



ENews

SPOTLIGHT - SHAREHOLDER LOANS

A few years ago you borrowed some money from the family company. The following year, you also paid some personal expenses through the company. You were not unduly concerned at the time when all this showed up on the company's balance sheet as a loan to you as a shareholder. Sound familiar?

There is a nasty sting in the tail here. You may find yourself in receipt of a deemed dividend (unfranked and fully taxable) unless you

- fully repaid the loan by the lodgment day of your company's tax return for the year in which the loan arises; or
- repay the loan on commercial terms where the loan is for more than a tax year.

The above example is one of the situations where a deemed dividend may crop up under what are known as the Division 7A rules. These rules try to prevent private companies from making tax-free distributions disguised as loans, expense payments or forgiven debt.

One of the biggest problems with these rules is that many taxpayers are unaware they have fallen foul of them. However, there is potential relief at hand.

The Commissioner of Taxation now has a new discretion to provide relief if you are in receipt of a Division 7A deemed dividend as a result of an honest mistake or an inadvertent omission. He can exercise this discretion going back to (and including) the 2001-02 income year.

Commissioner exercises his discretion

The good news is the Commissioner has decided to exercise his new discretion. The ATO announced recently that it will disregard a deemed dividend under the Division 7A rules where:

- you take "corrective action" in cases of honest mistakes or inadvertent omissions by 30 June 2008;
- the relevant transaction or event that caused the Division 7A dividend to arise occurred from (and including) the 2001-02 income year, up to (and including) the 2006-07; and
- all the required income tax returns for the periods concerned have been lodged if necessary.

A NOTE OF CAUTION

The ATO may not share your view about what constitutes an "honest mistake or inadvertent omission". Exercise care in assessing whether you may be able to rely on this concession!

At the risk of oversimplifying the corrective action you may need to take, according to the ATO this will typically involve:

- you entering into a loan agreement with the company;
- you paying any principal and interest that may have accrued so far over the term of loan; and
- the company including these payments in its 2007 company return.

TIP

As there are a number of potential Division 7A problem situations that may come within this discretion, it's best to get advice now about whether you may have a problem in the first place and whether you may be entitled to take advantage of the ATO's offer.

It's also worth noting that a number of other welcome changes have been made to the Division 7A rules (e.g., your company's franking account will no longer be debited when a deemed dividend arises under Division 7A - this results in an overall reduction of potential penalties).