


# ***CR 2019/34 - J2SI VIC SIB Limited - valuation methodology for loan guarantee provided by public and private ancillary funds***

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## Class Ruling

# J2SI VIC SIB Limited – valuation methodology for loan guarantee provided by public and private ancillary funds

### **📌 Relying on this Ruling**

This publication (excluding the 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 the ruling. That is, you will not pay any more tax or pay any penalties or interest in respect of the matters covered by this ruling.

Further, if we think that the 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 opinion on the valuation methodology to be used for a loan guarantee provided by a public or private ancillary fund (ancillary fund) to J2SI VIC SIB Limited (J2SI).
2. The valuation is required to determine the market value of the 'benefit' provided when an ancillary fund guarantees a loan provided to J2SI.
3. Full details of this scheme are set out in paragraphs 20 to 30 of this Ruling.

**Who this Ruling applies to**

4. This Ruling applies to ancillary funds, endorsed as a deductible gift recipient (DGR) under section 30-120 of the *Income Tax Assessment Act 1997*<sup>1</sup>, that are accepted as additional guarantors under the Master Guarantee Deed, dated 12 July 2018, between Sacred Heart Mission Inc. (SHM), J2SI and the Catholic Development Fund (CDF).

**When this Ruling applies**

5. This Ruling applies to entities that enter into the scheme outlined in paragraphs 21 to 30 of this Ruling from 1 July 2018 to 30 June 2024.

**Ruling****Providing a loan guarantee to J2SI is not a breach of the Private Ancillary Fund Guidelines**

6. In terms of paragraph 30-125(1)(d), an Ancillary Fund that provides a loan guarantee to J2SI in accordance with the terms of the Facility Agreement and the Master Guarantee Deed, will not be in breach of the Private Ancillary Fund (PAF) Guidelines if the loan guarantee is provided in the course or furtherance of the ancillary fund's purpose.

**The interest saving forms part of the ancillary fund's annual distribution**

7. In terms of paragraph 30-125(1)(d), the provision of a loan guarantee would be considered to be a 'benefit' provided by an ancillary fund to J2SI, which will form part of its minimum annual distribution for the purposes of the PAF Guidelines.

8. The value of the loan guarantee, will be equivalent to the interest saved by J2SI entering into a loan that is guaranteed compared to the higher interest rate that would be payable by J2SI if they entered into a loan that was not guaranteed.

9. The interest rate that is payable by J2SI under the loan is CDF's variable overdraft lending rate as published on its website from time to time, or if such rate is not available, the rate determined by the CDF (acting reasonably) from time to time. The CDF does not have a published interest rate for unsecured loans.

10. For the purposes of the PAF Guidelines, the guarantee benefit will be the difference between the following two interest rates as a percentage of the amount guaranteed:

- a comparable loan sourced from a financial institution at 'arm's length' throughout the relevant income year, and
- the interest rate charged by CDF in respect of the loan throughout the relevant income year.

11. Where these rates change during the income year, the guarantee benefit will be the sum of the differences calculated on a pro rata basis, as a percentage of the amount guaranteed.

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<sup>1</sup> All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

**Example 1**

12. On the 1 July for the relevant income year an ancillary fund provides a loan guarantee of \$500,000 to J2SI.

13. The 'Overdraft index rate' (unsecured) for businesses published by the Commonwealth Bank of Australia (CBA), being a comparable loan sourced from a financial institution at arm's length throughout the relevant income year (the market rate) is 9.31%.

14. The rate of interest charged by the CDF on the loan for the whole of the income year is 5.2% per annum.

15. The guarantee benefit for the ancillary fund to include in its minimum annual distribution for the relevant income year would be \$20,550, calculated as follows:

$$\begin{array}{r} \text{Loan guarantee} \quad \times \quad \text{the market rate less} \quad \times \quad \frac{\text{number of days interest rates are}}{\text{CDF interest rate}} \quad \times \quad \frac{\text{the same during the year}}{\text{days in the year}} \\ \\ \$500,000 \quad \times \quad 9.31\% \text{ less } 5.2\% \quad \times \quad \frac{365}{365} \\ \\ \$500,000 \quad \times \quad 4.11\% \quad \times \quad 1 \quad = \quad \mathbf{\$20,550} \end{array}$$

**Example 2**

16. On the 1 July for the relevant income year an ancillary fund provides a loan guarantee of \$500,000 to J2SI.

17. The 'overdraft index rate' (unsecured) for business published by the CBA is 9.31% for the period 1 July to 31 August (Period 1) for the relevant income year, and 9.81% for the period 1 September to 30 June (Period 2) for the relevant income year.

18. The rate of interest charged by the CDF on the loan for the whole of the income year is 5.2% pa.

19. The guarantee benefit for the ancillary fund to include in its minimum annual distribution for the relevant income year would be \$22,625, calculated as follows:

Period 1 guarantee benefit:

$$\begin{array}{r} \text{Loan guarantee} \quad \times \quad \text{the market rate less} \quad \times \quad \frac{\text{number of days for Period 1}}{\text{CDF interest rate}} \quad \times \quad \frac{\text{during the year}}{\text{days in the year}} \\ \\ \$500,000 \quad \times \quad 9.31\% \text{ less } 5.2\% \quad \times \quad \frac{62}{365} \\ \\ \$500,000 \quad \times \quad 4.11\% \quad \times \quad \frac{62}{365} \quad = \quad \mathbf{\$3,490.68} \end{array}$$

*Period 2 guarantee benefit:*

$$\begin{array}{r}
 \text{Loan guarantee} \quad \times \quad \text{the market rate less} \\
 \text{CDF interest rate} \quad \times \quad \frac{\text{number of days for} \\
 \text{Period 2 during the year}}{\text{days in the year}} \\
 \\
 \$500,000 \quad \times \quad 9.81\% \text{ less } 5.2\% \quad \times \quad \frac{303}{365} \\
 \\
 \$500,000 \quad \times \quad 4.61\% \quad \times \quad \frac{303}{365} = \quad \mathbf{\$19,134.65}
 \end{array}$$

*Add the guarantee benefit amounts calculated for each period where there has been a change in the market rate and/or the CDF interest rate during the relevant income year.*

*Guarantee benefit (whole of relevant income year):*

$$\$3,490.68 \quad + \quad \$19,134.65 \quad = \quad \mathbf{\$22,625.33}$$

## Scheme

20. 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.

21. J2SI:

- is a public company limited by guarantee which was incorporated on 15 December 2017
- is a registered charity with the Australian Charities and Not-for-Profits Commission (ACNC) under the sub category of a Public Benevolent Institution (PBI)
- is endorsed by the ATO as:
  - a DGR under item 1 of the table in section 30-15 under the category of registered PBI
  - income tax exempt
  - FBT exempt, and
  - entitled to GST concessions.
- has as its sole member, SHM which is an ACNC registered charity (also under the sub-category of a PBI).

22. J2SI was established as a special purpose vehicle by SHM to implement the Journey to Social Inclusion Program (J2SI Program) that has been developed by SHM over the past decade.

23. J2SI's objects are to provide benevolent relief in the form of support, care and nurturing for the purposes of alleviating and preventing homelessness, poverty and social isolation regardless of race, creed, sex or age and, in particular to:

- provide support and care to people experiencing poverty, who are socially excluded, have physical or mental health concerns, homeless or at risk of homelessness, or drug and/or alcohol dependent

- provide health care, food, clothing and other material support to those in need
  - provide shelter, either temporary or permanent, to those who are homeless or at risk of homelessness and/or socially isolated, and
  - establish programs that provide a range of diverse services that achieve permanent outcomes for people and support their connection to their communities and contribution to society both socially and or economically.
24. The J2SI Program:
- adopts a relationship-based approach
  - provides long term support for a period of three years
  - works from the premise that if people can sustain their housing, this provides a solid foundation to improving other areas of that person's life
25. The interaction between J2SI, SHM and the loan guarantors are determined by the following documents:
- the Facility Agreement
    - executed on 6 July 2018, where CDF has agreed to provide J2SI with a loan facility of \$6,000,000 to finance the delivery of the J2SI Program.
  - Master Guarantee Deed and Guarantor Accession Deed Polls
    - the Master Guarantee Deed (dated 12 July 2018) is a tripartite agreement between SHM, J2SI and the CDF which sets out
      - SHM is guarantor for the first loss payment, which is an amount separate to the loan facility amount provided by CDF, and
      - allows for additional guarantees to be added via a Guarantor Accession Deed Poll (GADP) to cover additional risk of loss up to the limit in the each guarantor's GADP (GADP Limit).
26. With regard to current and future guarantors:
- each Guarantor guarantees the payment by J2SI to the CDF of principal due and owing by J2SI to CDF up to the value of the GADP limit
  - J2SI shall pay each guarantor a fee computed at the rate of \$1 per \$500,000 (or part thereof) of their GADP limit
  - SHM is providing the first loss payment which prevents the CDF from calling on the other guarantors until the CDF first attempts to recover the first loss payment from SHM
  - there are currently two additional guarantors.
27. J2SI has obtained the loan from the CDF, to fund the implementation of the J2SI Program.
28. The loan is currently guaranteed by guarantors (one of whom is an ancillary fund). J2SI is seeking other ancillary funds to provide further guarantees in accordance with the terms of the Facility Agreement and the Master Guarantee Deed.
29. The interest rate that is payable by J2SI under the Facility Agreement is the CDF's variable overdraft lending rate as published on its website from time to time or if such rate

is not available, the rate determined by the CDF (acting reasonably) from time to time. The current rate of interest is 5.2%.

30. The CDF does not currently have a published interest rate for unsecured loans.

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**Commissioner of Taxation**

29 May 2019

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**Appendix – Explanation**

**ⓘ** *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**

31. Paragraph 30-125(1)(d) has the effect that an ancillary fund will only be entitled to remain endorsed as a DGR if the fund, and its trustees, comply with the PAF Guidelines.

32. A DGR is defined in section 30-227 and includes an entity which is endorsed under Subdivision 30-BA as an ancillary fund listed in item 2 of the table in section 30-15.

33. 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 an ancillary fund in order for the fund to remain endorsed as a DGR. By legislative instrument dated 9 December 2011 the Public Ancillary Fund Guidelines were made and titled '*Public Ancillary Fund Guidelines 2011*'.

34. 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 DGR. By legislative instrument dated 28 September 2008 the Private Ancillary Fund Guidelines were made and titled '*Private Ancillary Fund Guidelines 2009*'.

**Providing a loan guarantee is not a breach of the PAF Guidelines**

35. Pursuant to paragraph 41 of the PAF Guidelines 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 item 1 in the table in section 30-15 of the *Income Tax Assessment Act 1997*; and
- in the course or furtherance of the fund's purpose

36. J2SI is a DGR covered by item 1 of the table in section 30-15 and therefore, under the PAF Guidelines, an ancillary fund may provide a loan guarantee to J2SI.

37. The PAF Guidelines will therefore not be breached provided the loan guarantee is provided in the course, or furtherance of the ancillary fund's purpose.



## **Compliance with PAF Guidelines requires an annual distribution**

38. Under paragraph 19 of the PAF Guidelines, an ancillary fund must make an annual distribution.

39. Paragraph 19.3 states:

A distribution includes the provision of money, property or benefits. If the fund provides property or benefits, the market value of the property or benefit provided is used in determining whether the fund has complied with this guideline.

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

40. Broadly, in the context of paragraph 19.3 of the PAF Guidelines a 'benefit' is considered to mean something that confers an advantage or gain and which has a pecuniary value to the DGR.<sup>2</sup>

41. Example 5 of the PAF Guidelines provides the following example:

If a ... ancillary fund guarantees a loan provided by a financial institution to a deductible gift recipient, the fund is providing a benefit whose market value is equal to the discount to the interest rate which would be charged on a comparable arm's length unsecured loan sourced from that financial institution.

42. Therefore in providing a loan guarantee, an ancillary fund would be considered to be providing a benefit to JS2I equal to 'the interest saved' by J2SI entering into the loan at less than a market rate of interest.

43. The benefit is the difference between the interest that would have been paid at a market rate and the interest accrued under the loan for the relevant period.

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<sup>2</sup> *LexisNexis Concise Australian Legal Dictionary*, 2011, 4<sup>th</sup> edn, LexisNexis Butterworths, Sydney.

**References***Previous draft:*

Not previously issued as a draft

- ITAA 1997 30-125(1)(d)
- ITAA 1997 30-227
- TAA 1953
- TAA 1953 426-103
- TAA 1953 426-110

*Related Rulings/Determinations:*

TR 2006/10

*Legislative references:*

- ITAA 1997
- ITAA 1997 30-15
- ITAA 1997 Subdiv 30-BA
- ITAA 1997 30-120
- ITAA 1997 30-125

*Other references:*

- LexisNexis Concise Australian legal dictionary, 4th edn 2011
  - Private Ancillary Fund Guidelines 2009
  - Public Ancillary Fund Guidelines 2011
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## ATO references

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

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