

CR 2022/54 - Bionics Institute of Australia - loans from public and private ancillary funds



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Status: **legally binding**

Class Ruling

Bionics Institute of Australia – 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.

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What this Ruling is about

1. This Ruling sets out the income tax consequences for investors (who are public or private ancillary funds) entering into a loan agreement with the Bionics Institute of Australia (Bionics) (the arrangement).
2. Full details of this scheme are set out in paragraphs 32 to 37 of this Ruling.
3. This Ruling does not affect the obligations of public and private ancillary funds to comply with the rules in the *Taxation Administration (Private Ancillary Fund) Guidelines 2019* and the *Taxation Administration (Public Ancillary Fund) Guidelines 2022* (collectively, 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 Bionics' entitlement to endorsement as a deductible gift recipient.
5. Where used in this Ruling:
 - 'PAF' or 'PAFs' refers to both public and private ancillary funds collectively
 - capitalised terms take their meaning from the Model Loan Agreement (LA), and
 - legislative references are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Status: **legally binding**

Who this Ruling applies to

6. This Ruling applies to PAFs endorsed as deductible gift recipients under section 30-120 that enter into the arrangement and provide a loan to Bionics under the LA.

When this Ruling applies

7. This Ruling applies from 15 June 2022 to 30 June 2027.

Ruling

Entering into the arrangement is not a breach of the Guidelines

8. For the purposes of paragraph 30-125(1)(d), a PAF that enters into the arrangement with Bionics and provides a loan under the LA will not be in breach of the relevant Guidelines by virtue of entering into and complying with the LA, provided that the loan is in the course or furtherance of the PAF's purpose.

The interest saving on a loan forms part of the public or private ancillary fund's annual distribution

9. 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 loan and the interest which would accrue on a comparable loan sourced from a financial institution at 'arm's length' will form part of the PAF's annual distribution.

Forgiveness of part or all of the loan forms part of the public or private ancillary fund's annual distribution

10. For the purposes of paragraph 30-125(1)(d) and complying with the relevant Guidelines, where the PAF forgives part or all of the loan, the amount forgiven will form part of the PAF's annual distribution.

Example 1 – interest saving forms part of the annual distribution

11. On 1 July 2022, PAF A enters into a loan with Bionics under the LA. The loan principal is \$100,000 and the annual interest payable is \$13,500 (13.5% per annum).

12. If the interest rate on a comparable loan sourced from a financial institution at arm's length is 14.5%, the amount of interest that would be payable on the principal for the 2022–23 income year is \$14,500.

13. In the 2022–23 income year, Bionics pays \$13,500 interest to PAF A. PAF A has not forgiven the amount of interest accrued under the LA.

14. An amount of \$1,000 (being the difference between the market rate interest of \$14,500 and the interest accrued under the LA of \$13,500) qualifies as part of PAF A's annual distribution in the 2022–23 income year.

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Example 2 – no amount forms part of the annual distribution

15. On 1 July 2022, PAF B enters into the LA with Bionics. The loan principal is \$100,000 and the annual interest payable is \$13,500 (13.5% per annum).

16. If the interest rate on a comparable loan sourced from a financial institution at arm's length is 11.5%, the amount of interest that would be payable on the principal for the 2022–23 income year is \$11,500.

17. In the 2022–23 income year, Bionics pays \$13,500 interest to PAF B. PAF B has not forgiven the amount of interest accrued under the LA.

18. As the LA rate exceeds the market rate, no amount would qualify as part of PAF B's annual distribution in the 2022–23 income year.

Example 3 – forgiveness of an amount forms part of the annual distribution

19. On 1 July 2022, PAF C enters into the LA with Bionics. The loan principal is \$100,000 and the annual interest payable is \$4,500 (4.5% per annum). The LA between PAF C and Bionics prescribes a maturity rate of 4 years. No repayments of the Moneys Outstanding are made by Bionics for the 2022–23 and 2023–24 income years.

20. If the interest rate on a comparable loan sourced from a financial institution at arm's length is 13.5%, the amount of interest that would be payable on the principal for the 2022–23 and 2023–24 income years is \$13,500.

21. In the 2022–23 income year, Bionics does not pay any interest to PAF C. PAF C has not forgiven the amount of interest accrued under the LA.

22. An amount of \$9,000 (being the difference between the market rate interest of \$13,500 and the interest accrued under the LA of \$4,500) qualifies as part of PAF C's annual distribution in the 2022–23 income year.

23. By 30 June 2024, a Commercialisation Event has not occurred, and Bionics elects to terminate the Research Project under Clause 5.1(c) of the LA. Pursuant to Clause 5.4(a) of the LA, PAF C is obligated to forgive the Moneys Outstanding, being the principal of \$100,000, interest of \$4,500 accrued under the LA for the 2022–23 income year and interest of \$4,500 accrued for the 2023–24 income year.

24. An amount of \$118,000 qualifies as part of PAF C's annual distribution in the 2023–24 income year, which consists of:

- the principal of \$100,000
- the interest payable and forgiven under the LA for the 2022–23 and 2023–24 income years totalling \$9,000, and
- \$9,000, being the difference between the market rate interest of \$13,500 and the interest of \$4,500 accrued under the LA for the 2023–24 income year.

Example 4 – forgiveness of an amount forms part of the annual distribution

25. On 1 July 2022, PAF D enters into a LA with Bionics. The loan principal is \$100,000 and the annual interest payable is \$4,500 (4.5% per annum). The LA between PAF D and Bionics prescribes a maturity date of 4 years. No repayments of the Moneys Outstanding are made by Bionics for the 2022–23 and 2023–24 income years.

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26. *If the interest rate on a comparable loan sourced from a financial institution at arm's length is 13.5%, the amount of interest that would be payable on the principal for the 2022–23 and 2023–24 income years is \$13,500.*

27. *In the 2022–23 income year, Bionics does not pay any interest to PAF D. PAF D has not forgiven the amount of interest accrued under the LA.*

28. *An amount of \$9,000 (being the difference between the market rate interest of \$13,500 and the interest accrued under the LA of \$14,500) qualifies as part of PAF D's annual distribution in the 2022–23 income year.*

29. *In the 2023–24 income year, Bionics does not pay any interest to PAF D.*

30. *On 30 June 2024, a Commercialisation Event is deemed to have occurred. Pursuant to Clause 5.2 of the LA, the Lender accepts shares in the Commercialising Party as an alternate form of repayment. However, the value of the shares held in the Commercialising Party is independently valued at \$80,000. Under Clause 5.4(c) of the LA, PAF D agrees that the shortfall between Moneys Outstanding (that is, \$109,000) and the value of the shares provided by Bionics in the Commercialising Party (that is, \$80,000) will be forgiven.*

31. *Therefore, an amount of \$38,000 qualifies as part of PAF D's annual distribution in the 2023–24 income year, which consists of:*

- *\$29,000 shortfall between the Moneys Outstanding and the value of shares in the Commercialising Party, and*
 - *\$9,000, being the difference between the market rate interest of \$13,500 and the interest of \$4,500 accrued under the LA for the 2023–24 income year.*
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Scheme

32. 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.

33. Bionics is a not-for-profit medical research entity involved in the development of medical devices, therapies and diagnostic tools.

34. Bionics was endorsed as a deductible gift recipient on 10 November 2010 under section 30-120 and is covered by table item 1 of subsection 30-15(2) as a health promotion charity.

35. The purpose of the loans to be obtained by Bionics from PAFs is set out in Clause 2.2 of the LA as follows:

The Borrower acknowledges and agrees that it will apply the Principal Amount, and any further advances made by the Lender to it for the Research Project, to fund, manage and develop the Research Project and for no other purpose, except with the Lender's prior written consent.

36. The key terms of the LA are:

- The Lender, being a PAF, will advance a Principal Amount to Bionics by way of loan to be used by Bionics for a Research Project.
- Interest will be calculated and accrue annually in arrears on the Principal Outstanding at the Interest Rate from the date of advance until the Principal Outstanding has been repaid.

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- The Principal Outstanding means the aggregate of the Principal Amount, and all further amounts advanced by the PAF to Bionics for the Research Project (Clause 1.1 of the LA).
- The Moneys Outstanding means the Principal Outstanding together with any interest and other moneys payable (Clause 1.1 of the LA).
- Commercialisation Event is defined as (Clause 1.1 of the LA)
 - ... the date of a Commercialising Party being given the rights to develop and commercialise the results of the Research Project or the transfer of intellectual property arising out of the Research Project to a Commercialising Party
- If a Commercialisation Event occurs before the Maturity Date, Bionics must repay the Principal Outstanding and any other Moneys Outstanding by the Maturity Date (Clause 5.1(a) of the LA).
- Where a Commercialisation Event occurs, the PAF will accept repayment in full of Moneys Outstanding with another form of consideration (for example shares or options for shares in the Commercialising Party), provided an independent valuation of the consideration is provided at the Borrowers cost (Other Remuneration), or a combination of repayment and Other Remuneration (Clause 5.2) of the LA).
- Bionics shall be entitled to repay early all or any part of the Moneys Outstanding at any time (Clause 5.3 of the LA).
- If a Commercialisation Event does not occur before the Maturity Date, Bionics may elect to terminate the Research Project and the PAF agrees that Bionics will not be obliged to repay the Principal Outstanding or any other Moneys Outstanding under this Agreement. (Clause 5.1(c) of the LA).
- Where a Commercialisation Event does not occur before the Maturity Date, or the date on which the Research Project is terminated by Bionics, the obligation for Bionics to repay the PAF for Money Outstanding will be forgiven (Clause 5.4(a) of the LA). Where this occurs, pursuant to Clause 5.1(b) of the LA, no further interest will accrue on the Principal Outstanding and the debt forgiven will be deemed to be a distribution by the PAF to Bionics.
- If a Commercialisation Event occurs before the Maturity Date and the value of interests held by Bionics in the Commercialising Party falls short of the Moneys Outstanding at that time, the PAF agrees that, subject to notice requirements, the shortfall will be forgiven (Clause 5.4 (c) of the LA).
- Subject to notice requirements, the PAF may forgive the loan at any other time (Clause 5.4(d) of the LA).
- The Maturity Date will be specified in the LA and can be extended at any time prior to the original Maturity Date by written agreement of both parties.

37. Other information referenced is the LA, provided by the applicant to the ATO on 6 May 2022.

Commissioner of Taxation
15 June 2022

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.*

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Background

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

39. 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 in table item 2 of subsection 30-15(2).

40. Section 426-103 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) requires the Minister to formulate public ancillary fund guidelines that must be complied with by a PAF in order for the fund to remain endorsed as a deductible gift recipient. By legislative instrument dated 17 February 2022, the public ancillary fund guidelines were remade and titled the *Taxation Administration (Public Ancillary Fund) Guidelines 2022*.

41. 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. By legislative instrument dated 20 September 2019, the private ancillary fund guidelines were remade and titled the *Taxation Administration (Private Ancillary Fund) Guidelines 2019*. The most recent compilation is dated 25 February 2022.

Entering into an arrangement is not a breach of the Guidelines

42. Pursuant to section 22 of both Guidelines, a PAF 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 of subsection 30-15(2), and
- in the course or furtherance of the fund's purpose.

43. Bionics is a deductible gift recipient covered by table item 1 of subsection 30-15(2) and therefore, under the relevant Guidelines, a PAF 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).

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

Compliance with the Guidelines requires an annual distribution

45. Pursuant to section 15 of the Guidelines 2022, a PAF must make an annual distribution.

46. 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).

47. Subsection 15(4) of the *Taxation Administration (Public Ancillary Fund) Guidelines 2022* provides a similar requirement.

Interest savings form part of the public or private ancillary fund's annual distribution

48. Subsection 15(4) of the *Taxation Administration (Private Ancillary Fund) Guidelines 2019* provides 3 examples of how this subsection (and also subsection 15(4) of the *Taxation Administration (Public Ancillary Fund) Guidelines 2022*) 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.

49. More broadly, in the context of subsection 15(4) of the *Taxation Administration (Private Ancillary Fund) Guidelines 2019*, a benefit¹ is considered to mean something that confers 'an advantage or profit; a gain' and which has a pecuniary value to the deductible gift recipient.

50. Therefore, under the LA, a PAF would be considered to be providing a benefit to Bionics equal to 'the interest saved' by Bionics in paying less than a market rate of interest.

51. The amount of this benefit will therefore form part of the PAF's annual distribution.

Forgiveness of part or all of the loan forms part of the public or private ancillary fund's annual distribution

52. Where a PAF forgives part or all of the Moneys Outstanding, pursuant to Clause 5.4 of the LA, Bionics enjoys an advantage in being released from the obligation to repay that pecuniary amount. A benefit is therefore provided to the extent of the forgiveness. The amount forgiven forms part of the PAF's annual distribution in the financial year in which the forgiveness occurs.

¹ Definition of 'benefit': Nygh, PE & P Butt (ed.) (1998) *Butterworths Concise Australian Legal Dictionary*, 2nd edition, Butterworths.

Status: **not legally binding**

References

Legislative references:

- ITAA 1997 30-15
- ITAA 1997 Subdiv 30-BA
- ITAA 1997 30-120
- ITAA 1997 30-125(1)(d)
- ITAA 1997 30-227
- TAA 1953 Sch 1 426-103
- TAA 1953 Sch 1 426-110

Other references:

- Butterworths Concise Australian Legal Dictionary (2nd edition) 1998
- Taxation Administration (Public Ancillary Fund) Guidelines 2022
- Taxation Administration (Private Ancillary Fund) Guidelines 2019

ATO references

NO: 1-TG1AXCD

ISSN: 2205-5517

BSL: PW

ATOlaw topic: Income tax ~~ Deductions ~~ Gifts / donations ~~ Other

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