

Tax Office forgives 'honest mistakes'

By Albert Gigl, Managing Partner, MW Partners Chartered Accountants

It's hard to believe, but true, for dentists who operate through a company and may have fallen foul of the Div. 7A loan rules, some 'honest mistakes' will be forgiven until the end of June.

Division 7A of the 1936 Tax Act ensures that loans or payments made by companies to shareholders/directors or associates are considered to be assessable income in that person's hands. If a private company lends a director/shareholder say \$100,000, and even if that money is used by that person for business/investment purposes, the director/shareholder will need to include that \$100,000 as assessable income in their tax return. The \$100,000 is an unfranked 'deemed' dividend and therefore has no tax credits attached to it.

When a company makes a payment or loan to a shareholder/director, the consequences can be avoided if:

- a written loan agreement is entered into before the payment/loan is made,
- the loan agreement complies with the requirements of Division 7A in that it specifies minimum capital repayments over a seven year period for unsecured loans and charges interest at the prescribed rate, and
- minimum payments of principal and interest are made by the shareholder/director.

Prior to some recent changes, the effect of inadvertently not complying with the provisions of Division 7A was financially very punitive both to the company and the shareholder/director. A breach of Division 7A even in a minor aspect resulted in the automatic imposition of the default provisions with no ability for the taxpayer to rectify the error or for the Commissioner of Taxation to exercise some discretion in unusual circumstances.

Under the Commissioner of Taxation's Practice Statement PS LA 2007/20, which utilizes Sec. 109RB of the 1936 Tax Act, the Commissioner can **disregard** a deemed dividend in respect of the 2002 to 2007 income years.

This transitional arrangement **expires on the 30th June 2008** and only applies where:

- it is clear from the circumstances that the failure to comply with the provisions of Division 7A was the result of an **honest mistake or inadvertent omission** by the company or shareholders/director,
- the taxpayer has taken the necessary **'corrective action'** by 30 June 2008,

- the deemed dividend arose in respect of a transaction or action that occurred between 1 July 2001 and 30 June 2007, and
- the taxpayer has lodged all required tax returns up to and including the 2007 year.

The danger signs for dentists in incorporated practices are as follows:

- The company has lent money to them, a shareholder, a director, an associate or a company or trust, which is related to them.
- They vaguely remember their accountant or advisor telling them about debit loans, directors loans, Division 7A or deemed dividends but cannot recall what was done to correct them.
- The company provides them and/or their spouses with a motor vehicle and they do not pay any fringe benefits tax (because it gets offset in a directors' loan account).
- The dentist draws a low wage and the company 'reinvests' profits into other related entities.

The potential tax saved from correcting past mistakes can be quite substantial as one of our dentists found when they received a tax refund cheque from the Tax Office for over \$100,000 in respect of a Division 7A correction for only one year.

This is a genuine one-off opportunity to correct past 'honest mistakes' regarding Division 7A and all incorporated dentists should contact their accountants/tax advisors to confirm what action they may need to take.

Hot Topics

In addition to the issue of Division 7A, the top three 'hot topic' questions asked by dentists are:

- Q.** Do I need to pay Work Cover insurance for contract dentists engaged by me?
A. Yes, if they work 90 days or more for you and generate revenue for your dental practice.
- Q.** Do I need to pay superannuation (9%) for contract dentists engaged by me?
A. Not if they are a company, but possibly if they are an individual and a 'deemed' employee because you do not have an appropriate service agreement.



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Q. Do you have any practices for sale?

A. No, the market is very thin at the moment and MW Partners only advises on the financial and tax aspects of buying and selling practices.

MW Partners deals with complex technical issues such as Division 7A on a daily basis and can assist all members of the ADAVB with this as well as more detailed information on the above 'hot topics'.

If you would like to discuss your financial or tax affairs and are a member of the ADAVB, your first consultation is completely free of charge. Please call 03 9913 0030 to make an appointment.



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