## Taxation of loan accounts - changes on the horizon

**By Fordham** 4 December 2018



As noted in Fordham's 2018 Federal Budget Tax Alert, the Federal Government is proposing to make changes to Division 7A of the Tax Act. For some businesses, the changes may have a future detrimental effect on cash flow.

Division 7A is a tax integrity measure that many private business owners need to navigate on an annual basis.

The integrity measure, in its original form, was relatively easy to understand. Broadly, where a company made a loan to a shareholder, the amount of the loan could be deemed to be an unfranked dividend unless the taxpayer prepared formal loan documentation and made periodic interest and principal repayments. Unfortunately for taxpayers, the rules and associated ATO guidelines have grown into a complex regime that requires careful thought and analysis to avoid an inadvertent substantial tax liability being triggered.

Several years ago, the Board of Taxation was engaged to review the Division. This subsequent review recommended changes be made. As a result, the government announced that changes would apply from 1 July 2019.

In late October 2018, a Consultation Paper was released by Federal Treasury seeking feedback by 21 November 2018. The professional tax bodies have provided various feedback for Treasury to consider. The changes are yet to be finalised and legislated.

The proposed changes, if legislated, will require taxpayers to give careful thought to the ramifications, particularly from a cash flow perspective.

For those interested in the finer detail, Treasury's consultation paper can be found at <u>https://treasury.gov.au/</u>. Some changes proposed in this paper include:-

– In relation to relevant loans made after 1 July 2019, the adoption of a 10 year loan model at a higher RBA overdraft interest rate (which is currently 8.3%). Principal would be re-paid in a series of equal annual payments over the term of the loan. Interest would be calculated on the opening balance each year. Interest would be calculated for the full year, regardless of when the repayment is made (except year 1).

- Current 7 year unsecured loans would maintain their current outstanding term but need to adopt the new loan re-payment model and higher RBA overdraft interest rate from 1 July 2019.

– It would appear that existing 25 year secured loans would need be changed to a 10 year loan prior to lodgement date of the 2021 company tax return. The first re-payment under the new loan term would be in the 2022 tax year. However, the new, higher RBA overdraft interest rate would be adopted from 1 July 2019.

- Significantly, any previously quarantined Pre 4 December 1997 loans would treated as financial accommodation from 30 June 2021 requiring full repayment under a 10 year loan agreement. The first re-payment would be due in the 2022 tax year.
- All Post 16 December 2009 Unpaid Present Entitlements (UPEs) arising before 1 July 2019 that have not been placed on complying loan agreement would need to be put on complying terms by the end of the 2020 tax year. The first re-payment of these loans would be due in the 2020 year.
- UPEs arising after 30 June 2019 would need to meet the new 10 year loan model.
- There is uncertainty in relation to the proposed treatment of pre 16 December 2009 UPEs.

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- The distributable surplus rule which currently limits the amount of any loan or UPE deemed dividend implications would be removed.
- The ATOs amendment review period would be extended from 4 years to 14 years after the tax year which triggers the deemed dividend.
- Various other matters including a proposed taxpayer self-correction mechanism for errors and safe harbour rules for private use of assets held by a corporate entity.

Fordham will provide an update should the changes become law and of course will seek to provide tailored advice to clients given the significance of Division 7A to Private Business.

If you have any queries or would like to discuss further please do not hesitate to contact your <u>Fordham Partner.</u>

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