



Taxation Determination

Income tax: does a taxpayer in a passive investment have day to day control over the operation of an agreement for the purposes of paragraph 82KZME(3)(b) of the *Income Tax Assessment Act 1936*?

Preamble

*The number, subject heading, date of effect and paragraph 1 of this document are a 'public ruling' for the purposes of Part IVA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner.*

1. No.
2. Sections 82KZME and 82KZMF of the *Income Tax Assessment Act 1936* (ITAA 1936) provide that deductions for prepaid expenditure incurred under certain agreements, often referred to as tax shelter arrangements, are apportioned over the eligible service period to which the expenditure relates or 10 years, whichever is less.
3. Subsection 82KZME(4) defines 'agreement' for the purposes of section 82KZME to include 'all activities that relate to the agreement, including those that give rise to deductions or assessable income'.
4. Subsection 82KZME(3) sets out the features an agreement must possess to be within the provisions. Paragraph 82KZME(3)(b) requires that in relation to the agreement 'the taxpayer does not have day to day control over the operation of the agreement (whether or not the taxpayer has the right to be consulted or give directions)'. That is, the paragraph merely requires that the taxpayer does not have day to day control over the agreement's operation.
5. A passive investment may include both a retail financial product and other managed investments where the activities do not constitute the carrying on of a business.
6. When an investor enters into a passive investment they do not exercise any day to day control over the operation of the agreement in the sense required by paragraph 82KZME(3)(b). The fact that a taxpayer may organise finance, have occasional input into some decision making functions and occasionally participate in some activities does not mean they have day to day control over the operation of the agreement.

7. In practice, significant aspects of the day to day control of most retail financial products and other investments where the activities do not constitute carrying on a business are normally managed by someone other than the taxpayer. Accordingly, provided the other requirements of subsection 82KZME(3) are met, such products and investments will constitute agreements for the purposes of these provisions.

8. This will be the case notwithstanding that with many passive investments, there may in fact be relatively few functions requiring day to day control. Even if it were considered that there is an absence of such activities being carried out by the manager, arranger or promoter, it cannot be said that as a consequence the taxpayer therefore has day to day control.

Examples

Example 1

9. *Bank Ltd markets and promotes an agreement to members of the public under which participants acquire notes enabling them to gain exposure to the performance of underlying indices as selected by Bank Ltd. Paul borrows funds from an unrelated third party and uses these borrowings to invest in the agreement. Paul is required to prepay interest on the borrowings with the result that his allowable deductions exceed assessable income in the expenditure year. Bank Ltd will pay Paul interest on the notes each six months to maturity based on the performance of the notes. Bank Ltd will also provide annual reports to Paul indicating how the notes performed over the previous year. On maturity Bank Ltd will pay Paul the face value of the notes. Paul may, subject to the discretion of Bank Ltd, request early redemption of his investment.*

10. *Upon entering into the agreement, Paul has handed control of his funds to Bank Ltd. The nature of the investment is such that there are little, if any, day to day control activities to perform. Whilst Paul may actively monitor his investment and give directions in respect of requesting early redemption, he does not have day to day control over the operation of the agreement.*

11. *The requirements of subsection 82KZME(3) are satisfied.*

Example 2

12. *Peter entered into an agreement to acquire units in a unit trust that has at least 300 beneficiaries and which is a widely held unit trust as defined in section 272-105 in Schedule 2F of the ITAA 1936. The agreement is marketed and promoted to the public at large. Under the terms of the agreement Peter borrowed funds from the promoter to finance his acquisition. Interest payments on the borrowings were required to be paid in advance resulting in allowable deductions exceeding assessable income in the expenditure year.*

13. *After entering into the agreement, Peter is not required to perform any further functions. As he does not have day to day control over the operation of the agreement the requirements of subsection 82KZME(3) are satisfied.*

Date of effect

14. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of Taxation15 June 2005

Previous draft:

TD 2005/D2

Related Rulings/Determinations:

TR 92/20

Subject references:

- advance expenses & payments
- deductions & expenses
- tax shelters

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 82KZME
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(3)(b)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZMF
- ITAA 1936 Sch 2F 272-105

ATO references

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