

TD 2012/D10 - Income tax: will interest on a full recourse loan be denied deductibility as a consequence of Division 247 of the Income Tax Assessment Act 1997 where that loan is used to prepay interest on another loan which is a capital protected borrowing?

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This document has been finalised by TD 2013/1.



Draft Taxation Determination

Income tax: will interest on a full recourse loan be denied deductibility as a consequence of Division 247 of the *Income Tax Assessment Act 1997* where that loan is used to prepay interest on another loan which is a capital protected borrowing?

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This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation 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.

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Ruling

1. No. Where a taxpayer enters into a limited recourse loan (investment loan) which is made under a capital protected borrowing for the purposes of Division 247 of the *Income Tax Assessment Act 1997* (ITAA 1997) and a full recourse loan (interest loan) is entered into solely to fund an amount of prepaid interest on the investment loan, interest incurred on the interest loan will not be denied deductibility as a consequence of Division 247.

Date of effect

2. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Explanation

3. This draft Determination concerns the deductibility of interest incurred by a taxpayer (Investor) on a full recourse loan (interest loan) which is used to fund the prepayment of interest on a limited recourse investment loan.
4. Although details of the scheme may vary between different investment products, the situation dealt with in this draft Determination commonly arises in the following way:
 - (a) The Investor enters into a compulsory limited recourse loan (investment loan) which is used to fund the acquisition of shares, units in a trust or similar securities (the investments).
 - (b) There is a reasonable expectation that the investments will give rise to assessable income of the Investor.
 - (c) The Investor grants a mortgage or other security interest over the investments in favour of the lender to secure the Investor's obligations under the investment loan.
 - (d) The terms of the investment loan may require or permit the prepayment of interest on that loan.
 - (e) The Investor has the option of entering into a full recourse interest loan which is applied to fund the prepayment of interest under the investment loan.
 - (f) The investment loan and the interest loan may be documented in the same loan agreement or in separate agreements; however the provision of the investment loan is not contingent on the investor also entering into the interest loan. The terms of either loan do not depend on whether the other loan has been entered into.
 - (g) The Investor is wholly or partly protected against a fall in the market value of the investments, for example, by being granted a put option or put options over the investments.

Does Division 247 apply to interest incurred on the interest loan?

5. The object of Division 247 of the ITAA 1997 is to ensure that amounts paid for capital protection under some capital protected borrowings are treated as a payment for a put option for purposes including deductibility under section 8-1 of the ITAA 1997 and capital gains tax provisions. The Division sets out a methodology for reasonably attributing the cost of capital protection obtained by a borrower under a capital protected borrowing.
6. The concepts of a 'capital protected borrowing' and 'capital protection' are defined in section 247-10 of the ITAA 1997. In a situation where Division 247 of the ITAA 1997 applies to the investment loan as it is made under an arrangement that is a capital protected borrowing, a question arises about whether or not a subsequent interest loan is part of that capital protected borrowing.

7. Division 247 of the ITAA 1997 will not apply to the interest loan because it is a borrowing that is not used to any extent in either of the ways set out in paragraphs 247-10(1)(a) or 247-10(1)(b) of the ITAA 1997. The Investor does not use the interest loan to acquire the investments, nor are the investments used by the Investor as security for the interest loan. Further, the interest loan is provided on a full recourse basis.

Is a deduction for interest on the interest loan otherwise prevented under section 8-1?

8. The grant of a put option or put options to the Investor over the investments will not prevent interest on the interest loan from being deductible under section 8-1 of the ITAA 1997.

9. However, where the borrowings under the interest loan are applied to fund something other than, or additional to, amounts of interest under the investment loan, the application of section 8-1 of the ITAA 1997 would need to be examined in the context of the particular facts.

Appendix 2 – Your comments

10. You are invited to comment on this draft Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

11. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- be published on the ATO website at www.ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- borrowings & loans
- deductions
- limited recourse loans

Legislative references:

ITAA 1997 8-1
ITAA 1997 Div 247
ITAA 1997 247-10
ITAA 1997 247-10(1)(a)
ITAA 1997 247-10(1)(b)

ATO references

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