

Tax Office under microscope with its UPE approach

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Background

Subdivision EA of Division 7A applies when certain trustee payments, loans or forgiveness of debts are made in favour of a shareholder or an associate of a private company, at a time when the trust owes an unpaid present entitlement (UPE) to a company.

Where subdivision EA applies, the corporate beneficiary is deemed to have paid an assessable dividend to the trust.

Due to a perceived additional leakage to the revenue, in 2010, Tax Office introduced TR 2010/3 together with PS LA 2010/4, which set out a system for dealing with an UPE, subject to grandfathering for situations arising prior to 16 December 2009.

The particular mischief that was attacked by these announcements related to situations where a trust distributed income to a corporate beneficiary and simultaneously created an UPE with the funds, other than the tax payable by the corporate beneficiary, retained within the trust structure. In other words, subdivision EA (or EB if relevant) would not apply, as the trust would not ever make a loan that would be caught by those subdivisions.

In 2022, the Tax Office withdrew TR 2010/3 and PSLA 2010/4, however issued TD 2022/11 reconfirming its view that a UPE with a corporate beneficiary can be a loan, and implementing an updated regime for UPEs arising on or after 1 July 2022.

Bendel – initial decision

While the Tax Office has maintained its position in this area for some years, in *Bendel and Commissioner of Taxation (Taxation)* [2023] AATA 3074 it was held that a UPE with a corporate beneficiary was in fact not a loan under subsection 109D(3) of Division 7A.

The core arguments in relation to subdivision EA and section 109D, that the tribunal accepted, were as follows:

1. The statutory context and purpose of section 109D indicates that the definition of loan does not extend to amounts of trust income which are either set aside for a beneficiary on a separate trust or to which a beneficiary is presently entitled.
2. Statutory context must be considered.
3. This is particularly because that context might show that a word or words are used with some meaning other than their ordinary meaning.
4. That is especially the case where the relevant words, here 'credit' and 'financial accommodation', do not have a fixed ordinary meaning but can have a wide range of meanings depending on context.
5. A construction of section 109D(3) that includes UPEs to companies as loans would lead to absurd and unintended results from the dual operation of section 109D and subdivision EA.
6. That is, a loan within the meaning of section 109D(3) does not reach so far as to embrace the rights in equity created when entitlements to trust income (or capital) are created but not satisfied and remain unpaid - that is an UPE. The balance of an amount outstanding or UPE 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.

7. A beneficiary does not make a loan to a trust where an amount of trust income is set aside and held on a separate trust for the beneficiary. In contrast, it was also confirmed that where the trust has made a loan and an UPE to a company is outstanding (as was also the case here in relation an individual beneficiary), subdivision EA is triggered.

Importantly, the decision also commented on provisions in the relevant trust deed that provided that:

(a) '[a]ny amount set aside for any beneficiary... shall cease to form part of the Trust Fund and upon such setting aside... shall thenceforth be held by the Trustee on a separate trust for such person absolutely...' ; and

(b) determinations to pay, apply or set aside amounts for beneficiaries could be effectually made by passing a resolution or by placing such amounts to the credit of beneficiaries in the trust's books of account (which the trustee on paper appeared to have done).

Relevantly, the tribunal confirmed that it did not accept that a separate trust as conventionally understood arose merely upon creation of a right to income. That is, in conventional terms, for a trust to exist there needed to be sufficient identity of the subject matter of the trust. Here, notwithstanding the abovementioned clauses in the trust deed, it was not clear that any separate trust in could have arisen.

As confirmed in *Fischer v Nemeske* (2016) 257 CLR 615 (a case featured in other View posts), the trustee's exercise of a power to apply trust property does not necessarily involve a resettlement of trust property so as to result in the creation of a new trust. Rather, the exercise of the power by way of unconditional and irrevocable allocation of trust property results in the crystallisation of an immediate absolute beneficial entitlement in respect of property which, before and after the resolution of the trustee, remains property which the trustee holds on trust under the terms of the existing settlement, coupled with the corresponding obligation of the trustee.

Thus, despite the specific provisions of the trust deed, the tribunal confirmed that each party's contentions that were based on the concept of a separate trust having the effect that the entitlements to income were discharged or paid were not accepted.

Bendel – Appeal decision

The essence of the above conclusions were confirmed by the federal court in the appeal decision of *Commissioner of Taxation v Bendel* [2025] FCAFC 15.

While the court made a number of clarifying statements about the interpretation approach that should have been adopted by the tribunal, none of the tribunals' missteps meant that the Tax Office was successful in its appeal.

Relevantly, the court confirmed:

A. Section 109D(3) cannot be construed in isolation and, in particular, not in isolation from the use of the term 'loan' - in this regard the tribunal had (erroneously) failed to identify precisely which part of the definition it was referring.

B. The starting point for the ascertainment of the meaning of a statutory provision is the text of the statute whilst, at the same time, regard is had to its context and purpose. Context should be regarded at this first stage and not at some later stage and it should be regarded in its widest sense. This is not to deny the importance of the natural and ordinary meaning of a word, namely how it is ordinarily understood in discourse, to the process of construction. Considerations of context and purpose simply recognise that, understood in its statutory, historical or other context, some other meaning of a word may be suggested, and so too, if its ordinary meaning is not consistent with the statutory purpose, that meaning must be rejected (see *SZTAL v Minister for Immigration and Border Protection* [2017] HCA 34).

C. Furthermore, the task of statutory construction must begin with a consideration of the statutory text. So must the task of statutory construction end. The statutory text must be considered in its context. That context includes legislative history and extrinsic materials. Understanding context has utility if, and in so far as, it assists in fixing the meaning of the statutory text. Legislative history and extrinsic materials cannot displace the meaning of the statutory text. Nor is

their examination an end in itself (see *Federal Commissioner of Taxation v Consolidated Media Holdings Ltd* [2012] HCA 55).

D. The purpose of legislation must be derived from what the legislation says, not from any assumption about the desired or desirable reach or operation of the provisions (see *Certain Lloyd's Underwriters Subscribing to Contract No IH00AAQS v Cross* [2012] HCA 56), and an anomaly should not be used as a reason for rejecting what otherwise is the correct construction on all other tests of construction (see *Peter Greensill Family Co Pty Ltd (trustee) v Commissioner of Taxation* [2020] FCA 55).

E. The tribunal failed to align its reasoning with the above interpretation principles - and also failed to consider case law that confirms that not all forms of financial accommodation are loans, including that although an 'advance' may include financial accommodation, the essence of a loan is an obligation of repayment. That is, while there may be a debt, this does not automatically mean there is a loan (see *Prime Wheat Association Ltd v Chief Commissioner of Stamp Duties* (1997) 42 NSWLR 505).

F. For the purposes of Division 7A, the phrase 'a provision of credit or any other form of financial accommodation' in section 109D(3) encapsulates a concept of repayment and therefore is only engaged if there is an express or implied obligation to repay.

G. In this regard, section 109G makes it clear that under Division 7A, the concept of a 'debt' is not to be inevitably equated with a loan. That is, the concept of a loan is narrower than that of a debt, which in turn means not all forms of debtor-creditor relationships are automatically loans.

H. Ultimately, section 109D(3)(b) requires some form of financial accommodation which involves an obligation to repay an identifiable principal sum; rather than simply an obligation to pay (ie UPEs) - an interpretation which:

(i) is derived from the language of the statute construed in its context and results in each of the provisions in Division 7A being given operative effect;

(ii) does not give rise to absurd or irrational outcomes or leave unaddressed an obvious drafting error (see *Cooper Brookes (Wollongong) Pty Ltd v Commissioner of Taxation* [1981] HCA 26);

(iii) reflects the fact that Subdivision EA expressly excludes from its operation a private company's UPEs that make their way to another company (see s 109XA(1)(a) in respect of payments and s 109XA(2)(a) in respect of loans) - that is, the legislature did not perceive a mischief in respect of UPEs in the way that the Tax Office is on record as perceiving.

Tax Office response

With another 30 June fast approaching the response of the Tax Office (and perhaps Treasury, in an election year) will be highly anticipated by taxpayers and advisers alike.

