

PR 2008/40 - Income tax: tax consequences of investing in ABN AMRO Self Funding Instalment Warrants TL3SZZ Series 2006 Product Disclosure Statement - cash applicants and secondary market purchasers

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Product Ruling

Income tax: tax consequences of investing in ABN AMRO Self Funding Instalment Warrants TL3SZZ Series 2006 Product Disclosure Statement – cash applicants and secondary market purchasers

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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 Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.
2. In this Ruling the scheme is the acquisition of an ABN AMRO Self Funding Instalment Warrant TL3SZZ Series (TL3SZZ Self Funding Instalment(s)) under the 2006 Product Disclosure Statement, which provides an investment in shares in Telstra Corporation Limited (Shares) under the Telstra 3 Share Offer by way of Instalment Receipt(s) (which are listed for quotation on the Australian Securities Exchange (ASX)), and a put option (Holder's Put Option) using in part a loan made by ABN AMRO Australia Pty Limited (ABN AMRO).
3. This Ruling does not address the tax consequences for:
 - (a) Shareholder Applicants and Instalment Receipt Holder Applicants; and
 - (b) Rollover Applicants.

Class of entities

4. The class of entities who can rely on this Product Ruling consists of those entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is published, either through Cash Applications or secondary market purchases on the ASX and which execute relevant agreements mentioned in paragraph 18 of this Ruling on or before 30 June 2017. 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. These entities are referred to as 'Holders'.

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 18 to 25 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

9. This Product Ruling applies prospectively from 30 April 2008, the date this Ruling is published. It therefore applies to the specified class of entities that enter into the scheme from 30 April 2008 until 30 June 2011, 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. 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. Furthermore, 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

17. Subject to paragraphs 3 and 25 of this Ruling:

- (a) an amount equal to the Interest Amount and Capital Protection Fee incurred on the Loan Agreement in an income year (the Total Amount), reduced by
- an amount reasonably attributable to the cost of capital protection (if any) worked out under step 3 of the method statement in subsection 247-20(3) of the *Income Tax Assessment Act 1997* (ITAA 1997); and
 - the Capital Protection Fee,
- will be deductible under section 8-1 of the ITAA 1997;

- (b) Under subsection 247-20(3) of the ITAA 1997, the amount reasonably attributable to the cost of capital protection under Division 247 of the ITAA 1997, in an income year, is the amount by which the Total Amount exceeds an amount representing the interest that would have been incurred for the income year on the Loan if the following interest rates applied:
- where the interest rate incurred on the Loan is at a fixed rate for all or part of the term of the Loan – the relevant rate is the Reserve Bank of Australia's Indicator Rate for Personal Unsecured Loans – Variable Rate (benchmark rate) at the time when the first of the amounts included in the Total Amount is incurred during the term of the Loan, or the relevant part of the term of the Loan; and
 - where the interest rate incurred on the Loan is at a variable rate for all or part of the term of the Loan – the relevant rate is 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 of the Loan;
- (c) the amount reasonably attributable to the cost of capital protection under Division 247 of the ITAA 1997, as worked out under subparagraph 17(b) of this Ruling, to the extent that it exceeds the Capital Protection Fee (Additional Amount), constitutes a further cost of the Holder's Put Option under subsection 247-20(6) of the ITAA 1997. The Capital Protection Fee and the Additional Amount, if any, is not deductible under section 8-1 of the ITAA 1997;
- (d) section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny a Holder a deduction for the Interest Amount 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 Amount 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 Amount allowable under section 8-1 of the ITAA 1997 incurred by the Holder under the TL3SZZ Self Funding Instalments;

- (g) section 82KZM of the ITAA 1936 will not apply to deny immediate deductibility for the Interest Amount allowable under section 8-1 of the ITAA 1997 incurred by the Holder under the TL3SZZ Self Funding Instalments where at least one of the following applies for the year of income:
- the Holder is a small business entity as defined in subsection 328-110(1) of the ITAA 1997; or
 - the Holder is an individual who does not incur that expenditure in carrying on a business;
- (h) section 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the Interest Amount incurred under the TL3SZZ Self Funding Instalments that is deductible under section 8-1 of the ITAA 1997 to a Holder (other than a small business entity for the year of income) who is a taxpayer that is not an individual and does not carry on a business;
- (i) the Borrowing Fees, if any, will be deductible to the Holder under section 25-25 of the ITAA 1997;
- (j) the Capital Protection Fee together with the Additional Amount, if any, as described in subparagraph 17(c) of this Ruling will form part of the cost base or the reduced cost base of the Holder's Share(s) under section 134-1 of the ITAA 1997 if the Holder's Put Option is exercised. Any capital gain or capital loss upon the exercise of the Holder's Put Option will be disregarded by virtue of subsection 134-1(4);
- (k) the Capital Protection Fee together with the Additional Amount, if any, will form part of the reduced cost base (under section 110-55 of the ITAA 1997) of the Holder's Put Option if the Holder's Put Option is not exercised;
- (l) for capital gains tax (CGT) purposes the date of acquisition of the Instalment Receipt(s) or Share(s), in the case of a Cash Applicant, is the date of acceptance of the Cash Application, or in the case of a Secondary Market purchaser is the contract date for transfer of the TL3SZZ Self Funding Instalment;
- (m) no CGT event arises when the legal title to the Share(s) is transferred by the Security Trustee to the Holder on completion of the TL3SZZ Self Funding Instalment pursuant to subsection 104-10(7) of the ITAA 1997;

- (n) CGT event A1 will occur under section 104-10 of the ITAA 1997 to the Holder where the Instalment Payment is not made, where the Holder exercises the Put Option or does nothing at the Expiry Date, and the Share(s) is sold by the Trustee exercising its power of sale under the Security Interest. If the sale proceeds are insufficient to repay amounts outstanding under the Loan, ABN AMRO has no recourse against the Holder to recover the Loan shortfall. In these circumstances, the Holder will need to reduce the cost base of the Share(s) by the amount of the Loan shortfall under subsection 110-45(3) of the ITAA 1997;
- (o) any capital gain realised by a Holder on the sale of the Share(s) received pursuant to completion of the TL3SZZ Self Funding Instalment, will be treated as a discount capital gain under section 115-5 of the ITAA 1997 where the Holder is an individual, a complying superannuation entity, or a trust and has held the TL3SZZ Self Funding Instalment for at least 12 months;
- (p) CGT event C2 will occur under section 104-25 of the ITAA 1997 on the Expiry Date if the Holder's Put Option is not exercised or lapses. The capital proceeds received will be nil and the Holder will make a capital loss equal to the reduced cost base of the Holder's Put Option;
- (q) only the Holders in TL3SZZ Self Funding Instalment (and not the Security Trustee) are assessable under section 97 of the ITAA 1936 on all of the income derived from the Instalment Receipt(s) or Share(s) while the Instalment Receipt(s) or Share(s) is the subject of the separate trust, including dividends and any Refund Amount (Accretions) which are applied in the reduction of the Loan Amount; and
- (r) the anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to deny the deductibility of the interest incurred by the Holder in respect of the TL3SZZ Self Funding Instalments.

Scheme

18. The scheme that is the subject of this Ruling is described below. The description incorporates the following documents:

- application for a Product Ruling dated 19 November 2006 received from Baker & McKenzie on behalf of ABN AMRO;

- draft combined Product Disclosure Statement (the PDS), dated 20 November 2006, comprising draft Part 1 of the PDS and draft Part 2 of the PDS;
- Trust Deed for ABN AMRO Self Funding Instalment Warrants incorporated in the PDS (the Instalment Deed) to be executed by ABN AMRO (the Issuer) and ABNED Nominees Pty Limited (as Security Trustee); and
- additional information provided on 15 January 2007.

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

Overview

20. Following is a summary of the scheme.

21. On acquiring a TL3SZZ Self Funding Instalment, the Holder obtains a limited recourse loan (Loan) and acquires an interest in an Instalment Receipt which includes an interest over a Telstra Share (Share), and any Accretions in respect of the Instalment Receipt (or Telstra Share, when applicable), and a Holders Put Option.

22. The Holder appoints ABNED Nominees Pty Limited to act as its Nominee on the terms of the Instalment Deed.

23. A TL3SZZ Self Funding Instalment involves the payment of two instalments: an initial payment (First Payment) and then the optional Instalment Payment at the end of the Investment Term.

24. The details of the scheme the subject of this Ruling are summarised as follows:

- (a) there are several ways of investing in TL3SZZ Self Funding Instalments. The two ways covered in this Ruling are purchasing TL3SZZ Self Funding Instalments by Cash Application or on the ASX;
- (b) a Cash Applicant pays the First Payment and draws down the Loan made by ABN AMRO. The First Payment and the Loan Amount are applied towards the purchase of the Instalment Receipt(s), payment of the Interest Amount, payment of the Holder's Put Option (comprising the Capital Protection Fee and the Additional Amount, if any, worked out under Division 247 of the ITAA 1997) and Borrowing Fees (if any);
- (c) ABN AMRO purchases the Instalment Receipt(s) in the name of the Security Trustee for the benefit of the Cash Applicant and takes a security interest over the Instalment Receipt(s). ABN AMRO grants the Cash Applicant a Holder's Put Option which lasts for the life of the TL3SZZ Self Funding Instalment. The TL3SZZ Self Funding Instalment is issued in the name of the Cash Applicant;

- (d) the amount of the Loan provided to fund the purchase of each Instalment Receipt(s) will be fixed by ABN AMRO on acceptance of an Application;
- (e) repayment of the Loan will be secured by a mortgage over the Instalment Receipt(s). The Instalment Receipt(s) will be held by the Security Trustee on trust for the Holder. Each trust and each Instalment Receipt(s) to which it relates will be kept as a separate trust and there will be no pooling of interests or property to which the trust relates;
- (f) the Loan is made on a limited recourse basis. ABN AMRO's ability to recover the Loan Amount from the Holder is limited to the amount received by ABN AMRO either:
 - (i) if the Holder's Put Option is exercised by the Holder - the amount payable to the Holder under the Holder's Put Option; or
 - (ii) if the Holder's Put Option is not exercised by the Holder - the amount recoverable by ABN AMRO on the enforcement of its rights in respect of the Mortgaged Property;
- (g) the Loan Amount is reduced during the term of the TL3SZZ Self Funding Instalment by the amount of any cash dividends in respect of the Instalment Receipt(s) or Share(s) traded ex-entitlement;
- (h) where a dividend has an ex-entitlement date during an Interest Period, ABN AMRO will pay to the Security Trustee the portion of the prepaid Interest Amount that is referable to the amount of the dividend for the period from and including the ex-entitlement date until and including the next Annual Interest Date or Expiry Date, as applicable. The Holder directs the Security Trustee and ABN AMRO to apply the Refund Amount to reduce the Loan Amount;
- (i) interest on the Loan is payable on Cash Application and on each Annual Interest Date by way of automatic Annual Interest Drawdown. Interest is payable annually in advance for the period to the next Annual Interest Date or Expiry date, as applicable (the Interest Amount);
- (j) the Borrowing Fee is an amount that may be charged by ABN AMRO for making the Loan;
- (k) the Capital Protection Fee and the Additional Amount (if any) is an amount charged by ABN AMRO for providing the Holder's Put Option;

- (l) where the TL3SZZ Self Funding Instalments are purchased on the ASX, the purchaser acquires the TL3SZZ Self Funding Instalments on the same terms and conditions under which they were originally issued. In particular, the Secondary Market Purchaser will be offered and will accept a new Loan from ABN AMRO upon the transfer of the TL3SZZ Self Funding Instalments from the previous owner to the Secondary Market Purchaser. The Loan provided by ABN AMRO will be equal to the previous owner's Loan and will be applied to discharge the previous owner's Loan, refund part of the interest prepaid by the previous owner and to prepay the Interest Amount on the newly acquired Loan;
- (m) the term of the TL3SZZ Self Funding Instalments is up to 10 years; and
- (n) at the Expiry Date, the Holder has four options:
 - (i) make the Instalment Payment:

Holders can obtain the Telstra Share(s) by making the Instalment Payment. The Instalment Payment is equal to the Loan Amount.

When the Instalment Payment is made, the Loan is repaid, the security interest is discharged and the Telstra Share(s) is delivered to the Holder;
 - (ii) rollover the Instalment Warrant:

The Holder has the ability to facilitate the payment of the Instalment Payment by rolling his or her ABN AMRO TL3SZZ Self Funding Instalment into a new series of ABN AMRO instalments, if available;
 - (iii) exercise the Holder's Put Option:

ABN AMRO must purchase the Telstra Share(s) for the greater of the Loan Amount or the market value. The proceeds are applied to repay the Loan and the security interest is released; or
 - (iv) do nothing:

If the Instalment Payment is not made and the Holder's Put Option is not exercised ABN AMRO will sell the Telstra Share(s) and any proceeds after repayment of the Loan and other costs, will be paid to the Holder.

Assumptions

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

- (a) the Holders are Australian residents for taxation purposes;
- (b) the Holders are not traders in investments and are not treated for taxation purposes as trading in the Instalment Receipt(s) or Share(s), carrying on a business of investing in the Instalment Receipt(s) or Share(s), or holding the Instalment Receipt(s) or Share(s) as trading stock or as a revenue asset;
- (c) in respect of any interest charges to be paid in advance, these may be prepaid, but only in relation to loan interest payment periods of 12 months or less that end on or before the last day of the income year following the expenditure year;
- (d) the dominant purpose of a Holder in entering the scheme is to derive assessable income from their investment in the ABN AMRO TL3SZZ Self Funding Instalments;
- (e) the scheme will be executed in the manner described in the 'Scheme' section of this Ruling;
- (f) all dealings between the Holders and ABN AMRO will be at arm's length; and
- (g) the Instalment Receipt(s) or Share(s) will not be the subject of any securities lending arrangement entered into by or on behalf of the Holder.

Commissioner of Taxation30 April 2008

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. The interest paid on a borrowing used to acquire income producing assets is generally treated as deductible under section 8-1 of the ITAA 1997 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 of the ITAA 1997 applies to a TL3SZZ Self Funding Instalment as it is a capital protected borrowing, because the Holder uses the Loan to acquire an Instalment Receipt(s) that are listed for quotation on the ASX, and the Holder is wholly or partly protected against a fall in the market value of the Instalment Receipt(s) for the purposes of section 247-10 of the ITAA 1997.

28. Division 247 of the ITAA 1997 sets out a methodology for reasonably attributing the cost of capital protection incurred by a borrower under a capital protected borrowing (section 247-20 of the ITAA 1997). Division 247 ignores any amount (such as any Borrowing Fee) which is not in substance for capital protection or interest, in calculating the cost of capital protection (subsection 247-20(3) of the ITAA 1997).

29. Where a Holder enters into the arrangement as described in the Scheme section of this Ruling, the amount reasonably attributable to the cost of capital protection is worked out under the method statement in subsection 247-20(3) of the ITAA 1997, as set out in subparagraph 17(b) of this Ruling.

30. In calculating the total cost of a Holder's Put Option, the amount reasonably attributable to capital protection under subsection 247-20(3) of the ITAA 1997, will be reduced by any actual payment for the Holder's Put Option (the Capital Protection Fee) in accordance with subsection 247-20(6) of the ITAA 1997. That reduced amount (Additional Amount) constitutes a further cost of capital protection in addition to the Capital Protection Fee for the Holder's Put Option.

31. Where the amount reasonably attributable to capital protection under Division 247 of the ITAA 1997 is less than the amount of the Capital Protection Fee for a Holder's Put Option, the amount worked out under subsection 247-20(6) of the ITAA 1997 will be nil. In such a circumstance, the cost of capital protection will be the amount of the Capital Protection Fee.

32. For a Holder of a TL3SZZ Self Funding Instalment, the Holder's Put Option is a capital asset. As the cost of capital protection is the cost of the Holder's Put Option, this expense is capital in nature. The Interest Amount in a year of income will be deductible under section 8-1 of the ITAA 1997 only to the extent that it is not for the cost of capital protection.

Section 51AAA

33. By acquiring TL3SZZ Self Funding Instalments, it is contemplated that a Holder will derive assessable income by the receipt of dividend income and capital gains. As the Interest Amount, to the extent that it is not reasonably attributable to the cost of capital protection, will be deductible under section 8-1 of the ITAA 1997, notwithstanding the inclusion of a net capital gain in assessable income, section 51AAA of the ITAA 1936 has no application to a Holder acquiring TL3SZZ Self Funding Instalments.

Section 82KL

34. 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. Section 82KL of the ITAA 1936 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

35. Subdivision H of Division 3 of Part III of the ITAA 1936 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 Holder is a 'small business entity', whether the Holder is an individual and whether the Holder 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 of expenditure that are of a capital nature.

Subdivision 328-C – small business entities

36. Under Subdivision 328-C of the ITAA 1997, a Holder will be a small business entity for an income year if the Holder carries on a business and either:

- the Holder carried on a business in the previous income year and the Holder's aggregated turnover for the previous year was less than \$2 million; or
- the Holder's aggregated turnover in the current income year is likely to be less than \$2 million.

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

37. The interest allowable under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest for a period that is not more than 12 months. 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 principal 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, which is 12 months or less, and not to the period of the loan.

Sections 82KZME and 82KZMF – prepaid expenditure and 'tax shelter' arrangements

38. 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' arrangement for the doing of a thing that is not to be wholly done within the expenditure year.

39. 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 TL3SZZ Self Funding Instalments including the financing, share purchase, shareholding and disposal arrangements.

40. Under the scheme, when the Holder acquires a TL3SZZ Self Funding Instalment, they acquire beneficial ownership of the Instalment Receipt which evidences beneficial interest in a Telstra share.

41. Exception 1, as contained in subsection 82KZME(5), applies to exclude the interest incurred on borrowings under the TL3SZZ Self Funding Instalment from the operation of section 82KZMF, as:

- the prepaid interest expenditure under the TL3SZZ Self Funding Instalment is incurred in respect of money borrowed to acquire shares that are listed for quotation on the ASX;
- the Holder can reasonably be expected to obtain dividends or trust income from the investment;
- the Holder will not obtain any other kind of assessable income from the investment, except for capital gains; and
- all aspects of the TL3SZZ Self Funding Instalments are at arm's length.

Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 42 to 47 of this Ruling.

Section 82KZM – prepaid expenditure incurred by small business entities and individuals incurring non-business expenditure

42. 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:

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

43. 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.

44. As the eligible service period in relation to the deductible interest for the TL3SZZ Self Funding Instalment 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 Holders who are small business entities for the year of income, or to Holders who are individuals and the expenditure is not incurred in carrying on a business. Holders who satisfy these tests will be able to claim an immediate deduction for the interest allowable under section 8-1 of the ITAA 1997.

Sections 82KZMA and 82KZMD – prepaid non-business expenditure incurred by non-individual and non-small business entities

45. Section 82KZMA and 82KZMD of the ITAA 1936 set the amount and timing of deductions for expenditure for a Holder (other than a small business entity for the year of income) that is not an individual and does not incur the expenditure in carrying on a business.

46. 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.

47. For these Holders, the deduction for prepaid interest on the TL3SZZ Self Funding Instalments will be apportioned over the relevant interest payment period.

Section 25-25 – Borrowing Fees

48. The Borrowing Fee may be charged at the discretion of the Issuer. No part of the Borrowing Fee, if incurred, is a payment for the purchase of a Holder's Put Option. The Borrowing Fee will be an allowable deduction pursuant to section 25-25 of the ITAA 1997. The Borrowing Fee, if incurred, will be deductible on a straight line basis over the period of the shorter of:

- the period of the loan as specified in the original loan contract;
- the period starting on the first day on which the money was borrowed and ending on the day the loan is repaid; or
- five years.

Capital Protection Fee

49. The Capital Protection Fee together with the Additional Amount, if any, as described in subparagraph 17(c) of this Ruling, is the amount charged for the purchase of the Holder's Put Option. The payment in effect ensures that the borrower (Holder) is protected from liability to repay the principal if the market value of the Instalment Receipt(s) falls below the original purchase price. In effect, the Holder's Put Option ensures that ABN AMRO will acquire the Instalment Receipt(s) in full satisfaction of the Loan Amount if the Instalment Receipt(s) has fallen in value below the amount borrowed.

50. The Capital Protection Fee together with the Additional Amount, if any, is not deductible as it is incurred for a purpose other than to service or maintain the borrowed funds. The fee is capital in nature, being paid to acquire an asset, namely, the Holder's Put Option.

Sections 110-25, 112-35 and 134-1 of – Cost Base of the Holder's Put Option

51. The Capital Protection Fee together with the Additional Amount, if any, forms the cost base or the reduced cost base of the Share(s) under section 134-1 of the ITAA 1997 if the Holder's Put Option is exercised. Any capital gain or capital loss upon the exercise of the Holder's Put Option will be disregarded by virtue of subsection 134-1(4) of the ITAA 1997.

52. The Capital Protection Fee together with the Additional Amount, if any, forms part of the reduced cost base (under section 110-55 of the ITAA 1997) of the Holder's Put Option if the Holder's Put Option is not exercised. Where the Holder's Put Option is not exercised, CGT Event C2 will arise (paragraph 104-25(1)(c) of the ITAA 1997). The capital proceeds on the lapsing Holder's Put Option will be nil, therefore the capital loss will be equal to the reduced cost base of the Holder's Put Option.

Section 109-5 – time of acquisition

53. Section 109-5 applies to Holders to treat them as having acquired the Instalment Receipt(s) or Share(s) at the acquisition time. The acquisition time for a Cash Applicant, is the time the application was accepted, and for a Secondary Market Purchaser, is the contract date for the transfer of the TL3SZZ Self Funding Instalment.

Subsection 104-10(7) – no CGT event when Instalment Payment made

54. When the Instalment Payment is made, no CGT event will arise in respect of the transfer of the legal title to the Share(s) from the Security Trustee to the Holder by virtue of subsection 104-10(7) of the ITAA 1997.

Section 104-10 and subsection 110-45(3) – CGT event A1

55. CGT event A1 will arise to the Holder if the Holder does not make the Instalment Payment, where the Holder exercises the Put Option or does nothing at the Expiry Date, and the Share(s) is sold by the Trustee exercising its power of sale under the Security Interest. If the sale proceeds are insufficient to repay amounts outstanding under the Loan, ABN AMRO has no recourse against the Holder to recover the Loan shortfall. In this circumstance the Holder will need to reduce the cost base of the Share(s) by the amount of the Loan shortfall under subsection 110-45(3) of the ITAA 1997.

Section 115-5 – discount capital gains

56. Division 115 of the ITAA 1997 allows a taxpayer a discount on capital gains in certain circumstances. In accordance with section 115-5 of the ITAA 1997, any capital gain realised by a Holder on the sale of the Share(s) received pursuant to the completion of a TL3SZZ Self Funding Instalment will be treated as a discount capital gain where the Holder is an individual, a complying superannuation entity, or a trust and has held the TL3SZZ Self Funding Instalment for at least 12 months.

Section 104-25 – CGT event C2

57. Where, at the Expiry Date, the Holder makes the Completion Payment, the Put Option will expire. The expiration of the Put Option gives rise to CGT event C2 under paragraph 104-25(1)(c) of the ITAA 1997. The capital proceeds received on the expiry of the Put Option will be nil. The Holder will make a capital loss equal to the reduced cost base of the Holder's Put Option.

Section 97 – present entitlement

58. The Holder is presently entitled to all of the income derived from the Instalment Receipt(s) including dividends and the Refund Amount (Accretions) which represent a distribution applied to reduce the Loan. Therefore, section 97 of the ITAA 1936 will apply to assess the Holder on the income derived from the Instalment Receipt(s) and Share(s). The Security Trustee will not be subject to tax on this income.

Part IVA

59. Provided that the scheme ruled on is entered into and carried out as described (see the Scheme section of this Ruling), it is accepted that the scheme is an ordinary commercial transaction and that Part IVA of the ITAA 1936 will not apply.

Appendix 2 – Detailed contents list

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20; TR 95/33

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- capital protected borrowings
- financial products
- interest expenses
- prepaid expenses
- product rulings
- public rulings
- taxation administration

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