



Status: **legally binding**

## Class Ruling

# Vertical Telecoms Pty Limited – buy-back of employee shares acquired with a limited recourse loan

### **❗ 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.

| <b>Table of Contents</b>      | <b>Paragraph</b> |
|-------------------------------|------------------|
| What this Ruling is about     | 1                |
| Who this Ruling applies to    | 5                |
| When this Ruling applies      | 7                |
| <b>Ruling</b>                 | <b>8</b>         |
| <b>Scheme</b>                 | <b>13</b>        |
| <b>Appendix – Explanation</b> | <b>54</b>        |

### **What this Ruling is about**

1. This Ruling sets out the income tax consequences for shareholders in Vertical Telecoms Pty Limited (Vertel) who acquired Class A shares in Vertel (Class A shares) under the employee incentive arrangement described in this Ruling and who subsequently disposed of those shares in the buy-back of Class A shares described in this Ruling (Buy-Back).
2. Details of this scheme are set out in paragraphs 13 to 53 of this Ruling.
3. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.
4. Unless otherwise defined, capitalised terms in this Ruling take their meaning from the Shareholder's Agreement and Management Loan Agreement listed in paragraph 14 of this Ruling.

### **Who this Ruling applies to**

5. This Ruling applies to you if you acquired Class A shares in Vertel under the employee incentive arrangement described in this Ruling and you participate in the Buy-Back.

---

Status: **legally binding**

---

6. This Ruling does not apply to anyone who is subject to the taxation of financial arrangements rules in Division 230 in relation to the scheme outlined in paragraphs 13 to 53 of this Ruling.

**Note:** Division 230 will not apply to individuals unless they have made an election for it to apply.

#### **When this Ruling applies**

7. This Ruling applies to the income year in which the Buy-Back occurs.

## **Ruling**

#### **Division 7A**

8. Vertel will not be taken to have paid a dividend to a Class A Shareholder (as described in paragraph 19 of this Ruling) under subsection 109F(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) as a result of the debt forgiveness that occurs when the limited recourse provisions of the Loan come into effect because the proceeds from the Buy-Back are insufficient for the Class A Shareholder to fully repay the Loan.

#### **Commercial debt forgiveness**

9. The commercial debt forgiveness rules in Division 245 will not apply to reduce the tax attributes of a Class A Shareholder as a result of the debt forgiveness that occurs when the limited recourse provisions of the Loan come into effect because the proceeds from the Buy-Back are insufficient for the Class A Shareholder to fully repay the Loan.

#### **Proceeds from the buy-back are not taken to be dividends**

10. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the Buy-Back Price.

#### **Capital gains tax – cost base of Class A shares**

11. The cost base or reduced cost base of the Class A shares will be reduced by an amount equal to the shortfall amount between the Buy-Back Price and the Outstanding Amount on the Loan, in accordance with subsections 110-45(3) and 110-55(6).

#### **Fringe benefits consequences**

12. Employees will not have a reportable fringe benefits amount (as defined in subsection 995-1(1)) as a result of the Buy-Back of their, or their associate's, Class A shares.

---

Status: **legally binding**

---

## **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. The following documents are referred to in this description of the scheme and elsewhere in the Ruling:

- Class A Share Terms
- Shareholders' Agreement between Vertel and its shareholders dated on or about September 2017 (Shareholders' Agreement)
- Management Loan Agreement (Loan Agreement) and Addendum to Management Loan Agreement (Addendum).

### **Vertical Telecoms Pty Limited**

15. Vertel was incorporated in Australia on 8 February 1999.

16. Other than the Class A shares, Vertel's share capital consists of management and ordinary shares. The holders of the management and ordinary shares are referred to in this Ruling as an Ordinary Shareholder.

17. Vertel has not paid any dividends since its incorporation and does not have any retained earnings.

### **The employee incentive arrangement**

18. On 5 September 2017, Vertel established an arrangement for the purpose of incentivising its employees.

19. Under the arrangement, employees were offered the opportunity to purchase Class A shares. Employees participating in the arrangement are referred to in this Ruling as Employees. Employees were permitted to nominate an associated entity to acquire the Class A shares. The holders of the Class A shares from time to time are referred to in this scheme description as Class A Shareholders.

20. The rights conferred on Class A shares are set out in the Class A Share Terms and the Shareholders' Agreement. The Shareholders' Agreement prevails to the extent of any inconsistency between the Class A Share Terms and the Shareholders' Agreement.

21. Class A Shareholders are residents of Australia (as defined in subsection 6(1) of the ITAA 1936).

22. Class A Shareholders acquired the Class A shares with the expectation of participating in the growth of the company and deriving capital profits as well as deriving dividends to be paid out of profits from the company's success.

23. The Employees and Class A Shareholders are not Ordinary Shareholders in Vertel and have never been Ordinary Shareholders in Vertel, nor are they or have they ever been an 'associate' of any Ordinary Shareholder in Vertel within the meaning of section 318 of the ITAA 1936.

---

Status: **legally binding**

---

24. The number of Class A shares an Employee was entitled to purchase was subject to the:

- total number of Class A shares on issue at any time not exceeding 12% of all shares in Vertel on issue at that time
- proportions of Class A shares held by the Employee (or associated entity) not exceeding identified proportions of all shares in Vertel on issue at any given time.

25. Each Class A share was issued for an issue price that was the market value of the Class A share.

26. Under the arrangement, Vertel offered to loan funds to the employee (or their nominated entity) to purchase Class A shares under a limited recourse loan set out in the Loan Agreement.

27. Class A shares have the same rights as ordinary shares in Vertel and rank equally between themselves, except that Class A Shareholders are only entitled to receive notices of and vote at general meetings on a proposal that affects any right attached to or conferred on a Class A share.

28. Class A Shareholders are not permitted to transfer any Class A shares except with the prior written consent of the Board (such consent may be withheld or delayed in the Board's absolute discretion), subject to the terms of the Shareholders' Agreement.

29. On the occurrence of a Liquidity Event, a Class A Shareholder's shares are subject to the relevant provisions contained in the Shareholders' Agreement.

30. A Liquidity Event means:

- Vertel meeting the EBITDA Hurdle (in any given financial year Vertel achieves specified earnings from operations before interest, taxes, depreciation and amortisation but excluding extraordinary, abnormal and non-recurring items and defined items)
- the delivery of a Good Leaver Notice (see paragraph 31 of this Ruling), or
- the occurrence of an Exit Event (see paragraph 32 of this Ruling).

31. A Good Leaver Notice is a notice of termination of an Employee's employment given by Vertel or the Employee in circumstances involving a Good Leaver Event. A Good Leaver Event means an event that:

- results in a person, who has at least 3 years of continuous service with Vertel, ceasing to be an officer or employee due to
  - death
  - suffering of serious physical or mental deterioration that prevents the person from carrying out their duties
  - retirement at age 65
  - redundancy
  - termination without cause (as defined in the Shareholder's Agreement)
- results in a person ceasing to be an officer or employee of Vertel due to any other circumstance which the Board of Vertel determines to be a Good Leaver Event.

---

Status: **legally binding**

---

32. An Exit Event means:

- a sale of all of the shares in Vertel to a third party
- a sale of all of the assets of Vertel
- an initial public offering of securities in a company (formed as a special purpose vehicle for the initial public offering) in conjunction with a listing or quotation of securities in that company on a recognised securities exchange
- a series of transactions having a similar effect.

33. The happens on the occurrence of a Liquidity Event:

- On achievement of the EBITA Hurdle
  - a Class A Shareholder may transfer not less than 50% of their shares as at that date (Notice Shares) by giving Vertel a Transfer Notice specifying the number of shares it wishes to transfer, and
  - Vertel must buy-back the Notice Shares at the Buy-Back Price.
- If a Good Leaver Notice is given by a Class A Shareholder
  - a Transfer Notice is deemed to be given by the Class A Shareholder in respect of all of its shareholding as at that date (Good Leaver Shares)
  - the Company may, in its absolute discretion, elect to
    - buy-back the Good Leaver Shares at the Buy-Back Price, or
    - make an offer to an existing or prospective employee (Offeree) of Vertel who is not already a Participating Employee, and the Offeree may accept such an offer, to purchase the Good Leaver Shares at the Buy-Back Price.
- On the occurrence of an Exit Event
  - a Transfer Notice will be deemed to be given by each Class A Shareholder, and
  - Vertel or its nominee must buy-back the balance of that shareholder's shareholding at that date in accordance with the terms of any Exit Event, at the Buyback Price.

34. Where a Transfer Notice is given in the event of a Liquidity Event, Vertel may itself buy-back the shares or may nominate another person to acquire the shares or may require the Class A Shareholder to sell the shares to a third-party purchaser under an Exit Event.

35. The Buyback Price is:

- where the Liquidity Event is meeting the EBITA Hurdle or issue of a Good Leaver Notice – the fair market value of the Class A shares
- where the Liquidity Event is an Exit Event – the price agreed between Vertel and the Third-Party Purchaser applied equally between Ordinary Shares and Class A shares.

36. Where a buyback of the Class A shares is to occur, the consideration payable to the Class A Shareholder is the Buyback Price minus any amount the Class A Shareholder owes Vertel, including under the Loan Agreement.

---

Status: **legally binding**

---

37. If an Event of Default occurs (and is not remedied in accordance with the Shareholders' Agreement), the Class A Shareholder will be deemed to have irrevocably offered to Vertel the right to acquire all of their shares at the default price, being the lower of the issue price and Fair Market Value.

38. Events of Default include:

- termination of the Employee's employment other than under a Good Leaver Event, and
- a material breach of the Employee's terms of employment.

39. Under the Shareholders' Agreement, the shareholders and their affiliates are subject to non-competition obligations.

#### **The loan to the employee to purchase Class A shares**

40. The Employee or their nominated entity entered into the Loan Agreement with Vertel to borrow the amount required to subscribe or purchase the Class A shares (Loan Amount) in Vertel (Loan).

41. Under the Loan Agreement:

- The Loan Amount is immediately applied to subscribe for or purchase the Class A shares.
- The Loan Term is from the date the Loan is drawn (the initial Loan Amount is credited and the Class A share acquired) to the earlier to occur of
  - an Exit Event, or
  - the date that the Borrower ceases to be the registered holder of the Class A shares.
- No interest is payable on the Loan Amount.
- The Outstanding Amount (being at any time, the portion of the Loan Amount which is unpaid) must be repaid in full on the earlier of
  - the date the Borrower receives sales proceeds following a Liquidity Event, and
  - such other date as agreed to in writing by the Lender and the Borrower.
- The Borrower may repay any or all of the Outstanding Amount by giving the Lender not less than 5 business days' notice of their intention to do so. There is a minimum amount that may be repaid.
- The Loan has a limited recourse provision.
- The Lender agrees that despite anything else contained or implied in the Loan Agreement:
  - (a) the Borrower shall not be personally or otherwise liable to the Lender for or be liable to pay the Lender in respect of: (a) any Outstanding Moneys; or (b) any other moneys due to the Lender under any provision of this agreement, to any further or greater extent than the value of the moneys, if any, actually received by the Borrower (net of tax and expenses) from the sale or other disposal of the [Class A] Shares; and

---

Status: **legally binding**


---

- (b) the Lender is only entitled to enforce against the Borrower its rights powers and remedies under this agreement to the extent necessary to recover the value of moneys, if any, actually received by the Borrower (net of tax and expense) from the sale or other disposal of the [Class A] Shares.
  - If the Lender, upon enforcing such of its rights powers or remedies as are available to it after the application of the above provisions of clause 8 of the Loan Agreement, does not recover all of the Outstanding Moneys or all other moneys due to the Lender under any provision of the Loan Agreement, the Lender is not entitled to, and irrevocably waives any rights to, take any action or enforce any right power or remedy under the A Agreement or otherwise against the Borrower to recover any such shortfall.
  - Where the Class A shares are being purchased or bought back by the Lender in accordance with the Shareholders' Agreement, the Lender may set-off any amount owing by the Borrower under the Loan Agreement against any amount due for payment by the Lender to the Borrower (after deducting any tax payable by the Borrower). The balance of the relevant amount must be paid in cash to the Borrower without set off.
  - At the end of the Loan Term, the Outstanding Amount is due and payable by the Borrower subject to the limited recourse provision.
42. The operative clause of the Addendum provides:
- The parties agree that notwithstanding anything contained or implied in the Management Loan Agreement, the original intention of the parties at the time of entering into the Management Loan Agreement was, and has been, that the buyback of the Shares in accordance with the Shareholders' Agreement will be in full and final settlement of the Outstanding Amount under the Management Loan Agreement, and the Borrower is not obligated to pay any Outstanding Amount if the Lender buys back the Shares in accordance with the Shareholders' Agreement, even if the market value of Shares bought back at the time could be less than the Outstanding Amount.

#### **Proposed buy-back of Class A shares**

43. On 28 July 2022, Vertel resolved to buy-back all of the Class A shares from the Class A Shareholders (Board Resolution). The Buy-Back will be a selective buy-back under the *Corporations Act 2001*.
44. The Buy-Back Price will be the fair market value of the Class A shares at the time that the buy-back happens.
45. It is expected that the fair market value of the Class A shares will be less than the acquisition price of the Class A shares.
46. Pursuant to the Board Resolution and the Loan Agreement, the Buy-Back Price will be set off against any amounts owing by the Class A Shareholder to Vertel under the Loan Agreement. Under the Loan Agreement, the Class A Shareholders are released from paying any Outstanding Amount and Vertel waives any right to take any action or enforce any right against any of the Class A Shareholders to recover the shortfall.
47. Upon completion of the Buy-Back, Vertel will:
- cancel the Class A shares
  - cancel the share certificates issued to the Class A Shareholders
  - record the changes in the Member's Register.

---

**Status: legally binding**

---

48. The Company also releases the Class A Shareholders from all non-competition obligations under the Shareholder's Agreement.

49. For financial reporting purposes, Vertel treated the Class A shares as an option grant, in accordance with guidance on International Financial Reporting Standard IFRS 2 *Share-based Payment*. Vertel considered that the Class A shares were deemed to be an option grant and should not be recognised for accounting purposes until the limited recourse loan was repaid.

50. Vertel kept the following notional accounts:

|       |                                           |
|-------|-------------------------------------------|
| Debit | Notional limited recourse loan receivable |
|       | Credit                                    |
|       | Notional share capital                    |

51. There have been no changes to this notional share capital account. This notional share capital account of Vertel (as defined in section 975-300) was not tainted for the purposes of section 197-50.

52. Vertel will record the buy-back of the Class A shares against the notional accounts as follows:

|       |                                           |
|-------|-------------------------------------------|
| Debit | Notional share capital                    |
|       | Credit                                    |
|       | Notional limited recourse loan receivable |

53. Vertel decided to implement the Buy-Back at this time to simplify the ownership structure and because this arrangement is no longer considered an effective employee retention method.

---

**Commissioner of Taxation**

11 December 2024

---

Status: **not legally binding**

## Appendix – Explanation

**❶** *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.*

| <b>Table of Contents</b>                                 | <b>Paragraph</b> |
|----------------------------------------------------------|------------------|
| Division 7A                                              | 54               |
| Commercial debt forgiveness                              | 66               |
| Proceeds from the Buy-Back are not taken to be dividends | 80               |
| Capital gains tax – cost base of Class A shares          | 86               |
| <i>Recoupment</i>                                        | 87               |
| <i>Conclusion</i>                                        | 94               |
| Fringe benefits                                          | 95               |
| <i>Is the benefit a debt waiver fringe benefit?</i>      | 102              |
| <i>Has any fringe benefit been provided?</i>             | 110              |
| Conclusion                                               | 116              |

### Division 7A

54. Division 7A of Part III of the ITAA 1936 (Division 7A) is an integrity measure aimed at preventing private companies from making tax-free distributions of profits to shareholders (or their associates).

55. Under subsection 109F(1) of the ITAA 1936, a private company is taken to pay a dividend to an entity at the end of the private company's year of income if all or part of a debt the entity owed the private company is forgiven in that year and either:

- the amount is forgiven when the entity is a shareholder in the private company, or an associate of such a shareholder, or
- a reasonable person would conclude (having regard to all the circumstances) that the amount is forgiven because the entity has been such a shareholder or associate at some time.

56. The amount of the dividend equals the amount of debt forgiven (subsection 109F(2) of the ITAA 1936). Section 109Y of the ITAA 1936 limits the total amount of dividends taken to have been paid by a private company under Division 7A to the company's distributable surplus.

57. Relevantly, under subsection 109F(3) of the ITAA 1936, a debt will be forgiven for the purposes of Division 7A, if and when the amount would be forgiven under section 245-35.

58. Relevantly, under paragraph 245-35(a), a debt is forgiven if and when the debtor's obligation to pay the debt is released, waived, or is otherwise extinguished other than by repaying the debt in full.

59. In this case, the debt is forgiven at a time immediately after the Class A Shareholder has sold its Class A share back to Vertel under the Buy-Back and the proceeds from the Buy-Back are less than the amount required to satisfy the Outstanding

---

Status: **not legally binding**

---

Amount of the Loan, resulting in a shortfall in repayment of the Loan. The limited recourse provisions of the Loan Agreement come into effect at that time. The effect of the limited recourse provisions is to release the Class A Shareholder from the liability or obligation to repay the shortfall on the Loan and correspondingly, Vertel is no longer able to recover the shortfall amount from the Class A Shareholder. This constitutes a forgiveness of the debt, at that time, under paragraph 245-35(a) as the debt has been released, waived or otherwise extinguished, other than by repayment in full.

60. Taxation Determination TD 2008/14<sup>1</sup> confirms that paragraph 109F(1)(b) of the ITAA 1936 has broad application, such that where the debt was forgiven when the entity was not a shareholder or associate, the forgiveness can still give rise to a dividend if a reasonable person would conclude, having regard to all the circumstances, that the forgiveness occurred because the entity had been such a shareholder or associate at some time:

**Ruling**

1. In this context 'because' means by reason that. The reason must be a real and substantial reason for the payment, loan or debt forgiveness concerned, even if it is not the only reason or not the main reason for the transaction.
2. The test for determining whether the event falls within the relevant provisions of Division 7A is a reasonable person's conclusion which is an objective test requiring a weighing up of all the circumstances to determine whether the reason is real and substantial.

**Example 1**

3. *Jenny was a significant shareholder, a director and an employee of a private company but then ceased to be a shareholder, director or employee of the company. She was also then no longer an associate of any of the current shareholders. The remuneration paid to Jenny during her employment was less than that paid to arm's length employees undertaking similar work.*
4. *While Jenny was a shareholder the company made a loan to Jenny. Similar loans were not made to persons who were employees only. (Assume that, because of its features, the loan itself did not attract the operation of section 109D or 109E.)*
5. *The loan was not fully repaid when Jenny sold her shares in the company, ceased employment and resigned as a director.*
6. *When Jenny announced her intention to retire, it was proposed that the amount owed by Jenny to the company be forgiven. Jenny realised that Division 7A would apply if the debt were forgiven while she was still a shareholder, regardless of the reason for the forgiveness. Jenny arranged with the new owner for the loan to be forgiven after she sold her shares, and this duly occurred.*
7. *A reasonable person would conclude, having regard to all the circumstances and particularly to the arrangement made between Jenny and the new owner in the course of negotiating the sale of Jenny's shares, that a real and substantial reason for the forgiveness of the debt was that Jenny had been a shareholder of the company. This is so even though a reasonable person might also conclude that another reason for the forgiveness was that Jenny had previously been an employee of the company, in that the forgiveness was perhaps in partial recognition of services previously rendered by Jenny as an employee.*

---

<sup>1</sup> Taxation Determination TD 2008/14 *Income tax: Division 7A of Part III of the Income Tax Assessment Act 1936 – what is the meaning of 'because' in the context of the expression 'because the entity has been such a shareholder or associate at some time' in relation to payments, loans and debt forgiveness made by a private company to the entity?.*

---

Status: **not legally binding**

---

8. Therefore, the condition in paragraph 109F(1)(b) is satisfied and a dividend is taken to have been paid.

...

#### **Appendix 1 – Explanation**

...

20. ...For convenience the following discussion focuses on paragraph 109C(1)(b) which deals with payments but the reasoning applies equally to subparagraphs 109D(1)(d)(ii) and 109D(1A)(d)(ii) and paragraph 109F(1)(b), which are the equivalent provisions dealing with loans and debt forgiveness.

21. Paragraph 109C(1)(a) applies if a taxpayer is a shareholder, or an associate of a shareholder, when a payment is made. No causal relationship between the payment and the entity's status as a shareholder or associate is required.

22. Paragraph 109C(1)(b) does require a causal relationship. The word 'because' is not defined in the *Income Tax Assessment Act 1936*. It is defined in *The Australian Oxford Dictionary*, 1999, Oxford University Press, Melbourne as 'for the reason that; since'. This directs attention to the question of whether the fact that the entity was in the past a shareholder or associate is a *reason* for the payment being made.

23. However, the Commissioner considers that to be a cause of the payment, a reason must be real and substantial and not merely remote or insignificant. Whether a reason is real and substantial is a question of fact and degree determined on balance, according to the facts and circumstances.

24. In some cases it may be reasonable to conclude that there is more than one reason for the payment being made. The Commissioner considers that, as a matter of ordinary language, an event may occur *because of* a particular circumstance even if it also occurs because of one or more other circumstances.

25. Semantically there may be some room to argue that 'because' instead directs attention only to identifying the sole or dominant cause of the relevant event. However, the Commissioner considers that is not the most natural reading of the provision and that in any case the context of the provision supports the broader view of the matter.

26. Paragraph 109C(1)(b) prevents the operation of the primary rule in paragraph 109C(1)(a) from being avoided simply by ending the relevant shareholding or association before making a payment. Given the breadth of paragraph 109C(1)(a), which as mentioned above requires no causal relationship between the making of the payment and the entity's status, the Commissioner considers it appropriate to take a broad view of the rule in paragraph 109C(1)(b) that is intended to support its operation. In particular, it would tend to make paragraph 109C(1)(b) ineffective if the existence of some other reason for a payment were enough to prevent the paragraph from applying. In other words, because paragraph 109C(1)(b) is there to stop people contriving ways to avoid paragraph 109C(1)(a), paragraph 109C(1)(b) in turn should be interpreted in a way that makes it relatively difficult to avoid, including by means of further contrivances.

27. In conclusion therefore, the existence of multiple reasons for a transaction does not prevent a reasonable person from concluding that the payment, loan or debt forgiveness occurred because the entity has been a shareholder or associate at some time. For the purposes of paragraph 109C(1)(b), subparagraphs 109D(1)(d)(ii) and 109D(1A)(d)(ii) and paragraph 109F(1)(b) it is sufficient that a reasonable person would conclude (having regard to all the circumstances) that a real and substantial reason for a transaction occurring is that the entity was a shareholder, or an associate of a shareholder, at some time.

61. In this case, the offer to participate in the employee incentive arrangement and receive the limited recourse loan to acquire the Class A shares was extended to the Employees (and their nominated entities) because Vertel wanted to incentivise the relevant employees in performing their role as an employee of the company. The issue of Class A

---

Status: **not legally binding**

---

shares and the provision of the Loan to acquire the shares was the means or cause by which the Class A Shareholder became a shareholder, rather than the other way around as contemplated in the 'causal relationship' discussed in paragraph 22 of TD 2008/14.

62. Forgiveness of the amount outstanding under the Loan happens under the terms of the Loan Agreement that was entered into before the Employee (or their nominated entity) became a shareholder. The limited recourse provisions of the Loan were an integral part of the incentive arrangement offered to the relevant employees (and their nominated entity) *because* they were an employee that Vertel wanted to incentivise at that time.

63. The Employees and Class A Shareholders are not Ordinary Shareholders in Vertel nor have they ever been Ordinary Shareholders in Vertel nor are they or have they ever been, an 'associate' of any Ordinary Shareholder in Vertel within the meaning of section 318 of the ITAA 1936. The circumstances are in contrast to Example 1 in paragraphs 3 to 8 of TD 2008/14.

64. Although the Class A Shareholding precedes the forgiveness and its ending is part of the factual circumstances that bring into effect the limited resource provisions of the Loan, and therefore, the forgiveness, it cannot be concluded that the shareholding is the 'real or substantial' reason or cause of the forgiveness as contemplated by paragraph 23 of TD 2008/14.

65. Having regard to all of the circumstances, a reasonable person would not conclude that the forgiveness of the amount outstanding owed by the Class A Shareholder under the terms of the Loan Agreement was made because the Class A Shareholders were shareholders at some time. Rather, it occurred under the terms of the Loan provided to the Employees (and their nominated entities) to acquire the Class A shares with the aim of incentivising the Employees to perform well in their employment by aligning their interests with that of an owner.

#### **Commercial debt forgiveness**

66. Section 245-10 provides (in part) that a debt will be considered to be a commercial debt if:

- the whole or any part of the interest payable in respect of the debt can be deducted by the borrower, or
- where interest is not payable, but had interest been payable, the whole or any part of the interest payable would have been deductible to the borrower.

67. In this case, an interest-free loan has been provided to the Employees or their nominees to facilitate the acquisition of Class A shares in Vertel. The Class A shares were acquired with an expectation of receiving dividend income, and we accept that if interest had been payable on the Loan, it would have been deductible to the borrower. Therefore, the Loan provided by Vertel to the Employees or their nominated entity under the Loan Agreement is a commercial debt under section 245-10.

68. A debt is forgiven if and when the debtor's obligation to pay the debt is released, waived, or is otherwise extinguished other than by repaying the debt in full (paragraph 245-35(a)).

69. Where the limited recourse provisions of the Loan come into effect, the former Class A Shareholder is not required to repay the shortfall between the Outstanding Amount on the Loan and the proceeds received from the Buy-Back. As discussed in paragraph 59 of this Ruling, this results in the forgiveness of the debt at that time, under paragraph 245-35(a).

---

Status: **not legally binding**

---

70. Under Division 245, where the forgiveness of a commercial debt results in the debtor having a positive 'net forgiven amount', the debtor will be required to reduce certain tax attributes that could otherwise reduce their taxable income (in the same or a later income year), to the extent of the net forgiven amount.

71. To calculate the net forgiven amount of a debt, it is first necessary to calculate the 'gross forgiven amount' of a debt.

72. Under section 245-55, the gross forgiven amount is equal to the market value of the debt when it is forgiven less the amount (if any) that is offset against the value of the debt when it is forgiven.

73. However, there are special rules in section 245-60 for working out the value of a non-recourse debt. Subsection 245-60(1) states that the value of a non-recourse debt when it is forgiven is the lesser of:

- (a) the amount of the debt outstanding at that time; and
- (b) the market value at that time of the creditor's rights ...

74. A non-recourse debt covered by 245-60(1) includes a debt incurred to finance the acquisition of property where the creditor's rights against the borrower in the event of default in the payment of the debt were, just before the debt was forgiven, limited to rights (including the right to money payable) in relation to the property or the loss or disposal of the whole or a part of the property (subsections 245-60(2) and (3)).

75. The Loans to the Class A Shareholders are non-recourse debts for the purposes of Division 245. In the event of default, Vertel's rights against the Class A Shareholders are limited to repayment of the Loan to the extent of the value of money received by the Class A Shareholders from the disposal of the Class A shares. The limited recourse provisions of the Loan Agreement operate so that Vertel is not entitled to recover the shortfall in repayment of the debt and it is forgiven.

76. The rules to determine the amount that can be offset against the value of a debt are set out in section 245-65. In broad terms, section 245-65 sets out the rules to determine the consideration given by the debtor to the creditor in respect of the forgiveness of a debt, which reduces the value of the debt (determined here under section 245-60) to arrive at the gross forgiven amount of the debt.

77. Relevantly, under subsection 245-65(1), where there is a non-money lending debt, under table item 2 (where table items 3, 4, 5 and 6 do not apply), the amount offset is the sum of each amount the debtor has paid or is required to pay and the market value, when the debt is forgiven, of any property given or that is required to be given in respect of the debt forgiveness.

78. Under the Shareholders' Agreement and Loan Agreement, Vertel has the right to offset consideration to be paid by it (on buyback or other transfer) for the Class A shares against any amount owing to it by a Class A Shareholder. Under the Loan Agreement, Vertel has no right to recover any further amount from a Class A Shareholders and releases the Class A Shareholders from any obligation to pay the remaining balance of their loan. The amount offset under section 245-65, against the value of the non-recourse debt calculated under section 245-60, would accordingly be the market value of the Class A shares at the time of the buyback (or other transfer) as this determines the amount of the loan required to be repaid.

79. Therefore, there will be no gross forgiven amount in respect of the forgiveness of the shortfall in repayment of the Loan (subsection 245-75(2)) as both the value of the debt and offset amount are the same. Division 245 will have no practical effect.

Status: **not legally binding**

**Proceeds from the Buy-Back are not taken to be dividends**

80. Section 45A of the ITAA 1936 applies where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the capital benefits than other shareholders and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

81. Although a capital benefit (as defined in paragraph 45A(3)(b)) of the ITAA 1936 is provided under the Buy-Back, the circumstances indicate that there was no streaming of capital benefits to some shareholders and dividends to other shareholders. Therefore, section 45A does not apply to the Buy-Back.

82. Section 45B of the ITAA 1936 applies where certain capital payments are paid to shareholders in substitution for dividends. Subsection 45B(2) of the ITAA 1936 provides that section 45B applies where:

- (a) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company; and
- (b) under the scheme, a taxpayer (the **relevant taxpayer**), who may or may not be the person provided with the demerger benefit or the capital benefit, obtains a tax benefit; and
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling a taxpayer (the **relevant taxpayer**) to obtain a tax benefit.

83. In this case, the conditions of paragraphs 45B(2)(a) and (b) of the ITAA 1936 are met in respect of the Buy-Back. However, the requisite purpose under paragraph 45B(2)(c) of the ITAA 1936 of enabling a person to obtain a tax benefit, by way of a capital distribution, is not present.

84. Having regard to the relevant circumstances (as set out in subsection 45B(8) of the ITAA 1936), it cannot be concluded that a person entered into, or carried out, the Buy-Back for a more than incidental purpose of enabling a participating Class A Shareholder to obtain a tax benefit from the provision of capital benefits.

85. Therefore, section 45B of the ITAA 1936 does not apply to the Buy-Back.

**Capital gains tax – cost base of Class A shares**

86. The first element of a CGT asset's cost base and reduced cost base is the total of:

- the money you paid or are required to pay, in respect of acquiring it<sup>2</sup>, or
- the market value of any other property you gave, or are required to give, in respect of acquiring it (worked out at the time of the acquisition).<sup>3</sup>

**Recoupment**

87. However, expenditure does not form part of any element of the cost base or reduced cost base to the extent of any amount you have received as 'recoupment' of it,

<sup>2</sup> Paragraph 110-25(2)(a) and subsection 110-55(2).

<sup>3</sup> Paragraph 110-25(2)(b) and subsection 110-55(2).

---

Status: **not legally binding**

---

except so far as the amount is included in the taxpayer's assessable income (subsections 110-45(3) and 110-55(6)).<sup>4</sup>

88. Subsection 995-1(1) provides that 'recoupment' has the meaning given by section 20-25.

89. Section 20-25 defines a 'recoupment' of a loss or outgoing as including '... any kind of recoupment, reimbursement, refund, insurance, indemnity or recovery, however described'.

90. The ordinary meaning of the term 'recoup' includes '... to obtain an equivalent for; compensate for: to recoup one's losses', '... to regain or recover' and '... to reimburse or indemnify: to recoup a person for expenses'.<sup>5</sup>

91. Where a taxpayer borrows funds under a limited recourse loan and is not required to repay the full loan amount because the lender's rights are limited to the proceeds from the disposal of a particular CGT asset that has lost value, the taxpayer obtains an economic gain equivalent to the difference between the amount owing on the loan and the amount required to be paid to discharge the loan (shortfall amount). This economic gain is within the meaning of 'recoup' because the taxpayer has received an amount to compensate their loss as a result of the loan being discharged in full by an asset that is worth less than the loaned amount. Accordingly, the shortfall amount is a recoupment in accordance with the definition in section 20-25. The shortfall amount is also a recoupment in accordance with the definition in section 20-25 because it is an indemnity.

92. With respect to each Class A Shareholder, the Buy-Back Price will be less than the Outstanding Amount on the Loan. As a result of the limited recourse provision of the Loan coming into effect, the Class A Shareholder is not required to repay the shortfall amount. Thus, the Class A Shareholder has indirectly received the shortfall amount as a reduction in the Loan Amount. This economic gain is within the meaning of 'recoupment' of section 20-25. Vertel has compensated the Class A Shareholder for the loss incurred as a result of the decrease in market value of the Class A shares.

93. Accordingly, the shortfall amount is a recoupment under subsections 110-45(3) and 110-55(6) and therefore will not form part of the cost base or reduced cost base of the Class A shares when calculating any capital gain or capital loss made on the disposal of the shares under the Buy-Back.

### **Conclusion**

94. Each Class A Shareholder's first element cost base and reduced cost base in their shares will be equal to the amount of the Loan repaid by them at the time of the Buy-Back by Vertel. This cost base will be equal to the consideration paid by Vertel to each Class A Shareholder, proposed to be offset against the Amount Outstanding on each Loan. Accordingly, subject to any other cost base elements, each Class A Shareholder will make a nil net capital gain on disposal of its Class A shares.

### **Fringe benefits**

95. Subsection 135P(1) of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) provides that an employee has a 'reportable fringe benefits amount' for a year of income

---

<sup>4</sup> ATO Interpretative Decision ATO ID 2013/64 *Capital gains tax: cost base: limited recourse loan*.

<sup>5</sup> Pan Macmillan Australia (2024) *The Macquarie Dictionary Online*, [www.macquariedictionary.com.au](http://www.macquariedictionary.com.au), accessed 4 December 2024.

---

Status: **not legally binding**

---

(1 July to 30 June) if the employee's 'individual fringe benefits amount' for the fringe benefits tax year (1 April to 31 March) in the year of income is more than \$2,000.

96. Subsection 5E(2) of the FBTA provides that the 'individual fringe benefits amount' is the sum of the employee's share of the taxable value of each fringe benefit provided in respect of the employee's employment other than an 'excluded fringe benefit'.

97. It follows that for an Employee to have a reportable fringe benefits amount as a result of the Buy-Back of their, or their associates, Class A shares, the Buy-Back must result in the provision of a fringe benefit.

98. Relevantly, 'fringe benefit' is defined at subsection 136(1) of the FBTA to include:

... a benefit provided to the employee or to an associate of the employee by ... the employer ... in respect of the employment of the employee ....

99. The term benefit is very broadly defined in subsection 136(1) of the FBTA to include any right, privilege, service, or facility.

100. Divisions 2 to 11 of Part III of the FBTA define specific types of benefits. A debt waiver benefit is one of these specific types of benefit. In addition to these specific types of benefit, section 45 of the FBTA provides that a residual benefit will arise when something is provided that is not a specific benefit but comes within the definition of benefit in subsection 136(1).

101. When the limited recourse provisions come into effect and the Class A Shareholder is no longer obligated to repay the shortfall on the Loan, a benefit has been conferred on the Class A Shareholder under the definition of benefit in subsection 136(1) of the FBTA.

#### ***Is the benefit a debt waiver fringe benefit?***

102. A 'debt waiver benefit' is defined in subsection 136(1) of the FBTA to mean a benefit referred to in section 14 of that Act.

103. Section 14 of the FBTA states that:

Where, at a particular time, a person (in this section referred to as the **provider**) waives the obligation of another person (in this section referred to as the **recipient**) to pay or repay to the provider an amount, the waiver shall be taken to constitute a benefit provided at that time by the provider to the recipient.

104. The word 'waive' is defined in the FBTA at subsection 136(1) as: 'includes release'.

105. The term 'waive' is not otherwise defined in the FBTA and so the ordinary meaning of the word is relevant.

106. The meaning of the term 'waiver' was considered in *Banning v Wright* [1972] 2 ALL ER 987 where at [998], Lord Hailsham LC said:

'In my view, the primary meaning of the word "waiver" in legal parlance is the abandonment of a right in such a way that the other party is entitled to plead the abandonment by way of confession and avoidance if the right is thereafter asserted'.

This appears to accord with the dictionary meaning of the term and with the two discussions of the subject, each of the same, or similar, effect in Halsbury's Laws of England.... In the former of these it is said:

"Waiver is the abandonment of a right...A person who is entitled to the benefit of a stipulation in a contract or of a statutory provision may waive it, and allow the contract or transaction to proceed as through the stipulation or provision did not exist."

---

Status: **not legally binding**

---

107. Guidance for considering whether the limited recourse provision in the Loan Agreement and the Addendum's operative clause together constitute a waiver within the meaning of section 14 of the FBTAA, when the proposed Buy-Back happens, is provided by ATO ID 2003/317<sup>6</sup>, which states:

Where, under the terms of a loan agreement, a lender accepts a transfer of shares in full satisfaction of the loan balance, there is no release or waiver of any obligation to pay or repay an amount.

108. In these circumstances, the limited recourse provision was included as part of the terms in the Loan Agreement. Additionally, the operative clause of the Addendum to the Loan Agreement further confirmed that the intention of the parties at the time of entering into the Loan Agreement was that the buyback of the Class A shares in accordance with the Shareholders' Agreement will be in full and final settlement of the Outstanding Amount under the Loan Agreement, and the Borrower is not obligated to pay any Outstanding Amount even if the market value of shares bought back at the time could be less than the Outstanding Amount.

109. In applying ATO ID 2003/317, it is accepted that when the proposed Buy-Back of Class A shares happens and the limited recourse provisions come into effect, Vertel has not waived the obligation of the shareholder to pay the Outstanding Amount. The terms of the Loan Agreement provide that the proceeds of the Buy-Back are in full and final satisfaction of the Loan. Therefore, it can be concluded that a debt waiver benefit will not arise from the proposed Buy-Back.

#### ***Has any fringe benefit been provided?***

110. For a benefit to be a 'fringe benefit' it must be provided 'in respect of' an employee's employment.

111. A benefit is provided 'in respect of' employment, if there is a sufficient or material link between the benefit and the employment, rather than a causal connection.<sup>7</sup>

112. The benefit that arises upon the discharge of the Loan using the limited recourse provisions arises as a result of the rights the Class A Shareholder received under the Loan Agreement. Those rights were provided to the Class A Shareholder, in conjunction with the provision of Class A shares, because the Employee was an employee of Vertel.<sup>8</sup>

113. When the limited recourse provisions of the Loan take effect, the benefit to the Class A Shareholder is a result of the taking effect of the pre-existing rights under the Loan Agreement and is not a new or separate benefit provided 'in respect of' the Employee's employment.

114. This situation is considered analogous to that in *Commissioner of Taxation v McArdle, J.W.* [1988] FCA 738. McArdle was granted valuable rights in respect of his employment which he subsequently surrendered in return for a lump sum payment. The Court noted that what had occurred under the surrender agreement was not the granting of

---

<sup>6</sup> ATO Interpretative Decision ATO ID 2003/317 *Debt waiver benefits: benefit upon discharge of limited recourse loan*.

<sup>7</sup> *J & G Knowles v Commissioner of Taxation* [2000] FCA 196.

<sup>8</sup> A loan fringe benefit may arise on the making of a loan by an employer to an employee or their associate but any downside risk protection is not a separate benefit to the loan fringe benefit: see ATO Interpretative Decision ATO ID 2003/315 *Loan fringe benefits: loans with limited recourse loan facility*.

---

Status: **not legally binding**

---

a valuable benefit, but the exploitation of rights received from the employer in previous years.<sup>9</sup>

115. The benefit that arises when the limited recourse provisions take effect does not give rise to a 'fringe benefit' as no new benefit is provided in respect of the Employee's employment.

### **Conclusion**

116. Therefore, as there will be no fringe benefit provided as a result of the Buy-Back (when the limited recourse provisions of the Loan will take effect), an Employee will not have a 'reportable fringe benefits amount' when the Buy-Back happens.

---

<sup>9</sup> See also ATO Interpretative Decision ATO ID 2003/316 *Fringe Benefits Tax Fringe benefit: benefit arising upon discharge of a limited recourse loan*.

---

Status: **not legally binding**


---

## References

---

### *Related Rulings/Determinations:*

TD 2008/14

### *Legislative references:*

- ITAA 1936 6(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(8)
- ITAA 1936 45C
- ITAA 1936 Div 7A
- ITAA 1936 Pt III Div 7A
- ITAA 1936 109C(1)(b)
- ITAA 1936 109D
- ITAA 1936 109D(1)(d)(ii)
- ITAA 1936 109E
- ITAA 1936 109F(1)
- ITAA 1936 109F(1)(b)
- ITAA 1936 109F(2)
- ITAA 1936 109F(3)
- ITAA 1936 109Y
- ITAA 1936 318
- ITAA 1997 20-25
- ITAA 1997 110-25(2)(a)
- ITAA 1997 110-25(2)(b)
- ITAA 1997 110-45(3)
- ITAA 1997 110-55(2)
- ITAA 1997 110-55(6)
- ITAA 1997 197-50
- ITAA 1997 Div 230
- ITAA 1997 Div 245
- ITAA 1997 245-10
- ITAA 1997 245-35
- ITAA 1997 245-35(a)
- ITAA 1997 245-55
- ITAA 1997 245-60
- ITAA 1997 245-60(1)
- ITAA 1997 245-60(2)
- ITAA 1997 245-60(3)

- ITAA 1997 245-65
- ITAA 1997 245-65(1)
- ITAA 1997 245-75(2)
- ITAA 1997 995-1(1)
- ITAA 1997 975-300
- FBTAA 1986 5E(2)
- FBTAA 1986 Pt III Div 2
- FBTAA 1986 Pt III Div 3
- FBTAA 1986 14
- FBTAA 1986 Pt III Div 4
- FBTAA 1986 Pt III Div 5
- FBTAA 1986 Pt III Div 6
- FBTAA 1986 Pt III Div 7
- FBTAA 1986 Pt III Div 8
- FBTAA 1986 Pt III Div 9
- FBTAA 1986 Pt III Div 10
- FBTAA 1986 Pt III Div 11
- FBTAA 1986 45
- FBTAA 1986 135P(1)
- FBTAA 1986 136(1)
- Corporations Act 2001

### *Cases relied on:*

- Banning v Wright [1972] 2 ALL ER 987; 48 Tax Cas 421; [1972] TR 105; 116 Sol J 509; [1972] 1 WLR 972
- Commissioner of Taxation v McArdle, J.W. [1988] FCA 738; 89 ATC 4051; 19 ATR 1901
- J & G Knowles & Associates Pty Ltd v Federal Commissioner of Taxation [2000] FCA 196; 96 FCR 402; 2000 ATC 4151; 44 ATR 22

### *Other references:*

- ATO ID 2013/64
- ATO ID 2003/315
- ATO ID 2003/316
- ATO ID 2003/317
- Pan Macmillan Australia (2024), *The Macquarie Dictionary* online, [www.macquariedictionary.com.au](http://www.macquariedictionary.com.au)

### ATO references

NO: 1-12IDLJAD  
 ISSN: 2205-5517  
 BSL: PW

ATOlaw topic: Tax integrity measures ~~ Division 7A ~~ Debt forgiveness  
 Income tax ~~ Capital management ~~ Anti avoidance rules ~~ Section 45C  
 Income tax ~~ Commercial debt forgiveness ~~ What constitutes forgiveness of a debt?

---

Status: **not legally binding**

---

Income tax ~~ Commercial debt forgiveness ~~ Calculation of the gross forgiven amount of a debt

Fringe benefits tax ~~ Types of benefit ~~ Debt waiver benefits

---

© AUSTRALIAN TAXATION OFFICE FOR THE COMMONWEALTH OF AUSTRALIA

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).