


# ***CR 2016/1 - Income tax: loans from Public and Private Ancillary Funds to AUSiMED Limited***

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## Class Ruling

### Income tax: loans from Public and Private Ancillary Funds to AUSiMED Limited

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#### **① This publication provides you with the following level of protection:**

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

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

## What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

#### **Relevant provision(s)**

2. The relevant provisions dealt with in this ruling are:

- section 30-15 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 30-120 of the ITAA 1997
- section 30-125 of the ITAA 1997
- paragraph 30-125(1)(d) of the ITAA 1997
- section 30-227 of the ITAA 1997
- section 426-103 of Schedule 1 to the *Taxation Administration Act 1953* (TAA)
- section 426-110 of Schedule 1 to the TAA.

All subsequent legislative references are to the ITAA 1997 unless otherwise stated.

## Class of entities

3. The class of entities to which this Ruling applies is Private or Public Ancillary Funds (PAFs), endorsed as a Deductible Gift Recipient under section 30-120, that enter into a Loan Agreement with AUSiMED Limited (AUSiMED).

## PAF and DGR endorsement

4. This ruling does not affect the obligations of a PAF to comply with the rules in the *Public Ancillary Fund Guidelines 2011* or the *Private Ancillary Fund Guidelines 2009* (the PAF Guidelines), whichever are applicable. To remain endorsed as a Deductible Gift Recipient, a PAF must comply with the rules in the PAF Guidelines.

## Qualifications

5. This Ruling does not cover AUSiMED's entitlement to endorsement as a Deductible Gift Recipient.

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 10 of this Ruling.

7. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled, and
- this Ruling may be withdrawn or modified.

## Date of effect

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8. This Ruling applies from 1 July 2015 to 30 June 2020. The Ruling continues to apply after 30 June 2020 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling 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 Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

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## Scheme

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9. The following documents, or relevant parts of them form part of the scheme and are to be read with the description:

- Draft Loan Agreement (SLA) between AUSiMED and a PAF, drafted by Arnold Bloch Leibler, Ref JB:RDH 011785099 ABL/3848335v8.

10. The following description of the scheme is based on information provided by the applicant.

- AUSiMED is a not-for-profit entity that encourages and financially supports collaborations between medical researchers throughout Australia and Israel. AUSiMED established its corporate structure in 2012 after a group of Australian scientists and philanthropists visited Israel in March 2012 to review the potential for medical research collaborations between Australia and Israel.
- From 2 July 2012 AUSiMED is endorsed under section 30-120 as a Deductible Gift Recipient covered by item 1 in the table in section 30-15.
- AUSiMED enters into a loan agreement (SLA) with a PAF endorsed as a Deductible Gift Recipient (Item 2 DGR) under section 30-120.
- Unless stated otherwise, the defined terms in this class ruling have the same meaning as defined in the SLA.
- The key terms of the SLA are:
  - (a) The Lender, being a PAF, will advance the Principal Amount to AUSiMED by way of loan to be used by AUSiMED for the Research Project.
  - (b) Interest will be calculated and accrue quarterly on the principal of the loan at a rate which is either equal to or up to 14% above the Reserve Bank of Australia (RBA) cash rate at the end of each quarter (Clause 1.1 and clause 3.1 of the SLA).
  - (c) The Principal Outstanding means the aggregate of the Principle Amount and any further advances outstanding (that is the principal of the loan).
  - (d) The Moneys Outstanding means the amount of Principal Outstanding together with any Interest or other money outstanding.
  - (e) The Principal Outstanding and any other Moneys Outstanding will only be repayable to the PAF if the research project is commercially successful and a Commercialisation Event occurs (Clause 4.1)

- (f) A Commercialisation Event is defined as being 'the date of commencement of an agreement that provides for remuneration to the Research Organisations in the form of cash, shares or other forms of compensation in consideration for a Commercialising Party being given rights to develop and commercialisation the results of a Research Project' (Clause 1.1).
  - (g) AUSiMED is entitled to repay all or any of the Moneys Outstanding at any time (Clause 4.3).
  - (h) If a Commercialisation Event does not occur within 5 years from the date of the end of the Research Project, the PAF may determine that the obligation of AUSiMED to repay the principal and interest is forgiven.
  - (i) Further, subject to notice requirements, the PAF may forgive the loan at any other time (Clause 4.4).
- The minimum amount of the loan will be \$10,000.
  - The SLA will be entered into during any income year ended from the year ended 30 June 2015 until 2020.

## Ruling

### **Paragraph 30-125(1)(d): entering into the SLA with AUSiMED is not a breach of the PAF Guidelines**

11. In terms of paragraph 30-125(1)(d), A PAF that enters into a loan agreement with AUSiMED, as outlined in the SLA, will not be in breach of the Public Ancillary Fund or Private Ancillary Fund Guidelines (the PAF Guidelines) by virtue of entering into and complying with the SLA provided that the loan is in the course or furtherance of the PAF's purpose.

### **Paragraph 30-125(1)(d): the interest saving forms part of the PAF's annual distribution**

12. In terms of paragraph 30-125(1)(d), the difference, if any, between the amount of interest accrued under the SLA and the interest which would accrue on a comparable loan sourced from a financial institution at 'arm's length' (that is, the market rate of interest) will form part of the PAF's annual distribution for the purposes of complying with the PAF Guidelines.

**Paragraph 30-125(1)(d): forgiveness of the Moneys Outstanding forms part of the PAF's annual distribution**

13. In terms of paragraph 30-125(1)(d), where the PAF forgives the Moneys Outstanding under the SLA, the amount forgiven will form part of the PAF's annual distribution for the purposes of complying with the PAF Guidelines.

**Examples*****Example 1***

14. On 1 July 2015, PAF A enters into a SLA with AUSiMED. The principal of the loan is \$10,000. The annual interest payable under the SLA is \$1,225 (12.25% being 10% above the average RBA cash rate (assuming the RBA rate is 2.25%)).

15. If the interest rate on a comparable loan sourced from a financial institution at 'arm's length' is 14.25% the amount of interest that would be payable on the principal for the year ended 30 June 2016 is \$1,425.

16. In the year ended 30 June 2016, AUSiMED pays \$1,225 interest to PAF A.

17. An amount of \$200 (being the difference between the market rate interest of \$1,425 and the interest accrued under the SLA of \$1,225) qualifies as part of PAF A's annual distribution in the year ended 30 June 2016.

***Example 2***

18. On 1 July 2015, PAF B enters into a SLA with AUSiMED. The principal of the loan is \$10,000. The annual interest payable under the SLA is \$725 (7.25% being 5% above the average RBA cash rate (assuming the RBA rate is 2.25%)).

19. If the interest rate on a comparable loan sourced from a financial institution at 'arm's length' is 14.25% the amount of interest that would be payable on the principal for the year ended 30 June 2016 is \$1,425.

20. In the year ended 30 June 2016, AUSiMED does not pay any interest to PAF B, and PAF B has not forgiven the amount of interest accrued under the SLA.

21. An amount of \$700 (being the difference between the market rate interest of \$1,425 and the interest accrued under the SLA of \$725) qualifies as part of PAF B's annual distribution in the year ended 30 June 2016.

## **Example 3**

22. On 1 July 2015, PAF C enters into a SLA with AUSiMED. The principal of the loan is \$10,000. The annual interest payable under the SLA is \$1,425 (14.25% being 12% above the average RBA cash rate (assuming the RBA rate is 2.25%)).

23. If the interest rate on a comparable loan sourced from a financial institution at 'arm's length' is 14.25% the amount of interest that would be payable on the principal for the year ended 30 June 2016 is \$1,425.

24. In the year ended 30 June 2016, AUSiMED does not pay any interest to PAF C. However, under clause 4.4 of the SLA, PAF C forgives part of the Moneys Outstanding, being \$1,425 the amount of interest payable by AUSiMED for the year ended 30 June 2016.

25. An amount of \$1,425 qualifies as part of PAF C's annual distribution in the year ended 30 June 2016.

26. If PAF C did not forgive the \$1,425 amount of interest, no amount would qualify as part of PAF C's annual distribution in the year ended 30 June 2016 as the SLA rate and market rate are the same.

## **Example 4**

27. On 1 July 2015, PAF D enters into a SLA with AUSiMED. The principal of the loan is \$10,000. The annual interest payable under the SLA is \$225 (2.25% being the average RBA cash rate (assuming the RBA rate is 2.25%)). No repayments of principal are made by AUSiMED for each of the years ended 30 June 2016 or 30 June 2017.

28. If the interest rate on a comparable loan sourced from a financial institution at 'arm's length' is 14.25% the amount of interest that would be payable on the principal for each of the 2016 and 2017 income years is \$1,425.

29. In the year ended 30 June 2016, AUSiMED does not pay any interest to PAF D, and PAF D has not forgiven the amount of interest accrued under the SLA.

30. An amount of \$1,200 (being the difference between the market rate interest of \$1,425 and the interest accrued under the SLA of \$225) qualifies as part of PAF D's annual distribution in the year ended 30 June 2016.

31. On 30 June 2017, under clause 4.4 of the SLA, PAF D forgives the Moneys Outstanding being the principal of \$10,000, interest of \$225 accrued under the SLA for the year ending 30 June 2016, and interest of \$225 accrued under the SLA for the year ending 30 June 2017.

32. An amount of \$11,650 qualifies as part of PAF D's annual distribution in the year ended 30 June 2017. The \$11,650 is made up of the amount forgiven, being:

- the principal of \$10,000
- the interest payable and forgiven under the SLA for the 2016 and 2017 income years totalling \$450, and
- \$1200 being the difference between the market rate interest of \$1425 and the interest of \$225 accrued under the SLA for the year ending 30 June 2017.

### **Example 5**

33. On 1 July 2015, PAF E enters into a SLA with AUSiMED. The principal of the loan is \$10,000. The annual interest payable under the SLA is \$1,625 (16.25% being 14% above the average RBA cash rate (assuming the RBA rate is 2.25%)).

34. If the interest rate on a comparable loan sourced from a financial institution at 'arm's length' is 14.25% the amount of interest that would be payable on the principal for each of the 2016 and 2017 income years is \$1,425.

35. In the year ended 30 June 2016, AUSiMED does not pay any interest to PAF E, and PAF E has not forgiven the amount of interest accrued under the SLA. No amount of the interest qualifies as part of PAF E's annual distribution for the year ended 30 June 2016.

36. On 30 June 2017, under clause 4.4 of the SLA, PAF E forgives the Moneys Outstanding being the principal of \$10,000, interest of \$1,625 accrued under the SLA for the year ending 30 June 2016 and interest of \$1,625 accrued under the SLA for the year ended 30 June 2017.

37. An amount of \$13,250 qualifies as part of PAF E's annual distribution in the year ended 30 June 2017. The \$13,250 is made up of the amount forgiven, being:

- the principal of \$10,000, and
- the interest payable and forgiven under the SLA for the 2016 and 2017 income years totalling \$3,250.



## Appendix 1 – Explanation

**❶** *This Appendix 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.*

### 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 PAF Guidelines.

39. A Deductible Gift Recipient is defined by section 30-227 and includes an entity which is endorsed under Subdivision 30-BA as a PAF listed in item 2 of the table in section 30-15.

40. Section 426-103 of Schedule 1 to the TAA requires the Minister to formulate Public Ancillary Funds Guidelines that must be complied with to remain endorsed as a Deductible Gift Recipient. By legislative instrument dated 9 December 2011 the Public Ancillary Fund Guidelines were made and titled '*Public Ancillary Fund Guidelines 2011*'.

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 28 September 2008 the Private Ancillary Fund Guidelines were made and titled '*Private Ancillary Fund Guidelines 2009*'.

### Entering into the SLA with AUSiMED is not a breach of the PAF Guidelines

42. Pursuant to paragraph 41 of both the *Public Ancillary Fund Guidelines 2011* and the *Private Ancillary Fund Guidelines 2009* (the PAF 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 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

43. AUSiMED is a Deductible Gift Recipient covered by item 1 of the table in section 30-15 and therefore, under the PAF Guidelines, a PAF may enter into the SLA 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).

44. The PAF guidelines will therefore not be breached provided entering into the SLA is in the course, or furtherance of the PAF's purpose.

### Compliance with PAF guidelines requires an annual distribution

45. Pursuant to paragraph 19 of both the *Public Ancillary Fund Guidelines 2011* and the *Private Ancillary Fund Guidelines 2009* a PAF must make an annual distribution.

46. 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 PAF's annual distribution**

47. Paragraph 19.3 of the *Public Ancillary Fund Guidelines 2011* provides three examples of how this paragraph applies. Example 3 states:

If a public ancillary fund invests in a social impact bond issued by a deductible gift recipient with a return that is less than the market rate of return on a similar corporate bond issue, the fund is providing a benefit whose market value is equal to the interest saved by the deductible gift recipient from issuing the bond at a discounted rate of return.

48. Paragraph 19.3 of the *Private Ancillary Fund Guidelines 2009* is the same as paragraph 19.3 of the *Public Ancillary Fund Guidelines 2011* except for not containing Example 3. However it is considered the principle inherent in Example 3 would also be applicable to Private Ancillary Funds.

49. More broadly, in the context of paragraph 19.3 of the *Private Ancillary Fund Guidelines 2009*, a 'benefit' is considered to mean something that confers an advantage or gain and which has a pecuniary value to the DGR.<sup>1</sup>

50. Therefore under the SLA a Public or Private Ancillary fund would be considered to be providing a benefit to AUSiMED equal to 'the interest saved' by AUSiMED entering into the SLA at less than a market rate of interest.

51. The benefit is the difference between the interest that would have been paid at a market rate and the interest accrued under the SLA. The benefit does not include unpaid interest, accrued under the SLA, unless the interest is formally forgiven under clause 4.4 of the SLA.

52. The unpaid interest accrued under the SLA is a liability to AUSiMED until it is paid to, or forgiven by, the PAF. Therefore the unpaid interest accrued under the SLA is not a benefit provided to AUSiMED.

**Forgiveness of the Moneys Outstanding forms part of the PAF's annual distribution**

53. Where a PAF forgives all or part of the Moneys Outstanding, pursuant to clause 4.4 of the SLA, AUSiMED 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.

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<sup>1</sup> Butterworths Concise Australian Legal Dictionary, 2<sup>nd</sup> Edition

## Appendix 2 – Detailed contents list

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## References

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*Previous draft:*

Not previously issued as a draft

*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
- ITAA 1997 30-125(1)(d)

- ITAA 1997 30-227
- TAA 1953
- TAA 1953 426-103
- TAA 1953 426-110

*Other references:*

- Butterworths Concise Australian Legal Dictionary, 2<sup>nd</sup> Edition
- Private Ancillary Fund Guidelines 2009
- Public Ancillary Fund Guidelines 2011

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*ATO references*

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