

TD 2002/D9 - Income tax: can a private company be taken to have paid a dividend under either section 109C or section 109D of the Income Tax Assessment Act 1936 ('the Act') in respect of a payment or loan taken to have been made to a target entity by way of section 109T of the Act where the private company is taken to have made a loan to the interposed entity by way of section 109UB of the Act?

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This document has been finalised by TD 2003/2.

Draft Taxation Determination

Income tax: can a private company be taken to have paid a dividend under either section 109C or section 109D of the *Income Tax Assessment Act 1936* ('the Act') in respect of a payment or loan taken to have been made to a target entity by way of section 109T of the Act where the private company is taken to have made a loan to the interposed entity by way of section 109UB of the Act?

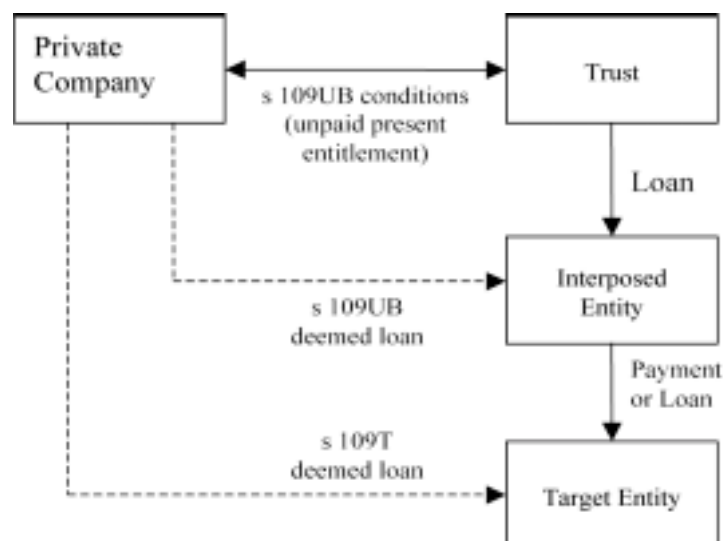
Preamble

Draft Taxation Determinations (DTDs) present the preliminary, though considered, views of the Australian Taxation Office. DTDs should not be relied on; only final Taxation Determinations represent authoritative statements by the Australian Taxation Office.

1. Yes.

Type of arrangement dealt with

2. This Determination deals with the situation set out in the following diagram:



3. Where:

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- a private company is, or has been, presently entitled to an amount from the net income of a trust estate;
- the trustee has not paid the amount to the private company; and
- the trustee has made a loan to a shareholder of the private company, or associate of such a shareholder, after the private company first became presently entitled to that amount,

the private company is taken to have made a loan to the shareholder of the private company, or the associate of such a shareholder, at the time the trustee made the loan (section 109UB).

4. Where:

- a private company makes a payment or loan to another entity that is interposed between the private company and a target entity; and
- that other entity, or a further entity interposed between the private company and the target entity, makes a payment or loan to the target entity,

a deemed payment or loan between the private company and the target entity can arise (see section 109T of the Act). However, it must be reasonable to conclude, having regard to all the circumstances, that the private company made the payment or loan solely or mainly as part of an arrangement involving a payment or loan to the target entity.

5. This determination deals with situations where a private company is taken to have made a loan pursuant to section 109UB of the Act and that deemed loan, in turn, forms part of an arrangement covered by section 109T of the Act involving a payment or loan to another entity. This determination only applies if the deemed loan to the interposed entity is itself not taken to be a dividend under section 109D of the Act. For example, a private company can not be taken to have paid a dividend in respect of the loan it is taken to have made pursuant to section 109UB where that loan is made to another company (see Taxation Determination TD 2002/19).

Deemed loan from private company

6. A loan that arises by operation of section 109UB can be a loan to an interposed entity of the kind specified in paragraph 109T(1)(a). This is because the private company is taken to have made that loan. The private company can be taken to pay a dividend to the target entity in this situation where the interposed entity is a company or any other entity.

7. Loans taken to have been made by operation of section 109UB are taken to be loans for the purposes of Division 7A of the Act. The provisions of Division 7A apply on the basis that a deemed loan is to be treated as if it were a loan. That is, Division 7A applies to a deemed loan in the same way as it applies to an actual loan. In our view, section 109T applies to a loan that is taken to have been made pursuant to subsection 109UB(1) in the same way as it applies to a loan actually made by a private company to an interposed entity.

Companies that are interposed entities or target entities

8. Section 109K of the Act provides that a private company is not taken to pay a dividend because of a payment or loan the private company makes to another company. However, subsection 109X(1) does not allow the private company to avoid being taken to have paid a dividend to a target entity where it is taken by operation of section 109UB to make a loan to a company which is interposed between the private company and the target entity. The reference in subsection 109X(1) to ‘this Subdivision’ rather than provisions other than section 109UB supports this view.
9. Subsection 109X(1) of the Act does not allow the private company to avoid being taken to have paid this dividend where it makes a loan to a company which is interposed between the private company and the target entity (see Taxation Determination TD 2001/2). Subsection 109X(1) applies because the private company is treated as having made a loan to the target entity pursuant to section 109T. Subsection 109X(1) operates to prevent the private company from avoiding being taken to have paid this dividend because of the loan it made (that is, the loan it is taken to have made by operation of section 109UB) to the company which is interposed between the private company and the target entity.
10. If the target entity is a company, the private company which made the initial payment or loan is not taken to have paid a dividend under section 109C or section 109D of the Act because of the deemed payment or loan (see section 109K of the Act and Taxation Determination TD 2001/2).

Alternative views***Alternative view – double deeming (paragraphs 109T(1)(a) and (b))***

11. There is an alternative view that section 109T applies only to loans actually made by a private company to an interposed entity. It is suggested that the application of section 109T to a deemed loan arising under section 109UB involves an inappropriate “deeming on a deeming”. Specifically, it is suggested that the context and purposes of section 109T support the view that section 109T and section 109UB are not intended to be connected and that the deeming arising under section 109UB is not intended to be imported into the application of section 109T.
12. When a question arises whether a fictional position deemed by one provision of an Act may be imported into another section to provide the required basis for the operation of that other deeming provision, it is necessary to examine the context of the two provisions and their object and purpose in the legislation to see whether the second deeming application appears to be envisaged by the provisions of the two sections (see *Woodlock v. Commissioner of Land Tax* (1974) 5 ATR 57 at 59).
13. Section 109T applies to situations where the Division is sought to be avoided by interposing one or more entities between the private company and the recipient. However, section 109UB is directed only at a more limited situation which does not involve a payment through an interposed entity and does not itself require consideration of a reasonable conclusion in the circumstances.

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14. Also, if the fictional position created by section 109UB is imported into section 109T, it is not possible to reach the conclusion required by paragraph 109T(1)(b). This is dealt with further at paragraph 22 and following.
15. In addition, the fact that section 109UB was introduced into the legislation at a later stage and directed at a specific set of facts assists in concluding that it was not intended to interact with more general provisions such as section 109T.
16. On this view, paragraph 109T(1)(a) should be applied only where there are actual, rather than deemed, payments or loans.

ATO response

17. We do not agree with this alternative view. Where a matter is deemed in legislation, the general rule is that the deeming is to be given effect to in applying the law to the extent and for the purposes to which that deeming applies unless it can be shown that that the deeming was not intended to apply. As a starting point, and on the face of the provisions, a loan that is deemed to have been made pursuant to section 109UB is treated as a loan made by the private company to an interposed entity, including for the purposes of section 109T. The effect of section 109T generally, and the effect it has when the deeming in section 109UB is applied in the present situation, does not produce a result that can reasonably be said to be clearly contrary to the intended operation of Division 7A. Accordingly, the general rule is not displaced and a deemed loan arising under section 109UB is taken to be a loan for the purposes of section 109T.
18. Section 109UB serves to extend the scope of actual circumstances that are given the treatment given to loans. The situation the section deals with has the statutory result that the private company is taken to have made a loan. Section 109UB is not a self-contained provision. It does not have any operative effect in itself. Any operative effect follows from the application of the statutory result in section 109UB to the operative provisions of Division 7A. For example, most clearly, the deemed loan serves as the subject matter for the operation of section 109D which is the basic provision under which loans can become deemed dividends. By combined effect of section 109UB and section 109D, a deemed dividend can arise in situations that do not involve interposed entities. This is not the result or effect of section 109UB itself. It involves the reading into section 109D the circumstances dealt with in section 109UB. In our view, as a matter of statutory interpretation, there is no basis on which to interpret the provision as applying to section 109D, but not applying to section 109T.
19. Moreover, we are of the view that the result is supported by and promotes the policy that underlies Division 7A and, specifically, the interposed entity provisions in Subdivision E of Division 7A. These rules are directed at ensuring that the consequences of a direct transaction are not avoided by interposing entities and achieving the same result by indirect means. Where a loan is made in any of the following situations, the private company can be taken to have paid a dividend pursuant to section 109D (subject to satisfying other conditions in Division 7A):
- where the private company makes a loan directly to the shareholder in the private company or associate of such a shareholder. The condition in section 109D(1)(a) is satisfied;

- where the private company makes a loan directly to an interposed entity. The condition in section 109T(1)(a) is satisfied; or
- where the trustee makes a loan directly to the shareholder in the private company or associate of such a shareholder. The condition in section 109UB(1)(c) is satisfied.

20. It would be incongruous and would undermine the policy intent of the provisions if the situation dealt with in this determination could not also satisfy the condition in section 109D for a deemed dividend to arise. If a deemed dividend can arise where a trustee makes a loan to a shareholder or associate, it is consistent with the intent of the interposed entity provisions that a deemed dividend can arise where the trustee makes the loan through an interposed entity.

21. Our view is not affected having regard to the timing of the original introduction of section 109T and section 109UB. As a matter of statutory interpretation, it is to be presumed that any section operates on the law that preceded it, or was contemporaneous with it.

Alternative view – deemed loan not part of an arrangement (paragraph 109T(1)(b))

22. There is an alternative view that paragraph 109T(1)(b) can only apply to loans actually made by a private company to an interposed entity. It is suggested that a deemed loan arising under section 109UB cannot satisfy the requirement that it be part of an arrangement involving a payment or loan to the target entity. Specifically, an arrangement of the kind specified can only involve an actual loan by the private company. A deemed loan is a fiction created by statute and is not capable of being part of an arrangement. The concept of arrangement is predicated on actual circumstances and does not have regard to matters that are deemed.

23. Paragraph 109T(1)(b) requires a conclusion that the private company made the loan as part of an arrangement involving a payment or loan to the target entity. Even if section 109UB, contrary to the alternative view starting at paragraph 11 above, is considered to deem the private company to have made a loan to the target entity as is required by paragraph 109T(1)(a), it does not deem the reasonable conclusion required by section 109T(1)(b), nor does it indicate by which party any arrangement would be concluded to have been made.

24. Cases such as *Rutherford v. FCT* 76 ATC 4304; (1976) 6 ATR 542 (the failure of section 108 in its then form to deem the notional dividend to have been paid “out of profits” as required by section 44) indicate that when a deeming provision is sought to operate in conjunction with another section under which several elements are required to be satisfied before that second section applies, it is necessary for the deeming provision to deem all the elements necessary for the application of that second section. If one attempts to apply section 109T(1)(b) to the situation deemed by section 109UB, it is necessary to conclude that the private company made a payment to the interposed entity as part of an arrangement.

25. The situation which section 109UB addresses is normally one where the trustees of a trust had determined to credit a distribution to the private company rather than to pay that distribution in cash, and where the trustees subsequently decide to make a loan to another party which happens to be an associate of the private company. The private company in this

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situation will have absolutely no involvement with any arrangement, so that the conclusion required by section 109T(1)(b) could not possibly be reached.

26. The fact that no attempt has been made to address this issue, either in section 109UB or by an amendment to section 109T, means that section 109T cannot have its full operation. Furthermore, that fact confirms the alternative view advanced at paragraph 11 and following, that the sections could not have been intended to operate in conjunction with each other.

ATO response

27. In our view, the matters raised are not applicable to the operation of section 109T(1)(b). In the situation dealt with in this determination, there is a real payment or loan to the target entity. There is also a real loan from the trustee to the interposed entity. There are also real factual circumstances that give rise to the conditions in section 109UB(1) being satisfied. These real circumstances support the relevant arrangement and the real loan from the trustee merely takes legislative effect by way of the statutory construction of a deemed loan. The deemed loan is merely a drafting device that describes the real factual circumstances that underlie the arrangement. The drafting device of there being a deemed loan should not divert attention from the real facts that support the existence of a wider arrangement. At issue is whether the deemed loan, or the set of real facts that underlie that deeming, is integral to making sense of how the real payment or loan came to be made to the target entity.

28. We are of the view that a private company can be involved in the interposed entity arrangement involving an unpaid present entitlement, depending on the facts of each case. For example, it is clearly possible that a trustee can be acting under the direction of, or with the involvement of, the private company in making the loan. It should be kept in mind that the unpaid present entitlement is held on trust for the company. Moreover, the existence of the unpaid present entitlement for the benefit of the private company of itself involves the private company in the arrangement.

29. We agree that the requirements for the operation of section 109T(1)(b) are not automatically satisfied or deemed to be present where section 109UB is involved. Section 109UB only operates to deem there to be a loan from the private company to the interposed entity. The additional requirements for the application of s 109T must still be satisfied. Whether these requirements are satisfied depends on the individual facts of each case.

30. In addition, it may be argued that the focus of the arrangement in question in section 109T(1)(b) is on the payment or loan to the target entity. That is, the relevant arrangement specifically involves the real payment or loan from the interposed entity to the target entity. The deemed loan simply forms part of the overall arrangement because it is integral to making sense of the circumstances surrounding the real payment or loan made to the target entity. The existence of a loan that is taken to have been made by the private company under section 109UB is a circumstance that is relevant and to which regard must be had in accordance with the requirements in section 109T(1)(b).

31. We accept that this matter is unclear. However, we consider that our view is appropriate having regard to the wording of the provisions, their intended operation and the policy that underlies Division 7A, in particular the interposed entity rules.

Application of anti-avoidance provisions

32. Consideration will also be given in appropriate cases to the application of the anti-avoidance provisions of Part IVA of the Act. This would be on a case by case basis having regard to individual circumstances. We consider that the provisions may apply where a scheme is entered into in order to avoid the operation of section 109UB by interposing an entity between the trust and the target entity.

Example 1

33. *On 30 June 2000, the trustee of the ABC trust resolves to distribute trust income of \$200,000 to its corporate beneficiary, private company A, but does not pay this amount to private company A. On 1 January 2001, the trustee of the ABC Trust makes a loan of \$100,000 to private company B which is an associate of a shareholder in private company A. Given that the conditions triggering the operation of section 109UB are satisfied, private company A is taken to have made a loan of \$100,000 to private company B. On 30 September 2000, private company B makes a loan of \$100,000 to individual Mr. D, who is an associate of a shareholder in private company A. The circumstances are such that a reasonable person would conclude that private company A had been taken to have made the deemed loan to private company B solely or mainly as part of an arrangement involving the loan to Mr D (the target entity). Under section 109W of the Act, private company A is taken to have made a notional loan of \$100,000 to Mr D. No part of the loan by private company B to Mr D has been repaid to private company B by the end of the year of income. Consequently, no part of the notional loan is taken to have been repaid and private company A is taken to have paid a dividend of \$100,000 to Mr D under section 109D in the year in which the notional loan is made.*

Example 2

34. *On 30 June 2000, the trustee of the ABC trust resolves to distribute trust income of \$200,000 to its corporate beneficiary, private company A, but does not pay this amount to private company A. On 1 January 2001, the trustee of the ABC Trust makes a loan of \$100,000 to private company B which is an associate of a shareholder in private company A. Given that the conditions triggering the operation of section 109UB are satisfied, private company A is taken to have made a loan of \$100,000 to private company B. On 30 September 2000, private company B makes a loan of \$100,000 to individual Mr. D, who is an associate of a shareholder in private company A. The loan is made because of unforeseen financial needs of Mr. D arising from a storm damaging his home in the previous week. The circumstances are such that a reasonable person would not conclude that private company A had been taken to have made the deemed loan to private company B solely or mainly as part of an arrangement involving the loan to Mr D (the target entity). Accordingly, the circumstances do not meet the conditions in section 109T(1) and private company A is not taken to have made a loan as described in section 109W of the Act.*

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Your comments

35. We invite you to comment on this draft Taxation Determination. We are allowing 4 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

Comments by Date: 25 September 2002

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Commissioner of Taxation

28 August 2002

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TD 2001/2; TD 2002/19

Subject references:

- anti-avoidance measures
- deemed dividends
- private company distributions
- shareholder loans
- shareholder payments
- trusts
- unpaid present entitlement

Legislative references:

- ITAA 1936 Div 7A of Pt III
- ITAA 1936 109C
- ITAA 1936 109D
- ITAA 1936 109D(1)(a)
- ITAA 1936 109K
- ITAA 1936 Subdiv E of Div 7A of Pt III
- ITAA 1936 109T
- ITAA 1936 109T(1)(a)
- ITAA 1936 109T(1)(b)
- ITAA 1936 109UB

- ITAA 1936 109UB(1)
- ITAA 1936 109W
- ITAA 1936 109X
- ITAA 1936 109X(1)
- ITAA 1936 Pt IVA

Case references:

- Rutherford v. FCT 76 ATC 4304; (1976) 6 ATR 542
- Woodlock v. Commissioner of Land Tax (1974) 5 ATR 57

ATO References

NO: 2002/015308

ISSN: 1038-8982