



# ***PR 2007/68 - Income tax: tax consequences of investing in equities using the Macquarie Geared Equity Investment plus***

 This cover sheet is provided for information only. It does not form part of *PR 2007/68 - Income tax: tax consequences of investing in equities using the Macquarie Geared Equity Investment plus*

 This document has changed over time. This is a consolidated version of the ruling which was published on *27 June 2007*



## Product Ruling

### Income tax: tax consequences of investing in equities using the Macquarie Geared Equity Investment plus

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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 section apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.
2. In this Product Ruling the scheme is the grant of a Put Option and the borrowing of moneys from Macquarie Bank Limited (the Bank) to fund the acquisition of shares listed on the Australian Securities Exchange (ASX) and or units of a widely held unit trust, and or stapled securities comprising of share/s and unit/s that are jointly listed for quotation on the ASX (Approved Securities), on the terms of a lending and investment facility named the Macquarie Geared Equities Investment plus (GEI plus). A call option may also be granted by the borrower under the Shared Upside feature for a reduced rate of interest (Call Option).
3. This Ruling does not address the tax consequences of a loan advanced against an existing portfolio of shares.
4. This Ruling does not address the tax consequences of:
  - converting the GEI plus loan to a Margin Loan;
  - the Limited Trading Feature;
  - the Refinancing Feature;
  - the Protection Reset Feature;
  - the Switching Feature; and
  - the Covered Calls Feature,

which are available under the terms of the GEI plus and described in the draft Combined Product Disclosure Statement and Financial Services Guide to be dated 1 July 2007. Interest deductions under section 8-1 of the ITAA 1997 for the amount referred to in paragraph 19(a) of this Ruling are available to the Investor up to the time that the Investor uses one or more of the features listed in paragraph 4 of this Ruling.

5. The Ruling does not address an investor's entitlement to franking credits.

### Class of entities

6. The class of entities who can rely on this Product Ruling are referred to as Investors. Investors will be those entities that enter into the scheme described below between 1 July 2007 and 30 June 2010 (the period of this Product Ruling's application). 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 of deriving assessable income from their involvement as set out in the description of the scheme.

**Superannuation Industry (Supervision) Act 1993**

7. 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**

8. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 20 to 25 of this Ruling.

9. 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**

11. This Product Ruling applies prospectively from 1 July 2007. It therefore applies to the specified class of entities that enter into the scheme from 1 July 2007 until 30 June 2010, being its period of application. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

12. 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.

13. 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)).

14. 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.

15. 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**

16. 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 this Product Ruling and, to that extent, this Product Ruling will have no effect.

17. 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**

18. 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

### Application of this Ruling

19. Subject to paragraphs 3, 4, 5 and 25 of this Ruling:

- (a) An amount equal to the interest charged on the GEI plus loan and Interest Prepayment Loan (if applicable), (the Total Amount), reduced by an amount reasonably attributable to the cost of capital protection worked out under step 3 of the method statement in subsection 247-20(3), will be deductible under section 8-1.

Under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection under Division 247, in an income year, is the amount by which the Total Amount exceeds:

- where the interest rate charged by the Bank is a fixed rate for all or part of the term of the loan – loan amount multiplied by the Reserve Bank of Australia's Indicator Rate for Personal Unsecured Loans – Variable Rate (benchmark rate) at the time when the interest is paid during the term of the loan, or the relevant part of the term; and
  - where the interest charged by the Bank is a variable rate for all or part of the term of the loan – the loan amount multiplied by the average of the benchmark rates published by the Reserve Bank of Australia during the term of the loan, or the relevant part of the term.
- (b) The amount reasonably attributable to the cost of capital protection under Division 247, as worked out under paragraph 19(a) of this Ruling, is treated as the cost of the Investor's Put Option (Put Option Premium) under subsection 247-20(6). This amount is not deductible under section 8-1.
- (c) Section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny an Investor a deduction for the interest charged on the GEI plus loan and the Interest Prepayment Loan (if applicable) allowable under section 8-1 of the ITAA 1997.
- (d) Section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest allowable as a deduction under section 8-1 of the ITAA 1997 incurred under the GEI plus loan or the Interest Prepayment Loan (if applicable).

- (e) Section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the interest charge allowable as a deduction under section 8-1 of the ITAA 1997 incurred under the GEI plus loan.
- (f) Section 82KZM of the ITAA 1936 will not apply to deny the Investor immediate deductibility of any part of the interest charge on the GEI plus loan allowable under section 8-1 of the ITAA 1997, where at least one of the following applies for the year of income:
  - the Investor is an STS taxpayer; or
  - the Investor is an individual who does not incur the interest charge in carrying on a business.
- (g) Sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the interest charge on the GEI plus 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.
- (h) The Put Option Premium will be included in the first element of the cost base and reduced cost base of the Put Option under subsections 110-25(2) and 110-55(2).
- (i) If the Investor exercises the Put Option at the end of the GEI plus loan term, the Put Option Premium will be included in the second element of the cost base and the reduced cost base of the Approved Securities under item 2 in subsection 134-1(1). Any gain or loss on the exercise of the Put Option will be disregarded by virtue of subsection 134-1(4).
- (j) If the Put Option is not exercised and it expires, a CGT event C2 will happen under paragraph 104-25(1)(c). The Investor will make a capital loss equal to the reduced cost base of the Put Option under subsection 104-23(3).
- (k) The grant of the Call Option by the investor to the Bank under the Shared Upside Feature is a CGT event D2 under section 104-40 which does not result in a capital gain or a capital loss.
- (l) If the Bank exercises the Call Option granted under the Shared Upside Feature, and the Investor transfers the Approved Securities to it, CGT event A1 will happen under section 104-10. The Investor will make a capital gain equal to the capital proceeds received by the Investor from the Bank less the Investor's cost base in the Approved Securities. The proceeds received by the Investor from the Bank will be the market value of the Approved Securities less the percentage of the increase the investor has agreed to forgo. The proceeds will thus equal the Exercise Price.

- (m) If the Investor repays the GEI plus loan and sells Approved Securities to fund the repayment, CGT event A1 will happen under section 104-10. The Investor will make a capital gain on selling the Approved Securities equal to the sale proceeds less the cost base of the Approved Securities.
- (n) If, at the Maturity Date, the Investor repays the GEI plus loan but retains the ownership of the Approved Securities, the payment of the Interest Reduction Fee based on the agreed percentage of increase in value of the Approved Securities in excess of 150% of purchase price will form part of the cost base and reduced cost base of the Approved Securities under subsections 110-25(6) and 110-55(2).
- (o) The anti-avoidance provisions 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 GEI plus loan used to fund the purchase of Approved Securities or in respect of the Interest Prepayment Loan.

## Scheme

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20. The scheme that is the subject of this Ruling is described below. The scheme is incorporated in the following documents:

- application for a Product Ruling dated 22 May 2007 received from Minter Ellison Lawyers on behalf of Macquarie Bank Limited; and
- the draft GEI plus Combined Product Disclosure Statement and Financial Services Guide to be dated 1 July 2007 (PDS) which includes the GEI plus Application Form.

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

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

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

23. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

## Overview

24. Following is a summary of the scheme:

- (a) Under the GEI plus, Investors borrow funds from the Bank to finance the purchase of certain Approved Securities. The Approved Securities are shares listed on the ASX or units in certain widely held listed trusts or stapled securities. Where the Approved Security is a stapled security, the stapled security comprises share/s and unit/s that are jointly listed for quotation on the ASX.
- (b) The Investors are required to select Approved Securities up to the amount of funds borrowed from the Bank from a list of Approved Securities which is provided to the Investor when they receive the GEI plus application form. The minimum loan amount is \$50,000.
- (c) The term of the GEI plus loan may be one, two, three, four or five years. Interest is payable monthly in arrears on a variable or fixed basis. Alternatively, Investors may fix their interest rate for 1 or more years and pay interest annually in advance for a 12 month period.
- (d) The Bank will calculate a different rate of interest for each Approved Security an Investor may invest in. The interest rate will be quoted and reported to an Investor as a single consolidated rate taking into account all of the shares held. The interest rate will also depend upon the term of the GEI plus loan. The shorter the period of the GEI plus loan and the greater the risk to the Bank given the security offered by the Approved Securities, the higher the rate of interest charged.
- (e) Investors may also choose to enter into an Interest Prepayment Loan with the Bank for the purpose of funding the payment of prepaid interest on a GEI plus loan. The term of each Interest Prepayment Loan equals the term of the prepaid interest period on the GEI plus loan and is limited to 12 months. The interest rate on an Interest Prepayment Loan will be determined by the Bank at the time of drawdown of the particular Interest Prepayment Loan. The Interest Prepayment Loan is repayable by way of twelve monthly in arrears principal and interest repayments over the prepaid interest period on the GEI plus loan immediately succeeding the date the Interest Prepayment Loan is borrowed. Under the Interest Prepayment Loan there is no limitation on the recourse of the lender. Repayment of the Interest Prepayment Loan prior to its maturity date may incur break costs.

- (f) For the purpose of securing the rights of the Bank under the GEI plus, the Investor grants a mortgage to the Bank over the acquired Approved Securities and related rights.
- (g) The GEI plus Loan and Security Agreement provides for a limited recourse facility through the grant of a Put Option by the Bank to the Investor. As such, the Bank is only entitled to enforce its rights as mortgagee in relation to the principal of the GEI plus loan against the Approved Securities held as security.
- (h) The Put Option operates to give the Investor the right to transfer to the Bank the Approved Securities purchased with the GEI plus loan where the market value of those Approved Securities has fallen below the acquisition cost of those Approved Securities. The price payable by the Bank to the Investor for that transfer of Approved Securities is the amount of the GEI plus loan borrowed by the investor to purchase such Approved Securities. The Bank is entitled to set-off the payment of that price against the obligations of the Investor to repay the GEI plus loan.
- (i) The Investor is not required to pay a separate fee for the Put Option, rather a portion of the interest payable under the GEI plus loan and the Interest Prepayment Loan (if applicable) is allocated to the Put Option Premium. The Put Option Premium will be determined in accordance with paragraph 19(b) of this Ruling and will vary depending on the term of the GEI plus loan.
- (j) The GEI plus also contains a Shared Upside feature. Under this feature, the Investor grants to the Bank a Call Option to purchase the Approved Securities when the GEI plus loan matures if the value of the Approved Securities increases to an amount in excess of 150% of the original purchase price.
- (k) Investors must choose at the time of entering into the Loan and Security Agreement whether or not they will grant the Call Option under the Shared Upside feature. If an Investor selects to enter into the Call Option, they will be charged a lesser interest rate in relation to the GEI plus loan than would have been applicable if the Shared Upside feature had not been selected.
- (l) If an Investor elects to enter into the Shared Upside feature, they must also choose, prior to GEI plus loan drawdown, what percentage of increase in the value of the Approved Securities in excess of 150% of the original purchase price will be used to calculate the Exercise Price (being the amount payable on the exercise of the Call Option) or the Interest Reduction Fee. An

Investor may select 0%, 25%, 50% or 100% as the relevant percentage. The level of reduction of the interest rate in relation to the GEI plus loan will depend on the level of percentage nominated for the purposes of the Call Option - the larger the percentage, the larger the interest rate reduction on the GEI plus loan.

- (m) No fee is charged by the Investor when it grants the Call Option to the Bank.
- (n) The Exercise Price payable by the Bank to the Investor on exercise of the Call Option is calculated as:

$$I + (P \times MV)$$

where:

**I** = an amount representing 150% of the Market Value of the Relevant Securities as at the date of grant of the Call Option;

**P** = the Nominated Percentage; and

**MV** = that part of the Market Value of the Relevant Securities in excess of I as at the Exercise Date.

- (o) If upon maturity of the GEI plus loan the market price of the Approved Securities is in excess of 150% of the original purchase price, the Investor may cash settle the Call Option arrangement rather than transferring ownership of the Approved Securities to the Bank.
- (p) Where the Investor chooses to cash settle the Call Option, it must repay the GEI plus loan in full using its own funds (being either personal or borrowed funds). In these circumstances, the Investor must also pay to the Bank using its own funds the Interest Reduction Fee calculated as:

$$SG - (I + (P \times MV))$$

where:

**SG** = the Market Value of the Relevant Securities at the date that is 3 Business Days prior to the Final Maturity Date;

**I** = an amount representing 150% of the Market Value of the Relevant Securities as at the date of the Call Option;

**P** = the Nominated Percentage; and

**MV** = that part of the Market Value of the Relevant Securities in excess of I as at the Exercise Date.

- (q) The Investor shall repay the GEI plus loan to the Bank in one amount on Final Maturity Date. At least five clear Business Days before the Final Maturity Date the Investor must inform the Bank whether:
  - (i) the Investor will repay all or part of the loan on Final Maturity Date; and/or
  - (ii) the Investor intends to exercise the Put Option; and/or
  - (iii) the Investor requests the loan be converted to a Margin Loan facility; and/or
  - (iv) the Investor intends to refinance the GEI plus and extend the term of all or part of their loan.
- (r) Any dividends or distributions paid in respect of the Approved Securities purchased under the GEI plus are paid to the Investor.
- (s) Any dividends paid during the period of the GEI plus loan and reinvested as part of a Reinvestment Plan will initially form part of the security for the GEI plus loan and will be retained by the Investor at the expiry of the GEI plus loan.
- (t) Bonus shares issued will form part of the security for the GEI plus. At the expiry of the GEI plus loan, should the market value of the original shares, and any bonus shares, be below the cost of the original parcel of Approved Securities, both the original and bonus shares may be subject to the Put Option.

### **Assumptions**

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

- (a) all of the Investors are Australian residents for taxation purposes;
- (b) the Investors are not traders in investments and are not treated for taxation purposes as trading in the Approved Securities, carrying on a business of investing in the Approved Securities, or holding the Approved Securities as trading stock or as revenue assets;
- (c) in respect of any interest charges to be paid in advance under the GEI plus loan, these 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) at all times during a scheme, where the Approved Securities includes units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- (e) the dominant purpose of an Investor in entering the scheme is to derive assessable income from their Approved Securities acquired under the GEI plus, comprising dividends or trust distributions and capital gains;
- (f) the scheme will be executed in the manner described in the Scheme section of this Ruling; and
- (g) all dealings by the Investors and the Bank under the GEI plus will be at arm's length.

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**Commissioner of Taxation**

27 June 2007

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## Appendix 1 – Explanation

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

### Section 8-1 and Division 247

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

27. Division 247 applies to the GEI plus scheme as a capital protected borrowing (CPB) because the Investor uses the GEI plus loan to acquire Approved Securities (being shares listed on the ASX and or units of a widely held unit trust, and or stapled securities comprising of share/s and unit/s that are jointly listed for quotation on the ASX) and the Investor is protected against the fall in the market value of the Approved Securities through the Put Option.

28. Division 247 sets out a methodology for reasonably attributing the cost of capital protection incurred by a borrower under a CPB (section 247-20). Division 247 ignores any amount which is not in substance for capital protection or interest, in calculating the cost of capital protection (subsection 247-20(3)).

29. Under the GEI plus scheme, the amount reasonably attributable to the cost of capital protection, being the Put Option Premium, is worked out according to the method statement in subsection 247-20(3) as set out in paragraph 19(a) of this Ruling. This amount is treated as the cost of the Investor's Put Option under subsection 247-20(6).

30. For an Investor in the GEI plus scheme, the Put Option is a capital asset. As the Put Option Premium is the cost of the Investor's Put Option, this expense is capital in nature. The Total Amount (as defined in paragraph 19(a) of this Ruling will be deductible under section 8-1 only to the extent that it does not constitute the Put Option Premium).

### Section 51AAA

31. Under the GEI plus it is contemplated that over a period of an Investor's involvement there will be assessable income derived by way of dividend income or trust income as well as by way of capital gain. As the interest would have been deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of a capital gain, section 51AAA of the ITAA 1936 has no application to an Investor in the GEI plus.

## **Section 82KL**

32. The operation of section 82KL of the ITAA 1936 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. It will not apply to deny the deductions otherwise allowable under 8-1 of the ITAA 1997.

## **Subdivision H of Division 3 of Part III**

33. Subdivision H of Division 3 of Part III of the ITAA 1936 (Subdivision H) deals with the timing of deductions for certain advance expenditure incurred under an arrangement 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 and whether the Investor 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 that are of a capital nature.

## ***Subdivision 328-F and Subdivision 328-G – STS taxpayer***

34. 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.

35. 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 having depreciating assets with a total adjustable value of 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***

36. The interest charge under the GEI plus loan deductible 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) of the ITAA 1936 provides that a payment of interest that is made in return for the making available of a loan principle 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 and not to the period of the GEI plus loan.

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

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

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

39. Exception 1, as contained in subsection 82KZME(5) of the ITAA 1936, applies to exclude the amount of interest allowable as a deduction under section 8-1 of the ITAA 1997 on borrowings under the GEI plus loan from the operation of section 82KZMF of the ITAA 1936, as:

- the prepaid interest expenditure under the GEI plus loan is incurred in respect of money borrowed to acquire Approved Securities that are listed for quotation on the ASX or units in a trust as described in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- the Investor can reasonably be expected to obtain dividends or trust income from the investment;
- the Investor will not obtain any other kind of assessable income from the investment, except for capital gains; and
- all aspects of the GEI plus loan and the Interest Prepayment Loan are at arm's length.

40. Deductibility of the prepaid interest must therefore be considered under the prepayment rules obtained in paragraphs 41 to 46 of this Ruling.

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

41. 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
- is a taxpayer that is an individual and the expenditure is not incurred in carrying on a business.

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

43. As the eligible service period in relation to the deductible interest payments for the GEI plus 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 of the ITAA 1936 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 interest amount allowable as a deduction under section 8-1 of the ITAA 1997 incurred on the GEI plus.

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

44. Sections 82KZMA and 82KZMD of the ITAA 1936 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.

45. 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.

46. For these taxpayers, the amount of prepaid interest allowable as a deduction under section 8-1 incurred on the GEI plus loan will be apportioned over the relevant interest payment period.

**Put Option and Cost Base**

47. The cost of the capital protection is not deductible to the Investor under section 8-1 (refer to paragraphs 19(a), 19(b) and 28 to 30 of this Ruling) and is included in the cost base of the Put Option acquired by the Investor pursuant to subsection 110-25(2). The Put Option constitutes an asset for CGT purposes and is separate and in addition to the other rights created under the GEI plus as described in this Ruling.

48. If the Investor exercises the Put Option at the end of the GEI plus loan term by transferring title to the Approved Securities to the Bank in satisfaction of the GEI plus loan, any gain or loss on exercise of the Put Option is disregarded (subsection 134-1(4)). The Investor will add the payment for acquiring the Put Option to the cost base of the Approved Securities disposed to the Bank (subsection 134-1(1), item 2).

49. If the investor does not exercise the Put Option by the Maturity Date, the Investor will make a capital loss at that time, equal to the cost base of the Put Option (CGT Event C2, paragraph 104-25(1)(c)).

### **Shared Upside – Call Option**

50. Under the scheme the Investor grants the Bank a Call Option which may be exercised when the GEI plus loan matures if the market price of the Approved Securities is greater than 150% of the purchase price. If the Call Option is exercised, the Investor is required to transfer the Approved Securities to the Bank at the agreed Exercise Price or cash settle the Call Option obligations by paying the Interest Reduction Fee to the Bank.

51. The grant of the Call Option by the investor to the Bank will be a CGT event D2 under section 104-40 that will not result in a capital gain or loss arising for the Investor.

52. Before the Bank issues the Call Option Notice, the Investor can elect to either:

- (a) transfer ownership of the Approved Securities to the Bank; or
- (b) cash settle the Call Option obligations.

53. Where the Investor chooses to transfer ownership of the Approved Securities to the Bank, CGT event A1 will happen under section 104-10. Where the capital proceeds of the disposal exceed the cost base of the Approved Securities, the Investor will make a capital gain. The cost base for the Approved Securities will include the purchase price.

54. The capital proceeds the Investor receives when they deliver their Approved Securities will be the market value of the Approved Securities less the percentage of the increase the Investor has agreed to forgo (the Exercise Price). The percentage forgone will equate to the Interest Reduction Fee.

55. Alternatively, the Investor may choose to cash settle the Call Option and repay the GEI plus loan by:

- (a) selling the Approved Securities themselves and using these funds to repay the GEI plus loan;
- (b) not selling the Approved Securities but using their own funds to repay the GEI plus loan; or

- (c) borrowing further funds from the Bank and refinancing the original GEI plus loan.

56. If the Investor does not sell the Approved Securities, but uses their own funds or borrows to repay the GEI plus loan, or refinances the original loan, the Investor will be required to pay the Interest Reduction Fee to the Bank. This payment is capital expenditure made to preserve the Investor's title to the Approved Securities and it will form part of the Approved Securities' cost base (subsection 110-25(6)).

## Part IVA

57. 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 Part IVA of the ITAA 1936 will not apply.

## **Appendix 2 – Detailed contents list**

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 95/33

*Subject references:*

- debt deductions
- financial products
- interest expense
- prepaid expense
- tax avoidance

*Legislative references:*

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| - ITAA 1936 82KZL(1)              | - ITAA 1936 Pt IVA           |
| - ITAA 1936 82KZL(2)(a)           | - ITAA 1997 8-1              |
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