

## **Bendel – are UPEs loans for Division 7A?**

### **Facts**

Steven Bendel was the sole director and shareholder of Gleewin Pty Ltd. Gleewin Pty Ltd was the trustee of The Steven Bendel 2005 Discretionary Trust (the **2005 Trust**). Steven was a beneficiary of the 2005 Trust, and was also the sole director and shareholder of Gleewin Investments Pty Ltd, a corporate beneficiary.

In the years ended 30 June 2014 to 30 June 2017, the 2005 Trust made Steven presently entitled to a share of its income and, from 2013 until 2017, the 2005 Trust made Gleewin Investments Pty Ltd presently entitled to a share of its income.

The trust deed for the 2005 Trust contained terms which allowed the trustee to determine to set aside, pay or apply any part of, or all of the income of the trust in each year for any of the beneficiaries of the trust. In relation to amounts set aside for a beneficiary, the trust deed provided that “[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 ...”.

The trust deed then provided the trustee with the power to invest amounts held on separate trusts for beneficiaries, in such manner as the trustee thinks fit.

During each of the 2013 to 2017 years, the financial affairs of the 2005 Trust were managed as follows:

1. Steven caused the 2005 Trust to advance money from its resources to him or for his benefit from time to time;
2. the advances to Steven were recorded with the description ‘Drawings’ by way of journals posted to a beneficiary account, ‘Bendel Current Account’;
3. distributions of (or creation of entitlements to) the 2005 Trust’s income or capital were made from time to time;
4. when the amounts of the distributions (entitlements) were ascertained, journals were posted to the Bendel Current Account; and
5. for each year, Steven’s entitlement to income from the 2005 Trust was less than the then balance owed by him to the 2005 Trust so that his entitlement to the 2005 Trust’s income was always fully discharged or paid (i.e. the current account was always in debit).

For each of the years under review, the 2005 Trust reported Steven’s entitlement as discharged and paid (due to the set off against amounts owed by Steven to the 2005 Trust).

The financial affairs of Gleewin Investments Pty Ltd were similarly managed. During each of the 2013 to 2017 years:

1. Steven caused the 2005 Trust to meet the tax liabilities and other expenses of Gleewin Investments Pty Ltd from time to time;
2. when the expenses of Gleewin Investments Pty Ltd were met by the 2005 Trust, entries were made to both entities’ accounts – in the 2005 Trust accounts, expenses were recorded in the Gleewin Investments Current Account, and in the accounts of Gleewin Investments Pty Ltd, the expenses were recorded in the account named ‘Steven Bendel 2005 Discretionary Trust’;

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3. from time to time amounts belonging to Gleewin Investments Pty Ltd (PAYG tax refunds) were received by the 2005 Trust and not passed on. These amounts also were posted to the same accounts by or on behalf of each of the 2005 Trust and Gleewin Investments Pty Ltd and reflected an increase in the obligations of the 2005 Trust to Gleewin Investments Pty Ltd; and
4. for each year the entitlement of Gleewin Investment Pty Ltd to income from the 2005 Trust was also posted to the Gleewin Investments Current Account, and for each of the 2013 to 2017 years that income entitlement was greater than the taxation and other expenses paid on behalf of Gleewin Investments Pty Ltd by the 2005 Trust from its resources so that its entitlement to the income of the 2005 Trust was always recorded as at least partly outstanding (i.e. the loan account was always in credit in the 2005 Trust).

The entitlements of Gleewin Investments Pty Ltd were reported in the 'Gleewin Investments Current Account' showing a running balance of unpaid present entitlements (**UPEs**).

Despite the requirements under the trust deed, Gleewin Pty Ltd did not report any asset held separately, did not purport to alienate or create any interest in any identified asset to meet or correspond with the UPEs and did not report or account for any separate trust.

#### ATO audit

The ATO conducted an audit of Steven's tax affairs, during which the UPEs of Gleewin Investments Pty Ltd were discovered.

On 4 September 2019 the Commissioner issued amended assessments contending that:

1. the UPEs of Gleewin Investments Pty Ltd to prior year trust income comprised loans within the meaning of section 109D(3) of the ITAA 1936 made by Gleewin Investments Pty Ltd in the current year to the 2005 Trust;
2. those loans were taken to be dividends paid within the meaning of section 109D(1) of the ITAA 1936;
3. those dividends were taken to be paid out of the profits of Gleewin Investments Pty Ltd by operation of section 109Z of the ITAA 1936;
4. the dividends taken to be paid out of profits were assessable income by operation of section 44(1) of the ITAA 1936 and included in the section 95 net income of the 2005 Trust; and
5. the beneficiaries who were entitled to the income of the 2005 Trust were liable to be assessed under section 97 for a proportion of each such dividend determined by reference to their proportionate shares of the income of the 2005 Trust.

In determining the quantum of the deemed dividends the ATO treated the tax payments made by the 2005 Trust for Gleewin Investments Pty Ltd up to the lodgement day for the relevant year's trust tax return, and any tax refunds received, as being netted off against the UPE balance. This had the effect of treating tax refunds, which were in effect a loan from the company to the 2005 Trust, as forming part of the UPE. The Tribunal, as part of its findings, separated these amounts out.

Objections were lodged on 1 November 2019. On 23 March 2021 the objections were disallowed for the 2014 to 2016 years, and allowed in part for the 2017 year. The Commissioner also issued penalty assessments.

#### Is there a loan for the purposes of section 109D(3)?

At the AAT hearing, the first issue raised was whether there was a "loan" for the purposes of section 109D(3). Section 109D(3) provides as follows:

*What is a loan?*

(3) *In this Division, loan includes:*

- (a) *an advance of money; and*
- (b) *a provision of credit or any other form of financial accommodation; and*
- (c) *a payment of an amount for, on account of, on behalf of or at the request of, an entity, if there is an express or implied obligation to repay the amount; and*
- (d) *a transaction (whatever its terms or form) which in substance effects a loan of money.*

Steven relied on two arguments to assert there was not a loan: one based on statutory interpretation and other based on the UPEs being held on separate trusts.

Steven submitted that the statutory context and purpose of section 109D of the ITAA 1936 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. Steven further submitted that a construction of section 109D(3) of the ITAA 1936 that includes UPEs to companies as loans would lead to absurd and unintended results, namely double taxation of the same amount, from the dual operation of section 109D and Subdivision EA (subdivision EA concerns the position where there is a UPE owing to a private company, and then a loan, payment or forgiveness occurs between the trustee and a shareholder or associate of a shareholder in the private company).

Steven's second contention was that 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 the present case, the entitlement to income was a function of a trust relationship and not a debtor and creditor relationship. Steven submitted:

1. the trustee had no obligation to pay money to Gleewin Investments Pty Ltd in the relevant sense. Credit or financial accommodation requires allowing time to pay, or forbearing, a monetary obligation. The trustee's obligation, as trustee of each separate trust, was not to pay the relevant amounts to Gleewin Investments Pty Ltd, but rather to hold them for Gleewin Investments Pty Ltd absolutely. In contrast to having an obligation to pay those amounts to Gleewin Investments Pty Ltd, the trustee was permitted to invest them on behalf of Gleewin Investments Pty Ltd; and
2. there is a fundamental distinction between a trust relationship and a debtor/creditor relationship as is implied by a loan or credit or other financial accommodation. Where the recipient of money is required to hold the money for the benefit of the other party (or a third party), there is a trust but not a debt. Where the recipient is only required to repay the same amount of money at a future time and is free to use the money as his or hers in the meantime, there is a debt but not a trust. This is, as is made explicit by the trust deed, a case of the former; the relevant amounts were required to be 'held by the Trustee on a separate trust for [Gleewin Investments Pty Ltd] absolutely'.

Steven argued that it could not be suggested that if a company gave money to a trustee to hold on trust for the benefit of the company (or some third party), that a loan arises, however that is what was occurring in this instance. Part of the income of the 2005 Trust was set aside on a separate trust for the benefit of Gleewin Investments Pty Ltd, and the mere fact that Gleewin Investments Pty Ltd could have called for payment of those amounts but did not, does not change the transaction from a trust relationship into a loan.

The Commissioner's submissions in relation to this first issue relied on two arguments, firstly that Gleewin Investments Pty Ltd made a loan as defined in the legislation to the 2005 Trust, and secondly that Subdivision EA does not inform the construction to be given to definition of a loan in section 109D(3) of the ITAA 1936.

The Commissioner's first argument was that Gleewin Investments Pty Ltd made a loan to the 2005 Trust because Gleewin Investments Pty Ltd provided a form of financial accommodation, in that the phrase 'any other form of financial accommodation' in section 109D(3)(b) covers a consensual arrangement where a beneficiary does not require the amount of a distribution to be paid, or does not exercise a power to bring a trust to an end, and in consequence, the trustee retains the use of funds, but remains obligated to pay the amount of the distribution in the future.

The Commissioner also noted that the relevant UPEs were recognised in the financial statements of the 2005 Trust where they were relating the 'Beneficiaries' Current Account' in respect of Gleewin Investments Pty Ltd, which the 2005 Trust recorded as a liability. There is no reference in the balance sheets to a sub-trust. Further to this point, the funds supposedly held on a sub-trust were intermingled with all other funds of the 2005 Trust. However, the Commissioner did not deny the existence of a sub-trust, due to the operation of the trust deed. If Gleewin Investments Pty Ltd were to call for its entitlement, it would be paid from the intermingled funds.

Regarding the statutory interpretation argument, the Commissioner noted that the existence of Subdivision EA and legislative history did not indicate that the definition of a “loan” in section 109D(3) excludes 'a consensual arrangement where a beneficiary does not require the amount of a distribution to be paid, or does not exercise a power to bring a trust to an end, and as a consequence a trustee retains the use of the funds but remains obligated to pay the amount of the distribution in the future'.

The Commissioner further noted that there is no dual application of Subdivision EA and 109D, because in order for section 109XA to be enlivened, it must be the case that the company in question (Gleewin

Investments Pty Ltd) is or becomes presently entitled to an amount from the net income of the trust estate (the 2005 Trust) which is not paid to it. That condition is not satisfied here because clause 3(5) of the trust deed provided for any amount set aside for Gleewin Investments Pty Ltd to cease to form part of the 'Trust Fund' and to commence to be held on a separate trust. Accordingly, only section 109D of the ITAA 1936 applies.

As an additional argument, Steven contended that, if the amount of the UPE was a loan, section 6-25 of the ITAA 1997 prevented it from being income for him.

Section 6-25 in part provides as follows:

- (1) *Sometimes more than one rule includes an amount in your assessable income:*  
\* *the same amount may be* \* *ordinary income and may also be included in your assessable income by one or more provisions about assessable income; or*  
\* *the same amount may be included in your assessable income by more than one provision about assessable income.*

...

*However, the amount is included only once in your assessable income for an income year, and is then not included in your assessable income for any other income year.*

Steven contended that the amount taken to be a deemed dividend paid by Gleewin Investments Pty Ltd to the 2005 Trust is the same amount determined to be assessable income by operation of sections 95 and 97 for Gleewin Investments Pty Ltd.

## Issues

1. Whether Gleewin Investments Pty Ltd made a loan within the meaning of section 109D(3) of the ITAA 1936 arising from the unpaid present entitlements owed by the 2005 Trust to Gleewin Investments Pty Ltd over the 2014 to 2017 years?
1. Whether section 6-25 of the ITAA 1997 prevents the amount that is taken to be a dividend paid by Gleewin Investments Pty Ltd from being included in the 2005 Trust's assessable income, or alternatively, Steven's assessable income, on the basis that the same amount has already been included in assessable income?

## Decision

### Accounting issue

The AAT noted that the manner in which the Commissioner had accounted for the UPE balances was generous, and apart from accounting separately for the tax refunds as separate loans, it would not disturb the Commissioner's treatment. If the tax payments which reduced the UPE balances had instead been accounted for on a FIFO (first in first out) basis, there would have been no reduction in the UPE balances for the years in question. For instance, the 2013 year distribution to Gleewin Investments Pty Ltd was \$236,251, but because the Commissioner accepted tax payments could reduce that balance the UPE that was treated as a loan was ultimately reduced to \$181,601.

### Is there a loan for the purposes of section 109D(3)?

The AAT noted that both parties presented an argument based on the existence of a sub trust. However, the AAT did not consider that creating a right to income gave rise to a sub-trust. Ordinarily you would expect that there is sufficient identity of the subject matter of the trust for there to be a trust, which was not the case here. Rather, based on case law, it is 'the exercise of the power by way of unconditional and irrevocable allocation of trust property' which results in 'absolute beneficial entitlement in respect of property which, before and after the resolution of the trustee, remained property which the trustee held on trust under the terms of the existing settlement' which could constitute a sub-trust.

The AAT noted that here the 2005 Trust did not make any appropriation of any asset, nor any investment decision regarding the trust funds referable to any income entitlements and has not identified any asset or property held on account of entitlements to income. At the end of each year there was no identifiable property that was held absolutely for Gleewin Investments Pty Ltd. The AAT therefore did not accept that a separate trust arose that had the effect of discharging the obligation to pay entitlements to income.

In relation to the statutory interpretation argument, the AAT did not accept a number of the Commissioner's contentions. The AAT noted that the purpose of Division 7A is to ensure that shareholders of private companies are not able to enjoy distributions of company profits tax-free. The AAT also considered in detail various media releases and the explanatory memoranda for the former section 109UB and then the later addition of Subdivision EA.

The AAT accepted Steven's argument that the statutory context is relevant, noting that an issue that arises between section 109D and Subdivision EA is that separate entities may be taxed on the same 'deemed dividend' resulting in double taxation, as suggested by Steven. Section 6-25 of the ITAA 1997 does not assist in this situation, as it is not the same taxpayer that is subject to double tax, but rather it is two separate entities who are both being assessed on a deemed dividend arising from the same underlying circumstances. Further, the AAT noted that there is no 'tiebreaker' provision in Division 7A, noting that section 109RB of the ITAA 1936 only applies to 'honest mistakes or inadvertent omissions'.

Ultimately, the AAT concluded that there was no "loan" under section 109D(3) of the ITAA 1936 as a loan for this purpose 'does not go so far as to embrace the rights in equity created when entitlements to trust income are created but not paid, and remain unpaid'. The AAT found that 'the balance of an outstanding or unpaid present entitlement of a corporate beneficiary of a trust, whether held on a separate trust or otherwise, is not a loan to the trust'.

This conclusion was reached having regard to the following reasons:

1. the policy of Division 7A to tax those who enjoy the benefit of corporate profits without paying the tax that would arise had the company paid dividends in the usual way;
2. statutory construction principles call for:
  - (a) regard to statutory context and legislative history; and
  - (b) potentially competing provisions to be construed in a manner which 'gives effect to harmonious goals';
3. that there is no tiebreaker provision which mandates which of two competing assessing provisions would apply if an unpaid present entitlement constitutes a loan within the meaning of section 109D(3);
4. that the section 109RB discretion is not designed to allow relieving discretions to be exercised outside the section 109RB(1)(b) gateways of honest mistakes and inadvertent omissions and thus not a discretion that would relieve inappropriate double taxing;
5. Subdivision EA being a specific, and therefore a lead, provision containing an express set of rules that can be regarded as a particular path that has been chosen to deal with the taxation effect of UPEs in favour of corporate beneficiaries in prescribed circumstances;
6. the lack of clarity as to the nature of a UPE and the separate trust concept;
7. the expressed explanation accompanying the former section 109UB of the ITAA 1936 to the effect:
  - (a) that an unpaid present entitlement in favour of a corporate beneficiary and a contemporaneous loan by the trustee to a shareholder in the corporate beneficiary (or associate) is in substance a loan by the company to the shareholder; and
  - (b) that an amount to which a company is entitled 'held on a secondary trust for the benefit of the company' is regarded as unpaid and within the ambit of section 109UB of the ITAA 1936;
8. the operation of Subdivision EA which taxes the shareholder in the foregoing circumstances as if the company had lent money directly to that shareholder which falls squarely within the Division 7A policy framework;
9. there being no provision in either of the tax acts that expressly allows assessment of two people arising out of the same circumstance with one of those people potentially not enjoying any benefit of the corporate profits that are the underlying cause of the assessment.

#### Will section 6-25 of the ITAA 1997 apply?

The AAT noted that section 6-25 of the ITAA 1997 uses the compound term 'same amount' which required the relevant amount to be the same in its identity, for example a particular dividend that is assessable under both section 6-5 of the ITAA 1997 and section 44 of the ITAA 1936. The compound term does not embrace amounts of a different identity that might have historical connections.

The amounts in question here are two separate amounts:

1. an amount assessed as a share of section 95 net income having its origins in entitlements to distributable income of a trust estate;

2. then a disputed amount assessable because, by reference to further events, the ITAA 1936 required a further calculation of a separately identified amount to be included in assessable income.

The AAT confirmed that the amount taken to be a dividend paid by Gleewin Investments Pty Ltd to the 2005 Trust was not the same as the amount determined to be assessable income by operation of sections 95 and 97 for Gleewin Investments Pty Ltd.

The AAT set aside the Commissioner's objection decisions.

**COMMENT** — the 'double tax' argument made by the taxpayer is in fact raised in the now withdrawn TR 2010/3, where the Commissioner implicitly acknowledged the potential for an amount to both be treated as a UPE, triggering subdivision EA, and a loan, triggering section 109D. In the final paragraph of that ruling the Commissioner stated that he would not treat a UPE that he considered to be a 109D loan as a UPE, effectively to prevent double taxation.

**COMMENT** — this case will have major importance if it is ultimately upheld on appeal, and presumably the Commissioner will appeal, given his public position is that a UPE can become a loan as a result of being a financial accommodation. The Commissioner is unlikely to change his position unless he receives an unfavourable decision in the Full Federal Court or High Court.

Citation *Bendel and Commissioner of Taxation (Taxation)* [2023] AATA 3074 (DP F O'Loughlin KC, SM K James, Melbourne)  
w <http://www8.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2023/3074.html>