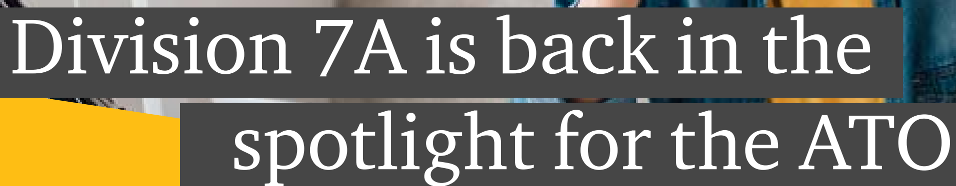


Have you considered whether Division 7A applies to loans, payments or use of assets by shareholders and their associated from a private company? Are appropriate documentation in place to mitigate Division 7A risks?

Division 7A is back in the spotlight for the ATO with changes to the treatment of unpaid present entitlements arising from 1 July 2022 and a renewed focus on compliance with documentation requirements.

What is Division 7A?

Broadly, Division 7A of the *Income Tax Assessment Act 1936* is a specific anti-avoidance measure designed to prevent private companies from making tax-free distributions of profits to shareholders or their associates in the form of payments, loans or debts that are forgiven. The rules extend to include arrangements where shareholders or their associates have received financial benefits via interposed entities, such as trusts.

What are the implications of Division 7A?

Where a private company makes a loan, or payment to a shareholder or an associate of the shareholder, Division 7A may apply to treat the payment, loan or forgiven debt by the company as an unfranked dividend in the hands of the shareholder. This can result in individual shareholders paying top-up tax of up to 47%.

However, Division 7A should not apply in certain circumstances. For example, where the loan is fully repaid by the lodgement due date of the company's tax return, or a complying Division 7A loan agreement is put in place.

A complying Division 7A arrangement:

- must be in writing;
- the interest rate must be at least equal to the ATO benchmark interest rate (8.77% for the income year ending 30 June 2025); and
- the loan term cannot be more than 7 years (or 25 years where the loan is secured over property)

Common examples where Division 7A applies

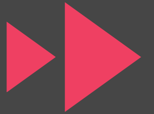
- A company pays for personal expenses (e.g. school fees, mortgage repayments, luxury car lease repayments, credit card bills) on behalf of the shareholders.
- A company owns assets (e.g. real estate, motor vehicles, a boat) that is at least partly used by the company's shareholders. This includes where the asset is made available for use, even if not used (e.g. keys are stored at shareholders' home).
- A company has lent funds to a trust which in turn lends them to an individual.

With Division 7A introduced almost 30 years ago, there is reduced leniency by the Commissioner of Taxation to apply discretion to disregard the unfranked dividend, or allow the deemed dividend to be franked.

Therefore, it is imperative for private companies to proactively manage Division 7A risks.

Wherever you are on your business journey, we can help you. To find out more, visit our **Private Business Life Cycle hub**.

For a more detailed discussion, please get in touch with your PwC advisor or contact:



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