
ATO'S NEW APPROACH TO UPE'S AND SUB-TRUSTS



The ATO has recently finalised the long-awaited Determination on its approach to the application of deemed dividend rules in Div 7A where a private company beneficiary is made presently entitled to trust income. This Determination applies from 1 July 2022. While this final Determination contains no substantive changes on the previously issued Draft Ruling, it does finally provide a definitive view and certainty for taxpayers.

Broadly, Div 7A operates to ensure that private companies cannot make tax-free distributions of profits to shareholders and their associates in the form of payments, loans or forgiven debts. Where a private company makes a loan to their shareholder or associate that is not repaid before the lodgement date of the company, then the company is taken to have made an unfranked dividend in that income year.

Under Div 7A the term “loan” has a wide meaning which includes both the provision of credit (ie a traditional loan) or any other form of financial accommodation. To help provide clarity for taxpayers, the ATO’s current opinion as contained in the Determination states that a private company will be providing financial accommodation to a trustee or a shareholder (and hence a loan for Div 7A purposes) in the following situations:

- Where there is an unpaid present entitlement (UPE) and the company has knowledge of an amount that it can demand, but does not do so, therefore, the company is taken to have consented to the trustee retaining that amount to continuing using it for trust purposes.
- Where present entitlements are satisfied by a sub-trust and the company has knowledge that a shareholder or an associate is using all or part of the sub-trust fund. This will be the case whether or not the use of the sub-trust fund is on commercial terms where a return is paid to the sub-trust fund.

In addition to the above, the private company will be deemed to have the requisite knowledge (ie knowledge of the amount that it can demand immediate payment of) if the company and trustee (or sub-trustee) have the same directing mind and will. According to the ATO, the term "same directing mind and will" of a private company beneficiary is not limited to its board or one or more directors. It notes that case law establishes that different persons may for different purposes satisfy the requirements of being an entity's directing mind and will.

"If the same person or persons are the directing mind and will of both the relevant private company beneficiary and the trustee in respect of affairs relevant to the private company beneficiary's UPE...[or sub-trust], then subject to sufficient evidence to the contrary the Commissioner takes the view that both the private company beneficiary and the trustee know what the other knows because they have this same directing mind and will."

This new ATO approach will apply to any trust entitlements arising on or after 1 July 2022. For trust entitlements arising before 1 July 2022, taxpayers can rely on the previous Ruling and Practice Statement which have now been withdrawn. In addition, and in order to instil certainty, the Commissioner notes that he will not dedicate compliance resources to sub-trust arrangements conducted in accordance with the previously issued guidance.

CONTACT

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