



Recent changes to shareholder loans and payments for private companies

If you are a business owner operating under a private company structure, we would like you to be aware of recent tax law changes.

The income tax law provides that certain payments and loans made to shareholders or their associates and debts owed by them which are forgiven by private companies may be deemed as unfranked dividend income for taxation purposes unless they come within specified exclusions.

The relevant provisions are contained in Division 7A of the *Income Tax Assessment Act (ITAA) 1936*. Division 7A is an integrity measure aimed at preventing private companies from making tax-free distributions of profits to shareholders or their associates.

The recent changes to Division 7A generally apply from 1 July 2006. Under the changes, a company's franking account is no longer automatically debited when a deemed dividend arises. This means the consequences of having an amount treated as unfranked dividend income are less severe.

The changes also provide more flexibility for taxpayers and reduce the extent to which they may be inadvertently caught by the provisions. For example under the changes:

- Division 7A will not apply to deem a taxable amount where a payment has either been converted to a loan that will be fully repaid, or has been placed on a commercial footing with a qualifying loan agreement before the private company's tax return lodgment day for the relevant income year;
- where minimum yearly repayments fall short of the required amount by their due date, the amount of the deemed dividend that arises is limited to that shortfall amount in an income year rather than the whole balance of the outstanding loan;
- certain loans can now be refinanced without triggering a deemed dividend;
- a private company may frank a deemed dividend that arises because of a family law obligation, i.e. because of marriage or relationship breakdowns. Franking can apply in the same circumstances as capital gains tax rollover relief applies to spouses;
- compliant loans made to a shareholder who is also an employee are exempt from fringe benefits tax;
- loans involving interposed entities will not be treated as a deemed dividend where a complying loan agreement is in place between the interposed entity and the shareholder or shareholder's associate. The agreement will be treated as a complying loan agreement between the private company and the shareholder or associate; and,
- where a shareholder or shareholder's associate defaults on a loan guaranteed by the private company, a deemed dividend will not arise if the shareholder or associate enters into a loan with the company that meets the requirements of a complying loan.

Section 108 of the *ITAA 1936*, the predecessor to Division 7A which had some continuing operation, has also now been fully repealed.



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INFORMATION

Commissioner's New Discretions

The Commissioner is also now able to extend the period for making minimum yearly repayments where the repayments have not been made due to circumstances beyond the taxpayer's control.

The changes also provide the Commissioner with a discretion to disregard a deemed dividend or allow it to be franked where it arises from an honest mistake or inadvertent omission. This discretion is retrospective and applies to the 2001-02 and later income years.

In deciding whether to exercise this discretion, the Commissioner must consider a range of factors including the circumstances that lead to the deemed dividend, whether any corrective action has been taken and whether there is a history of breaches of the relevant provision.

In addition, the Tax Office is giving business owners a one-off opportunity to self correct past mistakes regarding payments and loans from their private companies by 30 June 2008 and avoid penalties under Division 7A. Your tax advisor will be able to help you with this.

The offer applies to mistakes made in respect of the 2001-02 to 2006-07 income years inclusive. The Tax Office has issued [Practice Statement PS LA 2007/20](#) along with a number of fact sheets to assist people taking corrective action to fix these mistakes.

To read the Practice Statements and fact sheets, please visit the Tax Office website at <http://www.ato.gov.au/businesses> and select 'Investment'.