DLK ADVISORY

DEEMED DIVIDEND RULES: NEW 10-YEAR LOAN MODEL

The government is simplifying the Division 7A rules that govern deemed dividends, proposing a new 10-year loan model for compliant loans to start 1 July 2019. Significantly, companies with existing loans would be forced to transition to the new model, which also includes a considerably higher benchmark interest rate.

Division 7A is a long-standing tax integrity measure that treats certain payments by private companies to shareholders or their associates as unfranked "dividends" for tax purposes. Those deemed dividends then form part of the recipient's assessable income and are taxed at the marginal tax rate.

Currently, there is an exception to these rules: payment is not treated as a dividend if it is converted into a loan that meets certain requirements, including a maximum loan term of either 25 years for a loan secured by a registered mortgage over real estate, or seven years in any other case.

To simplify the rules for Division 7A-compliant loans, the draft laws propose that the qualifying maximum loan term should now be 10 years, regardless of whether the loan is secured. They also state that a higher benchmark interest should apply and that annual repayments should include both principal and interest.

In addition, the government proposes interim rules to help companies with existing loans transition to the new 10-year model. Significantly, all existing seven/25-year loans in place at 30 June 2019 would need to adopt the new, higher benchmark interest rate after that date and existing 25-year loans would need to convert to a 10-year term prior to the lodgment day of the company's 2020-2021 tax return.

The proposals have attracted criticism that a 10-year loan model and higher interest rate would create cashflow problems for those who rely on their corporate structures to access funds. Outstanding loans that are not converted to meet the new requirements would give rise to a deemed dividend. Taxpayers in this situation will therefore need to decide whether to convert or pay out the loan by the deadline.

While these proposals are not yet final and some aspects may change before the planned 1 July 2019 start date, the government has signalled a clear intention to cut the maximum term of compliant loans and introduce a higher benchmark interest rate.

Talk to us today about identifying possible consequences for your structures and to discuss strategies for managing future cashflow or restructuring.

CONTACT

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