


TD 2016/19EC - Compendium

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Ruling Compendium – TD 2016/19

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2015/D5 *Income tax: is a beneficiary of a trust entitled to a deduction under section 25-35 of the Income Tax Assessment Act 1997 for the amount of an unpaid present entitlement to trust income that the beneficiary has purported to write off as a bad debt?*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	<p>The reasoning expressed in TD 2015/D5 around a section 97 of the <i>Income Tax Assessment Act 1936</i> (ITAA 1936) ‘amount’ is highly questionable.</p> <p>Strictly, even trade debts are never themselves included in assessable income – only ever the amount of the sales income derived, which if not paid also gives rise to a (trade) debt, is captured by the relevant income tax provision (section 6-5 of the <i>Income Tax Assessment Act 1997</i> (ITAA 1997)).</p> <p>As subsection 25-35(1) of the ITAA 1997 expressly refers to ‘(or part of a debt)’, there is no reason why the part of a debt that continues to represent (per <i>Pope v. FC of T</i> [2014] AATA 532 (<i>Pope</i>)) previously assessed – by whatever mechanism under the tax law – but unpaid amounts, should not be eligible for deductibility under section 25-35. In other words, a blanket exclusion for UPEs, based on the tax law mechanics of how trust income is assessed, is not needed or supportable.</p> <p>Instead, section 25-35 of the ITAA 1997 is to be interpreted as being concerned with the amounts to which debts relate – not with an overly technical focus on how those amounts flow into</p>	<p>The amount included in the assessable income of the beneficiary under section 97 is entirely different from, and unrelated to (other than in a proportionate sense) the amount the taxpayer is entitled to receive from the trust. For example, to the extent it forms part of the income of the trust, a beneficiary only entitled to receive a non-assessable amount may be still be assessed on a proportionate share of the trust’s net income, none of which the beneficiary is presently entitled to receive. This is unlike a trade debt in which the sales are directly included in the assessable income. See further the comments of the High Court in <i>Commissioner of Taxation v. Phillip Bamford & Ors; Phillip; Bamford & Anor v. Commissioner of Taxation</i> [2010] HCA 10; 2010 ATC 20-170; (2010) 75 ATR 1 at [43]; of Sundberg J in <i>Zeta Force Pty Ltd v. Federal Commissioner of Taxation</i> (1998) 84 FCR 70 at 74-75; and the Full Federal Court in <i>FC of T v. Greenhatch</i> [2012] FCAFC 84 at [36].</p> <p>Moreover, we note that in some cases a bad debt deduction, a deduction for a loss, or a capital loss will be available at the trustee level in the calculation of its net income as defined in</p>

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	<p>assessable income. Otherwise, to be workable even for trade debts, section 25-35 should instead refer to the 'unpaid income represented by debts' as having been included in assessable income.</p> <p>On this basis, why does it matter if a present entitlement amount, equal to or less than the UPE debt, has been included in assessable income by section 97 of the ITAA 1936, rather than section 6-5 of the ITAA 1997? Like sales income and an outstanding amount of that income represented by a trade debt, the test is instead whether there is a sufficiently clear nexus between an assessed present entitlement and a debt representing that UPE.</p> <p>Where the debt (UPE) amount is less than (rather than more than, per Example 1) the amount included in assessable income, it would follow that only the lesser irrecoverable debt (UPE) amount could be deducted as a bad debt.</p> <p>This approach would deal with the situation in Example 1 (by limiting any deduction to the \$1,000 income assessed) – without unnecessarily denying bad debt deductions for actual amounts assessed and receivable but which later become irrecoverable.</p>	<p>section 95 of the <i>Income Tax Assessment Act 1936</i>. It would not be appropriate for such a loss to be separately duplicated at the beneficiary level.</p>
2	<p><i>Interaction between Draft Taxation Determination TD 2015/D4 Income tax: Division 7A: is a release by a private company of its unpaid present entitlement a 'payment' within the meaning of Division 7A of Part III of the Income Tax Assessment Act 1936? and TD 2015/D5</i></p> <p>We would like to raise attention to the high effective tax rate on income that can be caused by the interaction between TD 2015/D4 and TD 2015/D5. For example, consider the</p>	<p>This outcome results from the operation of the laws currently in force and it is not clear that it is inconsistent with the policy intent particularly when the issues discussed above, as well as consideration of economically similar transactions (such as what would be the case had the UPE been simply paid out and lent back, as was the case in <i>Pope</i> are taken into account.</p> <p>We note further that in the example given, on release of the UPE, the deemed dividend will be limited to the benefit</p>

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	<p>situation of a corporate beneficiary which writes off a UPE as part of the process of tidying up a group structure (which we would expect to be quite common):</p> <ul style="list-style-type: none"> • The income is initially included in the corporate beneficiary's taxable income and taxed at 30%. • On release of the UPE, this is a deemed dividend to the trust. • Assuming the ordinary income of the trust estate is (as would typically be the case) distributed to the corporate beneficiary, the deemed dividend is also assessable to the company. Accordingly, another 30% of tax is paid on the deemed dividend. • No deduction is available to the company however, for the bad debt. <p>The outcomes that will occur for unit trusts that are 'debt funds' where the only return paid to the unit holders is interest will also be harsh. In this case, where interest is accrued and is not received (and is written off as bad), the unitholders are assessed under section 97 of the ITAA 1936 and do not receive a capital loss for non-collection of their UPE or on cancellation of their units.</p> <p>The above examples illustrate the potential for what we see as effectively double taxation.</p> <p>We submit that to alleviate overly harsh outcomes in these circumstances either:</p> <ul style="list-style-type: none"> (i) a law change is required to the conditions needed 	<p>provided – if the trust has lost value through no fault of the trustee, this may be less than the face value of the UPE: see Taxation Determination TD 2015/20 <i>Income tax: Division 7A: is a release by a private company of its unpaid present entitlement a 'payment' within the meaning of Division 7A of Part III of the Income Tax Assessment Act 1936?</i>. Moreover, as discussed above, if the trust has lost value, there may be tax consequences at the trust level.</p> <p>Whilst the Government has announced that the Commissioner of Taxation will be provided with a statutory remedial power, the development of the power is a matter for Government. At the time such a power is legislated we intend to consult with interested stakeholders on any issues that may be appropriate to be resolved by the exercise of the power.</p>

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	<p>to be satisfied in order for a beneficiary to claim a deduction in respect of a bad debt, or</p> <p>(ii) the ATO should be prepared to exercise the Commissioner's proposed Statutory Remedial Power to disregard a deemed dividend from arising to the Trust.</p>	
3.	<p>Consequential tax outcomes</p> <p>We would like the Draft Determination to be extended to cover any other consequential tax outcomes, namely Division 7A deemed dividend implications and debt forgiveness outcomes.</p>	<p>Comments noted. The Determination was produced as part of a suite of products including one that considers the Division 7A consequences on release of a relevant UPE. See TD 2015/20. We will also consider whether further guidance products (including in respect of the commercial debt forgiveness provisions) are appropriate to issue separately in consultation with relevant stakeholders.</p>