

By email: peter.glindemann@ato.gov.au

2 May 2022

Mr Peter Glindemann
The Australian Taxation Office

Dear Sir,

DRAFT TD 2022/D1 - DIVISION 7A: UNPAID PRESENT ENTITLEMENTS AND SUB-TRUSTS - BDO SUBMISSION

BDO refers to the invitation by the Australian Taxation Office (ATO) to provide comments on the ATO's **Draft TD 2022/D1 - Division 7A: When will an unpaid present entitlement or amount held on sub-trust become the provision of 'financial accommodation'?**

BDO is pleased to provide comments on the Draft Taxation Determination (Draft TD). In summary, our main concerns are that the Draft TD contains a number of issues that create unnecessary complexity uncertainty and require clarification summaries as follows:

1. Timing for deemed loans created by fixed amount and proportionate resolutions should be treated the same i.e. when the accounts are determined
2. Clarity on transitional rules for conversion of sub-trusts to Division 7A loans following withdrawal of PS LA 2010/4
3. Clarifying how pre-16 Dec 2009 UPEs will be treated
4. Guidance on requirement to lodge a separate sub-trust income tax return

BDO's detailed comments in this regard are in the attached appendix.

Should you have any questions, or wish to discuss any of the comments made in our submission, please do not hesitate to contact me on 02 9240 9736 or lance.cunningham@bdo.com.au.

Yours sincerely

Lance Cunningham

BDO National Tax Technical Leader

BDO Submission to the Australian Taxation Office

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

BDO has considered the Draft TD 2022/D1 - Division 7A: When will an unpaid present entitlement (UPE) or amount held on sub-trust become the provision of 'financial accommodation'? (Draft TD) which sets out the ATO's revised draft views regarding when a private company beneficiary provides "financial accommodation" to the trustee or a shareholder (a loan for Division 7A purposes) where there is a UPE or where there is a sub-trust created and we provide the following comments on the issues of concern in the Draft TD.

1. **Timing for deemed loans created by fixed amount and proportionate resolutions should be treated the same i.e. when the accounts are determined**

The Draft TD states that, under subsection 109D(4) a loan is made to an entity at the time anything described in subsection 109D(3) is done in relation to an entity. Under subsection 109D(3)(b), a private company beneficiary makes a loan to the trustee of a trust, or another shareholder (or associate), when any other form of 'financial accommodation' is provided.

The ATO's view in the Draft TD is that where there is a UPE, financial accommodation is provided at the 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.

One of the problems with the ATO view in the Draft TD is the timing of when financial accommodation is taken to be provided would differ depending on the way the trustee expresses the present entitlement in the trustee resolution, particularly where the controllers of the trust are the same persons as the controllers of the private company beneficiary.

The draft TD makes a distinction between where the trustee makes a private company beneficiary presently entitled to a *proportionate/calculated amount* of the trust income say on or before 30 June 2023, and where the private company beneficiary is made presently entitled to a *fixed dollar amount* from the trust income, say on or before 30 June 2023.

In the first scenario, the trust distributable income generally won't be ascertained until sometime the following year (i.e. year when the accounts are prepared most likely the 2024 year). In this case the ATO accepts that the private company beneficiary doesn't have knowledge of the amount until the trust income is calculated. Therefore, the financial accommodation (deemed loan) is taken not to have been provided until the distributable income is determined for the year (when the accounts are prepared in the 2024 income year).

Conversely, In the second scenario, the Draft TD says the private company beneficiary provides a financial accommodation (has made a deemed loan) to the trustee on the date the trustee makes the resolution i.e. in the 2023 income year. The Draft TD states this is because on that date the private company beneficiary is taken to have knowledge of the amount and can demand payment, but does not, and allows the trustee to retain the amount. This would potentially result in a 12-month difference between the two scenarios for the commencement of the Division 7A loan and first minimum yearly repayment.

BDO Submits that the distinction made by the ATO in these two scenarios is not correct. In both scenarios the actual amount available for distribution will not be certain until the trust accounts are completed. Although, where a private company beneficiary is made presently entitled to a *fixed dollar amount*, the company's controllers do have an indication of the amount it may be presently entitled to, the company's controllers will not know whether the Trust has the available distributable income to fulfill the resolution until the trust accounts are prepared.

Where a trustee resolves to make a beneficiary presently entitled to trust income before the accounts have been completed the trustee will not know what distributable profits or gains will be available to fulfill the resolutions until the accounts confirm the trust income available for distribution to the beneficiaries. This is the case whether the distribution is of a *fixed dollar amount* or a *proportionate/calculated amount*.

For example, if the trustee makes the beneficiary presently entitled to an amount of say \$10,000, there may be no certainty the beneficiary will receive \$10,000, as there may be liabilities and other expenses that haven't been taken into account until when the accounts are finalised in the following year.

The trustee can only distribute an amount of income of the trust if it is available for distribution. This is the view of the ATO as expressed in *TR 2012/D1: meaning of 'income of the trust estate' in Division 6 of Part III of the Income Tax Assessment Act 1936 and related provisions*. Specifically at paragraphs 12 and 13 of TR 2012/D1 it says:

“12. In the context of Division 6, the ‘income of the trust estate’, ... is a reference to the income available for distribution to beneficiaries or accumulation by the trustee, commonly referred to as ‘distributable income’.

13. Notwithstanding how a particular trust deed may define income, the ‘income of the trust estate’ for Division 6 purposes must therefore be represented by a net accretion to the trust estate for the relevant period. ...”

The trustee will generally not know what the ‘net accretion to the trust estate’ is until the trust accounts are prepared.

For the private company beneficiary to be taken to have made the loan in the case of a fixed amount resolution, there needs to be certainty in the balance.

We consider that both the fixed amount and proportionate resolutions should be treated the same way as when the accounts are determined.

In addition, by making a distinction based on the way the trustee resolution is drafted would make it practically difficult to administer the timing of when a Division 7A loan is taken to be made and creates unnecessary complexity and uncertainty.

2. Clarity on transitional rules for conversion of sub-trusts to Division 7A loans following withdrawal of PS LA 2010/4

The Draft TD states that when it is finalised, the current rules in TR 2010/3 and PS LA 2010/4 (that provides three safe harbour investment options to invest funds representing the UPE) will be withdrawn from 1 July 2022. This will also bring to an end corresponding arrangements allowed under PCG 2017/13 and its updates, where the ATO accepts that if the trustee failed to pay the principal at the end of the loan term, another 7-year loan on complying terms could be put in place between the sub-trust and the corporate beneficiary, providing a further period for the amount to be repaid, with periodic payments of both principal and interest.

This means when the Draft TD is finalised, the year ended 30 June 2022 will be the final income year in which taxpayers can take advantage of complying sub-trust arrangements in PS LA 2010/4 and PCG 2017/13.

We acknowledge that the Draft TD confirms that the sub-trust arrangements can be put in place after year-end (e.g., by the 15 May 2023 lodgement day) so long as the trust entitlement arose before 1 July 2022. Therefore, 30 June 2022 UPEs that are put on a 7-year or 10-year complying sub-trust arrangements may allow for interest only payments each year and defer principal repayment until 14 May 2030 and 14 May 2033 respectively.

However, our concern is whether the ATO will provide further transitional rules for the rollover of 7-year or 10-year complying sub-trust arrangements as provided in PCG 2017/13.

We would request that before the Draft TD is finalised, the ATO clarify what the position is for further transitional rules after 30 June 2022 in relation to the UPEs covered by the three safe harbour investment options in PSLA 2010/4 if they are converted into complying Division 7A loans after the end of 7 or 10 year period.

3. Clarifying how pre-16 Dec 2009 UPEs will be treated

PS LA 2010/4 specifically stated that Division 7A will not apply to UPEs created prior to 16 December 2009 (provided they were not converted to loan or become subject to Subdivision EA). However, with the withdrawal of PS LA 2010/4 after 30 June 2022, what is the status of pre-16 December 2009 UPEs? Will they continue to be excluded from the operation of Division 7A?

We note that, when the final Tax Determination is issued the Draft TD states the ATO will not to 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 arose before 1 July 2022 (even if the sub-trust is put in place after 30 June 2022). This appears to include pre-16 December 2009 UPEs. However, not devoting compliance resources to them is not the same as saying “division 7A will not apply” to them.

Clarification is needed as to how the ATO will treat pre-16 December 2009 UPEs going forward and whether there will be any change to the Commissioner’s position with respect to UPEs in existence prior to 16 December 2009 and will they continue to be quarantined by the trust.

4. Requirement to lodge a separate sub-trust income tax return

Currently under PS LA 2010/D4, to avoid a UPE being treated as a Division 7A deemed dividend paid by a private company to a trust the trustee may either convert it to a Division 7A complying loan or place the funds in a separate sub-trust for the sole benefit of the private company beneficiary.

There are three options for this sub-trust. Options one and two provide for interest only loans from the sub-trust to the main trust and option three provides that the sub-trust uses the funds to acquire an income producing asset for the sole benefit of the corporate beneficiary.

The Commissioner has now changed his view so that options one and two are no longer considered to result in the sub-trust being held for the sole benefit of the corporate beneficiary, thus leaving option three as the only acceptable sub-trust arrangement that will avoid the operation of Division 7A.

In this regard the ATO's current view under PS LA 2010/4 is summarised via this link to ATO website: <https://www.ato.gov.au/Business/Private-company-benefits---Division-7A-dividends/In-detail/Division-7A---unpaid-present-entitlement/>

In this guidance on the Website the ATO indicates that, if options one or two are used for the sub-trust, the sub-trust does not have to prepare separate accounts and does not have to lodge a separate tax return. This implies that if an option three sub-trust is used there would be a requirement for separate accounts and tax return for the sub-trust.

As the new view of the ATO, in effect, only allows the use of an option three sub-trust, is it still the ATO's view that such sub-trusts must prepare separate accounts and separate tax return.

We request that in when finalising Draft TD the ATO clarify whether a separate sub-trust income tax return is required to be lodged.

Conclusion

BDO submits that the ATO should resolve and clarify many of the issues and inconsistencies contained in the Draft TD that are highlighted in our submission and provide a clear guidance of the ATO's revised approach to the arrangements in the Draft TD.