

# TRUST GUIDANCE FACT SHEET NO. 2

## DIVISION 7A, UPEs AND FINANCIAL ACCOMMODATION

TD 2022/11

When unpaid present entitlements and sub-trust arrangements will be treated as Division 7A loans and a checklist to ensure arrangements comply with section 109N

Updated: September 2022

## Introduction

*Taxation Determination TD 2022/11 Income tax: Division 7A: when will an unpaid present entitlement or amount held on sub-trust become the provision of 'financial accommodation'?* ([TD 2022/11](#)) signals a shift in the ATO's approach to compliance required for unpaid present entitlements (UPEs) and amounts held on sub-trust.

This guidance on TD 2022/11 will assist CPA Australia members to understand the issues arising from the ATO guidance on Division 7A, UPEs and financial accommodation and the position taken by the Commissioner of Taxation.

The information contained within this fact sheet can be considered when contemplating trust arrangements. However, it is important to note that each situation will be different, and the fact sheet is not a substitute for independent legal advice.

This information is based on the final guidance issued on 13 July 2022.

## UPEs and private company beneficiaries

Historic arrangements, including for pre-2009 UPEs and those entered into in reliance on [TR 2010/3](#), [PSLA 2010/4](#) and [PSLA 2017/13](#) will continue to be observed and administered by the ATO in accordance with those guidance products.

However, for trust arrangements entered into after 1 July 2022, Option 1 and Option 2 investment agreements (provided for in TR 2010/3 and PSLA 2010/4) are no longer an option. The way forward is standard loan agreements that comply with section 109N of the *Income Tax Assessment Act 1936* (section 109N).

The key differences that arise are that, whereas:

- investment agreements could be for either a seven-year term or a 10-year term, the maximum term for an unsecured section 109N agreement is seven years;
- investment agreements could be on an interest only basis for their term, section 109N agreements require repayment of interest and principal annually; and
- investment agreements could be evidenced by tax work papers, a separate legal agreement is required for section 109N-compliant agreements.

Per TD 2022/11, a private company will be taken to have paid an unfranked dividend in an income year if it makes a loan to a shareholder or their associate and that loan is not fully repaid by the private company's lodgement day. The deemed unfranked dividend is taken to be equal to the amount of the loan remaining unpaid at the lodgement day and is treated as paid to the recipient of the loan or beneficiary (ordinarily the trust for UPEs and sub-trusts).

An UPE occurs where a trustee appoints income to a beneficiary but doesn't actually distribute the amount. TD 2022/11 states that the choice of the beneficiary will be considered 'financial accommodation' to the trustee within the extended definition of a Division 7A 'loan' where a beneficiary:

- is a private company; and
- has knowledge of the amount it can demand immediately; and
- fails to demand the payment.

Further, if a private company beneficiary and the trustee have the same directors or controllers, knowledge of the amount will be assumed. As a consequence, the private company will be taken to have paid an unfranked dividend to the trust if the amount is not repaid by the company's lodgment day or put on section 109N-compliant terms by that date.

## Timing and expression of financial accommodation

The time when the amount of a beneficiary's entitlement is known will typically arise after the end of the income year, that is, in the following income year, in which the entitlement arises. This will be the case whether the entitlement is expressed as:

- a fixed amount from the trust income
- a percentage of trust income, or some other part of trust income identified in a calculable manner, or
- a combination of fixed and calculable amounts.

As the Determination applies to present entitlements arising on or after 1 July 2022, it is expected to apply mainly to present entitlements that arise on 30 June 2023 or later.

## Sub-trust arrangements

Where a private company beneficiary is presently entitled to trust income and the trustee sets aside that amount to be held on sub-trust exclusively for the beneficiary, the present entitlement is paid and no UPE arises. This is as the beneficiary has a new right to seek payment from the sub-trust, and the original trustee's obligation to distribute funds is discharged.

A choice by the private company not to demand payment from the sub-trust does not constitute financial accommodation in favour of the trustee of the sub-trust because the sole beneficiary is the private company.

However, the company is taken to consent to the use of the funds, constituting provision of financial accommodation under s109D(3)(b) by the private company beneficiary to the entity using the fund, if the sub-trustee allows:

- all or part of the sub-trust fund to be used by an associate or shareholder of the company; and
- the company has knowledge of the use.

Accordingly, the company will be taken to have paid an unfranked dividend to the sub-trust if the amount is not repaid by the company's lodgment day or put on section 109N compliant loan terms by that time.

This will be the case even if the use is on commercial terms where a return is paid to the sub-trust. As with UPEs, knowledge will be assumed where the private company beneficiary and trustee have the same directors or controllers.

## Compliance approach

The Commissioner will not devote compliance resources to sub-trust arrangements conducted in accordance with the now withdrawn TR 2010/3 and PS LA 2010/4 in respect of trust entitlements arising before 1 July 2022, even though those sub-trust arrangements may commence after 30 June 2022.

However, where a trust entitlement arising on or after 1 July 2022 is put on sub-trust arrangements that are consistent with PS LA 2010/4, this will amount to financial accommodation.

The Determination does not apply to unpaid present entitlements arising before 16 December 2009.

## Checklist for s109N compliant loan agreements

Requirement	Answer
1. Is the agreement in writing?	
2. Was the agreement entered into before the private company's lodgment day?	
3. Is the interest rate equal to or higher than the benchmark interest rate (published by the RBA before the start of the income year?)	
4. Does the loan agreement provide for minimum yearly repayments (comprising interest at the benchmark interest rate or higher plus proportional principal repayments)?	
5. Is the loan secured by a mortgage over real property?	If 'No' skip to question 7.
6. If 100% of the value is <b>secured</b> by a mortgage over real property (with a value of at least 110% of the loan at the time of registration), is the term of the loan 25 years or less?	
7. If <b>not secured</b> by a mortgage over real property, is the term of the loan 7 years or less?	

If the answers to questions one to four are yes, and the terms of the loan are in accordance with questions six or seven as appropriate, then the loan agreement will be compliant with section 109N.

### About the author

This checklist was originally prepared by Holding Redlich on behalf of CPA Australia and updated by CPA Australia.

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