
DIVISION 7A AND FINANCIAL ACCOMMODATION



The operation of the existing Div7A

The ATO has recently released a significant draft ruling around Div 7A, which operates to ensure that private companies cannot make tax-free distributions of profits to shareholders or their associates in the form of payments, loans, or forgiven debts.

Generally, a private company is taken to have paid an unfranked dividend in the income year if a loan made to a shareholder/associate is not fully repaid before lodgement day. Within private groups, a common practice is for trustees to appoint trust income to a related private company (ie a private company beneficiary). The appointed trust income is then included in the profits of the corporate beneficiary and the company is assessed on its share of the trust net income.

However, in some cases, while a private company beneficiary is made presently entitled to income of the trust, that entitlement remains unpaid (ie unpaid present entitlement – UPE), or the trustee will set aside the entitlement amount into a separate sub-trust for the exclusive benefit of the private beneficiary.

In its previous substantive ruling on Div 7A and trust entitlements, the ATO took the position that a loan was taken to have been made on any UPEs not called for by a corporate beneficiary unless the funds were held on sub-trust for the beneficiary's sole benefit. This, it argued is because a Div 7A loan includes the provision of credit or any other form of "financial accommodation" which includes the supply or grant of some form of pecuniary assistance or favour.

The operation of the new draft ruling

The new draft ruling outlines the circumstances in which “financial accommodation” applies and differs from the views of the ATO in its previous substantive ruling. Specifically, the new ruling states that the phrase “financial accommodation” has a wide meaning and extends to cases where an entity with a trust entitlement has knowledge of an amount that it can demand and does not call for the payment.

For example, “financial accommodation” is said to occur where a private company beneficiary with a UPE, by arrangement, understanding or acquiescence, consents to the trustee retaining an amount to continue using it for trust purposes (i.e. the company has knowledge of the amount that it can demand immediate payment from the trustee and does not demand the payment).

In that instance, the private company beneficiary is taken to have made a loan to the trustee under the extended definition of loan in Div 7A. Where a private company beneficiary and the trustee have the same directing mind and will, the private company beneficiary will be taken to have knowledge of the amount that it can demand immediate payment of from the trustee. Therefore, if no payment is demanded, “financial accommodation” will be taken to have occurred.

The new draft ruling also covers instances where a trustee sets aside an amount from the main trust and holds it on sub-trust for the exclusive benefit of the private company beneficiary. When the amount is set aside, the trustee’s obligation in respect of the entitlement to distributed income comes to an end and a new obligation arises for the sub-trustee under a separate trust.

In that scenario, a choice by a private company beneficiary not to exercise a right to call for the sub-trust to end does not constitute “financial accommodation” in favour of the trustee. However, “financial accommodation” is said to have been provided and thus a Div 7A loan occurs when the private company beneficiary has knowledge of the use of an amount of the sub-trust fund and does not call for payment of that part of the sub-trust fund by the private company beneficiary’s shareholder or their associate.

Again, if the private company beneficiary and the trustee has the same directing mind and will, the private company beneficiary is taken to have knowledge of the use of the sub-trust fund when the trustee does.

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