TD 2015/20 - 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?

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

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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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Ruling

1. Yes. A private company that releases all, or part, of 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 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.

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

3. This Determination does not apply to the extent that an amount is included in the assessable income of the entity in favour of whom the UPE is released because of the application of another provision of Division 7A in respect of the UPE, (section 6-25 of the *Income Tax Assessment Act 1997*).[2] This Determination also does not apply to the extent that the UPE has been converted to a debt to which section 109F may apply.[3]

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 on terms such that the subsisting UPE was not a Division 7A loan within the meaning of Taxation Ruling TR 2010/3 and was not a debt for the purposes of section 109F.*

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. The subsisting UPE was not a Division 7A loan within the meaning of Taxation Ruling TR 2010/3 and was not a debt for the purposes of section 109F.*

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.*

[2] For example, a UPE may be 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*) to which section 109D applies.
[3] Section 109F may apply where a UPE has been converted to a debt, which is subsequently forgiven.

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).*

Example 3

13. *Dishonest Dave (an individual) is the trustee of Target Trust. In 2012-13 he made PQR Beneficiary Pty Ltd (a company in which he is a shareholder) presently entitled to $1,000, which he was to set aside for PQR Beneficiary Pty Ltd's sole benefit.*

14. *However, in breach of trust, Dishonest Dave instead misappropriated the $1,000 for his personal use. The full amount was lost to gambling.*

15. *PQR Beneficiary Pty Ltd has a cause of action in equity against Dishonest Dave to recover the loss to the Target Trust estate.*

16. *PQR Beneficiary Pty Ltd subsequently entered into a deed, by which it relinquished its entire equitable interest in the Target 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.*

17. *In these circumstances, the release by PQR Beneficiary Pty Ltd confers a financial benefit on Dishonest Dave in the amount of the loss to which the cause of action in equity relates. Accordingly, the release is a payment within the meaning in subparagraph 109C(3)(b)(iii).*

Date of effect

18. This Determination applies to years of income commencing 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
25 November 2015

Appendix 1 – Explanation

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

Release involves crediting

19. 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.

20. 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.

21. The word 'credit' is not defined in the Income Tax Assessment Acts. Accordingly, it should be interpreted by having regard to its ordinary meaning in the context in which it is used. The *Macquarie Concise Dictionary* (2^{nd} Edition) defines it to mean:

> 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)

22. 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. In relation to former section 108, the Commissioner 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 (when accompanied by an intention, on the company's part, not to seek to recover the debt), constitute a crediting of an amount for the purposes of that section.[4]

23. Given the statutory context in which subsection 109C(3) appears, and the intended purpose of Division 7A, it is considered that the term 'credit' takes the wide meaning so as to encompass the release of a UPE.

24. The 'crediting' need not be formally recorded in the private company's books of account. What is relevant is the dealing with the UPE in a way that, if recorded, it would properly be reflected as a credit entry in the private company's books of account.

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

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[4] That view is contained in Taxation Ruling IT 2637 *Income tax: private companies: loans or advances which represent distributions of profits.*

26. 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).

27. 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.

28. 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.

29. 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 typically 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) to the extent it represents a financial benefit to an entity.[5]

30. 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.

31. It will also be the case regardless of whether or not the UPE is released voluntarily or at the direction of a court order (see, for example, Taxation Ruling TR 2014/5 *Income tax: matrimonial property proceedings and payments of money or transfers of property by a private company to a shareholder (or their associate)*.

32. 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

33. 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).

34. 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.

[5] The financial benefit provided on release will generally be the market value of the UPE. Where the trustee is not in financial distress or otherwise prevented from paying the beneficiary that to which they are entitled, the market value of the UPE will usually be its face value. See further paragraphs 33 to 37 of this Determination.

35. 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[6] (examples may, in certain circumstances, include loss caused by natural disaster, an economic market fall, liquidation of a debtor, or fraudulent or criminal actions of a third party), 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.

36. However if the beneficiary does have a cause of action against the trustee to recover the loss, any release of the UPE ordinarily 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.

37. It is the amount of the financial benefit conferred that is the amount of the dividend taken to have been paid for the purposes of subsection 109C(2).[7]

[6] 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).

[7] The amount of the dividend in subsection 109C(2) is the relevant 'Division 7A amount' taken into account in the calculation of the private company's distributable surplus under section 109Y.

References

Previous draft:

TD 2015/D4

Related Rulings/Determinations:

IT 2637; TR 2006/10; TR 2010/3; TR 2014/5; TR 2015/4

Legislative references:

- ITAA 1936
- ITAA 1936 108
- ITAA 1936 Pt III Div 7A
- ITAA 1936 109C
- ITAA 1936 109C(1)
- ITAA 1936 109C(2)
- 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 109D
- ITAA 1936 109F
- ITAA 1936 109G(4)
- ITAA 1936 109Y
- ITAA 1997 6-25
- TAA 1953

Cases relied on:

- Crichton v. Crichton (1930) 43 CLR 536; [1930] HCA 14
- Forbes v. Moffatt, Moffatt v. Hammond (1811) 34 ER 36
- 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
- Macquarie Concise Dictionary (2nd) Edition

ATO references

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