

Division 7A and UPEs: How Bendel interrupted the status quo, what might happen post appeal, and where things are at in the meantime

Introduction

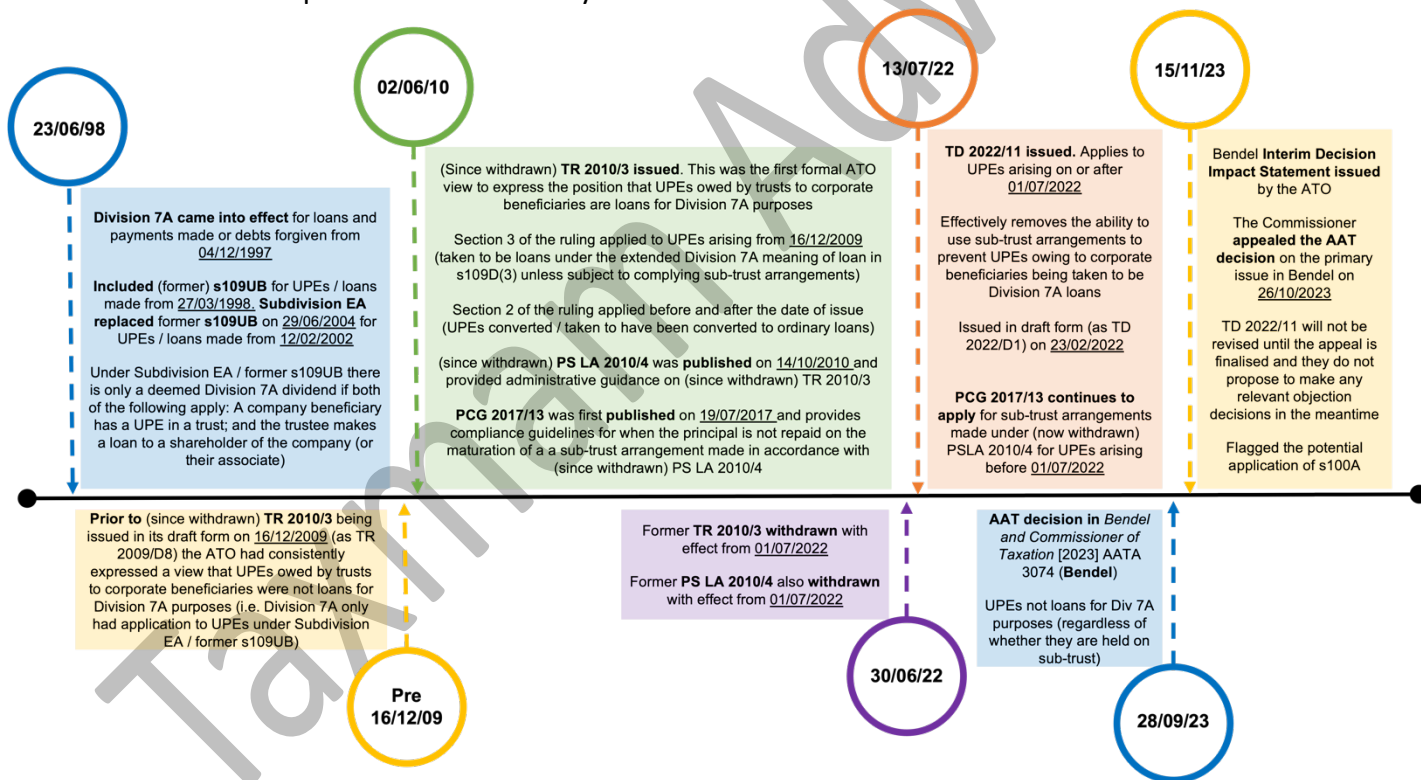
This article outlines the ATO view on how Division 7A applies to unpaid present entitlements (UPEs) owed by trustees of trusts to corporate beneficiaries within the same family group, in particular the position of the Commissioner (of Taxation) on whether such UPEs are loans for Division 7A purposes.

It includes a look at how this position has changed over time and how the administrative approach broadly taken by the ATO since December 2009, and arguably also largely adopted by the tax profession since then, has been challenged by the Administrative Appeals Tribunal (AAT) decision in *Bendel and Commissioner of Taxation* [2023] AATA 3074 (Bendel).

Finally, it considers what the outcome of the Commissioner’s appeal of the AAT decision in Bendel might mean in practice (either way), and where things are at in the meantime.

Timeline: Division 7A and UPEs

The intention of the discussion which follows is to provide an overview of what’s occurred to date (in chronological order as summarised in the below table) as context for understanding what might happen next and what the practical effect is likely to be.



Overview: Unpaid present entitlements (UPEs) and tax

A UPE occurs where a beneficiary has been made presently entitled to an amount of trust income (i.e. in accordance with trust law concepts) and the trustee of the trust has not yet made a payment to the beneficiary with respect to that entitlement (such that the funds representing the UPE continue to be held by the trustee of the trust).

The concept of UPEs is not limited to companies, but only UPEs owing to companies are relevant for the purposes of considering how Division 7A applies to UPEs.

There is no prescribed tax treatment specific to UPEs. Broadly speaking, net income of a trust for tax purposes for an income year is assessed to beneficiaries of the trust in the same proportion as their present entitlement to trust income for that income year, or taxed to the trustee of the trust to the extent there is any proportion of trust income to which no beneficiary is presently entitled for that income year.

Since withdrawn *Taxation Ruling TR 2010/3: Income tax: Division 7A loans: trust entitlements* (former TR 2010/3) indicated that the catalyst for the commencement of the longstanding ATO administrative approach with respect to Division 7A as it applies to UPEs was:

- a purported increase in the practice of trustees making corporate beneficiaries presently entitled to trust income whilst retaining the funds representing that UPE in the trust; and
- That practice being economically equivalent to accumulating income in the trust but with the effect that trust income is taxed at corporate rates rather than the higher rate applying to trustees.

Overview: Division 7A

Division 7A of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) (Division 7A) received royal assent on 23/06/1998 and broadly applies to loans and payments made and debts forgiven by private companies to their shareholders, or associates of their shareholders, from 14/12/1997.

In addition to loans within their ordinary meaning, Division 7A applies to the extended meaning of loan in Subsection 109D(3) ITAA 1936 (s109D(3)) which includes:

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

It is the 'or any other form of financial accommodation' inclusion above that is most relevant to the issues being considered.

Broadly speaking, and subject to some limited exceptions, if a private company makes a loan to a shareholder (or their associate) they will be taken to have paid an unfranked dividend to the shareholder (or associate) at the end of the income year in which the loan is made unless:

- The loan is repaid in full prior to the lodgement day for the income year in which the loan is made; or
- The loan is put on a complying Division 7A loan agreement prior to the lodgement day for the income year in which the loan is made.

The lodgement day is the earliest of: the day the income tax return for the company is due for that income year; and the day that income tax return is lodged.

The amount of the deemed unfranked dividend assessable to the shareholder (or their associate) is the amount of the loan outstanding at the lodgement day for the income year in which the loan is made.

In response to issues raised during consultation, as enacted Division 7A included former Section 109UB ITAA 1936 (s109UB) which applied to loans made from 27/03/1998. Former s109UB was replaced with Subdivision EA ITAA 1936 (Subdivision EA) on 29/06/2004 for loans made from 12/02/2002.

Subdivision EA (and former s109UB) are specific to UPEs and broadly provide that there will be a deemed dividend to the shareholder (or associate) if both:

- The company has a UPE to income of the trust: and
- the trustee of the trust makes a loan to a shareholder (or associate)

In circumstances where Subdivision EA applies the loan made by the trustee of the trust to the shareholder (or their associate) is taken to have been paid by the company, and is included as a deemed unfranked dividend in the assessable income of the shareholder (or their associate).

History of the ATO view on how Division 7A applies to UPEs

Prior to former TR 2010/3 being issued in its draft form on 16/12/2009, the consistent ATO view had been that UPEs owed by trustees of trusts to corporate beneficiaries were not loans for Division 7A purposes such that Division 7A only had any application to UPEs in the specific circumstances addressed by Subdivision EA (and former s109UB).

Any changes to the ATO view (pre and post 16/12/2009 and since) have not resulted from legislative change. Whilst there have been several amendments made to Division 7A since it was enacted, other than the introduction of Subdivision EA as noted above, none have been specific to UPEs.

As outlined below some aspects of the ATO view have changed since then, but 16/12/2009 marks the commencement of the longstanding ATO administrative approach which broadly continues to apply.

The (original) longstanding ATO administrative approach

Former TR 2010/3 was published in its draft form on 16/12/2009 and in its final form on 02/06/2022 and was the first formal ATO view published expressing the Commissioner's position that UPEs owing by trustees of trusts to corporate beneficiaries are loans for Division 7A purposes.

The position set out in former TR 2010/3 divided UPEs taken to be loans into two categories:

- Section 2 loans: Ordinary loans
- Section 3 loans: Loans within the extended Division 7A meaning in s109D(3)

Former TR 2010/3: Section 2 loans

Section 2 of former TR 2010/3 provided the Commissioner's position on when UPEs owed to corporate beneficiaries by trustees of trusts were loans within their ordinary meaning (ordinary loans) and can be summarised as follows:

- A UPE owed by a trustee of a trust to a company beneficiary is not in itself considered to be an ordinary loan, but could be discharged and replaced with one including where the UPE is paid out to the company and the funds are loaned back to the trustee of the trust.
- The paying out and loaning back need not be cash transactions, it could (for example) be given effect by an agreed set off or as provided for under the terms of the trust deed.
- An agreement for the company to lend the amount attributable to the UPE and the trustee of the trust to borrow that amount can be express (such as a written loan agreement) or implied.
- If the company has knowledge that the trustee of the trust has treated the amount of the UPE as paid out and loaned back, and acquiesces to that treatment, they will be taken to have agreed to the UPE being treated as a loan.

- If the trust and company are part of the same family group the company will be taken to have knowledge of such treatment unless there is evidence which supports a contrary intention (such as the company not treating the UPE amount as a loan to the trustee in their own accounts).

For cases where there was a written loan agreement in place, this view was pretty uncontroversial. The implied agreement aspect of the view came as a surprise to some, which was why the Commissioner gave a grace period during which the way UPEs were accounted for could be self-rectified. Section 2 of former TR 2010/3 otherwise applied before and after the date of issue.

Former TR 2010/3: Section 3 loans

Section 3 of former TR 2010/3 provided the Commissioner's position on when a UPE owed by a trustee of a trust to a corporate beneficiary was a loan within the extended meaning of loan for Division 7A purposes in s109D(3) and can be summarised as follows:

- Of the four extensions to the meaning of loan in s109D(3) paragraph b) being 'a provision of credit or any other form of financial accommodation' is particularly relevant.
- A 'a provision of credit or any other form of financial accommodation' includes circumstances where there is a 'consensual agreement by the company to provide pecuniary aid in favour of the trust'.
- There will be taken to be a 'consensual agreement by the company to provide pecuniary aid in favour of the trust' if the corporate beneficiary authorises the use of the funds representing the UPE for trust purposes (including by acquiescing to that use with knowledge) by not:
 - Calling for payment; or
 - Calling for investment of the funds representing the UPE for their sole benefit.
- The overall effect of the above being that where a corporate beneficiary has knowledge that funds representing the UPE owed to them are being used for trust purposes and doesn't call for their payment or investment, they will be taken to have made a Division 7A loan within the extended meaning in s109D(3) to the trustee of the trust.
- Funds will be taken to be used for trust purposes if funds representing the UPE are intermingled with other trust funds, such as if nothing more is done than recording the UPE in the accounts.
- Funds representing the UPE will also be taken to be used for trust purposes if the funds are held on sub-trust for the benefit of the company, but the corporate beneficiary allows the funds to remain intermingled with other trust funds (either informally or by the sub-trust loaning funds to the main trust or investing in the main trust in a manner which does not entitle the corporate beneficiary to the exclusive benefit of any income generated from the funds in addition to the return of capital).
- If the loan to or investment in the main trust by such a sub-trust is on terms that entitle the sub-trust to all the benefits from those funds, as well as the repayment of the principal of the investment, the corporate beneficiary is not taken to provide financial accommodation as the main trust is not taken to receive any pecuniary aid or favour from the private company.
- Since withdrawn *Practice Statement Law Administration PS LA 2010/4: Division 7A: trust entitlements* (former PS LA 2010/4) provided guidance on when a sub-trust arrangement would satisfy the above exception (as set out below).
- Unlike the circumstances addressed by Subdivision EA (and former s109UB) the Commissioner's view on when UPEs are taken to be loans within the extended meaning in s109D(3) has the

effect that Division 7A applies without the need for the trustee of the trust to also make a loan to a shareholder (or their associate) of the company with the UPE.

In acknowledgement that it departed from the Commissioner's previous view, section 3 of former TR 2010/3 only applied to UPEs arising after 16/12/2009, being when the draft ruling was published.

The view expressed in Section 3 of Former TR 2010/3 broadly relied on the Commissioner's interpretation and application of judicial precedent on the meaning of specific terms used in s109D(3), though such precedent broadly considers the use of those terms in contexts outside of Division 7A.

Consequences of a UPE being taken to be a loan for Division 7A purposes

Where a UPE is taken to be a loan by the corporate beneficiary to the trustee of the trust for Division 7A purposes, an unfranked Division 7A dividend is included in the net income of the trust for tax purposes, and then who is ultimately assessed on the amount will depend on which beneficiaries of the trust had a present entitlement to trust income for the year in which the Division 7A loan is taken to be made. Regardless, an amount representing the UPE is effectively subject to tax twice.

As is the case with any other loan to which Division 7A applies, assessable unfranked dividends from a UPE being taken to be a loan for Division 7A purposes can be avoided by repaying the amount taken to be a loan in full, or placing it on a complying Division 7A loan agreement, before the lodgment day for the income year in which the loan is taken to be made.

Complying sub-trust arrangements

Former PS LA 2010/4 provided administrative guidance on Former TR 2010/3. In particular, it addressed the circumstances in which the Commissioner would be satisfied that an amount (attributable to a UPE owed to a corporate beneficiary and held on sub-trust for their benefit) was held on terms which have the effect that the corporate beneficiary would not be taken to provide financial accommodation and therefore Division 7A would not apply. It detailed the following three options:

- Option 1: Invest the UPE amount on an interest only 7-year loan (at benchmark rates)
- Option 2: Invest the UPE amount on an interest only 10-year loan (at prescribed rates)
- Option 3: Invest the UPE amount in a specific income producing asset

For all three options former PS LA 2010/4 required that:

- All annual returns on investment flowed to the sub-trust and were paid to the corporate beneficiary by the lodgment day of the (main) trust for the income year; and
- The principle must have been repaid to the corporate beneficiary when the interest only loan matured (or when the investment ended for Option 3); and
- A sub-trust arrangement complying with any of these options must have been in place on or before the lodgment day for the main trust for the income year in which the UPE arose.

These sub-trust arrangement options were 'safe harbours' rather than the only way the Commissioner could be satisfied that funds representing a UPE were held on sub-trust for the sole benefit of the corporate beneficiary. These complying sub-trust arrangements were solely an ATO administrative approach rather than having any legislative basis.

When complying sub-trust arrangements mature

Practical Compliance Guideline PCG 2017/13: Division 7A - PS LA 2010/4 sub-trust arrangements maturing in or after the 2016-17 income year (PCG 2017/13) was originally published on 19/07/2023

and provides guidelines with respect to what happens when an interest only loan made under sub-trust arrangements complying with Option 1 or Option 2 of former PS LA 2010/4 matures.

The earliest a 7-year interest only loan (made in compliance with Option 1 of former PS LA 2010/4) could mature was the income year ended 30 June 2017. PCG 2017/13 as originally published provided the Commissioner's position that if the principal was not repaid when an interest only loan matured in either of the income years ending 30 June 2017 or 30 June 2018, the unpaid principal would be taken to be the provision of financial accommodation in the relevant income year (and a Division 7A loan would therefore be taken to have been made in that income year). However, it also included the Commissioner's view that a Division 7A complying loan agreement put in place between the sub-trust and the company by the company's lodgment day for the relevant income year would effectively discharge the requirement to repay the principle.

PCG 2017/13 was subsequently updated several times to extend its application to 7-year and 10-year interest only loans (made in compliance with Options 1 and 2 of former PS LA 2010/4) maturing in the income year ending 30 June 2019, then 30 June 2020, then 30 June 2021, before a final update such that PCG 2017/13 now applies to such interest only loans maturing in the income year ending 30 June 2017 and all later income years for UPEs arising up until 30/06/2022.

Former TR 2010/3 was withdrawn with effect from 01/07/202 on 30/06/2022. Former PS LA 2010/4 was also withdrawn with effect from 01/07/2022.

The (modified) longstanding ATO administrative approach

Taxation Determination TD 2022/11: Income tax: Division 7A: when will an unpaid present entitlement or amount held on sub-trust become the provision of 'financial accommodation'? (TD 2022/11) was published on 13/07/2022 and applies to UPEs arising on or after 01/07/2022.

TD 2022/11 provides the Commissioner's current position on when 'financial accommodation' will be taken to be provided, and therefore a loan taken to be made for Division 7A purposes in; circumstances where a UPE owed by a trustee of a trust to a corporate beneficiary remains unpaid; and in circumstances where the trustee sets aside an amount representing the UPE on sub-trust for the exclusive benefit of the corporate beneficiary.

In circumstances where the UPE remains unpaid, the corporate beneficiary will be taken to provide financial accommodation to the trustee of the trust when they:

- Have 'knowledge of an amount' that they can demand immediate payment of; and
- Do not demand that payment.

The corporate beneficiary cannot generally have 'knowledge of an amount' they are entitled to demand immediate payment of until the trust income for the relevant income year is determined. Therefore, financial accommodation with respect to a UPE arising during an income year will generally be taken to be provided in the following income year.

In circumstances where the trustee sets aside an amount representing the UPE on sub-trust for the exclusive benefit of the corporate beneficiary, the company is taken to provide financial accommodation if:

- All or part of the amount set aside on sub-trust is used by or for the benefit of a shareholder (or their associate) of the company; and
- The company has knowledge of that use; and
- By arrangement, understanding, or acquiescence the company consents to this use of the funds by the sub-trust.

In practice this means that if the main trust uses any part of the sub-trust funds, the corporate beneficiary will be taken to have provided financial accommodation to the trustee of the main trust at that time. This also applies to the use of the sub-trust funds by other entities in the family group.

Unlike the Commissioner's view in former TR 2010/3, the view in TD 2022/11 has the effect that financial accommodation will be taken to be provided by the corporate beneficiary to the (main) trust in such circumstances even if the (main) trust's investment in or loan from the sub-trust is on commercial terms.

TD 2022/11 therefore brings an end to sub-trust arrangements which comply with Option 1 or Option 2 of former PS LA 2010/4 providing a means to avoid any consequences under Division 7A with respect to amounts held on sub-trust attributable to UPEs of corporate beneficiaries.

There continues to be no 'financial accommodation' taken to be provided for sub-trust arrangements where the funds representing the UPE are not used in any capacity by the main trust or any other entity within the family group (e.g. when they are held in a separate bank account or asset that no other entity within the family group can use or benefit from). This is broadly consistent with Option 3 under former PS LA 2010/4 which anecdotally was rarely used in practice.

If the corporate beneficiary and the trustee of the trust have the same directing mind and will, the company is taken to have knowledge of an amount which they can demand immediate payment of, or funds held on sub-trust for their benefit being used by the main trust or another entity within the family group, at the same time that the trustee of the trust had such knowledge.

Given the Commissioner's view as set out in TD 2022/11 applies for trust entitlements arising on or after 01/07/2022 (i.e. from the income year ending 30 June 2023), the earliest applying the view can result in deemed Division 7A dividends being included in assessable income is the income year ending 30 June 2024. PCG 2017/13 continues to apply to existing sub-trust arrangements after 01/07/2022 (with respect to trust entitlements arising up to 30/06/2022).

Common criticisms of the longstanding ATO view

Whilst the tax profession has broadly been complying with the longstanding ATO administrative approach since former TR 2010/3 was first published, the Commissioner's view on how Division 7A applies to UPEs is not universally accepted, with some in the profession questioning the correctness of the view both before and since former TR 2010/3 was published in its final form (on 02/06/2010).

Aspects of the Commissioner's view commonly questioned or opposed include:

- Whether Division 7A is the right tool to address compliance concerns with the accumulation of funds retained within trusts where those funds have been subject to tax at corporate rates (rather than the higher rate of tax the trustee would pay if no beneficiary had a present entitlement to the same amount of trust income).
- Along similar lines to the above, that there is a tenuous link between the purported behaviour of concern and Division 7A and that it is not the policy intent of Division 7A to curtail the use of corporate beneficiaries.
- The appropriateness of the Commissioner purportedly administering around legislative deficiencies or stalled law reform (or in response to apparent changes of how UPEs are used and accounted for in practice since Division 7A was introduced).
- That there is no requirement that there be a tax avoidance motive in order for the ATO administrative approach to apply but it effectively results in double taxation (and can result in higher effective rates of tax than provisions that do require a tax avoidance motive).

- Connected to the above point, that it is common for beneficiaries of family trusts to allow funds representing their UPEs to be used by the trustee as working capital of the trust and it is inequitable to automatically assign consequences based on a presumed tax avoidance motive simply because (and only when) the UPE is owed to a company.
- The fact that there are provisions within Division 7A (former s109UB and now Subdivision EA) specifically dealing with the circumstances of when it applies to UPEs which evidences that the provision was never intended to apply to them more broadly.
- There being no 'tie-breaker' rule or other exclusion or carve-out within Division 7A to prevent both s109D ITAA 1936 and Subdivision EA (or former s109UB) applying, such that where the latter applies there will be two lots of unfranked dividends taken to be paid with respect to the same UPE amount.
- Complying with former TR 2010/3 and former PS LA 2010/4 can result in actual ordinary loans being created which would not otherwise have existed (the consequences of which may not be able to be reversed if it becomes apparent that the Commissioner's view is incorrect).

Both former TR 2010/3 and TD 2022/11 set out alternative views of how Division 7A applies to UPEs and the reason that the Commissioner does not support those views. These explanations acknowledge and respond to many of the above points.

The purpose of highlighting these common criticisms is to show that the respective positions of the Commissioner and the taxpayers, and the issues to be considered by the AAT, in Bendel did not present anything new, but it is the first time since former TR 2010/3 was published that a taxpayer has had any success in challenging the longstanding ATO administrative treatment.

A word on the proposed Division 7A reforms

Proposed reforms to Division 7A were announced by the then government in May 2016 with a commencement date of 01/07/2018. These planned amendments were drawn from recommendations made by the Board of Taxation in their November 2014 Post-Implementation Review of Division 7A final report.

In May 2018 the commencement date for the proposed Division 7A reforms was deferred to 01/07/2019. It was also announced that the proposed amendments to Division 7A would include UPEs being legislatively brought into the scope of Division 7A from 01/07/2019.

In October 2018 a consultation paper was issued on the proposed changes to Division 7A. The consultation paper included UPEs being legislatively brought into the scope of Division 7A, notably without any of the options the Board of Taxation had recommended accompany such a legislative change to continue to allow funds representing UPEs to be used by trusts as working capital (with appropriate adjustments to ensure no unfair advantage is gained in doing so).

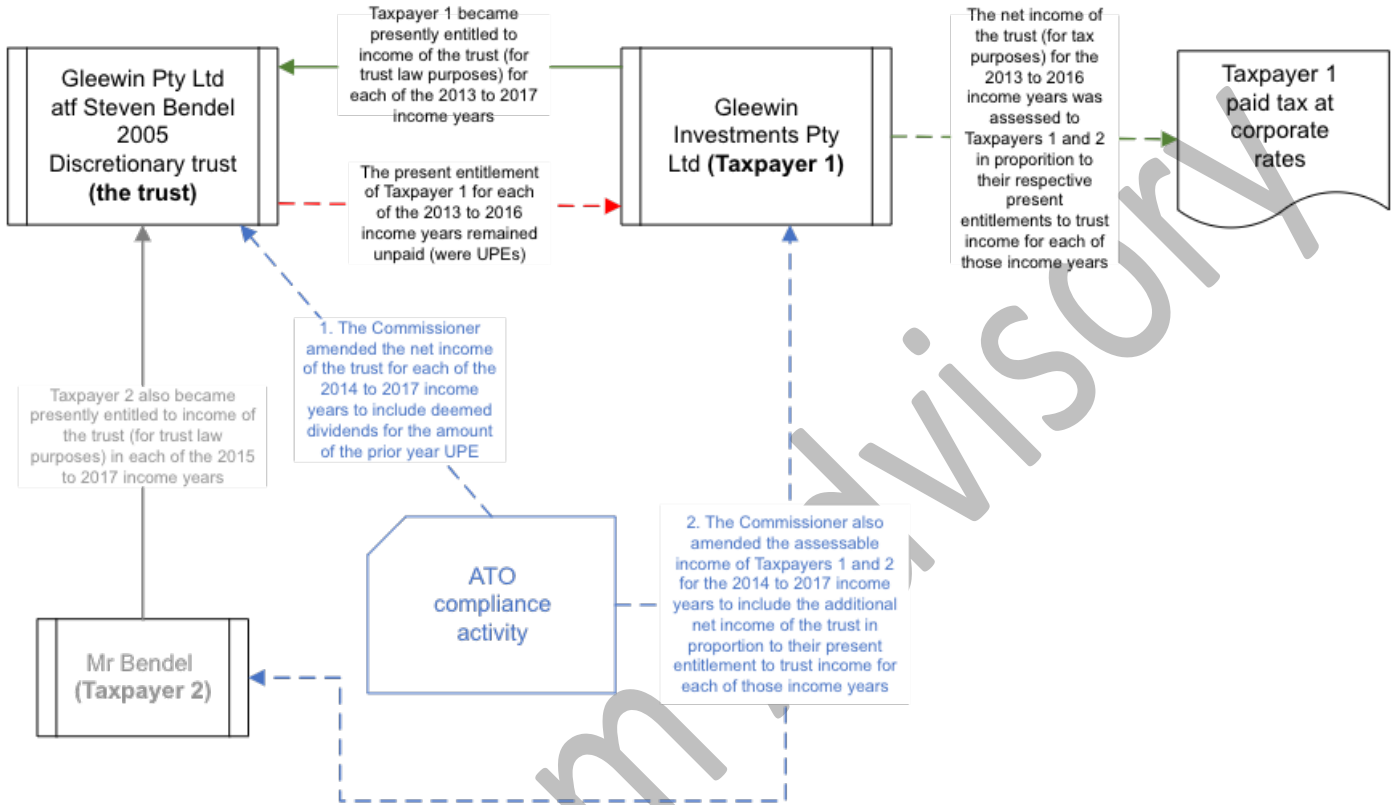
In April 2019 the commencement date for the proposed reforms was again deferred until 01/07/2020 to allow time for further consultation, and in October 2020 the commencement date was deferred a final time until the first 1 July following the date which the enabling legislation for the proposed reforms receives royal assent.

It is noted that the current ATO administrative approach broadly aligns with how it appears UPEs would be treated if and when the proposed Division 7A reforms are legislated, but they are not yet law and we don't know if or when they will be. No formal announcement has been made since October 2020 about whether or when the proposed Division 7A reforms will proceed.

These long delayed proposed reforms have no direct impact on the decision the AAT made in Bendel, or the outcome of the appeal with respect to that decision, but they are another moving part to be understood in considering what a final and settled view on how Division 7A applies to UPEs might be.

Bendel: Overview of the facts

The below table provides an overview of the facts and circumstances, and outcome of ATO compliance activity, with respect to the issues being considered by the AAT in Bendel.



Whilst the AAT decision in Bendel does not set a binding judicial precedent the Commissioner must follow going forward, the case considered a pretty vanilla arrangement and the decision made by the AAT did not turn on anything notably particular about the specific facts or circumstances.

Therefore, had the Commissioner not appealed the AAT decision on the primary issue in Bendel, there would likely have been an increase in taxpayers taking cases before the AAT on this issue (and in ATO objections and disputes) until the matter was otherwise definitively decided by a higher court (or by legislative changes to Division 7A).

Summary of the facts set out in the above table

All relevant entities were part of the Bendel group, which consisted of an accounting and tax agent practice controlled by Mr Bendel and some entities (which Mr Bendel operated with his brother) involved in property syndicates.

The following two taxpayers were both beneficiaries of Gleewin Pty Ltd as trustee of the Steven Bendel 2005 Discretionary trust (the trust):

- Gleewin Investments Pty Ltd (Taxpayer 1).
- Mr Bendel – The sole director and secretary of, and beneficial owner of the shares in, both Gleewin Pty Ltd and Gleewin Investments Pty Ltd (Taxpayer 2).

Taxpayer 1 became presently entitled to the following amounts of income of the trust for each of the income years ending 30 June 2013 to 30 June 2016:

Income year ended	Present entitlement to trust income in year it arose (Taxpayer 1)
30 June 2013	\$236,251
30 June 2014	\$149,513
30 June 2015	\$840,529
30 June 2016	\$433,188

Taxpayer 1 also became presently entitled to an amount of income of the trust for the income year ended 30 June 2017. Taxpayer 2 became presently entitled to an amount of income of the trust for the income years ended 30 June 2015 and 30 June 2017.

There were some amounts which the trust paid on behalf of Taxpayer 1 (who did not have their own bank account) which were offset against the amounts they were owed, but the trust income to which Taxpayer 1 was presently entitled for each of the income years ending 30 June 2013 to 30 June 2016 remained largely unpaid (were UPEs) at lodgement day for each of the income years that followed:

Income year in which present entitlement arose	UPE outstanding at lodgement day for the following income year: as calculated by the Commissioner (Taxpayer 1)
30 June 2013	\$181,601
30 June 2014	\$164,242
30 June 2015	\$807,417
30 June 2016	\$229,955

The trust also retained some amounts it received belonging to Taxpayer 1. These amounts (\$41,252 and \$9,431 in the income years ending 30 June 2015 and 30 June 2016 respectively) were broadly attributable to tax refunds payable to Taxpayer 1. These were taken to be additional Division 7A loan amounts unrelated to the UPEs (Referred to below as loan amounts without their origins in UPEs).

Summary of the outcome of ATO compliance activity

The ATO commenced an audit of Mr Bendel's affairs in October 2017 during which it discovered that Taxpayer 1 had UPEs owing from the trustee of the trust.

In September 2019 the ATO issued amended assessments in line with their longstanding ATO administrative treatment outlined above. Specifically, the Commissioner:

- Formed the view that Taxpayer 1 had provided the trustee of the trust with financial accommodation with respect to the outstanding UPEs for each of the income years ended 30 June 2013 to 30 June 2016 ; and
- Found that Taxpayer 1 had therefore made a loan to the trustee of the trust for Division 7A purposes in each of the income years ended 30 June 2014 to 30 June 2017; and

- Amended the net income of the trust for each of the income years ended 30 June 2014 to 30 June 2017 to include a deemed unfranked dividend of the amount of the prior year UPE that remained outstanding at lodgement day for each of those income years; and
- Amended the assessable income of Taxpayer 1 for each of the income years ended 30 June 2014 to 30 June 2017 to include amounts of additional net income of the trust from the deemed unfranked dividend in each of those years (in proportion to the present entitlement of Taxpayer 1 to trust income for each of those income years); and
- Amended the assessable income of Taxpayer 2 for the income years ended 30 June 2015 and 30 June 2017 to include amounts of additional net income of the trust from the deemed unfranked dividend in each of those income years (in proportion to the present entitlement of Taxpayer 2 to trust income for each of those income years); and
- Imposed administrative (shortfall) penalties.

Taxpayer 1 and Taxpayer 2 each objected to the abovementioned amended assessments in November 2019 which were largely disallowed (in March 2021) with the post objection amendments being as follows:

Income year in which Division 7A deemed unfranked dividend is included in net income of the trust and therefore assessable to beneficiaries	Increase in net income of the trust (s95 ITAA 1936 income)	Post objection position of the ATO: Increase in assessable income of beneficiaries of the trust (Assessed under s97 ITAA 1936 based on current year present entitlement)	
		Taxpayer 1	Taxpayer 2
30 June 2014	\$181,601	\$181,601	
30 June 2015	\$164,242	\$147,818	\$16,424
30 June 2016	\$807,417	\$807,417	
30 June 2017	\$229,955	\$172,466	\$57,489

Bendel: Overview of what was to be determined by the AAT

The matters to be decided by the AAT in Bendel can be summarised as follows:

- 1) Did Taxpayer 1 make a loan to the trustee of the trust within the extended s109D(3) meaning in each of the income years ended 30 June 2014 to 30 June 2017 with respect to their UPE to trust income for each of the prior income years? (the primary issue)
- 2) If the answer to question 1 is yes, does Section 6-25 of the *Income Tax Assessment Act 1997* (s6-25 ITAA 1997), which is about the same amount not being included in assessable income more than once even where more than one provision includes it, prevent amounts with respect to the UPEs from being included in either the net income of the trust or the assessable income of Taxpayer 1 and Taxpayer 2 in each of the above income years?
- 3) If the answer to questions 1 and 2 are yes and no respectively do the circumstances warrant the application of the Commissioner's discretion (to not treat the loans made as dividends for Division 7A purposes or to allow such dividends to be franked) in Section 109RB ITAA 1936 (s109RB)?

- 4) If the answers to questions 1, 2, and 3 are yes, no, and no respectively has the Commissioner correctly imposed administrative (shortfall) penalties in the circumstances?

The position the Commissioner brought to the AAT was consistent with both: the longstanding ATO administrative treatment of Division 7A as it applies to UPES; and the view reached during their compliance activity, both of which are summarised above. The key arguments of the Commissioner on the primary issue were:

- Taxpayer 1 made a loan as defined to the trust in each of the income years ended 30 June 2014 to 30 June 2017; and
- Subdivision EA does not inform the construction given to the s109D(3) extended meaning of loan for Division 7A purposes.

The position that Taxpayer 1 and Taxpayer 2 brought to the AAT relied heavily on the statutory context that the s109D(3) extended meaning of loan for Division 7A purposes appears in, and was reflective of some of the common criticisms of the longstanding ATO administrative approach summarised above. Their key arguments on the primary issue were:

- The statutory context in which the s109D(3) meaning of loan operates includes Subdivision EA with the effect that s109D(3) does not embrace UPES of corporate beneficiaries; and
- The s109D(3) extended meaning of loan for Division 7A purposes does not apply to amounts held on a separate trust.

Bendel: Overview of what the AAT decided

The primary issue

The AAT decision in Bendel was made on 28 September 2023. With respect to the primary issue as outlined above that decision was:

*'.... a loan within the meaning of s109D(3) does not reach so far as to embrace the rights in equity created when entitlements to trust income (or capital) were created but not satisfied and remained unpaid. **The balance of an outstanding or unpaid entitlement of a corporate beneficiary of a trust, whether held on a separate trust or otherwise, is not a loan to the trustee of that trust ..'***

The above conclusion, which broadly affirmed the position of Taxpayers 1 and 2, had regard to:

- The policy intent of Division 7A is to tax those who access corporate profits without the company having paid dividends and its shareholders being subject to tax on those dividends in the normal manner; and
- Statutory construction principles require that regard be given to the context and legislative history of the statute, and that potentially competing provisions be read in a way that 'gives effect to harmonious goals'; and
- Division 7A does not include a 'tie-breaker rule' for situations where both s109D(3) and Subdivision EA apply; and
- The discretion in s109RB can only be applied by the Commissioner in cases where there was an honest mistake or inadvertent omission, such that it cannot be used to address such a dual application of Division 7A; and
- Subdivision EA is the more specific (and therefore lead) provision applying to UPEs in the context of Division 7A more broadly, and it evidences a specific policy intent with respect to when and how the division will apply in circumstances where there is a UPE owed to a company; and

- The inclusion of former s109UB in Division 7A as introduced and the explanation accompanying it both supported the above point and evidenced that a UPE held on sub-trust was considered to remain unpaid and therefore still within scope of former s109UB (as opposed to views put forward by both the Commissioner and Taxpayers 1 and 2 that once a UPE is put on sub-trust it is discharged and replaced with a new right, being the right to the corpus of the sub-trust); and
- There being no clear view on the nature of a UPE and the separate (sub) trust concept often necessarily considered in conjunction with matters involving UPEs; and
- In contrast to the consequences of applying the Commissioner's view of when UPEs are within the s109D(3) extended meaning of loan, in circumstances where subdivision EA applies the Shareholder (or their associate) is taxed as if the loan was made from the company which clearly falls within the Division 7A policy framework; and
- There being no other tax law provisions which expressly allow assessment of two taxpayers arising out of the same circumstance with one of those taxpayers not enjoying any benefit of the corporate profits that are the underlying cause of that assessment.

In making the above decision the AAT did not accept that the corporate beneficiary merely acquiescing to the use of funds representing an amount of UPE payable to them (by not calling for payment of that amount) amounted to the provision of financial accommodation by the company to the trustee of the trust from which the UPE was payable.

The other issues

With respect to the second issue to be determined by the AAT in Bendel (outlined above):

- Given the outcome on the primary issue it was not strictly necessary to consider s6-25 ITAA 1997. However, the AAT noted that s6-25 ITAA 1997 would not have provided any relief had the primary issue been decided differently because the 'same amount' would not have been taxed twice. Division 7A requires a separately calculated amount to be included in assessable income owing to further events following the original assessment of trust income, as opposed to the same event or transaction being assessed under two separate provisions simultaneously.

With respect to the third and fourth issues to be determined by the AAT in Bendel (outlined above):

- Given the decision on the primary issue, these matters were only necessary to consider with respect to the residual loan amounts without their origins in UPEs (being amounts belonging to Taxpayer 1 paid from third parties to the trust bank account and retained by the trust).
- The AAT referred the taxpayers' objections (to the extent they were attributable to the residual loan amounts without their origins in UPEs) back to the Commissioner for reconsideration noting that no arguments had been advanced to support why the s109RB discretion should be applied in the circumstances.
- The AAT also referred the penalty assessments (as they applied to any remaining shortfall after reconsidering the above) back to the Commissioner noting that no arguments had been advanced with respect to the imposition or remission of penalties and that, because Mr Bendel was a registered tax agent to whom the outcome of the trust retaining funds belonging to the company should have been obvious, any penalty remaining should attract penalties at the same rate without remission.

Bendel: Overview of preliminary response from the ATO

The Commissioner appealed the AAT decision on the primary issue in Bendel to the Federal court on 26/10/2023, and published an Interim Decision Impact Statement on 15/11/2023 pending the outcome of that appeal which can be summarised as follows:

- They ATO will not revise their current administrative approach with respect to Division 7A and UPEs as set out in TD 2022/11 until the appeal process is finalised.
- The ATO do not propose to make any objection decisions that turn on the interpretation of s109D(3) before that process is finalised.
- If they are required to make such a decision before then, including where a taxpayer gives notice requiring the Commissioner to make an objection decision, it will be in accordance with the Commissioner's current view as set out in TD 2022/11.
- The Commissioner considers that the treatment of UPEs owed by trusts to corporate beneficiaries may have tax implications outside of Division 7A, Section 100A ITAA 1936 (s100A) being specifically mentioned.

What is likely to happen post appeal outcome

If the Commissioner's appeal of the AAT decision on the primary issue in Bendel is successful, it is likely that the modified longstanding ATO administrative approach as set out in TD 2022/11 and summarised above will continue to be applied as if the Bendel AAT decision never occurred.

If the ATO appeal of the AAT decision on the primary issue in Bendel is unsuccessful, it is unlikely to be the end of the road. In particular:

- Noting the ATO reference to s100A in their Interim Decision Impact statement, it will likely be some time before there is a settled and publicly available administrative approach advising exactly how the Commissioner intends to apply s100A, or any other provisions, to UPEs of corporate beneficiaries such that there may be an extended period of uncertainty for the tax profession with respect to how UPEs will be treated.
- There is unlikely to be an outcome that results in any long-term administrative treatment by the ATO that allows UPEs to corporate beneficiaries to remain unpaid indefinitely.
- The long deferred proposed Division 7A reforms may be brought off the backburner resulting in UPEs being broadly brought within the scope of Division 7A legislatively.

Where things are at in the meantime

The following is a summary of where things stand whilst we await the outcome of the Commissioner's appeal of the decision made by the AAT on the primary issue in Bendel:

- UPEs owed to corporate beneficiaries with respect to trust entitlements arising up to 30/06/2022 have likely been treated in compliance with former TR 2010/3 and former PS LA 2010/4 prior to the AAT decision in Bendel and there are unlikely to be any negative consequences from doing so.
- PCG 2017/13 also continues to apply to existing sub-trust arrangements with respect to UPEs owed to company beneficiaries arising up to 30/06/2022.
- The Commissioner's view in TD 2022/11 first applies to UPEs arising from 01/07/2022 (i.e. the income year ended 30 June 2023) such that the earliest applying this view can result in Division 7A dividends is the income year ended 30 June 2024. Taxpayers therefore have until lodgement

day for the income year ended 30 June 2024 to pay the amounts of such UPEs in full or put them on complying Division 7A loan agreements if necessary.

- There will hopefully be an outcome of the Commissioner's appeal before the lodgement day for the income year ended 30 June 2024. Regardless, we can probably expect some guidance from the ATO confirming their administrative treatment for the income year ended 30 June 2024.
- Whilst the ATO have signalled that they do not intend to make objection decisions that turn on an interpretation of s109D(3) in the interim, taxpayers who have been subject to amended assessments which included deemed dividends in line with the current ATO administrative approach may wish to consider the time they have left to object to such assessments and do so prior to the appeal outcome if necessary.
- Such taxpayers may also wish to consider whether they have grounds to request remission of penalties (particularly penalties imposed for not having a reasonably arguable position) regardless of the outcome of the appeal.

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