



COMMISSIONER'S CONCESSIONAL TREATMENT FOR INVESTMENT OPTION 1 LOANS AND DIVISION 7A

On 19 July 2017 the Commissioner of Taxation (**Commissioner**) issued Practical Compliance Guideline PCG 2017/13 (**Guideline**). This Guideline provides taxpayers with administrative guidance where an unpaid present entitlement (**UPE**) has been dealt with in accordance with investment Option 1 outlined in *Law Administration Practice Statement PS LA 2010/4 Division 7A: trust entitlements (Option 1 Investment and PS LA 2010/4)* and the repayment of the Option 1 Investment principal is required to be made in the 2017 or 2018 income years.

The Guideline only applies where an UPE:

- has been dealt with in accordance with Option 1 Investment; and
- the repayment of the principal of the Option 1 Investment is required to be made in the 2017 or 2018 income years.

PS LA 2010/4 provides guidance on the administrative aspects of where UPE funds remain intermingled with funds of a trust but are claimed to be held on sub-trust for the sole benefit of a private company beneficiary.

Pursuant to PS LA 2010/4 the Commissioner considers that UPE funds on a sub-trust are held for the sole benefit of the private company beneficiary if they are lent to the main trust under a 7-year interest only loan with the principal of the loan repayable at the end of the 7-year interest only loan. This is referred to in PS LA 2010/4 and this alert as an Option 1 Investment.

Trustees who adopted an Option 1 Investment on, or before, 30 June 2011 will be obligated to repay the Option 1 Investment principal in the 2017 or 2018 income years. PS LA 2010/4 makes it clear that to comply with Option 1 Investment, the trustee must *actually repay* the principal at the end of the Option 1 Investment term.

If the trustee fails to repay the principal when an Option 1 Investment matures (in the 2017 or 2018 income years), any unpaid principal will be treated by the Commissioner as the provision of financial accommodation and therefore a loan pursuant to Division 7A of the *Income Tax Assessment Act 1936 (ITAA 36 and Division 7A)* purposes. If not repaid prior to the private company's lodgment day, a Division 7A deemed dividend will arise, being the amount of the unpaid Option 1 Investment principal.

In the Guideline, the Commissioner accepts that a 7-year loan on complying terms in accordance with section 109N of the ITAA 36 (**Division 7A Loan**) may be put in place between the sub-trust and the private company beneficiary prior to the private company's lodgment day. *This will provide the taxpayer with a further period for the amount of the principal to be repaid with periodic payments of both principal and interest.* The Commissioner therefore provides taxpayers with the administrative concession, allowing repayment of the Option 1 Investment principal by placing it on Division 7A Loan terms.

In certain circumstances section 109R of ITAA 36 (**section 109R**) applies to disregard a payment as a repayment of a loan for Division 7A purposes. In the Guideline the Commissioner confirms that he *will not seek to apply section 109R* to the principal of an investment Option 1 loan placed on Division 7A loan terms in accordance with the Guideline.

On a cautionary note, the Commissioner states in the Guideline that where the facts and circumstances indicate that there has *never been an intention to repay* the principal of loan at the end of the 7-year interest only loan, the sub-trust arrangement was not entered into in accordance with PS LA 2010/4 and this may lead the Commissioner to consider that the purported arrangement was a sham, and/or that there was fraud or evasion. In these circumstances, the Commissioner may go back beyond the standard period of review and deem a dividend in the income year in which the provision of financial accommodation originally arose.

Cornwall Stodart can assist you with complying with the Commissioner's guidance, including preparation of Division 7A Loan agreements. We can also assist you with reviews of your ownership structures and Division 7A requirements.

Disclaimer

The statements herein are not intended to amount to advice and should not be relied upon without first obtaining specific advice applicable to your situation.

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