



OCTOBER NEWSLETTER 2009

ATO VIEWS ON DIVISION 7A AND UNPAID TRUST DISTRIBUTIONS OWING TO COMPANIES



The 17 September 2009 Financial Review contained an article on the proposed ATO attack on unpaid Trust Distributions made by Trusts to companies. The lead article highlighted the ATO's view that when a Trust distributes income or capital to a company, that unpaid present entitlement is actually a loan made by the company back to the Trust and caught by Division 7A.

If this view by the ATO is correct, then a trust distribution to a company would be immediately treated as an unfranked dividend paid by the company back to the Trust and taxable at 46.5%.

We consider that the ATO's view is incorrect. An overwhelming majority of legal and tax opinion is that the ATO is incorrect. The ATO themselves since the introduction of Division 7A have on several documented occasions publicly stated that Division 7A does not apply to unpaid trust distributions to companies. It is noted that had Parliament considered that an unpaid present entitlement could form a loan for these purposes, then the reforms to these provisions that were introduced in 2004 to further tighten the operation of Division 7A specifically to trusts with such unpaid present entitlements, would not have been necessary.

However, based on the ATO's recent audit and review activity of high net worth individuals in Australia, we understand that there is an estimated \$1 billion of trust distributions to companies that remain unpaid. Accordingly, it is easy to understand the incentive behind the ATO changing their view and seeking to tax unpaid trust distributions to companies. If there is to be a change in approach, the equitable way to achieve this would be to amend the law on a prospective basis.

Outcome of NTLG meeting on 25 September 2009

A National Tax Liaison Group meeting between the ATO and members of industry that form part of a Division 7A Working Party was held on 25 September 2009 to discuss this matter further. At the meeting, the ATO indicated that they would withdraw from the above position, and would not consider that an unpaid trust distribution owing to a corporate beneficiary is a transaction caught by Division 7A, unless some further action has occurred that would "convert" the unpaid trust distribution into a loan.

The ATO was also considering whether a trust distribution to a company that remains unpaid for a prolonged period of time, or whether certain passive or active actions taken by corporate beneficiaries to retain the money in the trust is something that could cause the unpaid trust distribution to convert into a loan that was caught by Division 7A. The ATO is expected to provide further guidance on this in the future, and is currently working on providing written examples of when an unpaid present

entitlement is a loan. Further consultation is expected to take place between the ATO and the Working Party with an aim for such discussions to occur in mid-October.

It would appear that the ATO's approach of going public on issues of contention may be a means for them to make taxpayers think twice before adopting approaches that the ATO may consider as objectionable, but for which arguably they are unable to administer the law as it presently stands without taking a case to court, given that they have not previously sought to apply the provisions in this way. As further guidance is provided by the ATO on this matter, we will keep you informed however we suggest that no immediate action would be necessary to repay such unpaid trust distributions until the ATO's position is clear.

In the meantime however, this may be the opportunity to review trust deeds to ensure that trust distributions have been administered in accordance with the terms of the deeds.

If you have any queries, or would like advice in relation to any matters relating to any of the above, please contact either Michelle Saunders or Marissa Bechta on (08) 6311 6900.

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