TR 2009/D8 - Income tax: Division 7A loans: trust entitlements

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Draft Taxation Ruling

Income tax: Division 7A loans: trust entitlements

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What this Ruling is about

1. This draft Ruling expresses the Commissioner's opinion on the circumstances in which a private company with a present entitlement to an amount from an associated trust estate, in circumstances where funds representing that present entitlement remain intermingled with funds of the trust, may be taken to have made a loan to that trust within the meaning of subsection 109D(3) of Division 7A of Part III (Division 7A) of the *Income Tax Assessment Act 1936* (ITAA 1936).[1]

2. This draft Ruling sets out the Commissioner's views in the context of Division 7A. Nothing in this draft Ruling should be taken as applying to the provisions of other legislation administered by the Commissioner such as specific superannuation legislation or fringe benefits tax legislation.

3. In this draft Ruling (unless context otherwise dictates):

- ***beneficiary*** means a private company beneficiary (the *private company*);
- ***Division 7A loan*** means a thing described in paragraph 5 of this draft Ruling;

[1] All legislative references in this draft Ruling are to the ITAA 1936 unless otherwise stated.

- ***family group*** means a group of entities including or comprising the *private company* and the *trust*, that share the same ultimate controller or controllers, being any entity or person who either directly or indirectly has the practical ability to, or capability to, control the family group;
- ***private company*** means a private company, as defined in Division 7 of Part III, that is part of the same *family group* as the *trust*;
- ***sub-trust*** (of a main-*trust*) means a trust in respect of which the *private company* is the sole beneficiary, that is settled in satisfaction of the *private company's* right to demand payment of an amount from another trust;
- ***subsisting UPE*** means a UPE that has not been satisfied, including by being converted into a loan;
- ***trust*** (other than a *sub-trust*) means a trust in respect of which loans to whom may be relevant for the purposes of Division 7A (typically where the *private company* plus one or more shareholders or associates of shareholders of that *private company* are objects of that trust, making the trust an associate of a shareholder of the *private company*),[2] that is part of the same *family group* as the *private company;* and
- ***unpaid present entitlement (UPE)*** means the *private company*'s unpaid present entitlement to an amount from the *trust* or *sub-trust.*

Ruling

Section one: background

4. This draft Ruling considers the application of Division 7A to certain private company loans, in circumstances where:

- that private company has a present entitlement to amounts from an associated trust estate that is part of the same family group of entities as the private company; and
- funds representing the present entitlement remain intermingled with other funds of the trust estate, or are otherwise able to be used for the purposes of the trust estate (whether or not they remain so intermingled or available by being paid back to, reinvested in, or lent back to the trust by a relevant sub-trust).

[2] Pursuant to section 109ZD, paragraph 318(1)(d) and paragraph 318(6)(a), the trustee of a trust will be an associate of a shareholder of a company for relevant purposes if any of the private company's shareholders or their associates are capable of benefiting (including as discretionary objects) under that trust.

5. For the purposes of Division 7A, a loan (a 'Division 7A loan') includes:

- a loan within its ordinary meaning, consisting of a payment and repayment of an amount;
- an advance of money with an expectation of repayment;
- a payment of an amount for, on behalf of, on account of or at the request of an entity, where there is an obligation of repayment;
- the provision of credit, being an arrangement for the deferred payment of a debt (an amount that is ascertainable and unavoidably due whether currently or in the future, that is not contingent on any future event or actions);
- the provision of any other form of financial accommodation, in the context in which it appears being the supply or grant of some form of pecuniary assistance or favour, under a consensual agreement where a principal sum or its equivalent is ultimately payable; and
- arrangements that in substance effect such a Division 7A loan of money (as described in any of the aforementioned dot-points).

6. To be a loan that may be treated as a dividend under section 109D, the loan must be *made* by the relevant private company. A private company may make a Division 7A loan by bringing a Division 7A loan into existence; or causing, occasioning, effecting or giving rise to such a loan.

7. In relevant circumstances, a private company can cause a Division 7A loan to occur by the conscious non-doing of an act, such as intentionally not calling for payment of a UPE.

Section two: loan instead of or in satisfaction of UPE

8. A private company beneficiary's UPE can be extinguished and be converted into a loan back to the trust. For example:

- A private company may make a loan to a trust by providing moneys to the trustee pursuant to an *agreement* under which the trustee borrows the money on behalf of the trust and the private company lends the moneys to the trust. Such a loan from the private company may be effected by an agreed set-off in satisfaction of the trustee's obligation to pay the private company its trust entitlement, rather than as a cash transaction.

- If a trustee credits amounts to a loan account held in the name of the private company beneficiary, with the *authorisation* of the private company, the private company will have lent money to the trust within the ordinary meaning of a loan. Such authorisation may arise through *acquiescence* with full *knowledge* of what the trustee has done. As the trust and beneficiary form part of the same family group, the Commissioner will form the view that the private company has knowledge of what the trustee has done, subject to sufficient evidence to the contrary.

9. In addition, a trustee may make a loan on behalf of the private company beneficiary by acting *pursuant to a term of the trust deed* which permits the trustee to pay or apply money to or for the benefit of the beneficiary. The application of trust funds for the benefit of the private company by way of a loan to the trust and corresponding assumption by the trustee of an obligation to repay that sum (whether or not at interest) to the private company would be such an application for the benefit of the private company beneficiary. That is, the relevant trust funds would be regarded as having been applied for the benefit of the private company, rather than an entitlement arising that is unpaid. The private company beneficiary, through the actions of the trustee in accordance with the trust deed, will be taken to have made a loan to the trust.

10. Where an amount has been credited to a loan account in the name of the corporate beneficiary *and* under the trust deed the trustee has the power to credit such amounts for the benefit of the corporate beneficiary as a payment or application of trust funds, the Commissioner will form the view that the trustee has exercised this power to do so unless there is sufficient evidence to the contrary.

11. A loan will not arise in the manner described in paragraph 9 of this draft Ruling where instead of a debtor/creditor relationship being created (or other Division 7A loan arising), it is outside the power of the trustee to treat the funds otherwise than as a UPE and the amount to which the corporate beneficiary is entitled remains a UPE. In this situation, consideration still needs to be given to whether the private company makes a Division 7A loan in respect of that subsisting UPE, which is considered in Section three: subsisting UPEs and Division 7A loans.

12. In each of the scenarios discussed in paragraphs 8 and 9 of this draft Ruling, the private company's entitlement does not remain unpaid, so the operation of Subdivision EA of Division 7A (Subdivision EA) upon any further dealings by the trust will not arise in respect of that entitlement.

Section three: subsisting UPEs and Division 7A loans

13. Subdivision EA is an integrity provision designed to supplement the main provisions of Division 7A, and does not operate as a code to deal with private companies with UPEs.

14. In some circumstances a private company beneficiary with a subsisting UPE may be taken to have made a Division 7A loan for the purposes of section 109D.

Subsisting UPE not a loan under normal meaning or many limbs of extended definition

15. Where the arrangement comprising the UPE only gives rise to an equitable right to payment of the distributed amount (and does not in substance comprise anything further), this will not amount to a loan:

- within its normal meaning; as the arrangement does not comprise the payment and repayment of an amount;
- within paragraph 109D(3)(a) of the extended definition of a loan; as there is no advance of money involving a payment in expectation of repayment;
- that is a 'provision of credit' referred to in paragraph 109D(3)(b) of the extended definition of a loan; as there is no deferred payment of an amount that is ascertainable and unavoidably due, whether currently or in the future, and not contingent on any future event or actions; or
- within paragraph 109D(3)(c) of the extended definition of a loan; as there is no payment coupled with an obligation to repay.

Subsisting UPE may amount to the provision of financial accommodation or an in-substance loan

16. A private company beneficiary will be said to have provided financial accommodation to a trust in which it has a UPE if that private company has, under a consensual agreement:

- supplied or granted some form of pecuniary aid or favour to the trust; and
- a principal sum or equivalent that is ultimately payable.

17. As the amount of the UPE is a principal sum ultimately payable to the private company beneficiary, the private company will have provided financial accommodation to a trust if it provided any pecuniary aid or favour to the trustee of that trust under a consensual agreement.

18. A consensual agreement may arise where the private company authorises (including by acquiescing with knowledge) the continued use by the main trust of funds representing the private company's UPE for trust purposes by not calling for:

- payment of that UPE; or
- investment of the funds representing the UPE for the private company's absolute benefit (and no benefit accruing to the main trust from the use of those funds).

19. Such an authorisation of the trustee's continued use of these funds for trust purposes would amount to a consensual agreement between the private company beneficiary and the trustee.

20. Further, in these circumstances the private company beneficiary would have provided pecuniary support to the trust by allowing it to use the relevant funds for trust purposes, rather than for the absolute benefit of that corporate beneficiary. The support so provided would be the whole amount of the UPE that the private company beneficiary has allowed the trustee to use (including by knowledgeably acquiescing to this use) otherwise than for the private company's absolute benefit.

21. Accordingly, where there is knowledge that funds representing the UPE are being used for trust purposes, rather than for the private company's absolute benefit without any benefit from use accruing to the trust, the non-calling for payment of the UPE amounts to the provision of financial accommodation and, by extension, the making of a Division 7A loan.

22. Moreover, in these circumstances, the mere declaration of the private company's trust entitlements does not embody the real nature of the overall transaction between the trustee and the beneficiary. Here the overall transaction between the private company beneficiary and the trustee includes the beneficiary's authorisation (or acquiescence with knowledge) that funds representing the UPE can be used for the benefit of the main trust and effects, in substance, a loan of money to the main trust.

23. As the trust and beneficiary form part of the same family group, the Commissioner will form the view that the private company has knowledge of the trustee's use of the funds representing the UPE for trust purposes, subject to sufficient evidence to the contrary.

Subdivision EA

24. The operation of Subdivision EA is dependent upon a private company having at the relevant point in time a present entitlement to an amount from the 'net income of the trust estate' that 'has not been paid'. Where a private company has a UPE to an amount from the net income of the trust which is satisfied by the settling on sub-trust of trust property for the benefit of that private company:

- the private company's entitlement to the amount from the net income of the main-trust will have been paid (within the meaning of subsection 109C(3)); and
- instead the corpus of the sub-trust so created will be held on behalf of the private company.

To the extent to which the settlement of property on sub-trust is a necessary consequence of the private company becoming presently entitled to income of the trust, subsection 109XA(6) will apply so that the settlement of the property, without more, will not be treated as a relevant 'payment' of the UPE for Subdivision EA purposes.

25. However, where the private company beneficiary has a subsisting UPE but has also provided financial accommodation or an in-substance loan to the trustee of the trust as discussed in paragraphs 21 and 22 of this draft Ruling, the relevant arrangement will have gone beyond the creation of a present entitlement 'of itself'. Accordingly, to the extent of that UPE, the private company is not treated as having a present entitlement to an amount of the net income of the trust estate of the main-trust that remains 'unpaid' for Subdivision EA purposes. This means that in situations where the private company beneficiary has made a Division 7A loan in respect of a subsisting UPE, Subdivision EA will have no subsequent operation in respect of that UPE.

26. In some instances, funds settled on sub-trust may be lent back to the main-trust for a return. In these instances, Subdivision EA will operate to treat that loan from the sub-trust to the main-trust as a dividend,[3] but only to the extent to which the private company has a present entitlement to an amount of the net income of the *sub*-trust estate (where the other provisions of section 109D are satisfied and the private company has a distributable surplus within the meaning of section 109Y as modified by subsection 109XC(7)).

Examples

27. Assume the following fact scenario for all examples:

- Ashley and Bo are individuals who are spouses.

[3] Pursuant to section 109XB.

- Ashley and Bo have (or have an association with) a private company, X Co Pty Ltd (X Co). Ashley and Bo have the practical ability to direct the Board of X Co to act in accordance with their directions and wishes (whether or not they are also shareholders and / or directors of X Co).
- Ashley and Bo, together with other family members and related entities (including X Co), are also objects of a discretionary trust, the AB Family Trust.
- Trustee Ltd is the trustee of the AB Family Trust. Trustee Ltd is either accustomed to acting, or would be expected to so act, in accordance with the directions and wishes of Ashley and Bo (whether or not they are also shareholders and / or directors of Trustee Ltd).
- During an income year ending after the date of publication of this draft Ruling (the income year), Trustee Ltd resolves that a $10,000 of AB Family Trust's income for that year be distributed to X Co. No cash payment has been made to X Co. The manner in which distributions can be made is described in the trust deed of the AB Family Trust.
- AB Family Trust's trust law income and net income as defined in subsection 95(1) are the same for the income year.

Example 1 – loan agreed

28. X Co enters into an agreement with Trustee Ltd in its capacity of trustee of the AB Family Trust, under which X Co agrees to lend Trustee Ltd $10,000. No payments are made, but Trustee Ltd credits a loan account in the name of X Co with $10,000 in satisfaction of X Co's trust entitlement to $10,000.

29. X Co makes a loan to the AB Family Trust for the purposes of section 109D, at the time the agreement is entered into. X Co's present entitlement to $10,000 from the AB Family Trust is satisfied by way of set-off against its obligation to advance $10,000 to Trustee Ltd under the loan agreement.

30. Assuming X Co has no other entitlements in respect of the AB Family Trust, if the AB Family Trust subsequently on-lends to a shareholder or associate of a shareholder of X Co, Subdivision EA will have no application as X Co has no entitlement to income of the AB Family Trust that remains unpaid (due to this entitlement being satisfied by way of set-off against the funds lent to Trustee Ltd as trustee for the AB Family Trust).

Example 2 – loan made pursuant to a term of the trust deed

31. In respect of amounts resolved to be distributed to a beneficiary, the trust deed of the AB Family Trust gives Trustee Ltd the power to:

- pay such amounts to the beneficiary;
- apply such amounts for the benefit of the beneficiary; or
- hold such amounts on sub-trust for the sole benefit of that beneficiary, under the same terms as the AB Family Trust.

32. Upon resolving to distribute $10,000 to X Co, Trustee Ltd applies $10,000 on behalf of X Co by depositing the funds in a loan account with itself (in its accounts crediting a loan account in the name of X Co). That is, Trustee Ltd it has made a loan to itself as trustee of the AB Family Trust, as it was entitled to do pursuant to the trust deed. The resolution was silent as to whether the amount to be distributed to X Co was to be held on sub-trust or applied for the benefit of X Co.

33. The accounting records of Trustee Ltd will evidence (but not be determinative of) its transactions. As an amount has been credited to a loan account in the name of X Co *and* under the trust deed of the AB Family Trust Trustee Ltd has the power to so credit amounts for the benefit of X Co as an application of trust funds, the Commissioner will form the view that this power has been so exercised, being no evidence to suggest otherwise. Accordingly, X Co will be taken to have made a loan under section 109D to Trustee Ltd (as trustee for the AB Family Trust) when Trustee Ltd credited an amount to an account in its name.

34. If instead Trustee Ltd had deposited the amount into a bank account in the name of X Co the amount so deposited would under the terms of the banking account be a debt owed by the bank to X Co pursuant to a debtor/creditor relationship. The relationship between Trustee Ltd and X Co in respect of the amount applied for X Co's benefit to an account with the AB Family Trust is no different.

35. Assuming X Co has no other entitlements in respect of the AB Family Trust, if the AB Family Trust subsequently on-lends to a shareholder or associate of a shareholder of X Co, Subdivision EA will have no application for the reasons given in Example 1.

Example 3 – loan authorised and adopted by X Co

36. Assume the same facts as in Example 2 except that Trustee Ltd has no power to apply amounts resolved to be distributed to a beneficiary for the benefit of the beneficiary, but only to pay the amounts to the beneficiary or hold them on sub-trust for the benefit of that beneficiary.

37. Upon resolving to distribute $10,000 to X Co, Trustee Ltd still credits this amount to a loan account in the name of X Co, and treats funds as having been lent back to itself by X Co. That is, Trustee Ltd continues to use the funds for the benefit of the AB Family Trust, rather than solely for X Co.

38. X Co adopts Trustee Ltd's treatment of the amount, also recognising a loan.

39. Being no evidence to the contrary, X Co's treatment of the amount to which it is entitled as a loan demonstrates its knowledge of the actions of Trustee Ltd. In adopting and acquiescing to these known actions, X Co is taken to have authorised Trustee Ltd's treatment of the amount resolved to be distributed to X Co. X Co's entitlement is treated as having been discharged, and set-off against an equal amount it lent to Trustee Ltd.

40. Having authorised Trustee Ltd's treatment of its entitlement as having been discharged and lent back, X Co will be taken to have made a loan under section 109D to Trustee Ltd (as trustee for the AB Family Trust) when the amount was credited to the account in its name.

41. Assuming X Co has no other entitlements in respect of the AB Family Trust, if the AB Family Trust subsequently on-lends to a shareholder or associate of a shareholder of X Co, Subdivision EA will have no application for the same reason as in Example 1.

Example 4 – loan authorised by X Co

42. Assume the same facts as in Example 3 except that X Co does not account for its entitlement as a loan.

43. Assuming X Co has no other entitlements in respect of the AB Family Trust, if the AB Family Trust subsequently on-lends to a shareholder or associate of a shareholder of X Co, Subdivision EA will have no application as X Co has no entitlement to income of the AB Family Trust that remains unpaid (due to this entitlement being satisfied by way of set-off against the funds lent to Trustee Ltd as trustee for the AB Family Trust).

44. As Ashley and Bo are the directing mind of both Trustee Ltd and X Co, X Co will be taken to have known that its trust entitlement was treated by Trustee Ltd as having been discharged and set off against a loan back to the AB Family Trust, there being no evidence to the contrary. Acquiescing in this treatment (by not calling for payment of its entitlement or for it to be held on sub-trust only for its absolute benefit), X Co is taken to have authorised the actions of Trustee Ltd.

45. Accordingly, X Co is taken to have made a loan to Trustee Ltd for the purposes of section 109D when Trustee Ltd credited the amount to an account in its name. Further, assuming X Co has no other entitlements in respect of the AB Family Trust, Subdivision EA will have no role to play in respect of any on-lending from the AB Family Trust for the reasons given in Example 1.

Example 5 – sub-trust loan back to main-trust

46. In respect of amounts resolved to be distributed to a beneficiary, the trust deed of the AB Family Trust gives Trustee Ltd the power to:

- pay such amounts to the beneficiary;
- apply such amounts for the benefit of the beneficiary; or
- hold such amounts on sub-trust for the sole benefit of that beneficiary, under the same terms as the AB Family Trust (which includes the power to invest and make loans, including interest free loans).

47. Upon resolving to distribute $10,000 to X Co, Trustee Ltd sets aside that amount on sub-trust, and (in its capacity as trustee of the sub-trust) lends or invests that sum back to the AB Family Trust interest-free.

48. For the same reasons as given in paragraph 44 of this draft Ruling, X Co will be taken to know how its trust entitlement is dealt with by Trustee Ltd at the time it is so dealt with. (Even if X Co and the AB Family Trust were not part of the same family group, deriving no income from the *sub*-trust (to which X Co would be absolutely entitled) would indicate to X Co that the funds to which it is entitled were being used other than for its absolute benefit.)

49. In acquiescing to this known treatment (by not calling for payment of its entitlement or calling for the amount of that entitlement to be used for its absolute benefit rather than for the trust purposes of the AB Family Trust), X Co has allowed funds to which it is entitled to be used for the benefit of the AB Family Trust under a consensual agreement with Trustee Ltd. In this relevant sense, X Co has provided the AB Family Trust with financial accommodation. Further, in agreeing that the funds to which it is absolutely entitled can be used by Trustee Ltd for the trust purposes of the AB Family Trust rather than for its absolute benefit, X Co has in substance provided a loan to Trustee Ltd (as trustee for the AB Family Trust). In either instance, X Co is taken to have made a loan under section 109D to Trustee Ltd (as trustee for the AB Family Trust) when the main-trust was allowed to use the relevant funds for trust purposes.

50. As the transaction under which X Co provided this loan to Trustee Ltd involved more than just the creation of a present entitlement 'of itself', notwithstanding subsection 109XA(6), the settling of this entitlement on sub-trust amounts to it having been paid for Subdivision EA purposes. Accordingly, assuming X Co has no other entitlements in respect of the AB Family Trust, Subdivision EA will have no role to play in respect of any on-lending from the AB Family Trust.

Example 6 – sub-trust loan invests in main-trust for full flow-through return

51. Assume the facts are as for Example 5, except that in its capacity as trustee of the sub-trust (and not as agent of X Co) Trustee Ltd ensures that the investment in the main-trust is on terms entitling the sub-trust to all the benefits that flow from use of those funds by the main-trust. As the sole beneficiary of the sub-trust, X Co will be entitled to any income derived by the sub-trust from this investment.

52. X Co has not made any loan to, or provided financial accommodation or an in-substance loan to the main-trust or the sub-trust. Rather, X Co has a UPE that is being invested for its sole benefit, and it has not made a Division 7A loan under section 109D.

53. However, if the main-trust on-lends funds to a shareholder or an associate of a shareholder of X Co, Subdivision EA may apply to treat such on-lending as a relevant dividend.

Date of effect

54. Subject to the exception mentioned in paragraph 55 of this draft Ruling, when the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, the Ruling 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 Ruling (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

55. Section three of this draft Ruling (contained in paragraphs 13 to 26 of this draft Ruling) provides the Commissioner's view regarding when a subsisting UPE may be a loan for the purpose of Division 7A. This view is illustrated in Example 5 of this draft Ruling (contained in paragraphs 46-50). In any case where Section three or Example 5 of this draft Ruling is less favourable to a taxpayer than the Commissioner's previous practice, it does not apply to UPEs arising before the date of issue of this draft Ruling.

56. Section three and Example 5 of this draft Ruling have this date of effect due to prior public statements the Commissioner has made which evidence a prior general administrative practice contrary to the view as set out in Section three. Many former versions of the fact sheet *Division 7A - Answers to frequently asked questions* published prior to February 2009 advised that the retention on trust of an unpaid present entitlement was not a loan for Division 7A purposes. Additional support for the existence of that prior practice is that, in the 5 December 2002 meeting of the *National Taxation Liaison Group*, the Tax Office considered trust distributions to private companies that remained outstanding for some years. The Tax Office advised that the former section 109UB of Division 7A may apply where the trustee on-lends funds to individual shareholders, but made no mention of whether the UPE could itself be a loan for Division 7A purposes.

57. Whilst the prior public statements referred to in paragraph 56 of this draft Ruling considered whether a *subsisting UPE* could be a loan for Division 7A purposes, they did not encompass the situation discussed in Section two of this draft Ruling. Section two of this draft Ruling describes circumstances where the entitlement of a corporate beneficiary is satisfied (and dealt with) by the actions of the parties, such that no UPE remains in existence. Where a loan is made by the corporate beneficiary to the trust in the circumstances considered in Section two of this draft Ruling, this is an actual loan, rather than a subsisting UPE that is treated as a loan for Division 7A purposes (which is considered in Section three of this draft Ruling). It has never been doubted that actual loans made by private companies to their shareholders (or associates of their shareholders) may attract the operation of Division 7A. As such, it is proposed that the final Ruling will apply both before and after its date of issue where an actual loan is made.

Commissioner of Taxation
16 December 2009

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.

Section one: background

58. One of the purposes of Division 7A is to ensure that private companies are not able to make distributions of profits to shareholders (or their associates) in the form of non-arm's length loans instead of in the form of dividends that would be assessable to the shareholder.[4] To achieve this purpose, subsection 109D(1) will generally operate to treat such loans as assessable dividends of the relevant shareholders (or their associates) where:

- the private company makes a loan as defined in subsection 109D(3) to a shareholder (or their associate);[5]
- the loan is not fully repaid before the company's lodgement day for the year in which the loan is made;[6]
- the exceptions in Subdivision D of Division 7A do not apply; and
- the private company has sufficient distributable surplus such that section 109Y will not operate to reduce the amount of the dividend that would otherwise be deemed to have been paid.

59. This draft Ruling considers the first of these conditions. Specifically, where:

- a private company has (or had) a present entitlement to an amount from a trust that is part of the same family group as the company; and
- funds representing the present entitlement remain intermingled with other funds of the trust estate, or are otherwise able to be used for the purposes of the trust estate (whether or not they remain so intermingled or available by being paid back to, reinvested in, or lent back to the trust by a relevant sub-trust),

in what circumstances will that private company be taken to 'make a loan' (within the meaning of subsection 109D(3)) to the trust?

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[4] See paragraphs 9.1 and 9.2 of the Explanatory Memorandum accompanying the *Taxation Laws Amendment Bill Act (No. 3) 1998,* and section 109N.

[5] Or to an entity which has been such a shareholder or associate at some time, and a reasonable person would conclude (having regard to all the circumstances) that that is why the loan is made: See subparagraph 109D(1)(d)(ii).

[6] See also subsection 109D(6).

Unpaid present entitlement

60. A trustee may create (usually by resolution) a present entitlement in a beneficiary to an amount from the trust. It is not uncommon for these funds to which the beneficiary is made presently entitled to continue to be held on trust for that beneficiary until such time as the beneficiary calls for payment. In these situations, the entitlement is referred to as an 'unpaid present entitlement' (UPE).

61. When a beneficiary is made presently entitled to an amount from a trust estate, it will have an equitable right to that amount. That is, the beneficiary has rights in equity and not, without more, as a result of any debtor-creditor relationship.[7]

62. When a beneficiary is made presently entitled to an amount but not paid that amount, trust property representing the UPE will typically be settled on a sub-trust. In these circumstances, the beneficiary's right to demand payment of its UPE from the trustee of the main-trust is discharged and replaced with a UPE to the whole of the estate of the sub-trust (when the sub-trust is first settled, its estate will comprise only corpus). The trustee will typically continue to legally hold property so settled on sub-trust, but in its capacity as trustee of the sub-trust rather than of the main-trust.

63. Depending on the facts, a sub-trust can arise whether or not there is a specific clause so providing. For example, in *Case U157*[8] the trustee distributed income to a minor beneficiary, and despite there being no clause in the relevant trust deed that such amounts were to be held on separate trust, the Tribunal found:

> As trustee, it was bound to hold that property on trust for its beneficiary. As that property was held specifically for the individual beneficiary.., it was not subject to the trusts of the [main trust]. It must, therefore, have been held on a separate trust for [that individual beneficiary].[9]

64. Any income derived from the investment of the corpus of the sub-trust (for example, by the sub-trust lending funds to the main-trust)[10] is properly the income of the sub-trust and not the main-trust.[11]

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[7] For example, see McCarthy J in *Commissioner of Inland Revenue v. Ward* 69 ATC 6050 at 6071; (1969) 1 ATR 287 at 313.

[8] 87 ATC 912; *AAT Case VT 85/597* (1987) 18 ATR 3772. See also *Case V4* 88 ATC 123 per KL Beddoe SM at 130 and *Case 24/96* 96 ATC 296; *AAT Case 10,796* (1996) 32 ATR 1168, at paragraph 12.

[9] 87 ATC 912 at 914; 18 ATR 3772 at 3774.

[10] See for example *Case U111* 87 ATC 667; *AAT Case 83* (1987) 18 ATR 3602 and *Case U157* 87 ATC 912; *AAT Case VT 85/597* (1987) 18 ATR 3772.

[11] See for example Davies J in *Case U111* 87 ATC 667 at 670; *AAT Case 83* (1987) 18 ATR 3602 at 3605.

Division 7A loans

65. A 'loan'[12] is defined for the purposes of Division 7A in subsection 109D(3) as including:

(a) an advance of money; and

(b) a provision of credit or any other form of financial accommodation; and

(c) a payment of an amount for, or on account of, on behalf of or at the request of, an entity, if there is an express or implied obligation to repay the amount; and

(d) a transaction (whatever its terms or form) which in substance effects a loan of money.

Loans within the ordinary meaning

66. It is a convention of statutory interpretation that a definition utilising the word 'includes' is not intended to be exhaustive and is used as a tool to illustrate and avoid possible uncertainty in borderline cases. For example, see the observations of Lord Selborne LC in *Robinson v. Local Board of Barton-Eccles*.[13]

67. Whilst subsection 109D(3) extends the meaning of a loan for Division 7A purposes, being an inclusive definition, a loan which falls within the ordinary meaning of the word will also be a Division 7A loan.

68. What a loan is, within its ordinary meaning, was explained by Sackville and Lehane JJ of the Full Federal Court in *Federal Commissioner of Taxation v. Radilo Enterprises Pty Ltd* (*Radilo*)[14] as follows:

> A loan involves an obligation on the borrower to repay the sum borrowed. The matter is put this way by Dr Pannam:
>
> > A loan of money may be defined, in general terms, as a simple contract whereby one person ('the lender') pays or agrees to pay a sum of money in consideration of a promise by another person ('the borrower') to repay the money upon demand or at a fixed date. The promise of repayment may or may not be coupled with a promise to pay interest on the money so paid. The essence of the transaction is the promise of repayment. As Lowe J put it in a judgment delivered on behalf of himself and Gavan Duffy and Martin JJ: ''Lend' in its ordinary meaning in our view imports an obligation on the borrower to repay'.[15] … Repayment is the ingredient which links together the definitions of 'loan' to be found in the *Oxford English Dictionary*, the various legal dictionaries and the text books. In essence then a loan is a payment of money to or for someone on the condition that it will be repaid.[16]

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[12] Herein referred to as a '**Division 7A loan**'.
[13] (1883) 8 App Case 798 at 801.
[14] (1997) 72 FCR 300; 97 ATC 4151; (1997) 34 ATR 635.
[15] *Ferguson v. O'Neil* [1943] VLR 30 at 32.
[16] At ATC 4161; ATR 646; quoting CL Pannam, *The law of money lenders in Australia and New Zealand* (1964), at 6.

69. The essential element of a loan within the ordinary meaning is repayment of an amount paid. The fact that a debt exists is not of itself sufficient to characterise an arrangement as a loan. For example, in *Prime Wheat Association Ltd v. Chief Commissioner of Stamp Duties (Prime Wheat Association)*[17] Gleeson CJ acknowledged that a share sale agreement which provided for payment by instalments over a 20 year period was a debt and the provision of financial accommodation, but as there was only 'payment' and not 'repayment', there was no loan.[18] Similarly, the Full Federal Court found that the sale and lease-back arrangement in *Eastern Nitrogen Ltd v. Commissioner of Taxation*[19] was a financing arrangement for financial accommodation, but without the obligation to repay a sum advanced, was not a loan.[20]

70. Once there is an arrangement for the repayment of an amount advanced, there will be a loan within the ordinary meaning irrespective of whether the rights in respect of that arrangement arise under contract or in equity.[21]

Loans within the extended definition of a Division 7A loan

71. As explained at paragraph 65 of this draft Ruling, under subsection 109D(3) a Division 7A loan is taken to include, in addition to loans as ordinarily understood:

(a) an advance of money; and

(b) a provision of credit or any other form of financial accommodation; and

(c) a payment of an amount for, or on account of, on behalf of or at the request of, an entity, if there is an express or implied obligation to repay the amount; and

(d) a transaction (whatever its terms or form) which in substance effects a loan of money.

Advances of money, payments on behalf of borrower and in substance loans

72. Paragraph 109D(3)(a) of the extended definition of a loan concerns the advance of money. The Macquarie Dictionary[22] defines 'advance' in the relevant sense as follows:

> **advance** ... **8.** to supply or pay in expectation of reimbursement: *to advance money on loan. …* **18.** *Commerce* 1. a giving beforehand; a furnishing of something before an equivalent is received. 2. the money or goods thus furnished. 3. a loan against securities, or in advance of payment due…

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[17] (1997) 42 NSWLR 505; 97 ATC 5015; (1997) 37 ATR 479.
[18] At NSWLR 512; ATC 5019–5020; ATR 484.
[19] (2001) 108 FCR 27; [2001] FCA 366; 2001 ATC 4164; (2000) 46 ATR 474.
[20] See in particular Carr J at FCR 39; ATC 4173; ATR 485.
[21] See *De Vigier v. Inland Revenue Commissioners* [1964] 2 All ER 907 at 911; [1964] 1 WLR 1073 at 1080; per Lord Pearce at All ER 911; WLR 1080; per Lord Upjohn at All ER 915; WLR 1084.
[22] *The Macquarie Dictionary,* [Multimedia], version 5.0.0, 1/10/01.

73. Accordingly, an advance of money included within the extended definition of a Division 7A loan would ordinarily suggest moneys advanced in expectation of repayment.

74. Paragraph 109D(3)(c) of the extended definition of a loan, like a loan as ordinarily understood, also involves arrangements consisting of a payment and repayment.[23]

75. Paragraph 109D(3)(d) of the extended definition of a loan covers arrangements that in substance effect a loan of money (that is, consisting of a payment requiring repayment). In considering similarly worded provisions in State money lending legislation, Pannam observes that reference to in substance arrangements which effect 'loans' of money, is a reference to arrangements which in substance effect relationships 'which are properly described as 'loans' at common law, or because they are embraced by the earlier limbs of the statutory definition'.[24]

76. It is the Commissioner's view that a transaction which in substance effects a loan within its ordinary meaning, an advance of money, the provision of credit, the provision of financial accommodation or a payment referred to in paragraph 109D(3)(c) will also be taken to be a loan for Division 7A purposes.

77. The only remaining paragraph of this extended definition (paragraph 109D(3)(b)) includes within the scope of a Division 7A loan 'a provision of credit or any other form of financial accommodation'.

Provision of credit

78. The term 'credit' is relevantly described as follows in the Encyclopaedic Australian Legal Dictionary:[25]

> Time allowed to the buyer of goods by the seller, in which to make payment for them; granting the use or possession of goods and services without immediate payment. It includes the delivery of goods or the advancing of money with the trust that the debtor will have the means to pay and will pay at a future date: *Herbert v. R.*[26]
>
> The right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment.

[23] Note that paragraph 109D(3)(c) is concerned with the payments of 'an amount for, on account of, on behalf of or at the request of' the *borrowing* entity: see for example *Fresta v. FC of T* 2002 ATC 2061; (2002) 49 ATR 1212.
[24] Pannam, CL (1965) *The law of money lenders in Australia and New Zealand,* The Law Book Company Limited, Australia, p. 29.
[25] Butterworth *Encyclopaedic Australian Dictionary*, [Multimedia], 9/09/2004.
[26] (1941) 64 CLR 461; [1941] HCA 12; [1941] ALR 100; per McTiernan J at CLR 467; ALR 104.

79. In the High Court case of *Herbert v. R* Rich ACJ also discussed the meaning of credit, observing:

> In the Oxford Dictionary one of the meanings of 'credit' is 'trust in a person's ability and intention to pay, as give credit, deal on credit, long credit,' and a quotation is given from Jevon's *Primer of Political Economy*, p. 110, 'Anyone who lends a thing gives credit, and he who borrows it receives credit.' In Johnson's Dictionary 'credit' is defined as being 'correlative to debt.'[27]

80. *Geeveekay Pty Ltd, Geoffrey Keogh and Veronica Keogh v. Director of Consumer Affairs Victoria* (*Geeveekay*)[28] in relation to the Consumer Credit Code held that for credit to be provided there must be a present ascertainable debt.

81. In *Webb v. Stenton*[29] Lindley LJ explained:

> ...a debt legal or equitable can be attached whether it be a debt owing or accruing; but it must be a debt, and a debt is a sum of money which is now payable or will become payable in the future by reason of a present obligation... An accruing debt, therefore, is a debt not yet actually payable, but a debt which is represented by an existing obligation... [30]

82. In *Re Australia and New Zealand Savings Bank Ltd; Mellas v. Everinadi*[31] Pape J held that 'a debt 'accruing due' must be a debt based upon a present obligation but which is payable at a definable approachable future date'.[32] So a debt that arose only on the performance of a condition precedent was not yet a debt.

83. However, If there is an existing obligation to pay an amount, it will be a debt regardless of whether it is payable currently or in the future. In *Geeveekay*, a terms contract for the sale of land involved the provision of credit under section 4 of the Consumer Credit Code, as the contract involved unavoidable future instalment payments.

84. Similarly, the 'provision of credit' used in the definition of 'loan' in subsection 109D(3) is a reference to an arrangement for the deferred payment of a debt. That is, an amount that is ascertainable and unavoidably due, whether currently or in the future, and not contingent on any future event or actions.

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[27] At CLR 465; ALR 103.
[28] [2008] VSC 50; [2008] 19 VR 512.
[29] (1883) 11 QBD 518.
[30] At 527.
[31] [1972] VR 690.
[32] At 693.

Financial accommodation

85. The term 'financial accommodation' is not defined in the ITAA 1936 and therefore takes on its ordinary meaning, to the extent applicable by its legislative context. The Australian Oxford English Dictionary[33] does not define the term 'financial accommodation'. However it does define the words individually as:

> **financial** … **1** of finance…
>
> **finance** ... **1** the management of (esp. public) money…
>
> **accommodation** ... **3** a convenient arrangement; a settlement or compromise…

86. Similarly, the Macquarie Dictionary[34] does not define the phrase 'financial accommodation' but defines the words individually as:

> **Financial** … **1.** relating to monetary receipts and expenditures; relating to money matters; pecuniary…
>
> **Accommodation** … **1.** the act of accommodating … **5.** anything which supplies a want; a convenience … **7.** readiness to aid others; obligingness. **8.** a loan or pecuniary favour …

87. Combining these two definitions indicates that the phrase 'financial accommodation' is a reference to ***a supply or grant of some form of pecuniary assistance or favour***.

88. The Macquarie dictionary[35] relevantly defines each term as follows:

> **favour … 1.** a kind act; something done or granted out of goodwill, rather than from justice or for remuneration: *ask a favour.* **2.** kindness; kind approval.…**5.** a gift bestowed as a token of goodwill, kind regard, love, etc.…**14.** to aid or support….
>
> **aid** … **1.** to afford support or relief to; help. **2.** to promote the course of accomplishment of; facilitate. **3.** to give financial support to: *a state-aided school.*

89. This ordinary meaning of financial accommodation is very broad and could be construed to include a wide range of arrangements. It is therefore necessary to look to other material to discern the intended scope of this definition.

[33] The Australian Oxford Dictionary, 1999, Oxford University Press, Melbourne.
[34] The Macquarie Dictionary, [Multimedia], version 5.0.0, 1/10/01.
[35] The Macquarie Dictionary, [Multimedia], version 5.0.0, 1/10/01.

90. The extended definition of 'loan' in subsection 109D(3) has not been judicially considered. However, former section 46D contained a definition of 'loan' which also included the 'provision of credit or any other form of financial accommodation'. This definition was considered by the Full Federal Court case of *Radilo*. The case concerned the issue of non-redeemable preference shares which paid a fixed annual dividend of a percentage of the issue price, and which converted to ordinary shares after a fixed time. The question at issue was whether the arrangement was a loan as defined in that section, consequently disentitling the respondent to imputation credits on the dividends. Sackville and Lehane JJ stated:

> The provision of credit implies a consensual transaction, such as the delivery of goods on terms permitting deferred payment or the granting of overdraft facilities by a bank… Similarly, in its statutory context, the expression 'or any other form of financial accommodation' refers to a consensual arrangement between the person providing the accommodation and the recipient. Under a consensual arrangement for the provision of credit or financial accommodation a principal sum, or its substantial equivalent (by way of indemnity against a liability on maturing bills, for example, in the case of accommodation provided in the form of a bill acceptance facility), will ultimately be payable.[36]

91. The Court concluded that there was a principal sum ultimately payable in this case as the company did not redeem the preference shares, rather they were converted to ordinary shares which the holder could sell if they wished. Importantly, the company would retain the capital rather than having to repay it. It was decided therefore, that the issue of the preference shares did not fit within the extended definition of 'loan' in section 46D.

92. Similarly the words of the extended definition of 'loan' in subsection 109D(3) need to be construed in their statutory context. The meaning of a word or phrase is to be derived from its context and a word of wide possible connotation may be limited by the context in which it appears.[37]

93. The other terms used within the definition of a Division 7A loan in subsection 109D(3) involve either a debt as such or arrangements involving payments and repayments. The combination of the term 'financial accommodation' with these other terms in the context of the definition of a loan has a narrowing effect. In the Commissioner's view, this context limits what amounts to financial accommodation under this definition to:

- the supply or grant of some form of pecuniary aid or favour (as suggested by the ordinary meaning of this term – see paragraph 87 of this draft Ruling);

[36] At FCR 312; ATC 4160–4161; ATR 645.
[37] This is the principle of statutory construction known as *noscitur a socii*. For a discussion see *Australian Postal Corporation v. Pac-Rim Printing Pty Ltd* (1999) 163 ALR 372; [1999] FCA 640; per Weinberg J at ALR 390; FCA paragraph 60.

- under a consensual arrangement (similarly to *Radilo*);[38] and
- where a principal sum or equivalent is ultimately payable (similarly to *Radilo*).[39]

Can a present entitlement become a loan taken to be a dividend for Division 7A purposes?

94. To be a loan that may be treated as a dividend under subsection 109D(1), the loan must be 'made' by the relevant private company.

95. The Macquarie dictionary[40] relevantly defines 'make' as follows:

> **make** … **1.** to bring into existence by shaping material, combining parts, etc.: *to make a dress.* **2.** to produce by any action or causative agency: *to make trouble.* **3.** to cause to be or become; render: *to make an old man young….* **6.** to bring into a certain form or condition: *to make bookcases out of orange boxes.* **7.** to cause, induce, or compel (to do something): *to make a horse go.* **8.** to give rise to; occasion. … **12.** to do; effect: *to make a bargain.***13.** to fix; establish; enact: *to make laws.*

96. Accordingly, in the usual case, section 109D is looking to some action on the part of a private company which brings into existence, causes, occasions, effects or gives rise to a loan, or to an arrangement or circumstance that is deemed to be a Division 7A loan under subsection 109D(3).

97. Section 109D is not concerned with a *mere* unpaid trust entitlement. Nonetheless, a UPE in respect of which the private company beneficiary brings a Division 7A loan into existence, causes a Division 7A loan or gives rise to a Division 7A loan may attract its operation.

98. Importantly, causing something to occur may include the non-doing of an act. For example, the Full Federal Court in *Corporate Initiatives Pty Ltd & Ors v. FC of T*[41] (*Corporate Initiatives*) considered whether in not calling for payment of a UPE (that is, inaction), a beneficiary could be said to 'provide' a benefit to the trustee. In deciding that it could, the Full Federal Court explained:

> …without positive action A can allow B to have or take or retain something that A has the power or right to deny or withdraw. In the present case the inaction of [the beneficiary] was the only means by which [the trustee] gained the benefit…[42]

[38] Per Sackville and Lehane JJ at FCR 312; ATC 4160-4161; ATR 645.
[39] Per Sackville and Lehane JJ at FCR 312; ATC 4161; ATR 645.
[40] The Macquarie Dictionary, [Multimedia], version 5.0.0, 1/10/01.
[41] (2005) 142 FCR 279; [2005] FCAFC 62; 2005 ATC 4392; (2005) 59 ATR 351.
[42] At FCR 285-286; FCAFC paragraph 30; ATC 4397; ATR 357.

Accounting treatment not determinative

99. Ordinarily, accounting entries will evidence actual transactions. However, a loan will not be taken to have been made by the private company recorded as having made a loan to the trust, if the true substance of the arrangement is different.

100. For example, in *Case 5/94*[43] a UPE of a beneficiary from a trust under which such entitlements were to be set aside on separate trust, was instead recorded in the trust's books of account as a loan from the beneficiary. Specifically, the amounts allocated were:

> distributed by way of journal entries in the Trust records and … the accountant engaged to write up the accounting records of the Trust … decided of his own volition to use the title of 'loan'. Furthermore, … the question of how those allocations should be treated was not addressed by the parties and … the choice exercised by the accountant was one of convenience.[44]

101. The Tribunal concluded:

> The provision … of the trust deed [that required amounts set aside for beneficiaries to be held on separate trust] is binding authority on the trustee of the trust and amounts set aside for any [beneficiary] become the subject of a separate and distinct trust. That position may vary where the parties meet and come to some other agreement … Nor do we believe the making of a journal entry transferring the share of net income to an account titled 'Loan' changes the trust arrangement to one of loan. The selection of a loan account to receive the allocation credit was not only in contravention of the deed but also lacked the authorisation of the parties.[45]

102. The authorities thus suggest that if a UPE is *incorrectly* described in the accounts as a loan, this will not change its essential character as a trust entitlement. Of course, the situation will be different if the amounts so credited evidence a real transaction. For example, in the Federal Court in *Di Lorenzo Ceramics Pty Ltd & Anor v. FC of T*[46] Lindgren J held that the accountant's characterisation of a transaction as a loan in that case, acting within the scope of his authority, was evidence of the loan.

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[43] 94 ATC 130; *AAT Case 5/94* (1993) 27 ATR 1117.
[44] At ATC 135; ATR 1124.
[45] At ATC 136; ATR 1125.
[46] (2007) 161 FCR 198; 2007 ATC 4662; (2007) 67 ATR 42.

Section two: loan instead of or in satisfaction of UPE

103. As explained in paragraph 97 of this draft Ruling, a mere UPE is not considered to be a relevant loan for section 109D purposes. However, it has long been acknowledged that a beneficiary's entitlement can be converted into a loan back to the trust (see for example *Space Investments Ltd v. Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd and Ors*,[47] *Re East Finchley Pty Limited v. Commissioner of Taxation (East Finchley)*;[48] and paragraph 8.10 of the Explanatory Memorandum accompanying the introduction of the Tax Laws Amendment (2004 Measures No. 1) Bill 2004 (the Explanatory Memorandum).

Actual loans

104. The following paragraphs explain how a private company beneficiary may make an actual loan to a trust by:

- *converting* a UPE in the main-trust into a loan by agreement with the trustee, or by the trustee crediting the private company's loan account with its authorisation or acquiescence with knowledge; or
- having an amount applied by the trustee for its benefit in the form of a loan asset *instead* of having a UPE.

By agreement

105. A private company may make a loan to a trust by providing moneys to the trustee **pursuant to an agreement** under which the trustee borrows the money on behalf of the trust and the private company lends the moneys to the trust.

106. Such a loan from the private company may be effected by an agreed set-off in satisfaction of the trustee's obligation to pay the private company its trust entitlement. The principle of set-off is explained by Mellish LJ in *Spargo's case*[49] as follows:

> Nothing is clearer than that if parties account with each other, and sums are stated to be due on one side, and sums to an equal amount due on the other side on that account, and those accounts are settled by both parties, it is exactly the same thing as if the sums due on both sides had been paid. Indeed, it is a general rule of law that in every case where a transaction resolves itself into paying money by A to B and then handing it back again by B to A, if the parties meet together and agree to set one demand against the other, they need not go through the form and ceremony of handing money backwards and forwards…[50]

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[47] [1986] 3 All ER 75; [1986] 1 WLR 1072.
[48] [1989] FCA 481; 89 ATC 5280; (1989) 20 ATR 1623.
[49] *In re Harmony and Montague Tin and Copper Mining Company (Spargo's Case)* (1873) 8 Ch. App. 407; [1861-73] All ER Rep 261.
[50] At Ch. App. 414; All ER Rep 265.

107. In *Manzi v. Smith*[51] the High Court reiterated that payment by journal entry, such as in set-off cases, will only be effective with the knowledge and agreement of the parties, Barwick CJ stating:

> … the appellants were not shown to be in any wise privy to the said entries in the company's books, or for that matter had any knowledge of them. They had certainly not adopted them.
>
> …
>
> We were referred to cases in which a payment of money was held to have been made by means of entries in books of account. But in those cases the entries represented the agreement of the appropriate parties e.g. *Eyles v. Ellis*[52] … *Spargo's Case*. These decisions, quite clearly, are not authority for the proposition for which they were advanced, namely, that a payment of money was made by the making by the company of a journal entry in the books of account without reference to, or without the agreement of, the persons said to be the recipients of the money.[53]

108. In Australia, it is settled law that a payment of money may be effected by the making of a journal entry in the books of account with the agreement of the relevant parties.

109. Where the private company has agreed to lend the amount to which it is entitled to the trust by way of set-off, no UPE will remain outstanding.

With authorisation (including acquiescence with knowledge)

110. If a trustee credits an entitlement to a loan account held in the name of the private company beneficiary, with the **authorisation** of the private company, the private company will have lent money to the trust within the ordinary meaning of a loan. In such a situation, the credit to the loan account will constitute payment of the entitlement. Thus, instead of having a UPE, the company here will have a loan owed to it by the trustee of the trust. It is fundamentally the same arrangement as a loan by agreement discussed in paragraphs 105 to 109 of this draft Ruling.

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[51] (1975) 132 CLR 671; [1975] HCA 35.
[52] [1827] EngR 409; (1827) 4 Bing. 112; 130 ER 710.
[53] HCA 35 at paragraphs 6 and 7; CLR 673 and 674.

111. For example, in the Federal Court case of *Re East Finchley Pty Limited v. Commissioner of Taxation* (*East Finchley*)[54] the trustee advised beneficiaries that income had been appointed to them and that it had been credited to loan accounts in their names. The beneficiaries sent letters back acknowledging their entitlements and authorising their loan accounts to be so credited. In this case Hill J found that the by authorising this treatment, the beneficiaries had lent money to the trust by way of set-off, explaining:

> [T]he combination of the two letters … constituted a sufficient demand for payment to bring about a situation that there was an obligation in equity by force of the trust deed to pay to the beneficiaries and an obligation by virtue of the loan agreement between the trustee and beneficiaries in law to pay by way of loan the moneys to the trustee by the beneficiaries so that the principle in Spargo's case brought about the result that there was in law a payment.[55]

112. The authorisation of the crediting of funds by the trustee to a loan account may also arise through **acquiescence** with **knowledge**.

113. *Taylor v. Smith*[56] involved an issue of an agent acting upon a mistake of fact and exceeding its authority. There, the High Court considered the issue of ratification through acquiescence, and the majority concluded that could only be done consciously, and with full knowledge of the facts. In that case Higgins J observed:

> I cannot conceive of authority being given by a principal to an agent, either prospectively or retrospectively (by ratification), unless it be given consciously. I include, of course, conscious acquiescence in the sense explained in *De Bussche v. Alt* (1878) 8 Ch. D., at p. 314.
>
> But it is also necessary for ratification that at the time thereof the alleged ratifier should have full knowledge of all the material circumstances under which the act was done…[57]

114. Accordingly, the company may authorise the actions of the trustee by its acquiescence and adoption, but only if it first has full knowledge of what the trustee has done. For example, the private company may be aware that the trust has credited amounts to a loan account in its name. If the private company then allows this arrangement to continue and adopts the trustee's actions, it would amount to authorisation through ratification of the trustee's actions. The private company therefore will be taken to have lent money to the trust, and would not have any outstanding UPE to the extent of that loan.

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[54] [1989] FCA 481; 89 ATC 5280; (1989) 20 ATR 1623.
[55] At ATC 5291; ATR 1635.
[56] [1926] HCA 16; [1926] VLR 271; (1926) 38 CLR 48.
[57] At CLR 59. See also Knox CJ at CLR 54 and Rich J at CLR 60.

Knowledge

115. In considering the knowledge the private company may have of the trustee's actions, it is relevant that the arrangements being considered in this draft Ruling are those where both the trustee and the private company beneficiary are entities within the same family group that share the same ultimate controllers.

116. In *Re Rossfield Group Operations Pty Ltd*[58] it was held that 'A company can be fixed with the knowledge of any person or entity who at the acquiescence of its board has assumed control of the company'.[59] Anyone to whom an entity's managing body defers control may be taken to practically control that entity, and the entity will be taken to share the knowledge of that controlling person or entity.

117. In circumstances where a number of entities share a common controller, the controller's knowledge of one of the group's affairs can generally be attributed to another member of the same group. In *Endresz v. Whitehouse*[60] it was accepted that where a director is a controller of two companies, each company will know what the other knows because they have the same directing mind and will.[61] It was suggested by the Court that the attribution of the director's knowledge to each company did not depend on the fact that the director was common to both entities but that the director was the controller of both companies.[62]

118. Moreover, case law establishes that different persons may for different purposes satisfy the requirements of being an entity's directing mind and will.[63]

119. Where a family group shares the same ultimate controllers or the same individuals have a directing mind in respect of cash flows and distributions within the family group, the Commissioner will take the view that the private company has knowledge of what the trustee has done in respect of amounts to which the private company is entitled, subject to sufficient evidence to the contrary. In these circumstances, where the trustee credits an entitlement to a loan account held in the name of the private company beneficiary, it will be taken to have been authorised by that private company beneficiary, subject to sufficient evidence to the contrary.

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[58] [1981] Qd R 372; (1980) 5 ACLR 237.
[59] At Qd R 377.
[60] (1997) 24 ACSR 208.
[61] Per Hansen J at 228–9.
[62] Per Hansen J at 228–9.
[63] See *El Ajou v. Dollar Land Holdings Ltd* [1993] EWCA Civ 4. See also *Tesco Ltd v. Nattrass* [1972] AC 153 per Lord Reid at 171F.

Pursuant to trust deed

120. A trustee may make a loan *on behalf* of the private company beneficiary by acting **pursuant to a term of the trust deed** which permits the trustee to pay money to or for the benefit of the beneficiary. The application of trust funds for the benefit of the private company by way of a loan investment in the trust and the corresponding assumption by the trustee of an obligation to repay that sum (whether or not at interest) to the private company, would be such a payment or application for the benefit of the private company beneficiary. That is, the relevant trust funds would be regarded as having been paid to or applied for the benefit of the private company, rather than an entitlement arising that is unpaid.

121. In these circumstances the trustee acting *on behalf* of the private company will have applied the funds to which the private company was entitled by advancing them to the trust, resulting in the trust owing the private company funds under the loan agreement (in satisfaction of the private company's entitlement). The company will here have a loan asset and not a UPE in the trust, and will be taken to have made the loan to the trust.

122. As explained in paragraphs 99 to 102 of this draft Ruling accounting records will evidence (but not be determinative of) particular transactions. Where an amount has been credited to a loan account in the name of the corporate beneficiary *and* under the trust deed the trustee has the power to so credit amounts for the benefit of the corporate beneficiary as a payment or application of trust funds, the Commissioner will take the view that this power has been so exercised unless there is sufficient evidence to the contrary. Accepting that the trust has applied funds for the benefit of the private company in this manner, the private company will be taken to have made a loan to the trust.

123. Note however that such a loan will not arise where instead of a debtor/creditor relationship being created (or other Division 7A loan arising) pursuant to an exercise of the trustee's powers under the trust deed, it is outside the powers of the trustee to treat the funds otherwise than as a UPE in the circumstances (for example, as in *Case V4*).[64] In these cases, an actual loan will not be made from the corporate beneficiary to the trust unless the company authorises the trustee treating the amount as a loan owed to the private company in discharge of its entitlement, as discussed in paragraphs 110 to 119 of this draft Ruling. If there is no *actual* loan, consideration still needs to be given to whether the private company makes a *Division 7A* loan in respect of that subsisting UPE, which is considered in Section three: subsisting UPEs and Division 7A loans.

[64] [1987] AATA 185; 88 ATC 123.

Summary

124. Essentially, each of the scenarios discussed at paragraph 105 to 121 of this draft Ruling involve either:

- the private company beneficiary lending (by agreement, authorisation or ratification) money in satisfaction of a UPE; or
- the trustee creating a loan for the benefit of the private company beneficiary pursuant to the trust deed, instead of creating a UPE.

125. In each of these scenarios, the private company will be taken to have made a Division 7A loan under section 109D, and will not have an outstanding UPE in the trust in respect of that amount. As no UPE remains outstanding in respect of the loaned sum, Subdivision EA cannot be triggered in respect of that same sum.

Section three: subsisting UPEs and Division 7A loans

126. Section two of this Explanation considered the situation where a private company beneficiary is taken to have made a Division 7A loan to a trust, such that it has no outstanding UPE. This section considers the situation where a private company has an outstanding UPE (either to an amount from the main-trust or to the amount settled on sub-trust for the benefit of the private company).

127. Notwithstanding Subdivision EA (which enables certain payments, loans and forgiven debts by trusts in which a private company has a UPE, to shareholders or associates of shareholders of that company to be treated as dividends), in some circumstances a private company beneficiary with a subsisting UPE may be taken to have made a Division 7A loan (within its extended meaning), in respect of that UPE. Subdivision EA is an integrity provision designed to supplement the main provisions of Division 7A, and does not operate as a code to deal with private companies with UPEs.

When will subsisting UPEs attract section 109D (loans made by a private company)?

128. Where there is a UPE there has been no payment, requiring repayment, in the sense required for a loan as ordinarily understood (see paragraphs 39 to 43 of this draft Ruling). There is merely an equitable right to payment of the distributed amount. Accordingly, a mere subsisting UPE will not amount to a common law loan.

129. However as discussed in paragraphs 71 to 93 of this draft Ruling, for the purposes of Division 7A in addition to loans as ordinarily understood, a Division 7A loan is defined under subsection 109D(3) to include:

(a) an advance of money; and

(b) a provision of credit or any other form of financial accommodation; and

(c) a payment of an amount for, or on account of, on behalf of or at the request of, an entity, if there is an express or implied obligation to repay the amount; and

(d) a transaction (whatever its terms or form) which in substance effects a loan of money.

Payments on behalf of a borrower and advances of money

130. Paragraph 109D(3)(c) of the extended definition of a loan deals with payments on behalf of the borrowing entity (see discussion at paragraph 47 of this draft Ruling). With a mere UPE there has been no payment to the trust, nor to any other entity on the trust's behalf such that this provision could be attracted.

131. Paragraph 109D(3)(a) of the extended definition of a loan concerns the advance of money, which would ordinarily suggest moneys advanced in expectation of repayment (see discussion at paragraph 73 of this draft Ruling) and therefore not extend to mere UPEs.

Provision of credit

132. As explained at paragraphs 78 to 84 of this draft Ruling, the 'provision of credit' referred to in paragraph 109D(3)(b) is a reference to an arrangement for the deferred payment of a debt. That is, an arrangement for the deferred payment of an amount that is ascertainable and unavoidably due, whether currently or in the future, and not contingent on any future event or actions.

133. As the right of a beneficiary to seek payment from the trustee of a UPE is, in the normal course, enforceable in equity and is not a debt enforceable at common law (see for example *Re Euroasian Holdings Pty Ltd v. Ron Diamond*)[65] there is no deferred payment of a debt in the relevant sense.

134. Nonetheless, a subsisting UPE will still amount to a Division 7A loan if the circumstances are such that the private company can be said to have:

- in substance effected a loan under a transaction (whatever its terms or form); or
- provided financial accommodation (as described in paragraphs 85 to 93 of this draft Ruling),

in respect to that UPE.

[65] (1996) 64 FCR 147; (1996) 14 ACLC 502; per Heerey J at FCR 150; ACLC 504.

Financial accommodation

135. A private company beneficiary will be said to have provided financial accommodation to a trust if that private company has under a consensual agreement:

- supplied or granted some form of pecuniary aid or favour to the trust or sub-trust; and
- a principal sum or equivalent is ultimately payable.

136. As the amount of the UPE is payable on demand to the private company beneficiary, a principal sum will ultimately be payable. The private company will therefore have provided financial accommodation to the trustee if it has provided or granted, under a consensual agreement with the trustee, any pecuniary ***aid*** (including financial support) or ***favour*** (including something granted other than for remuneration) to that trustee.

137. Funds representing a subsisting UPE may remain intermingled with the trust funds of the main-trust and used other than for the absolute benefit of the corporate beneficiary, *if* for example:

- the trustee of the main-trust has done nothing other than record in its books of account the private company's entitlement; or
- a sub-trust is recognised, but the trustee of this trust allows funds to remain intermingled in the main-trust either informally; or by making a loan to the trustee of the main-trust (who may be the same trustee entity, but acting in a different capacity); or investing in the main-trust; on terms that do not entitle the corporate beneficiary to the absolute benefit of any income generated by use of those funds.

138. The case of *Eldersmede Pty Ltd & Ors v. FC of T*[66] (*Eldersmede*) concerned a group of unit trusts ultimately beneficially owned by a common family group, with one individual in effective control of all relevant entities. A series of entitlements arose, but were not paid over to the relevant beneficiaries. At no relevant time did the relevant beneficiary call upon the trustee to pay or take any steps to recover the amount of the distribution, nor did it call upon the trustee (Eldersmede) to invest the amount of the distribution on a commercial basis for its (the beneficiary's) benefit. The Administrative Appeals Tribunal (AAT) held that in doing so, the beneficiary provided a benefit to the trust.[67] In reaching this decision the AAT noted that:

- once declared the UPE was held for the beneficiary under a trust for that beneficiary alone;[68] and

[66] [2004] AATA 710; 2004 ATC 2129; (2004) 56 ATR 1179.
[67] At ATC 2160-2161; ATR 1213.
[68] At ATC 2161; ATR 1214.

- in the absence of any contrary provisions in the Deed of Trust, Eldersmede was obliged to inform the beneficiary of the amount of the distribution transferred to it and invest the amount of the distribution prudently.[69]

139. On appeal, the Full Federal Court (in *Corporate Initiatives*) upheld the AAT's decision, finding:

> …the resolutions for distribution did not confer on [the beneficiary] any proprietary right in any assets of [the trust]. Eldersmede was free to deal with those assets for trust purposes including, although not limited to, funding the distribution to [the beneficiary]. Therefore it cannot be said that Eldersmede anyway could not make use of money it was holding for someone else and thus was in no better position by reason of [the beneficiary's] failure to make demand.
>
> In her written submissions counsel for the applicants readily accepted that for [the beneficiary] to 'formally provid(e) a loan to Eldersmede of the unpaid distribution' could be seen to be a benefit as the funds could be used by Eldersmede under the terms of the loan. … However, it is **difficult to see the practical difference between a formally recorded loan and what happened here. In effect, Eldersmede was the recipient of a loan** repayable on demand and, as stated above, could use the amount of the loan for trust purposes.
>
> …
>
> …**we think that in not calling on Eldersmede to pay the amount of the distribution [the beneficiary] 'provided' a benefit to [the trust].**
>
> …In the present case **the inaction of [the beneficiary] was the only means by which Eldersmede gained the benefit we have identified**.[70] [Emphasis added]

140. The Full Federal Court also noted that:

> The Tribunal referred to the obligation of Eldersmede as trustee of [the trust] to inform [the beneficiary] that it was entitled to a transfer of the amount of the distribution: *Whakatance Paper Mills Ltd v. Public Trustee* (1939) SR(NSW) 426 at 440 and other authorities cited by the Tribunal at ATC 2160-2161. However, in the circumstances of the present case where the **same individuals, [the controlling individual] and his accounting and legal advisors, were on both sides of the transaction** this aspect does not seem relevant. Those circumstances are highly relevant, in our view, to the conclusion by the Tribunal that there was a 'scheme', the effect of which was the provision of a benefit by [the beneficiary] to Eldersmede, the benefit being the continued use of funds by Eldersmede as a result of [the beneficiary] not calling for the payment of the funds distributed to it.[71] [Emphasis added]

[69] At ATC 2161; ATR 1214.
[70] At FCR 285; ATC 4397; ATR 356-357.
[71] At FCR 283; ATC 4395; ATR 354-355.

141. A failure to call for payment of a UPE or its investment for a commercial return for its benefit was held in *Eldersmede* to be the provision by the beneficiary of a benefit to the main-trust, in circumstances where the beneficiary and trust were in a related group of entities. For completeness, it is noted that the findings of the AAT and comments by the Full Federal Court indicate there would be a similar provision of a benefit by an unrelated beneficiary not calling for payment of funds distributed to it where it has knowledge of the UPE and authorises, or with this knowledge acquiesces to, the main-trust's continued use of those funds for trust purposes.

142. Where the UPE is an entitlement to an amount of money, such a provision of a benefit would also be the provision of financial accommodation. The benefit provided is use of funds for trust purposes, which is the provision of pecuniary support to the trust. In the circumstances described, the UPE would not be used for the sole benefit of the corporate beneficiary, but rather would be in aid or favour of the main-trust, for use for trust purposes. The financial accommodation provided would be the whole amount of the UPE that the beneficiary has allowed the trustee to use otherwise than for its (the beneficiary's) absolute benefit.

Transactions effecting in-substance loans

143. Paragraph 109D(3)(d) expands the definition of a Division 7A loan to include a 'transaction (whatever its terms or form) which in substance effects a loan of money', which as explained in paragraph 75 of this draft Ruling, contemplates arrangements that in substance effect ordinary loans (comprising a payment and repayment) or other loans within the extended meaning given to the term in subsection 109D(3).

144. *Prime Wheat Association* considered whether a share sale agreement which provided for payment by instalments over a 20 year period was a 'loan security' for stamp duty purposes. The relevant legislation considered by the New South Wales Supreme Court also defined a loan to include any 'transaction (whatever its terms or form) which in substance effects a loan of money', (although notably this definition did not include a provision of credit or any other form of financial accommodation). Gleeson CJ explained (at ATC 5020) that this paragraph of the definition of loan:

> …does not have a meaning which renders everything else in the definition superfluous. The definition had its origin in money lending legislation. There is ample authority to establish that the paragraph does not entitle a court to disregard the legal nature and effect of the instrument in question, or to treat all forms of financial accommodation as loans. … A sale on terms giving the purchaser time to pay is not a disguised loan. The essence of a loan is an obligation of repayment. Here what was involved on the part of the purchasers was payment, not repayment…

145. Similarly, on its face a UPE may only require the trust to make a payment rather than a repayment. However, the relevant transaction may go beyond the trustee declaring and not paying the entitlement. If the private company beneficiary is made aware of its entitlement, and chooses not to call for the amount to which it is entitled, its decision to allow the UPE to remain outstanding may form part of the overall transaction.

146. A 'transaction' is not defined for the purposes of paragraph 109D(3)(d). In *Grimwade v. Federal Commissioner of Taxation*[72] the meaning of 'transaction' was discussed by the High Court. Latham CJ and Webb CJ, delivering the majority judgement, held that to be a transaction there has to be a transaction with some other person.[73] A trust making a private company presently entitled to an amount from the trust, together with that private company beneficiary allowing the trust to retain use of the funds to which it has a UPE would satisfy this meaning of a 'transaction', with both the trust and the private company involved in the dealing.

147. In considering the benefit conferred on a trust by a beneficiary not calling for payment of its UPE, as quoted in paragraph 139 of this draft Ruling, the Full Federal Court in *Corporate Initiatives*[74] observed that:

> …it is difficult to see the practical difference between a formally recorded loan and what happened here [namely, a UPE that was not called for]. In effect [the trustee] was the recipient of a loan repayable on demand and … could use the amount of the loan for trust purposes.[75]

148. It is therefore considered that whilst a UPE may not involve a payment and a repayment, in effect a UPE that a beneficiary has *allowed* to remain outstanding for use by the trustee for trust purposes (as opposed to being used or invested or lent for the absolute benefit of the corporate beneficiary with no benefit accruing to the main-trust) is practically the same as a UPE that is paid to the beneficiary and lent back to the trust to use for broader trust purposes. In these circumstances, the mere declaration of the private company's trust entitlements does not embody the real nature of the overall transaction carried out by the trustee and the private company beneficiary. Such a transaction between the private company beneficiary and the trustee effects, in substance, a loan of money (as well as being the provision of financial accommodation – see paragraph 142 of this draft Ruling).

[72] [1949] HCA 9; (1949) 78 CLR 199.
[73] At paragraph 14; CLR 220.
[74] (2005) 142 FCR 279; [2005] FCAFC 62; 2005 ATC 4392; (2005) 59 ATR 351.
[75] At FCR 285; ATC 4397; ATR 356.

149. It has been said that 'in-substance' provisions such as that in paragraph 109D(3)(d) may do no more than recognise the general power of the judiciary to go behind the form of an agreement when it is clear that the agreement does not reflect the actual agreement between the parties.[76] Accordingly, an arrangement such as that set out in paragraph 148 of this draft Ruling may also fall within the ordinary meaning of a loan.

Loan must be 'made'

150. Once the private company beneficiary is aware that the funds to which it is entitled are being held or invested other than for its sole benefit (for example, where those funds are being used for the purposes of the main-trust), in allowing this to continue, the private company's actions amount to authorisation through ratification of the trustee's actions. The private company therefore will be taken to have allowed or enabled the provision of the main-trust with use of its UPE for trust purposes. Consequentially:

- in granting this pecuniary favour the private company beneficiary will be seen to have provided financial accommodation to the trust; and
- the overall transaction between the private company beneficiary and the trustee includes the beneficiary's authorisation (or acquiescence with knowledge) of such use and effects, in substance, a loan of money,

both of which result in the private company beneficiary being taken to have made a loan (the one loan) to the trustee for Division 7A purposes.

151. If the corporate beneficiary has a UPE that is being held on sub-trust, the trustee of which is entitled to invest its funds, the private company should expect the trust to do so prudently and to be solely entitled to any income generated by that sub-trust. The lack of such income should cause any such beneficiary to enquire as to whether the funds held for its benefit are actually being used for its sole benefit, rather than for broader trust purposes.

152. However, the corporate beneficiaries considered by this draft Ruling share a commonality of control with the trust in which they have a subsisting UPE. *Corporate Initiatives* illustrates that where both the trustee and the company have the same controlling mind, knowledge of the use to which the funds that the beneficiary is solely entitled may be imputed by virtue of the relationship.

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[76] See for example Pannam, CL (1965) *The law of money lenders in Australia and New Zealand,* The Law Book Company Limited, Australia, pp. 29-30; and Hill, G (1979) *Stamp and death duties (New South Wales and Australian Capital Territory),* 2nd edn, The Law Book Company Limited, Australia, p.174. See also *Metropolitan Discounts & Investment Co Ltd v. Bowra Radio & Electrical Co Ltd (in Liq)* (1944) 18 ALJ 88 at 90 and 92 and *Benison v. Custom Credit Corporation Ltd.* [1962] WAR 44 at 47 discussed therein.

153. Accordingly, subject to sufficient evidence to the contrary, the Commissioner will take the view that as the trust and corporate beneficiary are part of the same family group, the beneficiary has knowledge as to whether the funds to which it is presently entitled are being used for trust purposes (as opposed to being used for its absolute benefit and not for the benefit of the trust).

154. Where a private company is taken to have made a Division 7A loan, the trust may be taken to have received a dividend equal to the UPE owing to the company[77] unless the loan is put on a commercial footing prescribed in section 109N, with minimum yearly repayments as required by section 109E.

Subdivision EA

155. Where a private company has a present entitlement to income of a trust estate that has not been 'paid' to that company, Subdivision EA may apply to loans, payments and forgiveness by that trust (in respect of a shareholder or associate of a shareholder of that private company).

156. For the reasons given in paragraphs 61 to 64 of this draft Ruling, when a discretionary beneficiary is made presently entitled to an amount but not paid that sum, an amount representing the UPE will typically be satisfied by the settling on sub-trust of trust property for the benefit of that private company.

157. Even though such a settling on sub-trust is not a direct payment to the private company beneficiary, for the purposes of Division 7A paragraph 109C(3)(b) ensures that a payment to an entity (such as the private company beneficiary) includes the credit of an amount on behalf or for the benefit of that entity.

158. Nonetheless, for the purposes of Subdivision EA, subsection 109XA(6) provides that the creation of a present entitlement will not 'of itself' be a payment. The Explanatory Memorandum provides that 'the mere creation and/or recording of a present entitlement is not taken to be a payment for the purpose of these rules'.

159. To the extent to which the settlement of property on sub-trust is a necessary consequence of the private company becoming presently entitled to income of the trust, subsection 109XA(6) will apply so that the settlement of the property, without more, will not be treated as a relevant 'payment' of the UPE for Subdivision EA purposes. This is consistent with the clear policy intention that section 109UB (the predecessor to Subdivision EA) would have effect where a UPE was settled on a sub-trust, and the main-trust then lent money to shareholders or shareholders' associates.[78]

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[77] Pursuant to section 109D.
[78] See paragraph 9.82 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1998, which introduced section 109UB.

160. However, there will be instances of arrangements that go beyond the mere creation of a UPE 'of itself', to which the UPE should be taken as having been paid within the meaning of 109C, to which Subdivision EA will then have no application. Such instances should be determined having regard to the context of Subdivision EA, in the broader scheme of Division 7A.[79]

161. Subdivision EA was introduced in replacement of former section 109UB, contained in Subdivision E of Division 7A. Whilst neither former section 109UB nor Subdivision EA contain any anti-overlap rules to limit their application where Subdivision B might otherwise apply, Subdivision E was only intended to apply where the paid/lent/forgiven amount had not already taken to be an amount under Division 7A as an amount paid/lent/forgiven by the private company to the relevant interposed entity. The Explanatory Memorandum provided:

> 9.67 An amount will not be taken to be a dividend under new Subdivision E [which included section 109UB] if the amount is otherwise taxable under new Subdivision B [new subsection 109T(3)]. For example, an amount might be paid or lent to a shareholder or associate through an interposed entity which is also a shareholder or associate. In that case, the amount could be taxable to the interposed entity in its own right under new Subdivision B. [80]

162. That is, the policy seems to have been to avoid double taxation under Division 7A.

163. In light of this context, it is appropriate that where the actions of the private company beneficiary (including any acquiescence with knowledge) are such that it is said to have made a Division 7A loan in respect of a UPE, there has not just been the mere creation of a present entitlement 'of itself'. Through its own knowledge and acts, the private company is taken to have made a loan back to the trust for Division 7A purposes. The overall arrangement is not a mere creation of a present entitlement.

164. In situations where there has been such an arrangement beyond the mere creation of a UPE, the restrictions in subsection 109XA(6) do not apply and the usual definition of 'paid' contained in subsection 109C(3) can be relied upon. Under that definition, allocating the amount of the UPE to a sub-trust involves the crediting of an amount for the benefit of or on behalf of the private company, satisfying the meaning of 'paid'.

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[79] See *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 187 CLR 384; (1997) 141 ALR 618 and *MLC Limited & Anor v. DFT* 126 FCR 37; [2002] FCA 1491; 2002 ATC 5105; (2002) 51 ATR 283.

[80] See the Explanatory Memorandum accompanying the Taxation Laws Amendment Bill (No. 3) 1998.

165. Accordingly, in situations where the private company beneficiary has made a Division 7A loan in respect of a subsisting UPE, the company should not be treated as having a present entitlement to an amount from the main-trust that remains 'unpaid' for Subdivision EA purposes, avoiding any potential for double counting.

166. For completeness it is noted that in some instances, funds settled on sub-trust may be lent back to the main-trust for a return. In these instances, Subdivision EA will operate to treat that loan from the sub-trust to the main-trust as a dividend, pursuant to section 109XB but only to the extent to which the private company has a present entitlement to an amount of the net income of the *sub*-trust estate (where the other provisions of section 109D are satisfied and the private company has a distributable surplus within the meaning of section 109Y as modified by subsection 109XC(7)). No amount of the original UPE to an amount from the main-trust will be double counted in any subsequent application of Subdivision EA in respect of unpaid entitlements to income of the sub-trust.

Other considerations

167. Where the UPE of a private company is held on sub-trust and the funds are used only for the private company's sole benefit (and not for any benefit of the main-trust) the private company should not be taken to make a Division 7A loan, unless the sub-trust has made a Division 7A loan as agent for the private company.

168. In situations where the private company is an absolutely entitled beneficiary of the sub-trust and able to direct the trustee of the sub-trust, a Division 7A loan of the sub-trust will under ordinary agency principles be a Division 7A loan made by the private company. If there is insufficient evidence about the nature of the sub-trust, the Commissioner will assume that the property is being dealt with at the direction of the beneficiary.

169. In other situations (where the sub-trust is not acting as agent of the private company beneficiary), it should be considered whether any Division 7A loan made by the sub-trust, if it had instead been made by the private company directly, would have been treated as a dividend made under section 109D. In instances where it would have, unless the terms on which the sub-trust lends to the main-trust include terms in respect of interest, term of loan and repayment arrangements compliant with sections 109N and 109E, a tax benefit may arise and the application of Part IVA would need to be considered.

Appendix 2 – Your comments

170. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

171. A compendium of comments is also 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; and
- publish on the Tax Office 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:	**12 February 2010**
Contact officer:	**Tim Pentony**
Email address:	**TR2009-D8@ato.gov.au**
Telephone:	**(03) 9275 2833**
Facsimile:	**(03) 9275 2827**
Address:	**Australian Taxation Office** **PO Box 9977** **Box Hill VIC 3128**

Appendix 3 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

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Subject references:

- borrowings & loans
- companies
- credit
- deemed dividends
- family companies
- family group
- present entitlement
- private companies
- private company distributions
- trust beneficiaries
- trusts

Legislative references:

- ITAA 1936
- ITAA 1936 46D
- ITAA 1936 Pt III Div 7
- ITAA 1936 Div 7A
- ITAA 1936 109C
- ITAA 1936 109C(3)
- ITAA 1936 109C(3)(b)
- ITAA 1936 109D
- ITAA 1936 109D(1)
- ITAA 1936 109D(1)(d)(ii)
- ITAA 1936 109D(3)
- ITAA 1936 109D(3)(a)
- ITAA 1936 109D(3)(b)
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- ITAA 1936 109D(3)(d)
- ITAA 1936 109D(6)
- ITAA 1936 109E
- ITAA 1936 109EA(6)
- ITAA 1936 Pt III Div 7A Subdiv D
- ITAA 1936 109N
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- Benison v. Custom Credit Corporation Ltd [1962] WAR 44
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