



Your Link to Business Success

DIVISION 7A JUST GOT SCARIER

by Tim Olynyk

On 2 June 2010, the Australian Taxation Office (ATO) released TR 2010/3 which relates to the application of Division 7A to unpaid present entitlements (UPE's) payable from a trust to a corporate beneficiary. TR 2010/3 is the finalisation of draft ruling TR 2009/D8 which created significant (and unprecedented) public comment from various professional organisations disputing the legal validity of several principles outlined in TR 2009/D8.

Unfortunately, it appears that the ATO have not backed off and many of the principles outlined in TR 2009/D8 have made their way into the final ruling.

What TR 2010/3 states

Broadly, TR 2010/3 provides that it is the ATO's view that many UPE arrangements between a trust and a corporate beneficiary will be classified as loans for the purposes of Division 7A (thus resulting in them being classified as a deemed dividend unless they are created under commercial loan terms).

UPE's created prior to 16 December 2009

The ATO states that a UPE will be classified as a loan where there is agreement (actual or implied) between the trust and the corporate beneficiary that the amount owing is a loan rather than a UPE. This would arise for example where the UPE is accounted for as a loan rather than a UPE in the books of either the trust or the corporate beneficiary.

Interestingly, the ATO state that where the terms of the trust deed of the trust require the trust to hold the funds for the benefit of the private company as a UPE rather than as a loan, the amount outstanding cannot be classified as a loan (i.e. irrespective of how the trust accounts for it) if the private company continues to recognise the amount as a UPE rather than a loan.

What needs to be done

It is clear from the ATO's ruling that any existing UPE's that are not correctly accounted for in the books of the trust or the corporate beneficiary are at great risk of being reclassified as a loan for the purposes of Division 7A.

For UPE's established on or after 16 December 2009, it is critical that the UPE be segregated from other trust funds and a commercial return be provided to the corporate beneficiary. For example, this could be achieved by holding the UPE in a separate bank account.

Unless the above procedures are followed, the UPE will be classified as a loan (and thus potentially a deemed dividend) unless the loan is established on commercial loan terms.

Who should you contact

If you have any further questions relating to this article or TR 2010/3, please contact Tim Olynyk of this office on (03) 9810 0700.

UPE's created on or after 16 December 2009

For UPE's arising on or after 16 December 2009 (being the date that TR 2009/D8 was first released), the ATO states that it is the ATO's view that a UPE is a form of 'financial accommodation' and thus a loan within the ordinary meaning of Division 7A (i.e. irrespective of the way the UPE is accounted for by trust or corporate beneficiary) where the corporate beneficiary does not call upon the trust to invest the amount of the UPE at a commercial return for its own benefit.

(The ATO do acknowledge however that a UPE cannot become a loan in the same year it is first created as a corporate beneficiary is required to be provided with sufficient time to determine its appropriate investment strategy).