Targeted amendments to the Division 7A integrity rules

Consultation Paper
October 2018
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Targeted amendments to the Division 7A integrity rules

Consultation Process

Request for feedback and comments

The purpose of this paper is to set out the Government’s proposed implementation of the amendments to improve the integrity and operation of Division 7A.

These amendments incorporate the Government’s response on the findings and recommendations of the Board of Taxation in their final report on the ‘Post Implementation Review of Division 7A of Part III of the Income Tax Assessment Act 1936’.

The Government is committed to helping taxpayers comply with their Division 7A obligations by simplifying and clarifying the arrangements. The outcomes of this consultation will feed into the development of legislation required to implement this measure, helping to ensure it operates appropriately and achieves its policy outcomes.

Interested parties are invited to submit their responses to the discussion questions at Appendix B. Electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

If you would like part of your submission to remain in confidence, you should provide this information marked as such in a separate attachment. A request made under the Freedom of Information Act 1982 (Cth) for a submission marked ‘confidential’ to be made available will be determined in accordance with that Act.

Closing date for submissions: 21 November 2018

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Background: Division 7A

Policy intent
Division 7A of Part III the Income Tax Assessment Act 1936 is an integrity rule that is intended to protect the operation of the progressive personal income tax system and ensure taxpayers cannot access funds that have not been taxed at their applicable marginal tax rates for the year (e.g. amounts taxed at the corporate tax rate). Division 7A applies to shareholders of private companies and their associates, which may include other individuals or trusts.

In most cases, a private company will provide benefits to shareholders (or their associates) through the payment of dividends or compensate them for services rendered by way of wages, director’s fees or similar forms of remuneration, which are taxable as income in the hands of the recipient. Division 7A does not apply to these arrangements.

However, if the company makes other payments, provides assets for private use or loans money to shareholders (or their associates), then Division 7A may apply to treat these amounts as unfranked dividends, which are taxable in the hands of the recipient. This results in tax being paid at the applicable marginal tax rate for the recipient, unless certain exemptions apply (i.e. converting the amount into a complying loan).

Board of Taxation review
In May 2012, the Board of Taxation (Board) was commissioned by the Government to undertake a Post Implementation Review of Division 7A to determine whether Division 7A was operating in line with its policy intent.

The Board’s first discussion paper was released in December 2012. In November 2013, the terms of reference were extended to include consideration of Division 7A in the context of the broader tax framework. A second discussion paper was released in March 2014. The Board then provided its final report to the Government in November 2014.

The Board found that the Division 7A rules are complex, inflexible, and impose significant compliance costs on taxpayers, including many small businesses that find the rules difficult to comply with.

The Board also found that many taxpayers may not be aware of the impact or operation of the rules until they receive tax advice when they are preparing their annual income tax return and considered that taxpayers who intended to comply with the law may inadvertently fail to comply with the rules.

In its final report, the Board explored ways of making Division 7A simpler, easier to comply with and more robust and made a number of recommendations in this regard. The recommendations are listed at Appendix A.

Government’s response
The Board’s final report made far-ranging recommendations in relation to the operation of Division 7A.

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1 Unless otherwise stated, all legislative references are to the Income Tax Assessment Act 1936.
The Government’s response makes a number of enhancements to Division 7A, drawing on some of the Board’s observations and recommendations to improve the operation of Division 7A and address stakeholder concerns. The amendments will comprise:

- simplified Division 7A loan rules to make it easier for taxpayers to comply;
- a self-correction mechanism to assist taxpayers to promptly rectify breaches of Division 7A;
- safe harbour rules for the use of assets to provide certainty and simplify compliance for taxpayers;
- technical amendments to improve the integrity and operation of Division 7A while providing increased certainty for taxpayers; and
- clarification that unpaid present entitlements (UPEs) come within the scope of Division 7A.

These amendments will apply from 1 July 2019.

The stakeholder submissions received as part of this consultation process will assist in developing the legislation. The Australian Taxation Office (ATO) will provide online tools and administrative guidance to educate taxpayers in relation to the new rules.
Simplified loan rules

New loan rules will be implemented for complying Division 7A loans. The loan model will have a maximum term of 10 years with a variable interest rate and payments of both principal and interest in each income year. This is intended to better align with calculations for the repayment of principal and interest loans in commercial transactions. Appropriate transitional rules will also be introduced.

Single 10 year loan model

Under the existing operation of Division 7A, if a private company provides a benefit to a shareholder (or their associate), the value of that benefit will be treated as if it were a dividend paid by the company, and taxed as income in the hands of the recipient (i.e. the shareholder or their associate) at their marginal tax rates (known as a deemed dividend).

There are a number of exceptions to this general rule. One exception is where the value of the benefit is converted to a loan that meets the requirements outlined in Division 7A (i.e. it is a complying loan). In such cases, the amount is then not treated as a dividend. This requires the recipient to comply with maximum loan terms, minimum interest rates and minimum annual yearly repayments of principal and interest.

For these arrangements, the private company pays tax on the interest it receives from the shareholder (or their associate) at its corporate tax rate.

Reasons for change

The current Division 7A loan model includes complex rules relating to apportionment of repayments between principal and interest. These rules place an administrative burden on advisors and taxpayers. The new ten year loan model is simpler than the current apportionment model and more closely aligned to commercial practice for principal and interest loans.

It is noted that the Board proposed either an Amortisation Model (outlined in Appendix C) or an interest only model as the potential basis for a reformed Division 7A. The Board’s Amortisation Model operated on a principal and interest basis with deferred repayments of principal, whereas the interest only model did not require principal to be repaid until the conclusion of the loan.

Following consideration of the Board’s proposed models, a simpler alternative loan model has been developed. This loan model is preferred from a policy perspective as annual payment encourages proactive cash flow management by businesses and reduces the size of payments (ten smaller payments) relative to the Amortisation Model. It is also easier to calculate the required interest and principal repayment amounts than under the Amortisation Model.

Similarly, although an interest only model is simple in operation, it is not consistent with the policy intent behind Division 7A which requires repayment of principal over time. This is because there is an expectation that amounts borrowed from private companies will be returned over time to shareholders as dividends and taxed at the shareholders’ marginal tax rates.

New loan model

Proposed implementation approach

Currently, the rules allow Division 7A amounts to be converted into one of two types of loans. The maximum term of the loans must not exceed:

• 7 years for an unsecured loan; or
• 25 years for a secured loan.
The current 7 year and 25 year loan models will be replaced by a single loan model which has the following features:

• A maximum term of 10 years. Consistent with current practices, the loan effectively begins at the end of the income year in which the advance is made. This is because the taxpayer is given until the lodgment day (the earlier of the actual date of lodgment or lodgment due date) of the private company’s income tax return to repay the loan or put it on complying loan terms.

• The annual benchmark interest rate will be the Small business; Variable; Other; Overdraft - Indicator Lending rate most recently published by the Reserve Bank of Australia prior to the start of each income year.

• There will be no requirement for a formal written loan agreement, however written or electronic evidence showing that the loan was entered into must exist by the lodgment day of the private company’s income tax return. This evidence must show:
  – the parties to the loan;
  – the agreement that the loan be made, including details of the date and evidence of its execution and binding nature on the parties to the agreement; and
  – the loan terms (the amount of the loan, the date the loan was drawn, the requirement to repay the loan amount, the term of the loan and the interest rate payable).

  Consistent with current ATO practice, as set out in Taxation Determination 2008/8, this evidence may be included in an exchange of letters, emails, fax, accounting records, etc.

• The minimum yearly repayment amount consists of both principal and interest:
  – The principal component is a series of equal annual payments over the term of the loan.
  – The interest component is the interest calculated on the opening balance of the loan each year using the benchmark interest rate.

• The minimum yearly repayment amount reduces the balance of the loan each income year. Where the minimum yearly repayment has not been made in full any shortfall will give rise to a deemed dividend for the year.

• Interest is calculated for the full income year, regardless of when the repayment is made during the year (except Year 1). If the loan is paid out early, that is before Year 10, interest will not be charged for the remaining years of the loan.

• Repayments of the loan made after the end of the income year but before the lodgment day for the first income year are counted as a reduction of the amount owing even if they are made prior to the loan agreement being finalised. Interest for Year 1 is calculated for the full income year on the balance of the loan outstanding at lodgment day.
Example: Calculation of the deemed dividend

Bert is the sole director and shareholder of Sesame Pty Ltd.

On 1 August 2019, Bert withdraws $100,000 from Sesame Pty Ltd to pay for the renovation of his house. Bert does not have the funds to pay back Sesame Pty Ltd by the lodgment day of Sesame Pty Ltd’s income tax return, 15 May 2021. To avoid the $100,000 being treated as if it were a dividend paid from Sesame Pty Ltd, Bert decides to put in place a complying Division 7A loan agreement.

The repayments that Bert would be required to make according to the new loan model would be as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Interest Rate*</th>
<th>Opening Balance $</th>
<th>Interest Amount $</th>
<th>Principal Amount $</th>
<th>Minimum Repayment $</th>
<th>Closing Balance $</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020-21</td>
<td>8.50%</td>
<td>100,000</td>
<td>8,500</td>
<td>10,000</td>
<td>18,500</td>
<td>90,000</td>
</tr>
<tr>
<td>2021-22</td>
<td>7.00%</td>
<td>90,000</td>
<td>6,300</td>
<td>10,000</td>
<td>16,300</td>
<td>80,000</td>
</tr>
<tr>
<td>2022-23</td>
<td>6.50%</td>
<td>80,000</td>
<td>5,200</td>
<td>10,000</td>
<td>15,200</td>
<td>70,000</td>
</tr>
<tr>
<td>2023-24</td>
<td>8.00%</td>
<td>70,000</td>
<td>5,600</td>
<td>10,000</td>
<td>15,600</td>
<td>60,000</td>
</tr>
<tr>
<td>2024-25</td>
<td>9.00%</td>
<td>60,000</td>
<td>5,400</td>
<td>10,000</td>
<td>15,400</td>
<td>50,000</td>
</tr>
<tr>
<td>2025-26</td>
<td>8.25%</td>
<td>50,000</td>
<td>4,125</td>
<td>10,000</td>
<td>14,125</td>
<td>40,000</td>
</tr>
<tr>
<td>2026-27</td>
<td>7.90%</td>
<td>40,000</td>
<td>3,160</td>
<td>10,000</td>
<td>13,160</td>
<td>30,000</td>
</tr>
<tr>
<td>2027-28</td>
<td>8.00%</td>
<td>30,000</td>
<td>2,400</td>
<td>10,000</td>
<td>12,400</td>
<td>20,000</td>
</tr>
<tr>
<td>2028-29</td>
<td>9.20%</td>
<td>20,000</td>
<td>1,840</td>
<td>10,000</td>
<td>11,840</td>
<td>10,000</td>
</tr>
<tr>
<td>2029-30</td>
<td>7.50%</td>
<td>10,000</td>
<td>750</td>
<td>10,000</td>
<td>10,750</td>
<td>0</td>
</tr>
</tbody>
</table>

*Interest rates shown are for illustrative purposes only

The interest paid by Bert each year will be taxed as income to Sesame Pty Ltd at its corporate tax rate.

- If the repayment actually made in the income year is less than the required minimum yearly repayment, a deemed dividend will arise for the amount of the shortfall between the minimum yearly repayment and the actual repayment made for that income year.
  - For example, the minimum yearly repayment in the above loan model example for the 2022-23 income year would be $15,200. If the actual repayment made in the 2022-23 income year was $12,200, the deemed dividend would be $3,000. Bert will include this $3,000 as income for the year, and pay tax at his marginal tax rate.

Transitional rules

Transitional rules will be introduced to allow taxpayers that have existing 7 or 25 year loans to transition to the new 10 year loan model.

7 year loans

All complying 7 year loans in existence as at 30 June 2019 must comply with the new proposed loan model and new benchmark interest rate to remain complying loans, but will retain their existing outstanding term.
Targeted amendments to the Division 7A integrity rules

For instance, a loan maturing 30 June 2021 will continue to mature on this date. This means that under the transitional rules, its remaining term will be 2 years. The outstanding loan balance would be repayable over 2 years, and interest would be charged using the new benchmark interest rate under the proposed model.

Current loan agreements with written reference to the benchmark interest rate should not be required to be renegotiated under this option.

25 year loans

All complying 25 year loans in existence as at 30 June 2019 will be exempt from the majority of changes until 30 June 2021. However, the interest rate payable for these loans during this period must equal or exceed the new benchmark interest rate.

On 30 June 2021, the outstanding value of the loan will give rise to a deemed dividend unless a complying loan agreement is put in place prior to the lodgment day of the 2020-21 company tax return. The first repayment will be due in the 2021-22 income year.

Pre-1997 loans

Loans made before 4 December 1997 (pre-1997 loans) predate the existence of Division 7A, but become subject to Division 7A in certain circumstances.

Where a loan that existed prior to 4 December 1997 is varied on or after this date, i.e. by extending the term or increasing the amount of the loan, the loan will be treated as if it were a new loan entered into on the day it is varied and therefore Division 7A may apply.

Division 7A may also apply where the loan is forgiven on or after 4 December 1997. A loan will generally be treated as being forgiven in circumstances where it has become statute-barred under the relevant Limitations Act. Generally, a loan becomes statute-barred when the period within which a creditor is entitled to sue for recovery for the debt ends. It is expected that many loans made before 4 December 1997 would already have been statute barred and thus have given rise to a deemed dividend for the borrower.

For outstanding pre-1997 loans (i.e. those loans which have not already been forgiven and continue to be reported in tax returns), the proposed transitional rule will provide an affected borrower with a two year grace period before the first repayment is due, with the loan to be repaid over the subsequent 10 years.

Under the transitional rules, pre-1997 loans will be taken to be financial accommodation as at 30 June 2021. The taxpayer will have until the lodgment day of the 2020-21 company tax return to either pay out the amount of the loan or put in place a complying loan agreement, otherwise it will be treated as a dividend in the 2020-21 income year. The first repayment will be due in the 2021-22 income year.

This will provide certainty for taxpayers and protect them from exposure to Division 7A if the Commissioner were to consider that there was no longer a commercial loan in existence and deemed it to be forgiven.

Application to non-resident private companies

Section 1098C was introduced to clarify that Division 7A also applies to loans, payments and debt forgiveness by non-resident private companies.

Some stakeholders have highlighted that the application of Division 7A to non-resident private companies in certain circumstances continues to be uncertain – for example whether it applies only
where the shareholder of the private company (or their associate) is an Australian resident, how ‘source’ considerations apply to the deemed dividend and how the provisions potentially interact with the transfer pricing rules and double tax treaties.

Treasury would like feedback from stakeholders on the extent of any uncertainty and how best to remove any such uncertainty.

**Distributable surplus**

The concept of distributable surplus is a notion of profit which determines the total amount of dividends a private company can be taken to have paid under Division 7A. The amount of a deemed dividend under Division 7A is currently limited by the distributable surplus of the private company that provided the benefit.

Capping the amount of the deemed dividend is considered contrary to the efficient operation of the Division 7A integrity rule. That is, if a certain amount is ‘distributed’ to the shareholder, then tax should be paid on the entire amount, and it should not be arbitrarily limited.

The amendments will remove the concept of distributable surplus. This will ensure the integrity of Division 7A so that dividends can be deemed for the entire value of the benefit that was extracted from the private company. This will also align the treatment of dividends with section 254T of the *Corporations Act 2001* (Cth) which allows dividends to be paid out of both profits and capital.

**Discussion questions**

**Discussion Question 1:**

**Proposed loan model**

a. Is there an aspect of the proposed loan model that could be refined?

**Transitional rules**

b. Do the proposed transitional rules result in any unintended outcomes?

**Application to non-resident private companies**

c. In what circumstances (if any) is the application of Division 7A to non-resident private companies unclear?

d. Would the application of Division 7A to non-resident private companies benefit from additional public guidance material?

e. Are legislative amendments required to clarify the application of Division 7A to non-resident private companies?

**Distributable Surplus**

f. Does the removal of the concept of distributable surplus result in any unintended outcomes?

g. If this concept is removed, are there any interactions with other provisions of Division 7A that might become relevant?
Targeted amendments to the Division 7A integrity rules

Unpaid Present Entitlements

The Government announced amendments to clarify that unpaid present entitlements will come within the scope of Division 7A.

Reason for change

Where a trust makes a private company entitled to a share of its income (profits) for a year, and does not actually pay that amount to the private company, this gives rise to an unpaid present entitlement (UPE) for that income. UPEs generally do not have a prescribed tax treatment under the tax law.

The Commissioner has taken the view that UPEs are generally within the scope of Division 7A under the extended meaning of a loan in subsection 109D(3), unless the funds representing the UPE are held for the sole benefit of the private company. This view is outlined in Taxation Ruling 2010/3 Income tax: Division 7A: trust entitlements and applies to unpaid present entitlements that arise after 16 December 2009.

The Commissioner’s guidance in Practice Statement 2010/4 (PSLA 2010/4) - Division 7A: trust entitlements - provides practical guidance for taxpayers to demonstrate that the funds representing the UPE are held for the sole benefit of the private company, including by establishing a separate trust (referred to as a ‘sub-trust’) that lends the amount of the UPE to the trust for 7 or 10 years on interest only terms or invests the amount in a specific income-producing asset (of the trust).

Under these approaches, trusts are not required to repay the amount representing the UPE until the conclusion of the interest-only loan.

The amendments will ensure that the UPE will be treated consistently with other payments made by private companies to taxpayers, by either requiring the UPE to be repaid to the private company over time as a complying loan or subject to tax as a dividend.

Proposed implementation approach

Where a UPE remains unpaid at the lodgment day of the private company’s income tax return, the UPE will be a deemed dividend from the company to the trust (which is assessable at the marginal tax rates of the beneficiaries or the top marginal tax rate, if assessable to the trustee), or alternatively the UPE can be put on ‘complying loan terms’ under which principal and interest payments are required to be made.

All UPEs arising on, or after 16 December 2009 and on, or before, 30 June 2019, that have not already been put on complying loan terms or deemed to be a dividend, will need to be put on complying terms by 30 June 2020. The first repayment for such loans would be due in the 2019-20 income year. Any amounts outstanding that have not been put on complying loan terms by the end of the 2019-20 income year will result in a deemed dividend for the outstanding amount of the UPE.

All UPEs that arise on, or after, 1 July 2019 will need to be either paid to the private company or put on complying loan terms under the new 10 year loan model prior to the private company’s lodgment day, otherwise they will be a deemed a dividend.

UPEs that have already been placed on complying loan terms will be treated in accordance with the relevant 7 or 25 year loan transitional rules.
Discussion questions

**Discussion Question 2:**

**Unpaid present entitlements**

a. Are transitional rules required for UPEs arising on, or after, 16 December 2009 and on or before, 30 June 2019 where the funds are invested in the main trust using one of the investment options in PSLA 2010/4 and therefore the UPE is considered to be held for the sole benefit of the private company beneficiary? If so, what kind of transitional rules might be required?

b. Should UPEs arising prior to 16 December 2009 be brought within Division 7A?
Targeted amendments to the Division 7A integrity rules

Reviewing Breaches of Division 7A

Self-correction mechanism

The introduction of a self-correction mechanism will allow taxpayers to rectify inadvertent breaches of Division 7A. This will provide the opportunity to voluntarily correct their arrangements without penalty.

Reasons for change

Currently, to assist taxpayers to comply with Division 7A, section 109RB allows the Commissioner to exercise a discretion to disregard a deemed dividend or allow it to be franked if the dividend arose as a result of an honest mistake or inadvertent omission.

When a taxpayer applies for the Commissioner’s discretion, the Commissioner must consider a range of factors, including:

• the circumstances that led to the mistake or omission;
• the extent of any action taken by the parties to correct the mistake or omission;
• whether there have been any prior applications of the Division; and
• any other matters that the Commissioner considers relevant.

The Commissioner may make exercising the discretion subject to conditions such as corrective action. Currently this extends to putting parties in the position they would have been had they originally complied with their Division 7A obligations. This includes making catch-up payments of compounding interest and principal in the income year in which self-correction is made. The compounding interest is to be included as assessable income in the private company’s income tax return.

The objective of the Commissioner’s discretion is to assist the taxpayer to comply with their Division 7A obligations. However, the process of applying for the discretion imposes significant compliance costs on the taxpayer. This process also creates uncertainty for taxpayers and places a burden on both the taxpayer and the ATO.

The amendments will introduce a new self-correction mechanism to allow taxpayers to correct their tax affairs and rectify breaches of Division 7A without incurring substantial compliance costs.

Proposed implementation approach

Consistent with the Board’s recommendation, qualifying taxpayers will be permitted to self-assess their eligibility for relief from the consequences of Division 7A, which will operate to reverse the effect of a prior deemed dividend arising under the law.

To qualify for self-correction, the taxpayer will need to meet eligibility criteria in relation to the benefit that gave rise to the breach. The eligibility criteria will require that:

• on the basis of objective factors, the breach of Division 7A was an inadvertent breach;
• appropriate steps have been taken as soon as practicable (and no later than six months after identifying the error unless the Commissioner allows more time) to ensure that affected parties are placed in the position they would have been in had they complied with their obligations; and
• the taxpayer has taken, or is taking, reasonable steps to identify and address any other breaches of Division 7A.
Targeted amendments to the Division 7A integrity rules

Under this approach, in order to self-correct an eligible taxpayer must:

• convert the benefit into a complying loan agreement, on the same terms that would have applied had the loan agreement been entered into when it should have been; and

• make catch-up payments of the principal and interest that would have been payable as prior minimum yearly repayments had the taxpayer complied with Division 7A when it should have. The interest component of the catch-up payment will be compounded to reflect prior year non-repayments. This compounded interest should be declared as assessable income in the private company’s income tax return for the income year in which the catch-up payment is made.

In certain cases, the concept of self-correction may include other appropriate action considered reasonable by the Commissioner based on the taxpayer’s circumstances. Reasonable circumstances would be set out by the ATO in its public advice and guidance products.

The current Commissioner’s discretion will be removed in its current form, and remain available only in circumstances where the taxpayer seeks the Commissioner’s discretion to have the dividend franked.

Period of review

Under the current law, some taxpayers attempt to manipulate their Division 7A position by claiming the period in which the Commissioner may amend the relevant tax return to account for a deemed dividend for their payment, loan or debt forgiveness has expired.

The Board recommended that if the Amortisation Model was adopted, the period of review would commence from the lodging day for the income year in which each milestone payment was required (or would have been required, had a complying loan agreement been entered into).

To improve integrity and ensure compliance with the new loan model, as well as the ability to self-correct, it is proposed that the period of review for Division 7A transactions be extended to cover 14 years after the end of the income year in which the loan, payment or debt forgiveness gave rise or would have given rise to a deemed dividend. This will apply from 1 July 2019.

This approach is consistent with other areas of the law in which there are an extended period of review, including capital gains tax and loss recoupment rules.

Discussion questions

**Discussion Question 3:**

**Self-Correction Mechanism**

a. Are the eligibility criteria clear and concise?

b. Are additional objective factors necessary to include in determining a taxpayers’ eligibility?

c. What guidance should be provided to assist taxpayers in using the self-correction mechanism?

**Period of Review**

d. Will the period of review cause any unintended outcomes?

e. Are there any alternative options to a 14 year review period that would ensure the integrity of the revised Division 7A?
Safe Harbours – Provision of Assets for Use

Safe harbour mechanism

The introduction of new safe harbour rules for the provision of assets for use will provide certainty and simplify compliance for taxpayers.

Reasons for change

Rules for the provision of an asset for use by an entity (other than transfer of property) apply from 1 July 2009. Section 109CA treats the provision of an asset for use as a ‘payment’ for the purposes of Division 7A.

Where an asset is provided for use by a company to a shareholder (or their associate), the amount of the deemed dividend is the amount that would have been paid for the provision of the asset by parties dealing at arm’s length less any amounts actually paid. If the consideration given is equal to or exceeds the amount that would have been paid at arm’s length, the amount of the payment is nil.

The shareholder (or their associate) can avoid a deemed dividend by ensuring that an arm’s length amount for usage is paid.

The determination of this arm’s length amount in some cases can be difficult to ascertain and increases compliance costs for taxpayers.

The Board recommended the design of legislative safe harbours to facilitate compliance, reduce uncertainties and lower administrative costs for taxpayers. It was also suggested that the rules should distinguish between appreciating and depreciating assets.

Proposed implementation approach

In implementing the measure, a safe harbour comprising a formula and accompanying rules will be legislated.

The taxpayer will continue to be able to use their own calculation of the arm’s length value instead of the legislative formula.

The safe harbour will apply for the exclusive use of all assets excluding motor vehicles. This is because the market value for rental of a motor vehicle is readily ascertainable by other means.

The safe harbour will generally apply unless the taxpayer has received a non-exclusive right to use an asset.

The proposed formula for the safe harbour is:

$$\frac{A \times IR}{days \ in \ year} \times \ days \ used$$

Where:

$A = \text{Value of asset at 30 June for the income year in which the asset was used.}$

$IR = \text{benchmark interest rate plus 5 per cent uplift interest.}$

$Days \ used = \text{days shareholder (or their associate) used or had the exclusive right to use the asset.}$

$Days \ in \ year = \text{days in income year (i.e. 365 or 366).}$
The safe harbour will provide that:

- the value of the asset is its cost – this includes any improvements made over the life of the asset. Where an asset is held for more than five years, its value will instead be the greater of the cost or the value determined by a market valuation. This is to ensure that the formula, at a minimum, reflects the cost of the asset to the business while ensuring the increase in value for appreciating assets (e.g. real property) is factored into the calculation;
- a formal market valuation of the asset is required every five years;
- the charge is based on actual number of days used by the shareholder (or their associate), unless the shareholder (or their associate) have the exclusive right to use the asset at other times; and
- the rules apply to both appreciating and depreciating assets.

**Example:**

Sesame Pty Ltd owns a yacht valued at $1,200,000. Bert invites his friends Ernie and Oscar to spend the day on the yacht one Sunday every month. Bert has no right to use the yacht at any other time during the income year. The benchmark interest rate for the income year is 8.5 per cent. Therefore, the interest rate used in the formula is 13.5 per cent.

The charge is calculated as follows:

\[ \text{\$1,200,000} \times \left( \frac{13.5\%}{365} \right) = \text{\$443.84 per day} \]

The yacht was used for 12 days over the income year. Therefore, the deemed dividend calculated according to the safe harbour formula is $5,326.

**Discussion questions**

**Discussion Question 4:**

**Safe Harbours – Provision of assets for use**

a. Is there an alternative formula which could be used?

b. Should taxpayers have the option to elect between the statutory formula and providing their own arm’s length usage charge or should the statutory formula be the only option?

c. Is a 5 per cent uplift interest rate as part of the usage charge appropriate? Or should another rate (e.g. the benchmark interest rate) be used?

d. Should there be a ‘reasonableness’ test included in the statutory formula or alternatively, are multiple formulas needed?
Minor Technical Amendments

Technical amendments to improve the integrity and operation of Division 7A

Minor technical amendments will improve the integrity and operation of Division 7A while providing increased certainty for taxpayers.

Use of assets – timing rules

Subsection 109CA(2) outlines the time when a payment is taken to be made for Division 7A purposes where a private company provides an associated entity with the use of an asset. This payment occurs when the entity first uses the asset or has the right to use an asset in circumstances where the provider does not have that same right.

However, this rule currently does not address the case where an entity receives a valuable non-exclusive right (i.e. where the provider maintains a right to use the asset). In this case, while a payment will be taken to be made, the time at which the payment is taken to be made is ambiguous. This is an unintended anomaly.

Amendments will be made to ensure that a payment under section 109CA for an income year should be taken to be made on the first day in that income year that the entity uses the asset or has a right to use the asset (regardless of whether this is an exclusive right). This will provide certainty to taxpayers.

Interaction between debt forgiveness and loans

Section 109F provides that a private company will be taken to pay a dividend to an entity if the company forgives a debt owed by the entity to the company and the entity was either a shareholder or an associate of a shareholder at that time or a reasonable person would conclude that the debt was forgiven because the entity had been a shareholder or associate at some point.

However, section 109G sets out a number of exceptions to this general rule. In particular, subsection 109G(3) provides that a forgiven debt will not give rise to a dividend if the loan that resulted in the debt gave rise to a deemed dividend under section 109D.

Subsection 109G(3) will be amended to ensure this exception only applies where the earlier dividend that the company was taken to have paid has been taken into account in the income tax assessment of an entity or entities.

In the ordinary course of business

Section 109M prevents Division 7A from applying to loans made in the ordinary course of an entity’s business if the loan is made on the usual terms offered to arm’s length parties. This was intended to ensure that shareholders of businesses that primarily derived income from money-lending were not prevented from dealing with those businesses on their ordinary terms.

Section 109M was intended to operate so that a private company will not be taken to pay a dividend only in circumstances where the loan is made:

• in the ordinary course of a business of lending money to third parties;

• on an arm’s length basis; and

• on the usual terms on which the private company makes similar loans to parties at arm’s length.
Targeted amendments to the Division 7A integrity rules

It is noted that the ATO has recently updated its guidance on when a company carries on a business and that this may have flow-on effects for the operation of this provision.

Section 109M will be amended to limit the exception to loans in the ordinary course of a business of lending money to third parties, rather than in the ordinary course of any business. These loans will continue to be required to be made consistent with the usual terms on which the company makes loans to third parties and on an arm’s length basis. This amendment will provide clarity and further integrity to Division 7A.

Benefits provided through interposed entities

Currently, subsection 109T(1) sets out the circumstances in which a taxpayer will be taken to receive a payment or loan from a private company because of dealings involving an interposed entity or entities. In effect, these provisions are intended to ensure that private companies cannot escape the application of Division 7A by providing benefits to shareholders indirectly through an arrangement with another entity.

It can be problematic to establish that an entity is ‘interposed’ within the meaning of paragraph 109T(1)(a) where the quantum or nature of the benefit provided to the taxpayer differs from the benefit provided to the interposed entity.

Subsection 109T(1) will be amended to apply in any case where a loan, payment or other benefit is provided to a taxpayer, if a reasonable person would conclude that this benefit would not have been provided but for a loan, payment or other benefit being provided or being expected to be provided by the private company to another entity (whether or not this is the same entity that provided the benefit to the taxpayer).

This change ensures the provision gives effect to the underlying policy intention to bring to account indirect benefits, even if the payment or loan that results in the indirect benefit also has other commercial purposes.

Deemed dividends are non-deductible

To provide certainty, section 109Z will be amended to make clear that a payment that is taken to be a dividend under Division 7A is not an allowable deduction.

Currently, payments, loans and other benefits that give rise to a deemed dividend are not deductible, but this is not specifically addressed in the legislation.

Division 7A and Fringe Benefits Tax

Division 7A applies to benefits provided by private companies to shareholders, former shareholders and their associates (subsequently referred to as shareholders). In contrast, fringe benefits tax (FBT) applies to benefits provided by employers (including private companies) to employees, former employees and their associates (subsequently referred to as employees).

In cases where a shareholder in a private company is also an employee of that company, both FBT and Division 7A are potentially applicable. The current policy is that Division 7A should generally apply in preference to FBT for a benefit that is a loan or debt forgiveness, whereas FBT will generally apply in preference to Division 7A for benefits that are payments.
To improve the clarity and integrity in relation to the interaction between Division 7A and the FBT provisions, amendments will be made to clarify that:

- the exception in subsection 109ZB(3), which provides that Division 7A does not apply to payments made to shareholders (or their associates) in their capacity as an employee (or an associate of such an employee), only applies where that payment would constitute a fringe benefit. In determining if a payment is a fringe benefit within the meaning of subsection 136(1) of the Fringe Benefits Tax Assessment Act 1986, paragraph (r) should be disregarded;

- former shareholders (or their associates) should be treated consistently with current shareholders. The exception in subsection 109ZB(3) will be extended to ensure that Division 7A will not apply to payments to former shareholders or associates of former shareholders in their capacity as an employee if the payment was a fringe benefit; and

- FBT will not apply to payments to former shareholders and their associates that are otherwise captured by Division 7A.

These amendments will clarify and provide integrity in relation to the interaction between Division 7A and the FBT provisions.

Discussion questions

**Discussion Question 5:**

**Minor Technical Amendments**

a. Are any changes required to the interposed entity rules, apart from section 109T? For example, should section 109V and 109W be amended?

b. For the purposes of applying section 109M, is it necessary to have objective criteria to determine whether a loan is made in the ordinary course of a business of lending money? If so, what should be included in the criteria?

c. Do similar changes need to be made to other paragraphs of the definition of ‘fringe benefit’ in subsection 136(1) of the Fringe Benefits Assessment Act 1986 to clarify the interaction of FBT and Division 7A?
Other considerations

Discussion Question 6:

Other issues

a. Would the insertion of an objects clause in the legislation, consistent with the ‘Policy intent’ outlined on page 2 of this paper, be useful in clarifying the intent of the provisions?

b. Are there any other issues relevant to the amendments canvassed in this paper that have not been considered?
Appendix A: Board Recommendations

The Division 7A amendments incorporate the Government’s response on the findings and recommendations of the Board of Taxation in their final report on the ‘Post Implementation Review of Division 7A of Part III of the *Income Tax Assessment Act 1936*’. These recommendations are set out below.

<table>
<thead>
<tr>
<th>Recommendation</th>
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</table>
| **Recommendation 1** | As part of a wider tax reform process, the Board recommends explicitly considering wide-ranging reforms directed at treating profits consistently, including:  
  - taxing business accumulations at a business tax rate, irrespective of the structure chosen; and  
  - lowering the tax rate on undistributed trust income. |
| **Recommendation 2** | The Board recommends that, in the more immediate term, the Government make significant reforms to Division 7A in accordance with recommendations 3 to 15 of this report. |
| **Recommendation 3** | The Board recommends:  
  - including the principles that could define the policy framework for Division 7A in an objects clause in a reformed Division 7A; and  
  - making the content of the guiding principles a policy matter for consideration by the Government — in particular, whether Division 7A supports the overall objective of protecting the personal income tax system’s progressivity and has a role to play in not advantaging the accumulation of passive investments over the reinvestment of business profits in active business activities. |
| **Recommendation 4** | The Board recommends:  
  - retaining the existing rules concerning an entity’s right to use a private company asset, including the otherwise deductible and minor benefits rule exemptions;  
  - supplementing the existing rules with the provision of legislative safe harbour rules, which would assist in facilitating compliance, reduce uncertainties for taxpayers and lower administrative costs for the ATO;  
  - designing appropriate safe harbour rules that distinguish between those that would apply to depreciating assets and those that would apply to appreciating assets, such as land and buildings:  
    - for depreciating assets, a rental charge could apply, similar to that of an operating lease, comprising a finance amount (or interest amount), a depreciation component (being the cost of the asset to the lessor) and an amount for the relevant asset’s other operating costs.  
    - for appreciating assets, a usage charge could apply, calculated by multiplying the statutory interest rate by the asset’s indexed value, which could be updated with an arm’s length valuation every five years, thus reducing the need for yearly valuations. The usage charge could also include an amount representing the relevant asset’s other operating costs. |
Recommendation 5
The Board recommends retaining the rules regarding the calculation of distributable surplus, including the requirement for periodic testing, as part of any rewrite of the Division 7A rules.

Recommendation 6
Subject to the Government’s policy decision on the policy framework for reform of Division 7A (see Recommendation 3), the Board recommends enacting legislation that prescribes the following terms for complying Division 7A loans:

- There should be no requirement for a formal written agreement between the parties. However, written or electronic evidence showing that a loan was entered into must exist by lodgment day for the income year in which the loan was made.
- The statutory interest rate would be set at the start of the loan and fixed over the term of the loan.
- The statutory interest rate would be the Reserve Bank of Australia’s indicator lending rate for a small business; variable; other; overdraft for the month of May immediately before the start of that income year.
- The maximum loan term would be 10 years.
- The prescribed maximum loan balances during the term of the loan (including any accumulated interest) would be as follows:
  - 75 per cent of the original loan by the end of year three;
  - 55 per cent of the original loan by the end of year five;
  - 25 per cent of the original loan by the end of year eight; and
  - 0 per cent of the original loan (that is, fully repaid) by the end of year 10.
- Subject to meeting the maximum loan balances, there would be no specified annual principal repayments.
- Interest would be able to be accrued annually but would have to be paid by the end of years three, five, eight, and 10.
- Interest deductibility would be governed by existing income tax rules.

The Board further recommends:

- where a payment is not treated as a dividend, deeming the taxpayer liable for loan repayments as if a loan were made, and to which the Commissioner’s period of review may apply as if to a loan;
- ensuring that failure to make the repayments by the end of the milestone period results in the private company being taken to have paid a dividend to the entity;
- basing the amount of the deemed dividend on the amount of the shortfall in the payment required, calculated using the appropriate statutory interest rate, reduced by the amount of any prior deemed dividends assessed to the taxpayer;
- commencing the Commissioner’s period of review from the date of lodgment for the income year in which each milestone payment is required (or would have been required had a complying loan agreement been entered into);
- providing administrative guidance, reflecting general legal principles relating to forming binding contracts, on what constitutes acceptable evidence that a loan was entered into by lodgment day for the income year in which the loan was made, in order to avoid inadvertent non-compliance;
• grandfathering the terms of complying 25-year loans — that is, they should remain payable with interest over the remainder of the 25 years; and

• transitioning all other pre-existing Division 7A loans to the new 10-year loans from the application date of the new provisions. In accordance with this:
  – all existing complying seven-year loans would have their terms extended to the new maximum of 10 years;
  – all pre-1997 loans would be deemed to be new complying Division 7A loans, with a 10-year term starting from the application date of the new provisions; and
  – where the Commissioner is out of time to assess a deemed dividend arising from a payment, the rules should stipulate that the taxpayer is prevented from asserting that the payment was not made in the context of a loan.

**Recommendation 7**
The Board recommends that the ATO adopts administrative measures to assist taxpayers who choose to repay complying loans in annual instalments. This administrative assistance could include an online tool for calculating an annual repayment schedule under which minimum loan balance targets would be met.

**Recommendation 8**
The Board recommends introducing legislative amendments to align the treatment of UPEs with the treatment of loans for Division 7A purposes in conjunction with either Recommendations 6 and 9 (Amortisation Model option) or Recommendation 10 (Interest Only Model option).

**Recommendation 9**
If the Amortisation Model is adopted, the Board recommends:

• introducing a legislative amendment that allows trusts to make a once-and-for-all election for loans from companies (including UPEs owing to companies) to be excluded from the operation of Division 7A (the business income election);

• making the election by completing a label in the trust’s tax return by the due date for lodging the return for the year of income in which it is made (or such further time as the Commissioner allows);

• enabling the election to be made in any income year, subject to the requirement that Division 7A obligations must remain in place for income years prior to the income year in which the election is made;

• ensuring that a trust that makes such an election (an excluded trust) forgoes the CGT discount on capital gains arising from assets other than goodwill and ‘intangible assets inherently connected with the business carried on by the trustee’;

• applying a business income election to all loans the trust owes to a private company, whenever created, and to all CGT assets (other than goodwill or relevant intangible assets) whenever acquired;

• not excusing entities that make a business income election from Division 7A obligations for the period prior to the income year for which the election is made; and

• amending interposed entity rules to preserve the integrity of the provisions, without imposing undue compliance costs on trusts that wish to benefit from the proposed limited business income exception.
The Board further recommends that the Government consider the impact of applying a business income election to existing arrangements for small businesses in order to determine whether special transitional relief for that sector is warranted.

**Recommendation 10 — Alternative option: the Interest Only Model**

If, as a result of a policy choice, there is no need for Division 7A to support the overall objective of protecting the personal income tax system’s progressivity and not advantaging the accumulation of passive investments using profits taxed at the company tax rate over the reinvestment of business profits taxed at higher progressive tax rates in active business activities, the Board recommends enacting legislation that prescribes the following terms for a complying Division 7A loan exemption under an Interest Only Model:

- There should be no requirement for a formal written agreement between the parties. However, written or electronic evidence showing that a loan was entered into must exist by lodgment day for the income year in which the loan was made.
- A variable statutory interest rate should be set annually for all complying Division 7A loans in place in the relevant year of income.
- The interest rate for complying loans should be equal to the Reserve Bank of Australia’s indicator lending rate for a small business; variable; other; overdraft for the month of May immediately before the start of that income year.
- There should be no prescribed term for the loan, no required annual principal repayments, and reborrowings (of principal) would be permitted.
- Interest deductibility would be governed by existing income tax rules.

The Board further recommends:

- providing administrative guidance on what constitutes acceptable evidence that a loan was entered into by lodgment day for the income year in which the loan was made, in order to avoid inadvertent non-compliance;
- giving taxpayers the option to apply an otherwise deductible rule exemption, in accordance with which there would be no requirement to charge statutory interest where company loans or UPEs were used by a borrower for a deductible purpose;
- maintaining a company-to-company exemption under the new rules, but with an appropriate interposed entity rule as an integrity provision; and
- transitioning all pre-existing Division 7A loans to the new Division 7A complying loan terms from the application date of the new provisions.

The Board notes that, if adopted, this recommendation supersedes Recommendation 6 for complying loan rules under an Amortisation Model and Recommendation 9 for a business income election option.

**Recommendation 11**

The Board recommends enacting a self-correction mechanism with the following features:

- Qualifying taxpayers can self-assess their eligibility for an exception to Division 7A that will operate to reverse the effect of a prior deemed dividend.
- Eligibility for the exception will be based on satisfying two criteria:
  - It is reasonable to infer, on the basis of objective factors, that the conduct that caused the deemed dividend was unintentional; and
Targeted amendments to the Division 7A integrity rules

Appropriate steps have been taken to ensure that affected parties are placed in the position they would have been in had the dividend not arisen.

- Voluntary corrective action shall constitute prima facie evidence that the original breach was unintentional.
- A taxpayer who validly exercises self-correction may be liable for a penalty reflecting the degree of culpability (the self-correction penalty).

The Board further recommends:

- providing taxpayers with clear guidance on what constitutes appropriate corrective action, either in legislation itself, or in a form of administrative guidance developed by the ATO;
- if the Amortisation Model is adopted, designing the self-correction by applying the existing administrative penalty regime for tax shortfalls to the ‘notional tax shortfall’ that would have arisen had self-correction not been exercised; and
- if the Interest Only Model is adopted, ensuring any notional shortfall penalty is proportionate and represents an appropriate disincentive.

**Recommendation 12**

Under a legislated self-correction mechanism, where the ATO determines that self-correction was not validly made by a taxpayer, the Board recommends entitling the taxpayer to a review of the Commissioner’s decision via the AAT.

**Recommendation 13**

The Board recommends against adopting a principle that deemed dividends arising under a reformed Division 7A should generally be frankable.

Extending the imputation system to deemed dividends would introduce unnecessary complexity and, given the potential operation of other integrity provisions, provide limited certainty to affected taxpayers.

**Recommendation 14**

The Board recommends that the ATO reviews its guidance material on the imposition and remission of administrative penalties on tax shortfalls, with a view to amending it to give effect to the following principles:

- The inability to frank a deemed dividend under Division 7A can, depending on the circumstances, lead to an implicit penalty.
- The implicit penalty can arise both where the deemed dividend is assessable to a shareholder or a non-shareholder associate.
- The implicit penalty can, depending on the circumstances, constitute a harsh or unjust outcome.
- The implicit penalty should be considered when determining whether there are grounds for remitting an administrative penalty.
Recommendation 15

The Board recommends:

• that the Government, for whichever reform model it decides to implement, should support its implementation with a targeted education campaign on the scope of the provisions and how to comply with them;

• as part of a second stage in implementing the reforms:
  – ensuring anomalies in the existing law are not reproduced in the new regime; and
  – identifying and addressing remaining high-priority issues that would need to be addressed to ensure consistency with the new provisions; and

• providing relief to remove the Division 7A consequences where a company funds the acquisition of property from share capital and has a distributable surplus limited to unrealised profits.
  – Relief could take the form of:
    • a specific exclusion from section 109CA; or
    • limited roll-over relief that would enable taxpayers to restructure their affairs to ‘divest’ or ‘demerge’ the assets out of private companies to the ultimate non-corporate shareholders.
### Discussion Question 1:

**Proposed loan model**

a. Is there an aspect of the proposed loan model that could be refined?

**Transitional rules**

b. Do the proposed transitional rules result in any unintended outcomes?

**Application to non-resident private companies**

c. In what circumstances (if any) is the application of Division 7A to non-resident private companies unclear?

d. Would the application of Division 7A to non-resident private companies benefit from additional public guidance material?

e. Are legislative amendments required to clarify the application of Division 7A to non-resident private companies?

**Distributable Surplus**

f. Does the removal of the concept of distributable surplus result in any unintended outcomes?

g. If this concept is removed, are there any interactions with other provisions of Division 7A that might become relevant?

### Discussion Question 2:

**Unpaid present entitlements**

a. Are transitional rules required for UPEs arising on, or after, 16 December 2009 and on or before, 30 June 2019 where the funds in the sub-trust are invested in the main trust using one of the investment options in PSLA 2010/4 and therefore the UPE is considered to be held for the sole benefit of the private company beneficiary? If so, what kind of transitional rules might be required?

b. Should UPEs arising prior to 16 December 2009 be brought within Division 7A?

### Discussion Question 3:

**Self-Correction Mechanism**

a. Are the eligibility criteria clear and concise?

b. Are additional objective factors necessary to include in determining a taxpayers’ eligibility?

c. What guidance should be provided to assist taxpayers in using the self-correction mechanism?

**Period of Review**

d. Will the period of review cause any unintended outcomes?

e. Are there any alternative options to a 14 year review period that would ensure the integrity of the revised Division 7A?
Discussion Question 4:
Safe Harbours – Provision of assets for use
a. Is there an alternative formula which could be used?
b. Should taxpayers have the option to elect between the statutory formula and providing their own arm’s length usage charge or should the statutory formula be the only option?
c. Is a 5 per cent uplift interest rate as part of the usage charge appropriate? Or should another rate (e.g. the benchmark interest rate) be used?
d. Should there be a ‘reasonableness’ test included in the statutory formula or alternatively, are multiple formulas needed?

Discussion Question 5:
Minor Technical Amendments
a. Are any changes required to the interposed entity rules, apart from section 109T? For example, should section 109V and 109W be amended?
b. For the purposes of applying section 109M, is it necessary to have objective criteria to determine whether a loan is made in the ordinary course of a business of lending money? If so, what should be included in the criteria?
c. Do similar changes need to be made to other paragraphs of the definition of ‘fringe benefit’ in subsection 136(1) of the Fringe Benefits Assessment Act 1986 to clarify the interaction of FBT and Division 7A?

Discussion Question 6:
Other issues
a. Would the insertion of an objects clause in the legislation, consistent with the ‘Policy intent’ outlined on page 2 of this paper, be useful in clarifying the intent of the provisions?
b. Are there any other issues relevant to the amendments canvassed in this paper that have not been considered?
Appendix C: Amortisation Model

In their final report, the Board recommended the Amortisation Model be adopted in conjunction with other elements. The option below does not include these additional elements and is limited to the loan model mechanism of the recommendation which would operate as follows:

- The maximum loan term is 10 years.

- The statutory interest rate will be set at the start of the loan and fixed over the term of the loan. The statutory interest rate would be the Reserve Bank of Australia’s indicator lending rate for a Small business; Variable; Other; Overdraft for the month of May immediately before the start of that income year.

- There will be no requirement for a formal written agreement between the parties. However, written or electronic evidence showing that a loan was entered into must exist by lodgment day for the income year in which the loan was made.

- The prescribed maximum loan balances during the term of the loan (including any accumulated interest) will be as follows:
  - 75 per cent of the original loan by the end of year three;
  - 55 per cent of the original loan by the end of year five;
  - 25 per cent of the original loan by the end of year eight; and
  - 0 per cent of the original loan (that is, fully repaid) by the end of year 10.

- Subject to meeting the maximum loan balances for each milestone period, there will be no specified annual principal repayments.

- Interest will accrue annually but must be paid by the end of years three, five, eight, and 10 only.
Example: Calculation of deemed dividend under the Amortisation Model

The repayment schedule for Bert under the Amortisation Model would be as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Interest Rate*</th>
<th>Opening Balance $</th>
<th>Interest Amount $</th>
<th>Minimum Repayment $</th>
<th>Closing Balance $</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020-21</td>
<td>8.50%</td>
<td>100,000</td>
<td>8,500</td>
<td>0</td>
<td>108,500</td>
</tr>
<tr>
<td>2021-22</td>
<td>8.50%</td>
<td>108,500</td>
<td>9,223</td>
<td>0</td>
<td>117,723</td>
</tr>
<tr>
<td>2022-23</td>
<td>8.50%</td>
<td>117,723</td>
<td>10,006</td>
<td>52,729²</td>
<td>75,000</td>
</tr>
<tr>
<td>2023-24</td>
<td>8.50%</td>
<td>75,000</td>
<td>6,375</td>
<td>0</td>
<td>81,375</td>
</tr>
<tr>
<td>2024-25</td>
<td>8.50%</td>
<td>81,375</td>
<td>6,917</td>
<td>33,292³</td>
<td>55,000</td>
</tr>
<tr>
<td>2025-26</td>
<td>8.50%</td>
<td>55,000</td>
<td>4,675</td>
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<td>59,675</td>
</tr>
<tr>
<td>2026-27</td>
<td>8.50%</td>
<td>59,675</td>
<td>5,072</td>
<td>0</td>
<td>64,747</td>
</tr>
<tr>
<td>2027-28</td>
<td>8.50%</td>
<td>64,747</td>
<td>5,504</td>
<td>45,251⁴</td>
<td>25,000</td>
</tr>
<tr>
<td>2028-29</td>
<td>8.50%</td>
<td>25,000</td>
<td>2,125</td>
<td>0</td>
<td>27,125</td>
</tr>
<tr>
<td>2029-30</td>
<td>8.50%</td>
<td>27,125</td>
<td>2,306</td>
<td>29,431⁵</td>
<td>0</td>
</tr>
</tbody>
</table>

*Interest rates shown are for illustrative purposes only

Deemed Dividend – the Amortisation Model

- Failure to make the full repayments by the end of the milestone period will result in the private company being taken to have paid a dividend to the entity.

- The amount of the deemed dividend arises in income years 3, 5, 8 and 10 (if a shortfall arises in that year) and is the amount of the shortfall in the payment required at the end of each milestone period, calculated using the appropriate statutory interest rate, reduced by the amount of any prior deemed dividends assessed to the taxpayer. For example, the amount of the deemed dividend for the above Amortisation Model for the 2023 income year would be $52,729 if no repayments have been made.

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2 $117,723 + 10,006 - 75,000 = 52,729
3 $81,375 + 6,917 - 55,000 = 33,292
4 $64,747 + 5,504 - 25,000 = 45,251
5 $27,125 + 2,306 - 0 = 29,431