

DEBT FORGIVENESS RULES

Presenter:
Tony Evans
Tax Specialist
Gustax Consulting Pty Ltd

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1.0 CONTENTS

2. Commencement of these provisions
3. What is a commercial debt?
4. When is it forgiven?
5. How much is the forgiven amount
6. What are the implications?
7. Record keeping requirements
8. Effect on other taxes
9. Planning
10. Questions & case studies

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2.0 COMMENCEMENT

1. Introduced 27th June 1996
2. Apply to loans in place as of that date
3. Close loophole in relation to gains on forgiveness of debts
4. Comprehensive provisions

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3.0 COMMERCIAL DEBT - DEFINITIONS

1. Debts covered by these provisions
 - Definition of debt
 - Inclusions in debt
 - Commercial debt definition
2. Debts not covered by these provisions
 - Exclusions

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3.1 DEBT - DEFINITIONS

1. Enforceable obligation
2. Includes accrued interest
3. Includes commercial debts
4. Excludes
 - Certain fringe benefits
 - Amounts treated as income

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3.2 COMMERCIAL DEBT - DEFINITIONS

1. Interest on debt is/would be tax deductible
2. Non-share equity interests
3. Some exclusions

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4.0 FORGIVENESS

- 1. Acts covered by provisions**
- 2. Acts not covered by provisions**

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4.1 FORGIVENESS

- 1. Forgiveness**
- 2. Statute of limitations**
- 3. Arrangement into the future – non-recourse**
- 4. Debt parking**
- 5. Subscription for shares**

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4.1.1 FORGIVENESS

Obligation to pay debt is

- 1. Released**
- 2. Waived**
- 3. Otherwise extinguished**

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4.1.2 STATUTE OF LIMITATIONS

Debt is forgiven where:-

- The period the creditor is entitled to sue ends under statute of limitations
- Debt remains unpaid
- Usually six years from borrowing

Planning to avoid:-

- Creditor must re-affirm
- Do so on a regular basis
- Can do so in several ways

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4.1.3 NON RECOURSE / LIMITED RECOURSE ARRANGEMENTS

Debt forgiveness occurs where:-

- 1. Arrangement between parties**
- 2. Obligations cease at a point in time**
- 3. Nothing given in return or consideration in return is nominal or insignificant**

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4.1.4 DEBT PARKING

- 1. Creditor assigns debt**
- 2. Debtor & party receiving assignment are:-**
 - Associated
 - Parties to an agreement
- 3. Lack of capacity to pay**

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4.1.5 SUBSCRIPTION FOR SHARES

1. Entity cannot pay debt
2. Converts liability into equity
3. Becomes capable of paying remaining debt as a result
4. Forgiveness to extent of inability to pay

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4.2 NOT "FORGIVENESS"

1. Bankruptcy
2. Under a will
3. Natural love and affection
4. Section 109F(6)

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5.0 QUANTUM OF FORGIVENESS

1. Multi-step process
 - Determine debt subject to forgiveness
 - Determine gross forgiven amount
 - Determine net forgiven amount
- Complex process
- Many special rules to consider

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5.1 QUANTUM OF DEBT FORGIVEN

Where consideration provided in return for forgiveness, debt subject to forgiveness is:-

- Amount expressed as forgiven; or
- Amount prior to consideration

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5.2 GROSS FORGIVEN AMOUNT

Multi-step process

1. Determine the Notional value
 1. Special rules for debt parking
 2. Special rules for non-recourse debt
2. Determine the consideration provided in return
3. Deduct consideration from notional value

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5.2.1 NOTIONAL VALUE OF DEBT

Notional value of debt

1. Not a non-recourse debt
2. A non-recourse debt
3. A parked debt

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