

Document 5

From:
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To: @treasury.gov.au
Subject: Draft Debt/Equity Bill

Draft Debt/Equity Legislation

I refer to the draft Debt/Equity Legislation provided with your e-mail of 29 May 2001.

Thankyou for the opportunity to comment on the draft.

My comments focus on the debt/equity distinction where funds are advanced to a closely held company.

Where a loan is made to a closely held company, potentially "the scheme" will not satisfy the debt test due to the arm's length dealing test in s.960-203(1)(a).

Further, the loan may be on variable terms. For example, a company commencing a business may be provided with a loan that is interest free for a period of time until the business is established, whereupon interest commences to be charged. Or a company's existing business may suffer financial distress for a period of time, during which interest on the loan is waived. Would variable terms such as these be non-arm's length dealings for the purpose of s.960-203? A further example might be where interest is not called up by the creditor until such time as the company is able to generate sufficient cash flow.

I believe there should be clarification that the non-arm's length dealing provision will not apply in such a case, in order to prevent the loan being treated as an equity interest.

This could be the case if the return is effectively contingent on the economic performance of the company (s.153-10(1) table), which arguably is the case in a variety of circumstances including those described above. Due to the potential limit placed on the rate of interest that may be charged on such a loan under proposed s.25-85 there would not seem to be any mischief in advancing a loan to a closely held company as described above, such as may otherwise warrant treatment of the loan as an equity interest. That is, the interest rate may be lower than under an arm's length dealing, but due to the potential operation of s.25-85 may be prevented from being substantially higher.

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