draft Determination states that the Commissioner will take into account relevant factors occurring before the earlier of the due date for lodgment and the date of lodgment (lodgment date) of the private company's return for the income year in which the company is taken to have made the deemed payment or notional loan. The Commissioner should be able to take into account factors occurring after lodgment date that are relevant to determining the amount of the	The Commissioner agrees that he can take into account relevant factors occurring after lodgment date. Paragraph 1 in the final Determination will state that the Commissioner will take into account relevant factors within his knowledge at the time of determining the deemed payment or notional loan.

¹ All legislative references are to the ITAA 1936 unless otherwise stated.

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	deemed payment or notional loan.	
3	Additional guidance required for paragraph 2(g) of Draft Taxation Determination TD 2010/D10	
	We believe that the analysis of Subdivision E contained in the draft Determination is fundamentally the correct approach. However, short of any further valid illustration or clarification being provided paragraph 2(g) should be deleted from the finalised Determination.	In determining the amount of the deemed payment or notional loan the Commissioner is not limited to the factors in paragraphs 2(a) to 2(f) of TD 2010/D10. He will take into account all factors that he considers relevant given the facts and circumstances of the particular case. These will include: • The capacity of the interposed entity to repay the loan. • Non-compliance with the terms of the section 109N agreement between the private company and the interposed entity. • Any loan forgiveness. • The distributable surplus of any interposed private company. Additional guidance will be provided in the final Determination.
4	Division 7A requires the shareholder or associate of a shareholder to make loan repayment	
	To avoid a private company from being taken to have paid a dividend to a shareholder (or their associate) the loan either needs to be repaid in full before lodgment date or a complying loan agreement put in place before lodgment day. A fundamental principle is therefore the making good of the funds accessed by the shareholder (or their associate). The draft Determination is not consistent with that principle as there will be cases where no repayments are made by the shareholder (or their associate) to the interposed entity and no deemed dividend arises.	Division 7A is concerned with disguised or informal distributions of private company profits to shareholders (or their associates). Therefore, the transactions between the private company and the interposed entity are relevant in assessing interposed entity arrangements. If a loan is made by a private company to an interposed entity and repaid before lodgment day or considered to be a commercial loan for Division 7A purposes (complying loan agreement with minimum yearly repayments) then, in the absence of other relevant factors, the Commissioner does not consider that there has been a disguised or informal distribution of company profits.

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5	Transactions between the private company and interposed entity should not be taken into account	
	Nothing in Division 7A appears to support that any transactions between the company (or trustee) and the (first) interposed entity can or should be taken into account when determining the amounts as per subsections 109V(2), 109W(2) or 109XH(2), other than whether the payment or loan to the interposed entity was mainly or solely as part of an arrangement involving a loan to the target entity. For example, subsection 109X(1) clarifies that the nature of the transaction between the company and the interposed entity is irrelevant if the interposed entity is a company, and/or the amount paid or lent to the interposed entity is included in the assessable income. Further, subsections 109T(2) and 109XG(2) clarify that the amount provided to the interposed entity or the timing thereof is not relevant to determine the application of sections 109T or 109XG. In other words, what is important is what has been provided to the target entity and when. Paragraph 29 of TD 2010/D10 tries to justify that transactions between a company and an interposed entity are relevant to determine the amount a target entity has been paid or lent, because on the one hand there are exceptions available for borrowers subject to conditions, and on the other hand subsection 109T(3) will not deem a dividend to a target entity where a deemed dividend has already resulted from the transaction between the company and the first entity. The first part of that consideration, detailed in paragraph 27 of TD 2010/D10 gives an exemption to a borrower, the same exemption which is available to a target entity borrowing through a modification as per subsection 109X(3). The second part of the consideration, detailed in paragraph 28 of TD 2010/D10 merely recognises the punitive nature of Division 7A in that the Commissioner will not deem more than one dividend from what is	The Commissioner disagrees. The Commissioner can take into account the transactions between the private company and the interposed entity. In paragraph 25 of TD 2010/D10 it is stated that subsections 109V(2) and 109W(2) do not exhaustively define the factors which the Commissioner can consider when quantifying the payment or loan. In TD 2010/D10 paragraph 2(g) is also relevant. It does not automatically follow that if section 109N applies in respect of the loan made by the private company then the amount of a notional loan will be \$nil. Once the amount of the transaction is determined then sections 109C and 109D apply to the deemed payment and notional loan. Subdivision E is also relevant. Section 109X is relevant where there is a deemed payment or notional loan of an amount determined by the Commissioner. In the case of a loan subsections 109X(2) to 109X(4) enable sections 109E and 109N to have application. Paragraph 29 of TD 2010/D10 relates to paragraphs 27 and 28 of that Determination. The main point in paragraph 27 is that if loans made by the private company are on an acceptable commercial footing then it would be inappropriate to treat them as disguised distributions of profit.

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	potentially the same funds moving through multiple entities. It is difficult to see how the conclusion is drawn in paragraph 29 of TD 2010/D10 that the fact that no two deemed dividends should arise from the one arrangement, excuses the target entity from compliance with section 109N as modified by subsection 109X(3) because another entity has entered into a complying agreement. On the contrary, paragraphs 27 and 28 of TD 2010/D10 would lend support to the conclusion that unless the transaction(s) from the company to the first interposed entity is a deemed dividend (subsection 109T(3)), these transactions have no impact on how Division 7A operates in regard to the funds accessed by the target entity..	
6	Interpretation of paragraphs 109V(2)(b) and 109W(2)(b)	
	The draft Determination at paragraphs 2(b) and 24(b) refers to paragraphs 109V(2)(b) and 109W(2)(b), which have identical wording. The Explanatory Memorandum to Taxation Laws Amendment Bill (No.3) 1998 (EM) at paragraph 9.88 states: The Commissioner will determine the amount of the notional loan having regard to: ... • how much of that amount the Commissioner believes represents the arm's length consideration payable by the private company to the shareholder or associate or any of the interposed entities for the provision of goods or services. [New subsection 109W(2)] (Emphasis added) That is, the EM states that the Commissioner must consider any amount payable by the private company to the interposed entity, and not just amounts payable to the target entity. Accordingly, the EM suggests that paragraph 109W(2)(b) should be interpreted as follows: In determining the amount of the notional loan, the Commissioner	Before sections 109V and 109W can have application the conditions in subsection 109T(1) must be satisfied with the second condition being the requirement for a reasonable person to conclude (having regard to all the circumstances) that the private company made the payment or loan solely or mainly as part of an arrangement involving a payment or loan to the target entity. If the payment was made by a private company for the provision of goods or services in a commercial transaction then it may be difficult to satisfy all of the conditions in subsection 109T(1). The draft Determination and the final Determination are premised on the fact that all the conditions in section 109T have been satisfied. As noted, paragraphs 109V(2)(b) and 109W(2)(b) only refer to consideration payable to the target entity by the private company or any of the interposed entities for anything. The paragraphs do not refer to consideration payable by the private company to the interposed entity for the provision of anything. We note that the EM is not unequivocal. There is a question of whether the reference to 'or any of the interposed entities' is meant to be a reference to consideration provide by those interposed entities, or to those interposed entities. Given the legislative context, the quoted section from

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	must take account of: (b) how much (if any) of that amount the Commissioner believes represented consideration payable to the target entity by the private company or [by the private company to] any of the interposed entities for anything (assuming that the consideration payable equals that for similar transactions at arm's length). This different interpretation based on the EM becomes very relevant in certain factual scenarios. The draft Determination does not consider this issue and seems to proceed on an interpretation that refers only to amounts payable to the target entity. This determination is a good opportunity to clarify this issue.	the EM can be seen to be simply referring to the consideration payable to the target entity, in respect of the loan to the target entity, for anything. No change is required.
7	Example 1	
	1. Example 1 appears to be an example of a company to company loan with the interposed company then making a loan to an individual. It is conceivable that the interposed entity could be a trust. Perhaps the Example should make clear that the result would be the same regardless of whether or not the interposed entity was a trust or a company.	The Commissioner agrees that the interposed entity referred to in section 109T is not restricted to companies. Paragraph 109T(1)(a) refers to the private company making a payment or loan to another entity (the first interposed entity). Example 1 is altered to change the interposed entity to a trust and additional examples added to include as the interposed entity a private company.
	2. Example 1 in the draft refers to a 2011 income year loan (that is 15 September 2010) by Jones Pty Ltd, yet refers at paragraph 7 of the draft to that loan being made compliant prior to 2010 lodgment date. It would seem more instructive to have the loan made compliant prior to the 2011 lodgment date.	The Commissioner agrees that the reference to lodgment date should have been a reference to the 2011 lodgment date. This will be corrected in the final Determination.