

Tax experts say crackdown on private company assets will hurt SMEs despite exceptions for rural businesses

Patrick Stafford

The Government has softened its crackdown on the use of private company assets by shareholders by introducing exemptions for farmers and some small businesses operators after realising they may be unintentionally affected by legislation proposed in last year's budget.

But tax experts warn many small businesses will still be affected by the new Division 7a rules and say questions remain unanswered as to how much businesses should charge shareholders for use of company assets.

Assistant Treasurer Nick Sherry introduced the exemptions yesterday which effectively protect farm residences from the Division 7a rules.

Sherry says they would give clarity to rural businesses which believed they would be affected by the proposed crack down on non-commercial assets.

"Feedback told us genuine farming businesses and small businesses that include a residence located at the business itself may have been unintentionally impacted," Sherry says.

"I've taken those concerns on board and the draft legislation now includes two new rules designed specifically to provide certainty and clarity for farmers and small businesses."

The amendments come after the Government announced a crack down on non-commercial assets in last year's budget. Institute of Chartered Accountants tax counsel Yasser El-Ansary says this was an attempt to quash years of businesses attempting to exploit the law.

"Private companies used to give out loans to shareholders without imposing interest. The ATO found this was a problem, because individuals could access huge sums of money and benefits that come with that, and take out an interest-free loan."

"Obviously this stopped, as companies doing that are now deemed to be providing a dividend, which is subjected to tax. However, after that there have been people using a private company to buy assets, then allowing those shareholders in the company to use them for no money. A very easy way for people to get around the rules."

This is what the Government hoped to address with its proposals last year. However, El-Ansary says there have been a number of complaints from businesses in rural areas, as the Government has not yet clearly defined its proposals.

"Farms have found themselves in a position where they can be penalised under this legislation, because they usually have a company which buys the farm and holds onto it. Then the shareholders, usually a family, come along and work it, which is a business. This is usually in a trust structure."

This is now covered under the "residence exemption" rule, which effectively protects residences on a farm from being taxed under the Division 7a rules.

The Government has also unveiled a second exemption, known as the "otherwise deductible rule". El-Ansary says this will apply to other businesses not just in rural areas.

"This rule states that if an expenditure being incurred is normally deductible under the tax law, then the Government will not penalise that outcome – because what would be the point?"

But HLB Mann Judd tax partner Tony Fittler says despite the clarification on these issues, there are still many problems yet to be solved regarding the proposed legislation.

Fittler says that the proposed Division 7a laws will require private companies to charge shareholders market rates for using assets owned by the business, this rate has still yet to be defined.

"The principle is fine, it's just when you get to apply the law it becomes messy and untidy. If you have a boat involved in this farm, or in another business, when do you use it? Is it there for your use? If you a market rate, is that different from a commercial rate?"

"I think there is a good attempt to define this through exemptions, but there will need to be some sort of rule or guideline as to how this will all work in practice."

Additionally, Fittler says the new Division 7a laws will practically affect all private businesses using assets, including office hardware such as computers.

"Division 7a applies to private companies, but also to any use of an asset. This can even apply to normal business matters such as computers, and one area that needs definition is that line between what is business asset and what is private asset, that sort of thing."