TAX TALKS

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260 | Div 7A Dividends

Div 7A dividends allow you to make a Div 7A loan repayment through journal entry without moving any cash.

Div 7A Dividends

It is common to declare a dividend and then use this dividend to make a minimum Div 7A loan repayment. All this happens through a journal entry reducing retained earnings as well as the Div 7A loan balance.

But just because this is a common practice doesn't mean it is always compliant with the law.

So the question is when is or isn't it and why. How can a shareholder legally make a Div 7A payment through a declared dividend?

You find the answer in this episode with Robyn Jacobson of The Tax Institute. Here is what we learned from this interview and also from an article Robyn wrote for Accountants Daily in January 2020.

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Div 7A Dividends

In theory there is nothing wrong in using a dividend to make Div 7A loan repayments. And there is nothing wrong with using a journal entry rather than a cash payment. The problem is timing.

Timing

A dividend by journal entry is subject to the same rules as any cash dividend. And those rules – *Corporations Act, Income Tax Assessment Act 1997* and *Tax Agent Services Act 2009* – stipulate that a dividend can only be paid out – be it in cash or by a journal entry – after it has been duly declared.

And so to recognise a dividend by 30 June, the company's directors must meet and have duly declared the dividend by 30 June, documented in the resolution or minutes of the meeting.

The resolution or minutes must then be filed in the corporate register within one month of the meeting, so by 31 July.

And the company must give a distribution statement to the shareholder within four months of year-end, so by 31 October.

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The problem is that all these deadlines have long passed before accountants finally sit down to prepare the accounts for the past financial year and start thinking about dividends to pay the Div 7A loan.

The journal entry to record the payment of the dividend can be dated when it is posted. That is not the problem. The problem is that there is no dividend declared as of 30 June to record.

Journal Entry

A journal entry is only a record of a transaction that has already occurred, it is never the transaction itself.

The journal entry only amounts to a payment where the principle of mutual set-off applies. So you need an obligation on both sides.

You have the obligation to make the minimum yearly Div 7A payment. But there is no obligation on the other side, since no dividend had actually been declared by 30 June.

So you can’t do an offset. You have a Div 7A shortfall and hence a deemed unfranked dividend.

Deemed Dividend

With no dividends declared by 30 June, there is no dividend to make Div 7A loan payments. So unless the shareholder actually paid Div 7A loan repayments in cash, there is no loan repayment.

Without a loan repayment the shareholder is considered to have received a deemed dividend in the amount of the outstanding loan repayment. The dividend is unfranked.

The deemed unfranked dividend goes into the shareholder’s assessable income and triggers an additional tax liability with no franking credits softening the blow. Ouch.

Backdating

So what do most accountants do to solve this problem and avoid a deemed dividend? They backdate.

They backdate the relevant director minutes or resolution as well as the registration in the company register and the distribution statement. Or they don’t prepare any dividend documentation at all. No minutes or resolution, no company register and no distribution statement.

The problem is that backdating is fraud. And fraud means a breach of s30-10 of the *Tax Agent Services Act 2009.* And not preparing any dividend documentation is a breach of the Corporations Act.

Triangle Set Up

You often have a triangle set up involving a company and a separate trust with a shareholder in between. So the company gives a Div 7A loan to the trust, distributes dividends to the shareholder who then contributes these funds as a capital contribution into the trust.

This can easily result in a s109T issue because there is no mutual obligation. You need a mutual obligation to offset one obligation with the other. And the trust has an obligation to the company. But the company has no obligation towards the trust. Hence you got no mutual obligation that would allow an offset. But without an offset you have no repayment, and hence an issue.

How to avoid this issue, we will discuss more in the next episode, ep 261.

Forecast

It might feel daunting to pay a dividend before 30 June when you don’t know yet what the profit situation will be. But the Div 7A minimum yearly repayments are fixed. They are what they are. Use the ATO Div 7A calculator.

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So that is the amount of the dividend you need to declare and pay via journal entry by 30 June.

Summary

So in June each year, don't just focus on getting the trustee resolutions out of the door by 30 June. Also focus on getting the dividend declarations for Div 7A payments through before 30 June, updates of the company register done by 31 July and dividend statements by 31 October.

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