



Australian Government
Australian Taxation Office

Craig Shepard on behalf of Timbercorp Finance Pty. Ltd.
(In Liquidation)
C/- PricewaterhouseCoopers
Attention : Simon McKenna
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16 December 2015

For your information

Dear Mr Shepard

SUBJECT: Timbercorp Finance Pty Ltd (In Liquidation) – Financial Hardship Policy

In your correspondence dated 12 November 2015 you advised that Timbercorp Finance Pty Ltd (In Liquidation) (herein called Timbercorp Finance) had established a financial hardship policy that provides compassionate relief to certain investors who have outstanding loans (Borrowers).

Assistance under the financial hardship policy relates to Borrowers who entered into finance arrangements in connection with their participation in one of the Timbercorp Managed Investment Schemes (MIS) set out in Appendix 1, or in a combination of these MIS.

Under the financial hardship policy, Borrowers who are assessed by Timbercorp Finance as experiencing financial hardship are able to enter into a repayment arrangement where Timbercorp Finance may agree to settle the Borrower's outstanding loan for a reduced amount ('Reduced Payment'). The terms of the agreement and the Reduced Payment are set out in the Settlement Deed between Timbercorp Finance and the Borrower.

Under the financial hardship policy, the outstanding loan balance and the Reduced Payment amount may include principal and interest components. The breakdown of these components will be based on a commercially acceptable methodology.

Taxation Implications for Borrowers under the Financial Hardship Policy

Commercial debt forgiveness rules

Division 245 of the ITAA 1997 contains special rules for dealing with the tax implications arising from the forgiveness of "commercial debts". Where the rules apply, they may reduce a taxpayers' deductible revenue losses, deductible net capital losses, certain deductible expenditure or the relevant cost base of CGT assets. The rules apply 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).

Generally, the Reduced Payment agreed to by Timbercorp Finance as a result of the financial hardship policy, amounts to the release or waiver of all or part of the debt owed by Borrowers.

In circumstances where Borrowers entered into a MIS that was the subject of an Australian Taxation Office Product Ruling, the Product Ruling would have set out whether interest incurred on loans was deductible under section 8-1 of the ITAA 1997. Generally, where investors used borrowed funds in connection with their participation in the MIS it was expected that the investment would 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 would be deductible under section 8-1 of the ITAA 1997.

Therefore, where there has been a release, waiver or otherwise extinguishment of a debt under the financial hardship policy, the debt forgiveness rules will apply to Borrowers but **the amount of debt forgiven is not included in the Borrower's assessable income**. Borrowers will have to apply the 'net forgiven amount' of the debt to reduce certain specified amounts which the Borrower could have used to reduce their taxable income.

Most Borrowers will not have previously claimed a deduction for accrued unpaid interest on their loans. Some Borrowers may have previously claimed a deduction for accrued unpaid interest on their loans. It is necessary to separate the interest and principal component when applying the commercial debt forgiveness rules.

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

For further information on how to apply for a private ruling visit:

[https://www.ato.gov.au/general/ato-advice-and-guidance/ato-advice-products-\(rulings\)/private-rulings/](https://www.ato.gov.au/general/ato-advice-and-guidance/ato-advice-products-(rulings)/private-rulings/)

Calculating the 'net forgiven amount' on loan principal:

Each Borrower will have to calculate their **net forgiven amount on the loan principal** 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 in satisfaction of their obligations).
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. This arrives at the '**net forgiven amount**'.

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).

Interest Component under the Financial Hardship Policy

Borrowers that have not previously claimed a deduction for the accrued unpaid interest on their loans will now be entitled to claim a deduction under section 8-1 of the ITAA 1997 for the amount of the interest component of the Reduced Payment. That is, they can claim a deduction for interest expense for the amount of interest actually paid under the financial hardship policy, and reduce their taxable income by this amount. The unpaid amount of accrued interest is disregarded.

Borrowers that have previously claimed a deduction for accrued unpaid interest on their loans may now have to include an amount of interest they are no longer required to pay under the financial hardship policy, in their assessable income. This will depend on the Borrower's individual circumstances and Borrowers should obtain independent tax advice specific to their circumstances.

Practical example - commercial debt forgiveness rules

- A Borrower originally borrowed \$100,000 to enter the MIS and claimed a deduction of \$100,000 for the MIS expenses paid with the borrowed funds.
- The current outstanding loan is \$200,000 this is comprised of \$80,000 principal and \$120,000 interest.
- Under the financial hardship policy, the Borrower agrees to repay \$100,000. In this particular example, the Reduced Payment comprises of \$40,000 principal and \$60,000 interest.
- The Borrower has a \$10,000 carried forward tax loss and a \$5,000 carried forward capital loss.

Application of the commercial debt forgiveness rules on the Principal Amount

Step 1	Calculate the value of the debt under s 245-55	\$80,000
Step 2	Calculate the consideration given for the forgiveness	\$40,000
Step 3	Gross forgiven amount	= \$40,000
Step 4	Subtract any amount that will be included in assessable income s245-85(1) or any reduction in a deduction that was otherwise deductible s245-85(2)	\$0
	Net forgiven amount	= \$40,000

The net forgiven amount on the principal component is \$40,000 but this amount will not be included in the assessable income of the Borrower.

The \$40,000 net forgiven amount must be applied to the \$10,000 carried forward tax loss under section 245-130 of the ITAA 1997 to reduce the carried forward tax loss to nil. The remaining net forgiven amount is \$30,000. This is then applied to the carried forward capital losses to reduce the carried forward capital losses to nil. The remaining net forgiven amount is \$25,000.

As the Borrower has no other amounts that the net forgiven amount can be applied to, the remainder of \$25,000 will be disregarded.

Interest Component

Where a Borrower has **not claimed** any deductions for accrued unpaid interest, and

- **owes \$120,000 of accrued unpaid interest, and**
- **pays a Reduced Payment under the financial hardship policy that includes \$60,000 for the interest component,**
- **the Borrower can claim a deduction of \$60,000 for interest expense, and**
- **\$60,000 of accrued unpaid interest, that is no longer payable, is disregarded.**

Where a Borrower has **claimed** a deduction for \$120,000 accrued unpaid interest, and

- **owes \$120,000 of accrued unpaid interest, and**
- **pays a Reduced Payment under the financial hardship policy that includes \$60,000 for the interest component,**
- **the Borrower may need to include \$60,000 in their assessable income.**

More information

If you have any questions, please phone **13 28 69** between 8.00am and 5.00pm, Monday to Friday, and ask for Natasha De Rozario on extension **85948**. Alternatively, you can contact Natasha De Rozario directly on (08) 9268 5948 or Anne O'Callaghan directly on (08) 9268 5605.

ATO and Financial Hardship

We are determined to respond sensitively and quickly to the fiscal needs of people affected by financial hardship.

For information on the Financial Hardship you can visit:

<http://www.ato.gov.au/General/Financial-hardship/>

If you require further assistance on the ATO's financial hardship policy, you can contact us by calling **13 28 61** (individuals) or **13 28 66** (business).

Yours sincerely

Michael Cranston
Deputy Commissioner of Taxation

Per

(Natasha De Rozario)

Appendix 1

<u>Scheme</u>	<u>Product Ruling</u>
1992 Eucalypts	PR 2002/18W
1993 Eucalypts	PR 2002/19W
1994 Eucalypts	PR 2002/20W
1995 Eucalypts	PR 2001/165W
1996 Eucalypts	PR 2007/92 (PR 2001/166W)
1997 Eucalypts	PR 2008/12 (PR 2001/167W)
1998 Eucalypts	PR 2008/30 (PR 2001/168W)
1999 Eucalypts	PR 1998/5W
2000 Eucalypts	PR 2000/7W
2000 Olive - PO	PR 2001/123W
2001 Almond	PR 2007/81 (PR 2001/15W)
2001 Eucalypts	PR 2000/98W
2001 Olive	PR 2000/100W
2002 Almond - PO	PR 2002/15W
2002 Almond Early	PR 2002/24W
2002 Almond Standard	PR 2002/83W
2002 Eucalypts Early	PR 2002/101W (PR 2001/134W)
2002 Eucalypts Post June	PR 2002/101W
2002 Olive	PR 2002/11W
2002 Olive Post June	PR 2002/121W
2003 Almond Early	PR 2003/2W (PR 2002/143W)
2003 Almond Post June	PR 2003/2W (PR 2002/143W)
2003 Eucalypts Early	PR 2002/147W
2003 Eucalypts Pre Payment	PR 2002/146W
2003 Olive Early	PR 2003/24W
2003 Olive Post June	PR 2003/24W
2004 Almond Early	PR 2004/18W
2004 Citrus Early	PR 2004/51W
2004 Eucalypts Pre Payment	PR 2004/1W

2004 Eucalypts Post June	PR 2004/2W
2004 Olive Early	PR 2004/43W
2004 SP Timberlot - Post June	PR 2004/13W
2004 SP Timberlot - Pre Payment	PR 2004/12W
2004 Table Grape	PR 2004/29W
2005 Almond Early	PR 2005/15W
2005 Citrus Early	PR 2005/74W
2005 Mango Early	PR 2005/62W
2005 SP Timberlot - Pre 30 June	PR 2004/89W
2005 SP Timberlot - Post 30 June	PR 2004/90W
2005 Table Grape Early	PR 2005/33W
2006 (2005 Post June) SP Timberlot Project	PR 2004/90W
2006 Almond Early	PR 2006/1W
2006 Avocado Early	PR 2006/57WA1 (PR 2006/57W)
2006 Mango Early	PR 2006/74W
2006 Mango Post June	PR 2006/75W
2006 Olive Early	PR 2006/55W
2007 (2007/2008) SP Timberlot - Post 30 June	PR 2006/143
2007 (2007/2008) SP Timberlot - Pre 30 June	PR 2006/142W
2007 Almond Early	PR 2006/145W
2007 Almond Post June	PR 2006/146
2007 Avocado & Fruit early	PR 2007/54W
2007 Avocado & Fruit Post June	PR 2007/64W
2007 Olive Early	PR 2006/154
2007 Olive Post June	PR 2006/155
2008 FnYr (2007/2008) SP Timberlot - Post 30 June	PR 2006/143
2008 FinYr Almond (2007 Almond Post June)	PR 2006/146A
2008 Olive Early	PR 2007/105