

TECHNICAL UPDATE

SEVEN YEAR SUB TRUST ARRANGEMENTS MATURING – ATO UPDATE

The Australian Taxation Office (ATO) has recently released Practical Compliance Guideline PCG 2017/13. In this release, the ATO considers the possible actions that trustees may take where they have seven-year interest-only sub-trust arrangements that are approaching maturity.

BACKGROUND

In 2009, the ATO took the view that amounts which represented distributions of income from trusts to corporate beneficiaries that remained unpaid in subsequent income years (unpaid present entitlements or UPE) would be subject to Division 7A.

In Practice Statement PS LA 2010/4, the ATO provided trustees with a number of solutions to enable them to satisfy the requirements of Division 7A. One solution (referred to as Option 1 in the Practice Statement) required trustees to:

- ▶ Place the arrangement in a sub-trust
- ▶ Make annual interest payments to the corporate beneficiary, and
- ▶ Repay the principal amount at the end of the seven-year term.

The first series of Option 1 arrangements are maturing during the 2017 or 2018 income years, meaning that trustees with these types of arrangements will be required to take action to ensure the outstanding principal is not deemed to be a Division 7A dividend to the trust.

SEVEN-YEAR UPE LOANS MATURING IN 2017 AND 2018

In PCG 2017/13, the ATO states that trustees who adopted Option 1 on or before 30 June 2011 will be obligated by the terms of the arrangement to repay the loan principal in the 2017 or 2018 income years. It should be noted that the loan maturity date of 30 June 2018 will apply to a UPE that was created during the 2010 income year, and which the main trust placed on an Option 1 sub-trust arrangement by 30 June 2011.

In PCG 2017/13, the *“Commissioner maintains the clear expectation that this term of the investment agreement be met and that the principal of the loan, entered into under investment Option 1, must be repaid at the end of the loan term”*.

If the trustee fails to repay the principal where Option 1 matures in the 2017 or 2018 income years, any unpaid principal will be treated by the ATO as a Division 7A loan.

However, in this guidance, the ATO also provides a solution for trustees faced with the requirement to repay significant principal amounts. Where all or part of the principal is not repaid on or before the maturity date, the ATO will accept that a seven-year loan that complies with the requirements of section 109N (interest bearing at the benchmark rate, annual minimum repayments made

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and complying loan agreement) may be put in place between the sub-trust and the private company prior to the date for lodgement of the private company's income tax return for the income year in which sub-trust matures.

This will provide a further period for the amount to be repaid with periodic payments of both principal and interest. Where the maturity date for Option 1 expires by 30 June 2018, this means that a new Division 7A loan agreement must be entered into between the sub-trust and the corporate beneficiary in respect of the UPE by the due date for the lodgement of the corporate beneficiary's 2018 income tax return.

Most sub-trusts that resulted from UPE's in the 2010 income year will mature at 30 June 2018. However, some sub-trusts may have matured in the 2017 income year, in which case the new Division 7A loan agreement must be entered into between the sub-trust and the corporate beneficiary by the due date for the lodgement of the corporate beneficiary's 2017 income tax return.

The due date for the lodgement of the private company's tax return depends on a number of factors, such as whether it lodges through an agent's lodgement program, and if yes, its particular financial attributes and thresholds. Affected taxpayers should contact their tax adviser to ascertain the precise lodgement date.

It should also be noted that the ATO does not accept that any of the Option 1 amount can be rolled over into a new sub-trust arrangement. Furthermore, the ATO states that where the facts and circumstances indicate there was never an intention to repay the principal at the end of the seven-year interest only period, the sub-trust arrangement was not entered into in accordance with PS LA 2010/4. This may lead the ATO to consider that the arrangement was a sham, and/or that there was fraud or evasion and consequently can amend relevant assessments to include the deemed dividend in the relevant taxpayer's 2011 income tax assessment.

BDO COMMENT

This concessionary approach adopted by the ATO is welcomed as it provides some respite for taxpayers who are faced with managing and funding the impending repayment obligations from the Option 1 agreements maturing in the 2017 and 2018 income years. BDO can assist clients in managing deadlines to ensure they benefit from the changes, including repaying the principal of the loan and final interest before 30 June 2018 and creating new seven-year loans prior to the private company's lodgement.

Note that this release does not consider the consequences of the other sub-trust options outlined in PSLA 2010/4 (for example, investment Option 2 - UPE funds invested on an interest-only ten-year loan). Further, it does not consider what actions may be taken by trustees on Option 1 arrangements (seven-year interest only) taken out in later income years. Presumably, the ATO may issue follow up statements for these succeeding years and we will notify clients of further developments.

Ref: PCG 2017/13 - Division 7A - unpaid present entitlements under sub-trust arrangements maturing in the 2017 or 2018 income years

MORE INFORMATION

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