DIVISION 7A LOAN

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MEANING OF "DIVISION 7A LOAN"

Division 7A Loan means any advances, provisions of credits, transactions in any other form, or loans given by the company to shareholders, directors, associates, or affiliates companies and trusts.

- If private company makes one or more loan to a shareholder or their associate within the financial year, it may be combined.
- If a loan is issued in the form of a promissory note, it is a kind of credit or financial accommodation, and Division 7A may apply.
- If a private company beneficiary gives financial accommodation to the trustee of a trust in respect of an unpaid present entitlement, it will be considered a loan to the trustee of the trust for Division 7A purposes.

HISTORY OF DIVISION 7A

- First introduced on 4 December 1997, Division 7A would automatically deem certain payments/benefits provided by a private company to be an unfranked dividend, assessable to the shareholder or associate.

- On 12 December 2002, Division 7A was expanded to transactions between trusts and companies, where the company became presently entitled to income of the trust, which would not be paid and the cash would be distributed to shareholders/associates.

- On 1 July 2009, the Division 7A rules were extended to arrangements where interposed entities are used between trusts and shareholders/associates.

- In October 2018, Treasury released a consultation paper "Targeted amendments to the Division 7A integrity rules", in which Treasury proposed radical changes to the Division 7A regime as we understand it today. At the time, it was a hotly contested area amongst accountants and advisors, with no clear certainty on when further consultation would take place. But then the focus shifted to the 2019 Federal Election, then COVID-19, and here we are just before another Federal Election still dealing with the existing law, rather than the recommended changes.

PRIVATE COMPANY BENEFITS – DIVISION 7A DIVIDENDS

- A payment or other benefit provided by a private company to a shareholder, or their associate can be treated as a dividend for income tax purposes under Division 7A even if the participants treat it as some other form of transaction such as a loan, advance, gift or writing off a debt.

- Division 7A can also apply when a private company provides a payment or benefit to a shareholder or associate through another entity, or if a trust has allocated income to a private company but has not actually paid it, and the trust has provided a payment or benefit to the company's shareholder or their associate.

- A Division 7A deemed dividend is generally unfranked. Given this, the most effective way to provide a payment or other benefit to a shareholder or their associate is to pay it as a normal dividend (with a franking credit if available) and for the shareholder to include it in their assessable income.

- Division 7A doesn't apply to amounts that are assessable to the shareholder or their associate under other parts of the income tax law, such as normal dividends or director's fees.

ENTITIES AND TAXPAYERS AFFECTED

i. **Private companies:**

Division 7A applies to payments and other benefits by private companies including:

- *Non-Resident Private Companies*: The payment or other benefit does not need to be provided by a private company that is a resident or has any connection with Australia.
- *closely held corporate limited partnerships*: Partner or associates receive payments or benefits.

ii. **Shareholders and their associates:**

- Division 7A applies to payments or other benefits provided by a private company to shareholders or associates of the shareholders.
- Payments or loans to shareholders or their associates that are companies are not treated as Division 7A dividends except where the company shareholder or associate is trustee of a trust.
- Associate
  - Individual Shareholder
  - Company Shareholder,

ENTITIES AND TAXPAYERS AFFECTED

- Trustee shareholder
- partnership shareholder,

iii. Trusts

Division 7A applies to certain payments or other benefits provided by a trust to shareholders or their associates where the private company has an unpaid present entitlement (UPE) to the profits of the trust.

iv. Interposed entities

- An amount may be treated as a division 7A dividend even if it's paid or lent by the private company to the shareholder or their associate through one or more other entities.
- Payments or loans may be treated as Division 7A dividends where they are made on the understanding that the interposed entity, or a further interposed entity, will pay or lend an amount to the shareholder or their associate.

TAX TREATMENT OF DIVISION 7A DIVIDENDS

- Payments or benefits treated as dividends under Division 7A can be assessable income of the shareholder or their associate in the form of unfranked dividends.

- Division 7A dividends are generally not frankable even though they are taken to have been paid out of the company's profits. This means that the company can't attach a franking credit to the dividend, and the payment has no impact on the company's franking account.

- However:
  - a dividend that is taken to have been paid because of a family law obligation is frankable
  - if the Division 7A dividend arises because of an honest mistake or inadvertent omission, you can apply to allow it to be franked (see ATO relief).

- If the dividend is franked, a dividend statement indicating the value of the dividend and the amount of franking credit must be provided by the private company. A payment or benefit treated as a division 7A dividend is taken to have been paid as a dividend at the end of the income year in which it was provided.

COMPLYING LOAN

When a loan meets certain requirements, it is considered a 'complying loan'. Additionally, payments made by a private company can be converted into a 'complying loan'.

A loan that is on a complying agreement will not be considered a Division 7A dividend.

Criteria of a complying loan agreement:

To qualify for a 'complying loan', a loan must satisfy three criteria.

i. **Minimum interest rate**
   The interest rate for each loan year must at least equal the Division 7A – benchmark interest rate. The benchmark interest rates are updated annually.
   - Benchmark Interest Rate for FY2021-22 – 4.52%
   - Benchmark Interest Rate for FY2022-23 – 4.77%
   - Benchmark Interest Rate for FY2023-24 – 8.27%

ii. **Maximum term**
   The term of the loan must not exceed the following:

COMPLYING LOAN

- 25 years for a mortgage loan against real estate with the following conditions :
  - the entire loan must be secured by a registered mortgage over the property .
  - when the loan is first made, and the market value of the property (less liabilities secured over the property in priority to the loan) must be at least 110% of the loan amount.
- Any other loan has a term of 7 years.

iii. Written agreements

Before the private company's lodgment date for the income year in which the loan amount was given to the shareholder or associate, a written agreement must be in existence.

There is no standard format for the written agreement. However, at the very least, the agreement should:

- Identify the parties,
- put out the essential terms of the loan, such as the amount and period of the loan, the necessity to repay, and the interest rate payable, and
- have the parties sign and date it.

REFINANCING LOAN

Certain loans can be refinanced without resulting in a deemed dividend.

- The term of an unsecured loan that is converted to a loan secured by a registered mortgage over real property might be longer. The maximum loan length is 25 years less the portion of the term that has already expired when the loan was unsecured.

- A secured loan may be converted to an unsecured loan, however, the loan duration will be reduced accordingly. If the remaining term on the secured loan at the time of conversion was 18 years or less, the maximum length of the unsecured loan is 7 years.

- If the secured loan has been in place for more than 18 years, the maximum length of the unsecured loan will be adjusted so that the overall term of the loan (both secured and unsecured) is no more than 25 years. That is, subtract 7 years from the difference between:
  - The period commencing when the loan was made and ending when the loan was converted
  - 18 years

AMALGAMATED LOAN

- When a private firm provides one or more loans to a specific shareholder or partner within the fiscal year, each loan:
  - is not repaid by the company's due date
  - would be treated as a dividend, except it's under a complying loan agreement
  - has the same maximum term.

- Each Individual loans are referred to as 'constituent loans'. The sum of the constituent loans that have not been repaid before the lodgment day for the year of income in which the amalgamated loan is made is the amount of the amalgamated loan.

- At any given time, a private corporation may have multiple combined loans to a shareholder or their associate. Where applicable constituent loans have been made across a number of income years, this will occur.

- Private enterprises that have more than one aggregated loan must keep records for each loan

MINIMUM YEARLY REPAYMENT

The minimum yearly repayment must be calculated for each income year after the year in which the loan is made.

- If a private company has more than one amalgamated loan, each one is considered separately. The loans cannot be combined in order to calculate minimum yearly repayments. Each amalgamated loan requires a minimum yearly repayment.

- Minimum repayment can be calculated using ATO Calculator

  - https://www.ato.gov.au/Calculators-and-tools/Host/?anchor=DIV7A#DIV7A/questions

DISTRIBUTABLE SURPLUS

The total of all deemed dividends that a private company is taken to pay under Division 7A is limited to its distributable surplus for that income year. The amount of a private company's distributable surplus for its income year is calculated according to the distributable surplus formula.

Net assets
(+) Division 7A loan amount
(-) Non-commercial Loans
(-) Paid up share value
(-) Repayments of non-commercial loans

THANK YOU