DIVISION 7A

CHECKLIST 2021

This version of CPA Australia’s 2021 Division 7A checklist is a basic checklist only.

For guidance on the key areas that public practice members should address to determine whether Division 7A applies, see CPA Australia’s detailed checklist with tax agent instructions.

This checklist only deals with payments, loans and debt forgiveness that are made (directly or indirectly) by private companies to shareholders and/or their associates.

This checklist covers the following key areas:

* Payments, loans and debt forgiveness
* Guarantees
* Refinancing
* Meaning of distributable surplus
* Exclusions from Division 7A
* Integrity provisions
* Interposed entities
* Payments, loans or debt forgiveness by trusts with an unpaid present entitlement to a private company.

Please refer to CPA Australia’s [2021 Division 7A: UPE Checklist](https://www.cpaaustralia.com.au/-/media/project/cpa/corporate/documents/tools-and-resources/taxation/division-7a-upe-checklist-detailed-with-instructions-2021.docx) 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 and loans made through an interposed entity) by the trustee of the trust estate to a shareholder or an associate of a shareholder of the private company.

This information is based on legislation current as at 10 June 2021.

**PROPOSED AMENDMENTS TO DIVISION 7A**

Significant changes to Division 7A have been announced by the Federal Government. At the time of writing, the proposed start date for these changes has been deferred to the income year commencing on or after the date of Royal Assent of the enabling legislation. However it is noted that an exposure draft has not been released, nor has a bill dealing with the changes been introduced into Parliament. Notwithstanding this, it is important to be aware of the proposed changes when undertaking tax planning with clients, including when entering into new section 109N complying loans. Refer to the [ATO website](https://www.ato.gov.au/General/New-legislation/In-detail/Other-topics/Targeted-amendments-to-Division-7A/) for more information.

**About the author**

This checklist was prepared by Moore Australia (Vic) Pty Ltd on behalf of CPA Australia.

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| CURRENT YEAR DEEMED DIVIDEND? | | |
| 1. Has the private company entered into a payment, loan or debt forgiveness transaction with a shareholder or associate in the 2021 year? | Yes | No |
| If the answer is yes, continue to question 2.  If the answer is no, continue to question 6. | | |
| 2. Does the private company have a distributable surplus for the year of income? | Yes | No |
| If the answer is yes, Division 7A can potentially apply. Continue to question 3.  If the answer is no, continue to question 6. |  |  |
| 3. Did one of the following transactions occur during the current financial year? | Yes | No |
| 1. Did the private company make a payment to a shareholder or an associate of a shareholder, other than a loan (section 109C)? |  |  |
| 1. Has a loan provided by the private company to a shareholder or an associate of a shareholder prior to 4 December 1997 been varied by increasing the amount of the loan or extending the term of the loan (section 109D(5))? |  |  |
| 1. Did the private company make a new loan to a shareholder or an associate of a shareholder (section 109D)? |  |  |
| 1. Was a debt owed by a shareholder or an associate of a shareholder to the private company forgiven by the private company (section 109F)? |  |  |
| 1. 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 (section 109F(5))? |  |  |
| If the answer to ANY of the above is yes, continue to question 4.  If the answer to ALL of the above is no, continue to question 6. | | |
| **4. Does the transaction identified at question 3 satisfy any of the following criteria?** | **Yes** | **No** |
| 1. 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). |  |  |
| 1. 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). |  |  |
| 1. 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). |  |  |
| 1. The loan was made in the ordinary course of business of the private company and on the usual terms that similar loans are provided to arm’s length parties (section 109M). |  |  |
| 1. The loan or payment represents a distribution made by a liquidator in the course of winding-up a company (section 109NA). |  |  |
| 1. The loan was made to an employee shareholder or associate 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). |  |  |
| 1. 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 a 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. |  |  |
| 1. 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 (section 109D(1)(b)). |  |  |
| 1. The forgiven debt was owed to the private company by another private company (other than a company acting in the capacity of a corporate trustee) (section 109G(1)). |  |  |
| 1. Other exclusions or exemptions relating to forgiven debts apply under section 109G. |  |  |
| If the answer to ANY of the above is yes, the loan, payment or debt forgiveness will not be treated as a deemed unfranked dividend in the current year. Continue to question 6.  If the answer to ALL of the above is no, the loan, payment or debt forgiveness will be treated as a deemed unfranked dividend in the current year (unless the Commissioner otherwise exercises his discretion to allow the deemed dividend to be franked), subject to the amount of the distributable surplus for the current year and also subject to question 5 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 question 5. | | |
| **5. Has the Commissioner exercised his discretion in the taxpayer’s favour?** | **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 where that deemed dividend has arisen because of an honest mistake or inadvertent omission by the recipient entity, the private company or the tax agent. |  |  |
| If the answer is no, a deemed unfranked dividend is expected to arise. Continue to question 6.  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. Continue to question 6. |  |  |
| PRIOR YEAR COMPLYING LOANS | | |
| 6. Amalgamated loans (section 109E) | Yes | No |
| 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 6b. If the answer is no, continue to question 6c. | | |
| 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)? |  |  |
| 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 or the Commissioner has allowed an extension, no deemed dividend will arise. Continue to question 7.  If the answer is no, continue to question 6d. | | |
| 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 6e.  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 question 7. | | |
| 1. Taxpayers may apply in writing to the Commissioner requesting the Commissioner of Taxation 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? |  |  |
| 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. Continue to question 7.  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 question 7. | | |
| **INTERPOSED ENTITIES, GUARANTEES AND REFINANCING** | | |
| **7. Was a payment or loan made through an interposed entity in the current financial year? (Section 109T)** | **Yes** | **No** |
| 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 shareholder 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 7b.  If the answer is no, continue to question 8. | | |
| 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. Continue to question 8.  If the answer is yes, the first set of IEA provisions should not deem a dividend. However, minimum yearly repayments must be made on the second stage loan in subsequent income years. Continue to question 8. | | |
| **8. Did the private company guarantee a loan made by another private company? (Section 109U)** | Yes | No |
| Continue to question 9. | | |
| **9. 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. Continue to question 9b.  If the answer is no, continue to question 10. | | |
| 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 in section 109N? |  |  |
| Continue to question 10. | | |
| 10. Was an amalgamated loan made by the private company refinanced in the income year? | Yes | No |
| Continue to question 11. | | |

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| PAYMENTS, LOANS & DEBT FORGIVENESS IF UPE TO A PRIVATE COMPANY | | |
| 11. Has the trustee of a trust with a UPE owing to a private company made a loan, or 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, refer to CPA Australia’s [2021 Division 7A: UPE Checklist](https://www.cpaaustralia.com.au/-/media/project/cpa/corporate/documents/tools-and-resources/taxation/division-7a-upe-checklist-detailed-with-instructions-2021.docx). | | |