


# ***TA 2024/2 - Arrangements to circumvent Division 7A of the Income Tax Assessment Act 1936 through the guaranteeing by private companies of third-party loans***

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## Taxpayer Alert

# Arrangements to circumvent Division 7A of the *Income Tax Assessment Act 1936* through the guaranteeing by private companies of third-party loans

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### **!** About Taxpayer Alerts

Alerts provide a summary of our concerns about new or emerging higher risk tax or superannuation arrangements or issues that we have under risk assessment.

While an Alert describes a type of arrangement, it is not possible to cover every potential variation of the arrangement. The absence of an Alert on an arrangement or a variation of an arrangement does not mean that we accept or endorse the arrangement or variation, or the underlying tax consequences.

Refer to [PS LA 2008/15](#) for more information about Alerts. See [Alerts](#) issued to date.

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### **Overview**

- We are currently reviewing arrangements under which:
  - A private company (the first company) guarantees a loan made by a financial institution to a related private company that has no or minimal distributable surplus.
  - The related company on-lends (or pays) some or all of the amount borrowed from the financial institution to the first company's shareholders (or their associates) on terms that do not comply with the requirements of Division 7A of the *Income Tax Assessment Act 1936* (Division 7A).<sup>1</sup>
- The arrangements purportedly do not give rise to a deemed dividend under Division 7A. This is despite the fact that a deemed dividend may have arisen had the first company directly paid or on-lent the amount to its shareholders (or their associates).

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<sup>1</sup> For example, there is no loan agreement that complies with the requirements of section 109N of the *Income Tax Assessment Act 1936*.

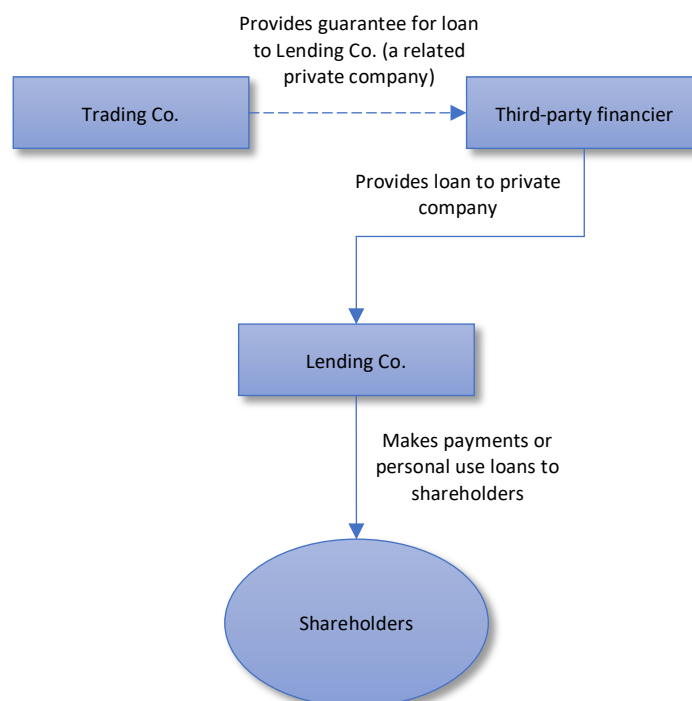
3. This Alert applies to arrangements which, when viewed objectively, involve a series of steps that are intended to circumvent the operation of Division 7A.

4. All legislative references in this Alert are to the *Income Tax Assessment Act 1936*, unless otherwise indicated.

### Description

5. The arrangements we are reviewing typically display the following features:

Diagram 1: Diagram illustrating typical features of an arrangement



- A private company (Trading Co.) guarantees a loan made to a related private company (Lending Co.) from a third-party financier that is not a private company, such as a bank.
- Lending Co. pays or loans some or all of the amount borrowed to the shareholders of Trading Co. (or the shareholders' associates). If Lending Co. does make a loan, the loan does not comply with the requirements of section 109N.
- The payment or loan made by Lending Co. is more than its distributable surplus.<sup>2</sup>
- Trading Co. may pay the amounts required under the loan agreement with the third-party financier because Lending Co. defaults on its obligation to repay the amounts required under the loan agreement to the third-party financier and calls on the guarantee of Trading Co.<sup>3</sup>

<sup>2</sup> Section 109Y.

<sup>3</sup> Section 109UA may also apply in the event of a default under the terms of the loan agreement. Subsection 109UA(2) operates to reduce the amount of any deemed dividend to the extent that section 109U applies.

- Alternatively, Trading Co. may pay the amounts required under the loan agreement with the third-party financier directly or pay money to Lending Co. to enable it to repay the third-party financier, and to prevent Lending Co. from defaulting on its obligations under the loan agreement.
- On an objective assessment, Trading Co.'s guarantee and Lending Co.'s loan were provided as part of the same contrived arrangement for the purpose of avoiding the Division 7A consequences that would have arisen had Trading Co. directly paid or lent the amount to its shareholders (or their associates).

### What are our concerns?

6. We are concerned that some taxpayers are entering these arrangements to circumvent the operation of Division 7A.

7. We are also concerned that these arrangements may be entered into on the misunderstanding that section 109U (within Division 7A) only applies if the third-party lender is a private company. This is not the case. Section 109U requires the entity which makes the payment or loan to the shareholders (in the arrangement in paragraph 5 of this Alert, Lending Co.) to be a private company, but it does not require the entity to which the guarantee is given (in the arrangement in paragraph 5 of this Alert, the third-party financier) to also be a private company.<sup>4</sup>

**Note:** Ordinarily, we will only have cause to apply compliance resources to consider the application of section 109U to arrangements involving a series of steps that, when viewed objectively, are intended to circumvent the operation of Division 7A. For more detail, see Appendix 2 of Draft Taxation Determination TD 2024/D3 *Income tax: Division 7A – does section 109U of the ITAA 1936 only apply to arrangements where a private company gives a guarantee to another private company?*

8. From our review of these arrangements, we consider that the following consequences may arise:

- Division 7A may apply to deem the private company which gave the guarantee (Trading Co. in the arrangement in paragraph 5 of this Alert) to have paid an unfranked dividend to the shareholders or associates who received the loan from the related private company (Lending Co. in the arrangement).
- The Commissioner may make a determination under Part IVA to cancel any tax benefit arising under the arrangement.

### What are we doing?

9. We are currently reviewing these arrangements and are engaging with taxpayers and advisers who have entered into, or are considering entering into, these and similar arrangements.

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<sup>4</sup> See Draft Taxation Determination TD 2024/D3 *Income tax: Division 7A – does section 109U only apply to arrangements where a private company gives a guarantee to another private company?*

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**What should you do?**

10. If you have entered, or are contemplating entering, into an arrangement of this type, we encourage you to:

- Phone or email us using the contact details provided at the end of this Alert.
- Ask us for our view through a [private ruling](#).
- Seek independent professional advice.
- [Make a voluntary disclosure](#) to reduce penalties that may apply.

11. Penalties may apply to participants in, and promoters of, this type of arrangement. This includes serious penalties for promoters under Division 290 of Schedule 1 to the *Taxation Administration Act 1953*. Registered tax agents involved in the promotion of this type of arrangement may be referred to the Tax Practitioners Board to consider whether there has been a breach of the *Tax Agent Services Act 2009*.

**Do you have information?**

12. To provide information about this type of arrangement, or a promoter of this or another arrangement:

- phone us on **1800 177 006**
- complete the [Tip-off form](#)
- contact the officer named in this Taxpayer Alert.

Contact officer: Anthony Pulvirenti  
Email: [anthony.pulvirenti@ato.gov.au](mailto:anthony.pulvirenti@ato.gov.au)  
Phone: 07 3213 8538

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**Commissioner of Taxation**  
11 December 2024

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**References**

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*Legislative references:*

- ITAA 1936 Division 7A
- ITAA 1936 109U
- ITAA 1936 109N
- ITAA 1936 109Y
- ITAA 1936 109UA
- ITAA 1936 109UA(2)
- ITAA 1936 Pt IVA

- TAA 1953 Sch1 Div 290
- Tax Agent Services Act 2009

*Other references:*

- TD 2024/D3

*Related practice statements:*

- PS LA 2008/15
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## ATO references

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Tax integrity measures ~~ Division 7A ~~ Loans

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