

PR 2008/58 - Income tax: tax consequences of investing in MQ Listed Protected Loan

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Product Ruling

Income tax: tax consequences of investing in MQ Listed Protected Loan

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	9
Ruling	17
Scheme	18
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	24
Appendix 2:	
Detailed contents list	58

! 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 in the Ruling part apply to the defined class of entities, who participate in the scheme to which this Product Ruling relates.
2. In this Product Ruling the scheme is the borrowing of moneys on limited recourse terms to fund 100% of the initial share price of shares and/or stapled securities listed for quotation on the Australian Securities Exchange (ASX) or units in a widely held unit trust as described in subparagraph 82KZME(5)(b)(iii) of the *Income Tax Assessment Act 1936* (ITAA 1936) referred to in this Product Ruling as 'Underlying Shares', on the terms of a lending investment known the MQ Listed Protected Loan (MQLPL) offered by Macquarie Bank Limited (Macquarie).
3. This Ruling does not address:
 - (a) an Investor's entitlement to franking credits;
 - (b) the tax consequences of investment in MQLPL where the Underlying Share is not listed for quotation on the ASX;
 - (c) the tax consequences of early termination of the Loan or the MQLPL prior to Maturity including the tax consequences of the Walk Away and early completion features described in the PDS; or
 - (d) the tax consequences of investors purchasing the MQLPL on- market.

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 and which execute relevant Agreements mentioned in paragraph 18 of this Ruling on or before 30 June 2011. At the time of entering the Scheme, 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 deriving assessable income from this involvement. These entities are referred to as Investor/s.

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 22 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 18 June 2008 the date this Ruling is published. It therefore applies to the specified class of entities that enter into the scheme from 18 June 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.

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.

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

13. 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.

14. On 13 May 2008, the Treasurer announced that the Government will amend the benchmark interest rate in the capital protected borrowing rules from the Reserve Bank of Australia's indicator variable rate for personal unsecured loans (referred to in paragraph 17(c) of this Ruling) to the Reserve Bank of Australia's indicator variable rate for standard housing loans for capital protected borrowings entered into after 7:30pm (AEST) on 13 May 2008. If enacted, such changes will take precedence over the application of this Ruling and, to that extent, this Product Ruling will have no effect.

15. As the proposed law has not been enacted, we cannot give a legally binding ruling on this change until the relevant legislation is enacted. Once the change is enacted, this Product Ruling will be amended and reissued to reflect the change in the law.

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 paragraph 3 of this Ruling and the assumptions in paragraph 23 of this Ruling:

- (a) The interest payable in respect of an MQLPL for an annual Interest Period (Interest Amount) will be incurred by a Cash Applicant at the time of Acceptance of the Cash Application and by an Investor who holds the MQLPL at the close of business on an Annual Interest Date on that Annual Interest Date.
- (b) The Interest Amount incurred on the Loan in an income year, reduced by an amount reasonably attributable to the cost of capital protection under step 3 of the method statement in subsection 247-20(3) of the *Income Tax Assessment Act 1997* (ITAA 1997), will be deductible under section 8-1 of the ITAA 1997.
- (c) The amount that is reasonably attributable to the cost of capital protection under Division 247 of the ITAA 1997 in an income year will be the amount by which the Interest Amount exceeds an amount representing the interest that would have been incurred in an income year if the Reserve Bank of Australia's Indicator Rate for Personal Unsecured Loans – Variable Rate (the benchmark rate) at the time the first Interest Amount is incurred by the Investor had been applied.
- (d) The amount reasonably attributable to the cost of capital protection as worked out under paragraph 17(c) of this Ruling, is treated as the cost of a notional put option (Notional Put Option) under subsection 247-20(6) of the ITAA 1997. This amount is not deductible under section 8-1 of the ITAA 1997. That amount will be included in the first element of the cost base and reduced cost base of the Notional Put Option under subsections 110-25(2) and 110-55(2) of the ITAA 1997.
- (e) Section 51AAA of the ITAA 1936 will not apply to deny an Investor a deduction for the Interest Amount allowable under section 8-1 of the ITAA 1997.
- (f) Section 82KL of the ITAA 1936 will not apply to deny an Investor any deductibility for the Interest Amount allowable as a deduction under section 8-1 of the ITAA 1997.
- (g) Section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the Interest Amount allowable as a deduction under section 8-1 of the ITAA 1997 on the Loan.

- (h) Section 82KZM of the ITAA 1936 will not apply to deny the Investor immediate deductibility for the Interest Amount allowable under section 8-1 of the ITAA 1997 where at least one of the following applies for the year of income:
 - (i) the Investor is a small business entity as defined in subsection 328-110(1) of the ITAA 1997 that does not elect for section 82KZMD of the ITAA 1936 to apply; or
 - (ii) the Investor is an individual who does not incur the expenditure in carrying on a business.
- (i) Sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the prepaid Interest Amount, allowable as a deduction under section 8-1 of the ITAA 1997 for an Investor who:
 - (i) carries on a business or is not an individual that does not carry on a business; and
 - (ii) is a small business entity for the expenditure year that elects for section 82KZMD of the ITAA 1936 to apply.
- (j) For capital gains tax (CGT) purposes, including for the purposes of the CGT discount, the date of acquisition of the Underlying Shares under section 109-5 of the ITAA 1997 for Cash Applications is the date on which the Security Trustee acquires the Underlying Share, being the issue date specified in the confirmation.
- (k) The transfer of legal title to the Underlying Shares by the Security Trustee to the Investor does not give rise to a CGT event.
- (l) If the Investor sells the Underlying Shares to repay the Loan on Maturity, if the Investor does not repay the Loan and the Underlying Shares are sold by Macquarie in exercising its Security Interest, CGT event A1 will happen under section 104-10 of the ITAA 1997.
- (m) If the capital protection feature of the Loan is not invoked, the Notional Put Option referred to in paragraph 17(d) of this Ruling will be treated under subsection 247-30(2) of the ITAA 1997 as not having been exercised. CGT Event C2 will occur under section 104-25 of the ITAA 1997 on the Maturity Date. The capital proceeds received on expiration of the Notional Put Option will be nil under section 116-20 of the ITAA 1997. The Investor will make a capital loss equal to the reduced cost base of the Notional Put Option under subsection 104-25(3) of the ITAA 1997.

- (n) If the capital protection feature of the Loan is invoked and the Investor disposes of the Underlying Shares, the Notional Put Option referred to in paragraph 17(d) of this Ruling will be treated under subsection 247-30(1) of the ITAA 1997 as having been exercised and the cost base of the Notional Put Option will be included in the second element of the cost base and reduced cost base of the Underlying Shares under subsections 110-25(3) and 110-55(3) of the ITAA 1997, pursuant to section 134-1 of the ITAA 1997. The capital proceeds on disposal of the Underlying Shares will be equal to the Loan Principal. Any gain or loss on the exercise of the Notional Put Option will be disregarded by virtue of subsection 134-1(4) of the ITAA 1997.
- (o) If the capital protection feature of the Loan is invoked, the Investor disposes of the Underlying Shares, but no Notional Put Option has arisen under paragraph 17(d) of this Ruling such that there is a shortfall in repayment of the Loan the Investors cost base and reduced cost base in the Underlying Shares will be reduced by the amount of the shortfall under subsection 110-45(3) and 110-55(6) of the ITAA 1997.
- (p) Any capital gain realised by an Investor on sale of the Underlying Shares will be treated as a discount capital gain pursuant to section 115-5 of the ITAA 1997 where the Investor is an individual or a trust or complying superannuation fund and has held MQLPL or the Underlying Share for at least 12 months (excluding the days of acquisition and disposal).
- (q) The Borrowing Fee paid by the Investor is deductible under section 25-25 of the ITAA 1997 over the shorter of 5 years and the period from the Effective Date to Maturity.
- (r) All of the income derived from Underlying Shares while the Underlying Shares are the subject of the Security Trust will be included in the assessable income of the Investor (and not the Security Trustee) under section 97 of the ITAA 1936.
- (s) The commercial debt forgiveness rules in Schedule 2C of the ITAA 1936 will not reduce the tax attributes of an Investor in relation to any debt forgiveness that arises because of the limited recourse nature of the Loan.
- (t) The anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not be applied to deny deductibility of the interest incurred by the Investor in respect of the Loan.

Scheme

18. 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 from Clayton Utz on behalf of Macquarie on 24 April 2008;
- Product Disclosure Statement for MQLPL (the PDS), dated 15 April 2008;
- Supplementary PDS (the SPDS), dated 15 April 2008;
- SPDS June Offer (Opens 2 June 2008 – Closes 30 June 2008) dated 23 May 2008;
- Loan Agreement between Macquarie and the Investor which forms part of the PDS;
- MQLPL Trust Deed (the Trust Deed), between Macquarie and Belike Nominees Pty Ltd (the Security Trustee);
- MQLPL Nominee Deed Poll (the Nominee Deed), between Macquarie and the Security Trustee which forms part of the Trust Deed;
- MQLPL Product Brochure current as at 16 April 2008; and
- Additional information received from Clayton Utz on behalf of Macquarie on 13 May 2008.

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

19. The documents highlighted are those that an Investor 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 an Investor or any associate of an Investor, will be a party to, which are a part of the scheme.

20. In this Ruling, unless otherwise defined, capitalised terms have the same meaning as in the scheme documents listed in paragraph 18 of this Ruling.

21. 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

22. Following is a summary of the scheme:

- (a) The MQLPL consists of a limited recourse loan from Macquarie (Loan), used by the Investor to finance 100% of the initial share price of Underlying Shares.
- (b) The MQLPL may be initially acquired through a Cash Application.
- (c) Where a MQLPL is acquired through a Cash Application:
 - (i) the Investor selects from a range of Underlying Shares that Macquarie has approved for inclusion in the MQLPL;
 - (ii) the Investor must lodge a written application form with Macquarie or by submitting a form on Macquarie's website. Macquarie can accept a Cash Application by recording its Acceptance in its books and records. This Acceptance need not be communicated to the Cash Applicant to be effective;
 - (iii) at the time of Macquarie's Acceptance of an Investor's application, the Investor will enter into and be bound by all the terms of the Loan Agreement with Macquarie and will appoint Belike Nominees Pty Ltd to act as its nominee under the terms of the Nominee Deed. However, the Loan Agreement contains certain conditions that must be satisfied prior to drawdown of the Loan, including payment of the First Payment in accordance with the Trust Deed. The Investor agrees to accept the MQLPL on the terms and conditions set out in the Trust Deed:
 - (iv) the Investor whose application is Accepted will pay the First Payment following Acceptance (generally during the 10 days of the relevant offer period). The First Payment will be applied to prepay interest, and pay Borrowing Fees, to Macquarie. Provided this payment is made and all other conditions contained in the Loan Agreement are satisfied the Loan Amount will be drawn down on the Effective Date. Proceeds of the Loan will be applied to purchase the Underlying Share at that time, the MQLPL will be issued in the name of the Cash Applicant and Macquarie will issue the Investor with a confirmation; and

- (v) the Interest and Borrowing Fees are payable by a Cash Applicant on or before the Effective Date and are paid from the variable First Payment. The Borrowing Fee will be an amount which is paid for acquiring the Loan from Macquarie.
- (d) The Underlying Share will be held by the Security Trustee as trustee for the Investor. Each trust and each Underlying Share 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.
- (e) Repayment of the Loan will be secured by a mortgage over the Underlying Share granted by the Security Trustee to Macquarie.
- (f) The Loan is provided on a limited recourse basis such that Macquarie's right to repayment of the Loan and all Interest Amounts are limited to the amount it can obtain by enforcing its right in respect of the Mortgaged Property.
- (g) An Interest Amount is payable in respect of a MQLPL by any Investor who holds the MQLPL at the close of business on the Annual Interest Date.
- (h) The Interest Amount payable by an Investor, who holds the MQLPL on the Annual Interest Date, will be set out in the SPDS. This amount must be paid in advance by each Investor who holds the MQLPL on the Annual Interest Date, on the Annual Interest Payment Date following the Annual Interest Date.
- (i) At Maturity, the Investor has two options:
 - 1. repay the Loan:

the Loan is repaid, the security interest is extinguished and the Underlying Share(s) are delivered to a holding in the Investor's name; or
 - 2. do nothing:

at Maturity if the Loan is not repaid, the Underlying Share(s) will be sold and the Investor will be paid any sales proceeds after deducting the Loan Amount. If the sale proceeds are insufficient to repay the increased Loan Amount, Macquarie has no recourse against the Investor to recover the shortfall.

Assumptions

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

- (a) all of the Investors are Australian residents for taxation purposes;
- (b) 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;
- (c) the Investors are not traders in investments and are not treated for taxation purposes as trading in the Underlying Shares, carrying on a business of investing in the Underlying Shares, or holding the Underlying Shares as trading stock or as revenue assets;
- (d) the Investors' purpose in investing in the MQLPL will be to invest in the Underlying Shares so as to derive income in the form of dividend income and a capital gain on the sale of the Underlying Shares on or after Maturity;
- (e) Macquarie and its associates may acquire MQLPLs as an Investor, may hold inventory stock of MQLPLs and may make a market in MQLPLs;
- (f) the Underlying Shares will not be the subject of any securities lending arrangement entered into by or on behalf of the Investor;
- (g) the scheme will be executed in the manner described in the 'Scheme' section of this Ruling; and
- (h) all dealings by the Investors and Macquarie under the MQLPL will be at arm's length.

Commissioner of Taxation18 June 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 – capital protected borrowings and deductibility of interest

24. The interest paid on a borrowing used to acquire income producing assets, such as shares or units in a unit trust, is generally treated as deductible at the time it is incurred 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). However, the ability to claim interest deductions may be subject to Division 247 of the ITAA 1997.

25. Division 247 of the ITAA 1997 limits the allowable deductions for expenditure incurred under a 'capital protected borrowing'. Broadly, a capital protected borrowing is created where an amount is borrowed under an arrangement where the borrower is protected against the fall in value of a specified share, unit in a unit trust or stapled security where that borrowing is made for the purpose of investing in that share, unit or stapled security.

26. Division 247 of the ITAA 1997 applies to the Loan under MQLPL as a capital protected borrowing (CPB) because the Investor:

- (a) uses the borrowing from Macquarie to acquire a beneficial interest in the Underlying Shares; and
- (b) is protected against a fall in the market value of the Underlying Shares.

27. Division 247 of the ITAA 1997 sets out a methodology for reasonably attributing the cost of capital protection incurred by a borrower under a CPB (section 247-20 of the ITAA 1997). 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) of the ITAA 1997).

28. Under the MQLPL, the amount reasonably attributable to the cost of capital protection is worked out according to the method statement in subsection 247-20(3) of the ITAA 1997. This amount is treated as the cost of the Investor's Notional Put Option under subsection 247-20(6) of the ITAA 1997.

29. Under step 1 of the method statement, the total amount incurred by the Investor under or in respect of the CPB for the income year, includes the interest incurred on the Loan for the income year.

30. Where the Interest Amount incurred by the Investor in step 1 of the method statement is less than the total interest that would have been incurred by the Investor worked out under step 2 of the method statement, there is no amount reasonably attributable to the cost of capital protection. In these circumstances the Interest Amount will be deductible under section 8-1 of the ITAA 1997.

31. Where the Interest Amount incurred by the Investor is greater than the total interest that would have been incurred by the Investor worked out under step 2 of the method statement, the excess amount is reasonably attributable to the cost of capital protection and is treated as if it were incurred only for a Notional Put Option under Division 247 of the ITAA 1997. The Notional Put Option is a capital asset for an Investor in the MQLPL. As the amount reasonably attributable to the cost of capital protection is the cost of the Investor's Notional Put Option, this expense is capital in nature. The interest charged under a MQLPL will therefore only be deductible under section 8-1 of the ITAA 1997 to the extent that it is not reasonably attributable to the cost of capital protection.

Section 51AAA

32. By entering into the MQLPL it is contemplated that an Investor will derive assessable income by the receipt of dividends and capital gains. As interest would have been 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 an Investor in the MQLPL.

Section 82KL

33. 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. Section 82KL 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

34. Subdivision H of Division 3 of Part III (Subdivision H) 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 Investor is a small business entity, 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. Subdivision H 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 of the ITAA 1997 – small business entity

35. An Investor will be a small business entity for an income year if the Investor carries on a business and either

- the Investor carried on a business in the previous income year and the Investor's aggregated turnover for the previous year was less than \$2 million, or
- the Investor'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

36. That part of the Interest Amount allowable as a deduction under section 8-1 of the ITAA 1997 is, if paid in advance, 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 principal is to be taken, for the purpose of Subdivision H, to be expenditure incurred under an agreement in return for the doing of a thing under the agreement for the period to which the interest payment relates. The eligible service period in relation to a payment of loan interest is determined by reference to the period to which the interest relates, and not to the period of the Loan.

Sections 82KZME and 82KZMF – prepaid expenditure and 'tax shelter' 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' 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 a part. Under subsection 82KZME(4) of the ITAA 1936, the relevant 'agreement' is all the contractual arrangements and activities associated with the participation in the MQLPL, including the financing, purchase, holding and disposal arrangements.

39. Exception 1, as contained in subsection 82KZME(5) of the ITAA 1936 applies to exclude that part of the Interest Amount that is allowable as a deduction under section 8-1 of the ITAA 1997 incurred on the Loan, from the operation of section 82KZMF of the ITAA 1936 as:

- (a) that part of the prepaid interest allowable as a deduction under section 8-1 of the ITAA 1997 is incurred in respect of money borrowed to acquire shares that are listed for quotation on the ASX and/or units in a unit trust as described in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- (b) the Investor can reasonably be expected to obtain dividend or trust income from the investment;
- (c) the Investor will not obtain any other kind of assessable income from the investment, except for capital gains; and
- (d) all aspects of the MQLPL are at arm's length.

Deductibility of expenditure must therefore be considered under the prepayment rules outlined below.

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

40. 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) a small business entity for the year of income that does not elect for section 82KZMD of the ITAA 1936 to apply; or
- (b) a taxpayer that is an individual and the expenditure is not incurred in carrying on a business.

41. 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.

42. As the eligible service period in relation to the deductible Interest Amount 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 small business entities for the year of income who do not elect for section 82KZMD of the ITAA 1936 to apply, 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 incurred.

Section 82KZMD – prepaid non-business expenditure incurred by taxpayers that are not individuals or small business entities

43. Section 82KZMD of the ITAA 1936 sets the amount and timing of deductions for expenditure for an Investor who:

- (i) carries on a business or is not an individual that does not carry on a business; and
- (ii) is a small business entity that elects for section 82KZMD of the ITAA 1936 to apply.

44. The expenditure must not be excluded expenditure and must be incurred in return for doing a thing under an agreement that is not wholly done within the expenditure year.

45. For these Investors, the deduction for prepaid interest incurred under the Loan allowable as a deduction under section 8-1 of the ITAA 1997 will be apportioned over the relevant interest payment period.

Section 25-25 – Borrowing Fees

46. The Borrowing Fee is incurred to obtain the Loan. No part of the Borrowing Fee is attributable to capital protection. The Borrowing Fee is deductible in accordance with section 25-25 of the ITAA 1997 from the Effective Date.

Section 110-25 – cost base of Notional Put Option

47. That part of any Interest Amount which is reasonably attributable to the cost of capital protection (if any) will form part of the cost base and reduced cost base of the Notional Put Option (subsections 110-25(2) and 110-55(2) of the ITAA 1997). Where the capital protection under the MQLPL is invoked, the Notional Put Option is taken to have been exercised pursuant to subsection 247-30(1) of the ITAA 1997. Any capital gain or capital loss on exercise of the Notional Put Option is disregarded (subsection 134-1(4) of the ITAA 1997). The second element of the Investor's cost base and the reduced cost base for the Underlying Shares will include that part of the Interest Amount which is reasonably attributable to the cost of capital protection, being the cost of the Notional Put Option (subsection 134-1(1) of the ITAA 1997, item 2).

Section 104-25 – CGT event C2

48. Where the capital protection under the MQLPL is not invoked, any Notional Put Option will expire at maturity. The expiration of the Notional Put Option gives rise to CGT event C2 (paragraph 104-25(1)(c) of the ITAA 1997). The capital proceeds on the lapsing of the Notional Put Option will be nil. The Investor will make a capital loss equal to the reduced cost base of the Notional Put Option.

Section 109-5 – acquisition of a CGT asset

49. Section 109-5 of the ITAA 1997 applies to an Investor to treat them as having acquired the Underlying Shares at the time the Investor obtained beneficial ownership of the Underlying Shares.

Section 115-5 – discount capital gains

50. 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 made by an Investor on the sale of the Underlying Shares will be treated as a discount capital gain where the Investor is an individual, trust or complying superannuation fund and has held the Underlying Shares for at least for 12 months (excluding the days of acquisition and disposal).

Schedule 2C – commercial debt forgiveness

51. Where the limited recourse feature of the Loan comes into effect, the Investor is not required to repay the Loan amounts and therefore there will be commercial debt forgiveness under section 245-35 of Schedule 2C of the ITAA 1936. Under Schedule 2C of the ITAA 1936 where forgiveness results in the Investor having a positive 'net forgiven amount', the Investor will be required to reduce certain tax attributes to the extent of the net forgiven amount.

52. To determine the net forgiven amount of debt forgiveness it is first necessary to determine the 'gross forgiven amount'. In the Investor's circumstances Schedule 2C of the ITAA 1936 will have no practical effect as the gross forgiven amount in respect of the debt will be equal to zero. The gross forgiven amount is equal to the 'notional value' of the debt less any consideration paid or given in respect of the debt.

53. The notional value of the Loan is the lesser of the limited recourse debt outstanding at the time of the debt forgiveness and the market value of the lender's rights in relation to the Underlying Shares at the time of the debt forgiveness, under section 245-60 of Schedule 2C of the ITAA 1936. The situation where the limited recourse feature of the Loan may come into effect is where the market value of the Underlying Shares will not cover the Loan Amount. In such a situation the market value of Macquarie's rights in relation to the Underlying Shares should be no more than the market value of the Underlying Shares at that point in time.

54. The consideration paid by an Investor in respect of the debt forgiveness would be equal to the market value of any property given by the Investor, in respect of the debt forgiveness as determined at the time of the forgiveness, under paragraph 245-65(1)(b) of Schedule 2C of the ITAA 1936. This market value should be equal to the market value of Macquarie's rights in relation to the Underlying Shares. Therefore the gross forgiven amount will be nil.

55. Accordingly, Schedule 2C of the ITAA 1936 will not reduce an Investor's tax attributes where the limited recourse feature of the Loan comes into effect.

Section 97 – present entitlement

56. The Investor is presently entitled to all of the income derived from the Underlying Share(s) including amounts which represent a distribution applied to reduce the Loan. Therefore, section 97 of the ITAA 1936 will apply to assess the Investor on the income derived from the Underlying Share(s). The Security Trustee will not be subject to tax on this income.

Part IVA

57. Provided that the arrangement ruled on is entered into and carried out as described(see the Scheme section of this Ruling), it would be accepted as an ordinary commercial transaction and that 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:

	Paragraph
What this Ruling is about	1
Class of entities	4
Superannuation Industry (Supervision) Act 1993	5
Qualifications	6
Date of effect	9
Changes in the law	13
Note to promoters and advisers	16
Ruling	17
Scheme	18
Overview	22
Assumptions	23
Appendix 1 – Explanation	24
Section 8-1 and Division 247 – capital protected borrowings and deductibility of interest	24
Section 51AAA	32
Section 82KL	33
Subdivision H of Division 3 of Part III	34
Subdivision 328-C of the ITAA 1997 – small business entity	35
The eligible service period for the purpose of Subdivision H	36
Sections 82KZME and 82KZMF – prepaid expenditure and ‘tax shelter’ arrangements	37
Section 82KZM – prepaid expenditure incurred by small business entities and individuals incurring non-business expenditure	40
Section 82KZMD – prepaid non-business expenditure incurred by taxpayers that are not individuals or small business entities	43
Section 25-25 – Borrowing Fees	46
Section 110-25 – cost base of Notional Put Option	47
Section 104-25 – CGT event C2	48
Section 109-5 – acquisition of CGT asset	49
Section 115-5 – discount capital gains	50
Schedule 2C – commercial debt forgiveness	51
Section 97 – present entitlement	56
Part IVA	57
Appendix 2 – Detailed contents list	58

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TR 95/33

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- interest expenses
- product rulings
- taxation administration
- tax avoidance

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