



Taxation Determination

Income tax: Does the payment of a 'commercial debt' by a guarantor, pursuant to a pre-existing guarantee, constitute forgiveness of the debt under section 245-35 of Schedule 2C of the *Income Tax Assessment Act 1936*?

Preamble

*The number, subject heading, date of effect and paragraphs 1 to 8 of this document are a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner.*

1. No, the payment by the guarantor does not of itself constitute the forgiveness of the debt within the meaning of Schedule 2C of the *Income Tax Assessment Act 1936* (ITAA 1936), provided that the guarantor is subrogated to the rights formerly held by the creditor in relation to the debt so that the debt is now enforceable by the guarantor. However, a subsequent forgiveness of the debt owed to the guarantor as result of the subrogation of the former creditor's rights may attract the operation of Schedule 2C.

Explanation

2. What constitutes 'forgiveness' of a debt is specified in section 245-35 of Schedule 2C. The relevant provision, for the purposes of this Taxation Determination, is subsection (1), which states:

A debt is forgiven if the debtor's obligation to pay the debt is released or waived, or is otherwise extinguished.

Released or Waived

3. The terms 'released' and 'waived' are not defined for the purposes of Schedule 2C. The Macquarie Dictionary of Law defines 'release' as 'the relinquishment of a legal right or claim against' another, and 'waiver' as 'the intentional renunciation of some legal right or immunity'. In the context of Schedule 2C both terms are considered to encompass circumstances where the debtor has been afforded relief from repaying the debt.

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4. The mere payment of a debt by a guarantor does not result in a debtor being afforded 'relief', as under the Common Law the guarantor is subrogated to the rights formerly held by the creditor in relation to the debt so that the debt is now enforceable by the guarantor.

Extinguished

5. In the context of Schedule 2C the payment of a debt by a guarantor does not extinguish the debt in any sense because the guarantor is subrogated to the rights of the creditor, so that the debt continues (albeit owed to a different person).

Definitions

Commercial debt

6. The definition of the term 'commercial debt' is found in section 245-25 of Schedule 2C. Note subsection 245-245(1) of Schedule 2C defines 'debt' as including a part of a debt.

Guarantee

7. Taxation Ruling TR 96/14 at paragraph 41 explains that:

A guarantee is an accessory contract by which the promisor undertakes to be answerable to the promisee for the debt, default or miscarriage of another person whose primary liability to the promisee must exist or be contemplated. In most jurisdictions it is required by statute that the contract must either be in writing or evidenced by a written note or memorandum signed by or on behalf of the party to be charged. The guarantor or surety is the person who engages with the creditor of a third party to be answerable in the second degree for the liability of the third party...

8. As explained in paragraph 51 of Taxation Ruling TR 96/23, a guarantee is to be distinguished from an indemnity.

Date of Effect

9. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of Taxation

23 June 2004

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FOI status: **may be released**

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Previous draft:

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Related Rulings/Determinations:

TR 92/20; TR 96/14; TR 96/23

Legislative references:

- ITAA 1936 Sch 2C
- ITAA 1936 Sch 2C 245-25
- ITAA 1936 Sch 2C 245-35
- ITAA 1936 Sch 2C 245-35(1)
- ITAA 1936 Sch 2C 245-245
- ITAA 1936 Sch 2C 245-245(1)
- TAA 1953 Pt IVA

ATO references

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