This checklist will assist you to determine whether Division 7A applies. To be completed by all private companies each year.

This checklist deals with payments, loans and debt forgiveness that are made (directly or indirectly) by private companies only. Please refer to CPA Australia’s 2016 Division 7A: UPE Checklist for potential Division 7A transactions involving trusts where:

* a private company beneficiary is owed an unpaid present entitlement by a trust estate
* a payment, loan or a debt forgiveness is made (including payments, loans and debt forgiveness through an interposed entity) by the trustee of the trust estate to a shareholder or an associate of a shareholder of the private company.

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**Overview**

This checklist covers the following key areas:

1. Current Year Loans

A1. Meaning of distributable surplus

B1. Payments, loans and debt forgiveness

C1. Exclusions from Division 7A

1. Prior Year Complying Loans
2. Integrity Provisions

* Interposed entities
* Guarantees
* Refinancing

1. Payments, loans or debt forgiveness by trusts with unpaid present entitlement to a private company

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| SECTION 1. CURRENT YEAR LOANS | | |
| A1. Does the private company have a distributable surplus for the year of income? | Yes | No |
| Does the private company have a distributable surplus\* (section 109Y) for the year of income? |  |  |
| If the answer is *yes*, Division 7A can potentially apply. **Continue to B1.** | | |
| If the answer is *no*, Division 7A cannot result in the private company being deemed to have paid an unfranked dividend (in which case there is no need to proceed).  \* Distributable surplus is essentially a formula prescribed by section 109Y(2) as:  *Net Assets plus Division 7A amounts less Non-commercial loans less Paid Up share capital less Repayments of non- commercial loans* | | |
| Note:  1. Where the distributable surplus of the private company is less than the amount of any deemed unfranked dividend calculation in accordance with Division 7A, the amount of the deemed unfranked dividend will be proportionally reduced (i.e. capped) to the balance of the distributable surplus existing in the private company. Note also that the Commissioner of Taxation may include the value of assets not shown in the company’s accounting records for the purposes of determining the company’s distributable surplus, as discussed in Taxation Determination TD 2009/5.  2. Where the private company making the loan or payment is part of a tax consolidated group, only the accounts of that private company are taken into account when determining the distributable surplus, as discussed in Taxation Determination TD 2004/68.  3. In working out the company’s distributable surplus it is important to take into account the income tax liability that may arise at the end of the income year, as well as any unpaid PAYG instalments, as discussed in Taxation Determination TD 2012/10.  4. Section 109Y(2) defines ‘net assets’ to mean the amount (if any), at the end of the company’s year of income by which the company’s assets (according to the company’s accounting records) exceed the sum of the company’s present legal obligations and provisions for depreciation, annual leave and long service leave, and the amortisation of intellectual property and trademarks. | | |
| B1. Did one of the following transactions occur during the current financial year? | Yes | No |
| Did the private company make a payment to a shareholder or an associate of a shareholder, other than a loan (section 109C)? (Refer to Note 1) |  |  |
| Was a loan was provided by the private company to a shareholder or an associate of a shareholder prior to 4 December 1997 that has been varied by increasing the amount of the loan or extending the term of the loan (sub section 109D(5))? |  |  |
| Did the private company make a new loan to a shareholder or an associate of a shareholder (section 109D)? (Refer to Note 2) |  |  |
| Was a debt owed by a shareholder or an associate of a shareholder to the private company forgiven by the private company (section 109F)? (Refer to Note 3) |  |  |
| Was a debt owed by a shareholder, or an associate of a shareholder to the private company, assigned to a new creditor being:   * an associate of the debtor or * a person who is party to an arrangement with the debtor about the assignment AND * a reasonable person would conclude that the new creditor would not call on the debt (subsection 109F(5))? |  |  |
| If the answer to any of the above is *yes*, **continue to C1**. If the answer to all of the above is *no*, **continue to D1**. | | |
| Note:   1. Sub section 109C(3) provides that a payment means:  * a payment to the extent that – it is to the entity, on behalf of the entity or for the benefit of the entity * a credit to the extent that – it is to the entity, on behalf of the entity or for the benefit of the entity * a transfer of property to the entity.   Section 109CA further provides that a payment also includes the provision of an asset by a private company for use by an entity being a current or former shareholder (or an associate of such a person). The amount of any payment which is a deemed dividend under section 109CA is the arm’s length value that would have been provided for the use of the asset less any consideration given for that use by the shareholder or associate. A payment will not be taken to have been made under section 109CA where the value of the usage of the asset is less than $300, the amount would otherwise have been deductible as a once-only deduction to the shareholder or associate or the use is in respect of certain residences.  Also, where a private company makes a payment to an entity which will trigger a deemed dividend under section 109C, it may also be possible for the payment to be converted into a loan before the lodgment day of the private company’s income tax return for the year in which the payment arose under section 109D(4A). Accordingly, in practice a shareholder or associate has until the day before the lodgment day to either fully repay the ‘converted’ loan or enter into a written excluded loan agreement under section 109N. | | |

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| **SECTION 1. CURRENT YEAR LOANS** | | | | |
| **B1. Did one of the following transactions occur during the current financial year?** *(continued)* | | **Yes** | **No** | |
| Note:   1. The ATO has issued Taxation Ruling TR 2010/3, which sets out circumstances in which certain unpaid present entitlements (UPEs) owing by a trustee of a trust to a private company beneficiary will be regarded as a loan under section 109D of the general provisions of Division 7A and thus potentially a deemed dividend. The ruling applies to certain UPEs that have been documented or accounted for as ‘actual loans’ whether made before or after 16 December 2009. However, where the UPE has not been documented or accounted for in this way, the ruling will only apply prospectively from 16 December 2009 to ‘deem’ post 16 December 2009 UPEs to be loans in certain circumstances. The ATO has released Practice Statement PSLA 2010/4, which sets out what must be done to ensure that a post 16 December 2009 UPE is not treated as a deemed loan by the Commissioner under section 109D. The ATO has explained that the UPE must be set aside on a sub-trust for the sole benefit of the company beneficiary – which can be achieved under the three methods that have been listed by the ATO in the Practice Statement. This Practice Statement also sets out the timeline for the application of Division 7A and TR 2010/3 in respect of post 16 December 2009 UPEs owing to private companies. For UPEs that arise from the entitlements to trust income and capital arising in the 2011 and subsequent income years, the UPE must be set aside for the sole benefit of the company beneficiary by the lodgment day of the main trust - otherwise a section 109D loan will be taken to have been made on the same day i.e. on the lodgment day. However, it should be noted that the above Taxation Ruling and Practice Statement are technically complex and that specialist advice on their application may be required. 2. Sub section 109F(3) provides that a debt is forgiven where the amount of the debt would be forgiven under sections 245-35 and 245-37 of the *Income Tax Assessment Act 1997* (the ITAA (1997)). Broadly, this would include where the debt is realised, waived or otherwise extinguished, the debt is deemed to be forgiven under a statute of limitations or if an entity subscribes for shares in a company to enable it to pay or discharge a debt it owes to the entity. | | | | |
| **C1. Does the transaction identified in B1 satisfy any of the following criteria?** | | **Yes** | **No** | |
| The payment made by the private company represents the discharge of an obligation by the private company to pay money to an entity where the amount paid in discharging the obligation is made on an arm’s length basis (section 109J). | |  |  | |
| The payment or loan made by the private company was made to another company (other than a company acting in the capacity of a corporate trustee) (section 109K). | |  |  | |
| The payment or loan is otherwise assessable to the shareholder or an associate of the shareholder or such amounts would be excluded from assessable income outside of Division 7A (section 109L). | |  |  | |
| The loan was made in the ordinary course of business of the private company and on the usual terms that such loans are provided to arm’s length parties (section 109M). | |  |  | |
| The loan or payment represents a distribution made by a liquidator in the course of winding-up a company (section 109NA). | |  |  | |
| The loan was made to employees solely for the purpose of purchasing shares or rights under an employee share scheme as defined in Division 83A of the ITAA (1997) (section 109NB). | |  |  | |
| The loan was established on excluded loan terms (section 109N).  Under section 109N, a loan will be established on excluded loan terms where, prior to the earlier of the lodgment due date or the actual lodgment date of the income tax return of the private company for the year in which the loan is made all the following conditions are satisfied:   * the loan is established under written loan agreement * the rate of interest payable on the loan for years following the year the loan is first established is equal to the benchmark interest rate (being the Indicator Lending Rates – Bank variable housing loans interest rate published by the Reserve Bank) of that particular year * the term of the loan does not exceed 25 years where the loan is fully secured by first registered mortgage (subject to certain conditions), or seven years in all other cases.   (Refer to Note 1 below) | |  |  | |
| The loan was fully repaid before the earlier of the due date for lodgment of the private company’s return of income for the current year and the actual date of lodgment of the private company’s return of income for the current year (sub sections 109D(1)(b) and 109D(6)). | |  |  | |
| The forgiven debt was owed to the private company by another private company (sub-section 109G(1)). | |  |  | |
| Other exclusions or exemptions relating to forgiven debts apply under sub-sections 109G where:   * the debt is forgiven because the debtor becomes a bankrupt or because of the operation of Part X of the *Bankruptcy Act* (1966) * the debt forgiven has previously been a loan which was treated as a deemed dividend under section 109D or as a deemed dividend under the amalgamated loan rules in section 109E to the extent that there was a failure to make the required minimum yearly repayment(s) or * the Commissioner of Taxation exercises a discretion to not apply section 109F on the basis that it would cause the debtor entity undue hardship.   (Refer to Note 2 below) | |  |  | |
| If the answer to any of the above is *yes*, the loan, payment or debt forgiveness *will not be* classified as a deemed unfranked dividend in the current year. **Proceed to D1**, which deals with ongoing implications of prior year loans.  If the answer to each of the above is *no*, the loan, payment or debt forgiveness *will be* classified as a deemed unfranked dividend in the current year (unless the Commissioner otherwise exercises his discretion), subject to the amount of the distributable surplus (which has been addressed in A1 above) for the current year and also subject to C2 below.  The private company taken to pay the unfranked dividend will not be required to debit its franking account when a deemed dividend arises. **Continue to C2.** | | | | |
| **SECTION 1. CURRENT YEAR LOANS** | | | | |
| **C1. Does the transaction identified in B1 satisfy any of the following criteria?** *(continued)* | | **Yes** | **No** | |
| Note:   1. If the loan was established as an excluded loan in the current financial year, a minimum repayment will not be required to be made on the loan in the current financial year. The first minimum repayment is only required to be made in the year of income after the year in which the loan was first established. The relevant benchmark interest rate for the 2015-16 tax year is 5.45% as per Taxation Determination TD2015/15. 2. Practice Statement PSLA 2006/2 GA also provides that the ATO will not take active compliance action in respect of a deemed dividend arising under section 109F where a debt forgiveness has been triggered in respect of a debt entered into before the commencement of Division 7A on 4 December 1997 which has expired after that time because of a statute of limitations. | | | | |
| **C2. The Commissioner’s discretion** | | **Yes** | **No** | |
| Taxpayers may apply in writing to the Commissioner of Taxation requesting the Commissioner to apply his discretion to disregard the deemed dividend or frank the deemed dividend under section 109RB. Has the Commissioner exercised his discretion in the taxpayer’s favour? | |  |  | |
| If the answer is *no*, a deemed unfranked dividend is expected to arise. **Continue to D1**, which deals with ongoing implications of prior year loans.  If the answer is *yes*, the loan, payment or debt forgiveness will either not be treated as a deemed dividend or will be treated as a franked dividend in the current year. | | | | |
| **Note:**   1. The ATO has issued Taxation Ruling TR 2010/8, which sets out the requirements to be satisfied before the Commissioner is able to exercise the discretion under section 109RB. The ruling also explains the Commissioner’s interpretation of the words “an honest mistake” or “inadvertent error”. The ATO has also released Practice Statement PS LA 2011/29, which sets out when the Commissioner is likely to exercise the discretion in section 109RB to disregard a deemed dividend or allow the deemed dividend to be franked. The Practice Statement also outlines what matters the Commissioner must have regard to when considering requests to exercise the section109RB discretion. | | | | |
| SECTION 2. PRIOR YEAR COMPLYING LOANS | | | | |
| D1. Amalgamated loans (section 109E) | Yes | No | | N/A |
| 1. In relation to loans established on excluded loan terms in prior years (in accordance with section 109N), has the required minimum yearly repayment been made on the loan in the current financial year? |  |  | |  |
| If the answer is *yes*, **continue to question b within D1.** If the answer is *no*, **continue to question c within D1.** | | | | |
| 1. Was the payment made with the intention to obtain a loan from the private company of an amount similar to or larger than the payment (section 109R)? |  |  | |  |
| If the answer is *no*, no deemed dividend will arise.  If the answer is *yes*, the payment will be disregarded. Hence, the minimum yearly repayment will beclassified as a deemed unfranked dividend, subject to the amount of the distributable surplus for the current year | | | | |
| Note:   1. A minimum yearly repayment made on or after 1 July 2009 will also be disregarded if it could be reasonably concluded that the shareholder or associate borrowed a similar or larger amount from the private company before the repayment was actually made with the intention to use that loan to fund the minimum yearly repayment. | | | | |
| 1. Has the Commissioner made a decision in writing under section 109RD to extend the date by which the minimum yearly repayment is required to be made because of circumstances beyond the taxpayer’s control? |  |  | |  |
| If the answer is *yes*, and the minimum yearly repayment was paid by the required time, no deemed dividend will arise.  If the answer is *no*, **continue to question d within D1**. | | | | |
| 1. Was the Commissioner satisfied that the taxpayer would suffer undue hardship if the private company was taken under section 109E to pay a dividend to the taxpayer at the end of the current year because of the loan (section 109Q)? |  |  | |  |
| If the answer is *no*, **continue to question e within D1**.  If the answer is *yes*, the shortfall in the minimum yearly repayment of the loan in that income year will not be classified as a deemed unfranked dividend. | | | | |
| 1. Taxpayers may apply in writing to the Commissioner requesting the Commissioner of Taxation to apply his discretion under section 109RB to disregard the deemed dividend or frank the deemed dividend. Has the Commissioner exercised his discretion in the taxpayer’s favour? |  |  | |  |

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| **SECTION 2. PRIOR YEAR COMPLYING LOANS** | | | |
| **D1. Amalgamated loans (section 109E)** *(continued)* | **Yes** | **No** | **N/A** |
| If the answer is *no*, the shortfall in the minimum yearly repayment of the loan in that income year *will be* classified as a deemed unfranked dividend, subject to the amount of the distributable surplus for the current year.  If the answer is *yes*, the shortfall in the minimum yearly repayment of the loan in that income year will not be classified as a deemed unfranked dividend.  **Continue to E1.** | | | |
| Note:   1. The ATO has issued Taxation Ruling TR 2010/8, which sets out the requirements to be satisfied before the Commissioner is able to exercise the discretion under section 109RB. The ruling also explains the Commissioner’s interpretation of the words “an honest mistake” or “inadvertent error”. The ATO has also released Practice Statement PS LA 2011/29, which sets out when the Commissioner is likely to exercise the discretion in 109RB to disregard a deemed dividend or allow the deemed dividend to be franked. The Practice Statement also outlines what matters the Commissioner must have regard to when considering requests for to exercise the 109RB discretion. | | | |
| **SECTION 3. INTERPOSED ENTITIES, GUARANTEES AND REFINANCING** | | | |
| **E1. Was a payment or loan made through an interposed entity in the current financial year? (Section 109T)** | **Yes** | **No** | **N/A** |
| 1. Did the private company provide a loan or a payment to an interposed entity (including a company, partnership, trust or individual) in the current financial year which the interposed entity then provided to the shareholders or associate of the private company (section 109T)? |  |  |  |
| If the answer is *yes*, the first set of interposed entity arrangement (IEA) provisions may apply - **continue to question b within E1.**  Broadly, the first set of IEA provisions apply where a reasonable person would conclude (having regard to all of the circumstances) that the private company made the payment or loan to the interposed entity solely or mainly so that the interposed entity would provide a payment or loan to the target entity.  The result of the first set of IEA provisions applying is that there will be a deemed loan or payment (and thus potentially a deemed unfranked dividend paid) provided directly from the private company to the target entity.  The amount of the deemed loan or payment will depend on various factors that the Commissioner will take into account (refer to Taxation Determination TD 2011/16). One such factor that the Commissioner will consider is whether the loan from the private company to the interposed entity (the first stage loan) was put on excluded loan terms.  If the answer is *no*, **continue to F1.** | | | |
| Note:   1. The first set of IEA provisions will not apply where the loan or payment provided from the private company to the interposed entity has already been classified as a deemed unfranked dividend in accordance with Division 7A (sub section 109T(3)). 2. Where the target entity is another private company, the deemed payment or loan will not be classified as a deemed unfranked dividend in accordance with section 109K. 3. Be aware that section 109T can also operate to treat a private company as having made a payment or loan to a shareholder or an associate of a shareholder (the target entity) in circumstances where the interposed entity is also a shareholder of the private company and the payment made to the interposed entity is the payment of an actual dividend (see for example the Commissioner’s application of section 109T in ATO ID 2011/104). | | | |
| 1. Was the loan from the interposed entity to the shareholder or associate (second stage loan) put on excluded loan terms under section 109N before the earlier of the due date or actual date of lodgment of the private company’s income tax return? |  |  |  |
| If the answer is *no*, the first set of IEA provisions could apply.  If the answer is *yes*, the first set of IEA provisions should not deem a dividend. However, ensure that minimum yearly repayments are made on the second stage loan in subsequent income years. | | | |
| **Example**  Company A makes a loan of $50,000 to Company B (a related company with no distributable surplus) on the condition that Company B will make a loan of the same amount to Mr A, a shareholder in Company A. Ordinarily, the loan from Company A to Company B would not be classified as a deemed unfranked dividend because of section 109K. Furthermore, the loan from Company B to Mr A would not be classified as a deemed unfranked dividend because Company B has no distributable surplus.  Company B is an interposed entity in relation to Company A. Mr A is the target entity in relation to the loan of $50,000 made by Company A to Company B. Company A may be deemed to have paid an unfranked dividend of $50,000 to Mr A under an IEA, subject to the amount of the distributable surplus of Company A for the year of income in which Company B makes a loan of $50,000 to Mr A.  However, if the loan from Company B to Mr A was put on excluded loan terms under section 109N, the loan will not give rise to a deemed dividend provided that minimum yearly repayments are made in subsequent income years.  **Continue to F1**. | | | |

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| **SECTION 3. INTERPOSED ENTITIES, GUARANTEES AND REFINANCING** | | |
| **F1. Payment or loan by interposed entity relying on guarantee by private company (section 109U)** | Yes | No |
| Did the private company guarantee a loan made by another private company in the current year? |  |  |
| If the answer is *yes*, the second set of IEA provisions could apply.  Broadly, the second set of IEA provisions apply where both of the following conditions apply:   * a reasonable person would conclude (having regard to all the circumstances) that the private company (‘the head company’) gave the guarantee to another private company (‘the first interposed entity’) solely or mainly so that either the first interposed entity would make a loan to another entity (‘the target entity’) or a third private company interposed between the first interposed entity and the target entity (‘the second interposed entity’) would make a payment or loan to the target entity * the amount of the payment or loan to the target entity is greater than the distributable surplus for the first interposed entity or, if appropriate, the second interposed entity.   The result of the second set of IEA provisions applying is that where the target entity is a shareholder or associate of a shareholder of the head company, there will be a deemed loan or payment made directly from the head company to the target entity and thus, potentially, a deemed unfranked dividend paid*.*  **Continue to F2.** | | |
| Note:   1. Where the target entity is another private company, the deemed payment or loan by the head company will not be classified as a deemed unfranked dividend in accordance with section 109K. | | |
| **F2. Did the private company provide a loan guarantee (Section 109UA)?** | **Yes** | **No** |
| 1. Has the private company provided a guarantee to enable a loan to be provided to a shareholder or an associate of a shareholder of the private company in any year of income? |  |  |
| If the answer is *yes* and the private company is required to make a payment under the guarantee in the current year (i.e. the guarantee is ‘called on’ in the current financial year), the private company may be deemed to have made a payment (and potentially to have paid a deemed unfranked dividend) directly to its shareholder or associate.  If the answer is *yes***, continue to question b within F2.**  If the answer is *no*, **continue to G1.** | | |
| Note:   1. If the recipient of the deemed payment (i.e. the entity that defaults on the loan) is another private company, the deemed payment will not be classified as a deemed unfranked dividend in accordance with section 109K. | | |
| 1. If the private company is required to make a payment under the guarantee in the current year (as a result of the shareholder defaulting on the loan guaranteed by the private company), has the defaulting borrower entered into a loan agreement (to formalise the common law debt) with the private company which meets the excluded term requirements on section 109N? |  |  |
| If the answer is *yes*, the payment *will not* be classified as a deemed unfranked dividend in the current year. However, the shareholder or associate (the borrower) should ensure that minimum yearly repayments are made in subsequent years.  If the answer is *no*, a deemed unfranked dividend will arise, subject to the amount of the distributable surplus of the private company guarantor.  **Continue to G1.** | | |
| **Note**:   1. If the borrower defaults on the third party loan, which causes the private company guarantor to make a payment to the third party to satisfy the guarantee, a common law debt will arise between the borrower and the private company guarantor. This common law debt may be formalised under a 109N loan agreement to limit the exposure of Division 7A. | | |
| G1. Was an amalgamated loan made by the private company refinanced in the income year? | Yes | No |
| Was an amalgamated loan (an excluded loan under s.109N) made by the private company refinanced in the income year? |  |  |
| Certain amalgamated loans can be refinanced without triggering a deemed dividend. Unsecured loans which are subsequently secured by a registered mortgage over real property can have their loan term extended. On a similar basis, a secured loan can be converted into an unsecured loan with a corresponding reduction in the loan term.  ***Example***  Hilda Pty Ltd has made a loan secured by a mortgage over real property to an associate of a shareholder, Sachin. The term of the loan was 25 years. However, after 20 years, the terms of the loan are changed and it is no longer secured by a mortgage over real property. If the expired term of the old secured loan was less than 18 years, the maximum term of the new loan will be seven years. However, in this particular instance, the original secured loan had already been in place for more than 18 years. As a result, in the written agreement governing the new loan, the maximum term of the loan can be five years (i.e. seven years – (20 years – 18 years) = five years).  A private company loan can also be refinanced without triggering a deemed dividend when the loan becomes subordinated to another loan from another entity, and the refinancing of the private company loan by the recipient shareholder / associate takes place because of that subordination.  **Continue to H1.** | | |

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| SECTION 4. PAYMENTS, LOANS AND DEBT FORGIVENESS IF UNPAID PRESENT ENTITLEMENT TO A PRIVATE COMPANY | | |
| H1. Has a trust with an unpaid present entitlement owing to a private company (either directly or indirectly) made a loan, payment to, or forgiven a debt in favour of, a shareholder, or an associate of a shareholder, of the private company (Subdivision EA)? | Yes | No |
| 1. Did the trustee of such a trust make a loan (either directly or indirectly) to a shareholder, or an associate of a shareholder, of a private company (except a shareholder or associate that is a company) during the current year that was not fully repaid before the earlier of the due date for lodgment and the actual date of lodgment of the trust’s tax return for the current year? |  |  |
| 1. Alternatively, did such a trustee forgive a debt or make a payment (directly or indirectly) in favour of a shareholder or associate of the private company beneficiary (except a shareholder or associate that is a company)? |  |  |
| If the answer is *no* to both question a and b, **you have completed this checklist.**  If the answer is *yes* to either question a or b, **please refer to CPA Australia’s *2016 Division 7A: UPE Checklist* for further details.** | | |
| Note:   1. The ATO has stated in Taxation Ruling TR 2010/3 that if an UPE has been treated as a loan under section 109D of the general provisions of Division 7A, Subdivision EA will not also apply to the loan made by the trustee of the trust to the company. This statement ensures that UPE is not subject to potential double taxation. However, where UPEs are held on sub-trust for the sole benefit of the private company, Subdivision EA may still apply where the trustee makes a payment or loan to, or forgives a debt owed, by a shareholder or an associate of a shareholder of the private company. 2. From 1 July 2009, due to the application of Subdivision EB, Subdivision EA may apply where a trust makes a loan or payment to a shareholder or an associate of a shareholder of a private company through one or more entities interposed between the trust and the shareholder or associate. This will only apply where it can be reasonably concluded that the entity was interposed solely or mainly as part of an arrangement involving a payment or loan made by the trust via an interposed entity to a shareholder or an associate of a shareholder. | | |