

# ***TD 2022/D1 - Income tax: Division 7A: when will an unpaid present entitlement or amount held on sub-trust become the provision of 'financial accommodation'?***

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This document has been finalised by TD 2022/11.

! There is a Compendium for this document: **TD 2022/11EC** .



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## Draft Taxation Determination

# Income tax: Division 7A: when will an unpaid present entitlement or amount held on sub-trust become the provision of ‘financial accommodation’?

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### **📌 Relying on this draft Determination**

This publication is a draft for public comment. It represents the Commissioner’s preliminary view on how a relevant provision could apply.

If this draft Determination applies to you and you rely on it reasonably and in good faith, you will not have to pay any interest or penalties in respect of the matters covered, if this draft Ruling turns out to be incorrect and you underpay your tax as a result. However, you may still have to pay the correct amount of tax.

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### **What this draft Determination is about**

1. Division 7A of Part III (Division 7A) of the *Income Tax Assessment Act 1936*<sup>1</sup> operates to ensure that private companies are not able to make tax-free distributions of profits to shareholders or their associates in the form of payments, loans or forgiven debts.<sup>2</sup>
2. A private company will be taken to pay an unfranked dividend in an income year if it makes a loan to a shareholder or their associate and the loan is not fully repaid before the private company's lodgment day<sup>3</sup>, and not excluded by Subdivision D.<sup>4</sup> A 'loan' for the purposes of Division 7A includes 'a provision of credit or any other form of financial accommodation'.<sup>5</sup>
3. Within private groups, it is common practice for trustees to appoint trust income to a related private company beneficiary. The appointed trust income is included in the profits of the corporate beneficiary. The company is assessed on its share of the trust's net income under the rules in Division 6.
4. This draft Determination<sup>6</sup> describes when a private company provides financial accommodation where it is made presently entitled to income of a trust<sup>7</sup> and either:
  - that entitlement remains unpaid (an unpaid present entitlement (UPE)), or
  - the trustee sets aside an amount from the main trust fund (main trust) and holds it on a new separate trust (sub-trust)<sup>8</sup> for the exclusive benefit of the private company beneficiary.

### **Ruling**

5. The phrase 'financial accommodation' in paragraph 109D(3)(b) has a wide meaning. It extends to cases where an entity with a trust entitlement has knowledge of an amount that it can demand and does not call for payment.

### **Circumstance one – where there is an unpaid present entitlement**

6. Where a private company beneficiary is made presently entitled to trust income and that entitlement is not satisfied, there is a UPE.

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<sup>1</sup> All legislative references in this draft Determination are to the *Income Tax Assessment Act 1936*, unless otherwise indicated.

<sup>2</sup> See paragraph 9.1 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1998 (EM). A summary of the Government's policy objective behind the enactment of Division 7A is expressed at paragraph 9.121 of the EM.

<sup>3</sup> Paragraph 109D(1)(b).

<sup>4</sup> Paragraph 109D(1)(c).

<sup>5</sup> Paragraph 109D(3)(b).

<sup>6</sup> All further references to 'this Determination' refer to the Determination as it will read when finalised. Note that this Determination will not take effect until finalised.

<sup>7</sup> Other than sub-trusts, references in this Determination to a trust are to be read as a trust in respect of which the private company beneficiary is either not the only beneficiary or not the only object (in the potential class of beneficiaries) for that trust. The principles in paragraphs 13 to 16 of this Determination (that apply to sub-trusts) apply similarly in respect of trusts where the private company beneficiary is the only beneficiary and only potential object.

<sup>8</sup> This Determination refers to the new separate trust as a sub-trust for consistency with similar references made in previous guidance contained in Taxation Ruling TR 2010/3 *Income tax: Division 7A loans: trust entitlements*.

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7. A private company beneficiary with a UPE, by arrangement, understanding or acquiescence, consents to the trustee retaining that amount to continue using it for trust purposes if the company:

- has knowledge of an amount that it can demand immediate payment of from the trustee, and
- does not demand payment.

8. This constitutes the provision of financial accommodation to the trustee under paragraph 109D(3)(b). As a result, the private company beneficiary makes a loan to the trustee under the extended definition of a 'loan' in subsection 109D(3).

9. The private company beneficiary makes a loan when the financial accommodation is provided.<sup>9</sup> This will occur at the point in time when the private company beneficiary has knowledge of an amount that it can demand immediate payment of from the trustee and does not demand payment of the amount.

10. If the private company beneficiary and the trustee have the same directing mind and will, the private company beneficiary is taken to have knowledge of the amount that it can demand immediate payment of from the trustee when the trustee does.

11. The time when the amount of a beneficiary's entitlement is known will depend on how that entitlement is expressed. If a trustee resolves to make a private company beneficiary presently entitled to:

- a fixed amount from the trust income, the private company beneficiary has a right to demand immediate payment of that amount from the trustee, or
- a percentage of trust income, or some other part of trust income identified in a calculable manner, the private company beneficiary cannot demand immediate payment from the trustee; it will only be able to demand immediate payment of an amount from the trustee when the trust income (or the relevant part they are entitled to) is calculated, typically after the end of the relevant income year.

### ***Circumstance two – where there is a sub-trust***

12. Where a private company beneficiary is made presently entitled to trust income and the trustee sets aside an amount from the main trust and holds it on sub-trust for the exclusive benefit of the private company beneficiary, the present entitlement to income is paid and there is no UPE. The amount set aside by the trustee ceases to be an asset of the main trust and forms the corpus of the sub-trust (the sub-trust fund). The trustee's obligation in respect of the entitlement to distributed income comes to an end and a new obligation arises for the sub-trustee under a separate trust.

13. The private company beneficiary has a new right to call for payment of the sub-trust fund and can call the sub-trust to an end. A choice by the private company not to exercise that right does not constitute financial accommodation in favour of the trustee in its capacity as trustee of the sub-trust, because the sub-trust fund is held for private company beneficiary's sole benefit.

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<sup>9</sup> Subsection 109D(4).

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14. However, the private company beneficiary by arrangement, understanding or acquiescence, consents to the sub-trustee allowing those funds to be used by the private company beneficiary's shareholder or their associate if:

- all or part of the sub-trust fund is used by that entity, and
- the private company beneficiary has knowledge of this use.

15. This constitutes the provision by the private company beneficiary of financial accommodation to the entity using the sub-trust fund under paragraph 109D(3)(b). This will be the case whether or not the use of the sub-trust fund is on commercial terms whereby a return is paid to the sub-trust fund. As a result, the private company beneficiary makes a loan to the entity using the sub-trust fund under the extended definition of a 'loan' in subsection 109D(3).

16. The private company beneficiary makes a loan when the financial accommodation is provided; that is, the point in time when the private company beneficiary has knowledge of the use of an amount of the sub-trust fund and does not call for payment of that part of the sub-trust fund by the private company beneficiary's shareholder or their associate. The amount of the loan in those circumstances is the amount of the sub-trust fund that the private company knows (or is taken to know) is used by its shareholder or their associate.

17. If the private company beneficiary and the trustee have the same directing mind and will, the private company beneficiary is taken to have knowledge of the use of the sub-trust fund (or part of the sub-trust fund) when the trustee does.

### **Examples**

18. The determination of when 'any other form of financial accommodation' is provided by a private company beneficiary depends on the circumstances of the particular case. Examples 1 to 4 of this Determination are not determinative of the Commissioner's views on cases with similar, but different, fact patterns.

19. Assume the following fact pattern for all examples:

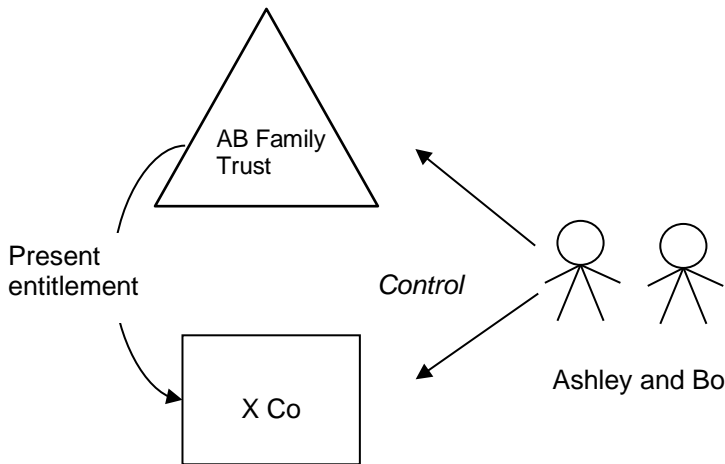
- Ashley and Bo are spouses.
- Ashley and Bo have organised their family business affairs via a discretionary trust, AB Family Trust. Ashley and Bo control Trustee Ltd, the trustee of their family trust.
- Ashley and Bo, together with other family members and related entities, are objects of AB Family Trust.
- X Co is one such related entity and is a private company controlled by Ashley and Bo.
- The income of AB Family Trust for trust law purposes for the 2022–23 income year is equal to its net income as defined in subsection 95(1).
- This fact pattern is depicted in Diagram 1 of this Determination.

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**Diagram 1**



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**Example 1 – circumstance one: unpaid present entitlement**

*Additional facts*

20. On 30 June 2023, Trustee Ltd resolves that 100% of AB Family Trust’s income for the 2022–23 income year be distributed to X Co.
21. At 30 June 2023, X Co does not know the amount of trust income, if any, that it can demand immediate payment of from Trustee Ltd.
22. On 1 August 2023, Trustee Ltd determines the net income of AB Family Trust for the 2022–23 income year as \$10,000. No cash payment is made to X Co. There is a UPE.
23. Trustee Ltd records the income entitlement of X Co in its accounts.
24. X Co has a right to demand immediate payment of \$10,000 from Trustee Ltd.

*Application of Division 7A*

25. Both X Co and Trustee Ltd are controlled by Ashley and Bo. Therefore, on 1 August 2023, X Co is taken to have knowledge of the amount that it can demand immediate payment of from Trustee Ltd.
26. There is no evidence to suggest that X Co does anything other than acquiesce to Trustee Ltd retaining that amount to continue using it for the purposes of AB Family Trust.
27. Accordingly, X Co allows Trustee Ltd to retain (and is taken to agree to its retaining) the \$10,000 and continue using it for the purposes of AB Family Trust.
28. X Co has provided a benefit to AB Family Trust. Trustee Ltd, in its capacity as trustee of AB Family Trust, is therefore in a better or more favourable position than it would have been had it been required to arrange funds for the payment of X Co’s entitlement. This is the provision of financial accommodation to Trustee Ltd as trustee for AB Family Trust.
29. X Co is taken to have made a loan to Trustee Ltd, in its capacity as trustee of AB Family Trust, on 1 August 2023. This is when X Co had knowledge of the amount that it could demand immediate payment of and did not do so.

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**Example 2 – circumstance two: sub-trust***Additional facts*

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

- *pay such amounts to the beneficiary, or*
- *set aside and hold such amounts on sub-trust for the exclusive benefit of that beneficiary.*

31. *On 1 August 2023, after determining the net income of AB Family Trust, Trustee Ltd sets aside \$10,000 on sub-trust by:*

- *creating a sub-account in its bank account with a third-party deposit-taking institution for the amount of \$10,000, and*
- *holding the ownership of this sub-account on sub-trust for the absolute benefit of X Co.*

32. *That is, Trustee Ltd remains the legal owner of the sub-account, but now in its capacity as trustee for the sub-trust.*

33. *The \$10,000 sub-account with the deposit-taking institution is corpus of the sub-trust and X Co, as the only beneficiary of this sub-trust, is entitled to all of the income derived in respect of that account. X Co has a new right to call for payment of the sub-trust and can call the sub-trust to an end.*

*Application of Division 7A*

34. *In this example, when the sub-trust is settled, Trustee Ltd satisfies its obligation in respect of the distributed income and there is no outstanding UPE.*

35. *Upon settlement of the sub-trust, X Co has a new right to call for payment of the sub-trust and can call the sub-trust to an end.*

36. *In this example, no part of X Co's entitlement is used by Trustee Ltd for the purposes of AB Family Trust, or by any other shareholder or their associate. Therefore, X Co has not provided financial accommodation to a shareholder or their associate, or made a loan to Trustee Ltd, in its capacity as trustee for AB Family Trust or the sub-trust, under the extended definition of a 'loan' in subsection 109D(3).*

**Example 3 – circumstance two: use of sub-trust fund by the trustee of AB Family Trust – no commercial rate of return***Additional fact*

37. *Assume the same additional facts as in Example 2 of this Determination and that Trustee Ltd uses the \$10,000 set aside on sub-trust fund for the purposes of AB Family Trust.*

*Application of Division 7A*

38. *When Trustee Ltd sets aside \$10,000 on sub-trust, the money is no longer part of the main trust fund. It is the corpus of the sub-trust. There is no outstanding UPE as Trustee Ltd, in its capacity as trustee for AB Family Trust, has no further obligations in relation to the distributed income.*

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39. As X Co and Trustee Ltd are controlled by Ashley and Bo, X Co is taken to have knowledge that the sub-trust fund is being used by Trustee Ltd for the purposes of AB Family Trust. Trustee Ltd as trustee for AB Family Trust receives a benefit, being the use of the sub-trust funds. This is the provision of financial accommodation to Trustee Ltd as trustee for AB Family Trust.

40. X Co can call for payment of its entitlement held on sub-trust if it does not agree to those funds being used for the purposes of AB Family Trust. On the facts, there is no evidence to suggest that X Co does anything other than acquiesce to Trustee Ltd using those funds for the purposes of AB Family Trust. Accordingly, X Co allows (and is taken to agree to) the use of funds to which it is entitled for the purposes of AB Family Trust.

41. In this example, X Co has provided financial accommodation to Trustee Ltd as trustee for AB Family Trust. X Co is taken to have made a loan to Trustee Ltd under the extended definition of a 'loan' in subsection 109D(3) when the sub-trust fund was so used.

**Example 4 – circumstance two: use of sub-trust fund by the trustee of AB Family Trust – commercial rate of return**

*Additional fact*

42. Assume the same additional facts as in Example 3 of this Determination, but Trustee Ltd uses the sub-trust fund for the purposes of AB Family Trust on the condition that a commercial rate of interest is paid to the sub-trust fund.

*Application of Division 7A*

43. As described in paragraphs 38 to 41 of this Determination, Trustee Ltd as trustee for AB Family Trust receives a benefit, being the use of the sub-trust fund. It is the use of the sub-trust fund that constitutes the provision of financial accommodation to Trustee Ltd as trustee for AB Family Trust.

44. The commercial rate of interest paid does not alter this outcome. In commercial transactions, where an entity uses another entity's funds, it will be required to pay some form of return for that use. The entity that uses the funds is always financially accommodated as it has the use of the money. The commercial return on the use of the funds is what is paid to enjoy the benefit of the financial accommodation received.

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**Date of effect**

45. When the final Determination is issued, it is proposed to apply to trust entitlements arising on or after 1 July 2022.

46. It is proposed that TR 2010/3 and Law Administration Practice Statement PS LA 2010/4 *Division 7A: trust entitlements* will be withdrawn with effect from 1 July 2022 for trust entitlements arising on or after that time.



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47. The Commissioner will take a compliance approach of not devoting compliance resources to sub-trust arrangements conducted in accordance with PS LA 2010/4 in respect of trust entitlements arising before 1 July 2022 (see paragraphs 89 and 90 of this Determination).

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**Commissioner of Taxation**

23 February 2022

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## **Appendix 1 – Explanation**

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**①** *This Explanation 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.*

48. Two circumstances of trust entitlements of private company beneficiaries are considered in this Determination.

### **Circumstance one – where there is an unpaid present entitlement**

49. If a trustee resolves to make a private company beneficiary presently entitled to trust income and does not discharge its obligation to pay the private company beneficiary, there is a UPE. The trustee has an equitable obligation to account to the private company beneficiary for the UPE and the private company beneficiary has a right to demand immediate payment of its entitlement.

### **Circumstance two – where there is a sub-trust**

50. Where a trustee resolves to make a private company beneficiary presently entitled to trust income and sets aside an amount from the main trust and holds it on sub-trust for the absolute benefit of the private company beneficiary, the trustee discharges its obligation to the private company beneficiary in respect of that entitlement. A sub-trust can be created where the terms of a trust instrument provide a mechanism for the distribution of trust income, which includes the settlement or setting aside of an amount commensurate with a beneficiary’s entitlement on a new separate trust. The amount set aside by the trustee ceases to be an asset of the main trust and forms the corpus of the sub-trust.

51. The trustee would no longer have active duties under the terms of the main trust in respect of that entitlement and a UPE does not remain outstanding. Rather, the sub-trustee would have a different equitable obligation by holding the sub-trust fund for the absolute benefit of the private company beneficiary and the private company beneficiary would have a new present right to direct the trustee to transfer the sub-trust property to it.

52. A private company’s choice not to exercise its right to end the sub-trust does not constitute financial accommodation in favour of the trustee of the sub-trust (in that capacity), because the sub-trust fund is held for the private company beneficiary’s sole benefit. However, if the funds are retained for use by the trustee in its capacity as trustee of the main trust or otherwise used by another shareholder or associate of a shareholder of the private company, as explained in this Determination, this may amount to the provision of financial accommodation by the private company beneficiary.

### **What is a Division 7A loan?**

53. For the purposes of Division 7A, a ‘loan’ is defined 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, 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

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

54. The scope of this Determination is concerned with the provision of ‘credit or any other form of financial accommodation’.

#### **Provision of ‘credit’**

55. The term ‘credit’ involves allowing time to pay a debt (including by granting a right to defer payment of a debt). A loan itself amounts to the provision of credit.<sup>10</sup> The provision of credit extends to allowing time to pay any debt, not just that arising under a loan agreement.<sup>11</sup> Whether the provision of credit extends to allowing time to pay an equitable obligation is not clear from case law.<sup>12</sup>

#### **Provision of ‘any other form of financial accommodation’**

56. Paragraph 109D(3)(b) also refers to ‘any other form of financial accommodation’. The Commissioner considers that the word ‘other’ in the phrase ‘any other form of financial accommodation’ suggests that the provision of financial accommodation is not limited to situations where there is also the provision of credit.

57. The phrase ‘any other form of financial accommodation’ is not defined for the purposes of Division 7A. It therefore has its ordinary and legal meaning in the statutory context in which it appears.

58. The purpose and policy of Division 7A, as described in paragraph 1 of this Determination, informs the consideration of what constitutes ‘any other form of financial accommodation’ under the extended definition of a loan in subsection 109D(3).

59. The following principles for interpreting this phrase can be drawn from relevant case law:

- any other form of financial accommodation is to be construed broadly<sup>13</sup>
- there must be a consensual arrangement between the parties<sup>14</sup>
- failure to call for payment of a UPE constitutes a benefit to the trustee.<sup>15</sup>

#### **Broad construction of ‘any other form of financial accommodation’**

60. The High Court, in *ILP*, considered the term ‘credit’, which for the purposes of the relevant regulation was defined as including ‘any form of financial accommodation’. The majority (comprising French CJ, Gummow, Crennan and Bell JJ) approached the issue by considering the widest definition of the term ‘credit’<sup>16</sup> and explained that the expression ‘any form of financial accommodation’ is of considerable width of denotation.<sup>17</sup> The

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<sup>10</sup> See *Herbert v R* [1941] HCA 12, 64 CLR 461 per McTiernan J at 467, where lending money, which necessarily involved allowing time for it to be repaid, was held to be the provision of credit.

<sup>11</sup> *Herbert v R* [1941] HCA 12.

<sup>12</sup> A UPE is not a common law debt but debts may also extend to equitable debts; see, for example, the comments of Lindley LJ in *Webb v Stenton* (1883) 11 QBD 518 at [527].

<sup>13</sup> *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* [2012] HCA 45 (*ILP*).

<sup>14</sup> *Commissioner of Taxation v Radilo Enterprises Pty Ltd* [1997] FCA 22.

<sup>15</sup> *Corporate Initiatives Pty Ltd v Commissioner Of Taxation* [2005] FCAFC 62 (*Corporate Initiatives*).

<sup>16</sup> *ILP* at [26].

<sup>17</sup> *ILP* at [28].

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majority then went on to confirm that financial accommodation is not limited to circumstances where an obligation to pay money has been deferred.<sup>18</sup>

61. The concurring judgment of Heydon J also noted the breadth of the language used in the relevant regulation and emphasised that the words ‘any’ and ‘form’ in the expression are to be construed amply.<sup>19</sup>

62. The Commissioner accepts that the meaning given to the expression ‘any form of financial accommodation’ by the High Court in *ILP* is not determinative of the meaning of those same words in section 109D. However, similarly to *ILP*, the meaning of the phrase in paragraph 109D(3)(b) is informed by the statutory context and purpose of Division 7A. Viewed in this light, the phrase ‘any other form of financial accommodation’ in paragraph 109D(3)(b) has the same breadth of meaning as was found in *ILP* with the words ‘any’ and ‘form’ indicating that the phrase ‘any other form of financial accommodation’ is to be construed amply.

#### *Consensual arrangement*

63. The requirement for a consensual arrangement was considered by the Administrative Appeals Tribunal (AAT) in *Montgomery Wools Pty Ltd as Trustee for Montgomery Wools Pty Ltd Super Fund and Commissioner of Taxation (Montgomery Wools)*<sup>20</sup> to determine if there was a ‘loan’ pursuant to section 10 of the *Superannuation Industry (Supervision) Act 1993*. The AAT considered this requirement in the context of whether failure to demand payment of a UPE could amount to financial accommodation.

64. The relevant definition of a ‘loan’ in the provisions considered in *Montgomery Wools* included ‘the provision of credit or any other form of financial accommodation’. The applicant argued that the word ‘provision’ before ‘financial accommodation’ requires positive action on behalf of the beneficiary such that failing to enforce a right cannot constitute a consensual arrangement. The AAT stated that a positive act will include acquiescence or ‘... the failure to enforce or demand a right, provided the party makes an active decision to acquiesce or refrain from enforcing a right or making a demand’.<sup>21</sup>

65. It was determined in *Montgomery Wools* that there was a consensual arrangement between the parties because the distribution was approved by the same person who was the controlling mind of the two relevant entities.<sup>22</sup>

#### *Failure to demand payment of an unpaid present entitlement*

66. The Full Federal Court, in *Corporate Initiatives*, considered the application of the trust loss provisions in Schedule 2F to a group of unit trusts ultimately owned by a family group, with one person controlling all the relevant entities. A series of income entitlements were created in favour of the beneficiaries but were not paid. The relevant beneficiary in the proceedings did not call upon the trustee to pay its UPE. By not demanding payment of the UPE, the trustee continued to have use of all the trust funds for trust purposes.

67. At issue was the effect of the unpaid distributions of income and whether the relevant beneficiary ‘provided a benefit’ to the trustee within the meaning of subsection 270-10(1) of Schedule 2F by failing to call for payment of its UPE.

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<sup>18</sup> *ILP* at [31].

<sup>19</sup> *ILP* at [44].

<sup>20</sup> [2012] AATA 61.

<sup>21</sup> *Montgomery Wools* at [95].

<sup>22</sup> *Montgomery Wools* at [85].

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68. It was determined that, where a beneficiary has a UPE, the beneficiary does not have a proprietary right in any assets of the trust and the trustee would be free to deal with the trust assets for trust purposes.<sup>23</sup>

69. The Full Federal Court also concluded that, by not calling for payment of funds distributed to it, the private company beneficiary with knowledge of the UPE provided a benefit to the trustee who could continue to use the trust funds for trust purposes, and stated that (emphasis added)<sup>24</sup>:

We therefore think the Tribunal was correct in proceeding on the basis that, **on demand being made by SBS as trustee for CUT, Eldersmede would have to do something to arrange funds for the payment, whether by selling, or borrowing against, available assets, which would then no longer be available for other trust purposes. Not having to do this was a benefit. Eldersmede was thus in a better or more favourable position than it would have been had it been required to fund the distributions.**

70. After concluding that failing to call for payment of a UPE constitutes a benefit to the trustee, the Full Federal Court expressed difficulty in differentiating between the practical effect of a formally recorded loan and a beneficiary failing to call for payment of a UPE.

#### **Conclusion as to the Commissioner's view**

71. The Commissioner takes the view in Circumstance one (see paragraphs 6 to 11 of this Determination) that a private company beneficiary that does not exercise its right to demand immediate payment of an amount of trust income provides financial accommodation to the trustee. If the private company beneficiary exercised its right, the trustee would be required to arrange funds for the payment of the UPE, whether by selling or borrowing against other assets which would then no longer be available.

72. In Circumstance two (see paragraphs 12 to 17 of this Determination), the Commissioner also takes the view that a private company beneficiary that does not exercise its right to call for payment of a sub-trust fund provides financial accommodation to the entity using the sub-trust fund (or part of the sub-trust fund). The amount of the loan is the amount of the sub-trust fund that the private company knows (or is taken to know) is used by its shareholder or their associate. This will be the case whether or not the use of the sub-trust fund is on commercial terms whereby a return is paid to the sub-trust fund. If the private company beneficiary exercised its right, the sub-trust fund would no longer be available for use.

#### **When is the requirement of knowledge met?**

73. For financial accommodation to be provided, there must be a consensual arrangement between the parties. A consensual arrangement can only arise where a private company beneficiary with a UPE:

- has knowledge of an amount of trust income that it can demand immediate payment of from the trustee (see Circumstance one at paragraphs 6 to 11 of this Determination), or
- has knowledge of the use of a sub-trust fund (see Circumstance two at paragraphs 12 to 17 of this Determination).

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<sup>23</sup> *Corporate Initiatives*, at [22].

<sup>24</sup> *Corporate Initiatives*, at [23].

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74. *Corporate Initiatives* illustrates that if both the trustee and the private company beneficiary are controlled by the same person, knowledge of an amount of trust income may be imputed by virtue of the relationship.

75. The doctrine of a corporation's 'directing mind and will' was explained by Millet J in *El Ajou v Dollar Land Holdings Plc*<sup>25</sup> (referred to with approval on appeal)<sup>26</sup> as follows:

Since a company is an artificial person, the knowledge of those who manage and control it must be treated as the knowledge of the company: see *J C Houghton & Co v Nothard, Lowe and Wills Ltd* [1928] AC 1...and *Re Montagu's Settlement Trusts* [1992] 4 All ER 308 at 328 ... Those who 'constitute the directing mind and will of the company' are the company for this purpose: *Tesco Supermarkets Ltd v Natrass* ... [1972] AC 153 at 187. Their minds are its mind; their intention its intention; their knowledge its knowledge.

76. 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 *Allan Paul Endresz v Patrick John Whitehouse*<sup>27</sup>, Ormiston JA referred to 'the principle applicable to controlling directors'. He quoted from Ford's Principles of Corporations Law as follows<sup>28</sup>:

"A distinction has to be drawn between the case where the director is a controller of two companies and where the director is only one of several directors of two companies. In the former case each company will know what the other knows because they each have the same directing mind and will: attribution of the director's knowledge to each company does not depend on the existence of a duty but on the director being identified with each company as its directing mind and will."

77. The directing mind and will of a private company beneficiary need not be limited to its board or one or more directors.<sup>29</sup> Case law establishes that different persons may for different purposes satisfy the requirements of being an entity's directing mind and will.<sup>30</sup>

78. If the same person or persons are the directing mind and will of both the relevant private company beneficiary and the trustee in respect of affairs relevant to the private company beneficiary's UPE (such as the treatment of that UPE and/or dealings with that UPE), then subject to sufficient evidence to the contrary the Commissioner takes the view that both the private company beneficiary and the trustee know what the other knows because they have this same directing mind and will.

### ***Knowledge of an amount that can be demanded***

79. Where a UPE remains outstanding, and the private company beneficiary and the trustee have the same directing mind and will<sup>31</sup>, the private company beneficiary will have knowledge of the amount of trust income that it can demand immediate payment of from the trustee. By not exercising its right to demand payment of the UPE, the private company beneficiary consents or acquiesces to the provision of financial accommodation to the trustee.

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<sup>25</sup> [1993] 3 All ER 717 at [740].

<sup>26</sup> See Nourse LJ in *El Ajou v Dollar Land Holdings Plc* [1994] 2 All ER 685; although note that Millet J's decision was overturned on this appeal.

<sup>27</sup> [1997] VSC 23.

<sup>28</sup> Paragraph 16.220 of Ford's *Principles of Corporations Law*, looseleaf edition, vol 1, Butterworths, Service 5: 4/96. Note that Ormiston J referred to this principle applicable to controlling directors without having to decide whether it was appropriate to the matters considered in that judgment.

<sup>29</sup> See, for example, *The Lady Gwendole; Arthur Guinness Son and Co (Dublin) Ltd v Owners of Motor Vessel Freshfield and Others* [1965] 2 All ER 283; *Nationwide News Pty Ltd v Naidu & Anor* [2007] NSWCA 377.

<sup>30</sup> See *El Ajou v Dollar Land Holdings Plc* [1993] 3 All ER 717. See also *Tesco Supermarkets Ltd v Natrass* [1971] 2 All ER 127, per Lord Reid.

<sup>31</sup> As the trustee is a shareholder or associate of a shareholder of the private company beneficiary.

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### ***Knowledge of the use of a sub-trust fund***

80. Where there is a sub-trust and the sub-trust fund is used by a shareholder or their associate, and the private company beneficiary and the trustee have the same directing mind and will<sup>32</sup>, the private company beneficiary will have knowledge of the use of the sub-trust fund. By not exercising its right to call for payment of the sub-trust fund, the private company beneficiary consents or acquiesces to the provision of financial accommodation to the entity that is using the sub-trust fund (or part of the sub-trust fund).

### ***Timing***

81. Subsection 109D(4) states that a loan is made to an entity at the time anything described in subsection 109D(3) is done in relation to the entity.

82. For the purposes of paragraph 109D(3)(b), a private company beneficiary makes a loan to the trustee of a trust, or another shareholder or their associate, when financial accommodation is provided.

83. Where there is a UPE, financial accommodation is provided at the point in time when the private company beneficiary has knowledge of an amount of trust income that it can demand immediate payment of from the trustee and does not exercise its right.

84. If a private company beneficiary is made presently entitled to a fixed amount from the trust income, it has a right to demand immediate payment of that amount from the trustee.

85. If the private company beneficiary is made presently entitled to a percentage of trust income, there is no amount that it can demand immediate payment of from the trustee. The private company beneficiary will only be able to demand immediate payment of an amount from the trustee when the trust income is determined, typically after the end of the relevant income year.

86. Likewise, where a beneficiary is made presently entitled to some other part of trust income identified in a calculable manner, it will only be able to demand immediate payment of an amount from a trustee when the part of trust income to which they have been made entitled has been calculated.

87. Where there is a sub-trust and the sub-trust fund (or part of the sub-trust fund) is used by a shareholder or their associate, financial accommodation is provided at the point in time when the private company beneficiary has knowledge of the use of an amount of the sub-trust fund and does not exercise its right to call for payment of that part of the sub-trust fund.

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<sup>32</sup> As the trustee is a shareholder or associate of a shareholder of the private company beneficiary.

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## **Appendix 2 – Compliance approach**

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**①** *This Appendix sets out a proposed practical administration approach to assist taxpayers in complying with relevant tax laws. When this Determination is finalised, provided you follow the advice in this appendix in good faith and consistently with the Ruling section, the Commissioner will administer the law in accordance with this approach.*

88. The application of the law as described in this Determination where a private company beneficiary is made presently entitled to income of a trust estate raises practical considerations for taxpayers and their advisers. These include how to meet the timing requirements to ensure that an entitlement does not cause a deemed dividend to arise.

### **Arrangements involving pre-1 July 2022 trust entitlements**

89. It is proposed to withdraw existing guidance in TR 2010/3 and PS LA 2010/4 with effect from 1 July 2022. In that guidance it was accepted that a private company beneficiary did not provide ‘credit or any other form of financial accommodation’ to a trustee where the funds representing a UPE were held on sub-trust and re-invested in the head trust on particular terms.<sup>33</sup>

90. We will not devote compliance resources to sub-trust arrangements that correspond to the guidance in TR 2010/3 and PS LA 2010/4 where the trust entitlement has been created on or before 30 June 2022. For the avoidance of doubt, this would include a sub-trust arrangement commenced on or after 1 July 2022 in respect of a trust entitlement arising before that date.

### **Implementation of a complying loan agreement**

91. In cases where financial accommodation is provided, as described in this Determination, the trustee and the private company beneficiary can avoid a dividend being taken to be paid if, before the private company’s lodgment day<sup>34</sup> for the income year in which the financial accommodation arises:

- the trustee pays the trust entitlement to the private company beneficiary, or
- the private company beneficiary and the trustee enter into a complying loan agreement<sup>35</sup> in respect of the financial accommodation.

92. This Appendix describes how a private company beneficiary and trustee in those circumstances can implement a complying loan agreement, in particular including the timing requirements, so that the financial accommodation does not give rise to a deemed dividend. This is illustrated by examples where:

- a UPE is made subject to complying loan terms
- a UPE is in fact satisfied and replaced with a new loan, and
- a sub-trust is created and the use of the sub-trust funds by the main trust is made subject to complying loan terms.

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<sup>33</sup> See paragraphs 49 to 100 of PS LA 2010/4.

<sup>34</sup> ‘Lodgment day’ for a private company beneficiary means, for an income year, the earlier of the due date of the private company’s return of income for that income year and the date the return is lodged.

<sup>35</sup> ‘Complying loan agreement’ refers to a written agreement which meets the minimum interest rate and maximum loan term as set out in section 109N.



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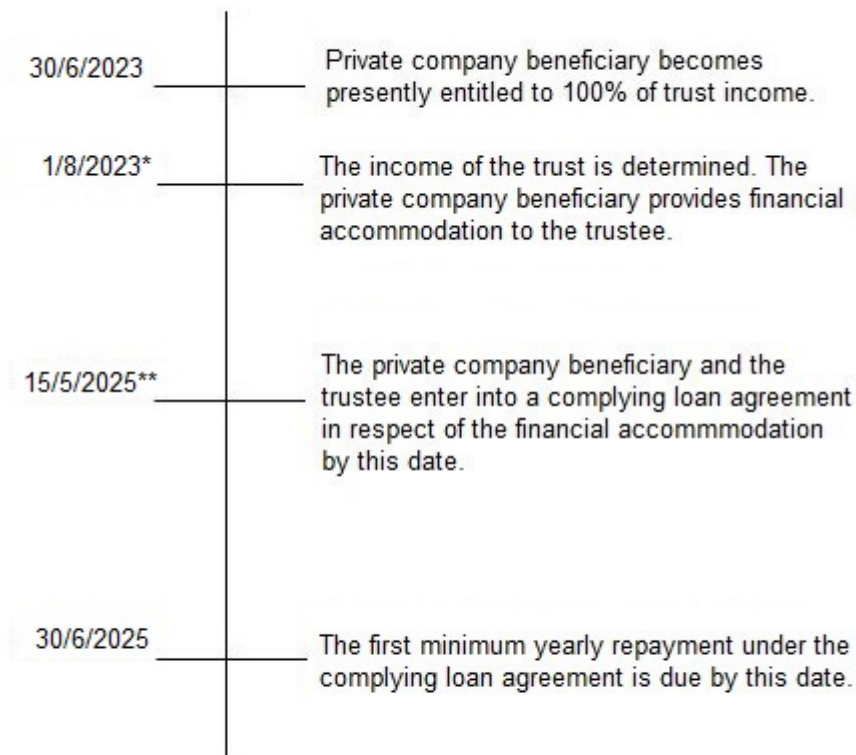
### **Making the financial accommodation subject to complying loan terms**

93. If a complying loan agreement is entered into in respect of the financial accommodation, the first minimum yearly repayment will be due by 30 June<sup>36</sup> of the year following the income year in which the financial accommodation was provided.

94. The following timeline illustrates compliance with Division 7A for financial accommodation that is provided to the trustee of a trust in the 2023–24 income year.

95. Present entitlements to trust income frequently arise at year end, typically being 30 June (for example, because of the terms of the trust and associated resolutions appointing trust income). As this Determination applies to present entitlements arising on or after 1 July 2022, it is expected to apply to present entitlements that arise on 30 June 2023 or later. For private company beneficiary entitlements to trust income that arise at 30 June 2023, but cannot be determined until later, financial accommodation (if any) will not be provided by the private company until a time in the 2023–24 income year.

#### Financial accommodation - complying with Division 7A



\*Date may be different depending on when the income of the trust is determined for the 2022-23 income year.

\*\*Date may be different depending on the lodgment day of the private company beneficiary's tax return for the 2023-24 income year.

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<sup>36</sup> If the company has a substituted accounting period, this date will instead be the end of that company's income year.

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### Replacing the financial accommodation with a new complying loan

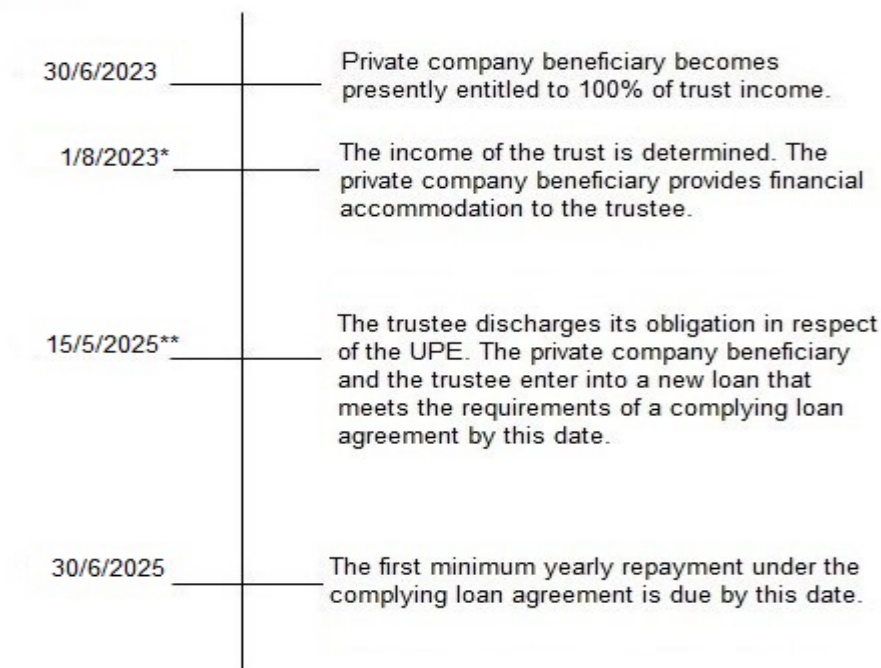
96. Where a trust entitlement results in the provision of financial accommodation, the Commissioner will also accept that the conditions in subsection 109N(1) are satisfied in respect of the financial accommodation if, before the lodgment day for the income year it has arisen, the entitlement is satisfied and replaced with a new loan that meets the requirements of a complying loan agreement. To do this:

- the trustee can pay the trust entitlement to the private company beneficiary and have that amount loaned back under a complying loan agreement, or
- the private company beneficiary and the trustee can enter into a complying loan agreement and set off their respective obligations; that is, the trustee's obligation to pay the trust entitlement to the private company beneficiary and the private company beneficiary's obligation to fund the loan are set off against each other.

97. The Commissioner will accept, having regard to the context of Division 7A, that these steps will result in the formalisation of the original loan identified in respect of the financial accommodation, rather than a refinancing of that loan for which section 109R may apply so as to cause the loan to remain unpaid at the lodgment day. The first minimum yearly repayment will remain due by 30 June of the year following the year in which the financial accommodation was provided.

98. The following timeline illustrates compliance under this approach where financial accommodation is provided to the trustee of a trust in the 2023–24 income year.

#### Financial accommodation replaced with a new loan



\*Date may be different depending on when the income of the trust is determined for the 2022-23 income year.

\*\*Date may be different depending on the lodgment day of the private company beneficiary's tax return for the 2023-24 income year.

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99. If instead there is no UPE because there is a sub-trust, a private company beneficiary provides financial accommodation to their shareholder or an associate of their shareholder when it has knowledge that the sub-trust fund is being used by that shareholder or their associate. The timeline in Example 3 of this Determination illustrates compliance under this approach where financial accommodation is provided to the shareholder's associate in the 2023–24 income year.

**Examples**

100. In each of the following examples, assume the private company beneficiary's distributable surplus (as defined in section 109Y) is greater than its trust entitlement.

**Example 5 – present entitlement to a sum certain**

101. Johann is the trustee of Grey Discretionary Trust. Silver Pty Ltd, a related private company beneficiary of Grey Discretionary Trust, is controlled by Johann.

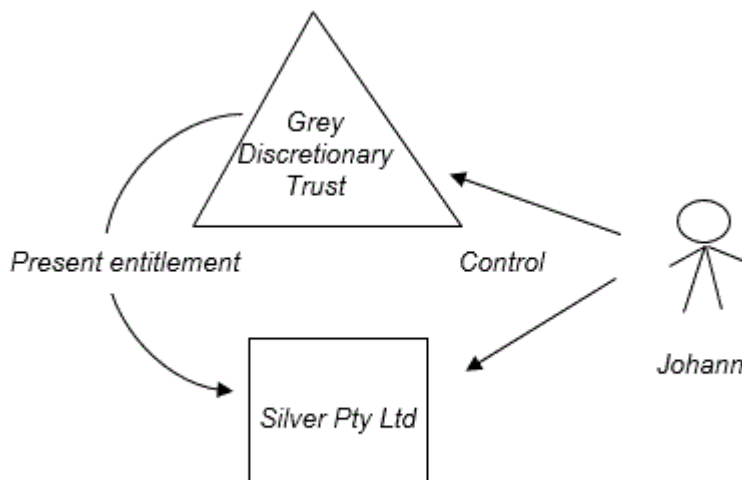
102. On 27 June 2023, Johann resolves that \$10,000 of Grey Discretionary Trust's income for the 2022–23 income year be distributed to Silver Pty Ltd.

103. The appointment of trust income and UPE are recorded in the accounting ledger of Grey Discretionary Trust as being made on 27 June 2023 and the entries are:

|                                     |          |          |
|-------------------------------------|----------|----------|
| DR Trust distribution               | \$10,000 |          |
| CR UPE – Silver Pty Ltd (liability) |          | \$10,000 |

104. In the accounting ledger of Silver Pty Ltd, the transaction is recorded as:

|  |          |          |
|--|----------|----------|
| DR UPE – Grey Discretionary Trust<br>(asset) | \$10,000 |          |
| CR Trust distribution (income)               |          | \$10,000 |



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## Tax consequences

105. *Silver Pty Ltd is taken to have knowledge of the amount it can demand immediate payment of from the trustee on 27 June 2023. If Silver Pty Ltd does not demand payment of the \$10,000 then it provides financial accommodation to Johann as trustee for Grey Discretionary Trust in the 2022–23 income year.*

106. *Silver Pty Ltd's lodgment day for the 2022–23 income year is 31 March 2024.*

107. *To avoid a deemed dividend under Division 7A, Silver Pty Ltd and Johann as trustee for Grey Discretionary Trust agree to discharge the UPE; they enter into a new loan that meets the requirements of a complying loan agreement on 31 March 2024 and set-off their respective obligations. That is, Johann's obligation to pay the UPE to Silver Pty Ltd and Silver Pty Ltd's obligation to fund the complying loan are set off against each other.*

108. *The discharge of the UPE and the new complying loan agreement are recorded in the accounting ledger of Grey Discretionary Trust on 31 March 2024 as:*

|   |                 |                 |
|---|-----------------|-----------------|
| <i>DR UPE – Silver Pty Ltd</i>              | <i>\$10,000</i> |                 |
| <i>CR Loan – Silver Pty Ltd (liability)</i> |                 | <i>\$10,000</i> |

109. *In the accounting ledger of Silver Pty Ltd the transaction is recorded as:*

|   |                 |                 |
|---|-----------------|-----------------|
| <i>DR Loan – Grey Discretionary Trust<br/>(asset)</i> | <i>\$10,000</i> |                 |
| <i>CR UPE – Grey Discretionary Trust</i>              |                 | <i>\$10,000</i> |

110. *The first minimum yearly repayment under the complying loan agreement will be due by 30 June 2024. That is, the transaction replacing the UPE with a formal loan is not treated as a new loan made in the 2023–24 income year. To avoid Division 7A consequences, subsequent minimum yearly repayments are required to be made until the loan is fully repaid by 30 June 2030.*

| <i>Timeline - present entitlement to a sum certain</i> |   |
|--|---|
| <i>27/6/2023</i>                                       | <i>Private company beneficiary becomes presently entitled to \$10,000.</i>  |
| <i>31/3/2024*</i>                                      | <i>The trustee discharges its obligation in respect of the UPE. The private company beneficiary and the trustee enter into a new loan that meets the requirements of a complying loan agreement by this date.</i> |
| <i>30/6/2024</i>                                       | <i>The first minimum yearly repayment under the complying loan agreement is due by this date.</i>   |

*\*Date may be different depending on the lodgment day of the private company beneficiary's tax return.*

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**Example 6 – present entitlement to a percentage share where trust income is subsequently determined**

111. Ashley and Bo are spouses and they have organised their family business affairs via a discretionary trust, AB Family Trust. Ashley and Bo control Trustee Pty Ltd, the trustee of their discretionary trust.

112. X Pty Ltd, a private company that is a beneficiary of AB Family Trust, is controlled by Ashley and Bo.

113. On 30 June 2023, Trustee Pty Ltd resolves that 100% of AB Family Trust's income for the 2022–23 income year be distributed to X Pty Ltd.

114. At 30 June 2023, X Pty Ltd does not know the amount of trust income, if any, that it can demand immediate payment of from Trustee Pty Ltd.

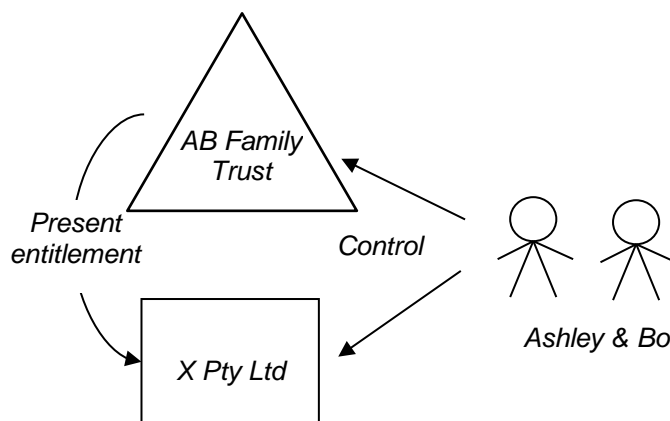
115. On 1 August 2023, Trustee Pty Ltd determines the net income of AB Family Trust as \$50,000. X Pty Ltd has a right to demand immediate payment of \$50,000 from Trustee Pty Ltd on 1 August 2023.

116. The distribution and UPE are recorded in the accounting ledger of AB Family Trust as being a distribution for the year ended 30 June 2023 and the entries are:

|                              |                                |          |
|------------------------------|--------------------------------|----------|
| DR Loan – Trust distribution | \$50,000                       |          |
|                              | CR UPE – X Pty Ltd (liability) | \$50,000 |

117. In the accounting ledger of X Pty Ltd, the transaction is recorded as:

|                                  |                                |          |
|----------------------------------|--------------------------------|----------|
| DR UPE – AB Family Trust (asset) | \$50,000                       |          |
|                                  | CR Trust distribution (income) | \$50,000 |



*Tax consequences*

118. X Pty Ltd is taken to have knowledge of the amount it can demand immediate payment of from Trustee Pty Ltd on 1 August 2023. If X Pty Ltd does not demand immediate payment of the \$50,000, then it provides financial accommodation to Trustee Pty Ltd as trustee for AB Family Trust in the 2023–24 income year.

119. X Pty Ltd's lodgment day for the 2023–24 income year is 15 May 2025.

120. To avoid a deemed dividend under Division 7A, X Pty Ltd and Trustee Pty Ltd as trustee for AB Family Trust agree to discharge the UPE; on 15 May 2025 they enter into a



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*new loan that meets the requirements of a complying loan agreement and set-off their respective obligations. That is, Trustee Pty Ltd’s obligation to pay the UPE to X Pty Ltd and X Pty Ltd’s obligation to fund the complying loan are set off against each other.*

121. *The discharge of the UPE and the new complying loan agreement are recorded in the accounting ledger of AB Family Trust on 15 May 2025 as follows:*

|  |                 |                 |
|--|-----------------|-----------------|
| <i>DR UPE – X Pty Ltd</i>              | <i>\$50,000</i> |                 |
|  |                 | <i>\$50,000</i> |
| <i>CR Loan – X Pty Ltd (liability)</i> |                 |                 |

122. *In the accounting ledger of X Pty Ltd, the transaction is recorded as follows:*

|  |                 |                 |
|--|-----------------|-----------------|
| <i>DR Loan – AB Family Trust (asset)</i> | <i>\$50,000</i> |                 |
|  |                 | <i>\$50,000</i> |
| <i>CR UPE – AB Family Trust</i>          |                 |                 |

123. *The first minimum yearly repayment under the complying loan agreement will be due by 30 June 2025. That is, the transaction replacing the UPE with a formal loan is not treated as a new loan made in the 2024–25 income year. To avoid Division 7A consequences, subsequent minimum yearly repayments are required to be made until the loan is fully repaid by 30 June 2031.*

| <i>Timeline - present entitlement to a percentage share</i> |   |
|---|---|
| <i>30/6/2023</i>  | <i>Private company beneficiary becomes presently entitled to 100% of trust income.</i>  |
| <i>1/8/2023*</i>  | <i>The income of the trust is determined. The private company beneficiary provides financial accommodation to the trustee.</i>  |
| <i>15/5/2025**</i>  | <i>The trustee discharges its obligation in respect of the UPE. The private company beneficiary and the trustee enter into a new loan that meets the requirements of a complying loan agreement by this date.</i> |
| <i>30/6/2025</i>  | <i>The first minimum yearly repayment under the complying loan agreement is due by this date.</i>   |

*\*Date may be different depending on when the income of the trust is determined for the 2022-23 income year.*

*\*\*Date may be different depending on the lodgment day of the private company beneficiary's tax return.*

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**Example 7 – present entitlement to a sum certain, sub-trust created and loan to a shareholder or their associate**

124. Dave is an individual who has organised his family business affairs via a discretionary trust, Pets Plus Trust. Dave controls Corgi Pty Ltd, the trustee of Pets Plus Trust.

125. Dave, together with other family members and related entities, is a beneficiary of Pets Plus Trust. Cavalier Pty Ltd is a related private company beneficiary that is controlled by Dave.

126. In respect of amounts resolved to be distributed to a beneficiary, the trust deed of Pets Plus Trust gives Corgi Pty Ltd the power to:

- pay such amounts to the beneficiary, or
- set aside and hold such amounts on sub-trust for the absolute benefit of that beneficiary.

127. On 30 June 2023, Corgi Pty Ltd resolves that \$50,000 of Pets Plus Trust's income for the 2022–23 income year be distributed to Cavalier Pty Ltd by setting aside that amount on sub-trust for the absolute benefit of Cavalier Pty Ltd.

128. The distribution is recorded in the accounting ledger of Pets Plus Trust as being a distribution on 30 June 2023 and the entries are:

|                       |                 |          |
|-----------------------|-----------------|----------|
| DR Trust distribution | \$50,000        |          |
|                       | CR Cash at bank | \$50,000 |

129. The setting aside of \$50,000 on sub-trust is recorded in the sub-trust accounts on 30 June 2023 and the entries are:

|                         |                    |          |
|-------------------------|--------------------|----------|
| DR Cash at bank (asset) | \$50,000           |          |
|                         | CR Corpus (equity) | \$50,000 |

130. In the accounting ledger of Cavalier Pty Ltd, the distribution is recorded as:

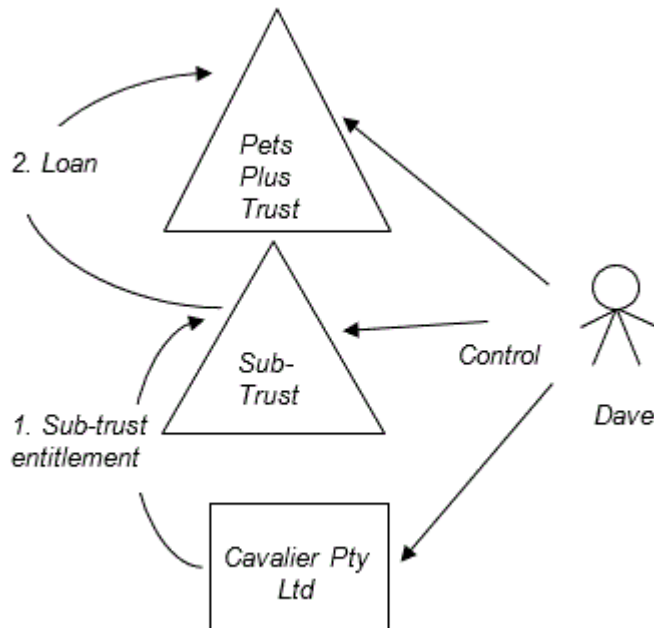
|                                       |  |          |
|---------------------------------------|--|----------|
| DR Sub-trust fund entitlement (asset) | \$50,000                                       |          |
|                                       | CR Trust income – Pets Plus Trust<br>(revenue) | \$50,000 |

131. On 1 February 2024, Corgi Pty Ltd as trustee for Pets Plus Trust uses the \$50,000 corpus of the sub-trust.

132. The loan of the sub-trust corpus to Pets Plus Trust on 1 February 2024 is recorded in the accounting ledger of the sub-trust and the entries are:

|   |                 |          |
|---|-----------------|----------|
| DR Loan receivable – Pets Plus Trust<br>(asset) | \$50,000        |          |
|   | CR Cash (asset) | \$50,000 |

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#### *Tax consequences*

133. From 1 February 2024, the Commissioner will infer, based on the relationships of the parties, that Cavalier Pty Ltd has knowledge of the use of the sub-trust fund by Corgi Pty Ltd as trustee for Pets Plus Trust. As a result, Cavalier Pty Ltd provides financial accommodation to Corgi Pty Ltd as trustee for Pets Plus Trust in the 2023–24 income year.

134. The Commissioner considers that Cavalier Pty Ltd would provide financial accommodation to Pets Plus Trust in these circumstances, whether or not the use of sub-trust funds by Corgi Pty Ltd as trustee for Pets Plus Trust is specifically acknowledged as a loan and whether or not it is recorded in the trust accounts appropriately.

135. Cavalier Pty Ltd's lodgment day for the 2023–24 income year is 15 May 2025.

136. To avoid a deemed dividend under Division 7A, Cavalier Pty Ltd and Corgi Pty Ltd as trustee for Pets Plus Trust agree to enter into a new loan on 15 May 2025 that meets the requirements of a complying loan agreement by Cavalier Pty Ltd calling for payment of the \$50,000 and, subsequently, setting off their obligations. That is, Corgi Pty Ltd's obligation to pay the \$50,000 to Cavalier Pty Ltd and Cavalier Pty Ltd's obligation to fund the loan are set off against each other.

137. The first minimum yearly repayment under the complying loan agreement will be due by 30 June 2025. That is, the transaction replacing the UPE with a formal loan is not treated as a new loan made in the 2024–25 income year. To avoid Division 7A consequences, subsequent minimum yearly repayments are required to be made until the loan is fully repaid by 30 June 2031.



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| <i>Timeline - use of a sub-trust fund</i> |  |
|---|--|
| <i>30/6/2023</i>                          | <i>The trustee of the main trust sets aside \$50,000 on sub-trust.</i>   |
| <i>1/2/2024*</i>                          | <i>The trustee of the main trust uses the sub-trust fund. The private company beneficiary provides financial accommodation to the trustee.</i> |
| <i>15/5/2025**</i>                        | <i>Complying loan agreement entered into by this date.</i>   |
| <i>30/6/2025</i>                          | <i>The first minimum yearly repayment under the complying loan agreement is due by this date.</i>  |

*\*Date may be different depending on when a shareholder or their associate (here, the trustee of the main trust) uses the sub-trust fund.*

*\*\*Date may be different depending on the lodgment day of the private company beneficiary's tax return.*

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## **Appendix 3 – Alternative views**

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**①** *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.*

### **TR 2010/3 view**

138. It has been raised with us that, contrary to the views in this Determination, certain aspects of the former advice and reasoning in TR 2010/3 remain correct. Paragraphs 113 and 114 of TR 2010/3 provide:

113. ... if there is a sub-trust but the funds representing the UPE remain intermingled in the main trust as a consequence of an investment back by the sub-trust, the private company does not provide any financial accommodation to the main trust if this investment by the sub-trust is *on terms entitling* the sub-trust to:

- all the benefits from use of those funds; and
- a repayment of the principal of the investment.

114. The private company provides no financial accommodation in these circumstances because the main trust receives no pecuniary aid or favour from the private company. These circumstances may be evidenced by the terms of the agreement between the sub-trust and the main trust.

139. We do not agree with that view and consider that in those circumstances the private company beneficiary has provided financial accommodation to the trustee of the main trust.

140. As referred to at paragraphs 55 to 70 of this Determination, the weight of case law authority, including Court and Tribunal decisions following the publication of TR 2010/3, demonstrates that the statutory expression ‘any other form of financial accommodation’ is capable of having a wide meaning. In 2012, the majority of the High Court in *ILP* noted as examples of the wide meaning of ‘any form of financial accommodation’ an agreement by a bank to lend its name to a bill of exchange for the accommodation of its customer, the provision of the guarantee of the obligations to the creditor of the principal debtor and the extension by a bank to a customer of an overdraft facility.<sup>37</sup> A vendor can provide financial accommodation to a purchaser where a title is transferred without waiting for actual receipt of the full purchase price.<sup>38</sup> The case law examples do not support an argument that financial accommodation will not happen where the party who provides the accommodation obtains a commercial rate of return.

141. As referred to at paragraph 62 of this Determination, the Commissioner considers that there is no reason that the expression should be given a narrower meaning where it appears in the definition of loan in paragraph 109D(3)(b), having regard to the context and purpose of that definition.

142. The example at paragraphs 113 and 114 of TR 2010/3 involves the private company beneficiary acquiescing to the use of the funds by the trustee of the main trust. In our view, consistent with the examples drawn from the case law, in that example the private company beneficiary has provided financial accommodation to the trustee of the main trust.

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<sup>37</sup> *ILP* at [28], per French CJ and Gummow, Crennan and Bell JJ.

<sup>38</sup> *Prime Wheat Association Ltd v Chief Commissioner of Stamp Duties* [1997] NSWSC 546, per Glesson CJ, Handley JA and Sheppard AJA.

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### Scope of Subdivision EA

143. Appendix 3 of TR 2010/3 sets out the alternative view that the position in this Determination inappropriately limits the scope for Subdivision EA to operate. Specifically, it observes:

172. During consultation on this Ruling it has been said that the existence of Subdivision EA makes it clear that in situations involving trusts which have a private company beneficiary with a UPE to income from that trust, Division 7A is only intended to apply when the trust separately pays or lends amounts to, or forgives debts of, a shareholder or associate of the private company.

173. In support of this view its proponents cite extrinsic materials to the predecessor of Subdivision EA (the former section 109UB) including:

- drafting instructions for section 109UB, which stated:  
The definition of *loan* in subsection 109D(3) includes 'a transaction (whatever its terms or form) which in substance effects a loan of money'. There is some doubt whether this phrase covers the situation where income of a trust estate to which a private company beneficiary had become presently entitled is not actually paid over by the trustee but instead is lent by the trustee to a shareholder of the private company beneficiary. There is persuasive opinion that such an amount is held by the trustee under a separate trust for the benefit of the corporate beneficiary. Accordingly, it is arguable that Division 7A would not apply to the amount held in the subtrust [sic] if it is lent by the trustee to a shareholder of the corporate beneficiary. This is because the amount held in the subtrust [sic] has not actually been lent by the private company to the trust.
- the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1998 introducing section 109UB, which stated:  
**New section 109UB** will apply if a private company, as a beneficiary of a trust estate, is or has been presently entitled to some or all of the net trust income which has not actually been paid. In such a situation the amount to which the company is presently entitled is held on a secondary trust for the benefit of the company. The provision applies to any subsequent loan by the trustee to a shareholder (or associate) of the company.

174. The Board of Taxation's November 2002 report on *The Taxation of Discretionary Trusts* is also cited. This report proceeded on the basis that Division 7A would practically only apply to trusts if the former section 109UB applied. The report acknowledged that trusts in the circumstances under consideration would be effectively accumulating income and made no mention of a sub-trust. It recommended improvements be made, either by enhancements to section 109UB (which were ultimately legislated as Subdivision EA) or by effectively deeming the amount of the UPE to have been accumulated in the trust (or subject to a top-up tax by the company) if it were not paid out within a reasonable time.

175. Support for the alternative view is also said to come from the fact that Division 7A contains no specific anti-overlap rule dealing with UPEs treated as loans under section 109D and the potential for Subdivision EA to apply to relevant dealings by the respective trustee.

144. Those observations indicate that when Division 7A was introduced, the prevailing view was that UPEs were held on a separate trust for the benefit of the private company beneficiary. The Commissioner's view before 16 December 2009 (that the retention of a UPE was not a loan for Division 7A purposes) was based on that understanding. That is, at the time Subdivision EA was introduced, private company UPEs were not generally considered to be within the scope of subsection 109D(3). The lack of a specific anti-overlap rule to deal with private company UPEs being treated as loans by subsection 109D(3) is explicable by that context.

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145. Taking that background into consideration, the Commissioner considers that the express terms of subsection 109D(3) are not required to be interpreted in a constrained way to accommodate a specific integrity rule within Division 7A (that is, Subdivision EA).

146. Consistent with the legislative context of Division 7A, an amount that has been treated as a loan and dealt with under section 109D (for example, a UPE that constitutes financial accommodation and is made subject to a complying loan agreement, as described in paragraphs 93 to 95 of this Determination) should be regarded as a loan for all purposes of Division 7A, including Subdivision EA. Accordingly, the Commissioner will not treat a UPE in those circumstances as a present entitlement that remains unpaid for Subdivision EA purposes. This is consistent with the position taken in TR 2010/3.

147. Subdivision EA also still has scope to operate in circumstances where the UPE of a private company does not result in financial accommodation (for example, because the private company does not have knowledge of the amount that it can demand immediate payment of from the trustee at the relevant time).

148. As described in paragraph 12 of this Determination, where a private company beneficiary is made presently entitled to trust income and the trustee sets aside an amount from the main trust and holds it on sub-trust for the exclusive benefit of the private company beneficiary, the present entitlement to income is paid and there is no UPE. In those circumstances, the conditions for Subdivision EA to operate are not satisfied.

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## **Appendix 4 – Your comments**

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149. You are invited to comment on this draft Determination, including the proposed date of effect. Please forward your comments to the contact officer by the due date.

150. A compendium of comments is prepared when finalising this Determination, and an edited version (names and identifying information removed) is published to the Legal database on ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

**Due date:**                      **29 April 2022**

Contact officer details have been removed following publication of the final determination.

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10; TR 2010/3

*Legislative references:*

- ITAA 1936
- ITAA 1936 Div 6
- ITAA 1936 Pt III Div 7A
- ITAA 1936 Subdiv D
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- ITAA 1936 109D
- ITAA 1936 109D(1)(b)
- ITAA 1936 109D(1)(c)
- ITAA 1936 109D(3)
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- ITAA 1936 109D(4)
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- SISA 1993 10
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*Cases relied on:*

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- Commissioner of Taxation v Radilo Enterprises Pty Ltd [1997] FCA 22; 72 FCR 300; 97 ATC 4151; (1997) 34 ATR 635
- Corporate Initiatives Pty Ltd v Commissioner Of Taxation [2005] FCAFC

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- El Ajou v Dollar Land Holdings Plc [1994] 2 All ER 685; [1994] BCLC 464; [1994] BCC 143;
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- The Lady Gwendole; Arthur Guinness Son and Co (Dublin) Ltd v Owners of Motor Vessel Freshfield and Others [1965] 2 All ER 283; [1965] 3 WLR 91

*Other references:*

- Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1998
- PS LA 2010/4

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ATO references

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