

RECEIVING LOANS OR OTHER BENEFITS FROM YOUR COMPANY? BEWARE!

Earlier this year, the High Court handed down an important decision about the operation of Division 7A (Div 7A). This is the rule in the tax law that, broadly, treats company loans made to shareholders (or their associates) as a deemed dividend in the hands of the shareholder.

In that decision, the High Court held that the ATO practice of treating an unpaid present entitlement (UPE) of a company beneficiary of a trust as a Div 7A loan back to the trust was *wrong!* The decision overturned some 20 years of ATO practice.*

This information has been prepared without taking into account your objectives, financial situation or needs. Because of this, you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation or needs.

More precisely, the High Court held that UPEs from a trust to a corporate beneficiary do not automatically become a Div 7A loan made to the trust.

Otherwise, the decision has no bearing on the operation of Div 7A in general, namely where a shareholder (or an "associate") receives a loan directly from a company, or obtains some other form of "financial accommodation" from the company because they are a shareholder (or an "associate").

In other words, Div 7A continues to prevent small business owners, shareholders and directors from taking company profits tax-free in the form of loans or informal cash drawings.

Div 7A is ordinarily triggered whenever company funds are used for personal purposes without being paid out through normal channels like salary or a franked dividend.

Apart from making a direct loan to a shareholder or associate, other ways Div 7A can be triggered include:

- moving company cash directly to a personal account.
- company-owned assets (such as a holiday home, vehicle or yacht) being used privately.
- directing the business to pay personal costs like school fees or private home renovations.

If these amounts are still sitting on the balance sheet as an unpaid "shareholder loan" or "drawings account" by the company's tax return lodgment date, Div 7A treats the entire amount as an assessable dividend, without any franking credits to reduce the tax payable on it.

For private business owners, keeping personal expenses separate from company funds is very important.

However, the tax law provides a "safe harbour" rule known as a "complying loan agreement".

To be accepted by the ATO, the agreement must be in writing and must meet strict commercial terms:

- the loan term cannot exceed 7 years if unsecured, or 25 years if the loan is secured by a registered mortgage.
- the loan must charge interest at or above the benchmark rate, which is based on a Reserve Bank of Australia housing loan rate.
- the borrower must make a minimum yearly repayment of principal and interest by 30 June of each later income year.

The ATO remains heavily focused on Div 7A in private groups, using data matching to cross-check company balance sheets, bank data and personal returns to catch non-compliant arrangements. It is also not afraid to go to court in this area.

So, if you are concerned about Div 7A in any way, talk to us.

*Be assured, if you were a party to this type of arrangement, we are looking at it closely and waiting to see how, exactly, the government may respond to it.

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