

***TD 2022/1 - 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?***

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! There is a Compendium for this document: **TD 2022/1EC** .



Status: **legally binding**

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?

❶ Relying on this Determination

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Determination applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Determination. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Determination.

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Ruling

1. Yes – the exclusion for debts forgiven for reasons of natural love and affection requires that the creditor is a natural person.
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 and the object of their love and affection must be one or more other natural persons. Where the conditions for the exclusion are otherwise satisfied, there is no requirement that the debtor must be a natural person.

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

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

Status: **legally binding**

Date of effect

4. Subject to paragraph 5 of this Determination, this Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

5. It is recognised that this 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). 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 this Determination.

Commissioner of Taxation
9 February 2022

Status: **not legally binding**

Appendix 1 – Explanation

① *This Explanation is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the 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, whose interaction is important:

- 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.

Element 1 – ‘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.

Element 2 – ‘for reasons of’

10. The second element is comprised in the phrase ‘for reasons of’, which 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 for another natural person.

Element 3 – ‘natural love and affection’

11. The third element in paragraph 245-40(e) is the phrase ‘natural love and affection’, which 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 the Commonwealth 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) – refer to *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].

Status: **not legally binding**

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 self-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 for some other natural person. That is, an entity that is not a natural person cannot feel natural love and affection.

The debtor

16. As the natural love and affection required for paragraph 245-40(e) to operate must arise in consequence of ordinary human interaction, the object of the creditor's natural love and affection that is the reason for the debt forgiveness must be another natural person.

17. However, paragraph 245-40(e) does not further require that the object of the creditor's natural love and affection is also the debtor.

18. Accordingly, paragraph 245-40(e) is capable of applying in circumstances where the debtor is not a natural person (for example, a company). It still remains necessary to establish that the creditor forgave the debt for reasons of natural love and affection, notwithstanding the debtor was not the object of that sentiment (for example, where a parent forgives a debt owed by a company that is 100% owned by their child).

19. The reasons for a creditor's decision to forgive a debt (the second element in paragraph 245-40(e)) need to be determined on a case-by-case basis. That is, taking into account the surrounding circumstances, it is necessary to identify that the creditor's natural love and affection for a person (who may not be the debtor) motivated the creditor's decision to forgive the debt.

⁴ LexisNexis, *Encyclopaedic Australian Legal Dictionary*, viewed 24 January 2022.

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 ...

and *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 *Sharrington v Strotton* (1565) 1 Plowd 298.

Status: **not legally binding**

Creditor is a natural person acting in a trustee or partnership capacity

20. A natural person may forgive a debt in their capacity as a trustee of a trust, or as a partner in a partnership. It is possible that the conditions in paragraph 245-40(e) would be satisfied where the natural love and affection of that person motivates the forgiveness of a debt owed to the trust or partnership respectively.

21. However, the cases where this could happen would be limited. The acts that an individual may take in their capacity as a trustee or as a partner are subject to limitations that arise under trust and partnership law principles⁶, statute⁷ and the terms of any trust deed or partnership agreement. Accordingly, within the scope of a particular trust or partnership relationship, a trustee or partner may not be permitted to forgive a debt owed to the respective trust or partnership for reasons of natural love and affection.

⁶ For example, as referred to in *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64 at [75].

⁷ Such as the *Trusts Act 1973* (Qld) and *Partnership Act 1891* (Qld).

Status: **not legally binding**

Appendix 2 – Alternative view

❶ *This Appendix sets out an alternative view and explains why it is not supported by the Commissioner. It does not form part of the binding public ruling.*

22. An alternative view that has been put to the Commissioner is that a debt forgiven by a non-individual creditor can come within the application of paragraph 245-45(e).

23. 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.

24. The Commissioner does not accept this 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.⁸

⁸ 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 – refer to *Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28 at [69]. The purpose of the legislation resides in its text and structure – refer to *Lacey v Attorney-General of Queensland* [2011] HCA 10 at [44] per French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ, and *CIC Insurance Ltd v Bankstown Football Club Ltd* [1997] HCA 2, per Brennan CJ, Gaudron, Gummow, Dawson and Toohey JJ, which sets out:
...[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.

Status: **not legally binding**

References

Previous draft:

TD 2019/D9

Related Rulings/Determinations:

TR 2006/10

Legislative references:

- ITAA 1997 245-40
- ITAA 1997 245-40(e)
- ITAA 1997 SubDiv 245-C
- ITAA 1997 SubDiv 245-D
- ITAA 1997 SubDiv 245-E
- ITAA 1997 SubDiv 245-F
- ITAA 1997 SubDiv 245-G
- TAA 1953
- Trusts Act 1973 (Qld)
- Partnership Act 1891 (Qld)

Cases relied on:

- A v Minister for Immigration & Multicultural Affairs [1997] HCA 4; 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; 78 ALJR 854; 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 Ltd [1997] HCA 2; 187 CLR 384; 71 ALJR 312; 141 ALR 618
- Director of Public Prosecutions for Victoria v Le [2007] HCA 52; 232 CLR 562; 82 ALJR 92; 240 ALR 204
- Hospital Products Ltd v United States Surgical Corporation [1984] HCA 64
- 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; 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) Plowd 298

Other references:

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

ATO references

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