

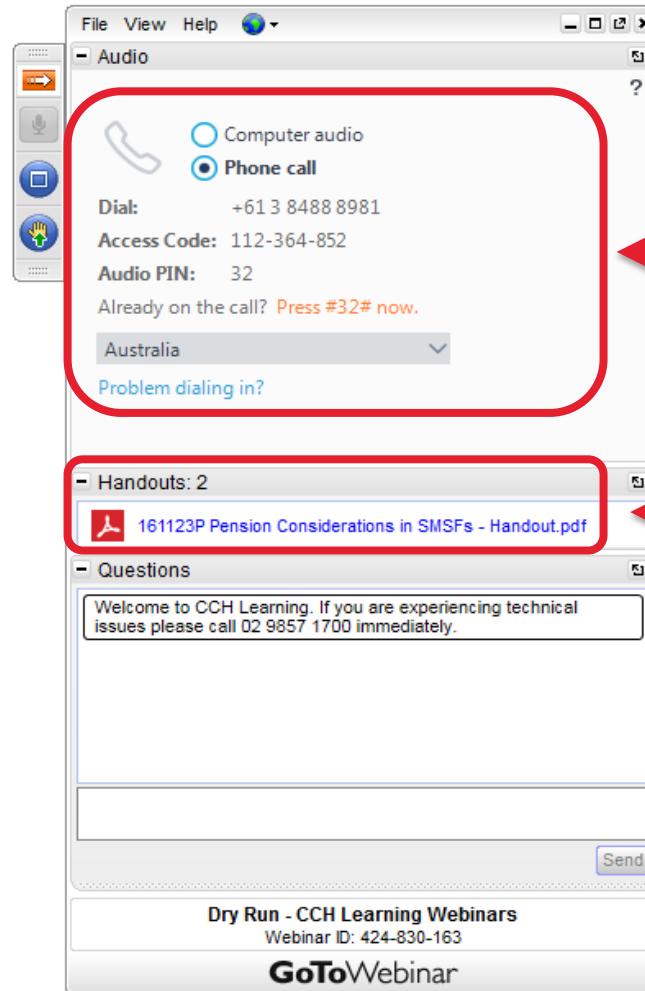
SME Loans

Carlo Di Loreto

Tuesday 6 February 2024



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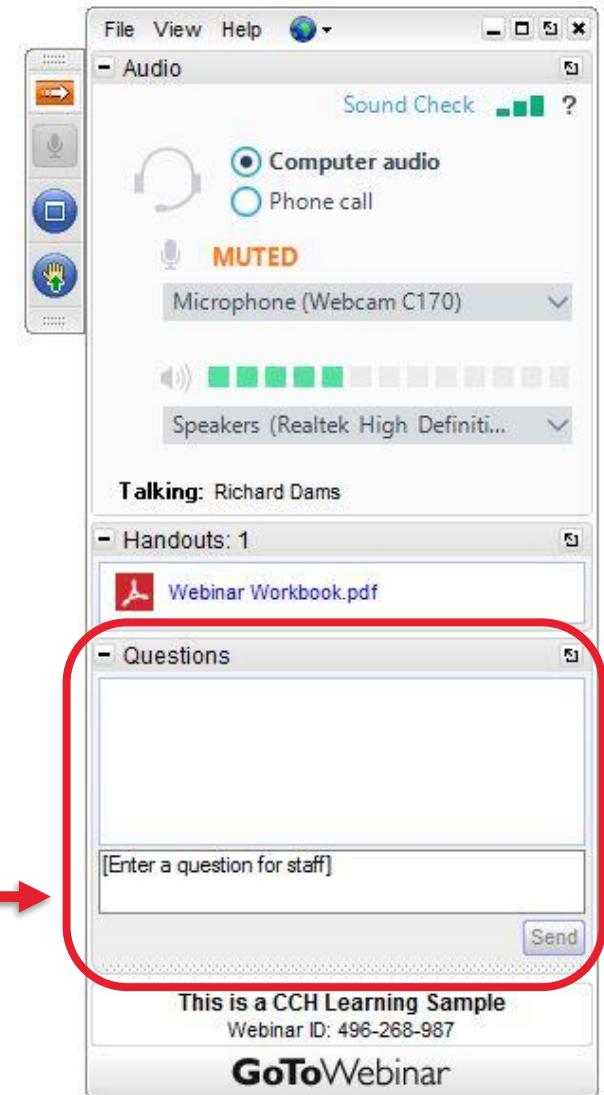


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Your Presenter



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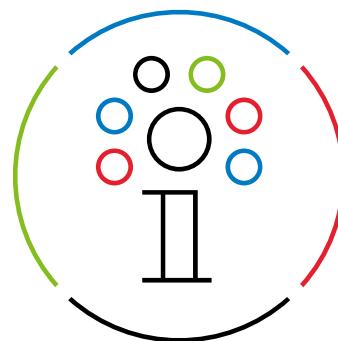
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Overview

- treatment of loans in the SME space still cause problems for practitioners
- complexity of the legislative provisions often adds to the confusion and uncertainty
- experience shows that many practitioners still find themselves ‘blindsided’ by the legislative provisions
- a lack of understanding on how the respective provisions interact can also lead to difficulties
- the purpose of this session is to provide practical guidance on how to deal with loans in SME groups



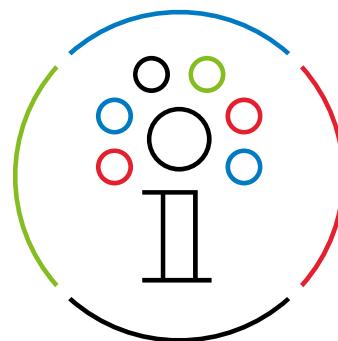
Today's session will cover



SME Loans

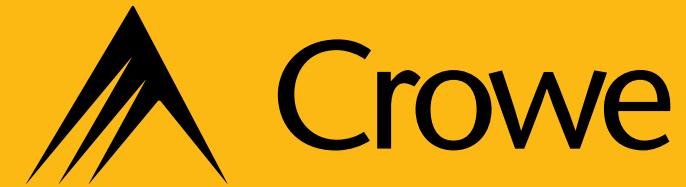
- Loans from private companies
 - Division 7A and loans
 - Division 7A and debt forgiveness
 - proposed changes to Division 7A
 - 109T loans
- Loans from trusts
 - subdivision EA loans
 - 109T loans

Today's session will cover



SME Loans

- Commercial debt forgives rules
 - issues for borrower
 - issues for lender
- Interest deductibility in general and for funds on-lent
- Personal use assets
- Debt : Equity provisions
- International Dealings
- Foreign Exchange
- Withholding Taxes



Loans – companies – Division 7A ITAA 1936

Companies to individuals / associates – Division 7A

- applies to all payments or loans made on or after 4 December 1997
- provisions treat three kinds of transactions as dividends paid by a private company:
 - payments made to a shareholder or its associate (s 318 ITAA 1936)
 - loans to a shareholder or its associate
 - debts forgiven by the company to a shareholder or its associate



Companies to individuals / associates – Division 7A

- a loan made during an income year will be treated as a payment of a dividend in the following circumstances:
 - loan made by a private company; and
 - loan is not fully repaid by the "lodgment day"; and
 - it is not an “excluded loan” [Subdiv D of Division 7A]; and
 - made to shareholder or associate of shareholder.
- Division 7A provisions can apply to loans from foreign companies [s109BC ITAA 1936]



Companies to individuals / associates – Division 7A

Section 109N

- loan will not be treated as a dividend if all the criteria has been met prior to the lodgment date of the company's tax return:
 - there is a written agreement
 - the term of the loan does not exceed the specified maximum term (7 years or 25 years)
 - interest is charged at a rate equal to or more than the benchmark interest rate



Companies to individuals / associates – Division 7A

Distributable Surplus s109Y

- dividend amount limited to the distributable surplus of the company and is unfranked
- distributable surplus = Net assets (at year end)
 - + Division 7A amounts (incl. forgiveness of debt)
 - Non-commercial loans
 - Paid-up share value
 - Repayments of non-commercial loans
- Division 7A amounts are the total amounts company made under s109C (payments) or s109F (debt forgiveness) in the income year



Companies to individuals / associates – Division 7A

Distributable Surplus s109Y

- Net assets = amount by which company assets - as reflected in accounting records - exceed the sum of the following:
 - Present legal obligations [TD 2007/28; TD 2012/10 ‘income tax’]
 - Provision for depreciation
 - Provision for Annual Leave and Long Service Leave
 - Provision for amortisation of intellectual property and trademarks

Note

- Commissioner may substitute a value of assets or provisions under/over valued [TD 2009/5]



Companies to individuals / associates – Division 7A

Distributable Surplus s109Y

- Non-commercial loans
 - amounts taken under former s108 or s109D (loans) that have been treated as deemed dividends in earlier years and shown as assets in the accounts
 - Includes deemed dividends under subdiv EA (trusts)
- Repayments of loans that have triggered either former s108 or loans previously subject to Div7A



Companies to individuals / associates – debts forgiven

- if a company forgives a debt owed by the shareholder or associate, Division 7A applies
- debt taken to be forgiven if a reasonable person would conclude company will not insist on repayment of the debt
- if Division 7A applies, commercial debt forgiveness rules will not apply because Division 7A takes priority over the commercial debt forgiveness provisions
- pre-1997 loan – not subject to Division 7A but care needs to be taken if loans treated as statute barred and subsequently forgiven [acknowledgement of debt by the debtor may also affect the 6-year period]



Companies to individuals / associates – common errors

- S109N loan agreements incorrectly prepared or not prepared by due date
- incorrect calculation of distributable surplus e.g. net assets = amount (if any) the assets exceed certain liabilities and provisions
 - Net assets have to be 0 or (+)
 - Net assets cannot be (-) even where liabilities exceed assets*
- incorrect interest rate or not complying with minimum repayment terms
- in relation to secured loans, property value is less than 110% of the loan secured

Note

In practice, a common error is for balance sheet 'net liabilities' to be used as the starting point.



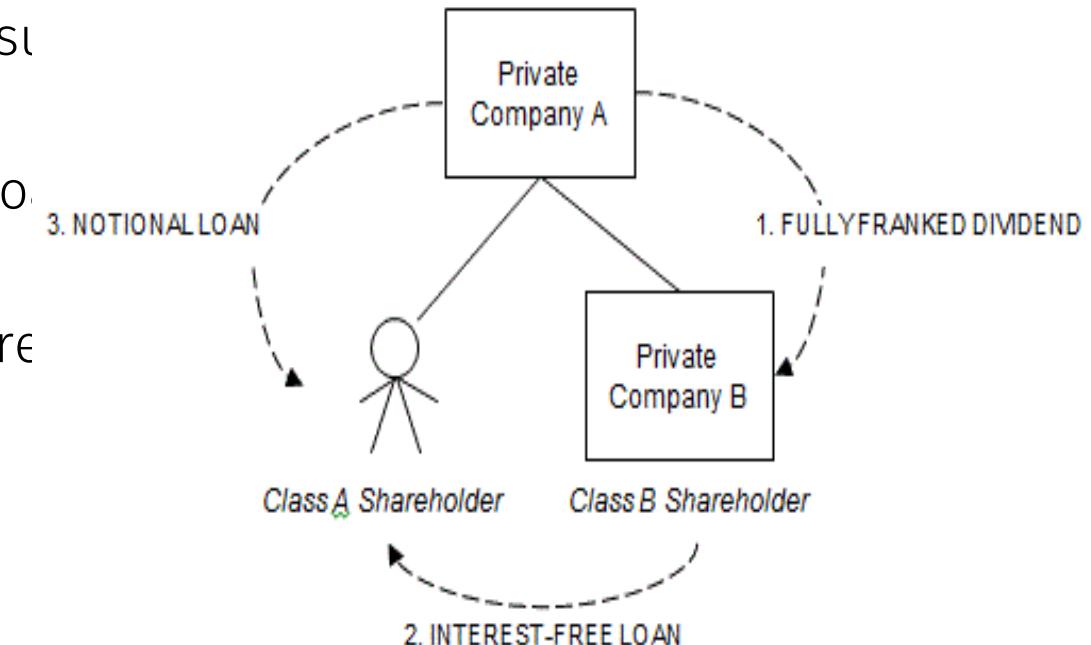
Companies to other companies

- generally, company to company loans (unless acting as trustee for Trust) are not subject to Division 7A
- however, s109T targets certain loans made through interposed entities
- Division 7A only applies if part of an “arrangement” which is widely defined and covers various situations
- TD 2018/13 issued for common 109T situations- says 109T may apply where a loan is part of an “ordinary commercial transaction”

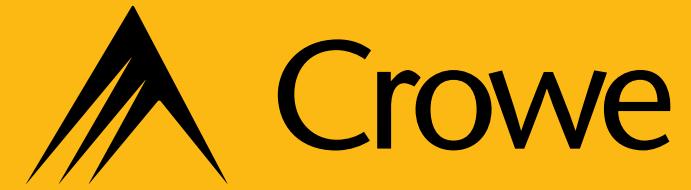


Companies to other companies – TD 2018/13 & 109T

- company has two class of shareholders
- pays dividend to another entity with no distributable si
- shareholder borrows funds from other entity and no lo
- 109T will apply and notional loan made to class A share



source : TD 2018/13



Loans – trusts

Trust borrowings – from Companies

- pre-December 2009 UPEs owed to Companies
 - did not convert to loans (ensure quarantined in financial statements)
 - however, may be caught out by Subdivision EA
- post December 2009 UPEs owed to Companies
 - converts to loan in the following year (“financial accommodation” - TR 2010/3)
 - need to put a complying loan agreement in place when required
 - TR 2010/3 and PSLA 2010/4 were withdrawn with effect from 1 July 2022
 - Replaced with TD 2022/11



Trust borrowings – from Companies – TD 2022/11

- post 30 June 2022 UPEs owed to Companies
 - converts to loan when the company becomes aware of the entitlement (“financial accommodation” - TD 2022/11)
 - need to put a complying loan agreement in place when required
 - Investment options are not available for UPEs arising from 1 July 2022



Trust borrowings – from Companies – TD 2022/11

- Considers when an unpaid present entitlement or amount held on sub-trust become the provision of ‘financial accommodation’
- Applies to trust entitlements arising on or after 1 July 2022
- Replaces TR 2010/3, which was withdrawn with effect from 1 July 2022
- Provision of financial accommodation [s109D(3)(b)] occurs where:
 - A UPE is held by a private company
 - The company has knowledge of the UPE
 - The company does not demand payment



Trust borrowings – from Companies – TD 2022/11

- s109D(3) defines the term ‘loan’ – it includes:
 - An advance of money [s109D(3)(a)]
 - A provision of credit or any other form of *‘financial accommodation’* [s109D(3)(b)]
 - A payment of an amount if there is an express or implied obligation to repay the amount [s109D(3)(c)]
 - A transaction which in substance effects a loan of money [s109D(3)(d)]



Trust borrowings – from Companies – TD 2022/11

- A private company will be taken to pay an unfranked dividend in an income year if
 - it makes a loan to a shareholder or their associate, and
 - the loan is not fully repaid before the private company's lodgment day, and it is not excluded by Subdivision D
- TD 2022/11 describes when a private company provides financial accommodation where it is presently entitled to income of a trust, and either
 - The UPE remains unpaid, or
 - The UPE is satisfied by holding it on a new sub-trust for the benefit of the private company



Trust borrowings – from Companies – TD 2022/11

- A provision of financial accommodation to the trustee occurs where:
 - A private company beneficiary with a UPE and consents to the trustee retaining that amount to use for trust purposes
 - The company has knowledge of an amount that it can demand immediate payment of from the trustee and does not demand payment
- As a result, the private company makes a loan to the trustee
- The loan is made when the financial accommodation is provided – when the private company is taken to have knowledge of the amount



Trust borrowings – from Companies – TD 2022/11

- The time when the private company's entitlement is known typically is after the end of the year in which the entitlement arises

Sub-trust

- Trustee may hold the UPE on sub-trust for exclusive benefit of private company
- Forms corpus of the sub-trust – UPE comes to an end and new obligation arises under the sub-trust under a separate trust
- ATO view is that NO financial accommodation arises where sub-trust is for the sole benefit of the private company



Trust borrowings – from Companies – TD 2022/11

Sub-trusts

- However, if the private company consents to the sub-trustee allowing those funds to be used by or for the benefit of the main trust where:
 - All or part of the sub-trust fund is used by or for the benefit of that entity, and
 - The private company has knowledge of this
- Will constitute the provision of financial accommodation by the private company – *regardless of whether this is done on commercial terms*



Trust borrowings – from Companies

Bendel & Anor v FC of T 2023 AATA 3074

- The AAT in the Bendel case did not agree with the ATO's view as expressed in TD 2022/11
- AAT held that UPFs to income of a trust estate were considered not to constitute loans to the trust to be included in the assessable income of the discretionary beneficiaries of the trust
 - *'A loan within the meaning of s 109D(3) does not reach so far as to embrace the rights in equity created when entitlements to trust income (or capital) are created but not satisfied and remain unpaid'*

Trust borrowings – from Companies

[Bendel & Anor v FC of T 2023 AATA 3074](#)

- ATO has released an interim decision impact statement on Bendel on 15 November 2023 – it will appeal the Bendel decision
- Until the appeal process is determined, the ATO will:
 - continue to administer the law in accordance with its published views relating to private company entitlements and trust income in TD 2022/11
 - will not finalise objection decisions in relation to objections to past year assessments where the decision turns on whether a UPE was a s109D(3) loan
- Unless a decision is required to be made (eg. because a taxpayer gives notice requiring the Commissioner to make an objection decision)



Trust borrowings – from Companies

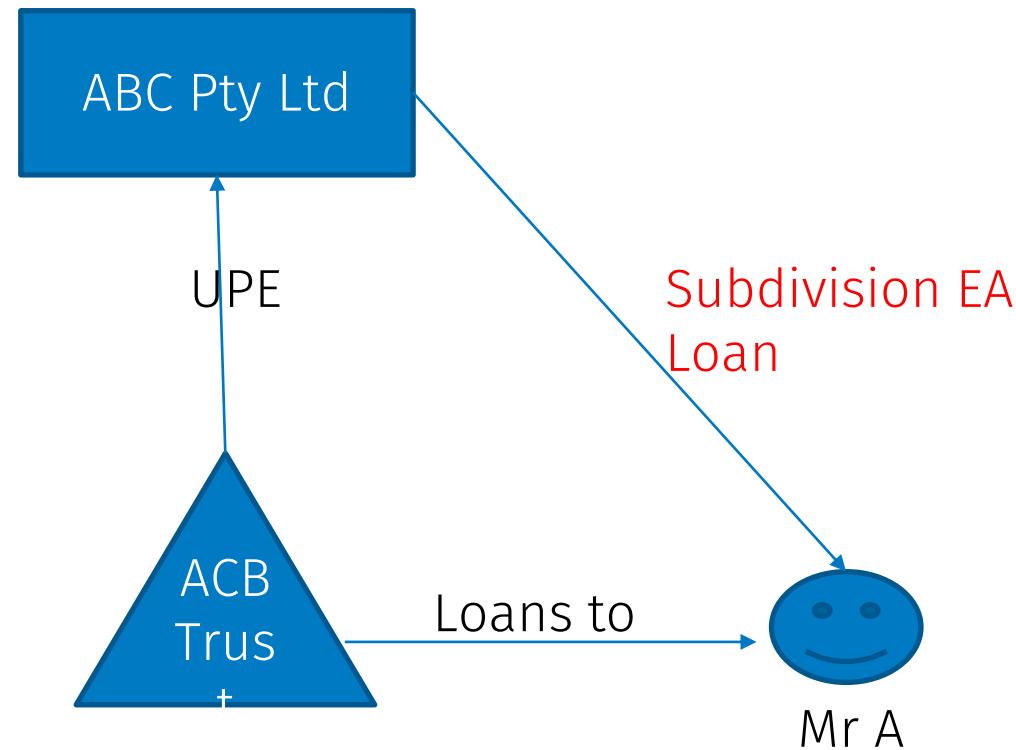
Subdivision EA Loans

- subdivision EA applies where a trust:
 - makes a payment representing an unrealised gain; or
 - makes a loan (not repaid, no loan agreement, etc); or
 - forgives a debt
 - in relation to a shareholder or associate of a private company; and
- the trust also has an unpaid PE owing to the private company
- *Subdivision EA will NOT apply where UPE is a financial accommodation under TD 2022/11*



Trust borrowings – from Companies

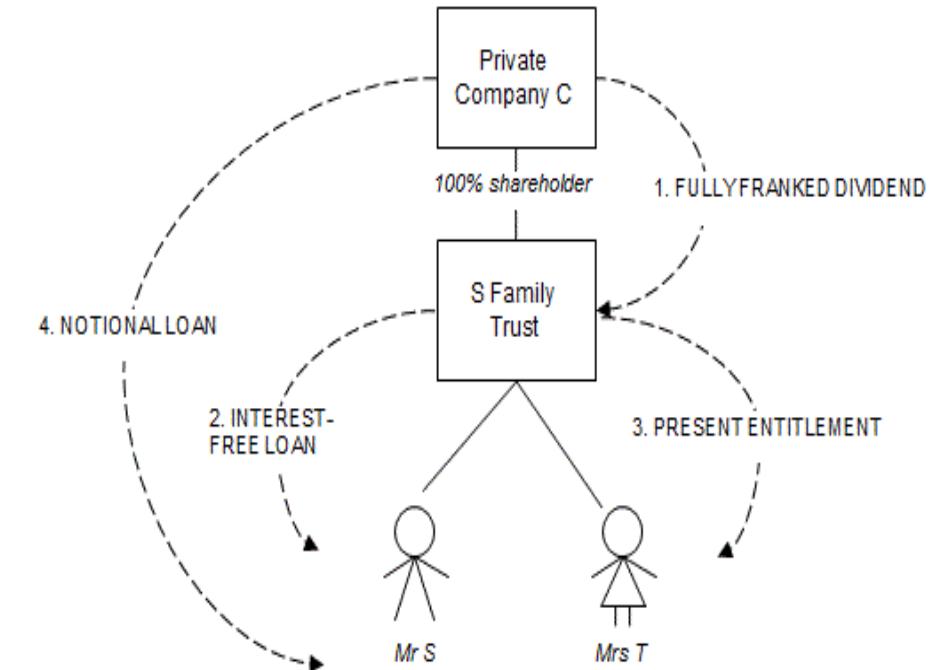
- Subdivision EA loans



Trust borrowings – to individuals – 109T

TD 2018/13 – be careful of dealings not within family unit

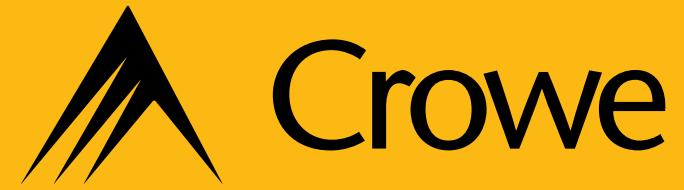
- Mr. S and Mrs. T not spouses
- company pays dividend to FT
- FT distributes to Mrs. T (non-resident)
- Mr. S takes an interest free loan for the same amount
- 109T may apply to this scenario



Note:

If Mr. S and Mrs. T were spouses, deemed dividend amount may be reduced under 109V.

source TD 2018/13



Division 7A proposed changes

Proposed changes – overview

- in the 2016-17 Federal Budget, the Government announced it will make amendments to the operation and administration of Division 7A ITAA 1936
- consultation paper was released in October 2018 highlighting the proposed changes to Division 7A and it was intended that the changes will apply from 1 July 2019
- in the 2019-20 Federal Budget, the Government delayed the start date from 1 July 2019 to 1 July 2020
- at this time - no draft legislation has been released and it is not clear which changes will proceed



Proposed changes – loan requirements

- remove concept of “distributable surplus”
- single 10-year loan model to replace 7 year and 25-year loans
- interest rate to be measured based on rates published by the RBA and interest is calculated on the full year
- no requirement for formal loan documentation, however parties must have written or electronic evidence that a loan was entered into



Proposed changes – transitional rules for loans

- **7-year loans**
 - must comply with new interest rate and repayments model
 - **25-year loans**
 - will be exempt from changes for a transitional period however must comply with new interest rate and repayments model
 - At a certain date, these loans will need to be put on a complying loan agreement i.e. 10-year loan
 - **Pre-1997 loans**
 - will be taken as financial accommodation and will need to be put on a 10-year loan

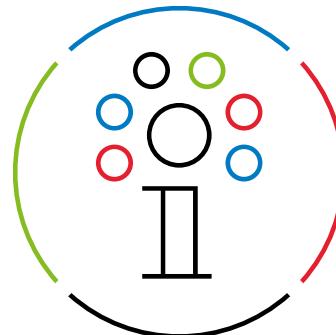
Proposed changes –transitional rules for UPES

- **Pre-16 December 2009 UPES** – not subject to changes provided quarantined and have not been “refreshed”
- **Post 16 December 2009 UPEs** – needs to be put on a complying 10-year loan agreement

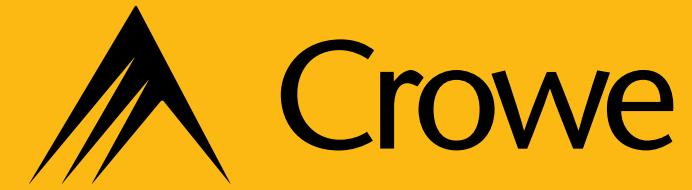


Poll Question 1

Where minimum repayments have not been made on a complying loan agreement during a year, the amount of the deemed dividend would be:



- a) The entire value of the loan
- b) The shortfall in minimum repayments
- c) Nil



Loans – commercial debt forgiveness (CDF)

CDF – in general

- a debt is a commercial debt if:
 - interest paid on the debt is an allowable deduction ; or
 - if interest was paid on the debt, it would have been an allowable deduction
- borrower of debt - subject to CDF rules where forgiven and can apply to individuals and trusts if not subject to Division 7A/FBT
- lender of debt- subject to ordinary income / capital gains tax rules



CDF – in general

- CDF does not apply
 - as a result of bankruptcy
 - as a result of debt forgiveness through a will
 - for reasons of natural love and affection
- TD 2022/1 confirms the person must be a natural person if the reason to forgive the debt was for natural love and affection – means companies may no longer be able to rely on this exemption
- previously, the ATO's view was companies can forgive debts because of the directors' love and affection to the debtor



CDF – in general

Forgiveness can arise in five ways

1. obligation to pay debt waived or otherwise extinguished
2. right to recover debt ends (statute of limitations)
3. agreement to forgive debt
4. debt assigned to an associate of the debtor - debt parking
5. debt for equity swaps



CDF – in general

- forgiveness is not effective merely by writing off the loan in the financials/ accounting systems
- there needs to be a formal contract (e.g. deed of release) to effect the forgiveness of the loan
- the deed of release needs to specify the debt being discharged or released
- timing of deed of release important to ensure capital/tax losses are deducted in the correct year



CDF – amount forgiven?

- care needs to be taken where lending to related parties
- amount forgiven (245-C) = value of debt – consideration received
- value of debt = market value at time of forgiveness assuming
 - at the time the debt was incurred, the debtor was able to pay the debt
 - the debtor was solvent when loan was advanced and forgiven



CDF – amount forgiven?

- for arms length transaction, in most cases, the debtor would have capacity to repay the loans when borrowing funds
- complications arise in dealings with related parties
- you cannot rely on “at the time the debt was incurred, the debtor was able to pay the debt” for non-arms length (e.g. related party) transactions – [s245-55 (3) (b)]
- market value substitution rule would kick in under s112-20 and substitute the value forgiven to the market value at the time the loans were funded

CDF – issues for borrower

- If there is a forgiven amount, the amount forgiven is applied to reduce the following tax balances of the debtor (in order):
 - a) prior year revenue losses [s 245-115];
 - b) prior year capital losses [s 245-130];
 - c) certain deductible expenditure [s 245-145]
 - d) cost bases of certain CGT assets [s 245-175]

Note:

If amount of loan forgiven exceeds total of above, no further taxation issues for borrower



CDF – issues for borrower

- A Pty Ltd has a commercial debt of \$15,000 that has been forgiven

Reducible Balances	Pre Forgiveness Balances	Reduction	Post Forgiveness Balance
Prior year carried forward tax losses	4,000	4,000	0
Prior year carried forward capital losses	2,000	2,000	0
Capital allowances	3,000	3,000	0
Cost base of assets	3,000	3,000	0
Total	12,000	12,000	0
Unapplied / residual forgiven amount		3,000	
		15,000	



CDF – issues for lender

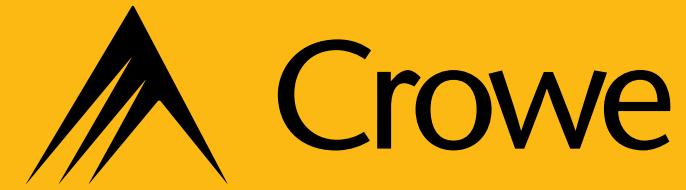
- when a lender forgives a debt, would need to consider tax treatment of amounts forgiven
- generally, the lender would have a capital gains tax event C2
 - when ownership of an asset ends by being cancelled, redeemed, forfeited etc.
- if lender is in a business of money lending, may be able to claim a tax deduction for the amount forgiven (i.e. bad debt)



CDF – common ownership exclusion

- companies under “common ownership” can ignore the impact of Division 245 [s245-90]
- debtor can enter into agreement with creditor company
- creditor company forgoes deduction or capital loss in relation to the debt being written off
- common ownership means:
 - they are members of the same wholly owned group (different subsidiaries of same parent)
 - held by the same individuals (directly or indirectly) in same proportions





Loans – deductions for interest on loans

Interest deductions

- interest may be deductible under 8-1 to the extent that:
 - (a) it is incurred in gaining or producing your assessable income; or
 - (b) it is necessarily incurred in carrying on a * business for the purpose of gaining or producing your assessable income.
- Steele's case – interest incurred prior to earning assessable income is deductible provided:
 - interest is incurred with one end in view, the gaining or producing of assessable income;
 - interest is not incurred 'too soon', is not preliminary to the income earning activities and is not a prelude to those activities



Interest deductions

- the “Use Test” established in FCT v Munro is the basic test and looks at the application of how the funds are used.
- special rules – line of credit and redraw facilities (TR 2000/2)
 - divide loan for each purpose
 - ascertain deductibility of each purpose based on whether used for income producing purposes
 - repayments of principal are applied proportionately
 - exception: where money is recouped from a particular purpose (e.g. sale of asset), it could be applied against that purpose



Interest deductions for vacant land

- S26-102 ITAA 1997 - a taxpayer cannot claim deductions for losses or outgoings incurred that relate to holding vacant land
- Does not apply to any losses or outgoings relating to holding vacant land to the extent the land was:
 - used or held available for use by the taxpayer in the course of a business the taxpayer carries on; or
 - used or held available for use by an affiliate, spouse or child of the taxpayer, or an entity that is connected with the taxpayer or of which the taxpayer is an affiliate, in carry on a business



Interest deductions for vacant land

- Does not apply to corporate tax entities (e.g., companies) and superannuation plans
- However, SMSF's, MITs & public unit trusts are caught

WARNING

- will deny deductions for private trusts, individuals and SMSF's that hold vacant land *unless they are carrying on a business*
- SMSFs cannot carry on business and will not be able to claim deductions for vacant land until an income producing structure is constructed on the land



Interest deductions – commencement / cessation

TR 2004/4

- interest is not capital in nature
- prior to commencement of business - following Steele's case, deductible if intention is to produce assessable income and not incurred "too" soon i.e. it is not preliminary
- after cessation of business – may be deductible in certain scenarios
 - unless taxpayer keeps loan for unassociated income producing activities; or
 - taxpayer makes a decision to keep the loan in a way there is a ongoing commercial advantage



Interest deductions – penalty interest

TR 2019/2

- Penalty interest is an amount payable under a loan agreement in consideration for the lender agreeing to an early repayment of the loan and in general:
 - may be deductible under s 8-1 if borrowings were used for gaining or producing assessable income or in a business carried on for that purpose
 - may not be deductible under s 25-25 (borrowing costs)
 - may be deductible under s 25-30 (discharge of mortgage)
 - may be an incidental cost to acquire or sell a CGT asset (cost base)
 - may be deductible under s 40-880 (catch all provision)



Interest deductions – penalty interest

Example 1:

- refinancing of loan to a lower interest rate for a rental property is deductible under s 8-1 if the amount was incurred for future interest savings

Example 2:

- penalty interest incurred for early repayment of loan to discharge mortgage on sale of asset is not deductible under s 8-1 as it is capital in nature but may be deductible under s 25-30 as a cost of discharging the mortgage

Example 3:

- penalty interest incurred for early repayment of unsecured loan on sale of asset is neither deductible under s 8-1 or s 25-30 – may be considered a cost base (incidental to sale)



Loans to companies – interest-free on lending

FCT v Total Holdings (Aust) Pty Ltd

- company borrowed funds from parent company
- on lent funds to subsidiary on an interest-free basis
- claimed interest deductions on the loan from parent company

Court found that:

- on-lending was designed to make subsidiary profitable
- company would generate income by dividends
- therefore, interest would be deductible



Loans to trusts – interest-free on lending

TD 2018/9

- beneficiaries cannot claim interest on funds on-lent to discretionary trusts
- generally, beneficiaries only have a mere expectancy to receive income from trust
- interest can only be claimed if:
 - beneficiary is presently entitled to income at the time of incurring the expense; and
 - expense has a nexus with the income to which presently entitled



Loans to trusts – interest-free on lending

Example

- Mr. A has taken a bank loan of \$100,000 on which he incurred interest of \$8,000. He then lends this to his discretionary trust, ABC Trust. He did not charge interest on the loan.
- Mr. A cannot claim interest on the loan ordinarily
- If Mr. A charged interest to the Trust, he would declare \$8,000 interest income and claim \$8,000 interest deduction
- The Trust would claim a \$8,000 deduction

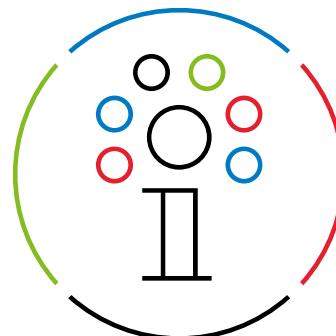
Trust borrowings – money lent to pay off beneficiaries

TR 2005/12

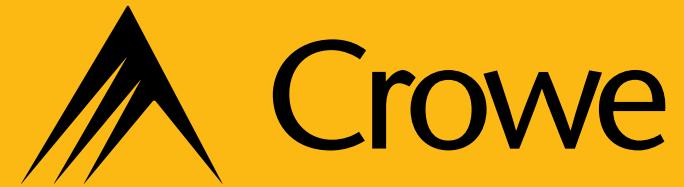
- trustees may not be able to claim interest on funds borrowed to discharge an obligation to pay a beneficiary's present entitlement - Hayden's case
- in order to claim a deduction, the interest needs to have sufficient connection with assessable income generated or business carried on by trustee
- sufficient connection where ,viewed objectively, is to refinance a “returnable amount”
- “returnable amount” represents money or property transferred by beneficiary or money or property retained by Trustee i.e. UPEs

Poll Question 2

Company A's creditor has forgiven a debt totalling \$100,000 during the 2018-19 financial year. The company had carried forward losses of \$50,000 at the end of the 2017-18 financial year and incurred a further \$15,000 in tax losses during the 2018-19 year. What is the amount to reduce tax losses by?



- a) \$100,000
- b) \$15,000
- c) \$50,000
- d) \$65,000



Loans – other issues

Debt : equity rules – small businesses

- purpose of the debt: equity provisions is to provide a set of rules under which financing arrangements can be classified either as debt or as equity
- interest on debt interest is deductible however interest incurred on equity interests is non-deductible and it is therefore important to consider these provisions
- a loan is generally a debt interest if:
 - borrowing is required to be repaid within a period of 10 years; or
 - if the term exceeds 10 years, then the present value of the repayments must be at least equal to the nominal value of the borrowings.



Debt : equity rules – small businesses

- there is a small business ‘carve-out’ for related party ‘at call’ loans to be treated as debt interests
- the company’s GST turnover must be below \$20 million in accordance with s188-10(2) of the GST Act 1999
- where the carve-out conditions are not met, care must be taken and if the interest is an equity interest,
 - interest paid on the loan will not be deductible
 - may be frankable subject to the availability of franking credits
 - the company will also need to maintain a non-share capital account



Personal use assets

- Losses from personal use assets must be disregarded under s108.20 of ITAA 1997
- A personal use asset is:
 - (a) a * CGT asset (except a * collectable) that is used or kept mainly for your (or your * associate's) personal use or enjoyment; or
 - (b) an option or right to * acquire a * CGT asset of that kind; or
 - (c) a debt arising from a * CGT event in which the * CGT asset the subject of the event was one covered by paragraph (a); or
 - (d) a debt arising other than:
 - (i) in the course of gaining or producing your assessable income; or
 - (ii) from your carrying on a * business.



Personal use assets

- from the definition of personal use assets, a key condition is that the debt must have arisen in the course of producing assessable income
- therefore, unless the debt arose in the course of carrying on a business, care needs to be taken in relation to interest-free lending as they may be deemed personal use assets
- this catches a lot of practitioners out as generally it is assumed shareholders/ trustees/ beneficiaries will be able to claim a capital loss where they have loan funds which have been 'written off' or forgiven



Personal use assets – forgiveness of UPEs / loans

- UPEs are not commercial debts and therefore not subject to CDF provisions
- interest free loans from beneficiaries may be considered personal use assets
 - made the loan without the expectation of receiving income
- therefore, may not be able to claim capital loss on forgiveness of UPE's or interest free loans
- bank guarantees may be caught out by personal use assets too (TR 96/23)

International issues - transfer pricing

- ‘transfer pricing’ refers to process of setting prices charged between related parties
- anti-avoidance allows ATO to adjust prices charged between related enterprises
- centres on application of ‘arm's length principle’
- requires prices charged in international dealings between related enterprises
 - to reflect prices that would have been charged
 - had enterprises been independent & dealing with each other at arm's length



International issues - transfer pricing

- to make it simpler for businesses to meet the documentation requirements, ATO released PCG 2017/2 for “Simplified Transfer pricing record-keeping options”
 - provided other conditions are met, can charge 5.81% for 2024 year (5.65% for 2023) for inbound & outbound loans.
 - however, may get a more tax effective result by undergoing a transfer pricing study

Claiming interest deductions – thin capitalisation

- under the thin capitalisation rules - amount of debt used to fund operations is limited
- applies to Australian operations of foreign entities investing into Australia & Australian entities investing overseas
- rules disallow a deduction for portion of specified expenses an entity incurs in relation to its debt finance (debt deductions)
- however, does not apply where debt deductions are less than \$2 million
- *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Bill 2023* when passed will amend the way the Thin Capitalisation rules operate from 1 July 2023



Withholding taxes – interest payments

- interest paid to non-residents subject to 10% final withholding tax (rate may be lower if there is a DTA in place)
- needs to be remitted to ATO in activity statements- does not require physical payment of interest to trigger liability (TD 93/146)
- can apply for a “certificate of payment” from ATO if non-resident requires proof of payment
- in practice, many loan agreements have gross up clauses to ensure non-resident is not out of pocket (gross up may be deductible - TD 92/152)



Withholding taxes – interest payments

- under s26-25 of ITTA 1997, you cannot claim deduction for interest where you have failed to withhold the correct amount from interest payments
- there are no amendment periods in relation to amending assessment for interest payments where withholding tax liabilities arise
- can apply to individuals as well as other entities e.g., borrowing from overseas family members to buy a rental property
- can apply to payments to overseas banks - DTAs may exclude it if there is a treaty



International dealings schedule

- additional schedule required to be completed & lodged with income tax return of a company, partnership, trust or fund
- required when aggregate amount of transactions or dealings with international related parties is > \$2 m
- aggregate amount of dealings is the total amount of all dealings, whether on revenue or capital account
- includes the balance of any loans or borrowings outstanding with the international related parties



Forex issues

- if loan is denominated in another currency, will need to consider FOREX rules.
- can elect to disregard gains and loss for accounts with a balance of less than \$250,000
- if this election is not made, need to consider all transactions going in and out of the account
- forex rules apply to individuals, trusts and companies.



Forex issues

- foreign realisation event 2 (FRE2) happens when you cease to have an obligation to receive foreign currency i.e., when a loan is repaid to you
- foreign realisation event 4 (FRE4) happens when you cease to have an obligation to pay foreign currency i.e. when you repay a loan
- forex acquisition time depends on type of transaction e.g. for CGT assets, the time the asset was acquired.
- exclusions for private and domestic – not defined in ITAA 1997 so takes the ordinary meaning



FBT and loan fringe benefits

- will not apply where loans provided to directors/shareholders are covered under Division 7A
- loan fringe benefit applies to loans provided to employee and/or their associates
- required to charge interest on the loan based on benchmark interest rate
- if interest is not charged, FBT will be payable on the taxable value of the benefit



FBT and debt waiver fringe benefits

- will not apply where loans/debt forgiveness provided to directors/shareholders are covered under Division 7A
- debt waiver fringe benefit arises when a debt to an employee is waived
- FBT will be payable on the value of the debt waiver- no reductions apply
- Commonly arises in situations of overpayment of salaries, underpayment of employee contributions etc.



Associated expenses – borrowing costs

- under s25.25
 - you can deduct the cost of borrowing over the period of the loan; or
 - 5 years from the date of the loan
- costs you can claim:
 - loan establishment fees
 - lenders mortgage insurance (ATO ID 2002/173 – now included in ATO guide to rental properties)
 - loan valuation
 - stamp duty on mortgage
 - mortgage broker fees



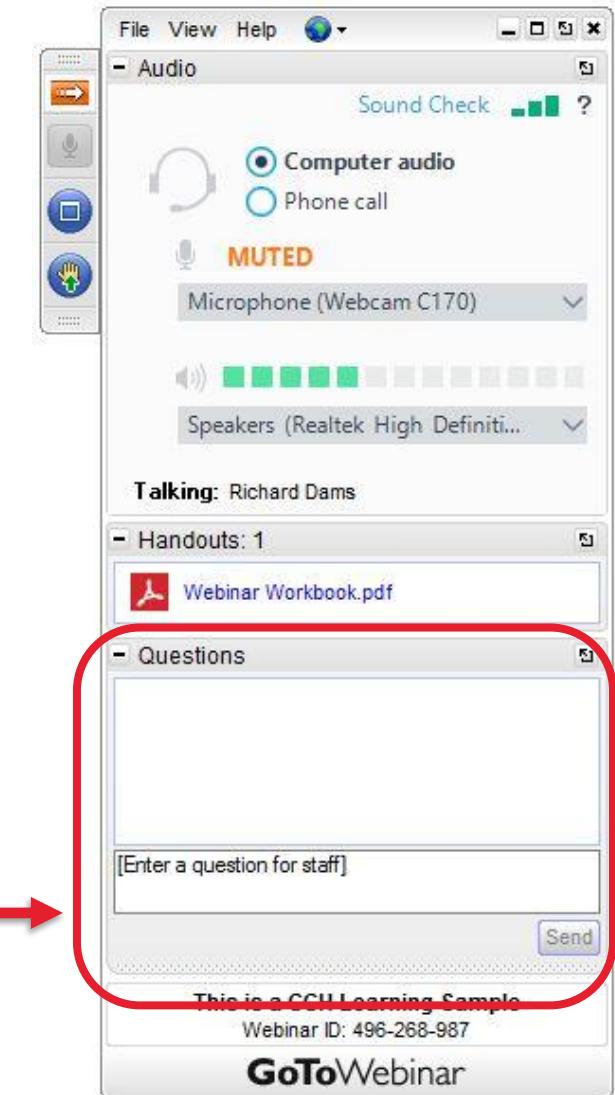
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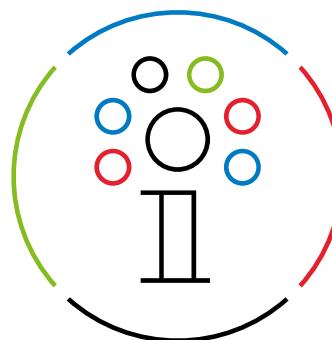
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