


# ***PR 2007/84 - Income tax: tax consequences of borrowing in relation to the Momentum Investor Funding Product (Post 30 June 2007)***

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## Product Ruling

# Income tax: tax consequences of borrowing in relation to the Momentum Investor Funding Product (Post 30 June 2007)

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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

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1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling part apply to the defined class of entities, who participate in the scheme to which this Product Ruling relates. The scheme in this Product Ruling involves the Loan Agreement that will be entered into between the Borrower, the Guarantor (if any) and Allco Managed Investments Limited as Trustee for the Gateway Momentum Funding Trust No. 1 (GMFT) (the Lender). All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.

### Class of entities

2. This part of the Product Ruling specifies which entities can rely on the tax outcomes set out in the Ruling section of this Product Ruling and which entities cannot rely on those tax outcomes. In this Product Ruling, those entities that can rely on the tax benefits set out in this Ruling are referred to as Borrower(s).

3. The class of entities who can rely on this Product Ruling consist of those entities:

- who execute a Loan Agreement with the Lender between 26 September 2007 and 30 June 2008;
- who will be accepted to participate in a primary production business that has a Product Ruling issued under Division 358 of Schedule 1 of the *Taxation Administration Act 1953* (the Project);
- who will execute the relevant agreements of the Project on or before the last day participants can be accepted into the Project as set out in that Project's Product Ruling but no later than 30 June 2008;
- will have a purpose of staying in the Project until it is completed (that is being a party to the relevant agreements until their term expires); and
- who intend to derive assessable income from their involvement in the Project.

4. The class of entities who can rely on the tax outcomes set out in the Ruling section of this Product Ruling does not include entities:

- who are not Australian residents for taxation purposes;
- who enter into a loan agreement with the Lender that differs materially from the Loan Agreement provided to the Tax Office with the application for this Product Ruling and described below;

- who executed a Loan Agreement prior to 26 September 2007;
- who are accepted to participate in the Project on or after 1 July 2008; and
- who are accepted to participate in a Project whose Product Ruling has been withdrawn.

### **Superannuation Industry (Supervision) Act 1993**

5. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product Ruling as to whether investment in this product may contravene the provisions of SISA 1993.

### **Qualifications**

6. The class of entities defined in this Product Ruling may rely on it provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 24 to 44 of this Ruling.

7. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then:

- this Product Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Product Ruling may be withdrawn or modified.

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## Date of effect

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9. This Product Ruling applies prospectively from 26 September 2007, the date this Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 26 September 2007 until the last day that participants may be accepted into the Project but no later than 30 June 2008, being its period of application. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities for the income years up to 30 June 2010.

10. However, the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

11. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

12. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

13. 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

14. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of the Ruling and, to that extent, this Product Ruling will have no effect.

15. 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**

16. 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**

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17. Subject to the stated qualifications, this part of the Product Ruling sets out the tax outcomes for a Borrower in the defined class of entities who enters into the scheme described at paragraphs 24 to 44 of this Ruling for the income years up to 30 June 2010.

**Small business concessions**

18. From the 2007-08 income year, a range of concessions previously available under the Simplified Tax System (STS), will be available to an entity if it carries on a business and satisfies the \$2 million aggregated turnover test (a 'small business entity').

19. A small business entity can choose the concessions that best suit its needs. Eligibility for some small business concessions is also dependent on satisfying some additional conditions. Accordingly application of the small business concessions to Growers who qualify as a 'small business entity' is not able to be dealt with in this Ruling.

**Interest and borrowing costs****Section 8-1**

20. Interest paid to the Lender is deductible under section 8-1 in the year in which it is incurred. The deductibility or otherwise of interest arising from agreements entered into with financiers other than the Lender is outside the scope of this Ruling.

**Section 25-25**

21. The loan establishment fee and any costs payable in relation to the stamping and registration of the loan are deductible under section 25-25. They are incurred for borrowing money that is used or is to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than the Lender is outside the scope of this Ruling.

## **Sections 82KZME and 82KZMF**

22. Expenditure by the Borrower does not fall within the scope of sections 82KZME and 82KZMF of the *Income Tax Assessment Act 1936* (ITAA 1936) (see paragraphs 52 to 55 of this Ruling).

## **Anti-avoidance provisions**

### **Section 82KL and Part IVA**

23. For a Borrower who incurs expenditure as required by the Loan Agreement, the following provisions of the ITAA 1936 have application as indicated:

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the anti-avoidance provisions contained in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

## **Scheme**

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24. The scheme that is the subject of this Product Ruling is described below. The scheme is incorporated within the following documents:

- Application for a Product Ruling received on 16 November 2006 which includes additional documents and information provided on 24 and 25 January and 14 February 2007 and 13 and 16 March 2007 and 22 June 2007;
- Draft **Finance Application (including the Loan Agreement)** between GMFT and a Borrower, received 22 June 2007; and
- Draft **Schedule of Projects and Loan Details** between GMFT and a Borrower, received 16 March 2007.

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

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

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

### **Overview**

27. The Momentum Investor Funding Product provides an independent source of finance to participants of a Project, being a primary production business that has a Product Ruling issued by the Tax Office.

28. This Ruling only applies to Borrowers who are accepted to participate in a Project between 26 September 2007 and 30 June 2008. The funds borrowed from the Lender will be made available to the Responsible Entity of that Project on or before the date the Borrower is accepted into that Project.

### **The Loan Agreement**

29. The Borrower will enter into a loan agreement with GMFT and will have the following features.

30. The loan amounts must be used for the purpose of funding the Borrower's participation in a Project and that Project must have a Product Ruling (Part B, Form 1 of the Finance Application).

31. Loans may be either principal and interest repayments or interest only followed by principal and interest repayments (Part B, Form 2).

32. The initial loan amount will include an amount for the Establishment Fee payable to the Lender (clause 2.1), and will be paid directly to the Project's Responsible Entity, less the amount of Establishment Fee (clause 2.3).

33. Further loan amounts as set out in item 10 of the Loan Details may also be borrowed but only if the Borrower's loan is not in default (clause 2.2(b)(ii)) and credit references for the Borrower and each Borrower's Guarantor and any other documents and information are satisfactory to the Lender (clause 2.2(b)(iii)). The further loan amount is paid directly to the Project's Responsible Entity (clause 2.4).

34. Interest is payable on the loans at either:

- an agreed initial interest rate for the initial loan amount (clause 3.1(a));
- an applicable further interest rate for further loan amounts (clause 3.1(b)); or
- a default interest rate for amounts due and payable but remaining unpaid (clause 3.1(c)).

35. Repayment of the loans is by monthly instalments (clause 4.1) and must be paid by direct debit (clause 4.2).

36. The Loan for an individual Borrower will be secured by a security interest over the interest in the Project. The loan for a corporate Borrower will be secured by an ASIC registered charge over the interest in the Project (clauses 6.1, 6.2 and 6.3). The Borrower must obtain consent from the Lender to assign, transfer or grant any interest in the Project (clause 6.4).
37. Where insurance cover is available the Borrower must insure its interest in the Project and any proceeds from the insurance must be paid to the Lender or as the Lender directs (clause 6.5).
38. Clause 7.1 sets out the circumstances that a Borrower may be in default while clause 7.2 sets out the options available to the Lender.
39. The following fees are also payable in respect of the loan:
- the loan Establishment Fee of \$250 plus 0.5% of the loan amount (Part B, Form 1 of the Finance Application);
  - an early repayment fee of \$400 which may be imposed at the discretion of the Lender (clause 4.3);
  - an amount equal to any Government charges, taxes, fees or duties (including penalties in stamping and registering the loan agreement or the security (clause 5.1)); and
  - any cost to the Lender in connection with enforcing their rights under the loan agreement or the security interest and a fee for any re-payments dishonoured (clause 5.2).

## **Schedule of Projects and Loan Details**

40. The Schedule of Projects and Loan Details sets out options for the length of the loan term, amount of deposit, balance of loan required and the applicable interest rate. Guidance notes are to assist Borrowers. The Lender will only provide Loans to Borrowers where the loan term, amount of deposit, balance of loan required and applicable interest rate fall within these guidance notes.
41. Included in the guidance notes is advice to Borrowers that:
- the interest rates are commercial and in line with the interest rate used by a preferred financier of the Project that is independent of the Project Promoter;
  - the term of the loan will be less than 80% of the term of the Project or 15 years, whichever is lesser; and
  - principal and interest is required to be repaid over the term of the loan in equal monthly principal and interest repayments, unless there is an interest-only period. Any interest-only period will be restricted to the lesser of 20% of the term of the Project up to a maximum of 3 years.

42. The Borrower at the time the initial loan application is made can apply for further loan amounts to meet future fees of the Project when they fall due. While there may be multiple drawdowns, the loan will be treated as a single loan. This means that the maximum loan term will be the lesser of 80% of the term of the Project or 15 years from the first drawdown. Any interest only period will be restricted to 20% of the term of the Project with a maximum period of 3 years from the first drawdown.

43. Only the finance arrangement set out above is covered by this Product Ruling. A Borrower cannot rely on this Product Ruling if they prepay interest or enter into a finance arrangement with the Lender that materially differs from that set out in the documentation provided to the Tax Office with the application for this Product Ruling. A Borrower who prepays interest or enters into a finance arrangement with the Lender that is materially different may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements and is not covered by this Product Ruling.

44. This Ruling does not apply if the finance arrangement entered into by the Borrower includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the Borrower's risk;
- additional benefits are or will be granted to the borrowers for the purpose of section 82KL of the ITAA 1936 or the funding arrangements transform the Project into a scheme to which Part IVA of the ITAA 1936 may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the Lender or any associate of the Lender; or
- the Lender does not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting Borrower.

## Appendix 1 – Explanation

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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.*

### **Is the Borrower carrying on a business?**

45. For the interest payable and loan establishment fees to constitute allowable deductions the Borrower's activities as a participant in a Project must amount to the carrying on of a business of primary production.

46. Two Taxation Rulings are relevant in determining whether a participant in a Project will be carrying on of a business of primary production.

47. The general indicators used by the Courts are set out in Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production?

48. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as a Project. As Taxation Ruling TR 2000/8 sets out, the relevant principles have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

### **Interest**

#### **Section 8-1**

49. Interest incurred on a borrowing used to carry on a business is generally treated as deductible under section 8-1 where it is expected that assessable income would be derived from that activity (see Taxation Ruling TR 95/33).

50. The interest incurred by a Borrower in relation to monies borrowed from GMFT under the Momentum Investor Funding Product will be deductible under section 8-1.

### **Loan Establishment Fee**

#### **Section 25-25**

51. The Loan Establishment Fee, if applicable, incurred by a Borrower upon successful application for a Project loan will be an allowable deduction pursuant to section 25-25. The Loan Establishment Fee will be deductible on a straight line basis over the shorter of:

- the term of the Project loan; or
- five years.

**Prepayment provisions*****Sections 82KZL to 82KZMF***

52. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (for example, the provision of finance) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of finance to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

53. For this Product Ruling, the only prepayment provisions that are relevant are section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME and 82KZMF of the ITAA 1936 (operative provisions).

***Application of the prepayment provisions to this scheme***

54. Under the scheme to which this Product Ruling applies interest payable to GMFT is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this scheme.

55. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Borrower in this scheme prepays interest under the loan agreement.

56. As noted in the Scheme section at paragraph 43 of this Ruling, Borrowers who prepay interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this scheme.

**Section 82KL – recouped expenditure**

57. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of ‘additional benefits(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 deduction otherwise allowable under section 8-1 of the ITAA 1997.

**Part IVA – general tax avoidance provisions**

58. For Part IVA of the ITAA 1936 to apply there must be a ‘scheme’ (section 177A), a ‘tax benefit’ (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

59. Projects entered into by the Borrower which are funded by loans with the Lender will be schemes and a Borrower will obtain a tax benefit from entering into such schemes, in the form of tax deductions detailed in each Ruling and the tax deductions detailed in paragraphs 20 and 21 of this Ruling. Tax deductions that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

60. Borrowers to whom this Ruling applies intend to stay in their Project for its full term and derive assessable income from the business activities. There are no facts that would suggest that Borrowers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) of the ITAA 1936 it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

**Appendix 2 – Detailed contents list**

61. 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; TR 97/11; TR 98/22;  
TR 2000/8

*Subject references:*

- carrying on a business
- deductions and expenses
- financial products
- interest expenses
- producing assessable income
- product rulings
- tax benefits under tax avoidance schemes
- taxation administration

- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 8-1
- ITAA 1997 25-25
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- TAA 1953 Sch 1 Div 358
- SISA 1993
- Copyright Act 1968

*Legislative references:*

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA

*Case references:*

- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

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ATO references

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