

ATO debunks Division 7A myths

Myth 1: The tax consequences are the same if I operate my business as a sole trader, partnership, trust or private company.

ATO response: Each type of business structure comes with its own set of rules and key tax obligations. If the business is run through a private company, Division 7A may apply to payments and other benefits provided by the company to its shareholders and their associates.

Myth 2: If I own a company, I can use the company money any way I like.

ATO response: A company is a separate legal entity. It is separate to the taxpayer, even if they are a shareholder or a director or both. This means the company's money is not the taxpayer's money, and there will be consequences every time the taxpayer takes money or accesses other benefits from their private company.

Taxpayers can access private company money in the form of salary and wages, directors fees or dividends. All of these amounts will be included in the recipient's assessable income. Private companies may also provide fringe benefits to its employees, including directors.

Division 7A may apply to the private use of assets or money from a private company in a way not described, for example as **payments** by private companies (including **use of assets**), **loans** by private companies, or **debt forgiveness** by private companies.

Myth 3: Division 7A only applies to the shareholders of my private company.

ATO response: Division 7A applies to both shareholders **and** associates of shareholders. The definition of an 'associate' is broad and depends on what type of entity the shareholder is. For example, for individual shareholders, an associate can include their relatives, spouse, children, a company they control (or their associate controls) or a trustee of a trust that they (or their associate) can benefit from.

Myth 4: I don't need to keep records when my private company makes payments, loans, or provides other benefits to other entities.

ATO response: Taxpayers are legally required to keep records of all transactions relating to their tax affairs when they are running a business. They should adopt good record-keeping practices to ensure they identify and account for all payments, loans and other benefits correctly. Failure to do so can result in unintended consequences, including breaching Division 7A.

Myth 5: I can record a dividend in a journal entry, after an income year has ended, and use that to effectively offset my minimum yearly repayment obligation for that income year.

ATO response: A journal entry, without other supporting evidence and contemporaneous action, will not be effective to offset a minimum yearly repayment obligation on a complying loan. The dividend and minimum yearly repayment obligations must exist at the time of the offset, and the borrower and the company must have agreed to the offsets. The agreement and offsets must be made by the end of the income year, usually 30 June.

Myth 6: There are no tax consequences if I use my private company's money to fund another business or income earning activity.

ATO response: Division 7A may apply to any loan a private company makes (directly or indirectly) to its shareholders or their associates. Division 7A may apply **regardless** of what the loan recipient uses the amounts for, including for any taxable purpose. Division 7A may apply where a shareholder or their associate uses a private company's assets for private purposes.

Myth 7: I can avoid Division 7A by making payments or loans to shareholders and their associates through other entities.

ATO response: Division 7A may apply to payments or loans made from a private company through other entities, where the private company's shareholder or their associate is the target entity to whom the payment or loan is ultimately directed. The other entities involved in this type of arrangement are called 'interposed entities'. For Division 7A purposes, an interposed entity can be an individual, company, partnership or trust.

Myth 8: Division 7A won't apply to payments or loans my private company makes to trusts.

ATO response: Division 7A may apply to payments or loans made from private companies to trusts, and may also apply to trust entitlements of private company beneficiaries.

Myth 9: The interest rate I use to calculate my minimum yearly repayment on my complying Division 7A loan is the same every year.

ATO response: Taxpayers need to calculate their minimum yearly repayment for each income year using the benchmark interest rate for that particular income year. The benchmark interest rate generally changes each year.

Myth 10: I can avoid Division 7A by temporarily repaying my loan before the private company's lodgment day, or using the company's money to make my repayments.

ATO response: A repayment that is made on a loan by a private company may not be taken into account if similar or larger amounts are reborrowed from the company after making the repayment, or money borrowed from the company is used to make the repayment.