

Taxation Ruling TR 2010/3

Income tax: Division 7A loans: trust entitlements

The ruling is the Commissioner of Taxation opinion on operation of Division 7A Income Tax Assessment Act 1936 (ITAA 1936) of loan accounts between a private company and an associated trust (i.e. family trust).

Example

A family trust holds assets / investments on behalf of the beneficiaries. The list of beneficiaries includes a private company, which is associated to the trust. Each year the trust distributes part of its net income to the corporate beneficiary in the trust tax return. The trust does not make a cash payment to the corporate beneficiary but records a loan account receivable in the company accounts for the amount of the distribution.

Commissioner's view

The commissioner view is that this transaction is captured by Division 7A and the division can operate to deem the value of the loan account as a dividend.

How are Division 7A dividends taxed?

Deemed dividends of Division 7A are taxed as 'Unfranked' dividends.

How do you prevent this?

1. The simplest solution is to make a cash payment from the trust to the company equal to the accounting distribution each year.
2. Otherwise the company would need to apply the steps within Division 7A:
 - a. Prepare a loan agreement between the borrower and lender
 - b. Execute the agreement
 - c. Charge interest between the parties at a rate no less than the ATO published rate
 - d. Repay the loan within the loan agreement terms (7 years for unsecured loans and 25 years for secured loans)

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