



Product Ruling

Income tax: tax consequences of investing in JPMorgan Dividend Advance Resettable Warrant Instalments Series IQA, IQB May 2007 Product Disclosure Statement – cash applicants and secondary market purchasers

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❗ 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 the scheme is the investment in JPMorgan Dividend Advance Resettable Warrant Instalments Series IQA and IQB under the May 2007 Product Disclosure Statement (Instalments). The investment is in shares and/or units, which are listed for quotation on the Australian Securities Exchange (ASX), and a put option (Put Option) using in part a loan made by JPMorgan Investments Australia Limited (JPMIAL).
3. This Ruling does not address:
 - (a) the tax consequences for Shareholder Applicants and Rollover Applicants;
 - (b) the tax consequences for Holders who elect to roll Instalments into another Series (if available) on either a Reset Date or the Expiry Date, of the making of such election; and
 - (c) the tax consequences for Holders who elect to have a Reset Cashback paid to them in cash, of the making of such election.

Class of entities

4. The class of entities who can rely on this Product Ruling consists of those entities that are accepted to participate in the scheme specified below on or after 1 August 2007, the date this Product Ruling is published, either through Cash Applications or secondary market purchases and which execute relevant agreements mentioned in paragraph 17 of this Ruling on or before 30 June 2011. At the time of entering the scheme, 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 Holders.

Superannuation Industry (Supervision) Act 1993

5. 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

6. 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 23.

7. 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

9. This Product Ruling applies prospectively from 1 August 2007, the date this Ruling is published. It therefore applies to the specified class of entities that enter into the scheme from 1 August 2007 until 30 June 2011, 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.

10. 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.

11. 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)).

12. 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.

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 23 of this Ruling:

- (a) section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) will apply to allow a Holder a deduction for each Interest Amount and Dividend Interest Amount charged under the Loan Agreement;

- (b) each Put Option Fee separately incurred by a Holder on Application or at a Reset Date will be the cost of capital protection, being the cost of a Holder's Put Option, as no part of any Interest Amount or Dividend Interest Amount will be treated under subsection 247-20(6) of the ITAA 1997 as a cost of capital protection;
- (c) for a Transferee who acquires an Instalment on the ASX, the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection will be the cost of a Holder's Put Option, because no part of any Interest Amount or Dividend Interest Amount will be treated under subsection 247-20(6) of the ITAA 1997 as the cost of capital protection;
- (d) section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny a Holder a deduction for any Interest Amount or Dividend Interest Amount otherwise allowable under section 8-1 of the ITAA 1997;
- (e) section 82KL of the ITAA 1936 will not apply to deny a Holder a deduction for any Interest Amount or Dividend Interest Amount otherwise allowable under section 8-1 of the ITAA 1997;
- (f) section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for any Interest Amount or Dividend Interest Amount incurred by a Holder under the Instalments;
- (g) section 82KZM of the ITAA 1936 will not apply to deny the Holder immediate deductibility for any part of an Interest Amount or Dividend Interest Amount incurred by the Holder under the Instalments where at least one of the following applies for the year of income:
 - the Holder is a Simplified Tax System (STS) taxpayer; or
 - the Holder is an individual who does not incur the interest charge in carrying on a business;
- (h) sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for each Interest Amount and Dividend Interest Amount incurred under the Instalments that is deductible to a Holder (other than an STS taxpayer for the year of income) who is not an individual and does not carry on a business;

- (i) each Borrowing Fee will be deductible to the Holder under section 25-25 of the ITAA 1997 as follows:
 - if the Borrowing Fee is \$100 or less, the Borrowing Fee will be fully deductible in the income year in which it is incurred; or
 - if the Borrowing Fee is greater than \$100, the Borrowing Fee will be deductible on a straight line basis over the shorter of the remaining period of the Loan and 5 years;
- (j) if a Put Option Fee is incurred on a Reset Date, under sections 247-25 and 247-30 of the ITAA 1997, the Holder will be taken to have been granted a new Holder's Put Option on that date. The Holder's existing Put Option, which can be exercised on the Reset Date, will be taken to have expired on the Reset Date;
- (k) if a Holder's Put Option is not exercised on a Reset Date or Expiry Date, then under section 110-55 of the ITAA 1997:
 - the Put Option Fee for that Holder's Put Option will form part of the reduced cost base of that Holder's Put Option (refer to paragraph 16(b) of this Ruling);
 - for a Holder's Put Option acquired by a Transferee, the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection (refer to paragraph 16(c) of this Ruling) will form part of the reduced cost base of that Holder's Put Option;
- (l) a capital gains tax (CGT) event will occur under section 104-25 of the ITAA 1997 if the Holder does not exercise a Holder's Put Option and it expires. The Holder will make a capital loss equal to the reduced cost base of the Holder's Put Option;
- (m) if the Holder exercises a Holder's Put Option, the Put Option Fee (or for a Holder's Put Option acquired by a Transferee, the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection) for that Holder's Put Option will form part of the cost base or the reduced cost base of the Holder's Underlying Parcel under section 134-1 of the ITAA 1997. Any capital gain or capital loss on exercise of the Holder's Put Option will be disregarded under subsection 134-1(4) of the ITAA 1997;

- (n) for CGT purposes, including for the purposes of CGT discount, the date of acquisition of the beneficial interest in the Underlying Parcel under section 109-5 of the ITAA 1997 is the date on which the Holder acquires the Instalment to which the Underlying Parcel relates;
- (o) no CGT event happens when the legal title to the Underlying Parcel is transferred by the Security Trustee to the Holder;
- (p) a CGT event will happen at the Expiry Date under section 104-10 of ITAA 1997 for the Holder where:
- the Holder exercises the Holder's Put Option; or
 - the Holder does nothing at the Expiry Date and the Underlying Parcel is sold by JPMIAL exercising its power of sale under the Security Interest,
- where any of the above scenarios occur at the Expiry Date and the sale proceeds are insufficient to repay amounts outstanding under the Loan, JPMIAL will have no recourse against the Holder to recover the Loan Shortfall. In this circumstance, the Holder will need to reduce the cost base of the Underlying Parcel by the amount of the Loan Shortfall under subsection 110-45(3) of the ITAA 1997;
- (q) insofar as the funds borrowed under a Dividend Advance are applied to acquire an Underlying Parcel and there is a Dividend Advance Shortfall as defined under paragraph 22(k) of this Ruling, the Holder will need to reduce the cost base of the Underlying Parcel by the amount of the Dividend Advance Shortfall under subsection 110-45(3) of the ITAA 1997;
- (r) any capital gain made by a Holder on 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 or a trust, and has held the Instalment for at least 12 months;
- (s) all of the income derived from the Underlying Parcel while the Underlying Parcel is the subject of the separate trust will be included in the assessable income of the Holder of the Instalment (and not the Security Trustee) under section 97 of the ITAA 1936; and
- (t) the anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to deny deductibility to any Interest Amount or Dividend Interest Amount incurred by the Holder in respect of borrowings used to fund the purchase of the Underlying Parcel.

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 27 March 2007 received from Mallesons Stephen Jaques on behalf of JPMIAL;
- Product Disclosure Statement for JPMorgan Dividend Advance Resettable Warrant Instalments (Instalments) dated 9 May 2007 (PDS);
- the Terms of DARWINS (reproduced as an attachment to the PDS) (Terms);
- the Loan Agreement (reproduced as an attachment to the PDS); and
- additional information received on 31 May 2007, 28 June 2007 and 24 July 2007.

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. The documents highlighted are those that an Investor may enter into. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an Investor or any associate of an Investor, will be a party to, which are a part of the scheme.

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

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

21. An Underlying Security may be a share or a unit that is listed for quotation on the ASX. Any reference in this Ruling to 'shares' includes units and to 'shareholders' includes unit holders. Any reference in this Ruling to 'dividends' includes distributions in respect of units.

Overview

22. Following is a summary of the scheme:

- (a) on acquiring an Instalment, the Holder obtains a limited recourse loan(s) from JPMIAL, and acquires beneficial ownership of an Underlying Parcel (subject only to a security interest in favour of JPMIAL), and a Put Option;

- (b) there are three ways of investing in Instalments in the primary market, one of which is by Cash Application. As the Instalments are listed on the ASX, investors may also purchase them on the ASX (under a Transfer);
- (c) on acceptance of a potential Holder's application for an Instalment, the Holder will be bound by the Terms and the Loan Agreement;
- (d) under a Cash Application, the Cash Applicant pays the First Payment to JPMIAL. On the Issue date, JPMIAL lends funds to the Cash Applicant under the Loan and, generally, under one or more Dividend Advance(s). JPMIAL uses part of the First Payment and the loan funds to purchase shares in the name of the Security Trustee, to be held by the Security Trustee on a separate trust for the Holder. JPMIAL takes a security interest over the Underlying Parcel, to secure moneys owing by the Holder in relation to the Loan. The Holder is granted a Put Option. Funds that are borrowed on the Issue Date under the Loan and the Dividend Advance(s) are applied, together with the First Payment received from the Cash Applicant, to purchase the shares comprising the Underlying Parcel, prepay interest (that is, Interest Amount and any Dividend Interest Amounts) to JPMIAL, and pay a Borrowing Fee and Put Option Fee to JPMIAL. The Instalment is issued in the name of the Cash Applicant;
- (e) where the Instalments are purchased on-market under a Transfer, the Transferee acquires the Instalments on the same terms and conditions under which they were originally issued. In particular, the Transferee will be offered, and will accept from JPMIAL upon the Transfer, a Loan, and, if the Transferor owed amounts under one or more Dividend Advances at the time of Transfer, Dividend Advance(s). The funds advanced to the Transferee under the Loan and any Dividend Advances will be equal to the sum of:
 - (i) the amount outstanding under the Transferor's Loan and any Dividend Advances (as reduced by any refund by JPMIAL to the Transferor of prepaid interest, and as adjusted by the amount of any Transfer Costs payable between the Transferor and JPMIAL); and
 - (ii) the amount of prepaid interest payable by the Transferee to JPMIAL in respect of the Loan and any Dividend Advance(s) made to the Transferee. The Transferee acquires, from the Transferor, the beneficial interest in the Underlying Parcel held in the name of the Security Trustee, subject to a security interest in favour of JPMIAL, and the Put Option;

- (f) the term of the Loan is the period between the drawdown date (that is, either the Issue Date or the date of Transfer) and the Expiry Date;
- (g) repayment of the Loan will be secured by a mortgage in favour of JPMIAL over the Underlying Parcel (JPMIAL's Security Interest). The Underlying Parcel will be held by the Security 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. However, the Security Trustee may:
 - (i) aggregate all Underlying Securities in respect of Instalments held by Holders and hold those Underlying Securities using the same HIN; and
 - (ii) hold all Underlying Securities or Underlying Parcels in one or more omnibus accounts, provided that it ensures that the Underlying Securities are kept separate in its records;
- (h) the Loan is provided on a limited recourse basis, such that JPMIAL's right to repayment of the Loan is limited to the amount it can obtain by enforcing its rights in respect of the mortgaged property;
- (i) the term of a Dividend Advance is the period between the drawdown date (which could be any of the Issue Date, the date of Transfer or a Reset Date) and the end of the Dividend Advance Repayment Period, which is the period, in broad terms, in which the ex-dividend date for an expected Dividend (to which the Dividend Advance relates) is likely to occur;
- (j) a Dividend Advance relates to an expected Dividend on an Underlying Security. The amount lent under a Dividend Advance is calculated with reference to the expected Dividend to which it relates. The amount loaned under each Dividend Advance will be approximately 30% to 70% of the expected Dividend to which it relates;
- (k) if the sum of the cash amount of the Dividend to which a Dividend Advance relates and any Special Dividend with an ex-dividend date within the Dividend Advance Repayment Period is less than the amount outstanding under the Dividend Advance, JPMIAL has no recourse against the Holder to recover the shortfall (Dividend Advance Shortfall);

- (l) on a Reset Date, the Holder may:
- (i) pay the Final Instalment Payment:
the Loan is repaid, the Security Interest is extinguished and the shares are delivered to a holding in the Holder's name; or
 - (ii) exercise the Put Option:
the shares are purchased by JPMIAL for the higher of the Final Instalment Payment or the market price and the proceeds are applied to repayment of the Loan (and any other Secured Monies), with any residual paid to the Holder; or
 - (iii) roll the Instalments into another Series (if available); or
 - (iv) do nothing;
- (m) if, on a Reset Date, the Holder does not roll the Instalments into another Series (if available), exercise the Put Option or pay the Final Instalment Payment (that is, the Holder does nothing):
- (i) the amount under the Loan may be increased or decreased;
 - (ii) new Dividend Advance(s) may be made;
 - (iii) the Holder must:
 - prepay interest in respect of the Loan;
 - prepay interest in respect of any new Dividend Advance(s);
 - pay a Borrowing Fee for the succeeding 12 month period in respect of the Loan (but not if the Holder is a Transferee); and
 - pay a Put Option Fee in respect of the Loan;
 - (iv) if the sum of the funds advanced under any new Dividend Advance(s) on the Reset Date, and the revised Loan Amount (which applies from the Reset Date), reduced by the previous Loan Amount (which applied before the Reset Date):
 - exceeds the payments required to be made by the Holder on the Reset Date (as set out in (iii) above), the excess (the Reset Cashback) will be applied to acquire additional Instalments for the Holder (that is, as if the Reset Cashback were the First Payment under a Cash Application);

- is less than the payments required to be made by the Holder on the Reset Date (as set out in (iii) above), the Holder is required to pay the deficit to JPMIAL (Reset Payment);
- (n) the Final Instalment Payment is equal to the amount outstanding under the Loan on the date the Final Instalment Payment is made;
- (o) the Borrowing Fee is an annual fee payable by Cash Applicants on the Issue Date and each Reset Date and is equal to an amount up to 1.5% of the Loan Amount;
- (p) the Put Option Fee is payable to JPMIAL by a Cash Applicant on the Issue Date to acquire the Put Option, and by all Holders, on each Reset Date, to maintain the Holder's capital protection in respect of the Loan;
- (q) JPMIAL will advise Transferees of the part of the amount paid for the Instalment that is for capital protection, calculated as follows:
- (i) if the market value of the Underlying Security at the time of acquisition is greater than the sum of the Transferee's Loan Amount and Dividend Advance Amount(s), the amount is the greater of nil, and:

$$W + LA + DAA - DIA - S - IA$$
 - (ii) if the market value of the Underlying Security at the time of acquisition is equal to or less than the sum of the Transferee's Loan Amount and Dividend Advance Amount(s), the amount is the greater of nil, and:

$$W - IA - DIA$$
- where:
- W = purchase price of Instalment
 - LA = Transferee's Loan Amount
 - DAA = Transferee's Dividend Advance Amount(s)
 - IA = Interest Amount prepaid by Transferee
 - DIA = Dividend Interest Amount(s) prepaid by Transferee
 - S = market value of the Underlying Security at time of acquisition

- (r) the aggregate of the Interest Amount and any Dividend Interest Amount payable by a Holder in respect of the Instalment for an income year will always be less than the amount that would have been incurred for the income year on the Loan and any Dividend Advance(s) at the applicable rate worked out by reference to the Reserve Bank of Australia's Indicator Rate for Personal Unsecured Loans as specified under subsection 247-20(4) or 247-20(5) of the ITAA 1997;
- (s) on the Expiry Date, the Holder may:
 - (i) pay the Final Instalment Payment:
the Loan is repaid, the Security Interest is extinguished and the shares are delivered to a holding in the Holder's name; or
 - (ii) exercise the Put Option:
the shares are purchased by JPMIAL for the higher of the Final Instalment Payment or the market price and the proceeds are applied to repayment of the Loan (and any other Secured Monies), with any residual paid to the Holder; or
 - (iii) roll the Instalments into another Series (if available); or
 - (iv) do nothing:
on the Expiry Date, if the Instalments are not rolled over into another Series (if available), the Final Instalment Payment is not made and the Put Option is not exercised, the Underlying Parcel will be sold and any surplus from net proceeds, after repayment of the Loan and costs, will be paid to the Holder. If the sale proceeds are less than the Secured Monies, JPMIAL has no recourse against the Holder to recover the shortfall (Loan Shortfall).

Assumptions

23. This Ruling is made on the basis of the following assumptions:
- (a) 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 under the Loan Agreement, these may be prepaid, but only in relation to a loan interest payment period of 12 months or less that ends on or before the last day of the income year following the expenditure year;
- (d) the dominant purpose of a Holder in entering into the scheme is to derive assessable income from their investment in the Instalments;
- (e) at all times during the scheme, where the Underlying Parcel includes units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- (f) all dealings by the Holders and JPMIAL will be at arm's length;
- (g) the scheme will be executed in the manner described in the 'Scheme' section of this Ruling;
- (h) the Underlying Parcel will not be the subject of any securities lending scheme entered into by or on behalf of the Holder; and
- (i) any Reset Cashback will be wholly applied to acquire additional Instalments (that is, the Holder will not elect for the Reset Cashback to be paid to them in cash).

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.*

Part 1 – interest amounts and dividend interest amounts

Section 8-1 and Division 247: deductibility of interest

24. The interest paid on a borrowing used to acquire income producing assets such as shares or units in a trust is generally treated as deductible under section 8-1 of the ITAA 1997 where it is expected that dividends or other assessable income would be derived from the investment (see Taxation Ruling TR 95/33).

25. Division 247 of the ITAA 1997 applies to an Instalment as it is a capital protected borrowing, because the Holder uses the Loan to acquire a beneficial interest in an Underlying Parcel comprising a share or a unit in a unit trust that is listed for quotation on the ASX, and the Holder is protected against the fall in the market value of the Underlying Parcel for the purposes of section 247-10 of the ITAA 1997.

26. Division 247 of the ITAA 1997 sets out a methodology for reasonably attributing the cost of capital protection incurred by a borrower under a capital protected borrowing (section 247-20 of the ITAA 1997). 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 (subsection 247-20(3) of the ITAA 1997).

27. Where a Holder enters into an Instalment, 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.

28. In calculating the total cost of a Holder's Put Option, the amount reasonably attributable to capital protection under subsection 247-20(3) of the ITAA 1997, will be reduced by any actual payment for the Holder's Put Option in accordance with 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 of the ITAA 1997 is less than the amount of any actual payment for a 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 amount of any actual payment for the Holder's Put Option.

30. The aggregate of the Interest Amount and any Dividend Interest Amount(s) payable by a Holder in respect of the Instalment for an income year will always be less than the amount that would have been incurred for the income year on the Loan and any Dividend Advance(s) at the applicable rate worked out by reference to the Reserve Bank of Australia's Indicator Rate for Personal Unsecured Loans as specified under subsections 247-20(4) or 247-20(5) of the ITAA 1997. The Put Option Fee will always be equal to or greater than the amount reasonably attributable to capital protection under subsection 247-20(3) of the ITAA 1997. In this situation, the Put Option Fee will be the cost of capital protection.

31. For a Transferee who acquires an Instalment on the ASX, the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection will always be equal to or greater than the amount reasonably attributable to capital protection under subsection 247-20(3) of the ITAA 1997. Therefore, the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection will be the cost of capital protection.

32. For a Holder of 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 Interest Amount and any Dividend Interest Amount(s) in a year of income will be deductible under section 8-1 of the ITAA 1997 to the extent that it is not the cost of capital protection. As no part of the Interest Amount and any Dividend Interest Amount(s) for a year of income are a cost of capital protection, section 8-1 will allow a Holder a deduction for each Interest Amount and Dividend Interest Amount(s) charged under the Loan Agreement. This is the case where the Holder acquires the Instalment by Cash Application or by purchase on the ASX.

Section 51AAA

33. By investing in Instalments, it is contemplated that a Holder will derive assessable income by the receipt of dividend income and in due course possibly capital gains. As the Interest Amount and Dividend Interest Amount would have been deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of any net capital gains in assessable income, section 51AAA of the ITAA 1936 has no application to a Holder acquiring the Instalments.

Section 82KL

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

Subdivision H of Division 3 of Part III

35. 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.

Subdivision 328-F and Subdivision 328-G of the ITAA 1997: STS taxpayer

36. 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.

The eligible service period for the purposes of Subdivision H of Division 3 of Part III

37. 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, in the case of the Loan, is 12 months, and not the term of the Loan.

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

38. 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.

39. For the purposes of section 82KZME of the ITAA 1936, 'agreements' are defined broadly 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.

40. Under the scheme, when the purchaser acquires Instalments, they acquire beneficial ownership of the Underlying Parcel.

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

- (a) the Interest Amount and Dividend Interest Amount each constitute expenditure that is interest incurred on money borrowed to acquire shares that are listed for quotation in the official list of an approved stock exchange and/or units in a trust as described in subparagraph 82KZME(5)(b)(iii);
- (b) the Holder can reasonably be expected to obtain dividends or trust income from the investment;
- (c) the Holder will not obtain any other kind of assessable income from the investment, except possibly in due course capital gains; and
- (d) all aspects of the Instalments are at arm's length.

42. Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 43 to 48 of this Ruling.

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

43. 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.

44. 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 either 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 in either case the expenditure would otherwise be immediately deductible under section 8-1 of the ITAA 1997.

45. 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 either to a Holder who is an STS taxpayer for the year of income, or to a Holder who is an individual and where the expenditure is not incurred in carrying on a business. A Holder who satisfies 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

46. Sections 82KZMA and 82KZMD of the ITAA 1936 set the amount and timing of deductions for expenditure for a Holder (other than an STS taxpayer for the year of income) who, among others, is a taxpayer that is not an individual and that does not carry on a business.

47. 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.

48. For these taxpayers, the deduction for the Interest Amount and the Dividend Interest Amount will be apportioned over the relevant interest payment period.

Part 2 – borrowing fee

Section 25-25: deductibility of Borrowing Fee

49. Each Borrowing Fee is deductible under section 25-25 of the ITAA 1997 because it is incurred to obtain and/or maintain the Loan where the proceeds of the Loan are applied for the purpose of producing assessable income.

50. If a Borrowing Fee is \$100 or less, the Borrowing Fee will be fully deductible in the income year in which it is incurred.

51. If a Borrowing Fee is more than \$100, the deduction for the Borrowing Fee will be spread on a straight line basis over the shorter of:

- the remaining term of the loan, and
- 5 years.

Part 3 – Put Option

52. The Put Option in effect ensures that JPMIAL will acquire the shares in full satisfaction of the amount outstanding under the Loan, if the shares have fallen in value below the amount borrowed under the Loan. Accordingly, the payment for the Put Option (whether to JPMIAL in the form of a Put Option Fee or to the Transferor comprising the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection) is a payment for capital protection. The payment is capital in nature, being paid to acquire an asset, namely, the Put Option.

Sections 247-25 and 247-30: separate put options

53. The Put Option can be invoked on more than one occasion, as it can be invoked on each Reset Date and the Expiry Date. Therefore, under subsection 247-25(1) of the ITAA 1997, the Act applies as if there were a separate Put Option for each Reset Date and the Expiry Date.

54. If a Holder's Put Option is not exercised on a Reset Date or the Expiry Date, as the case may be, the Holder's Put Option is taken, under section 247-30 of the ITAA 1997, to have expired on that date.

Section 247-20: cost of capital protection for Transferee

55. For a Transferee who acquires an Instalment on the ASX, the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection will always be equal to or greater than the amount reasonably attributable to capital protection as worked out by the method statement under subsection 247-20(3) of the ITAA 1997. Therefore, the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection will be the cost of capital protection.

Sections 134-1 and 110-55: cost of the Holder's Put Option

56. If a Holder's Put Option is exercised, the Put Option Fee (or for a Holder's Put Option acquired by a Transferee, the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection) is included in the cost base of the Underlying Parcel under section 134-1 of the ITAA 1997.

57. If a Holder's Put Option is not exercised, the Put Option Fee (or for a Holder's Put Option acquired by a Transferee, the part of the amount paid for the Instalment as advised by JPMIAL that is for capital protection) is included in the reduced cost base of the Holder's Put Option under section 110-55 of the ITAA 1997.

Section 104-25: expiry of a Holder's Put Option

58. If a Holder's Put Option expires, a CGT Event C2 will occur for the Holder under section 104-25 of the ITAA 1997. The capital proceeds received in respect of this event will be nil.

Part 4 – Underlying Parcel***Section 109-5: time of acquisition***

59. Section 109-5 of the ITAA 1997 applies to a Holder to treat them as having acquired the Underlying Parcel at the same time as the Holder obtains the beneficial ownership of the Underlying Parcel. The acquisition time for a Cash Applicant is the time the application was accepted, and, for a Transferee, is the contract date for the transfer of the Instalment.

Subsection 104-10(7): no disposal when Final Instalment Payment made

60. When the Final Instalment Payment is made, no CGT event will arise in respect of the transfer of the legal title to the Underlying Parcel from the Security Trustee to the Holder, because of subsection 104-10(7) of the ITAA 1997.

Section 104-10 and subsection 110-45(3): disposal where Security Interest exercised

61. CGT event A1 will happen if the Holder does not make a Final Instalment Payment on the Expiry Date, a Reset Payment on the Reset Date or payment of a TFN/ABN Amount owing to JPMIAL, and the Underlying Parcel is sold to JPMIAL or to a third party. If the sale proceeds are insufficient to repay the Loan, JPMIAL 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.

62. Insofar as the funds borrowed under a Dividend Advance are applied to acquire an Underlying Parcel and there is a Dividend Advance Shortfall, the Holder will need to reduce the cost base of the Underlying Parcel, under subsection 110-45(3) of the ITAA 1997, by the amount of the Dividend Advance Shortfall in respect of the Dividend Advance.

Section 115-5: CGT discount

63. 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 realised by a Holder on the sale of an Underlying Parcel received pursuant to the completion of an Instalment 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 at least 12 months.

64. In accordance with section 115-25 of the ITAA 1997, the 12 month period for the purposes of the CGT discount will run from the date of acquisition of the Instalment.

Part 5 – present entitlement

Section 97

65. As a Holder is presently entitled to all of the income derived from the Underlying Parcel while the Underlying Parcel is the subject of the Separate Trust, section 97 of the ITAA 1936 will apply to assess the Holder on that income.

Part 6 – Part IVA

66. Provided that the scheme ruled on is entered into and carried out as disclosed (see the Scheme part of this Ruling), it is accepted that the scheme is an ordinary commercial transaction and that Part IVA of the ITAA 1936 will not apply.

Appendix 2 – Detailed contents list

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 95/33

Subject references:

- capital gains tax
- capital protected borrowing
- financial products
- instalment warrants
- interest expense
- prepaid expenses
- put option

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