

LIGHTNING STRIKES TWICE

TAX BRIEF COWELL CLARKE'S TAX & REVENUE GROUP

Lightning struck twice at 1.30pm on 2 June 2010 with the Federal Commissioner of Taxation issuing two highly topical tax announcements concerning trusts. The first lightning bolt was the highly anticipated Taxation Ruling on circumstances where unpaid present entitlements (“**UPEs**”) in favour of companies trigger Division 7A. The second lightning bolt was the Decision Impact Statement on the High Court decision in *Commissioner of Taxation v Bamford* (“**Bamford**”).¹

DIVISION 7A LIGHTNING BOLT

Taxation Ruling TR 2010/3 represents the finalised version of the Draft Taxation Ruling 2009/D8. TR 2010/3 confirms the Commissioner’s view in TR 2009/D8 on the circumstances in which an associated private company with a UPE from a trust will be caught by the Division 7A loan provisions.

Broadly, the Commissioner considers there are three scenarios where a private company may make a loan caught by the Division 7A:

- where the UPE is converted to a loan: by agreement between the private company and the trustee; or where the trustee credits the private company’s loan account and the private company acquiesces to that treatment (“**Scenario 1**”);
- where the trust deed permits the trustee to pay or apply money to or for the benefit of a private company beneficiary and, pursuant to that power, the trustee applies money by crediting a loan account for that private company beneficiary and assumes a corresponding obligation to repay the sum credited (“**Scenario 2**”); and
- where the company provides the trust with financial accommodation by either not calling for a UPE to be paid, or, if it remains unpaid, not calling for the UPE funds to be invested for the private company beneficiary’s absolute benefit (“**Scenario 3**”).

TR 2010/3 makes a distinction between Division 7A “loans within the ordinary meaning” (Scenario 1 and 2) and “loans within the extended meaning” (Scenario 3). Those UPEs in Scenario 3 may be quarantined from triggering Division 7A if the UPE arose before 16 December 2009 (although, even then, the Commissioner could argue that you are dealing with a “loan within the ordinary meaning”).

A UPE arising on or after 16 December 2009 from a trust to a company will generally be viewed by the Commissioner as triggering Division 7A (i.e. Scenario 3), with very limited exceptions. The circumstances requiring Division 7A loan agreements are expanding!

Cowell Clarke (along with many other commentators) question the view of the Commissioner as set out in TR 2010/3. TR 2010/3 merely represents the Commissioner’s interpretation of the law and that this interpretation is open to judicial scrutiny.

¹ [2010] HCA 10.

BAMFORD LIGHTNING BOLT

The Decision Impact Statement (“DIS”)

On 30 March 2010 the High Court handed down the much awaited decision in *Bamford*. The DIS outlines the Commissioner’s view of the *Bamford* decision. The Commissioner accepts the decision of the High Court, acknowledging:

- the ‘income of the trust estate’ for the purposes of s97(1) takes its meaning from the general law of trusts; and
- the proportionate approach is to be preferred in dealing with any excess of s95 net income over distributable income.

The DIS also notes the following:

- PS LA 2009/7 will be withdrawn and a replacement Practice Statement will be issued;
- the Commissioner accepts that other Taxation Rulings and Practice Statements will also need to be withdrawn, amended and/or reissued;² and
- the Commissioner will generally not seek to disturb returns for the 2009-10 and earlier income years if taxpayers relied on a view of Division 6 reasonably open prior to *Bamford*.

Practical Implications

The DIS underscores the importance of ensuring the following:

- trust distribution minutes take account of applying the proportionate approach so that any excess tax net income is taxed in a manner that is anticipated; and
- trust deeds should contemplate situations where a trust derives a net capital gain but (apart from the impact of the trust deed) has no distributable income.

In light of *Bamford* and the DIS, we suggest that a review of all trust deeds be undertaken. Any amendments to existing trust deeds should be effected with a significant amount of care.

If you require further information in relation to the decision, please speak to any partner in our Tax & Revenue Group.

Dated 4 June 2010

Andrew Sinclair

Partner

T +61 8 8228 1142

E asinclair@cowellclarke.com.au

Andrea Melillo

Partner

T +61 8 8228 1173

E amelillo@cowellclarke.com.au

Peter Slegers

Partner

T +61 8 8228 1158

E pslegers@cowellclarke.com.au

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² Taxation Ruling TR 92/13, Taxation Ruling TR 95/29, Practice Statement PS LA 2005/1 (GA) and Taxation Ruling No IT 331.