TD 2015/D4 - Income tax: Division 7A: is a release by a private company of its unpaid present entitlement a 'payment' within the meaning of Division 7A of Part III of the Income Tax Assessment Act 1936?

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This document has been finalised by TD 2015/20.

There is a Compendium for this document: **TD 2015/20EC** .

Draft Taxation Determination

Income tax: Division 7A: is a release by a private company of its unpaid present entitlement a 'payment' within the meaning of Division 7A of Part III of the *Income Tax Assessment Act 1936*?

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This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

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Ruling

1. Yes. A private company that releases its unpaid present entitlement (UPE) credits an amount within the meaning of that word in paragraph 109C(3)(b) of the *Income Tax Assessment Act 1936* (ITAA 1936).[1] Such a crediting is taken to be a payment for the purposes of subparagraph 109C(3)(b)(iii) to the extent that the release represents a financial benefit to an entity.

2. In this Draft Taxation Determination, a reference to a UPE is a reference to a beneficiary's right to receive an amount of trust income and/or capital that:

   (a) arises as a result of the beneficiary having been made presently entitled to that amount, and

   (b) has not been satisfied (including by being paid to or as directed by the beneficiary, or by being effectively converted into a loan from the beneficiary) or effectively disclaimed.

3. If a UPE has been converted to, a 'Division 7A loan' (as that phrase is used in paragraph 5 of Taxation Ruling TR 2010/3 *Income tax: Division 7A loans: trust entitlements*) the UPE ceases to be one to which this determination applies.

[1] All legislative references are to the ITAA 1936 unless otherwise indicated.

Example 1

4. *ABC Pty Ltd is the trustee of ABC Trust (a discretionary trust). XYZ Pty Ltd is within the class of potential objects. On 30 June 2012, ABC Pty Ltd resolved to make XYZ Pty Ltd presently entitled to $100 of the income of the trust estate. The amount to which XYZ Pty Ltd was presently entitled was not paid and, in accordance with the terms of the ABC Trust deed, was set aside separately in the accounts of the ABC Trust.*

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

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

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

Example 2

8. *Unlucky Bob (an individual) is the trustee of Unlucky Trust, a sub-trust (within the meaning in TR 2010/3) settled in the 2011-12 income year with $1,000 of trust property to which a UPE relates. The sole beneficiary, and owner of the UPE, is XYZ Beneficiary Pty Ltd. Unlucky Bob is a shareholder of XYZ Beneficiary Pty Ltd.*

9. *Unlucky Bob entered into a range of investments with the proper care and skill that a person of ordinary prudence would exercise.*

10. *During the 2013-14 income year, a market fall caused the value of the investments to become worthless. No amount of the loss was caused by an act or omission intentionally or negligently done, and there was no breach of trust which Unlucky Bob was required to make good to the Unlucky Trust estate.*

11. *XYZ Beneficiary Pty Ltd subsequently entered into a deed, by which it relinquished its entire equitable interest in the Unlucky Trust, It accounted for the released interest by making a credit entry against a 'trust entitlement' ledger to reflect that the interest ceased to be an asset of the company.*

12. *In these circumstances, the release by XYZ Beneficiary Pty Ltd confers no financial benefit upon Unlucky Bob. Accordingly, the release is not a payment within the meaning in subparagraph 109C(3)(b)(iii).*

Date of effect

13. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
10 June 2015

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

Release involves crediting

14. Subsection 109C(1) provides that a private company is taken to pay a dividend to a shareholder (or an associate of a shareholder) at the end of a year of income if the private company pays an amount to the entity during the year.

15. For the purposes of Division 7A of Part III, payment has the meaning in subsection 109C(3) and section 109CA. Relevantly, subsection 109C(3) defines 'payment' as meaning:

(a) a payment to the extent that it is to the entity, on behalf of the entity or for the benefit of the entity; and

(b) a credit of an amount to the extent that it is:

(i) to the entity; or

(ii) on behalf of the entity; or

(iii) for the benefit of the entity; and

(c) a transfer of property to the entity.

16. The phrase 'credits an amount on behalf of, or for the individual benefit of' was used in former section 108 which, like section 109C, applied to deem certain payments, made by private companies to shareholders or their associates, to be dividends paid out of company profits to the recipient as a shareholder.

17. In relation to former section 108, the Commissioner already takes the view that, in the context of a private company forgiving amounts owed to it, both the formal forgiveness of a debt (for example, by way of deed of release or agreement), and the writing off of a debt in a company's books of account, constitute a crediting of an amount for the purposes of the section.

18. That view is expressed in paragraph 21 of Taxation Ruling IT 2637 *Income tax: private companies: loans or advances which represent distributions of profits*, where it is also noted that 'support for this view is found in the judgment of Sweeney J in *DFCT v. Black* 90 ATC 4699'. In that case Sweeney J observed (at 4705) that the 'removal of a debit standing against the taxpayer constitute[s]…an amount credited to the taxpayer...'.

19. In respect of former section 108, the Federal Court held in *Lonsdale Sand & Metal Pty Ltd v. FCT* (1998) 38 ATR 384 at 391 that:

> There is nothing to suggest that the word 'credited' in s 108(1)(b) should be given any particular confined meaning. It is not separately defined in the Act. Its general meaning includes: '*to enter upon the credit side of an account; give credit for or to; to give the benefit of such an entry to (a person, etc)*' (The Macquarie Concise Dictionary, 2ed, at 218).

20. Similarly, it is considered that the word 'credit' in paragraph 109C(3)(b) takes a wide meaning, and includes any action or dealing that would be properly reflected as a credit entry in the private company's books of account.

21. A UPE is an asset (an equitable interest) which stands as a debit entry in a beneficiary's books of account.

22. A release (by way of deed or agreement) constitutes a binding undertaking, which leaves the entity to whom the interest is released with full legal ownership, free of any separately identifiable equitable interest of the releasing beneficiary in the underlying property (*Crichton v. Crichton* (1930) 43 CLR 536; *Vandervell v. IRC* [1966] Ch 261).

23. To properly reflect the effect of the release in the beneficiary's books of account, the beneficiary would make a credit entry in the amount of the UPE released.

24. Whether or not the entity that is the trustee of the trust in relation to which the UPE exists ultimately holds legal ownership of the property represented by the UPE in their own right (for example, by reason of the equitable doctrine of merger of estates, see for example, *Forbes v. Moffatt, Moffatt v. Hammond* (1811) 34 ER 36), or as trustee for another entity (see for example, *Re Brockbank (dec'd)* [1948] Ch 206; [1948] 1 All ER 287), or as agent of the releasing beneficiary (see for example, Ford, HA, Lee, WA (1990) *Principles of the Law of Trusts (2nd edn)* The Law Book Company Limited, NSW, para 617), will depend upon the facts and circumstances surrounding the release and, in particular, the intention of the parties involved.

25. Nonetheless, it is considered that the release of a UPE (that ought to be properly reflected by a credit entry in the private company beneficiary's books of account) is a credit of an amount that is for the benefit (whether in their own capacity or not) of the entity to whom the UPE is released. Accordingly, the release of a UPE is a payment within the meaning of subparagraph 109C(3)(b)(iii).

26. This will be the case regardless of whether or not the UPE is held in the main (originating) trust or in a sub-trust (within the meaning in TR 2010/3), and whether or not the release is unconditional or conditional upon the property representing the UPE being paid for the benefit of a third party.

27. In some circumstances, the release of a UPE may also be a payment within the ordinary meaning of that term or a transfer of property within the meaning of payment in paragraph 109C(3)(c).

Release of UPE that does not give rise to benefit

28. In the context of subparagraph 109C(3)(b)(iii), the word 'benefit' means something which is capable of being enjoyed and which has a monetary value (that is, a financial benefit).

29. The release of a UPE is a payment for the purposes of subparagraph 109C(3)(b)(iii) only to the extent that a financial benefit is conferred on the entity to which the UPE is released.

30. If a trustee has lost the ability to satisfy a UPE due to circumstances beyond their control so that the beneficiary has no cause of action against the trustee to recover that loss (for example the loss arose due to natural disaster),[2] the release of the UPE does not confer a financial benefit on the trustee. This is because the release confers nothing upon the trustee of a monetary value that is capable of being enjoyed.

[2] A beneficiary generally only has a cause of action in equity against a trustee in breach of trust for compensation to the extent that there is a causal connection between the breach of trust and the loss to the trust estate (see for example, *Target Holdings Ltd v. Redferns (a firm)* [1995] 3 All ER 785 at 793-794; *Maguire v. Makaronis* (1997) 188 CLR 449 at 469).

31. However if the beneficiary does have a cause of action against the trustee to recover the loss, any release of the UPE confers a financial benefit upon the trustee because the trustee's exposure to make good the loss is extinguished. In such circumstances, the extinguishment of that exposure is a payment within the meaning of subsection 109C(3). The effect of this is similar to the effect of subsection 109G(4) in respect of debts forgiven in similar circumstances.

Appendix 2 – Your comments

32. You are invited to comment on this draft Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

33. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**24 July 2015**
Contact officer:	**Richard Mold**
Email address:	**Richard.Mold@ato.gov.au**
Telephone:	**(03) 6221 0090**
Address:	**Australian Taxation Office** **GPO Box 9977** **Hobart TAS 7001**

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 2637; TR 2006/10; TR 2010/3; TR 2015/D2; TD 2015/D5

Subject references:

- deemed dividends
- present entitlement
- shareholder payments
- trust distributions

Legislative references:

- ITAA 1936
- ITAA 1936 108
- ITAA 1936 108(1)(b)
- ITAA 1936 Pt III Div 7A
- ITAA 1936 109C
- ITAA 1936 109C(1)
- ITAA 1936 109C(3)
- ITAA 1936 109C(3)(b)
- ITAA 1936 109C(3)(b)(iii)
- ITAA 1936 109C(3)(c)
- ITAA 1936 109CA
- ITAA 1936 109G(4)

Case references:

- Crichton v. Crichton (1930) 43 CLR 536; [1930] HCA 14
- DFCT v. Black 90 ATC 4699; (1990) 21 ATR 701
- Forbes v. Moffatt, Moffatt v. Hammond (1811) 34 ER 36
- Lonsdale Sand & Metal Pty Ltd v. FCT (1998) 81 FCR 419; 98 ATC 4175; (1998) 38 ATR 384
- Maguire v. Makaronis (1997) 188 CLR 449; [1997] HCA 23; (1997) 144 ALR 729
- Re Brockbank (dec'd) [1948] Ch 206; [1948] 1 All ER 287
- Target Holdings Ltd v. Redferns (a firm) [1995] 3 All ER 785
- Vandervell v. IRC [1966] Ch 261

Other references:

- Ford, HA, Lee, WA (1990) Principles of the Law of Trusts (2nd edn) The Law Book Company Limited, NSW
- The Macquarie Concise Dictionary, 2ed

ATO references

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