



Class Ruling

Living Learning Pty Ltd – loans from public and private ancillary funds

❶ Relying on this Ruling

This publication (excluding appendix) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Further, if we think that this Ruling disadvantages you, we may apply the law in a way that is more favourable to you.

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What this Ruling is about

1. This Ruling sets out the Commissioner's view on the application of certain income tax provisions for investors (who are public or private ancillary funds) in the Partnership Addressing Disadvantage Arrangement (PAD arrangement) through loans to Living Learning Pty Ltd.
2. Full details of this scheme are set out in paragraphs 13 to 24 of this Ruling.
3. This Ruling does not affect the obligations of public ancillary funds and private ancillary funds to comply with the rules in the *Taxation Administration (Private Ancillary Fund) Guidelines 2019* or the *Public Ancillary Fund Guidelines 2011* (the Guidelines), whichever is applicable. To remain endorsed as a deductible gift recipient, an ancillary fund must comply with the relevant Guidelines.
4. This Ruling does not address Living Learning Pty Ltd's entitlement to endorsement as a deductible gift recipient.
5. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* unless otherwise indicated. Where the general term 'ancillary fund' is used, this refers to both public and private ancillary funds collectively.

Who this Ruling applies to

6. This Ruling applies to ancillary funds endorsed as deductible gift recipients under section 30-120, that enter into the PAD Arrangement and provide loans to and by way of loan agreement with Living Learning Pty Ltd.

When this Ruling applies

7. This Ruling applies from 1 July 2020 to 30 September 2027.

Ruling**Entering into the PAD Arrangement is not a breach of the Guidelines**

8. For the purposes of paragraph 30-125(1)(d), an ancillary fund that enters into the PAD Arrangement with Living Learning Pty Ltd and provides Tranche A and/or Tranche B loans under loan agreement(s) will not be in breach of the relevant Guidelines by virtue of entering into and complying with the relevant loan agreement, provided that the loan is in the course or furtherance of the ancillary funds purpose.

Non-recourse grant funding provided as part of Tranche A loans forms part of the ancillary fund's annual distribution

9. For the purposes of paragraph 30-125(1)(d), and complying with the relevant Guidelines, a non-recourse grant of funding provided as part of Tranche A loans forms part of an ancillary fund's annual distribution, being a provision of money.

The interest saving on Tranche A loans forms part of the ancillary fund's annual distribution

10. For the purposes of paragraph 30-125(1)(d), and complying with the relevant Guidelines, as no interest is accrued on Tranche A (non-interest bearing) loans, the interest that would be accrued on a comparable loan or bond sourced from a financial institution at 'arm's length' (that is, the market rate of interest) will form part of the ancillary fund's annual distribution.

The interest saving on Tranche B loans forms part of the ancillary fund's annual distribution

11. For the purposes of paragraph 30-125(1)(d), and complying with the relevant Guidelines, the difference, if any, between the amount of interest accrued under the Tranche B loans and the interest which would accrue on a comparable loan or bond sourced from a financial institution at 'arm's length' (that is, the market rate of interest) will form part of the ancillary fund's annual distribution.

Forgiveness of part or all of the Tranche A loans forms part of the ancillary fund's annual distribution

12. For the purposes of paragraph 30-125(1)(d), and complying with the relevant Guidelines, where the ancillary fund forgives part or all of the Tranche A loans, the amount forgiven will form part of the ancillary fund's annual distribution.

Scheme

13. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

14. Other information referenced is as follows:

- Implementation Agreement between the State of Victoria and Living Learning Pty Ltd (Implementation Agreement), and Schedule attachments
- draft Loan Agreement – Tranche A between Living Learning Pty Ltd and an ancillary fund drafted by Maddocks, dated 28 February 2020, and supplied by Maddocks to the ATO on 15 April 2020
- draft Loan Note Deed Poll, for issue of Tranche B loan notes by Living Learning Pty Ltd and guaranteed by Melbourne City Mission (MCM), drafted by Maddocks, dated 9 April 2020, and supplied by Maddocks to the ATO on 15 April 2020, and
- draft Security Deed between Living Learning Pty Ltd, MCM and a security trustee, to secure repayment of the Tranche B loan notes, drafted by Maddocks, dated 9 April 2020, and supplied by Maddocks to the ATO on 15 April 2020.

15. MCM is a public benevolent institution registered as a charity with the Australian Charities and Not-for-profits Commission.

16. MCM proposes to enter into a PAD Arrangement with the State of Victoria, called 'Living Learning'.

17. Living Learning Pty Ltd is a special-purpose vehicle, wholly-owned by MCM, that will provide the services required to achieve the objectives of the PAD Arrangement.

18. Living Learning Pty Ltd was endorsed as a deductible gift recipient on 30 January 2020 under section 30-120 and is covered by table item 1 in section 30-15 as a public benevolent institution.

19. The objectives of the PAD Arrangement are set out at clause 3.1(a) in the Implementation Agreement as follows:

- (i) to raise funds for, and otherwise assist and support, individuals of or between the ages of 15 - 21 years old who are persistently not engaged in employment, education or training ("NEET youth") and who have a mental health condition;
- (ii) ... to further an improvement of the cognitive development, relational skills and engagement in secondary education of a group of NEET youth who have a mental health condition as compared to a similar group of NEET youth who have a mental health condition and have not received the Services; and
- (iii) to leverage the existing capabilities, services of partnerships of MCM and [Hester Hornbrook Academy] to address the barriers to personal and education achievement of a Cohort and facilitate the transition of the participants to a positive education or training pathway through the delivery of the Services.

20. Living Learning Pty Ltd will obtain the following types of funding:
- initial debt funding from investors in the not-for-profit sector being private and public ancillary funds, and
 - outcome payments – funding throughout the term of the PAD Arrangement from the State of Victoria, the quantum of which will depend on the level of achievement of the target outcomes.
21. As set out in Item 6 of Schedule 1 to the Implementation Agreement, the funding from the ancillary funds will be structured as follows:
- Tranche A funding will be made up, at the election of the investor, of either forgivable loans (**Tranche A Loans**) bearing no interest or non-recourse grant funding ...
- and
- Tranche B funding will be commercial loans with a variable return of between 2.6% and 7.9% depending on the amount of Outcome Payments received by [Living Learning Pty Ltd].
22. The Tranche A loans will be forgiven in full if there is an early termination of the PAD Arrangement, and be partially forgiven in the event that the Applicant does not meet the target outcomes under the PAD Arrangement and there is, as a result, a funding shortfall in Living Learning Pty Ltd.
23. The following arrangements (also set out in Schedule 1 to the Implementation Agreement) apply to the loans:
- Living Learning Pty Ltd is the Bond Issuer
 - the issue amount is \$4 million (excluding goods and services tax)
 - the 'Prescribed Rate' means, at any time, a rate equal to the latest cash rate published by the Reserve Bank of Australia at that time plus a margin of 5 percentage points ...'
24. Living Learning Pty Ltd intends to enter into loan agreements with, and issue loan notes to, ancillary funds endorsed as a deductible gift recipient under section 30-120.

Appendix – Explanation

① *This Explanation is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public Ruling.*

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Background

25. Paragraph 30-125(1)(d) has the effect that an ancillary fund will only be entitled to remain endorsed as a deductible gift recipient if the fund and its trustees comply with the relevant Guidelines.

26. A deductible gift recipient is defined in section 30-227 and includes an entity which is endorsed under Subdivision 30-BA as an ancillary fund listed in table item 2 in section 30-15.

27. Section 426-103 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) requires the Minister to formulate public ancillary funds guidelines that must be complied with by an ancillary fund in order for the fund to remain endorsed as a deductible gift recipient. By legislative instrument dated 9 December 2011 the Public Ancillary Fund Guidelines were made and titled the *Public Ancillary Fund Guidelines 2011*.

28. Section 426-110 of Schedule 1 to the TAA requires the Minister to formulate private ancillary fund guidelines that must be complied with to remain endorsed as a deductible gift recipient. These are the *Taxation Administration (Private Ancillary Fund) Guidelines 2019*.

Entering into the PAD Arrangement is not a breach of the Guidelines

29. Pursuant to section 22 of the *Taxation Administration (Private Ancillary Fund) Guidelines 2019* and guideline 41 of the *Public Ancillary Fund Guidelines 2011*, an ancillary fund must not enter into any transaction that is uncommercial when entered into unless the transaction is:

- with a *deductible gift recipient covered by table item 1 in section 30-15 of the *Income Tax Assessment Act 1997*, and
- in the course or furtherance of the fund's purpose.

30. Living Learning Pty Ltd is a deductible gift recipient covered by table item 1 in section 30-15 and therefore, under the relevant Guidelines, an ancillary fund may enter

into the relevant loan agreement despite the fact that the loan is uncommercial (that is, being at below a market rate of interest and having the risk that the loan will not be repaid).

31. The relevant Guidelines will therefore not be breached provided entering into the relevant loan agreement is in the course or furtherance of the ancillary fund's purpose.

Compliance with the Guidelines requires an annual distribution

32. Pursuant to section 15 of the *Taxation Administration (Private Ancillary Fund) Guidelines 2019* and guideline 19 of the *Public Ancillary Fund Guidelines 2011*, an ancillary fund must make an annual distribution.

33. Subsection 15(4) of the *Taxation Administration (Private Ancillary Fund) Guidelines 2019* states:

A **distribution** is the provision of money, property or benefits. Where a fund distributes property or benefits, the market value of the property or benefit provided is to be used in determining whether the fund has complied with [subsection 15(1)].

34. Guideline 19.3 of the *Public Ancillary Fund Guidelines 2011* provides a similar requirement.

Non-recourse grant funding forms part of the ancillary fund's annual distribution

35. A provision of money is made where an ancillary fund provides non-recourse grant funding as part of Tranche A loans and will form part of the ancillary fund's annual distribution under the relevant Guidelines.

Interest saving forms part of the ancillary fund's annual distribution

36. Subsection 15(4) of the *Taxation Administration (Private Ancillary Fund) Guidelines 2019* provides three examples of how this subsection (and thus also how guideline 19.3 of the *Public Ancillary Fund Guidelines 2011*) applies. Example 3 states:

Where a private ancillary fund invests in a social impact bond that is issued by an eligible deductible gift recipient and has a return that is less than the market rate of return on a similar corporate bond issue, the fund is providing a benefit the market value of which is used in calculating how much it has distributed. The fund may determine the market value as an amount equal to the interest saved in the financial year by the deductible gift recipient from issuing the bond at a discounted rate of return.

37. More broadly, in the context of subsection 15(4) of the *Taxation Administration (Private Ancillary Fund) Guidelines 2019*, a 'benefit'¹ is considered to mean something that confers 'an advantage or profit; a gain' and which has a pecuniary value to the deductible gift recipient.

38. Therefore, under a Tranche A (non-interest bearing) loan agreement, an ancillary fund would be considered to be providing a benefit to Living Learning Pty Ltd equal to 'the interest saved' on Tranche A loans, by Living Learning Pty Ltd entering into the relevant loan agreement at less than a market rate of interest.

39. The return on Tranche A loans will be less than market rate and therefore the resultant interest forgone will form part of the ancillary fund's annual distribution.

¹ Nygh, PE & Butt, P 1998, *Butterworths concise Australian legal dictionary*, 2nd edn, definition of 'benefit'.

40. A Tranche B loan agreement may have a return on a Tranche B loan that is below market rate depending on Learning Living's performance against target outcomes. In the event such returns are below market rate, the forgone interest would form part of the ancillary fund's annual distribution.

Forgiveness of part or all of the Tranche A loans form part of the ancillary fund's annual distribution

41. Where an ancillary fund forgives part or all of the loan due to early termination of the PAD Arrangement because the target outcomes are not met by the Living Learning program, a benefit is provided to the extent of the forgiveness. The amount forgiven forms part of the ancillary fund's annual distribution in the financial year in which the forgiveness occurs.

References

Previous draft:

Not previously issued as a draft

- ITAA 1997 30-227
- TAA 1953
- TAA 1953 426-103 of Sch 1
- TAA 1953 426-110 of Sch 1

Related Rulings/Determinations:

TR 2006/10

Other references:

Legislative references:

- ITAA 1997 30-15
- ITAA 1997 Subdiv 30-BA
- ITAA 1997 30-120
- ITAA 1997 30-125
- ITAA 1997 30-125(1)(d)

Butterworths Concise Australian Legal Dictionary, 2nd Edition
Taxation Administration (Private Ancillary Fund) Guidelines 2019
Public Ancillary Fund Guidelines 2011

ATO references

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