

Of the billionaires I have known, money just brings out the basic traits in them. If they were jerks before they had money, they are simply jerks with a billion dollars.

----- Warren Buffett

Division 7A Loans

1. What is the aim of Division 7A and why is it needed?

Division 7A of Part III of the ITAA 1936 is an integrity measure to ensure that private companies can no longer make tax free distributions of profits to shareholders or shareholders' associates in the form of payments, loans and debts forgiven.

2. How does Division 7A work?

Division 7A treats three kinds of amounts as dividends paid by a private company:

- amounts paid by the company to a shareholder or shareholder's associate (section 109C)
- amounts lent by the company to a shareholder or shareholder's associate (sections 109D and 109E), and
- amounts of debts owed by a shareholder or shareholder's associate to the company that the company forgives (section 109F).

Treatment of the amounts as dividends makes the amounts assessable income of the shareholder or shareholder's associate (section 44).

Amounts treated as dividends under Division 7A are generally not frankable, even though they are taken to be paid out of the private company's profits.

Division 7A also contains provisions (subdivision EA) which are designed to ensure that a trustee cannot shelter trust income at the prevailing company tax rate by creating a present

entitlement to a private company without paying it and then distributing the underlying cash to a shareholder (or their associate) of the company. These provisions apply to certain trustee payments, loans and debt forgiveness made in favour of a shareholder (or shareholders associate) of a private company with an unpaid present entitlement from the trust.

3. What were the June 2007 amendments to Division 7A?

Where a deemed dividend arises under Division 7A, the private company's franking account will not be debited.

A 'payment' can be converted to a loan that can be either fully repaid before the private company's lodgment day for the year of income or be placed on a qualifying commercial footing meeting the terms of section 109N of Division 7A.

Where minimum yearly repayments under a loan fall short of the required amount by the due date, the amount of the deemed dividend that arises is the amount of the shortfall in the income year.

4. What is the effect on the private company's franking account if the company is taken to pay a dividend at the end of an income year?

In general, amounts treated as dividends under Division 7A are not frankable, even though they are taken to be paid out of the private company's profits. Generally where amounts are treated as deemed dividends, a private company cannot allocate a franking credit to the dividend and you are not entitled to a tax offset in relation to the dividend.

5. What if the loan made during an income year is fully repaid before the lodgment day?

Generally Division 7A has no application for:

- private company loans made in the 2004-05 year of income or a later year of income, or
- trustee loans made on or after 12 December 2002.

The 'lodgment day' is the earlier of the due date for lodgment and the date of the lodgment of the lender's tax return for the year of income. The 'lender' is the private company or trustee that made the loan that is subject to Division 7A.

6. What criteria must a loan meet so as not to be treated as a dividend in the year it is made?

Loans that meet all the following criteria will not be treated as dividends in the year the loan is made.

- The loan is put under a written agreement. The written agreement must be in place:
- The rate of interest payable on the loan in the income years after the year the loan is made equals or exceeds the Indicator Lending Rates - Bank variable housing loans interest rate last published by the Reserve Bank of Australia before the start of the private company's or trustee's income year.
- The term of the loan does not exceed the maximum term prescribed by the legislation for that kind of loan (see below).