



Product Ruling

Income tax: tax consequences of investing in ABN AMRO Protected Equity Instalment Series 2007 Product Disclosure Statement – cash applicants

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	8
Ruling	16
Scheme	17
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	23
Appendix 2:	
Detailed contents list	65

❗ 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, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are 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.

No guarantee of commercial success

The Tax Office **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling part apply to the defined class of entities, who participate in the scheme to which this Product Ruling relates.
2. In this Product Ruling this scheme is referred to as the ABN AMRO Australia Pty Limited Protected Equity Instalments (the Instalments).

Class of entities

3. The class of entities who can rely on this Product Ruling consists of those entities that are Cash Applicants accepted to participate in the scheme specified below on or after the date this Product Ruling is published and which execute relevant Agreements mentioned in paragraph 17 of this Ruling on or before 30 June 2010. They must have a purpose of staying in the scheme until it is completed (that is being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement. These entities are referred to as the Holder(s).

Superannuation Industry (Supervision) Act 1993

4. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product ruling as to whether investment in this product may contravene the provisions of SISA 1993.

Qualifications

5. The class of entities defined in this Product Ruling may rely on it provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 17 to 22 of this Ruling.
6. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then:
 - this Product 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 Product Ruling may be withdrawn or modified.

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Date of effect

8. This Product Ruling applies prospectively from 6 June 2007, the date this Ruling is published. It therefore applies to the specified class of entities that enter into the scheme from 6 June 2007 until 30 June 2010, being its period of application. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

9. However, the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Changes in the law

13. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of the Ruling and, to that extent, this Product Ruling will have no effect.

14. Entities who are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

15. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling is issued.

Ruling

16. Subject to the assumptions in paragraph 22 of this Ruling:

- (a) the Interest Amount, excluding any Borrowing Fee (Total Amount), reduced by the greater of:
 - an amount reasonably attributable to the cost of capital protection under either:
 - subsection 247-15(1) of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997) for Holders entering into an Instalment before 1 July 2007; or
 - step 3 of the method statement in subsection 247-20(3) of the *Income Tax Assessment Act 1997* (ITAA 1997) for Holders entering into an Instalment on or after 1 July 2007;

AND:

- the Capital Protection Fee;

will be deductible under section 8-1 of the ITAA 1997;

- (i) where a Holder invests in an Instalment before 1 July 2007, under subsection 247-15(1) of the IT(TP)A 1997 the amount reasonably attributable to the cost of capital protection in an income year is the greater of:

- the extent to which the Total Amount exceeds an amount equal to the Loan Amount multiplied by the Indicator Rate, the Indicator Rate being:
 - where interest on the Loan is charged at a variable interest rate, the Reserve Bank of Australia's Indicator Rate for Personal Unsecured Loans – Variable Rate prevailing at the time when the Interest Amount was first incurred for the income year; or
 - where interest on the Loan is charged at a fixed interest rate, the Reserve Bank of Australia's Indicator Rate for Personal Unsecured Loans – Fixed Rate prevailing at the time the Loan was entered into;

AND:

- an amount equal to the relevant percentage of the Total Amount for the income year, being:
 - 40% if the term of the Instalment is 1 year;
 - 20% if the term of the Instalment is 3 years; or
 - 15% if the term of the Instalment is 5 years;

(ii) where a Holder invests in an Instalment on or after 1 July 2007, under subsection 247-20(3) of the ITAA 1997 the amount reasonably attributable to the cost of capital protection in an income year is the amount by which the Total Amount exceeds:

- where interest is charged on the Loan at a fixed rate for all or part of the term of the Instalment, the Loan Amount multiplied by the Reserve Bank of Australia's Indicator Rate for Personal Unsecured Loans – Variable Rate (benchmark rate) at the time when the Interest Amount is paid during the term of the Instalment, or the relevant part of the term; and

- where interest is charged on the Loan at a variable rate for all or part of the term of the Instalment, the Loan Amount multiplied by the average of the benchmark rates published by the Reserve Bank of Australia during the term of the Instalment, or the relevant part of the term;
- (b) the amount reasonably attributable to capital protection under Division 247 of the ITAA 1997, to the extent that it exceeds the Capital Protection Fee constitutes a further cost of the Holder's Put Option;
- (c) section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny a Holder a deduction for the interest on the borrowing allowable under section 8-1 of the ITAA 1997 incurred under the Instalments;
- (d) section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest on the borrowing allowable under section 8-1 of the ITAA 1997 incurred under the Instalments;
- (e) section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the prepaid interest on borrowings allowable under section 8-1 of the ITAA 1997 incurred under the Instalments;
- (f) section 82KZM of the ITAA 1936 will not apply to deny immediate deductibility for the prepaid interest on borrowings allowable under section 8-1 of the ITAA 1997 incurred by the Holder under the Instalments where at least one of the following applies for the year of income;
 - (i) the Holder is a Simplified Tax System (STS) taxpayer; or
 - (ii) the Holder is an individual who does not incur the expenditure in carrying on a business;
- (g) sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the prepaid interest on borrowings allowable under section 8-1 of the ITAA 1997 incurred under the Instalments that is deductible to a Holder (other than an STS taxpayer for the year of income) who is a taxpayer that is not an individual and does not carry on a business;
- (h) the Borrowing Fee, if charged, will be deductible under section 25-25 of the ITAA 1997;

- (i) if the Holder's Put Option is exercised, the cost of capital protection as worked out according to paragraph 16(a) of this Ruling forms part of the cost base and the reduced cost base of the Underlying Parcel ('Underlying Parcel' is defined in the Scheme section of this Product Ruling) pursuant to section 134-1 of the ITAA 1997. Any capital gain or capital loss on exercise of the Put Option will be disregarded;
- (j) if the Holder's Put Option is not exercised, the cost of capital protection as worked out according to paragraph 16(a) of this Ruling forms part of the reduced cost base of the Holder's Put Option under section 110-55 of the ITAA 1997;
- (k) for capital gains tax (CGT) purposes a Cash Applicant's date of acquisition of the beneficial interest in the Underlying Parcel is the date when their application is accepted by ABN AMRO Australia Pty Limited (ABN AMRO), being the Issue Date pursuant to subsection 109-5(2) of the ITAA 1997;
- (l) no CGT event happens when legal title to the Underlying Parcel is transferred by the Trustee to the Holder on completion of the Instalments pursuant to paragraph 104-10(7)(a) of the ITAA 1997;
- (m) the Holder's cost base in the Underlying Parcel will include the Loan Amount and incidental costs of acquisition and disposal pursuant to section 110-25 of the ITAA 1997;
- (n) a CGT event will happen in relation to the Underlying Parcel under section 104-10 of the ITAA 1997 for the Holder where either:
 - (i) the Holder exercises the Holder's Put Option; or
 - (ii) the Holder does nothing at the Expiry Date and the Underlying Parcel is sold by the Trustee exercising its power of sale under the Security Interest.

Where either of the above scenarios occur at the Expiry Date and the sale proceeds are insufficient to repay the Loan, ABN AMRO has no recourse against the Holder to recover the shortfall. In these circumstances the Holder will need to reduce the cost base of the Underlying Parcel by the amount of the shortfall under subsection 110-45(3) of the ITAA 1997;

- (o) any capital gain made by a Holder on the sale of an Underlying Parcel received pursuant to completion of an Instalment, will be treated as a discount capital gain under section 115-5 of the ITAA 1997 where the Holder is an individual, a complying superannuation entity, or a trust and the sale occurs more than 12 months after the Issue Date;
- (p) a CGT event will happen under section 104-25 of the ITAA 1997 on the Expiry Date if the Holder's Put Option is not exercised. The capital proceeds received when the Holder's Put Option is not exercised will be nil and the Holder will make a capital loss equal to the reduced cost base of the Holder's Put Option;
- (q) the Holders of the Instalments, not the Trustee, are assessable under section 97 of the ITAA 1936 on all of the income derived from the Underlying Parcel while the Underlying Parcel is the subject of the Separate Trust, including dividends and any Accretion representing a Distribution which is applied to reduce the Loan;
- (r) the commercial debt forgiveness rules in Schedule 2C of the ITAA 1936 will not reduce the tax attributes of a Holder in relation to any debt forgiveness that arises because of the limited recourse nature of the Loan; and
- (s) the anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not apply to a Holder in respect of Instalments.

Scheme

17. The scheme that is the subject of this Product Ruling is described below. The scheme is incorporated within the following documents:

- Application for a Product Ruling dated 8 March 2007 received from Baker & McKenzie on behalf of ABN AMRO; and
- the Product Disclosure Statement (PDS) dated and received on the 13 April 2007 which includes a Loan Agreement to be entered into by ABN AMRO and a Holder and a copy of an ABN AMRO Protected Equity Instalment Trust Deed (Trust Deed) to be executed respectively by ABN AMRO as the Issuer and ABNED Nominees Pty Limited as the Trustee.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

18. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements apart from those noted above, whether formal or informal, and whether or not legally enforceable, which a Holder or any associate of a Holder, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows.

19. In this Ruling, unless otherwise defined, capitalised terms take their meaning as per the PDS.

20. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

Overview

21. Following is a summary of the scheme:

- (a) on acceptance of a Holder's application for an Instalment, the Holder enters into the Loan Agreement with ABN AMRO and appoints ABNED Nominees Pty Limited to act as Trustee;
- (b) the Holder uses the Loan from ABN AMRO to acquire certain shares and units in Australian Securities Exchange (ASX) listed companies and unit trusts (the 'Underlying Parcel'). The Underlying Parcel includes Accretions conferred in respect of those shares and units. The Holder will be registered as holder of the Instalment and will have a beneficial interest in the Underlying Parcel. The legal title to the Underlying Parcel will be held by the Trustee;
- (c) the Holder also acquires a Put Option;
- (d) the term of an Instalment will be 1, 3 or 5 years;
- (e) the Instalment will not be tradeable on the ASX;
- (f) the amount of the Loan provided to fund the purchase of each Underlying Parcel will be fixed by ABN AMRO on acceptance of an application based on the market value of the Underlying Parcel at that time;
- (g) repayment of the Loan will be secured by a mortgage over the Underlying Parcel. The Underlying Parcel will be held by the Trustee on trust for the Holder. Each trust and each Underlying Parcel to which it relates will be kept as a separate trust and there will be no pooling of interests or property to which the trust relates;

- (h) the Loan is made on a limited recourse basis. Under the Loan Agreement ABN AMRO's ability to recover the Loan Amount from the Holder is limited to the amount received by ABN AMRO either:
 - (i) if the Holder's Put Option is exercised by the Holder – the amount payable to the Holder under the Holder's Put Option (this amount is equal to the Loan Amount); or
 - (ii) if the Holder's Put Option is not exercised by the Holder – the amount recoverable by ABN AMRO on the enforcement of its rights in respect of the Mortgaged Property;
- (i) interest on the Loan is prepaid annually, and is charged at either a fixed or variable rate. The interest is payable on Application and on each anniversary of the Issue Date as a component of the Interest Amount;
- (j) the Borrowing Fee relates to the cost to ABN AMRO of providing the Loan (these costs may include fees paid by ABN AMRO to approved licensed financial advisors or participating organisations of the ASX whose stamp appears on the relevant Application Form). The Borrowing Fee may be prepaid as a component of the Interest Amount, either as a single payment on Cash Application, or periodically on Cash Application and each anniversary of the Issue Date;
- (k) the Capital Protection Fee is an amount charged by ABN AMRO for providing the Holder's Put Option. The Capital Protection Fee will be paid in accordance with the terms of issue of an Instalment as determined by ABN AMRO (this may be progressively over a number of years) and forms part of the Interest Amount charged to a Holder;
- (l) Distributions (dividends and trust distributions) received in respect of the Underlying Parcel will either:
 - (i) be distributed to the Holder; or
 - (ii) where the Holder agrees, form an Accretion to the Underlying Parcel, and may be used by the Trustee, if directed by ABN AMRO, to partially repay the Loan;

- (m) at the Expiry Date, the Holder has a number of options, including:
- (i) pay the Loan Amount:
 Holders can obtain the Underlying Parcel by paying an amount equal to the aggregate of the Loan Amount (the 'Instalment Payment'), the Processing Fee and Transfer Tax payable (if any). When this amount is made the Loan is repaid, the Security Interest is discharged, the Underlying Parcel is delivered to the Holder and the Holder's Put Option expires;
 - (ii) exercise the Holder's Put Option:
 ABN AMRO must purchase the Underlying Parcel for the Loan Amount. The proceeds are applied to repay the Loan and the Security Interest is released; or
 - (iii) do nothing:
 If the Holder does none of the above actions the Trustee will sell the Underlying Parcel and any proceeds after payment of the Loan Amount and other costs incurred by ABN AMRO or the Trustee in selling the Underlying Parcel, will be paid to the Holder. The Holder's Put Option will expire.

Assumptions

22. This Ruling is made on the basis of the following necessary assumptions:

- (a) all of the Holders are Australian residents for taxation purposes;
- (b) the Holders are not traders in investments and are not treated for taxation purposes as trading in the Underlying Parcel, carrying on a business of investing in the Underlying Parcel, or holding the Underlying Parcel as trading stock or as a revenue asset;
- (c) in respect of any interest charges to be paid in advance, these may be prepaid, but only in relation to loan interest payment periods of 12 months or less that end on or before the last day of the income year following the expenditure year;
- (d) the dominant purpose of a Holder in entering the arrangement is to derive assessable income from their investment in the Instalments;

- (e) at all times during the arrangement, where the Underlying Parcel includes units in a trust, the trust will be of the type contemplated in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- (f) the arrangement will be executed in the manner described in the Scheme section of the Ruling;
- (g) all dealings between the Holders and ABN AMRO will be at arm's length; and
- (h) the Underlying Parcel will not be the subject of any securities lending arrangement entered into by or on behalf of the Holder.

Commissioner of Taxation

6 June 2007

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.*

Section 8-1 and Division 247 of the ITAA 1997 and Division 247 of the IT(TP)A 1997: capital protected borrowings and deductibility of interest

23. The interest paid on a borrowing used to acquire income producing assets such as shares is generally treated as deductible under section 8-1 where it is expected that dividends or other assessable income would be derived from the investment (see Taxation Ruling TR 95/33).

24. Division 247 applies to an Instalment as:

- an Instalment is a capital protected borrowing, because the Holder uses the Loan Amount to acquire a beneficial interest in an Underlying Parcel comprising a share, a unit in a unit trust or a stapled security, and the Holder is protected against the fall in the market value of the Underlying Parcel; and
- the share, unit in a unit trust or stapled security is listed for quotation on the ASX.

25. Division 247 sets out a methodology for reasonably attributing the cost of capital protection incurred by a borrower under a capital protected borrowing. Division 247 ignores any amount (such as any Borrowing Fee) which is not in substance for capital protection or interest, in calculating the cost of capital protection, pursuant to subsections 247-20(1) and 247-25(1) of the IT(TP)A 1997 and subsection 247-20(3) of the ITAA 1997.

26. Where a Holder enters into an Instalment before 1 July 2007, pursuant to subsection 247-20(2) of the ITAA 1997, the amount reasonably attributable to the cost of capital protection is worked out under Division 247 of the IT(TP)A 1997, as set out in subparagraph 16(a)(i) of this Ruling.

27. Where a Holder enters into an Instalment on or after 1 July 2007, the amount reasonably attributable to the cost of capital protection is worked out under the method statement in subsection 247-20(3) of the ITAA 1997, as set out in subparagraph 16(a)(ii) of this Ruling.

28. In calculating the total cost of the Holder's Put Option, the amount reasonably attributable to capital protection under subsection 247-15(1) of the IT(TP)A 1997 and subsection 247-20(3) of the ITAA 1997 (as applicable) will be reduced by any actual payment for the Holder's Put Option (the Capital Protection Fee as described in the PDS) under subsection 247-20(6) of the ITAA 1997. That reduced amount constitutes a further cost of capital protection in addition to any actual payment for the Holder's Put Option.

29. Where the amount reasonably attributable to capital protection under Division 247 is less than the amount of any actual payment for the Holder's Put Option, the amount worked out under subsection 247-20(6) of the ITAA 1997 will be nil. Therefore the cost of capital protection will be the greater of:

- the amount reasonably attributable to the cost of capital protection under either subsection 247-15(1) of the IT(TP)A 1997, or subsection 247-20(3) of the ITAA 1997 as applicable (being in substance the amount of any actual payment for the Holder's Put Option, plus any further cost of capital protection as worked out under section 247-20 of the ITAA 1997); and
- the amount of any actual payment for an explicit Put Option.

30. For a Holder in an Instalment, the Holder's Put Option is a capital asset. As the cost of capital protection is the cost of the Holder's Put Option, this expense is capital in nature. The Total Amount (as defined in paragraph 16(a) of this Ruling) will be deductible under section 8-1 of the ITAA 1997 only to the extent that it is not the cost of capital protection.

Section 51AAA

31. By acquiring Instalments, it is contemplated that a Holder will derive assessable income by way of the receipt of dividend income and capital gains. As interest would have been deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of a net capital gain in assessable income, section 51AAA of the ITAA 1936 has no application to a Holder acquiring Instalments.

Section 82KL

32. The operation of section 82KL of the ITAA 1936 depends, amount other things, on the identification of a certain quantum of 'additional benefits'. Insufficient additional benefits will be provided to trigger the application of section 82KL. Section 82KL will not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997.

Subdivision H of Division 3 of Part III

33. Subdivision H of Division 3 of Part III of the ITAA 1936 (Subdivision H) deals with the timing of deductions for certain advance expenditure incurred under an agreement in return for the doing of a thing under that agreement that will not be wholly done within the same year of income. Separate rules apply depending on whether the expenditure is incurred in carrying on a business, whether the Holder is an STS taxpayer, whether the Holder is an individual and whether the Holder is not an individual and incurs the expenditure otherwise than in carrying on a business. This Subdivision does not apply to 'excluded expenditure' which is defined in subsection 82KZL(1) of the ITAA 1936 to include amounts of less than \$1,000, or amounts of expenditure that are of a capital nature.

Subdivisions 328-F and 328-G – STS taxpayer

34. A Holder will be an STS taxpayer for an income year if the Holder is eligible to be an STS taxpayer for that year and the Holder notifies the Commissioner of the choice to become such a taxpayer for that year.

35. A Holder will be eligible to be an STS taxpayer for an income year if the Holder carries on a business and the STS average turnover of the business and related business for that year is less than \$1 million and the business and related businesses have depreciating assets with a total adjustable value below \$3 million at the end of the year.

The eligible service period for the purposes of Subdivision H

36. The interest allowable under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest for a period that is not more than 12 months. Paragraph 82KZL(2)(a) of the ITAA 1936 provides that a payment of interest that is made in return for the making available of a loan principal is to be taken, for the purposes of Subdivision H of the ITAA 1936, to be expenditure incurred under an agreement in return for the doing of a thing under the agreement for the period to which the interest payment relates. The eligible service period in relation to a payment of loan interest is determined by reference to the period to which the interest relates, which is 12 months or less, and not the period of the Loan.

Sections 82KZME and 82KZMF: prepaid expenditure and 'tax shelter' arrangements

37. The rules in sections 82KZME and 82KZMF of the ITAA 1936 apply, subject to the exceptions in section 82KZME, where expenditure is incurred in relation to a 'tax shelter' arrangement for the doing of a thing that is not to be wholly done within the expenditure year.

38. For the purposes of section 82KZME of the ITAA 1936, 'agreements' are broadly defined to include an entire arrangement of which a contract may form part. Under subsection 82KZME(4), the relevant 'agreement' is all the contractual arrangements and activities associated with the participation in the Instalments including the financing, share purchase, shareholding and disposal arrangements.

39. Under the arrangement, when the Holder acquires an Instalment, they acquire beneficial ownership of the Underlying Parcel.

40. Exception 1, as contained in subsection 82KZME(5) of the ITAA 1936, applies to exclude the interest incurred on borrowings under the Instalment from the operation of section 82KZMF of the ITAA 1936, as:

- the prepaid interest expenditure under the Instalment is incurred in respect of money borrowed to acquire shares that are listed for quotation on the ASX and/or units in a trust as described in subparagraph 82KZME(5)(b)(iii);
- the Holder can reasonably be expected to obtain dividends or trust income from the investment;
- the Holder will not obtain any other kind of assessable income from the investment, except for capital gains; and
- all aspects of the Instalment are at arm's length.

41. Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 42 to 47 of this Ruling.

Section 82KZM: prepaid expenditure incurred by STS taxpayers and individuals incurring non-business expenditure

42. Section 82KZM of the ITAA 1936 operates to spread over more than one income year a deduction for prepaid expenditure incurred by a taxpayer that is either:

- an STS taxpayer for the year of income; or
- a taxpayer that is an individual and the expenditure is not incurred in carrying on a business.

43. The expenditure must not be excluded expenditure and must be incurred otherwise than in carrying on a business. Section 82KZM of the ITAA 1936 applies if the eligible service period for the expenditure is longer than 12 months, or the eligible service period for the expenditure is 12 months or shorter but ends after the last day of the year of income after the one in which the expenditure was incurred and the expenditure would otherwise be immediately deductible under section 8-1 of the ITAA 1997.

44. As the eligible service period in relation to the deductible interest for an Instalment is not more than 12 months and does not end after the last day of the year of income after the one in which the expenditure was incurred, section 82KZM of the ITAA 1936 will have no application to Holders who are STS taxpayers for the year of income, or to Holders who are individuals and the expenditure is not incurred in carrying on a business. Holders who satisfy these tests will be able to claim an immediate deduction for the interest incurred.

Sections 82KZMA and 82KZMD: prepaid non-business expenditure incurred by non-individual and non-STs taxpayers

45. Section 82KZMD of the ITAA 1936 sets the amount and timing of deductions for expenditure for a Holder (other than an STS taxpayer for the year of income) that is not an individual and does not incur the expenditure in carrying on a business.

46. Section 82KZMA of the ITAA 1936 requires that the expenditure must not be excluded expenditure and must be incurred in return for the doing of a thing under an agreement that is not to be wholly done within the expenditure year.

47. For these taxpayers, the deduction for prepaid interest on the Instalments will be apportioned on a straight line basis over the period to which it relates.

Section 25-25: Borrowing Fee

48. A Borrowing Fee may be charged at the discretion of ABN AMRO as a single payment at the time of Cash Application for making the Loan, or periodically at the time of Cash Application and each anniversary of the Issue Date. A Borrowing Fee will be payable as a component of the Interest Amount. No part of any Borrowing Fee charged is a payment for the purchase of the Holder's Put Option. The Borrowing Fee will be an allowable deduction pursuant to section 25-25 of the ITAA 1997. Each Borrowing Fee will be deductible on a straight line basis over the shorter of:

- the remaining period of the loan; and
- five years.

Sections 110-25, 110-55 and 134-1: cost base of the Holder's Put Option and Underlying Parcel for Cash Applications

49. If the Holder exercises the Put Option and transfers the Underlying Parcel to ABN AMRO, any capital gain or capital loss on the exercise of the Put Option is disregarded. The cost of capital protection as worked out according to paragraph 16(a) of this Ruling will form part of the second element of the Holder's cost base for the Underlying Parcel under item 2 of subsection 134-1(1) of the ITAA 1997.

50. If the Holder's Put Option is not exercised the cost of capital protection as worked out according to paragraph 16(a) of this Ruling forms part of the reduced cost base of the Holder's Put Option under section 110-55 of the ITAA 1997.

51. The Holder's cost base in the Underlying Parcel will include the Loan Amount and incidental costs incurred by the Holder in acquiring and disposing of the Underlying Parcel (this includes stamp duty and costs of transfer) pursuant to section 110-25 of the ITAA 1997.

Section 109-5: time of acquisition of the Underlying Parcel

52. Section 109-5 of the ITAA 1997 applies to Holders to treat them as having acquired the Underlying Parcel at the time when the Holder obtains the beneficial ownership of the Underlying Parcel. The acquisition time for a Cash Applicant is the time their application was accepted by ABN AMRO, being the Issue Date.

Paragraph 104-10(7)(a): no CGT event when Instalment Payment is paid

53. When an Instalment Payment is made, no CGT event will arise in respect of the transfer of legal title to the Underlying Parcel from the Trustee to the Holder by virtue of paragraph 104-10(7)(a) of the ITAA 1997.

Section 104-10 and subsection 110-45(3): CGT event A1

54. CGT event A1 will arise for the Holder if either the Holder exercises the Holder's Put Option or the Holder does nothing at the Expiry Date and the Underlying Parcel is sold by the Trustee. If the sale proceeds are insufficient to repay the Loan, ABN AMRO has no recourse against the Holder to recover the shortfall. In this circumstance the Holder will need to reduce the cost base of the Underlying Parcel by the amount of the shortfall under subsection 110-45(3) of the ITAA 1997.

Section 115-5: discount capital gains

55. Division 115 of the ITAA 1997 allows a taxpayer a discount on capital gains in certain circumstances. In accordance with section 115-5 of the ITAA 1997, any capital gain made by a Holder on the sale of the Underlying Parcel will be treated as a discount capital gain where the Holder is an individual, a complying superannuation entity or a trust and has held the Instalment for more than 12 months from the Issue Date.

Section 104-25: CGT event C2

56. Where, at the Expiry Date, the Holder's Put Option ends and CGT event C2 is triggered, the capital proceeds received on the expiry of the Holder's Put Option will be nil.

57. The Holder will make a capital loss equal to the reduced cost base in the Holder's Put Option. Pursuant to section 110-55 of the ITAA 1997, the reduced cost base will include the cost of capital protection as worked out according to paragraph 16(a) of this Ruling.

Section 97

58. The Holder is presently entitled to all of the income derived from the Underlying Parcel including dividends, trust distributions and Accretions that represent a Distribution which is applied to reduce the Loan. Therefore, section 97 of the ITAA 1936 will apply to assess the Holder on the income derived from the Underlying Parcel.

Schedule 2C: commercial debt forgiveness

59. Where the limited recourse feature of the Loan comes into effect, the Holder is not required to pay the Instalment Payment, and therefore there will be a commercial debt forgiveness under section 245-35 of Schedule 2C to the ITAA 1936. Under Schedule 2C where a forgiveness results in the Holder having a positive 'net forgiven amount', the Holder will be required to reduce certain tax attributes to the extent of the net forgiven amount.

60. To determine the net forgiven amount of a debt forgiveness it is first necessary to determine the 'gross forgiven amount'. In the Holder's circumstances Schedule 2C of the ITAA 1936 will have no practical effect as the gross forgiven amount in respect of the debt will be equal to zero. The gross forgiven amount is equal to the 'notional value' of the debt less any consideration paid or given in respect of the debt.

61. The notional value of the Instalment Payment debt is the *lesser* of the limited recourse debt outstanding at the time of the debt forgiveness and the market value of ABN AMRO's rights in relation to the Underlying Parcel at the time of the debt forgiveness, under section 245-60 of Schedule 2C of the ITAA 1936. The situation where the limited recourse feature of the Instalments may come into effect is where the market value of the Underlying Parcel will not cover the Instalment Payment. In such a situation the market value of ABN AMRO's rights in relation to the Underlying Parcel will arguably be no more than the market value of the Underlying Parcel at that point in time.

62. The consideration paid by a Holder in respect of the debt forgiveness would be equal to the market value of any property given by the Holder in respect of the debt forgiveness as determined at the time of the forgiveness, under paragraph 245-65(1)(b) of Schedule 2C of the ITAA 1936. Arguably, this market value is equal to the market value of ABN AMRO's rights in relation to the Underlying Parcel. Therefore the gross forgiven amount will be nil.

63. Accordingly, Schedule 2C of the ITAA 1936 will not reduce a Holder's tax attributes where the limited recourse feature of the Loan comes into effect.

Part IVA

64. Provided that the arrangement ruled on is entered into and carried out as described (see the Scheme part of this Ruling), it would be accepted as an ordinary commercial transaction and Part IVA of the ITAA 1936 would not apply.

Appendix 2 – Detailed contents list

65. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Class of entities	3
Superannuation Industry (Supervision) Act 1993	4
Qualifications	5
Date of effect	8
Changes in the law	13
Note to promoters and advisers	15
Ruling	16
Scheme	17
Overview	20
Assumptions	22
Appendix 1 – Explanation	23
Section 8-1 and Division 247 of the ITAA 1997 and Division 247 of the IT(TP)A 1997: capital protected borrowings and deductibility of interest	23
Section 51AAA	31
Section 82KL	32
Subdivision H of Division 3 of Part III	33
<i>Subdivisions 328-F and 328-G – STS taxpayers</i>	34
<i>The eligible service period for the purposes of Subdivision H</i>	36
<i>Sections 82KZME and 82KZMF: prepaid expenditure and 'tax shelter' arrangements</i>	37
<i>Section 82KZM: prepaid expenditure incurred by STS taxpayers and individuals incurring non-business expenditure</i>	42
<i>Sections 82KZMA and 82KZMD: prepaid non-business expenditure incurred by non-individuals and non-STS taxpayers</i>	45
Section 25-25: Borrowing Fee	48
Sections 110-25, 110-55 and 134-1: cost base of the Holder's Put Option and Underlying Parcel for Cash Applications	49
Section 109-5: time of acquisition of the Underlying Parcel	52
Paragraph 104-10(7)(a): no CGT event when Instalment Payment is paid	53

PR 2007/55

Section 104-10 and subsection 110-45(3): CGT event A1	54
Section 115-5: discount capital gains	55
Section 104-25: CGT event C2	56
Section 97	58
Schedule 2C: commercial debt forgiveness	59
Part IVA	64
Appendix 2 – Detailed contents list	65

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TR 95/33

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