



PR 2003/44 - Income tax: tax consequences of investing in the UBS Protected Geared Investment Product

 This cover sheet is provided for information only. It does not form part of *PR 2003/44 - Income tax: tax consequences of investing in the UBS Protected Geared Investment Product*

 This document has changed over time. This is a consolidated version of the ruling which was published on *17 December 2003*



Product Ruling

Income tax: tax consequences of investing in the UBS Protected Geared Investment Product

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications sections**), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

No guarantee of commercial success

The Australian Taxation Office (ATO) **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.

Participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for participants by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, participants lose the protection of this Product Ruling. Participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Participants should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the 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 Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of person who takes part in the arrangement to which this Ruling relates. In this Ruling the arrangement is the grant of a Put Option and the borrowing of moneys from UBS AG, Australia Branch ('UBS') to fund the acquisition of shares listed on the Australian Stock Exchange and/or units in a unit trust as described in subparagraph 82KZME(5)(b)(iii) of the *Income Tax Assessment Act 1936*, on the terms of a lending and investment facility named the 'UBS Protected Geared Investment', which is referred to in this Ruling as the 'PGI'.

2. This Ruling does not address the tax consequences of:

- using the Share-Roll In Facility;
- using the Loan Extension Facility;
- extending the Protected Loan at maturity; and
- using the limited trading facility

under the terms of the PGI.

3. This Ruling does not address an investor's entitlement to franking credits.

Tax law(s)

4. The tax laws dealt with in this Ruling are:

- section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 104-10 (ITAA 1997);
- section 110-25 (ITAA 1997);
- Division 116 (ITAA 1997);
- Division 134 (ITAA 1997);
- section 51AAA of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KL (ITAA 1936);
- section 82KZM (ITAA 1936);
- section 82KZMA (ITAA 1936);
- section 82KZMB (ITAA 1936);
- section 82KZMC (ITAA 1936);

- section 82KZMD (ITAA 1936);
- section 82KZME (ITAA 1936);
- section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Class of persons

5. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed and of deriving assessable income from their involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Investors'.

Qualifications

6. The Commissioner rules on the precise arrangement identified in the Ruling.

7. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner and it will be withdrawn or modified.

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Date of effect

9. This Ruling applies prospectively from 18 June 2003, the date this Ruling is made. However, the Ruling 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 issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

10. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

12. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- application for a Product Ruling as amended, received from Blake Dawson Waldron on behalf of UBS on 16 April 2003;
- draft Information Memorandum for the Protected Geared Investment (the 'Information Memorandum') as amended, received from Blake Dawson Waldron on 6 June 2003;
- draft UBS Protected Geared Investment Loan and Put Option Agreement (the 'Loan Agreement') as

amended, received from Blake Dawson Waldron on 6 June 2003;

- draft Example Protected Geared Investment Term Sheet (the 'Example Term Sheet') as amended, received from Blake Dawson Waldron on 17 March 2003;
- draft Example Protected Geared Investment Portfolio Selection Sheet (the 'Example Portfolio Selection Sheet') as amended, received from Blake Dawson Waldron on 17 March 2003;
- draft Sample Confirmation Notice (the 'Sample Confirmation') as amended, received from Blake Dawson Waldron on 17 March 2003; and
- additional information provided on 12 February 2003, 14 February 2003, 17 February 2003, 17 March 2003, 21 March 2003, 16 April 2003 and 6 June 2003.

13. The details and aspects of the arrangement subject to this Ruling are summarised as follows:

- a) each Investor will enter into the Loan Agreement with UBS on or after the date of this Ruling. The PGI involves the grant of a Put Option and the making of a limited recourse loan by UBS to an Investor for a fixed term of either one, two, three, four or five years (at the Investor's option). The term will commence on the issue date agreed between the Investor and UBS. Although the issue date (and therefore the maturity date) will not necessarily be the same for all Investors in the PGI, each Investor's loan will have a term of either one, two, three, four or five years;
- b) the funds provided under the loan are used to finance 100% of the purchase price of one or more 'Approved Securities' to be acquired by the Investor. In this Ruling, the Approved Securities will be shares listed on the Australian Stock Exchange and/or units in a trust as described in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936. UBS will offer Investors a choice of Approved Securities. An Investor may choose to invest in a single Approved Security or in a number of Approved Securities. Where the Approved Security includes a stapled security, the stapled security is comprised of share/s and unit/s that are jointly listed for quotation on the Australian Stock Exchange;
- c) alternatively, Investors may use the PGI to release cash from an existing holding of securities using the 'Share

Roll-in Facility'. In this case, the Investor provides an existing holding of Approved Securities as security for the limited recourse loan provided by UBS to the Investor. In the case of Investors using the Share Roll-in Facility, the loan funds may only be used for investment or business purposes;

- d) where there is more than one Approved Security, the loan is segmented into tranches (each tranche separately being a 'Protected Loan'). Each Protected Loan comprises the amount applied to purchase each tranche of Approved Securities acquired by the Investor or the initial amount borrowed by an Investor using the Share Roll-In Facility, and will also include any amount borrowed by the Investor under the Loan Extension Facility described in paragraph 13(h) (if applicable);
- e) UBS may offer a further loan to Investors to fund the payment of the interest payable on the Protected Loan for the first (and in certain limited circumstances, the second) interest payment period (the 'Interest Funding Loan'). Availability of the Interest Funding Loan will be specified in the applicable term sheet (or may be agreed with UBS) and is subject to credit approval by UBS. The Interest Funding Loan will be a full-recourse loan, with principal repayable over a two year period in the case of a PGI having a three year term, and over a three year period in the case of a PGI with a four or five year term. Interest on an Interest Funding Loan is payable at the start of each interest payment period (which coincides with the interest payment periods under the Protected Loan) during the term of the Interest Funding Loan, at the interest rate set out in the Investor's Confirmation;
- f) the Loan Agreement provides an Investor with an option ('Put Option') to sell the Approved Securities for the amount outstanding under the Protected Loan which relates to those Approved Securities. The Put Option may only be exercised by the Investor at maturity of the Protected Loan. Each Put Option granted to the Investor may be exercised independently of each other Put Option (for example, if an Investor has a number of Approved Securities and one of the Approved Securities in the basket falls in value, the Investor can exercise their Put Option for that Approved Security, but need not exercise their Put Options for the other Approved Securities);

- g) a portion of the interest payable on the Protected Loan and the Interest Funding Loan (if applicable) is allocated to the Put Option premium. The Put Option premium is based on the 'Put Option Premium Rate', which is the rate published by UBS and applicable for the relevant interest payment period. This premium is no less than the excess of the interest rate charged on the Loan above the Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans. The Put Option Premium Rate will be calculated as a percentage of the Interest Rate, and will vary depending on the term of the Protected Loan;
- h) UBS may, at its discretion, make a 'Loan Extension Facility' available to the Investor. The Loan Extension Facility allows an Investor to draw down additional loan funds (thereby increasing the principal of the Protected Loan) where the market value of the Approved Securities has increased above the existing Protected Loan amount. The extended Protected Loan amount cannot exceed the market value of the Approved Securities at the time the loan extension is approved;
- i) an Investor using the Loan Extension Facility will be entitled to borrow an amount from UBS equal to the excess of the extended Protected Loan above the existing Protected Loan (the 'Additional Advance'). Following the approval by UBS of the loan extension, the Additional Advance may be drawn down at any time up to the maturity date. If an Investor who uses the Loan Extension Facility has not drawn down the Additional Advance prior to maturity, the Additional Advance will be drawn down on maturity, and the funds released to the Investor (after payment of any amounts owing to UBS at that time);
- j) the Investor may be required to pay a Loan Extension Fee at the time the loan extension is approved, as consideration for UBS providing the Loan Extension Facility;
- k) interest is payable on the Additional Advance at the start of each interest payment period which, other than for the first period, will coincide with the interest payment periods on the Protected Loan, at the interest rate set out in the Investor's Confirmation for the Additional Advance. As the Investor may draw down an Additional Advance for which a loan extension has

been approved at any time during the term of the PGI, the first interest payment on the Additional Advance will relate to the period from the date the Additional Advance is drawn down to the end of the current interest payment period. This interest payment and the Loan Extension Fee (if any) may be set-off against the Additional Advance payable to the Investor. Where the Additional Advance is drawn down within the two weeks prior to the date on which an interest payment on the Protected Loan is due, UBS may also deduct the next interest payment amount from the Additional Advance;

- l) the Protected Loan and the Interest Funding Loan (if applicable) are secured by a mortgage in favour of UBS over, amongst other things, the Approved Securities, the Put Option, any distributions paid or payable on the Approved Securities, any amount (or units) held by UBS on the Investor's behalf after sale of the Approved Securities in accordance with the trading facility and all other rights in respect of the Approved Securities;
- m) the Protected Loan provided by UBS to the Investor is a 'limited recourse' loan. Under the terms of the Loan Agreement, UBS' ability to recover the principal amount of the Protected Loan (including any Additional Advance but not the amount of any Interest Funding Loan) is limited to either:
 - (i) if the Put Option is exercised by the Investor - the amount payable to the Investor under the Put Option; or
 - (ii) if the Put Option is not exercised by the Investor - the amount that UBS is able to obtain by enforcing its rights in respect of the mortgaged property.

In all other respects, UBS' recourse against an Investor will not be limited;

- n) UBS may allow Investors the option to pay the interest for any interest payment period in two or more instalments. The instalment payment options may not apply for every interest payment period during the term of the Protected Loan. Investors choosing to pay interest by instalments may be charged a higher rate of interest compared to those paying interest in advance for the whole of the interest payment period;

- o) interest on the Protected Loan is usually prepaid for the full interest payment period at or before the start of the relevant interest payment period. UBS may, however, stipulate in the Investor's Confirmation that interest may be paid in arrears for one or more of the interest payment periods;
- p) for each Protected Loan or Interest Funding Loan (if applicable), the interest rate for the first interest payment period will be set out in the applicable term sheet, or will be as agreed with UBS, and will be confirmed in the Investor's Confirmation. Where there is more than one interest payment period, the interest payable after the first interest payment period will be based on market interest rates at that time. Alternatively, the interest rate may be fixed from the start and apply throughout the term of the Protected Loan or Interest Funding Loan (as applicable). Interest rates applying to an Additional Advance will be based on market interest rates applicable at the time the Additional Advance is drawn down and agreed with UBS. The applicable interest rate will be set out in the Investor's Confirmation provided to Investors following the draw down of the Additional Advance;
- q) the terms of the Loan Agreement allow an Investor to choose to cap the capital growth on the Approved Securities under the 'Call Sale Facility'. The Call Sale Facility involves the Investor selling an option (the 'Call Option') to UBS to purchase the Approved Securities at maturity if the market value of the Approved Securities at maturity is equal to or exceeds the 'Capped Amount' chosen by the Investor (being a percentage greater than 100% of the protected price of the Approved Securities). The Investor may grant a Call Option over one or more tranches of Approved Securities. The Investor's election to use the Call Sale Facility is irrevocable;
- r) under the Call Sale Facility, Investors may also elect to retain, and therefore share with UBS, part of the capital growth of the Approved Securities above the Capped Amount. The percentage of the capital growth of the Approved Securities above the Capped Amount that the Investor chooses to retain is the 'Participation Rate'. The Investor may also request to vary the Capped Amount and/or the Participation Rate for the Call Sale Facility at the time the Investor makes a Loan Extension Request. If UBS agrees to that request, the

- calculation of the Loan Extension Fee will take into account UBS' costs in varying the Capped Amount and/or the Participation Rate;
- s) no fee is payable to the Investor for the grant of the Call Option to UBS. However, if the Investor elects to use the Call Sale Facility, the interest payable by the Investor on the Protected Loan and the Interest Funding Loan (if applicable) will be reduced. The reduction in the interest rate will depend on the level of the Capped Amount and the Participation Rate applicable;
 - t) where on maturity of the PGI, UBS exercises its Call Option, the amount payable by UBS to the Investor to acquire the Approved Securities will be the sum of the Capped Amount and the Participation Rate multiplied by the capital growth of the Approved Securities above the Capped Amount (the 'Settlement Amount');
 - u) alternatively, where UBS exercises its Call Option on maturity, the Investor may elect to repay the Protected Loan by either:
 - (i) repaying the Protected Loan from their own funds; or
 - (ii) extending the Protected Loan (if available);
 - v) in either case, the Investor would be required to pay UBS the amount of UBS' share of the capital growth on the Approved Securities above the Capped Amount (the 'Cash Settlement Amount');
 - w) on maturity of the PGI, an Investor who has not used the Call Sale Facility has four alternatives:
 - (i) repay the Protected Loan and Interest Funding Loan (if applicable) from their own funds (which will result in a release of the mortgage over the Approved Securities);
 - (ii) extend the Protected Loan for a further fixed term (if UBS makes this option available to the Investor) subject to the consent of UBS;
 - (iii) exercise the Put Option; and
 - (iv) if none of the above apply or the Investor applies to rollover the Protected Loan where this alternative is not available, UBS may proceed to exercise its rights as mortgagee of the mortgaged property, and distribute surplus disposal proceeds, if any, to the Investor after

- repayment of the Protected Loan and the Interest Funding Loan (if applicable) and any costs and expenses;
- x) the alternatives available on maturity to an Investor who has used the Call Sale Facility will depend on the market value of the Approved Securities at maturity. Where the market value of the Approved Securities is less than the Capped Amount, UBS will not exercise the Call Option, and the alternatives outlined in paragraph 13(w) above will be available to the Investor. Where the market value of the Approved Securities is equal to or greater than the Capped Amount such that the Call Option is exercised, the following three alternatives are available to Investors on maturity:
- (i) sell the Approved Securities to UBS pursuant to the Call Option, with the Settlement Amount applied to repay the Protected Loan, Interest Funding Loan (if applicable) and any costs and expenses (resulting in a release of the mortgage), with any surplus proceeds distributed to the Investor;
 - (ii) repay the Protected Loan and Interest Funding Loan (if applicable) from their own funds and pay the Cash Settlement Amount to UBS (which will result in a release of the mortgage over the Approved Securities); and
 - (iii) extend the Protected Loan for a further fixed term (if UBS makes this option available to the Investor, and subject to UBS' consent) and pay the Cash Settlement Amount to UBS;
- y) the Investor may repay part or all of the Protected Loan and the Interest Funding Loan (if applicable) prior to the maturity of that loan. If this occurs, the Investor may be liable for break fees to cover any costs incurred by UBS as a result of the early unwinding of the PGI;
- z) any distributions paid to the Investor in respect of the Approved Securities will either be passed directly on to the Investor or will be held for the Investor by UBS or its nominee. Where distributions are held on the Investor's behalf, the Loan Agreement provides that such amounts may be used towards payment of the Investor's interest obligations to UBS. Any distributions remaining after an interest payment date may be released to the Investor. Where the Investor has an outstanding Interest Funding Loan, such

amounts may be applied towards payment of principal and interest on the Interest Funding Loan;

- aa) the terms of the Loan Agreement allow, at UBS' discretion, a limited trading of the Approved Securities during the term of the Protected Loan. Under this trading facility, Investors may sell and repurchase their Approved Securities (in accordance with the Loan Agreement), with any sale proceeds (after deducting any costs associated with the trade) applied on the Investor's behalf to acquire units in a cash management trust or other trust satisfying the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936 (the 'Approved Units'). The proceeds on redemption of the Approved Units may be used to repay the Protected Loan or Interest Funding Loan (if applicable), or to repurchase the Approved Securities under the trading facility; and
- bb) at maturity, the Investor may choose to extend the Protected Loan for a further period (if UBS makes this option available to the Investor) subject to UBS' consent. Any extension will not affect the mortgage over the Approved Securities.

14. The PGI will be marketed through UBS and a variety of financial intermediaries, whereby the PGI will be offered to existing clients of those intermediaries. All promotional material and the Information Memorandum will clearly state that the PGI is being offered solely by UBS, and the PGI is the UBS PGI.

The Participants

15. UBS is the provider of the Protected Loans and Interest Funding Loans (if applicable) to Investors under the PGI. UBS may also purchase a Call Option from the Investor under the Call Sale Facility. UBS Securities Australia Ltd, a related entity of UBS, will act as a broker for the Investor if they utilise the limited trading facility.

16. The Investors may be individuals, companies or trusts.

Ruling

17. Subject to paragraphs 2, 3 and 18 of this Ruling:

- a) the interest charge on the Protected Loan allowable under section 8-1 of the ITAA 1997 is the amount that does not exceed the lower of the Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans and the relevant percentage of the total interest charged by UBS under the Loan Agreement as follows:
- (i) 60% (for Protected Loans with a term of one year);
 - (ii) 72.5% (for Protected Loans with a term of two years);
 - (iii) 80% (for Protected Loans with a term of three years);
 - (iv) 82.5% (for Protected Loans with a term of four years); or
 - (v) 85% (for Protected Loans with a term of five years).

Where the interest rate charged on a Protected Loan is a variable rate the Reserve Bank Bulletin Indicator Lending Rate for Personal Unsecured Loans Variable is to be used, and where the interest rate charged is a fixed rate the Reserve Bank Bulletin Indicator Lending Rate for Personal Unsecured Loans Fixed is to be used;

- b) as the difference between the total interest charge on the Protected Loan and the deductible amount as calculated in paragraph 17(a) above, is an instalment of the premium payable for the Put Option/s, it is not deductible under section 8-1 of the ITAA 1997 and becomes part of the cost base of the Put Option under subsection 110-25(2) of the ITAA 1997;
- c) the interest charge on the Interest Funding Loan is deductible under section 8-1 of the ITAA 1997 to the same extent that a deduction is allowable for the corresponding Protected Loan interest charge (as described in paragraph 17(a) above). The non-deductible portion of the interest charge on the Interest Funding Loan represents further consideration for the payment of the premium for the Put Option referred to in paragraph 17(b) above by instalments and is included in the cost base of the Put Option under subsection 110-25(2) of the ITAA 1997;
- d) section 51AAA of the ITAA 1936 will not apply to deny an Investor a deduction of the interest charge on their Protected Loan or Interest Funding Loan (if

- applicable) allowable under section 8-1 of the ITAA 1997;
- e) section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest charge on the Protected Loan or the Interest Funding Loan (if applicable) 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 the interest charge on the Protected Loan;
 - g) section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the interest charge on the Interest Funding Loan where the interest charge is 'excluded expenditure' that is, where the deductible portion of the interest amount on the Interest Funding Loan is less than \$1,000 in a particular income year. Where this is the case, the interest charge on the Interest Funding Loan will be deductible (to the same extent that a deduction is allowable for the corresponding Protected Loan interest, as described in paragraph 17(a)) in the income year in which it is prepaid;
 - h) if the deductible portion of the interest charge on the Interest Funding Loan, as described in paragraph 13(e), is not 'excluded expenditure' and therefore not deductible in full in the income year in which it is prepaid, the deductible amount is calculated using the formula in paragraph 82KZMF(1)(b) of the ITAA 1936;
 - i) section 82KZM of the ITAA 1936 will not apply to deny the Investor immediate deductibility for the interest charge on the Protected Loan or Interest Funding Loan (if applicable) allowable under section 8-1 of the ITAA 1997 where at least one of the following applies for the year of income:
 - (i) the Investor is an STS taxpayer; or
 - (ii) the Investor is an individual taxpayer who does not incur the interest charge in carrying on a business;
 - j) sections 82KZMA, 82KZMB, 82KZMC and 82KZMD of the ITAA 1936 will apply to determine the amount and timing of deductions for the interest charge on the Protected Loan that is deductible to an Investor (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;
- k) the grant of the Call Option by the Investor to UBS under the Call Sale Facility is a CGT event which does not result in a capital gain or a capital loss;
 - l) if UBS exercises the Call Option and the Investor transfers the Approved Securities to it, CGT event A1 will occur on maturity. The Investor will make a capital gain equal to the capital proceeds received from UBS less the Investor's cost base in the Approved Securities. The proceeds received by the Investor will be equal to the Capped Amount plus the percentage that the Investor has elected to retain of the capital growth of the Approved Securities above the Capped Amount. The proceeds will be equal to the Settlement Amount;
 - m) if UBS exercises its Call Option and the Investor pays the Cash Settlement Amount and repays the Protected Loan, the Investor will be able to retain ownership of the Approved Securities. The Cash Settlement Amount will be included in the Investor's cost base of the Approved Securities under subsection 110-25(6) of the ITAA 1997; and
 - n) the anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not be applied to deny deductibility of the interest incurred by the Investor in respect of the Protected Loan or the Interest Funding Loan.

Assumptions

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

- a) the Investors are Australian residents;
- b) the Investors are not traders in investments and are not treated for taxation purposes as either trading in Approved Securities or carrying on a business of investing in Approved Securities. Further, the Investors do not otherwise hold the Approved Securities as revenue assets;
- c) interest charges paid in advance under the PGI Loan Agreement may be prepaid only in relation to a loan interest payment period of 12 months or less, and which ends on or before the last day of the income year following the expenditure year;

- d) the dominant purpose of the Investor entering into the arrangement is to derive assessable income comprising dividends or trust distributions and capital gains;
- e) the Investors will not have an intention of repaying the Protected Loan prior to maturity or terminating the arrangement early;
- f) all dealings by the Investors and UBS will be at arm's length; and
- g) the arrangement ruled on will be executed in the manner described in the 'Arrangement' section of this Ruling.

Explanation

Section 8-1 of the ITAA 1997

19. The ATO generally accepts that interest incurred to acquire shares or units in a trust that produce or may in the future produce income is deductible (Taxation Ruling TR 95/33).

20. Part of the interest charge under the Protected Loan is allocated to the consideration for the Put Option (being the 'Put Option Premium'). The Put Option Premium ensures that the borrower is protected from liability to repay the principal if the market value of a tranche of Approved Securities falls below their original purchase price. The Put Option Premium is not deductible under section 8-1.

21. Part of the interest charge under the Interest Funding Loan is also allocated to the Put Option Premium and that amount is not deductible under section 8-1.

22. Investors should only claim deductions equal to the amount of interest on the Protected Loan and the Interest Funding Loan determined as follows - the lower of the applicable Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans or the applicable interest amounts as calculated in accordance with the formula described in paragraph 17(a) above.

23. That amount of the interest charge which is not deductible to the Investor under section 8-1 forms the cost base of a Put Option and constitutes an asset for capital gains tax purposes which is separate and in addition to the other rights created under the PGI as described in this Ruling.

Section 51AAA of the ITAA 1936

24. By entering into the PGI it is contemplated that an Investor will derive assessable income by the receipt of dividend or trust income and capital gains. Accordingly, the interest would have been deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of a net capital gain in assessable income. Accordingly, section 51AAA has no application to an Investor in the PGI.

Section 82KL of the ITAA 1936

25. 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. It 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 of the ITAA 1936

26. This Subdivision 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 Investor is an 'STS taxpayer', whether the Investor is an individual, whether the Investor is not an individual and incurs the expenditure otherwise than in carrying on a business and whether the expenditure qualifies for transitional treatment. This Subdivision does not apply to 'excluded expenditure' which is defined in subsection 82KZL(1) to include amounts of less than \$1,000 or amounts of expenditure that are of a capital nature.

Subdivisions 328-F & 328-G of the ITAA 1997 - STS taxpayer

27. An Investor will be an STS taxpayer for an income year if the Investor is eligible to be an STS taxpayer for that year and the Investor notifies the Commissioner of the choice to become such a taxpayer for that year.

28. An Investor will be eligible to be an STS taxpayer for an income year if the Investor 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 that year.

The eligible service period for the purposes of Subdivision H of Division 3 of Part III of the ITAA 1936

29. The interest charge on the Protected Loan and Interest Funding Loan (if applicable) allowable under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest for a period that is 12 months or less. Paragraph 82KZL(2)(a) 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, 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, and not to the period of the loan.

Sections 82KZME and 82KZMF of the ITAA 1936: prepaid expenditure and 'tax shelter' arrangements

30. The rules in sections 82KZME and 82KZMF 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.

31. For the purposes of section 82KZME, '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 PGI, including the financing, share and/or unit purchase, share and/or unit holding and disposal arrangements.

32. Exception 1, as contained in subsection 82KZME(5), applies to exclude the interest incurred on the Protected Loan from the operation of section 82KZMF, as:

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

33. Interest on the Interest Funding Loan will not be interest on money borrowed to acquire the Approved Securities and, unlike interest on the Protected Loan, will not fall within Exception 1. Where the amount of the interest prepayment on the Interest Funding Loan is less than \$1,000, it will be 'excluded expenditure' (as defined in section 82KZL of the ITAA 1936), and Exception 3 in subsection 82KZME(7) will apply, such that the deductible amount of the interest on the Interest Funding Loan will be immediately deductible to the Investor.

34. If the deductible portion of the interest on the Interest Funding Loan is not excluded expenditure, section 82KZMF will apply to set the amount and timing of deductions. Investors will be entitled to a deduction for this interest calculated using the formula set out in paragraph 82KZMF(1)(b).

Section 82KZM of the ITAA 1936: prepaid expenditure incurred by STS taxpayers and individuals incurring non-business expenditure

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

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

36. The expenditure must not be excluded expenditure and must be incurred otherwise than in carrying on a business. Section 82KZM 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.

37. As the eligible service period in relation to the deductible interest payment for the Protected Loan 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 will have no application to Investors who are STS taxpayers for the year of income, or to Investors who are individuals and the expenditure is not incurred in carrying on a business. Investors who satisfy these tests will be able to claim an immediate deduction for the allowable interest incurred under the Protected Loan.

Sections 82KZMA - 82KZMD of the ITAA 1936: prepaid non-business expenditure incurred by non-individual and non-STS taxpayers

38. Sections 82KZMA, 82KZMB, 82KZMC and (in respect of income years after the income year including 21 September 2002) section 82KZMD set the amount and timing of deductions for expenditure for an Investor (other than an STS taxpayer for the year of income) who is an Investor that is not an individual and does not incur the expenditure in carrying on a business.

39. 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.

40. For these taxpayers, the allowable deduction for prepaid interest on the Protected Loan will be apportioned over the relevant interest payment period, subject to the transitional provisions in section 82KZMB (applying to expenditure incurred before or during the Investor's year of income that includes 21 September 2002).

41. Section 82KZMD will not apply to an Investor in respect of interest payments on the Protected Loan incurred before or during the Investor's year of income that includes 21 September 2002 as the eligible service period to which the interest payments relate will end not more than 13 months after the expenditure is incurred.

Call Sale Facility

42. Under the PGI, the Investor may, either on application or, at UBS's discretion, at any other time during the term of the PGI, use the Call Sale Facility. This involves the Investor granting to UBS a Call Option to purchase the Approved Securities on maturity. The Call Option will be exercised if the market value of the Approved Securities on maturity is equal to or greater than the Capped Amount that is chosen by the Investor.

43. The grant of the Call Option by the Investor to UBS will not result in a capital gain or loss arising for the Investor.

44. Where the Investor chooses to sell the Approved Securities to UBS, CGT event A1 will occur in relation to the disposal of the Approved Securities on maturity (section 104-10 of the ITAA 1997). Where the capital proceeds of the disposal exceed the Investor's cost base of the Approved Securities, the Investor will make a capital gain.

45. The capital proceeds the Investor receives when they sell their Approved Securities to UBS pursuant to the Call Option will be the sum of the Capped Amount and the percentage of the capital growth of the Approved Securities above the Capped Amount that the

Investor has elected to retain. That is, the proceeds will equal the Settlement Amount.

46. Alternatively, the Investor may choose to cash settle the Call Option and repay the Protected Loan, thereby retaining ownership of the Approved Securities. No CGT event will arise in respect of the Approved Securities that have been retained by the Investor in these circumstances.

47. The Cash Settlement Amount is capital expenditure made to preserve the Investor's title to the Approved Securities. It will form part of the Investor's cost base in the Approved Securities (subsection 110-25(6) of the ITAA 1997).

Section 110-25 of the ITAA 1997 - Cost Base of Put Option

48. The amount of the interest charged on the Protected Loan and the Interest Funding Loan (if applicable) which is not deductible to the Investor under section 8-1 of the ITAA 1997 forms the cost base of a Put Option (under subsection 110-25(2) of the ITAA 1997) which constitutes an asset for capital gains tax purposes that is separate and in addition to the other rights created under the PGI as described in this Ruling.

Part IVA of the ITAA 1936

49. Provided that the PGI arrangement ruled on is entered into and carried out as disclosed in this Ruling, it is accepted that the arrangement is a normal commercial transaction and Part IVA will not apply.

Detailed contents list

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Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 95/33;
TR 97/16; TD 93/34; PR 1999/95

Subject references:

- debt deductions
- financial products
- interest expenses
- prepaid expenses
- product rulings
- public rulings
- small business Investor
- taxation administration
- tax avoidance

Legislative references:

- TAA 1953 Part IVAAA
- ITAA 1936 51AAA
- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZL(2)(a)

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- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(5)
- ITAA 1936 82KZME(5)(b)(iii)
- ITAA 1936 82KZME(7)
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- ITAA 1936 82KZMF(1)(b)
- ITAA 1936 Pt IVA
- ITAA 1936 Subdiv H, Div 3, Part III
- ITAA 1997 8-1
- ITAA 1997 104-10
- ITAA 1997 110-25
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