

PR 2008/59 - Income tax: tax consequences of investing in equities using the Macquarie Geared Equities Investment plus



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This document has changed over time. This is a consolidated version of the ruling which was published on *23 July 2008*



Product Ruling

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

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	10
Ruling	19
Scheme	20
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	26
Appendix 2:	
Detailed contents list	50

! 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 referred to as Macquarie Geared Equities Investment plus (GEI plus) offered by Macquarie Bank Limited (the Bank), which is a financial product offered under the GEI plus Combined Product Disclosure Statement and Financial Services Guide.
3. This Ruling does not address the tax consequences of:
 - (a) a loan advanced against an existing portfolio of shares;
 - (b) converting the GEI plus loan to a Margin Loan;
 - (c) the Limited Trading feature;
 - (d) the Refinancing feature
 - (e) the Protection Reset feature;
 - (f) the Switching feature;
 - (g) the Stock Lending feature; or
 - (h) the Covered Calls feature;

which are available under the terms of the scheme and described in the draft Combined Product Disclosure Statement and Financial Services Guide. Interest deductions under section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) for the amount referred to in subparagraph 19(a) of this Ruling are available to the Investor up to the time that the Investor uses one or more of the features listed in paragraph 3 of this Ruling.

4. This Ruling does not address an Investor's entitlement to franking credits.

Class of entities

5. 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 20 of this Ruling on or before 30 June 2011. 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

6. 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 the SISA 1993.

Qualifications

7. 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 20 to 25 of this Ruling.

8. 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

10. This Product Ruling applies prospectively from 23 July 2008, the date this Ruling is published. It therefore applies to the specified class of entities that enter into the scheme from 23 July 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.

11. 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.

12. 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)).

13. 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).

Previous ruling

14. This Product Ruling replaces PR 2007/68 which is withdrawn on and from 23 July 2008 due to a change in the Product Disclosure Statement under which the GEI plus loan is provided. PR 2007/68 will continue to apply to Investors who entered into the arrangement on or before 23 July 2008.

Changes in the law

15. 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.

16. 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 this ruling at subparagraph 19(b)) 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.

17. 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

18. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling is issued.

Ruling

19. Subject to paragraphs 3 and 4 of this Ruling, and the assumptions in paragraph 25 of this Ruling:

- (a) An amount equal to the interest charged on the GEI plus loan and the Interest Prepayment Loan (if applicable) (the Total Amount), reduced by an amount reasonably attributable to the cost of capital protection worked out under step 3 of the method statement in subsection 247-20(3), will be deductible under section 8-1 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 in an income year is the amount by which the Total Amount exceeds:
 - where the interest rate charged by the Bank is a fixed rate for all or part of the term of the loan, the amount of the loan multiplied by the Reserve Bank of Australia's indicator variable rate for personal unsecured loans (the 'benchmark rate') at the time when the interest charge is first incurred during the term of the loan, or the relevant part of the term; and
 - where the interest charged by the Bank is a variable rate for all or part of the term of the loan, the amount of the loan multiplied by the average of the benchmark rates published by the Reserve Bank of Australia during the term of the loan, or the relevant part of the term.
- (c) The amount reasonably attributable to the cost of capital protection under Division 247 of the ITAA 1997, as worked out under subparagraph 19(b) of this Ruling, is treated as the cost of a 'deemed' put option (Put Option) granted by the Bank to the Investor under subsection 247-20(6) of the ITAA 1997. This amount 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 an Investor a deduction for the interest charged on the GEI plus loan and the Interest Prepayment Loan (if applicable) allowable under section 8-1 of the ITAA 1997.
- (e) Section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest allowable as a deduction under section 8-1 of the ITAA 1997 incurred under the GEI plus loan or the Interest Prepayment Loan (if applicable).
- (f) Section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the interest charge incurred under the GEI plus loan allowable as a deduction under section 8-1 of the ITAA 1997.
- (g) Section 82KZM of the ITAA 1936 will not apply to deny the Investor immediate deductibility of any part of the interest charge on the GEI plus loan allowable under section 8-1 of the ITAA 1997, where at least one of the following applies for the year of income:
 - the Investor is a small business entity, as defined in subsection 328-110(1) of the ITAA 1997, that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure; or
 - the Investor is an individual who does not incur the interest charge in carrying on a business.
- (h) Sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the interest charge on the GEI plus loan that is deductible to an Investor (other than a small business entity that has not chosen to apply section 82KZMD to the expenditure for the year of income) who is a taxpayer that is not an individual and does not carry on a business.
- (i) The cost of the Put Option will be included in the first element of the cost base and reduced cost base of the Put Option under subsections 110-25(2) and 110-55(2) of the ITAA 1997.
- (j) If the Investor exercises the Put Option at the end of the GEI plus loan term, the cost of the Put Option will be included in the second element of the cost base and the reduced cost base of the Approved Securities pursuant to item 2 in subsection 134-1(1) of the ITAA 1997. Any gain or loss on the exercise of the Put Option will be disregarded by virtue of subsection 134-1(4) of the ITAA 1997.

- (k) If the Put Option is not exercised and it expires, a CGT event C2 will happen under paragraph 104-25(1)(c) of the ITAA 1997. The Investor will make a capital loss equal to the reduced cost base of the Put Option under subsection 104-25(3) of the ITAA 1997.
- (l) If the Investor repays the GEI plus loan and sells Approved Securities to fund the repayment, CGT event A1 will happen under section 104-10 of the ITAA 1997. The Investor will make a capital gain on selling the Approved Securities equal to the sale proceeds less the cost base of the Approved Securities.
- (m) The anti-avoidance provisions in Part IVA of the ITAA 1936 will not apply to deny deductibility of the interest incurred by the Investor in respect of the GEI plus loan or the Interest Prepayment Loan (if applicable) used to fund the purchase of Approved Securities.

Scheme

20. 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 23rd May 2008;
- the draft GEI plus Combined Product Disclosure Statement and Financial Services Guide to be dated 30 April 2008 (PDS) which includes the Loan and Security Agreement and the GEI plus Application Form;
- Additional information provided on 30th June 2008 and 7th July 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.

21. 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. The effect of these agreements is summarised as follows.

22. 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.

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

Overview

24. Following is a summary of the scheme:

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

- (g) The GEI plus loan and Security Agreement provides for a limited recourse facility by the Bank in relation to the Investor. As such, the Bank is only entitled to enforce its rights as mortgagee in relation to the principal of the GEI plus loan against the Approved Securities held as security.
- (h) The limited recourse loan facility operates to limit the Investor's liability under the loan facility to the Approved Securities and operates as a mechanism of capital protection. If requested to do so by the Investor, the Bank will exercise its rights under the mortgage facility at the Final Maturity Date where the market value of those Approved Securities (or a parcel of Approved Securities) has fallen below the acquisition cost of those Approved Securities. The Bank is entitled to set-off the payment of that price against the obligations of the Investor to repay the GEI plus loan in respect of the Approved Securities (or the parcel of Approved Securities). The Investor will have no further obligation to the Bank in respect of the GEI plus loan (or the portion of the GEI plus loan in respect of the respective parcel of Approved Securities).
- (i) The Investor is not required to pay a separate fee for the limited recourse loan facility.
- (j) The Investor shall repay the outstanding portion of the GEI plus loan to the Bank in one amount of Final Maturity Date. At least five clear Business Days before the Final Maturity Date the Investor must inform the Bank whether:
 - (i) the Investor will repay all or part of the loan on Final Maturity Date; and/or
 - (ii) the Investor intends to activate the limited recourse loan facility; and/or
 - (iii) the Investor requests the loan be converted to a Margin Loan facility; and/or
 - (iv) the Investor intends to refinance the scheme and extend the term of all or part of their loan.
- (k) Any dividends or distribution paid in respect of the Approved Securities purchased under the scheme are paid to the Investor.
- (l) Bonus shares issued will form part of the security for the GEI plus loan. At the expiry of the GEI plus loan, should the market value of the original shares, and any bonus shares, be below the cost of the original parcel of Approved Securities, both the original and bonus shares may be subject to the limited recourse loan facility.

Assumptions

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

- (a) all of the Investors are Australian residents for taxation purposes;
- (b) the Investors are not traders in investments and are not treated for taxation purposes as trading in the Approved Securities, carrying on a business of investing in the Approved Securities, or holding Approved Securities as trading stock or as revenue assets;
- (c) in respect of any interest charges to be paid in advance under the GEI plus loan, these may be prepaid only in relation to a loan interest payment period of 12 months or less and which ends on or before the last day of the income year following the expenditure year;
- (d) at all times during the scheme, where the Approved Securities includes units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- (e) the dominant purpose of an Investor in entering the scheme is to derive assessable income from their Approved Securities acquired under the scheme, comprising dividends or trust distributions and capital gains;
- (f) the scheme will be executed in the manner described in the Scheme section of this Ruling; and
- (g) all dealings by the Investors and the Bank under the scheme will be at arm's length.

Commissioner of Taxation

23 July 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. Interest paid on a borrowing used to acquire income producing assets such as shares or units 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 the scheme as a capital protected borrowing because the Investor uses the GEI plus loan to acquire Approved Securities (being shares listed on the ASX and/or units of a widely held unit trust, and/or stapled securities comprising of shares/s and unit/s that are jointly listed for quotation on the ASX) and the Investor is protected against a loss arising from the fall in the market value of the Approved Securities through the limited recourse loan facility.

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. 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).

29. Under the scheme, the amount reasonably attributable to the cost of capital protection afforded by the limited recourse loan facility, is worked out according to the method statement in subsection 247-20(3) of the ITAA 1997 as set out in subparagraph 19(b) of this Ruling. This amount is treated as the cost of the Investor's Put Option under subsection 247-20(6) of the ITAA 1997.

30. For an Investor in the scheme, the Put Option is a capital asset. As the cost of capital protection is the cost of the Investor's Put Option, this expense is capital in nature. The Total Amount (as defined in subparagraph 19(a) of this Ruling) will be deductible under section 8-1 of the ITAA 1997 only to the extent that it does not constitute the cost of capital protection.

Section 51AAA

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

Section 82KL

32. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient additional benefits will be provided to trigger the application of section 82KL of the ITAA 1936. It will not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997.

Subdivision H of Division 3 of Part III

33. Subdivision H of Division 3 of Part III of the ITAA 1936 (Subdivision H) deals with the timing of deductions for certain advance expenditure incurred under an arrangement in return for the doing of a thing under that agreement that will not be wholly done within the same year of income. Separate rules apply depending on whether the expenditure is incurred in carrying on a business, whether the Investor is 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. This Subdivision does not apply to 'excluded expenditure' which is defined in subsection 82KZL(1) of the ITAA 1936 to include amounts of less than \$1,000 or amounts that are of a capital nature.

Subdivision 328-C of the ITAA 1997 – small business entities

34. Under section 328-110 of the ITAA 1997, an Investor carrying on a business in an income year will be a small business entity for that year (the current year) if:

- (a) the Investor carried on a business in the previous income year and the aggregated turnover for that year was less than \$2 million;
- (b) the aggregated turnover for the current year is likely to be less than \$2 million and, where the Investor carried on a business in each of the two previous income years, the aggregated turnover for each of those income years was less than \$2 million; or
- (c) the aggregated turnover for the current year, worked out as at the end of the year is less than \$2 million.

The eligible service period for the purposes of Subdivision H

35. The interest charge under the GEI plus loan deductible under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest for a period that is 12 months or less. Paragraph 82KZL(2)(a) of the ITAA 1936 provides that a payment of interest that is made in return for the making available of a loan principal is to be taken, for the purposes of Subdivision H, to be expenditure incurred under an agreement in return for the doing of a thing under the agreement for the period to which the interest payment relates. The eligible service period in relation to a payment of loan interest is determined by reference to the period to which the interest relates and not to the period of the scheme.

Section 82KZME and 82KZMF – prepaid expenditure and ‘tax shelter’ type arrangements

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

37. 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) of the ITAA 1936, the relevant ‘agreement’ is all the contractual arrangements and activities associated with the participation in the scheme, including the financing, share and/or unit purchase, share and/or unit holding and disposal arrangements.

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

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

39. Deductibility of the prepaid interest must therefore be considered under the prepayment rules contained in paragraphs 40 to 45 of this Ruling.

Section 82KZM – prepaid expenditure incurred by certain 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 small business entity for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure; or
- is 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 payments for the GEI plus loan is not more than 12 months and does not end after the last day of the year of income after the one in which the expenditure was incurred, section 82KZM of the ITAA 1936 will have no application to Investors who are a small business entity that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure for the year of income, or to Investors who are individuals and the expenditure is not incurred in carrying on a business. Investors who satisfy these tests will be able to claim an immediate deduction for the interest amount allowable as a deduction under section 8-1 of the ITAA 1997 incurred on the GEI plus loan.

Section 82KZMA and 82KZME – prepaid non-business expenditure incurred by non-individual and non-small business entities

43. Section 82KZMA and 82KZMD of the ITAA 1936 set the amount and timing of deductions for expenditure for an Investor (other than a small business entity taxpayer for the year of income that has not chosen to apply section 82KZMD to the expenditure) who is an Investor that is not an individual and does not incur the expenditure in carrying on a business.

44. 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.

45. For these taxpayers, the amount of prepaid interest allowable as a deduction under section 8-1 of the ITAA 1997 incurred on the GEI plus loan will be apportioned over the relevant interest payment period.

Capital protection and cost base

46. The cost of the capital protection is not deductible to the Investor under section 8-1 of the ITAA 1997 (refer to paragraph 19 of this Ruling) and is included in the cost base and reduced cost base of the Put Option acquired by the Investor pursuant to subsections 110-25(2) and 110-55(2) of the ITAA 1997. The Put Option constitutes an asset for CGT purposes and is separate and in addition to the other rights created under the scheme as described in this Ruling.

47. If the Investor exercises the Put Option at the end of the GEI plus loan term by activating the limited recourse loan provisions, any gain or loss on exercise of the Put Option is disregarded pursuant to subsection 131-1(4) of the ITAA 1997. However, the Investor will add the payment for acquiring the Put Option to the cost base and reduced cost base of the Approved Securities disposed by the Bank under its rights as mortgagee pursuant to subsection 134-1(1), item 2 or the ITAA 1997. As the sale proceeds will be insufficient to repay the GEI plus loan, the Bank has no recourse against the Investor to recover the shortfall. In this circumstance the Investor will need to reduce the cost base for the Approved Securities by the amount of the shortfall under subsection 110-45(3) of the ITAA 1997. The combined effect will be to give rise to a capital loss equal to the cost base of the Put Option.

48. If the Investor does not exercise the Put Option by the Maturity Date, the Put Option will be taken to have expired pursuant to subsection 247-30(2) of the ITAA 1997. The Investor will make a capital loss at that time, equal to the cost base of the Put Option pursuant to paragraph 104-25(1)(c) of the ITAA 1997. This would occur where:

- (a) the Investor sold the Approved Securities and repaid the GEI plus loan at the Final Maturity Date, where the sale proceeds were higher than the balance of the GEI plus loan;
- (b) the Investor repaid the GEI plus loan at the Final Maturity Date, whether from other existing funds or by refinancing the Approved Securities, where the market value of the Approved Securities was equal to or higher than the balance of the GEI plus loan; or

- (c) the Investor repaid the GEI plus loan at the Final Maturity date, whether from other existing funds or by refinancing the Approved Securities, where the market value of the Approved Securities was less than the balance of the GEI plus loan.

Part IVA

49. Provided that the scheme ruled on is entered into and carried out as disclosed, it is accepted that the scheme is an ordinary commercial transaction and Part IVA of the ITAA 1936 will not apply.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Class of entities	5
Superannuation Industry (Supervision) Act 1993	6
Qualifications	7
Date of effect	10
Previous ruling	14
Changes in the law	15
Note to promoters and advisers	18
Ruling	19
Scheme	20
Overview	24
Assumptions	25
Appendix 1 – Explanation	26
Section 8-1 and Division 247	26
Section 51AAA	31
Section 82KL	32
Subdivision H of Division 3 of Part III	33
Subdivision 328-C of the ITAA 1997 – small business entities	34
The eligible service period for the purposes of Subdivision H	35
Section 82KZME and 82KZMF – prepaid expenditure and ‘tax shelter’ type arrangements	36
Section 82KZM – prepaid expenditure incurred by certain small business entities and individuals incurring non-business expenditure	40
Section 82KZMA and 82KZME – prepaid non-business expenditure incurred by non-individual and non-small business entities	43
Capital protection and cost base	46
Part IVA	49
Appendix 2 – Detailed contents list	50

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 95/33

Previous Rulings/Determinations:

PR 2007/68

Subject references:

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

Legislative references:

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