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### Forgiveness of Div 7A loans by deceased estates: the ATO changes position

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The ATO appears to have recently changed its position in relation to the forgiveness of debts owed by deceased estates.

#### Background

As profiled regularly in this *Bulletin*, Division 7A of the ITAA 1936 prevents companies from making tax-free distributions of profits to shareholders (or their associates) by deeming loans made by the company to its shareholders (or their associates) as deemed dividends.

In particular, s 109D deems a loan by a private company to an "entity" to be a dividend paid in certain circumstances where the loan is not fully repaid by the end of the year in which the loan is made. The relevant entity must be a shareholder in the private company or an associate of the shareholder.

Further, a private company is taken to have paid a dividend to an entity at the end of that year under s 109F(1) if the amount is forgiven whilst the entity is a shareholder or an associate of such a shareholder.

In relation to estate planning arrangements, the issue of whether the legal personal representative (LPR) of the borrower is an "entity" is critical.

#### Historical position

Over recent years, there have been a number of pronouncements which reflect the ATO's application of Div 7A rules in relation to outstanding Div 7A loans that are a liability in deceased estates.

Broadly, the approach that appears to have historically been adopted by the ATO is that it allowed Div 7A loans to be forgiven after death.

For example, in Private Ruling 58896, the ATO provided guidance about the correct treatment of a Div 7A loan in the following circumstances:

- on the death of the shareholder, where the loan had not been repaid and no repayments were made in the relevant income year - the ATO ruled that the company was not taken to have paid a dividend to the LPR of the shareholder, notwithstanding that no loan repayments were made during that year; and
- where the loan was forgiven by the private company - again, the ATO confirmed that if the company chose to forgive the loan, it would not have been taken to have paid a dividend because the LPR of the estate was not an "entity".

The above treatment was also confirmed in private rulings 54358 and 94873. The main principle which can be derived from these private rulings is that the LPR is not to be treated as the "entity" to which the loan was made for the purpose of s 109F.

### **New position: ATOID 2012/77**

In ID 2012/77 (reported at 2012 WTB 40 [1623]), the ATO reviewed the application of s 109F in relation to a deceased shareholder's LPR.

### **Facts**

The relevant individual (**S**) was a director and shareholder of a private company (**Company**). During the 2008-09 income year, the Company made a loan to S. The loan was subject to a written loan agreement satisfying the requirements of s 109N. The minimum repayment requirements had been complied with.

In the 2011-12 income year S died. Before 30 June 2012, probate was granted. During the 2012-13 financial year, the Company forgave the LPR from repaying the loan.

### **Issue**

The issue was whether the forgiveness of the loan would be treated as a dividend under s 109F(1). In contrast to the previous guidance provided by the ATO in the abovementioned private rulings, the ATO took a different approach to the interpretation of "entity".

### **Decision**

The Company was deemed to have paid a dividend to the LPR of S.

### **Reasons**

Under the relevant probate legislation regulating the estate of S, all real and personal property of S (including title to the shares) was deemed to have passed to and become vested absolutely in the LPR as from the date of death.

As title to the shares in the Company passed to the LPR, the LPR became the relevant shareholder for the purpose of s 109F(1)(a) and in turn satisfied the definition of "entity". The forgiveness of the debt owed by the LPR therefore triggered the deemed dividend provisions in the same way as would have been the case before S died.

This interpretative decision appears to be in direct contrast with the private rulings mentioned above where it was decided that the LPR is not the "entity" to which the loan was made and should not be treated as the relevant shareholder for the purposes of s 109F.

### **Implications of ID 2012/77**

The ATO's treatment of the LPR as an "entity" in ID 2012/77 means that the beneficiaries of deceased estates may now be subject to the operation of Div 7A on forgiveness of outstanding loans during the administration of the estate.