



Draft Taxation Determination

Income tax: commercial debt forgiveness – does the exclusion for debts forgiven for reasons of natural love and affection require that the creditor be a natural person?

1 Relying on this draft Ruling

This publication is a draft for public comment. It represents the Commissioner's preliminary view on how a relevant provision could apply.

If this draft Ruling applies to you and you rely on it reasonably and in good faith, you will not have to pay any interest or penalties in respect of the matters covered, if this draft Ruling turns out to be incorrect and you underpay your tax as a result. However, you may still have to pay the correct amount of tax.

Ruling

1. Yes.
2. Paragraph 245-40(e) of the *Income Tax Assessment Act 1997*¹ excludes a debt forgiven for reasons of natural love and affection from the application of the commercial debt forgiveness provisions.²
3. The context of paragraph 245-40(e) requires a direct causal nexus between the forgiveness and the natural love and affection, and the natural love and affection must arise in consequence of ordinary human interaction. For this to occur, the creditor must be a natural person.

Date of effect

4. Subject to paragraph 5 of this draft Determination, when the final Determination is issued, it is proposed to apply before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10 *Public Rulings*).
5. It is recognised that this draft Determination takes a different view to ATO Interpretative Decision ATO ID 2003/589 *Commercial debt forgiveness - can a company forgive a debt for reasons of natural love and affection?* (withdrawn on 6 February 2019).

¹ All legislative references are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

² The commercial debt forgiveness provisions are Subdivisions 245-C to 245-G.

TD 2019/D9

The Commissioner will not devote compliance resources to apply the views expressed in this Determination in relation to debts forgiven prior to 6 February 2019 that would have been covered by ATO ID 2003/589. However, if the Commissioner is asked or required to state a view (for example, in a private ruling or in submissions in a litigation matter), the Commissioner will do so consistently with the views set out in the final Determination.

Commissioner of Taxation

2 October 2019

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the proposed binding public ruling.*

6. Paragraph 245-40(e) provides that the commercial debt forgiveness provisions do not apply to a debt forgiven for reasons of natural love and affection.

7. Whether a debt has been forgiven for reasons of natural love and affection necessitates a careful examination of the reasons for forgiving the debt. This is a question of fact and includes taking into account the surrounding circumstances of the debt, and the nature of the relationship said to be the subject of the natural love and affection.

8. The text in paragraph 245-40(e) comprises three elements:

- The first element requires that there must be ‘forgiveness of a debt’.
- The second element, ‘for reasons of’, requires a causal nexus between the first and third element.
- The third element, ‘natural love and affection’, can be characterised as a limitation on the first element.

The interaction of these elements is important.

Forgiveness of a debt – the creditor

9. The use of the phrase ‘forgiveness of a debt’ in section 245-40 denotes creditors generally, and read in context, paragraph 245-40(e) indicates that the reasons of natural love and affection must be those of the creditor.

For reasons of

10. The second element is comprised in the phrase ‘for reasons of’. This phrase requires a causal nexus between the forgiveness and the natural love and affection. It is not sufficient that there is forgiveness of the debt and there is natural love and affection, the forgiveness must be because of the natural love and affection.³ The Commissioner takes the view that the causal nexus requires that the forgiveness be for the reason of the natural love and affection felt by the creditor.

Natural love and affection

11. The third element in paragraph 245-40(e) is the phrase ‘natural love and affection’. The phrase has both a legal meaning and an ordinary meaning. No contrary intention appears from the text or context of paragraph 245-40(e) to displace the presumption that Parliament intended the term to have these ordinary and legal meanings.

³ This construction is consistent with statements of the High Court interpreting that phrase in the context of the definition of a refugee in the Refugee Convention (United Nations High Commission for Refugees, 1967, *Convention and Protocol relating to the Status of Refugees*, UNHCR, Geneva) – see *Applicant S v Minister for Immigration and Multicultural Affairs* [2004] HCA 25 at [64]; *A v Minister for Immigration & Multicultural Affairs* [1997] HCA 4, per Dawson J; and the similar phrase of ‘by reason of’ in *Republic of Croatia v Snedden* [2010] HCA 14 at [69].

12. The ordinary meaning of this phrase imports strong emotions of caring, fondness and attachment that arise in consequence of ordinary human interaction. The term's legal meaning refers to goodwill towards, or emotional attachment to, another person, particularly that of a parent to their children.⁴

13. In testing the state of mind of a creditor to establish the presence of natural love and affection, a number of factors may be relevant including past dealings, existing relationships and future intentions. Whether natural love and affection is present in a relationship can only be determined on a case by case basis.

14. In the context of a conveyance, the phrase 'natural love and affection' ordinarily arises between family members, where the making of a gift could constitute good consideration, although not valuable consideration. Ordinarily, it is considerations of moral obligation or emotional willingness, irrespective of personal interest, which are the catalyst for the relevant action, rather than a promise of something in return.⁵

15. This interpretation is further supported by considering the elements of paragraph 245-40(e) as a whole. The notion of forgiveness is confined by the use of 'natural love and affection'. That term serves to identify the motivation for the forgiveness. The requisite connection between that motivation and the forgiveness can only be satisfied when the creditor feels the natural love and affection.

16. The Commissioner considers that the second and third elements would not be satisfied in the case of an individual acting in their capacity as a trustee because the fiduciary relationship will govern the decisions taken by the trustee.⁶

⁴ LexisNexis, *Encyclopaedic Australian Legal Dictionary*, viewed 5 August 2019.

⁵ For example, Applegarth J's reference in *Bestjet Travel Pty Ltd v The Australian Federation of Travel Agents Ltd* [2016] QSC 81 at [6.27 of the Annexure] to the judicial observation in *Otta International Pty Ltd v Asia Pacific Carbon Pte Ltd* [2015] NSWSC 1818 at [18] that '... it is common that the ties of love and affection between wife and husband may incline a spouse to act in a certain way by reason of the relationship, irrespective of the interests of that party.'; *Director of Public Prosecutions for Victoria v Le* [2007] HCA 52 at [43]. It is also noted that 'historically' natural love and affection was itself effective to pass a use, without any other form of reciprocation, for example, in *Sharington v Strotton* (1565)1 Plowd 298.

⁶ Refer to subsection 960-100(3).

Appendix 2 – Alternative view

❶ *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.*

17. There is an alternative view that a debt forgiven by a non-individual creditor can come within the application of paragraph 245-40(e).

18. Proponents of this view argue that paragraph 245-40(e) specifies only that the debt is forgiven for reasons of natural love and affection. It does not expressly stipulate that the creditor forgiving the debt must feel the requisite love and affection. Consequently, the love and affection underpinning the forgiveness can effectively be traced through the creditor, to the ultimate individual.

19. The Commissioner does not accept the alternative view. The Commissioner considers that the provision, when read in full and in context, does require the natural love and affection to be felt by the creditor.⁷

⁷ The primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of all the provisions of the statute – see *Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28 at [69]. The purpose of the legislation resides in its text and structure – see *Lacey v Attorney-General of Queensland* [2011] HCA 10 at [44] per French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ. ‘...[I]nconvenience or improbability of result may assist the court in preferring to the literal meaning an alternative construction which ... is reasonably open and more closely conforms to the legislative intent.’ – see *CIC Insurance Ltd v Bankstown Football Club Ltd* [1997] HCA 2, per Brennan CJ, Gaudron, Gummow, Dawson and Toohey JJ.

Appendix 3 – Your comments

20. You are invited to comment on this Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

21. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: 1 November 2019

Contact officer details have been removed following publication of the final determination.

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Legislative references:

- ITAA 1997
- ITAA 1997 245-10
- ITAA 1997 245-35
- ITAA 1997 245-36
- ITAA 1997 245-37
- ITAA 1997 245-40
- ITAA 1997 245-40(e)
- ITAA 1997 960-100(1)
- ITAA 1997 960-100(3)
- ITAA 1997 995-1(1)

Cases relied on:

- A v Minister for Immigration & Multicultural Affairs [1997] HCA 4; (1997) 190 CLR 225; 71 ALJR 381; 142 ALR 331; 2 BHRC 143
- Applicant S v Minister for Immigration and Multicultural Affairs [2004] HCA 25; 217 CLR 387; (2004) 206 ALR 242

- Bestjet Travel Pty Ltd v The Australian Federation of Travel Agents Ltd [2016] QSC 81
- CIC Insurance Ltd v Bankstown Football Club [1997] HCA 2; (1997) 187 CLR 384; 71 ALJR 312; 141 ALR 618
- Director of Public Prosecutions for Victoria v Le [2011] HCA 10; 242 CLR 573; 85 ALJR 508; 275 ALR 646
- Lacey v Attorney-General of Queensland [2011] HCA 10; 242 CLR 573; 85 ALJR 508; 275 ALR 646
- Otta International Pty Ltd v Asia Pacific Carbon Pte Ltd [2015] NSWSC 1818
- Project Blue Sky Inc v Australian Broadcasting Authority [1998] HCA 28; (1998) 194 CLR 355; 72 ALJR 841; 153 ALR 490
- Republic of Croatia v Snedden [2010] HCA 14; 241 CLR 461; 84 ALJR 334; 265 ALR 621
- Sharington v Strotton (1565)1 Plowd 298

Other references:

- ATO ID 2003/589 (Withdrawn)
- Encyclopaedic Australian Legal Dictionary (LexisNexis)

ATO references

NO: 1-H6EYX8U

ISSN: 2205-6211

BSL: PW

ATOlaw topic: Income tax ~~ Commercial debt forgiveness ~~ Forgiveness to which operative rules do not apply

© 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).