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28 April 2025

Pri Wijesooriya
Australian Taxation Office

By Email: *Pri.Wijesooriya@ato.gov.au*

Dear Pri

TD 2025/D2

1. Thank you for the opportunity to provide comments on Draft Taxation Determination TD 2025/D2 ("**Draft TD**") in relation to the application of section 109R[1] where notional loans are involved.

2. Pitcher Partners specialises in advising taxpayers in what is commonly referred to as the middle market. Accordingly, we service many taxpayers that are required to manage Division 7A loans that would be impacted by the views contained in the Draft TD and the administration of them.

3. We highlight that for the purposes of Division 30 of the *Tax Agent Services Act 2009* and, in particular, the amendments to the Code of Conduct by the *Tax Agent Services (Code of Professional Conduct) Determination 2024 ("***Determination**"), all of the comments made in this submission are directly relevant to us as a firm and our clients. While this may result in a conflict of interest for the purposes of section 20 of the Determination, we highlight that we have tried to ensure that our comments and suggestions in this submission are balanced and consistent with the policy, principles and intention of the rules as we understand them.

Correctness of view

4. We do not agree with the view expressed in paragraph 8 of the Draft TD that section 109R can apply to disregard a loan repayment where the repaying entity is

[1] All legislative references in this submission are to the *Income Tax Assessment Act 1936* unless otherwise indicated.

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taken to have obtained a notional loan as a result of the operation of sections 109T and 109W.

5. The words of section 109R are plain and unambiguous. Under either paragraphs 109R(2)(a) or (b), repayments of loans can only be disregarded where a reasonable person test is satisfied in respect of a loan or loans obtained "from the private company". The use of the definite article in the legislation makes it clear that the subsequent loan or loans obtained must be obtained from the same private company that made the original loan.

6. The Draft TD attempts to subvert this plain reading of the legislation through a strained interpretation of deeming rules contained in a separate Subdivision of Division 7A. The application of this view requires the reasonable person test to be applied in an overly complex way that necessitates conclusions to be made - not in respect of actual events, but in respect of notional events requiring an intervening step of the Commissioner making a determination as to the size of notional loan.

7. The purpose of the provisions in Subdivision E is elucidated in section 109S which states that:

> *This Subdivision allows a private company to be taken under Subdivision B to pay a dividend to an entity (the **target entity**) …*

8. It is evident that the object of provisions such as section 109T and 109W is not to create rules of general application, but to tax shareholders (and their associates) of private companies by way of deemed dividend where profits of the private company are accessed through arrangements involving interposed entities.

9. Further, in respect of subsection 109W(3), the formula contained in that subsection is merely a mechanism that recognises that a notional loan may be smaller than the actual amount lent to the target by the interposed entity. In this regard, section 109S states:

> *If the target entity repays a fraction of the loan made by the interposed entity, the target entity is treated as repaying the same fraction of the loan taken to have been made by the private company. (See subsection 109W(3).)*

10. The narrow operation of Subdivision E is recognised in Appendix 2 in the Draft TD. However, this view is dismissed (without proper explanation) by declaring that it is "not considered to represent the better view of the law" and not the view "which best achieves the purposes or object of section 109R, 109T and 109W and Division 7A as a whole".

11. We understand that the Commissioner is taking an interpretation of the law with a view in mind to increase the level of integrity of Division 7A. However, we do not believe that the view will ultimately be sustained by judicial scrutiny. We believe that such an approach will inevitably lead to greater confusion and uncertainty for taxpayers, similar to the current situation that has resulted from the recent litigation in the *Bendel* case[2] which illustrates the dangers of the Commissioner trying to fill gaps in the legislation through awkward interpretations of the law that are not plainly evident on their face.

12. If Parliament wished to express the view contained in the Draft TD, it could have easily done so by adding words such as "directly or indirectly", or "including a notional loan

[2] *FCT v Bendel* [2025] FCAFC 15.

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under Subdivision E" into section 109R. The lack of any such wording, any notes to this effect, any provision stating this to be the case "to avoid doubt," or any comments to this effect in the explanatory memorandum suggests that section 109R was not intended to be applied in the way outlined in the Draft TD.

13. Section 109R is an integrity rule within Division 7A that has limited operation. It is not intended to cover every possible type of circumvention of Division 7A done by way of refinancing of loans. For example, a reborrowing of an amount which is much less than the repayment is not within the scope of section 109R (which requires the reborrowing to be a larger amount or similar). Strained interpretations of multiple provisions should not be adopted to fill a perceived gap.

14. In *FCT v Comber*,[3] Fisher J stated:

> *I find the Commissioner's construction unacceptable. In my opinion deeming provisions are required by their nature to be construed strictly and only for the purpose for which they are resorted to (Ex parte Walton (1881) 17 Ch.D. 746 per James L.J. at p. 756). It is improper in my view to extend by implication the express application of such a statutory fiction. It is even more improper so to do if such an extension is unnecessary, the express provision being capable by itself of sensible and rational application.*

15. There is no cause for the deeming rules sections 109T and 109W to be interpreted broadly so that they go beyond their strict purpose. Such a broad deeming is not necessary for section 109R to operate sensibly and rationally. Stating that a broad deeming best achieves the purpose of Division 7A as a whole is not a licence to take such a broad application, nor is this statement supported by any statutory context or extrinsic materials.

16. Where the operation of section 109R is attempted to be subverted through contrived and artificial arrangements involving interposed entities, this should be within the purview of the general anti-avoidance rules in Part IVA, rather than a strained application of various deeming rules beyond their purpose.

17. This is critical as the arrangements that are described in the examples in the Draft TD are ones that objectively may have a tax avoidance purpose in mind. As such, these arrangements are of the kind that should fall within the consideration of Part IVA.

18. The manner in which private groups operate (with many entities not even having bank accounts) is such that a multitude of intra-group loans and payments arise in any given income year. There may be no intention or actual reborrowing of amounts indirectly. However, the interpretation offered by the Commissioner in the draft TD may find a 'casual' link between the otherwise unconnected payments and loans resulting in the ATO seeking (in an audit context) improperly apply section 109R.

19. We are concerned that it is far too easy to draw a link between various intra-group payments and loans to find a notional loan that can then be used to invoke the application of section 109R to disregard repayments, even though the group can establish that its Division 7A loans are in fact being serviced by means other than a re-borrowing from the same private company (via interposed entities).

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[3] [1986] FCA 92.

20. In summary, applying section 109R together with section 109T will give rise to significant complexities for taxpayers in trying to apply the provisions.

    20.1. Section 109R and 109T (per the ATO's view) does not contain a tax purpose test, while Part IVA does.

    20.2. Section 109R and section 109T both require separate reasonable person tests to be applied before the provisions can operate.

    20.3. Section 109T requires the Commissioner to make a positive determination under section 109W before the quantum of the reborrowing can be determined.

    20.4. The quantum of the reborrowing is a pre-requisite for section 109R to apply (i.e. as it must be approximately equal to or larger than the repayment).

    20.5. If the new loan is placed on arm's length Division 7A terms and full consideration is provided by the recipient by way of the promise to repay, the promise to repay should constitute arm's length consideration which will reduce the amount under section 109W(2) to nil. Irrespective of the view held by TD 2011/16 (which we believe is an incorrect view), a court will need to take into account this consideration provided by the target entity.

21. Therefore, we strongly disagree with the view outlined by the ATO Draft TD and believe that it is critical that section 109R not be applied in the way the Draft TD contends. Instead, Part IVA should be considered for arrangements that are tax avoidance schemes that are entered into to avoid the application of Division 7A.

Consistency with TD 2011/16

22. Paragraph 49 of TD 2011/16 states that:

    In particular cases there may be other matters that need to be taken into account by the Commissioner to ensure that Subdivision E is not circumvented. For example, if the actual loans referred to in subsection 109T(1) are repaid in a manner that would be disregarded under section 109R if it applied to those repayments, it should not be taken into account by the Commissioner in determining the amount of any deemed loan under section 109W.

23. While this statement is somewhat ambiguous, we take it to mean that the Commissioner can take into account any circumvention of the interposed entity rules via re-borrowings of the kind envisaged in section 109R in determining the size of a notional loan.

24. That is, applying this to circumstances of the kind in example 2 of the Draft TD, the Commissioner can take into account the fact that Apple Trust borrowed from Banana Co in order to make the repayment of the actual loan to Orange Co in determining the amount of the notional loan previously made by Banana Co to Apple Trust. Importantly, TD 2011/16 appears to concede that section 109R cannot apply to disregard any repayment by stating that where any facts are present that suggest a refinancing of the actual loan, this will be taken into account in determining the amount of the notional loan. If section 109R was capable of application to disregard the repayment, there would be no need to consider this as merely a factor. Rather, section 109R could have simply been applied to disregard repayments of the actual loan, as the Draft TD suggests.

25. We recommend that the Commissioner clarify the comments regarding section 109R made in TD 2011/16 when finalising the Draft TD and explain how these are to be read together in a coherent manner. The inconsistency of views between the two documents appears to indicate a change in interpretation by the Commissioner that has occurred after 2011.

Practical guidance for taxpayers

26. Although we maintain that the view in the Draft TD is not correct, based on the limited consultation and opportunity to have meaningful discussions on other recent issues involving Division 7A, we do not anticipate that the Commissioner will resile from his view when the determination is finalised. We also accept that the Commissioner is entitled to hold whatever view it believes to be correct.

27. Should, as we expect, the Commissioner maintain the view expressed in the Draft TD, we believe it is incumbent on the Commissioner to provide taxpayers with some level of certainty regarding the practical application of the provisions.

28. Without any further guidance about how the Commissioner intends to apply the reasonable person tests (in either section 109R or section 109T) or what the amount of the notional loan (including a nil amount) the Commissioner will determine under section 109W, it will be almost impossible for taxpayers (in multi-entity groups) to self-assess their compliance with Division 7A with any degree of certainty. This cannot be an acceptable position.

29. We highlight TD 2011/16 again as an example of a product that provided meaningful guidance as the examples in that determination allow taxpayers to understand what they need to do to ensure no deemed dividend is to arise in situations involving back-to-back loans. We recommend that similar guidance be included when the Draft TD is finalised.

30. Most importantly, we recommend that similar to TD 2011/16, where factors indicate that intra-group arrangements reflect genuine transactions that are not designed to avoid the application of section 109R, that the Commissioner will generally determine the amount of any notional loan will be determined as nil, for the purposes of working out how much of a repayment can be disregarded under section 109R.

31. As mentioned, we are concerned that ordinary transactions that arise between members of private groups could easily be identified as invoking the application of section 109R under the view contained in the Draft TD, despite their being no intention to circumvent the normal operation of Division 7A.

32. To illustrate, a private group may have a number of trusts and companies through which it conducts its activities, including a company that is a corporate beneficiary of the trusts. As is common amongst private groups, there may be a series of Division 7A loans between the private companies and the various trusts, including those that arose as a result of unpaid present entitlements being converted into complying loans.

33. The group may seek to rationalise and simplify the intra-group financing arrangements by replacing the various Division 7A loans owed by multiple trusts with Division 7A loans only owing by one trust, acting as a financier (i.e. Finance Trust). This may involve the private companies assigning their loans to the Finance Trust, which pays for these receivables by obtaining a new Division 7A loan from the private companies. Additionally, any receivables that the trusts have against other group entities are

assigned to the Finance Trust in a similar manner, some of which are assigned in order to set-off amounts owed by the assignor trust (e.g. under the original Divon 7A loans).

34. Arrangements of this kind are commonplace and done for administrative ease. However, there is a risk the view in the Draft TD could result in adverse tax outcomes. For example, the original Division 7A loans may be considered to have been repaid and replaced with a new Division 7A loan made to the Finance Trust, which will have receivables owing to it by the original borrowers. In essence, the Finance Trust is being interposed between the original borrower and lender. It may be possible to apply the view in the Draft TD to conclude that the original borrowers were able to repay their obligations owing to the original lenders through a borrowing obtained via an interposed trust. This is broadly similar to example 1 in the Draft TD.

35. It should be a critical factor in determining the size of the notional re-borrowing (upon which section 109R can operate) whether there has been any attempted circumvention of Division 7A. In particular, where there has been no “refresh” of the maturity date and where the loan repayments are being financing by income taxed at marginal rates, the Commissioner should determine any notional loan is nil so that no amount of a repayment can be disregarded.

36. In the example, at paragraph 32 above, if the Finance Trust borrows on terms that match the loan it is being assigned, this should be permissible without any adverse Division 7A consequences. That is, if the Finance Trust obtains a loan with 3 years to maturity and finances this by obtaining a 3-year Division 7A loan from the original lender company The Finance Trust services the Division 7A loans by way of franked dividends that ultimately flow to individuals (rather than corporate beneficiaries) or otherwise from after-tax money borrowed from individuals

37. Such arrangements result in numerous related party loans to and from the central finance entity. However, the arrangement is one that may be entered into with administrative ease in mind, with no mischief intended or in fact achieved from a Division 7A perspective. However, we are concerned such arrangements could easily be ones covered by the Draft TD if the commercial realities are not properly considered.

38. Another example may be that a taxpayer makes a Division 7A loan repayment to a company (Company A) from after-tax dollars (e.g. salary and wages or dividends, and can demonstrate that this has occurred), and then later borrows an amount from another company in the group for other purposes (Company B). If a loan exists between Company A and Company B, the ATO draft view could result in the ATO seeking to apply section 109R and 109T to the arrangement, even though it is clear that in this circumstance the provisions should not be applied.

39. We recommend that the ATO consult further on appropriate guidance and examples that can be included so that taxpayers can comply with the view provided.

40. Including additional practical guidance covering these types of scenarios is critical not only to provide taxpayers with a degree of certainty regarding their financing arrangements but will also serve as a useful guide for ATO staff in administering the provisions so that they do not adopting a rigid application of the view in the Draft TD in an unfair manner.

If you would like to discuss any aspect of this submission, please contact either Leo Gouzenfiter on (03) 8612 9674 or me on (03) 8610 5170.

Yours sincerely

A M KOKKINOS
Executive Director