


Decision impact statement

BPFN and Commissioner of Taxation

AAT citation:	[2023] AATA 2330
Venue:	Administrative Appeals Tribunal
Venue reference no(s):	2021/8256, 2021/8257 and 2021/8258
AAT member name:	Deputy President I R Molloy
Judgment date:	28 July 2023
Appeals on foot:	No
Decision outcome:	Unfavourable to the Commissioner

Impacted advice

 This decision has no impact on any related advice or guidance.

Summary

This Decision impact statement outlines the ATO's response to this case, which concerns whether under subsection 295-550(5) of the *Income Tax Assessment Act 1997*, the income derived by a self-managed superannuation fund was non-arm's length income (NALI).

All legislative references in this Decision impact statement are to the *Income Tax Assessment Act 1997* (ITAA 1997).

All judgment paragraph references in this Decision impact statement are to the judgment of *BPFN and Commissioner of Taxation* [2023] AATA 2330, unless otherwise indicated.

Brief summary of facts

The applicant, BPFN, was the trustee of a self-managed superannuation fund. At all relevant times, BPFN was the sole unit holder of JJUT, a unit trust, having a fixed entitlement to distributions under the JJUT trust deed.

Through a series of loan agreements, JJUT lent funds to entity, ABC. ABC then lent funds to DEF and DEF then on lent to unrelated third parties.

BPFN, JJUT, ABC and DEF were related parties. The directing mind of each entity in relation to these dealings, was Mr J.¹ This structure was determined by Mr J on advice from Mr B's firm (advisor and accountant for Mr J and his associated entities since 2000), with documents drafted by Mr C's firm (solicitor for Mr J).

DEF entered into a number of loan agreements with unrelated third parties. It was not in contest in the proceedings that these loan agreements were on arm's length terms.

¹ At [49].

For each advance that DEF made to unrelated third parties, JJUT, ABC and DEF executed a funding resolution. The funding resolutions detailed:

- the loan amount, which was initially drawn down by ABC from JJUT, and subsequently by DEF from ABC
- the interest rate to be applied on the loan to the third party, and thereby the minimum interest payable under the loans between DEF and ABC, and ABC and JJUT
- the term of the loan, and
- the security provided by the third party.

The funding resolutions also set out the fees or other consideration payable to ABC and DEF.

The terms of the loan agreements, through the funding resolutions, required each of JJUT, ABC and DEF to agree to the terms of the third-party loan (including the sharing of risk, the interest rate and fees charged) before any funds were advanced to the third party under the on-lending arrangement. ABC only drew down on the loan from JJUT at the same time that DEF drew down on its loan from ABC.

Issues decided by the Tribunal

The Tribunal considered whether income derived by BPFN during the 2015, 2016 and 2017 income years was NALI pursuant to subsection 295-550(5).²

Income derived by BPFN as a beneficiary of JJUT, through holding a fixed entitlement in the income of the trust, is NALI if it is shown that:

- (a) BPFN acquired the fixed entitlement under a scheme, or the income was derived under a scheme, the parties to which were not dealing with each other at arm's length, and
- (b) the amount of the income is more than the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length.

In determining whether subsection 295-550(5) applied, the Tribunal considered 3 issues:

1. What was the scheme?
2. Were the parties dealing with each other on an arm's-length basis?
3. Did BPFN derive more income under the scheme than if the parties were dealing with each other on an arm's-length basis?

What was the scheme?

BPFN contended that, in determining whether the income derived under the scheme was more than might have been expected, a comparison to the hypothetical position where the scheme had not been entered into, was required. Under that hypothetical situation, BPFN asserted that JJUT would have dealt directly with the third-party borrowers on the same terms as DEF ultimately lent to those borrowers. Accordingly, BPFN contended that ABC and DEF did not need to feature at all in considering that hypothetical comparison.

² This matter concerned subsection 295-550(5) in the form it was before the amendments made to the legislation for non-arm's length expenditure.

BPFN, relying on the observations of Allsop J in *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [90] advanced an argument that ‘*The form of that transaction may, to a degree, be altered if it is necessary to do so to permit the transaction to be analysed through the lens of mutually independent parties*’.

In rejecting BPFN’s argument, the Tribunal decided that:

- The hypothetical position proposed by BPFN was a substantial restructure of the scheme which was not necessary to permit the transactions to be analysed.
- To accept BPFN’s hypothetical position would fail to give effect to the wording and intent of paragraph 295-550(5)(b), which requires consideration as to the amount of income that might have been expected to be derived if all the parties, including ABC and DEF, had been dealing with each other on arm’s-length terms.³

The Tribunal confirmed that the scheme was the totality of the arrangement between JJUT, ABC, DEF and the third-party borrowers.⁴

Were the parties dealing at arm’s length?

The Tribunal determined that JJUT, ABC and DEF were not dealing with each other at arm’s length.⁵ As Mr J controlled all the parties and was involved in all decision-making, it could not be said that the dealings between the related parties were as a result of real bargaining between them.⁶

Was the income derived under the scheme more than if the parties were dealing with each other on an arm’s-length basis in relation to the scheme?

While deciding that there was no real bargaining, the Tribunal concluded that BPFN had derived no more income than it would have derived had the parties been dealing with each other at arm’s length.

The Tribunal determined that the evidence established that:

- (a) The fees ABC charged were consistent with market rate fees charged by parties dealing at arm’s length.⁷
- (b) The scheme established under the private lending facility did not differ from what might be expected between independent parties dealing independently with one another in the private lending market at the time of the transactions.⁸
- (c) The income derived was not ‘more than the amount that the entity might have been expected to derive ... when dealing at arm’s length’ and, accordingly, that the interest income received by BPFN in the income years ended 30 June 2015, 2016 and 2017 was not NALI.⁹

ATO view of decision

The Tribunal’s conclusion regarding the identification of the ‘scheme’ for the purposes of subsection 295-550(5) is consistent with the ATO’s view of the meaning

³ At [61–62].

⁴ At [47].

⁵ At [48].

⁶ At [52].

⁷ At [93].

⁸ At [94].

⁹ At [95].

of the term.¹⁰ When considering whether the income derived under this scheme was more than if the parties were dealing with each other at arm's length in relation to the scheme, the same steps and parties, without the exclusion of ABC or DEF from that scheme, is required.¹¹ As the Commissioner outlines in paragraph 2 of Taxation Determination TD 2016/16 *Income tax: will the ordinary or statutory income of a self-managed superannuation fund be non-arm's length income under subsection 295-550(1) of the Income Tax Assessment Act 1997 (ITAA 1997) when the parties to a scheme have entered into a limited recourse borrowing arrangement on terms which are not at arm's length?*:

...it is necessary to identify both the steps of the relevant scheme and the parties that deal with each other under those steps of the scheme. Having identified the steps and parties to the scheme, ... the ITAA 1997 requires a determination of the amount of ordinary or statutory income that the SMSF might have been expected to derive if the same parties to the scheme had been dealing with each other on an arm's length basis under each identified step of the scheme.

Similarly, the Tribunal's conclusion that the parties to the scheme in question were not dealing at arm's length is also consistent with the ATO's view of the scheme.

While noting the Tribunal's conclusion at [95], that JJUT (and presumably BPFN as sole unit holder) did not derive more income under this particular scheme based on the evidential findings made by the Tribunal, we would question whether this decision can be extrapolated to arrangements involving private lending arrangements more broadly.

When considering the application of subsections 295-550(1) or (5) to a scheme involving private lending arrangements, it is necessary in each case to consider whether the terms, rates of return and other remuneration of the parties dealing with each other in relation to each step of the scheme are consistent with that which arm's length parties bargaining in their own self-interest would expect.

Implications for impacted advice or guidance

None.

Comments

We invite you to advise us if you feel this decision has consequences we have not identified. Please forward your comments to the contact officer.

Date issued: 10 April 2024

Contact officer details have been removed as the comments period has expired.

¹⁰ See also Law Companion Ruling LCR 2021/2 *Non-arm's length income – expenditure incurred under a non-arm's length arrangement* and Draft Taxation Determination TD 2023/D1 *Income tax: how the non-arm's length income and capital gains tax provisions interact to determine the amount of statutory income that is non-arm's length income.*

¹¹ At [61].

Legislative references

ITAA 1997 295-550(1)

ITAA 1997 295-550(5)

ITAA 1997 295-550(5)(b)

Case references

BPFN and Commissioner of Taxation [2023] AATA 2330; 2023 ATC 10-679

Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [2017] FCAFC 62;
(2017) 251 FCR 40; 105 ATR 599; 2017 ATC 20-615

Other references

LCR 2021/2

TD 2023/D1

ATO references

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