DIVISION 7A:

UPE CHECKLIST 2019

COMPANY TAX

RETURN PREPARATION

CHECKLIST 2019

This checklist will assist public practice members to determine whether Subdivision EA of Division 7A applies. To be completed for relevant entities each year.

The main focus of the checklist is on the transaction undertaken by a trust that either directly or indirectly (e.g. via a chain of trusts) owes the Unpaid Present Entitlement (UPE) to the private company.

This checklist is designed to deal with a situation where:

- a private company is owed an unpaid present entitlement of the income of a trust estate

- the trustee of a trust estate that either directly or indirectly\* owes the present entitlement to the private company undertakes one or more of the following transactions in favour of a shareholder or an associate of a shareholder of the private company (except a shareholder or associate that is a company)\*\*:

- - a loan

- - a payment or

- - a debt forgiveness.

\* An indirect unpaid present entitlement owing to a private company would encompass a situation where there are unpaid present entitlements owing via a chain of trusts to a private company. For example, Trust A has an unpaid present entitlement owing to Trust B, which has an unpaid present entitlement owing to private Company C. Rules in Division 7A deem Trust A in effect to have an unpaid present entitlement owing to Company C.

\*\* Division 7A also contains complex integrity rules to ensure that payments, loans and debt forgiveness through an interposed entity are also potentially caught.

This checklist does not deal with unpaid present entitlements formerly owed by a trust to a private company that has been subsequently discharged in that it has been converted into a loan. Refer to CPA Australia’s standard [2019 Division 7A Checklist](https://www.cpaaustralia.com.au/professional-resources/taxation/2019-year-end-resources) in these circumstances.

This checklist has two sections:

**Section A:** Instructions for tax agents

**Section B:** Checklist to complete with clients

This information is based on legislation current as at 14 June 2019.

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**SECTION A: INSTRUCTIONS FOR TAX AGENTS**

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| 1. Unpaid present entitlement and sub-trust arrangement |
| 1. Was a private company owed a present entitlement to the income of a trust estate as at the earlier of the due date for lodgment and the actual date of lodgment of the trust’s tax return for the current year? |
| If the answer is no, Subdivision EA does not apply to you. You have completed the checklist.  If the answer is yes, continue to question 1b. |
| 1. Has the unpaid present entitlement been converted into an actual loan? |
| If the answer is no, continue to question 1c.  If the answer is yes, please proceed to CPA Australia’s standard [2019 Division 7A Checklist](https://www.cpaaustralia.com.au/professional-resources/taxation/2019-year-end-resources). You have completed this checklist.  The ATO has issued Taxation Ruling TR 2010/3, which sets out circumstances in which certain unpaid present entitlements (UPEs) made 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 a deemed dividend. The ATO contends that the ruling will potentially apply 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 under section 109D in certain circumstances. |
| 1. Was the unpaid present entitlement in existence before 16 December 2009? |
| If the answer is no, continue to question 1d. If the answer is yes, continue to question 2. |
| 1. Has the unpaid present entitlement been put on a sub-trust arrangement (by the required deadline) for the sole benefit of the private company beneficiary? |
| If the answer is yes, continue to question 2.  If the answer is no, the unpaid entitlement will have converted into a deemed loan and Subdivision EA does not apply to you. Please proceed to CPA Australia’s standard [2019 Division 7A Checklist](https://www.cpaaustralia.com.au/professional-resources/taxation/2019-year-end-resources). You have completed this checklist.  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 also not apply to the loan made by the distributing trust. This statement ensures that the 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 in respect of transactions undertaken at the trust level.  Practice Statement Law Administration PSLA 2010/4 provides guidance on the administration of Taxation Ruling TR 2010/3 in relation to the unpaid present entitlement owed by a trust estate to a private company. |
| 2. Does the private company (which is owed the present entitlement) have a distributable surplus for the year of income? |
| If the answer is yes, Subdivision EA of Division 7A can potentially apply. Continue to question 3.  If the answer is no, Subdivision EA of 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. You have completed this checklist.  Whether or not the private company has a distributable surplus is determined under section 109Y.  Under sections 109XA(4) and 109XC(7) the amount of any deemed dividend that arises under Subdivision EA will be the lower of the amount of the actual payment, loan or debt forgiveness transaction; the amount of the UPE owed to the private company beneficiary; and the distributable surplus of the private company beneficiary as at the end of the tax year in which the actual transaction occurred.  Where the private company is part of a tax consolidated group, and the shareholder or associate is outside that 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.  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. |

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| 3. Did the trustee of the trust make a loan (either directly or indirectly) to a shareholder, or an associate of a shareholder, of the private company? |
| Loans to shareholders or associates made by a trust with an unpaid present entitlement owing to a private 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 is dealt with under section 109XA(2).  If the answer is no, continue to question 5. If the answer is yes, continue to question 4.  From 1 July 2009, due to the application of Subdivision EB, Subdivision EA may apply where a trust makes a loan 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. |
| 4. Did the trustee and the shareholder, or shareholder’s associate, place the loan on excluded terms before the earlier of the due date for lodgment and the actual date of lodgment of the trustee’s return of income for the trust for the current year? |
| If the answer is yes, Subdivision EA should not be applicable to the loan. However, the shareholder or associate should ensure that minimum yearly repayments are made in subsequent years.  If the answer is no, the private company may be deemed to have paid a deemed unfranked dividend to the shareholder (or associate of a shareholder) of the private company, subject to a cap equal to the distributable surplus of the private company.  Continue to question 5. |
| 5. Payments by a trust with an unpaid present entitlement owing to a private company (either directly or indirectly) to a shareholder, or an associate of a shareholder, of the private company |
| 1. Did the trustee make a payment to a shareholder, or an associate of a shareholder (either directly or indirectly), of a private company (except a shareholder or associate that is a company) during the current year, other than a loan? (Refer section 109XA(1)) |
| If the answer is no, continue to question 7. If the answer is yes, continue to question 5b.  From 1 July 2009, due to the application of Subdivision EB, Subdivision EA may apply where a trust makes a 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. |
| 1. Was the payment a discharge or a reduction in a present entitlement of the shareholder or an associate of the shareholder that is wholly or partly attributable to an amount that represents an unrealised gain (see note below) in the trust? |
| If the answer is no, continue to question 7. If the answer is yes, continue to question 6.  Section 109XA(7) defines an unrealised gain as ‘any unrealised gain, whether of a capital or income nature’. For example, a capital profit generated from the revaluation of an asset. However, an unrealised gain will not arise to the extent that the gain will be included in the assessable income of the trust in the year before the year in which the payment was made, or the year in which the payment is made or in the year of income after the year in which the payment was made. |
| 6. Was the payment a discharge of an obligation by the trustee, other than a payment discharging an unpaid present entitlement? |
| If the answer is no, the private company may be deemed to have paid a deemed unfranked dividend to the shareholder (or associate or a shareholder) of the private company subject to the distributable surplus of the private company.  If the answer is yes, continue to question 7.  Division 7A exemptions under section 109J, section 109K, section 109NA and section 109NB are not applicable to transactions subject to Subdivision EA. |

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| 7. Trusts with an unpaid present entitlement owing to a private company (either directly or indirectly) that forgives a debt in favour of a shareholder, or an associate of a shareholder, of the private company |
| 1. Was all or part of a debt owed to a trustee by a shareholder or an associate of a shareholder of a private company (except a shareholder or associate that is a company) forgiven during the current year? (Refer section 109XA(3)) |
| If the answer is no, you have completed the checklist. If the answer is yes, continue to question 7b.  Section 109F(3) provides that a debt is forgiven where the amount of the debt would be forgiven under sections 245-35 or 245-37 of the Income Tax Assessment Act 1997. This would include where the debt is realised, waived or otherwise extinguished, the debt is deemed to be forgiven because the right to recover the debt expires 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. A debt forgiveness will also arise in relation to certain debt parking arrangements under section 109F(5), or where it can be reasonably expected that a private company will not insist on payment or rely on the debtor’s obligation to repay under section 109F(6). However, section 109F(8) provides that if the same debt is forgiven at different times under different provisions of section 109F then section 109F will only apply to the first debt forgiveness. |
| 1. Has the loan that was forgiven been included in the assessable income of the shareholder or associate of shareholder under Subdivision EA in the current or an earlier year of income? |
| If the answer is no, continue to question 8.  1bdivision EA of e present entitlement)If the answer is yes, Subdivision EA should not be applicable to the debt forgiveness. You have completed the checklist. |
| 8. Has the debt been forgiven under the *Bankruptcy Act*? |
| If the answer is no, continue to question 9.  1bdivision EA of e present entitlement)If the answer is yes, Subdivision EA should not be applicable to the debt forgiveness. You have completed the checklist. |
| 9. Has the Commissioner made (or will make) a determination that the debt forgiven will not give rise to a deemed dividend? |
| Such determinations are made on the basis that all the following conditions are satisfied:  - the debt has been forgiven because payment would result in undue hardship  - the debtor had the capacity to pay the debt when initially borrowed  - the debtor lost the capacity to pay the debt (in the foreseeable future) because of circumstances beyond its control.  If the answer is no, continue to question 10.  1bdivision EA of e present entitlement)If the answer is yes, Subdivision EA should not be applicable to the debt forgiveness. You have completed the checklist. |
| 10. Has the debt forgiveness arisen because of the rule that deems a debt to be forgiven under a statute of limitations and relates to a Pre-Division 7A loan? |
| If the answer is no, the private company may be deemed to have paid a deemed unfranked dividend to the shareholder (or associate of a shareholder) of the private company, subject to a cap equal to the distributable surplus of the private company.  1bdivision EA of e present entitlement)If the answer is yes, Subdivision EA should not be applicable to the debt forgiveness. You have completed the checklist.  Practice Statement PS LA 2006/2 (GA) sets out the circumstances where a statute barred trustee loans made prior to the enactment of Division 7A will not be treated as giving rise to a deemed dividend under Division 7A (note that this Practice Statement should not be regarded as a licence to write off and clean out old loans without adverse tax consequences). |
| **You have completed the checklist.** |

**SECTION B: CHECKLIST TO COMPLETE WITH CLIENTS**

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| 1. Unpaid present entitlement and sub-trust arrangement | Yes | No |
| 1. Was a private company owed a present entitlement to the income of a trust estate as at the earlier of the due date for lodgment and the actual date of lodgment of the trust’s tax return for the current year? |  |  |
| If the answer is no, you have completed the checklist. If the answer is yes, continue to question 1b. | | |
| 1. Has the unpaid present entitlement been converted into an actual loan? |  |  |
| If the answer is no, continue to question 1c.  If the answer is yes, please proceed to CPA Australia’s standard [2019 Division 7A Checklist](https://www.cpaaustralia.com.au/professional-resources/taxation/2019-year-end-resources). You have completed this checklist. | | |
| 1. Was the unpaid present entitlement in existence before 16 December 2009? |  |  |
| If the answer is no, continue to question 1d. If the answer is yes, continue to question 2. | | |
| 1. Has the unpaid present entitlement been put on a sub-trust arrangement (by the required deadline) for the sole benefit of the private company beneficiary? |  |  |
| If the answer is yes, continue directly to question 2.  If the answer is no, please proceed to CPA Australia’s standard [2019 Division 7A Checklist](https://www.cpaaustralia.com.au/professional-resources/taxation/2019-year-end-resources). You have completed this checklist. | | |
| 2. Does the private company (which is owed the present entitlement) have a distributable surplus for the year of income? | Yes | No |
| If the answer is yes, continue to question 3. If the answer is no, you have completed this checklist. |  |  |
| 3. Did the trustee of the trust make a loan (either directly or indirectly) to a shareholder, or an associate of a shareholder, of the private company? | Yes | No |
| If the answer is no, question to question 5. If the answer is yes, continue to question 4. |  |  |
| 4. Did the trustee and the shareholder, or shareholder’s associate, place the loan on excluded terms before the earlier of the due date for lodgment and the actual date of lodgment of the trustee’s return of income for the trust for the current year? | Yes | No |
| Continue to question 5. |  |  |
| 5. Payments by a trust with an unpaid present entitlement owing to a private company (either directly or indirectly) to a shareholder, or an associate of a shareholder, of the private company | Yes | No |
| 1. Did the trustee make a payment to a shareholder, or an associate of a shareholder (either directly or indirectly), of a private company (except a shareholder or associate that is a company) during the current year, other than a loan? |  |  |
| If the answer is no, continue to question 7. If the answer is yes, continue to question 5b. | | |
| 1. Was the payment a discharge or a reduction in a present entitlement of the shareholder or an associate of the shareholder that is wholly or partly attributable to an amount that represents an unrealised gain (see note below) in the trust? |  |  |
| If the answer is no, continue to question 7. If the answer is yes, continue to question 6. | | |
| 6. Was the payment a discharge of an obligation by the trustee, other than a payment discharging an unpaid present entitlement? | Yes | No |
| If the answer is no, the private company may be deemed to have paid a deemed unfranked dividend.  If the answer is yes, continue to question 7. |  |  |

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| 7. Trusts with an unpaid present entitlement owing to a private company (either directly or indirectly) that forgives a debt in favour of a shareholder, or an associate of a shareholder, of the private company | Yes | No |
| 1. Was all or part of a debt owed to a trustee by a shareholder or an associate of a shareholder of a private company (except a shareholder or associate that is a company) forgiven during the current year? |  |  |
| If the answer is no, you have completed the checklist. If the answer is yes, continue to question 7b. | | |
| 1. Has the loan that was forgiven been included in the assessable income of the shareholder or associate of shareholder under Subdivision EA in the current or an earlier year of income? |  |  |
| If the answer is no, continue to question 8. 1bdivision EA of e present entitlement)If the answer is yes, you have completed the checklist. | | |
| 8. Has the debt been forgiven under the Bankruptcy Act? | Yes | No |
| If the answer is no, continue to question 9. If the answer is yes, you have completed the checklist. |  |  |
| 9. Has the Commissioner made (or will make) a determination that the debt forgiven will not give rise to a deemed dividend? | Yes | No |
| If the answer is no, continue to question 10. If the answer is yes, you have completed the checklist. |  |  |
| 10. Has the debt forgiveness arisen because of the rule that deems a debt to be forgiven under a statute of limitations and relates to a Pre-Division 7A loan? | Yes | No |
| If the answer is no, the private company may be deemed to have paid a deemed unfranked dividend to the shareholder (or associate of a shareholder) of the private company subject to a cap equal to the distributable surplus of the private company.  1bdivision EA of e present entitlement)If the answer is yes, Subdivision EA should not be applicable to the debt forgiveness |  |  |
| **You have completed the checklist.** | | |