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Your Reference: Deed of Debt Forgiveness
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Monday, 8 March 2021

UXEY Holding Pty Ltd ACN 549 848 945
463 Victoria Road
West Melbourne VIC 3003
Australia

Dear Lender,

Build this legal document at
[https://www.legalconsolidated.com.au/
forgive-debt-agreement/](https://www.legalconsolidated.com.au/forgive-debt-agreement/) – telephone
us, we can help you complete the
questions.

Adj Professor, Dr Brett Davies – Partner

Deed of Debt Forgiveness

Thank you for instructing us to prepare the attached Deed of Debt Forgiveness.

How to print your document

When you are satisfied that the document is according to your instructions please:

1. Download the PDF (Don't print directly from the browser.)
2. Print the PDF *Printer settings: A4 paper
100% scale (turn off 'fit to page')*
3. Print single sided (**NOT** duplex).
4. Once signed keep this covering letter with the document
(However, do not staple the covering letter to the document.)

Warning

The ATO released Draft Taxation Determination 2019/D9. This is over 7 months since it withdrew ATO ID 2003/589 on 6 February 2019.

In TD 2019/D9, the ATO now takes the view that the exclusion for debts forgiven for natural love and affection are only between human beings – not companies or trusts.

The ATO's new view is that "the creditor cannot be a company or an individual acting in the capacity of a trustee".

As part of the explanation of the ATO's view, it notes that "the notion of forgiveness is confined by the use of 'natural love and affection'. That term serves to identify the motivation for forgiveness. The required connection between that motivation and forgiveness is only satisfied when the creditor feels natural love and affection." It is a human trait. While you can love your car and your dog, perhaps you cannot love your company and your trust! The ATO has made its way into your home and now into your bedroom. The ATO now claims to know your inner thoughts.

TD 2019/D9 turns on its head the ATO's old interpretation of section 245-40(e) ITAA 1997.

Have a read of section 245-40(e). There is no requirement that a creditor is a natural person. The only reason for forgiveness is 'natural love and affection'.

However, the ATO does not "devote compliance resources to debt forgiven prior to 6 February 2019". However, Deeds of Debt forgiveness for companies and trust after that date may well be legal, but incur the wrath of the ATO. Tread carefully. Family Court decisions since 6 February 2019 may have to be reconsidered if there was forgiveness of debt.

Note the ATO's position is that neither a trust nor a company, as the creditor, can express 'feelings' such as 'love' and 'affection'. It may still be possible for a human being, such as a beneficiary to forgive a debt to a company, or as is more usually a family trust. We will see what the ATO has in store for us, in due course.

Therefore, the advice contained in this letter below is subservient to this warning and the ATO's new approach. Speak with your accountant before you sign the Deed of Debt Forgiveness.

The Law

Income tax implications

Legislative references are based on the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) and the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936).

In broad terms, from an income tax perspective, the two primary issues that arise as a result of forgiving the debt are:

1. whether a deduction for the release of debt is available; and
2. whether the commercial debt forgiveness provisions apply for the debt.

Deductibility of release of Debt

Revenue account

If the debt is on revenue account, there are two sections in the ITAA 1997 that potentially apply to write off a debt. The sections are the general deduction provision (section 8-1) and the specific deduction provision for bad debts (section 25-35).

Essentially, to be deductible, the debt must be in existence at the time it is treated as a bad debt and claimed as such. A release of a debt extinguishes it, leaving nothing to be incurred within the meaning of section 8-1, or to be written off as bad under section 25-35: *Point v FC of T* [1970] 119 CLR 453. This is also the case wherever a debt is released, compromised or otherwise extinguished by the voluntary or acquiescent act of the creditor: *GE Crane Sales Pty Ltd v FC of T* [1971] 126 CLR 177.

You have built the document on the basis that the Lender agrees to forgive the debt for love and affection. No repayment of the debt is required. Therefore, if the debt is on revenue account, no deduction is generally available under sections 8-1 or 25-35.

Capital account

If the release of debt is on capital account, then CGT event C2 may apply (section 104-25). Section 104-25 covers situations where debts and other 'choses in action' are

redeemed, cancelled, released, discharged, satisfied, abandoned, surrendered or forfeited.

In *CGT Determination Number TD2* the Commissioner describes the consequences for the creditor of forgiving a debt as follows:

1. if the creditor receives no consideration for the waiver, or the consideration is less than the market value of the debt, the creditor is treated as receiving an amount equal to the market value of the debt at the time, calculated as if the waiver of the debt had never been intended (section 116-30(1)).
2. the cost base of the debt is normally the amount of the Debt.
3. a capital loss is not available for a debt that is a personal use asset (section 108-20(1)).

Section 108-20(2)(d) defines a personal use asset to include a debt arising other than:

- (i) in the course of gaining or producing your assessable income; or
- (ii) from carrying on a business.

Further, section 104-25(2) provides that CGT event C2 occurs:

- (a) when you enter into the contract that results in the asset ending; or
- (b) if there is no contract - when the asset ends.

Accordingly, the timing of any capital loss that may result from the release of the debt owed is dependent upon when the parties enter into the Deed of Debt Forgiveness (see *Taxation Determination TD 95/29*).

As the Lender has forgiven the debt out of love and affection, no repayment is required.

Therefore, because the Lender has forgiven the debt for no consideration, the Lender is treated as receiving an amount equal to the market value of the debt at the time, calculated as if the waiver had never been intended. Although there is an argument that a capital loss may be available, the likely effect is that no capital loss is available to the lender as the market value of the unrecoverable debt is offset against the cost base.

The timing of this potential capital loss is dependent upon when the parties enter into the Deed of Debt Forgiveness.

Commercial Debt Forgiveness

For the Borrower, consider the rules in Division 245 of the ITAA 1997. These rules set out the taxation implications for a debtor when a commercial debt is forgiven by a creditor.

Section 245-10 provides that a debt is a commercial debt if the whole or any part of the interest payable on the debt is, was, or will be, an allowable deduction to the debtor (for example, a family trust). If the debt is a debt for which no interest is payable, the section 245-10 rules still apply if, assuming interest had been charged, a deduction under section 8-1 of the ITAA 1997 would have been allowable.

A 'debt' is an enforceable obligation imposed by law on a person (a debtor) to pay an amount to another person (a creditor). The term 'debtor' is not defined in the legislation. Therefore, it is defined by its ordinary meaning.

A debt forgiven under a bankruptcy law, by a Will or for reasons of “natural love and affection” is excluded (section 245-40).

It is arguable that the debt forgiveness rules do not apply in these circumstances as the debt is being forgiven by reason of natural love and affection. We have drafted the Deed of Debt Forgiveness on this basis.

If the Rules Applied

If the commercial debt forgiveness rules in subdivision 245-E ITAA 1997 did apply, assuming that the debts occurred after 19 September 1985 and all persons are Australian residents, the position would be as follows:

The debt forgiveness rules provide for the ‘total net forgiven amount’ of all debts of the debtor that are forgiven in the same year of income to be applied in reduction of amounts that would otherwise be taken into account in reducing the debtor’s taxable income of the forgiven year of income or any later year of income.

Therefore, when a Lender agrees to forgive a debt, the Borrower is required to reduce certain amounts (reducible amounts) in the order listed below by the ‘net forgiven amount’. The reducible amounts are:

1. deductible revenue losses (section 245-115);
2. deductible capital losses (section 245-130);
3. a wide range of deductible expenditures (section 245-145), and
4. the cost bases of certain assets (sections 245-175, 245-180, 245-185 and 245-190).

Section 245-85 provides that the gross forgiven amount (section 245-75) be reduced by certain amounts, including indirect value shifts, to determine the net forgiven amount. Any part of the net forgiven amount that remains after being successively applied against any available reducible amount is disregarded except where the debtor is a partnership (section 245-195).

When the Lender of say a Family Trust loan agrees to forgive the debt, if the commercial debt forgiveness rules do apply (that is, they are not excluded by reason of natural love and affection), then the Borrower, being the Trustees of the Family Trust, is required to reduce certain amounts (reducible amounts) in the order listed above by the ‘net forgiven amount’.

Family Trust distributions - UPEs

An ‘Unpaid Present Entitlement’ (UPE) is a distribution from a trust to a Beneficiary. The Beneficiary is ‘presently entitled’ to the income and therefore is required to pay tax on the income. The income tax rate is the Beneficiaries’ marginal tax rate (which may be zero, if they received little income that year). In contrast, if the Trustee forgot or was unable to allocate income then the Trustee itself has to pay the tax. This is at the highest marginal tax rate.

The Beneficiary, however, while ‘presently entitled’ does not actually get the income. The income (generally minus any tax that the Beneficiary had to pay) just stays in the Family Trust. The unpaid money is called an ‘unpaid present entitlement’.

An ‘unpaid present entitlement’ arises when a trustee:

- makes a Beneficiary entitled to the income of the trust for a particular income year; but
- continues to hold those funds on trust for that Beneficiary, until the Beneficiary calls for payment.

When used for this purpose, the Deed of Debt Forgiveness operates to forgive the debt. The family trust no longer owes the money to the Beneficiary.

Reimbursement agreement

For a Family Trust a reimbursement agreement is where:

- someone presently entitled to the Trust Income, pays the tax on the income;
- but someone else benefits from that income.

The term 'benefit' includes the payment or loan of money, the transfer of property, the provision of services or other benefits; or the release, abandonment, failure to demand payment, or postponed payment, of a debt.

The Deed of Debt Forgiveness is not a transfer of the benefit to someone else, rather it is a forgiveness of a debt. It is therefore not a reimbursement agreement. To support this proposition, we have considered the list of examples provided by the ATO as to what constitutes a reimbursement agreement. They are:

1. the Trustee of a trust owns all of the shares in a private company. The company is also a beneficiary of the trust and undertakes no activity, but derives a small amount of bank interest on its own account;
2. the directors of the Trustee company and the Beneficiary company are the same (or related) individuals;
3. the Trustee resolves to make the company presently entitled to all, or some part of, trust income at the end of year 1, and distributes it to the company in year 2 before the company lodges its year 1 income tax return;
4. the company includes its share of the trust's net income in its assessable income for year 1 and pays tax at the corporate rate. (Division 7A does not apply because the company's entitlement is paid before it lodges its income tax return for the year in which the entitlement arose);
5. the company pays a fully franked dividend to the Trustee in year 2, sourced from the trust income, and the dividend forms part of the trust income and net income in year 2;
6. the Trustee makes the company presently entitled to all, or some part of, the trust income at the end of year 2 (possibly including the franked distribution). The arrangement is repeated;

A Deed of Debt Forgiveness does not fall within the spirit or intent of any of these ATO provided examples.

See also:

<https://www.ato.gov.au/General/Trusts/In-detail/Distributions/Trust-taxation---reimbursement-agreement/#Ordinaryfamilyorcommercialdealing>

[*Commissioner of Taxation v. Prestige Motors Pty Ltd* 98 ATC 4241; 36 ATR 568](#)

[*Idlecroft Pty Ltd v. Commissioner of Taxation* 2005 ATC 4647; 60 ATR 224](#)

We note in passing that another way of dealing with the Unpaid Present Entitlement for a Discretionary Trust is to merely transfer it to another person. We believe that this is unsafe as it may be construed as a reimbursement agreement.

Stamp Duty

You do not need to lodge this document because no duty is generally payable on this type of Deed.

Fringe Benefit Tax Implications

The Law

If a debt owing by an individual (or associate) to say a trust is waived or forgiven, potential Fringe Benefit Tax (FBT) implications arise. FBT provisions can only apply if the Lender is an employer. The employer provides the benefit in respect of employment. It does not matter whether such employment is past, present or future.

Application of the law to your facts

In considering the FBT implications of the release of debt, if any of the parties to the deeds are in an employer/employee relationship, FBT may apply. It is important to examine this issue further if any of the parties concerned have been employed by the Lender, and if there is any connection between the debt and the employment of the person concerned.

How much of the debt is forgiven?

The definition of 'Amalgamated Debt' in the agreement ensures that all money currently owed, as of the date of the Deed is forgiven. Therefore, we do not write the actual monetary amount into the Deed. Next year if there is more money owing then just print out another copy of the Deed and sign it again, with the new date. You can do this every year, or as often as you want. If you are not forgiving all of the Debt then state this in a Minute.

Recording the forgiveness of debt in the accounts

From a taxation position, if the above applies, the forgiveness of debt is neither income nor a taxable capital gain. Under these circumstance it has no tax consequences. The forgiven amount ends up in the trust corpus. For the accounts, to be true and useful, the accounts should reflect this. Like the settled sum and gifts, the forgiven UPE merely increases the corpus of the trust. The accounts should be entered in a similar vein.

The Settlor settles a nominal sum to prime or start the Family Trust. This is recorded in the Chart of Accounts as the 'Settled Sum'. It has no tax consequences. Similarly, the Appointor or a family member may later, and from time to time, gift money into the Trust. This is recorded, much like the 'Settled Sum'. This also has no tax consequences. Similarly, forgiven debts are recorded in the capital account. From both an accounting and tax position, there are no tax consequences.

Journal Entries

1. The Beneficiaries' Unpaid Present Entitlement or Loan account is reduced to zero.

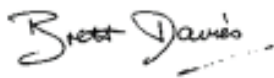
2. Next to the 'Settled Sum' settled by the Settlor (usually \$10) add to your Chart of Accounts in the capital account 'Forgiven UPEs' or 'Forgiven Loans'.

Summary

Because the debt is forgiven for 'natural love and affection', there is generally no taxation implication. If you are unsure then speak to your accountant or ourselves. When you are satisfied the document is according to your instructions, please sign two copies, one for the Lender, and one for the Borrower. This now concludes the matter. Thank you for your instructions.

If I can further clarify the above you are welcome to contact me on my direct telephone number 1800 141 612

Yours sincerely,



Adj Professor, Dr Brett Davies, CTA, AIAMA, BJuris, LLB, LLM, MBA, SJD
National Taxation Partner
LEGAL CONSOLIDATED BARRISTERS & SOLICITORS

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*Dr Brett Davies
Partner
Legal Consolidated Barristers & Solicitors*

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Adj Professor, Dr Brett Davies- Partner



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National Law Firm

Head Office
39 Stirling Highway
Nedlands WA 6009

T: 1800 141 612

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Deed of Debt Forgiveness

This Deed is between

UXEY Holding Pty Ltd ACN 549 848 945
463 Victoria Road, West Melbourne VIC 3003, Australia

(Lender)

and

Tony Zhao
of 72 South Street, Brighton VIC 3186, Australia

(Borrower)

It is agreed:

What is a Deed of Debt Forgiveness?

The Borrower owes you money. You, as the Lender, sign the Deed of Debt Forgiveness. The debt is gone. The Borrower no longer owes you, the Lender any money.

1. Dictionary

Unless there is a contrary intention, in this Deed these terms mean:

Amalgamated Debt all monies and the Debt owing by the Borrower to the Lender that remain unpaid as at the date of this Deed

Debt (subject to clause 5) any amount owed, or similar obligation, by the Borrower to the Lender on or before the date of this Deed and includes:

any advance of money to the Borrower including unpaid present entitlements and any distribution from a trust or a Family Trust; the provision of credit or any other form of financial accommodation to the Borrower; and

any amount paid on or before that date for, on account of, on behalf of or at the request of, the Borrower where the Borrower is subject to an obligation to repay the amount.

2. Forgiveness of the Amalgamated Debt

With effect on and from the date of this Deed, or an earlier date if any minutes state otherwise, the Lender releases the Borrower from all its obligations relating to the Amalgamated Debt and all actions, claims or proceedings that the Lender may have against the Borrower under or in respect of the Deed and Amalgamated Debt for natural love and affection.

3. Background

1. The Borrower owes a Debt to the Lender.
2. The Lender for natural love and affection has agreed to release and forgive the Debt under the terms of this Deed.

4. Governing law

This Deed is governed and construed by the law as the parties unanimously decided. If no decision is made then the governing law is the law in the State or Territory in which the first party to this Deed resides as evidenced by the address shown in this Deed. Each of the parties submits to the non-exclusive jurisdiction of its Courts.

5. Deed subject to Nominal Duty

This Deed is subject to, and conditional upon, the release of the Amalgamated Debt being subject only to nominal stamp duty or no duty by the relevant authority. If this Deed is assessed as being subject to *ad valorem* duty based on the value of the Amalgamated Debt forgiven then the parties warrant that this Deed is void *ab initio*.

6. No Partnership

The Deed does not create the relationship of partners, or of principal and agent, between the parties nor as between each other.

7. Severing to reduce tax and stamp duty

5. The Deed is interpreted to reduce taxes, imposts, duties and stamp duty (including State and Federal) (Taxes) and avoid any illegality. If any clause nonetheless fails to reduce Taxes or is illegal, it is severed, read down or fettered, as required, from the Deed to the extent of the illegality or in the furtherance of the reduction of Taxes.
6. The Deed is read down so that no mandatory taxation law or Taxes, from time to time, is contravened that would lead to an unfavourable taxation position.

8. Decision making in more than one place and Notices

7. This Deed may be executed in different locations by signing identical documents and all counterparts together constitute the Deed.
8. Meetings and decision making can be conducted in more than one place by telephone, the Internet or other means.
9. Notices may be provided via the post or email.

This Deed of Debt Forgiveness is not appropriate when you or your trust owes money to a company. That is probably a Division 7A loan that your company should not forgive. Get your accountant and financial planner to telephone us.

9. Interpreting the Deed

In the Deed, unless the context indicates a contrary intention:

1. headings are for convenience only and do not affect interpretation.
2. a reference to a person includes a reference to: individual, body corporate (whether incorporated), body politic, association of persons (whether incorporated or unincorporated) partnership, trust, person in the capacity as a Trustee, person in the capacity as the Personal Representative of a deceased estate and superannuation fund the plural includes the singular and vice versa.
3. a reference to any gender includes every other gender.
4. a reference to the Deed includes a reference to any amendment, novation, supplemental deed or replacement from time to time.
5. references to any party to this Deed include its successors and permitted assigns.
6. references to laws in the Deed refer to those laws as amended as consistent with the overall purpose of the Deed and does not lead to an anomaly.
7. reference to any statute, or any subordinate legislation or instrument includes all statutes, subordinate legislation or instruments amending, modifying, consolidating, re-writing, re-enacting or replacing them and a reference to a statute includes all subordinate legislation and instruments made under that statute.

Executed as a Deed on the day of 20

EXECUTED for and on behalf of
UXEY Holding Pty Ltd
ACN 549 848 945

Member, by authority of its Directors in
accordance with section 127
Corporations Act 2001 (Cth)

Signature of Director or Secretary

Signature of Director (if a 2nd)

SIGNED, SEALED AND DELIVERED by
Tony Zhao

Tony Zhao

(Signature of witness)

(Name of witness)

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