

The ATO's proposed treatment of Unpaid Present Entitlements

On 10 June 2015, the Australian Taxation Office (ATO) released two draft taxation determinations and a draft taxation ruling, outlining its proposed treatment of unpaid present entitlements (UPE) for the purposes of bad debt write-offs, Div 7A, and the maximum net asset value test.

No deduction when UPE is written off as a bad debt

In [draft Taxation Determination TD 2015/D5](#) the ATO states that a beneficiary of a trust is not entitled to a deduction under section 25-35 of the Income Tax Assessment Act (ITAA) 1997 for the amount of a UPE that the beneficiary has purported to write off as a bad debt. This is because the amount of a UPE is not included in a beneficiary's assessable income. Rather, the entitlement is used to determine the amount (if any) of the net income of the trust included in the beneficiary's assessable income under Division 6 of Part III of the ITAA 1936.

Release of a UPE by a corporate beneficiary constitutes a "payment" for Div 7A purposes

In [draft Taxation Determination TD 2015/D4](#) the ATO states that the word "credit" in paragraph 109C(3)(b) of the ITAA 1936 takes a wide meaning, and includes any action or dealing that would properly be reflected as a credit entry in a private company beneficiary's books of an account. A release (by way of deed or agreement) constitutes a binding undertaking, leaving the entity to whom the interest is released with full legal ownership, free of any separately identifiable equitable interest of the releasing beneficiary in the underlying property. Therefore, a release of a UPE should be treated as a credit in the corporate beneficiary's accounting books, and is considered a payment within the meaning of subparagraph 109C(3)(b)(iii) to the extent that a financial benefit is conferred on the entity to which the UPE is released. However, this determination would not apply in respect of UPEs that have already been converted to Div 7A loans.

Small business concessions and the maximum net asset value test

In [draft Taxation Ruling TR 2015/D2](#) the ATO states that where a connected beneficiary has a UPE, the value of that UPE will be included once in determining whether or not a taxpayer economic group satisfies the maximum net asset value test in section 152-15 of the ITAA 1997. The way in which the ATO proposes to treat the value of the UPE varies depending on the beneficiary's entitlement and whether or not the UPE has been placed on a sub-trust:

1. Where a connected beneficiary's UPE is an absolute entitlement to one or more trust assets, the assets corresponding to the UPE are treated as being held by the connected beneficiary. The UPE will not be included in the net value of the CGT assets of the trust as either an asset or a corresponding liability;

2. Where the connected beneficiary is not absolutely entitled and funds representing the UPE are set aside on sub-trust, the UPE will form part of the assets of the sub-trust (without any corresponding liability). The UPE is not taken into account in the net value of the CGT assets of the connected beneficiary, being an asset that is disregarded under s.152-20(2)(a). No amount is taken into account in the main trust as the funds representing the UPE are not relevant assets (or liabilities) of the main trust.
3. Where the connected beneficiary is not absolutely entitled and there is no sub-trust, the value of the UPE will be reflected in the total assets of the trust and offset by a corresponding liability to pay it to the connected beneficiary, and the UPE is included an asset of the beneficiary that is not disregarded under s.152-20(2)(a).

The final taxation determinations and ruling are proposed to apply both before and after the dates of issue. The ATO has invited comments on these publications by 24 July 2015.

We have written a technical article addressing the draft determinations and draft ruling to be published in the August 2015 edition of The Taxation Institute's journal "Taxation in Australia". This article will also be published on the Sladen Legal website in October 2015.

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