NEWSLETTER

August 2010

MEDICAL & DENTAL ACCOUNTING

THE HEALTH WEALTH SPECIALISTS

CHARTERED ACCOUNTANT

DIVISION 7A/UNPAID PRESENT ENTITLEMENTS: ACTION ITEMS FOR 30 JUNE 2010

On 2 June 2010 the ATO issued Taxation Ruling TR 2010/3 and a draft Practice Statement *PS LA 3362* in relation to unpaid present entitlements in investment companies. In our view the ATO is providing some practical options which enable trustees to distribute to a company without placing unmanageable financial burdens on cashflow.

This email is only being sent to clients who are affected by this ruling i.e. those that have credit loan accounts in discretionary trusts and have distributed to investment companies without actually transferring the cash or an investment across.

In this situation you have a deemed loan – an unpaid present entitlement (UPE).

Under the practice statement the ATO will deem a UPE to be a loan – in the form of financial accommodation – if it remains unpaid at 30 June in the *following* year.

Action required before 30 June 2010:

Your immediate concerns should be to:

- Check UPEs existing at 16 December 2009. (We will do for you). The ATO's new approach will be applied retrospectively where, rather than there being a UPE, there is an actual loan or if there is documentation or accounting treatment which implies a loan.

  You need to make sure the financial statements clearly reflect the legal arrangement if there is in fact just a UPE. (We will do for you)

  The draft Practice Statement is somewhat vague at this stage: do you just look at the final, signed financial statements or can you look at the general ledger - which might be different? We think the outcome will be that, if the financial statements are unambiguous - that it is recorded as a UPE by both the trust and the company - you need not look further.

- Quarantine existing UPEs - you do not need to take any action other than to identify and separately record existing UPEs. However, there is no harm in actually paying them out!

- We will discuss with you whether to resolve to make 2010 distributions to a company. If you wish to do so you need to be prepared to:

  - pay the distribution out by 2011 lodgement day - March 2012, which gives 21 months' "grace".

    What remains unclear is whether interest will be deductible if borrowed funds are used to pay out the distribution.

  - turn it into a complying loan by 2011 lodgement day and make the minimum repayment by 30 June 2012 (which in most cases will be covered by the payment of the company's tax on the distribution) and pay interest on the loan.

Unless you have spare funds available to invest in the investment company, it may be time to bite the bullet and not distribute to the company in future. If you distribute for 30 June 2010 and pay tax at 30% but then have to pay out a fully franked dividend the following year and pay top up tax, you have only achieved a deferral of the top up tax (generally at 16.5%) for one year.

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