

TD 2025/D2 - Income tax: disregarding certain payments under section 109R of the Income Tax Assessment Act 1936 in determining how much of a loan has been repaid in situations where notional loans are involved

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Draft Taxation Determination

Income tax: disregarding certain payments under section 109R of the *Income Tax Assessment Act 1936* in determining how much of a loan has been repaid in situations where notional loans are involved

📌 Relying on this 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 Determination 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. Section 109R of the *Income Tax Assessment Act 1936* (ITAA 1936) operates to disregard certain payments which might otherwise be taken into account in determining whether a loan has been repaid in whole or in part, or a minimum yearly repayment has been made. It is intended to prevent shareholders and their associates from avoiding the operation of Division 7A of the ITAA 1936 by repaying a loan, or making a minimum yearly repayment, with another loan from the same company.
2. This draft Determination¹ sets out our view on the following 2 separate but related issues. Our view is that:
 - Section 109R of the ITAA 1936 can apply to disregard certain loan repayments made to a private company where the repaying entity is taken to have obtained a loan from the company by the interposed entity rules in sections 109T and 109W of the ITAA 1936.
 - Where a private company is taken to have made a notional loan under sections 109T and 109W of the ITAA 1936, section 109R of the ITAA 1936 can apply to disregard certain repayments when determining how much (if any) of that loan has been notionally repaid.
3. Alternatively, we may also consider the application of Part IVA of the ITAA 1936 to arrangements whereby loans from a private company are refinanced for the purposes of obtaining a tax benefit.
4. All legislative references in this Determination are to the ITAA 1936, unless otherwise indicated.

Ruling

5. Section 109R prevents some repayments from being taken into account in working out the amount of a loan that has been repaid for the purpose of section 109D, or whether the minimum yearly repayment required to be made for an amalgamated loan for an income year under subsection 109E(5) has been made.
6. Section 109R states that payments are not taken into account where a reasonable person would conclude that the entity intended to borrow, or borrowed, a similar or larger amount from the private company in order to make the payment.
7. Section 109T extends the operation of Division 7A to loans (and payments) that are made indirectly, through interposed entities. Loans that are made from a private company, through interposed entities, to the target entity (notional loans) under certain circumstances may result in assessable dividends under section 109D because of section 109W.
8. We consider that section 109R can apply to disregard:
 - an actual loan repayment, where the repaying entity is taken to have obtained a loan from the private company as a result of the interposed entity rules in sections 109T and 109W, and
 - a notional loan repayment otherwise taken to have been made under subsection 109W(3).

¹ For readability, 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.

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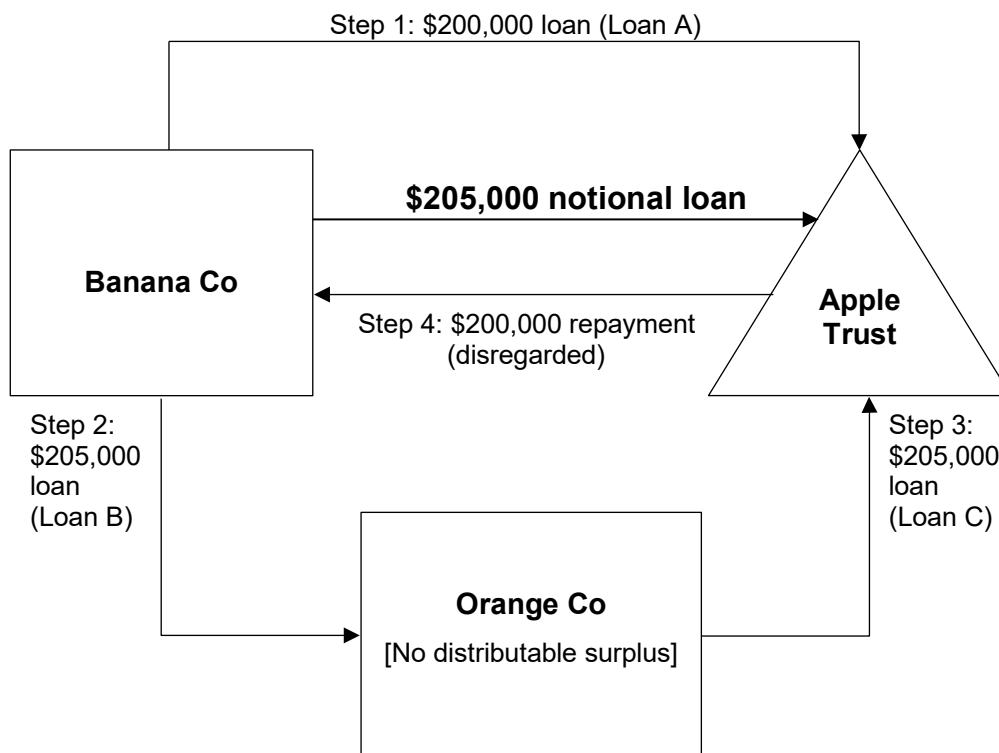
Example 1 – a trust obtains a notional loan from a private company to repay a loan from the same private company

9. *Apple Trust, Banana Co and Orange Co are controlled by the same family group. Apple Trust has minimal liquid assets and requires working capital to operate its business. Banana Co is a private company that has significant retained earnings. Orange Co is a private company that has no distributable surplus. Banana Co's lodgment day for the 2023 income year is 15 May 2024.*

10. *The following transactions occur:*

- *30 March 2023: Banana Co lends \$200,000 to Apple Trust – Loan A*
- *10 May 2024: Banana Co lends \$205,000 to Orange Co – Loan B*
- *11 May 2024: Orange Co lends \$205,000 to Apple Trust – Loan C*
- *14 May 2024 (the day before Banana Co's lodgment day for the 2023 income year): Apple Trust repays Loan A in full.*

Diagram 1: Notional loan from private company and repayment



Application of section 109T

11. *Having regard to all the circumstances, a reasonable person would conclude that Banana Co made Loan B solely or mainly as part of an arrangement involving making Loan C to Apple Trust. These circumstances include the timing and amount of the relevant loans, the liquidity of Apple Trust and Banana Co and the relationship between the 3*

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entities. Accordingly, section 109T applies and we determine under section 109W that Banana Co made a notional loan to Apple Trust of \$205,000 on 11 May 2004.²

Application of section 109R

12. Before Apple Trust repaid Loan A, it was taken to have borrowed \$205,000 (a similar or larger amount) from Banana Co, (the 'notional loan'). Having regard to all the circumstances, a reasonable person would conclude that Apple Trust obtained the notional loan in order to make the payment. These circumstances include the timing and amount of the loan and repayment, the liquidity of Apple Trust and Banana Co and the relationship between the 3 entities. Accordingly, Apple Trust's \$200,000 repayment of Loan A will be disregarded.³

Application of section 109D

13. Section 109D will apply to deem Banana Co to pay a \$200,000 dividend to Apple Trust (subject to Banana Co's distributable surplus) on 30 June 2023. This is because Loan A is taken not to have been repaid before Banana Co's lodgment day.

Example 2 – a trust obtains a loan from a private company to repay a notional loan from the same private company

14. Further to Example 1 of this Determination, the following transactions now occur:

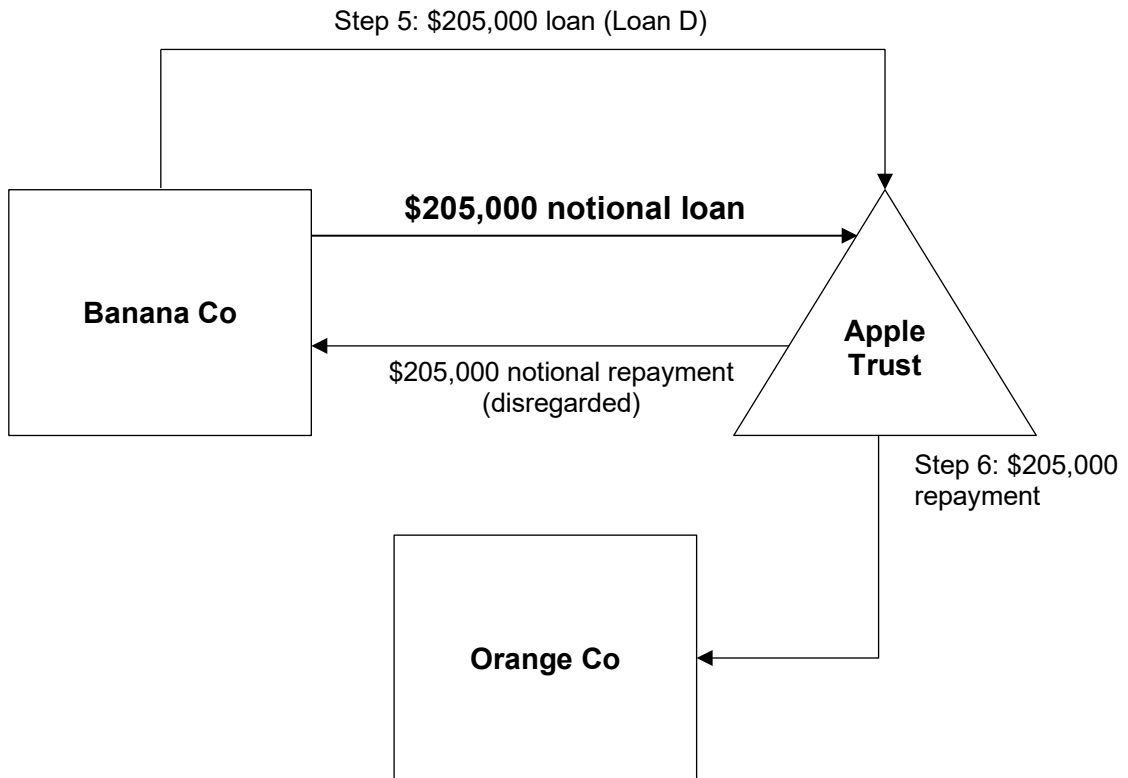
- 31 January 2025: Banana Co lends \$205,000 to Apple Trust – Loan D
- 14 May 2025 (the day before Banana Co's lodgment day for the 2024 income year): Apple Trust makes a repayment of \$205,000 to Orange Co.

² See further, Taxation Determination TD 2011/16 *Income tax: Division 7A - payments and loans through interposed entities - factors the Commissioner will take into account in determining the amount of any deemed payment or notional loan arising under section 109T of the Income Tax Assessment Act 1936.*

³ Paragraph 109R(2)(b).

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Diagram 2: Trust obtains loan from a private company to repay notional loan from same company



15. As explained in Example 1, Banana Co is taken to have made a notional loan totalling \$205,000 to Apple Trust during the 2024 income year.

Application of subsection 109W(3)

16. Applying the formula in subsection 109W(3), the amount of the ‘notional repayment’ to Banana Co (before any application of section 109R) is \$205,000.

$$\text{Repayment made by target entity to lender} \times \frac{\text{Amount of notional loan}}{\text{Amount actually lent to target entity}}$$

17. In this example, the ‘repayment made by target entity to lender’ refers to the \$205,000 repayment Apple Trust (target entity) makes to Orange Co (interposed entity).⁴

Application of section 109R

18. Before Apple Trust is taken to have repaid \$205,000 to Banana Co, it borrowed \$205,000 from Banana Co (Loan D). Having regard to all the circumstances, a reasonable person would conclude that Apple Trust obtained Loan D in order to make the repayment. Accordingly, Apple Trust’s \$205,000 notional repayment to Banana Co is disregarded.⁵

⁴ The notional loan divided by the amount actually lent to target entity would result in a factor of 1.

⁵ Paragraph 109R(2)(b).

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Application of section 109D

19. Accordingly, section 109D will apply to deem a dividend of \$205,000 to be paid to Apple Trust (subject to Banana Co's distributable surplus) at the end of the 2024 income year on the basis that no repayments are treated as having been made with respect to the notional loan.

Application where loan obtained after repayment of loan

20. Examples 1 and 2 of this Determination cover situations where paragraph 109R(2)(b) applies. However, the same principles can apply where paragraph 109R(2)(a) applies (that is, where there is an intention to obtain a loan from the private company after the payment is made).

Application to minimum yearly repayments

21. Examples 1 and 2 of this Determination cover situations where the loans are repaid in full. However, the same principles can apply where loans are put on terms satisfying section 109N and amounts are borrowed to make minimum yearly repayments (under subsection 109E(5)).

Date of effect

22. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

Commissioner of Taxation

5 March 2025

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Appendix 1 – Explanation

❶ *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.*

23. Division 7A is an integrity provision directed at preventing private companies from making tax-free distributions of profits to shareholders (or their associates) in the form of payments, loans or forgiven debts.⁶

Section 109R: anti-refinancing rule

24. Section 109R is intended to prevent shareholders or their associates from avoiding the operation of Division 7A by repaying a loan or making a minimum yearly repayment, with another loan from the same company.⁷ Section 109R has 2 limbs.

25. The first limb, contained in paragraph 109R(2)(a), covers the situation where an entity repays a part or all of a loan to a private company and then subsequently reborrows from the same private company.

26. Paragraph 109R(2)(a) applies to disregard a payment where a reasonable person would conclude (having regard to all the circumstances) that, when the payment was made, the entity intended to obtain a loan or loans from the private company of a total amount similar to, or larger than, the payment.

27. The second limb, contained in paragraph 109R(2)(b), covers the situation where an entity obtained a loan from the private company in order to repay part or all of an earlier loan from the same private company.

28. Paragraph 109R(2)(b) is satisfied where:

- (i) the entity obtained, before the payment was made, a loan or loans from the private company of a total amount similar to, or larger than, the amount of the payment;
- (ii) a reasonable person would conclude (having regard to all the circumstances) that the entity obtained the loan or loans in order to make the payment.

Sections 109T and 109W: interposed entity rules

29. Subdivision E extends the application of Division 7A to a private company that makes a payment or loan to a shareholder (or their associate) through one or more interposed entities.

30. A key requirement in section 109T is that a reasonable person would 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’.⁸

31. Where section 109T is triggered due to a loan from an interposed entity to the target entity, the characteristics of the notional loan between the private company and the target entity (shareholder or their associate) are determined by reference to section 109W.

⁶ See paragraphs 9.1 and 9.2 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No.3) 1998.

⁷ See paragraph 9.60 of the Explanatory Memorandum to Taxation Laws Amendment Bill (No. 3) 1998.

⁸ Paragraph 109T(1)(b).

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32. Subsection 109W(1) provides that where the interposed entity has lent an amount to the target entity, Division 7A operates as if the private company has made a loan (the notional loan) to the target entity. The amount of the notional loan is determined by us having regard to the matters set out in subsection 109W(2), including the amount the interposed entity lent to the target entity.

33. As section 109W treats the private company as having made a loan to the target entity (being a shareholder or their associate), section 109D is capable of applying in respect of that notional loan to deem a dividend to the target entity.

34. Subsection 109W(3) addresses the effect of actual loan repayments made to an interposed entity in circumstances where a notional loan has been deemed to have been made from a private company.

35. The label ‘repayment made by target entity to lender’ in the formula in subsection 109W(3) refers to the amount of any repayment the target entity has in fact made of the loan to it from the interposed entity. Subsection 109W(3) effectively deems repayments of this actual loan to be repayments of the notional loan.

Actual repayments disregarded under section 109R

36. We consider that section 109R may apply to disregard an actual loan repayment⁹ in circumstances where the private company is or will be taken to have made another loan under sections 109T and 109W.

37. Where sections 109T and 109W apply, the private company is effectively taken to have made the loan which the interposed entity in fact made. This loan can therefore be taken into account in considering the potential application of section 109R to the repayment of another loan by the same borrower.

38. The first limb in section 109R¹⁰ requires that a reasonable person would conclude that the repaying entity had an intention to obtain one or more loans from the private company at the time they made the repayment.

39. The second limb in section 109R¹¹ first requires that a reasonable person would conclude that the repaying entity obtained one or more loans from the private company in order to make the repayment.

40. Both of these tests are concerned with objective purpose; they do not require, or permit, an enquiry into anyone’s actual or subjective motives or state of mind.¹²

41. In considering what a reasonable person would conclude for the purposes of section 109R, this notional loan must be taken as an objective fact, without any regard to the actual or subjective intentions of the parties.

42. In this context, the conclusion of a reasonable person as to the purpose of the notional loan or intention to obtain one is instead deduced from:

- the amount and timing of the loan
- the amount and timing of other connected loans or payments
- the relationship between the parties

⁹ In Example 1 of this Determination, this is the repayment to Banana Co which occurs in Step 4.

¹⁰ Paragraph 109R(2)(a).

¹¹ Paragraph 109R(2)(b).

¹² In this regard, the ‘reasonable person’ test in section 109R is comparable to the purpose test in Part IVA, see *Commissioner of Taxation v Hart* [2004] HCA 26 at [65], per Gummow and Hayne JJ.

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- the financial positions of the parties, and
- any other circumstances which are objectively relevant to the loan.

Notional repayments disregarded under section 109R

43. We consider that section 109R can apply to disregard notional loan repayments otherwise taken to have been made under subsection 109W(3).¹³

44. Where subsection 109W(3) applies, the repaying entity is effectively taken to repay all or part of the notional loan it was taken to have obtained from the private company under sections 109T and 109W. This repayment can therefore be taken into account in considering the potential application of section 109R.

45. These notional repayments are considered to be treated in the same way as any other repayment for the purposes of section 109D. Accordingly, provisions in Division 7A which address loan repayments, including section 109R, continue to operate in the ordinary manner.

46. In considering what a reasonable person would conclude for the purposes of section 109R, a notional repayment must be taken as an objective fact, without any regard to the actual intentions of the parties.¹⁴

47. In this context, the conclusion of a reasonable person as to the purpose of a notional loan or intention to obtain one is instead deduced from the matters referred to in paragraph 42 of this Determination, which include any notional repayments arising under subsection 109W(3).

¹³ In Example 2 of this Determination, this is the repayment to Banana Co which is taken to occur at Step 6.

¹⁴ Refer to paragraph 40 of this Determination.

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Appendix 2 – Alternative views

❶ *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.*

Actual repayments disregarded under section 109R

48. Some practitioners have argued against the proposition that the deeming in sections 109T and 109W can be taken into account for the purposes of section 109R.

49. First, it has been argued that the terms used in sections 109R and 109T are different. In particular, section 109T provides that the ‘Division operates as if a private company makes a payment or loan to an entity’ whereas section 109R requires that the entity intended to ‘obtain a loan’ and in fact ‘obtained a loan’ from the private company.

50. Second, it has been argued that, even if these notional loans are recognised as existing for the purposes of section 109R, sections 109T and 109W do not provide them with any particular purpose. Accordingly, a reasonable person would not be in a position to determine whether the repaying entity intended to obtain the notional loan, or obtained it in order to repay another loan, for the purposes of section 109R.

51. While we understand these arguments, they are not considered to represent the better view of the law. The interpretation in this Determination seeks to reconcile the existence of the various definitions and deeming rules in Division 7A with the need to draw conclusions as to the objective purpose of the parties in particular cases.¹⁵ This interpretation is also considered to be the one which best achieves the purpose or object of sections 109R, 109T and 109W and Division 7A as a whole.¹⁶

52. Concerns have also been raised about ‘double taxation’ which may arise where a repayment is disregarded in respect of the original loan under section 109R, resulting in a deemed dividend and also the potential for a deemed dividend in respect of the further notional loan.

53. However, we note that the potential for multiple deemed dividends to arise as a result of section 109R applying is not limited to arrangements involving notional loans arising under sections 109T and 109W. The same result may arise where loans from a private company are refinanced by actual loans from the same company.

Notional repayments disregarded under section 109R

54. Some practitioners have contended that section 109R cannot apply in respect of repayments of a notional loan, on the basis that subsection 109W(3) has exclusive operation in this context.

55. We do not agree with this interpretation. As explained in paragraphs 43 to 47 of this Determination, the repayment of a notional loan supplied by subsection 109W(3) is considered to be subject to the same treatment as any other repayment for the purposes of Division 7A.

56. The interpretation in this Determination is also considered to be the one which best achieves the purpose or object of sections 109R, 109T and 109W and Division 7A as a whole.¹⁷

¹⁵ See also section 109UA, which deems a guarantor to make a payment for the purposes of section 109T.

¹⁶ Section 15AA of the *Acts Interpretation Act 1901*.

¹⁷ Section 15AA of the *Acts Interpretation Act 1901*.

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57. We consider that subsection 109W(3) was not intended to operate independently of section 109R. The alternative view would allow section 109R, and therefore Division 7A, to be circumvented by interposing an entity, allowing the very mischief which Subdivision E is directed towards preventing.¹⁸

¹⁸ Paragraphs 9.63 to 9.91 of the Explanatory Memorandum to Taxation Laws Amendment Bill (No. 3) 1998.

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Appendix 3 – Your comments

58. 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.

59. 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: 17 April 2025

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; TD 2011/16

Legislative references:

- ITAA 1936 Div 7A
- ITAA 1936 109D
- ITAA 1936 109E(5)
- ITAA 1936 109N
- ITAA 1936 109R
- ITAA 1936 109R(2)(a)
- ITAA 1936 109R(2)(b)
- ITAA 1936 109T
- ITAA 1936 109T(1)(b)
- ITAA 1936 109UA

- ITAA 1936 109W
- ITAA 1936 109W(1)
- ITAA 1936 109W(2)
- ITAA 1936 109W(3)
- ITAA 1936 Subdiv E
- Acts Interpretation Act 1901 15AA

Cases relied on:

- Commissioner of Taxation v Hart [2004] HCA 26; 217 CLR 216; 2004 ATC 4599; 55 ATR 712; 206 ALR 207

Other references:

- Explanatory Memorandum to Taxation Laws Amendment Bill (No. 3) 1998

ATO references

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