



Australian Government
Australian Taxation Office

TIMBERCORP FINANCE PTY. LTD.
C/- KORDAMENTHA
ATTENTION: ANDREW RYAN
GPO BOX 2985
MELBOURNE VIC 3001

Reply to: PO Box 3546
ALBURY NSW 2640
Contact officer: Heidi Armin-Grimm
Phone: 13 28 69
Fax: 1300 300 591
ABN: 88 054 581 190

21 December 2012



For your information

Dear Mr Ryan

SUBJECT: Timbercorp Securities Limited (In Liquidation) – Discounts offered to borrowers

In your correspondence dated 30 October 2012 you advised that Timbercorp Finance Pty Ltd (In Liquidation) made offers to certain borrowers to repay all or part of their loans in advance of maturity for a discount on the outstanding loan principal. These offers were made during February 2012 and October 2012 ('Offer Periods'), with exercise periods of 1 July 2012 to 31 December 2012 and 1 December 2012 to 31 May 2012, respectively (collectively, 'the Offers').

The Offers were made to borrowers who entered into finance arrangements in connection with their participation in 33 managed investment schemes of which Timbercorp Securities Limited (In Liquidation) was the responsible entity and three private offer schemes ('Affected Projects'). Whilst the terms of the Offers differed between Affected Projects and within each Offer Period, all offers gave borrowers the right to exercise prepayment and early repayment options within the relevant exercise period.

Repayment options

Upon acceptance of an Offer, a borrower can exercise a Prepayment Option and/or Early Repayment Option.

Where a borrower makes a lump sum payment in an amount equal to 50% or more of the total amount owing during the relevant exercise period, Timbercorp Finance Pty Ltd (In Liquidation) will apply a discount (Prepayment Discount Percentage) to the remaining total amount owing following the application of the lump sum payment to reduce the loan balance ('Prepayment Option').

Where a borrower repays the total amount owing in full during the exercise period, Timbercorp Finance Pty Ltd (In Liquidation) will agree to accept the amount owing at the time of the repayment less the Early Repayment Discount Percentage in full and final satisfaction of the borrower's obligations under the Loan Agreement ('Early Repayment Option').

Where a borrower has exercised the Prepayment Option they may subsequently exercise the Early Repayment Option. In this event, Timbercorp Finance Pty Ltd (In Liquidation) will accept an amount equal to the total amount owing at the time the borrower exercised the Prepayment Option less the Early Repayment Discount Percentage in full and final satisfaction of the borrower's obligations under the Loan Agreement.

Taxation Implications for borrowers who accept an offer

Commercial debt forgiveness rules

Division 245 of the ITAA 1997 applies where all or part of a commercial debt is released or waived or otherwise extinguished other than by paying the debt in full (paragraph 245-35(a) of the *Income Tax Assessment Act 1997* (ITAA 1997)). Debts which fall subject to Division 245 of the ITAA 1997 include debts where interest was deducted, or could have been deducted, by the debtor (paragraph 245-10(a) of the ITAA 1997).

The discounts provided by Timbercorp Finance Pty Ltd (In Liquidation) as a result of the Offers amount to the release or waiver of all or part of the debt owed by borrowers.

In circumstances where borrowers entered into managed investment schemes subject of Australian Taxation Office Product Rulings, the Product Rulings would have set out whether interest incurred on Project loans was deductible under section 8-1 of the ITAA 1997. Generally, where investors used borrowed funds to acquire an interest in a managed investment scheme, either on capital or revenue account, it is expected that the investment will produce assessable income for the investor in the form of proceeds from the full or partial disposal of their interest or project produce. Accordingly, any interest incurred on the loan principal used for this assessable income producing purpose or, alternatively, in a business activity which is directed to the production of assessable income will be deductible under section 8-1 of the ITAA 1997.

Therefore, Division 245 of the ITAA 1997 will apply to borrowers who accepted an offer to repay all or part of their loan(s) with Timbercorp Finance Pty Ltd (In Liquidation) at a discount during the relevant exercise period(s). As a result, borrowers will have to apply the 'net forgiven amount' of the debt to reduce certain specified amounts which the borrowers could have used to reduce their taxable income.

Each borrower will have to calculate their **net forgiven amount** having regard to their personal circumstances in accordance with the following steps:

1. Calculate the value of the debt at the forgiveness time under section 245-55 of the ITAA 1997 (generally, this will be the market value of the debt at the forgiveness time unless the second test yields a lesser sum).
2. Calculate the amount of consideration given for the forgiveness under section 245-65 of the ITAA 1997 (generally, this will be the amount the borrower pays to Timbercorp Finance Pty Ltd (In Liquidation) in satisfaction of their obligations during the 2012-13 financial year).
3. Subtract the consideration (Step 2, above) from the value of the debt (Step 1, above) to arrive at the '**gross forgiven amount**' of the debt.
4. Reduce the gross forgiven amount of the debt (Step 3, above) by any amounts which, as a result of the forgiveness, are taken into account in arriving at the borrower's taxable income under section 245-85 of the ITAA 1997.

Borrowers must then apply their total net forgiven amount for the year, which includes any net forgiven amounts relating to other debts subject to Division 245 of the ITAA 1997, to reduce:

- i. deductible tax losses carried forward from prior financial years (section 245-115 of the ITAA 1997);
- ii. net capital losses carried forward from prior financial years (section 245-130 of the ITAA 1997);
- iii. deductible expenditure listed in the table to subsection 245-145(1) of the ITAA 1997; and
- iv. the cost bases or reduced cost bases of certain CGT assets specified in section 245-175 of the ITAA 1997.

Borrowers can choose the relevant loss, item of expenditure or asset against which the net forgiven amount is to be applied and the amount to be applied, but the net forgiven amount must be applied to the maximum extent possible within each class in successive order. Any part of the net forgiven amount which remains after being applied against all available amounts in each category is disregarded (section 245-195 of the ITAA 1997) unless the borrower is a partner in a partnership, in which case it flows through for application against the tax balances of the other partners (section 245-215 of the ITAA 1997).

Refinancing Timbercorp Finance Pty Ltd (In Liquidation) loans

Where a borrower obtains separate finance ('new loan') to repay all or part of their loan with Timbercorp Finance Pty Ltd (In Liquidation) ('existing loan') they will be able to claim a deduction for interest incurred on the new loan under section 8-1 of the ITAA 1997 provided that, immediately prior to obtaining the new loan, the existing loan was being used in an assessable income producing activity or used in a business activity which is directed to the production of assessable income (paragraph 42 of Taxation Ruling TR 95/25).

Borrowers seeking taxation advice specific to their individual circumstances on the application of the commercial debt forgiveness rules or deductibility of interest incurred on the existing loan or a new loan should consult their accountant or tax agent or request a private ruling.

More information

If you have any questions, please phone **13 28 69** between 8.00am and 5.00pm, Monday to Friday, and ask for Heidi Armin-Grimm on extension **86051**. Alternatively, you can contact Heidi Armin-Grimm directly on (08) 9268 6051.

Yours faithfully

Tim Dyce
Deputy Commissioner of Taxation

Per
(Heidi Armin-Grimm)

