TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

The following information is only of a general nature and should not be taken as professional advice.

152 | DIV 7A Reform

What will the upcoming Div 7A reform look like?

Div 7A Reform

There are two recent developments in the consorted effort to bring a Div 7A reform to life.

The first one is the Board of Taxation's review of Div 7A. The second one is Treasury' discussion paper issued in late 2018 in response to the Board of Taxation's review. And it is this response by Treasury that Andrew Henshaw of Velocity Legal in Sydney will focus on today.

In these shownotes here we list what we learned from this interview. But please listen to the episode itself since Andrew Henshaw explains the current status of the Div 7A reform much better than we ever could.

To listen while you drive, walk or work, just listen through a podcast app on your mobile phone.

Why a Div 7A Reform?

Why do we need a Div 7A reform? What pain points is the DIV 7A reform trying to address? What isn't working that needs fixing ?

Is it a) the extent and amount of pre-97 loans that are still sitting around, or b) the hassle of constantly having to do s109N loan agreements or is it c) that the ATO's position on UPEs is treading on thin ice?

It is probably d) as in 'all of the above'. Div 7A has become a 'Game of Loans'.

History

Division 7A has seen a raft of changes since its introduction on 4 December 1997. Here is a timeline.

Subdivision EA came in on 12 December 2002, followed by Subdivision EB with effect from 1 July 2009.

And then the big one was TR 2010/3 that was first published as Draft TR 2009/D8, effective from 16 December 2009. With this ruling most UPE's become 'financial accommodation', thus caught by Division 7A.

Work on the big Div 7A reform started with the government announcing on 18 May 2012 that the Board of Taxation (Board) would undertake a post-implementation review of Division 7A. Two-and-a-half years later the Board provided their final report to the government on 12 November 2014.

On 3 May 2016 in its 2016/17 Federal Budget, the Government agreed to implement recommendations. Implementation of the Div 7A reform was to commence on 1 July 2018.

But then the government moved the starting date to 1 July 2019 in its 2018/19 Federal Budget on 8 May 2018.

On 22 October 2018, the Government released its discussion paper on the ‘targeted amendments’ to improve the integrity and operation of Division 7A for public consultation. The proposed changes to take effect was still 1 July 2019 at that stage.

But on 2 April 2019 as part of its 2019/20 Federal Budget, the Government postponed the proposed amendments to 1 July 2020. And promised further consultations.

Targeted Amendments

Here is an overview of what Div 7A currently looks like. What the Board of Taxation suggested. And what ‘targeted amendments’ do Div 7A the Treasury Consultation Paper picks up.

Loan term

This is currently 7 year unsecured and 25 year secured. Both the Board review and the Treasury paper propose to change to 10-year maximum loan terms.

Interest Rate

This is currently a 5.2% rate set by the Reserve Bank of Australia (RBA) and calculated on the existing balance of the loan. The Board suggested a 8.3% rate set by the RBA and calculated on the existing balance of the loan. Treasury’s discussion paper also suggests a 8.3% rate set by RBA, but calculated on the opening balance of the loan and incurred for a full income year, regardless of when repayment occurs during that income year

Pre-1997 Loans

Pre-1997 loans are currently exempt from Division 7A if terms or amounts have not been varied. The Board recommended to transition all pre-1997 Loans to new 10-year loans. Treasury suggests that all pre-CGT loans must be put on complying 10-year loan agreement terms by 30 June 2021 to be repaid with an increased benchmark interest rate.

Existing Seven Year-Loans

The Board suggested that the current term is extended to the new maximum of 10 years. Treasury on the other hand suggests that the existing terms continue to apply, but the new benchmark interest rate will apply

Existing 25-Year Loans

The Board suggested that the current terms are grandfathered, i.e. repayable in accordance with existing terms. Treasury on the other hand suggests to exempt these from changes until 30 June 2021. From 1 July 2021, any existing 25-year loans will then need to be put on a complying 10-year loan agreement terms

Pre-2009 UPEs

The current Div 7A has a quarantine on re-2009 UPEs. The Board suggested to no longer quarantin these but to bring them within the scope of Division 7A and require these to be put on complying 10-year loan agreement. Treasury didn’t pick this up but continues to quarantine pre-2009 UPEs.

Review Period

At the moment the usual review periods apply, so generally four years, unless the Commissioner alleges fraud or evasion. The Board of Taxation didn’t touch this point in their review. Treasury on the other hand intends to extend the period of review to 14 years after the end of the income year in which the loan or payment gave rise to a deemed dividend.

Distributable Surplus

Currently a company must have a distributable surplus for a deemed dividend to arise. So the current Div 7A limits deemed dividends to the amount of distributable surplus in the year the deemed dividend arises.

The Board suggested to retain the distributable surplus concept. Treasury on the other hand intends to remove the concept of a distributable surplus. So a loan from a company with no 'distributable surplus' (aka profits) would still be subject to Division 7A.

Tick the Box

The Board suggested to offer trusts a once-and-for-all election to exclude UPE's to companies from being subject to Division 7A if the Trust makes an election to forgo the CGT discount all CGT assets (other than goodwill). Treasury did not mention this proposal in their discussion paper.

MORE

Div 7A UPE Issue

Div 7A Fixes

Div 7A Listener Questions

Disclaimer*: Tax Talks does not provide financial or tax advice. All information on Tax Talks is of a general nature only and might no longer be up to date or correct. You should seek professional accredited tax and financial advice when considering whether the information is suitable to your or your client's circumstances.*