TAX CONSEQUENCES OF PRIVATE COMPANY PAYMENTS AND ASSET TRANSFERS

Many separating couples operate businesses through a variety of different corporate and trust structures for tax minimisation purposes. Such structures can complicate property settlements if certain tax costs are not identified and taken into account at the time of settlement negotiations.

Not unlike public companies, private companies have shareholders and payments are often made to these shareholders (in addition to that shareholder's salary). These payments are referred to as dividends. Ordinarily, a dividend payment received by a shareholder will be taxable, as if it were regular income.

However, historically such payments to shareholders were often referred to as "loans"; thereby avoiding any taxation that would be paid on such dividends. Typically payments of this nature would be made to the Directors themselves, as shareholders, because using company money taxed at 30% gives more spend than paying marginal income tax rates. Not surprisingly, the Australian Taxation Office tried to minimise business owners treating company money as their own by implementing Division 7A of the Income Tax Assessment Act 1936 ("Div 7A") ("The Tax Act").

OVERVIEW: DIVISION 7A

In certain circumstances, the transfer of an asset or payment from a private company to a party (or associate) will result in that party being deemed to receive a taxable dividend. A "payment" can include the transfer of property, a lease, licence or other right to use an asset, or the granting of guarantees and meeting of guarantee obligations.

Div 7A treats 3 kinds of amounts as deemed dividends paid by a private company:

1. Amounts paid by the company to a shareholder or shareholder's associate;
2. Amounts lent by the company to a shareholder or shareholder's associate; and
3. Amounts of debts owed by a shareholder or shareholder's associate to the company that the company forgives.

An "associate" of a shareholder is broadly defined as a relative, partner, trust controlled by the shareholder or company controlled by the shareholder.

Exceptions

There are certain payments which may qualify as excluded payments which are not classified as deemed dividends. Some of the exclusions include:

- Where a payment is a legitimate commercial loan which satisfies the requirements specified by the Tax Act (repayment schedules, minimum interest rate, maximum term etc.);
- Loans made from one private company to another private company (other than a company in the capacity of trustee); and
- Payment of a genuine debt as defined by the Tax Act.

Marriage Breakdown Concessions

Transfers of property and other payments related to a marriage or relationship breakdown are caught by Division 7A, even though they may be non-voluntary (required by a Court Order). However, Div 7A provides a further exception in respect of marriage or relationship breakdowns where payments made after 1 July 2006 (including the transfer of an asset, such as a house) from a company to a shareholder or an associate, although still classified as a dividend, can be fully franked by the transferor company. This means that the company will absorb the tax payable on the dividend, rather than the shareholder.

Examples of where deemed dividends may be franked include:

- a court order under the *Family Law Act 1975* ('the FLA') or a corresponding foreign law;
- a maintenance agreement approved by a court under section 87 of the FLA, or a corresponding agreement approved by a court under a corresponding foreign law; and
- a court order under state, territory or foreign law relating to de facto relationship breakdowns.

However it is important to note that, because there is a difference in the tax rates for companies and individuals, the payment of such a dividend (even a fully franked dividend) may require "top up tax" to be paid by the individual recipient if the individual's ultimate tax bracket is higher than that payable by the company.

Div 7A and Trusts

In certain circumstances Div 7A can also apply to treat dealings with trusts as deemed dividends where a private company has an unpaid present entitlement to receive an amount from a Trust.

An unpaid present entitlement will arise where a distribution is declared in favour of for example, a company beneficiary, but all of the entitlement is not physically paid to the company. One advantage of this type of arrangement is that the distribution is taxed at 30%, even if it has not physically been paid and the cash remains in the trust for investment. The operation of Div 7A extends to cover these arrangements.