

COMMISSIONER'S STATEMENT

# **Income tax treatment of facilitation payments to farmers and debt remission on settlement of a loan**

Issued: 18 February 2021

CS 21/01

This Statement sets out the Commissioner's approach to facilitation payments to farmers and debt remission arising from the settlement of loans to farmers.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

## Summary

1. This Statement sets out the Commissioner's position on the income tax treatment of facilitation payments to farmers – these are payments made by a lender (typically a bank) to a farmer to assist in the sale of the farmer's business or assets in order to settle their debt with the lender.
2. Because of the financially distressed position of the recipient, the settlement may also involve the lender forgiving part of the loan.
3. The Commissioner considers that these facilitation payments are taxable income to the recipient.
4. Furthermore, the forgiveness of the debt by the lender (in full or in part) may also result in remission of debt income to the borrower under that loan agreement.
5. The purpose of this Statement is to alert payers and recipients of these facilitation payments of their income tax implications.
6. The Commissioner has become aware of such payments being made by banks to financially distressed farmers, so this Statement is in response to that specific context. Similar principles (and therefore treatment) could apply to other facilitation payments in other areas. These may be subject to further guidance in the future.

## Background

7. To assist a farmer in selling their business and assets in an orderly manner and in settling their debt, a lender may agree to pay a facilitation payment to the farmer. The payment could also act as an incentive to ensure, where the assets in question include land, that the farmer provides vacant possession when the property is sold.
8. This payment may be made in the form of cash, or in kind (such as for example cattle). The payment is not always made directly to the borrower itself (which may be a company or trust that owns the farm or business). It may instead be made to someone associated with the borrower such as a shareholder of the company or beneficiary of the trust.
9. As part of the settlement with the borrower, the lender may also agree to forgive a portion of the debt that would otherwise be payable.

## The Commissioner's view of facilitation payments to farmers and remission of debt income

10. The issue that arises is whether a facilitation payment in the context of such debt restructuring is taxable income to the recipient.
11. The taxation consequence of any debt being forgiven or remitted should also be considered.
12. The Commissioner's view is that facilitation payments will be taxable income to the recipient under the financial arrangement rules in the ITA07. Any debt forgiveness or remission under the settlement with the lender will also be income to the borrower under the financial arrangement rules.<sup>1</sup>
13. The reasons for this view are explained in the following section of this Statement.

### Analysis

14. A loan is a common financial arrangement between a lender and a borrower. As a result, the financial arrangement rules must be applied to work out the income and expenditure from the financial arrangement for the lender and the borrower.
15. The financial arrangement rules require the parties to identify all consideration paid to a person or by a person "for or under" the loan. The definition of "consideration" in the financial arrangement rules is wide.
16. If the borrower is the person who receives the facilitation payment, the Commissioner considers that the payment will be part of the consideration "for or under" the loan. This is because the facilitation payment is made with regard to or in accordance with the financial arrangement - the facilitation would not be made without the loan's existence and ensures that the loan is settled promptly.
17. The financial arrangement rules will apply to include the facilitation payment as income to the borrower.<sup>2</sup> The borrower will need to complete a calculation (referred to as a base price adjustment or BPA) in the income year that the loan is settled between the lender and the borrower – the formula for this calculation is set out in section EW 31.

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<sup>1</sup> Strictly speaking the facilitation payments are "consideration" for the purposes of determining whether there will be income under the financial arrangement rules. Debt forgiveness or remission is also taken into account as part of that process.

<sup>2</sup> Under section CC 3 of the ITA07.

18. A facilitation payment can also be made to someone other than the borrower – for example if the borrower is a company or trust and the payment is made to the shareholder or beneficiary respectively. The Commissioner still considers that the financial arrangement rules apply as the payment will likely be part of a composite or wider financial arrangement because it is interdependent and interconnected to the repayment of the loan.
19. The payment has sufficient connection with the wider financial arrangement to be consideration “for or under” a financial arrangement for similar reasons set out above.
20. This means that the recipient of the facilitation payment will also need to complete a BPA. The recipient derives income from a financial arrangement that must be allocated to the relevant income year.
21. In addition to the above, any forgiveness or remission of debt by the lender will result in income from the loan for the borrower. This is because the amount of debt forgiven or remitted by the lender must be taken into account by the borrower in completing the BPA.
22. The result will be tax to pay unless there are enough deductible expenses or losses to offset against the income arising from the facilitation payment and the debt forgiveness or remission. Where the BPA results in tax to pay, the recipient should include that amount in their income tax return.

## Financial Relief

23. When they file their income tax return, recipients of facilitation payments may have income tax to pay. Recipients of these payments may be in a position of financial distress, so it is important that they contact a tax professional or Inland Revenue as soon as possible to discuss the situation. The Commissioner may be able to provide assistance if they are not able to pay on time, such as entering into an instalment arrangement for the amount to be paid off over time and may (depending on the circumstances) be able to write off or remit amounts owing so that they don't need to be paid.

## Application

24. This Statement sets out the Commissioner's position on facilitation payments made to a farmer and remission of debt income upon settlement of a loan, including where these took place prior to the release of this Statement.

25. The Commissioner will continue to apply this position to all cases.
26. If you have any concerns about your compliance with the tax obligations outlined in this Statement, you should discuss this matter with a tax professional or contact Inland Revenue to make a voluntary disclosure

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## About this document

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular tax matter.