

Level 19,  
15 William Street,  
Melbourne 3000

Ref: PTR

16 April 2010

Department of the Senate  
PO Box 6100  
Parliament House  
Canberra ACT 2600  
Australia

Email: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Sir/Ms

**Tax Laws Amendment (2010 Measures No. 2) Bill 2010 (“the Bill”)**

By way of background, in my professional life I am a partner and Executive Director of the Pitcher Partners Melbourne Firm. I note that the Pitcher Partners association<sup>1</sup> is making a separate submission. For many years I have been regarded as the Senior tax professional in the Melbourne Firm and in the association.

However I am writing in a personal capacity. The comments in the prior paragraph are in order to qualify my experience.

I note that on 18 March 2010 the Senate referred the Tax Laws Amendment (2010 Measures No. 2) Bill 2010 for inquiry and report. It has asked that the committee ensure no unintended consequences will arise from passage of the Bill, particularly as a result of the amendments contained in Schedule 1.

Consistent with the terms of reference my focus is upon the unintended consequences that will arise from passage of the Bill.

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<sup>1</sup> The Pitcher Partners association comprises 5 independent firms operating in Adelaide, Brisbane, Melbourne, Perth and Sydney. Collectively it would be regarded as one of the largest accounting associations outside the Big Four. Its specialisation is servicing and advising smaller public companies, large family businesses, small to medium enterprises (“SMEs”) and high wealth individuals.

Certain of the points herein are drawn from the Pitcher Partners submission which I have had a hand in drafting.

### 1. **Comments re Subdivision EA amendments generally**

Since the Government announcement in May 2009 that there would be changes to Division 7A (“the existing Division 7A”) Draft Tax Ruling TR 2009/D8, on the interpretation of the existing Division 7A has been issued by the ATO. Broadly, based upon its current form, the interpretation adopted by the ATO in this draft Ruling means that it would be rare that an unpaid present entitlement (“UPE”) due to a private company by a trust would not be a loan as defined in section 109D.

I attach as Appendix One an extract from TR 2009/D8. This purports to justify Subdivision EA, in a sense as a provision of last resort, when either Section 109C or 109D have not already operated in relation to a ‘proper’ unpaid present entitlement that remains outstanding as such.

Indeed one accepts this proposition it is difficult to conceive many circumstances where Subdivision EA would have operation.

I note the following comment in relation to the relevant agenda item for the 31 March 2010 National Tax Liaison Group (“NTLG”) meeting-

*“... under Draft Ruling TR 2009/D8 unpaid present entitlements will retain that status for Division 7A purposes in many situations, including where:*

- the amount representing the UPE is physically held on sub-trust for the sole benefit of the private company beneficiary;*
- the amount representing the UPE is being used by the trustee but all benefits from this use are held for the sole benefit of the private company; or*
- the private company beneficiary is not aware and cannot be taken to be aware that the funds representing its UPE are being used for the potential benefit of any or all discretionary objects of the trust (rather than being physically set aside or used for its sole benefit).”*

In my 35 years in practice I cannot recall having encountered one of these circumstances.

I have sought the input of my direct tax Executive Directors along with private client tax specialist partners from 4 other Melbourne firms. Not one respondent has seen the circumstances covered by the NTLG response.

Thus Subdivision EA - a key feature of has negligible operation. There can be no greater unintended consequence than introducing and/or extending measures that have no practical effect.

## 2 Specific Comments re Subdivision EA

### 2.1 *Unintended outcome occasioned by the delay in introducing the Bill*

It appears that the proposed amendments to Subdivision EA and the new Subdivision EB will apply where the UPEs arose before 1 July 2009.

I submit that as the Bill was introduced some nine and a half months into the current financial year it was simply issued too far into the 2009/10 income year for taxpayers to have been made aware of the potential application of the amendments to UPEs that arose pre 1 July 2009. In particular, many loans will have been made between 1 July 2009 and the present time ("2009/10 loans").

Thus the operative date to amendments of Subdivision EA should be 1 July 2010.

### 2.2 *By the operation of proposed sections 109XF and 109XG a deemed dividend can arise when a company has not made a disguised distribution of profits, but has merely discharged a genuine obligation.*

Assuming the preconditions of subsection (1) in each case are satisfied (and that as appropriate the further criteria are satisfied), it appears that each provision operates on the basis that the transaction entered into by the interposed entity is attributed to the private company or to the relevant trust as the case may be.

If the transaction entered into by the private company or the relevant trust merely discharges an existing pecuniary obligation of that entity then neither of these provisions should have application.

Notwithstanding that the trust is discharging a pecuniary obligation (and thus cannot be said to be making a disguised distribution of profits to which another entity is directly or indirectly entitled), it seems that Section 109XF or section 109XG have operation.

The absurdity of this outcome is that, all other things being equal, a deemed dividend arises when the relevant entity has not made a disguised distribution of profits, but has merely discharged a genuine obligation.

2.3 *By the operation of proposed sections 109XF and 109XG a deemed dividend can arise even when a loan by a company or trust is otherwise Division 7A compliant*

Much of the compliance complexity in the proposed sections 109XF and 109XG (and in the existing section 109T) can be substantially reduced, if not totally eliminated, by ensuring that neither section can apply where either:

- the (initial) loan to the first interposed entity; or
- the (final) loan to target entity

is a complying Division 7A loan.

That is, if either/both of the above loans comply with the requirements of section 109N there is no ‘mischief’ achieved - in the latter case the target entity is not getting the cost (and tax) free use of funds if it has to make regular capital repayments and interest payments; and in the former case the private company is not being ‘stripped’ of profits.

Example:

- Trust/Private Company makes a loan (“the initial loan”) to an interposed entity; and
- The borrower interposed entity makes a loan (“the final loan”) to a relevant shareholder or associate of a Private Company.

The policy of Division 7A appears to be satisfied if either the initial loan or the final loan is on complying Division 7A terms.

Presently this is the operation of the provisions in relation to the final loan but it is not the case if the initial loan is Division 7A compliant.

If the (initial) loan to the interposed entity by the company or the relevant trust were similarly to give rise to exclusions from section 109T and the proposed sections 109XF and 109XG this would considerably aid compliance.

## 2.4 *Anomalies within proposed section 109XI*

This section deals with distributions through multiple trusts which are left unpaid. Where it applies it has the effect that an earlier distribution is deemed to have been made to the private company - as a consequence Subdivision EA applies in respect of the trust making the earlier distribution as well as the trust making the final distribution.

In this respect:

2.4.1 Firstly, noting the opening comments regarding TR 2009/D8, these provisions have no practical application as the Commissioner's interpretation is that unpaid distributions are loans.

2.4.2 More specifically two points are noted:

1. The trust making the earlier distribution is referred to in the section as the *target trust* and the trust actually making the distribution to the private company is identified as the *first interposed trust*. Double jeopardy arises here because it seems on the face of it that Subdivision EA then has the potential to apply both in respect of the target trust and the first interposed trust.
2. As the provision operates on the basis of deeming the target trust to have a UPE to a private company, the legislation needs to make it clear that once either: (a) the actual UPE by the target trust to one or more other trusts; or (b) the actual UPE to the private company is discharged, then Subdivision EA should no longer apply to the target trust. (In other words, if the actual UPE is discharged there should no longer be a deemed UPE).

I would be happy to discuss this with the committee and/or its delegates should you require. I would be pleased to give evidence at any formal hearings. I may be contacted on 8610-5170 or by email ([peter.riley@pitcher.com.au](mailto:peter.riley@pitcher.com.au))

Kind Regards  
Yours Sincerely

(...)

Peter Riley

## Appendix One

### Subdivision EA

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161. Subdivision EA was introduced in replacement of former section 109UB, contained in Subdivision E of Division 7A. Whilst neither former section 109UB nor Subdivision EA contain any anti-overlap rules to limit their application where Subdivision B might otherwise apply, Subdivision E was only intended to apply where the paid/lent/forgiven amount had not already taken to be an amount under Division 7A as an amount paid/lent/forgiven by the private company to the relevant interposed entity. The Explanatory Memorandum provided:

9.67 An amount will not be taken to be a dividend under new Subdivision E [which included section 109UB] if the amount is otherwise taxable under new Subdivision B [new subsection 109T(3)]. For example, an amount might be paid or lent to a shareholder or associate through an interposed entity which is also a shareholder or associate. In that case, the amount could be taxable to the interposed entity in its own right under new Subdivision B.<sup>80</sup>

162. That is, the policy seems to have been to avoid double taxation under Division 7A.

163. In light of this context, it is appropriate that where the actions of the private company beneficiary (including any acquiescence with knowledge) are such that it is said to have made a Division 7A loan in respect of a UPE, there has not just been the mere creation of a present entitlement 'of itself'. Through its own knowledge and acts, the private company is taken to have made a loan back to the trust for Division 7A purposes. The overall arrangement is not a mere creation of a present entitlement.

164. In situations where there has been such an arrangement beyond the mere creation of a UPE, the restrictions in subsection 109XA(6) do not apply and the usual definition of 'paid' contained in subsection 109C(3) can be relied upon. Under that definition, allocating the amount of the UPE to a sub-trust involves the crediting of an amount for the benefit of or on behalf of the private company, satisfying the meaning of 'paid'.

165. Accordingly, in situations where the private company beneficiary has made a Division 7A loan in respect of a subsisting UPE, the company should not be treated as having a present entitlement to an amount from the main-trust that remains 'unpaid' for Subdivision EA purposes, avoiding any potential for double counting.

166. For completeness it is noted that in some instances, funds settled on sub-trust may be lent back to the main-trust for a return. In these instances, Subdivision EA will operate to treat that loan from the sub-trust to the main-trust as a dividend, pursuant to section 109XB but only to the extent to which the private company has a present entitlement to an amount of the net income of the *sub*-trust estate (where the other provisions of section 109D are satisfied and the private company has a distributable

surplus within the meaning of section 109Y as modified by subsection 109XC(7)). No amount of the original UPE to an amount from the main-trust will be double counted in any subsequent application of Subdivision EA in respect of unpaid entitlements to income of the sub-trust.