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Loans to Associated Persons

Where a family business is conducted through a corporate entity, the Australian Taxation Office may deem excessive drawings by associated persons to be unfranked dividends in the hands of shareholders. Accordingly, associated persons should avoid excessive drawings to the extent that they create an overdrawn or debit loan account. Funds withdrawn from the company, including company funds applied in direct settlement of a personal debt, should represent genuine loan repayments, wages or dividends.

If a debit loan arises prior to balance date, every endeavour should be made to repay the funds before 30 June.

Where a Division 7A loan agreement has already been entered into, the borrowers need to ensure that minimum yearly repayments, incorporating interest for the year, are made prior to 30 June 2011.

Through a series of Income Tax Rulings, the Deputy Commissioner of Taxation has widened the definition of loans by private companies to associated persons to include unpaid present entitlements (UPE). A UPE arises where a family trust has distributed an amount to an associated company, but cash representing the distribution has been retained by the trust.

While there are some quarantining provisions in respect of trust distributions made prior to 30 June 2010, where a trust distribution to a private company remains unpaid, the deemed loan will be subject to the provisions of Division 7A. Accordingly, it may be important to review the longer term effects on cash flow prior to making such a distribution in the future.

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